TAX UPDATE

For period: 1 July 2019 to 30 September 2019

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1. INTRODUCTION

The purpose of this update is to summarise developments that occurred during the third 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.

Take some time and consider the tax cases.

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!

Ambition in America is still rewarded . . . with high taxes.

America is the land of opportunity. Everybody can become a taxpayer.

If my business gets much worse, I won't have to lie on my next tax return.[1]

1 source: http://www.jokes4us.com/miscellaneousjokes/irsjokes/deathandtaxesonelinersjokes.html

2. MEDIA STATEMENT – PUBLICATION OF THE 2019 BUDGET DRAFT TAX BILLS FOR PUBLIC COMMENT

The National Treasury and the South African Revenue Service (SARS) today publish, for public comment, the 2019 Draft Taxation Laws Amendment Bill (Draft TLAB) and the 2019 Draft Tax Administration Laws Amendment Bill (Draft TALAB). The public is also invited to submit any comments on the 2019 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (Draft Rates Bill), which was first published on Budget Day (20 February 2019). All these bills will be tabled in Parliament after revising the bills to take account of public comments received, as well as any recommendations made following hearings on the draft bills in Parliament.

The Draft Rates Bill contains tax announcements made in Chapter 4 and Annexure C of the 2019 Budget Review that deal with changes to the rates and monetary thresholds and increases of the excise duties. The 2019 Draft Rates Bill is today published for the second time in order to solicit public comments on the tax proposals contained therein.

The 2019 Draft TLAB and the 2019 Draft TALAB provide the necessary legislative amendments required to implement the more complex tax announcements made in Chapter 4 and Annexure C of the 2019 Budget Review (and not dealing with a simple change in a rate or threshold of a tax) that will require greater consultation with the public.

In addition to considering the comments and submissions received, National Treasury and SARS will also engage with stakeholders through workshops that are normally held after the receipt of written comments on the draft bills. The Standing and Select Committees on Finance in Parliament are expected to make a similar call for public comment, and convene public hearings on these draft bills before their formal introduction in Parliament. Thereafter, a response document on the comments received will be presented at the parliamentary committee hearings, after which the bills will then be revised, taking into account public comments and recommendations made during committee hearings, before they are tabled formally in Parliament for its consideration.

A first batch of the 2019 Draft TLAB (initial batch) was published on 10 June 2019 containing two specific amendments that are more urgent and require further public consultation. The specific amendments included addressing abusive arrangements aimed at avoiding the anti-dividend stripping provisions as well as aligning the effective date of tax neutral transfers between retirement funds with the effective date of annuitisation for provident funds, which is 1 March 2021. The 2019 Draft TLAB, which is published today, includes these two proposals with further amendments that have arisen from public comments received on the initial batch.

For legal reasons, the draft tax amendments that do not relate to changes to rates and monetary thresholds continue to be split into two bills, namely a money bill (section 77 of the Constitution) dealing with money bill issues and an ordinary bill (section 75 of the Constitution) dealing with issues relating to tax administration.

The 2019 Draft Rates Bill gives effect to the following key tax proposals announced in the 2019 Budget Review:

- Changes in rates and monetary thresholds to the personal income tax tables
- Adjustments to the eligible income bands that qualify for the employment tax incentive
- Increases of the excise duties on alcohol and tobacco

The 2019 Draft TLAB gives effect to the following key tax proposals announced in the 2019 Budget Review:

- Aligning the effective date of tax neutral transfers between retirement funds with the effective date of annuitisation for provident funds
- Adjusting the withholding tax treatment of surviving spouses' pensions to limit tax debts on assessment
- Addressing abusive arrangements aimed at avoiding the anti-dividend

stripping provisions

- Clarifying the interaction between corporate reorganisation rules and other provisions of the Income Tax Act
- Refining the tax treatment of long-term insurers
- Refining investment criteria and anti-avoidance measures for the Special Economic Zone regime
- Limiting the allowable deduction for investors investing in a venture capital company
- Reviewing the controlled foreign company comparable tax exemption and addressing the circumvention of the anti-diversionary rules
- Reviewing section 72 of the VAT Act

The 2019 Draft TALAB gives effect to the following key tax proposals:

- Removal of requirement to submit a declaration to a regulated intermediary in respect of tax free investments
- Authorisation for the Commissioner to prescribe rules relating to the making of advance foreign currency payments
- Alignment of time limitations on requesting refunds
- Model mandatory disclosure rules and non-compliance penalties
- Tax compliance certificates

The 2019 draft bills,the 2019 Draft Explanatory Memorandum containing a comprehensive description of the proposed tax amendments contained in the 2019 Draft TLAB and the 2019 Draft Memorandum on the Objects of the 2019 Draft TALAB can be found on the National Treasury (www.treasury.gov.za) and SARS (www.sars.gov.za) websites. More general information underlying the changes in rates, thresholds or any other amendments to specific taxes can be found in the Budget Review, available on the above treasury website.

3. EXPLANATORY MEMORANDUM ON THE DRAFT TAXATION LAWS AMENDMENT BILL, 2019

3.1. Extending the scope of amounts constituting variable remuneration

[Applicable provision: Section 7B of the Act, No. 58 of 1962 ('the Act')]

BACKGROUND

In 2013, section 7B was introduced to the Act. The main aim of this section was to match the timing between accrual and payment of various forms of variable remuneration. Consequently, the introduction of section 7B made provision for certain amounts to be deemed to accrue to the employee when they are actually paid.

REASONS FOR CHANGE

It has come to Government's attention that the current scope of section 7B is limited. There are certain types of variable remuneration that are not currently catered for in this section. This includes for example, night shift allowances and standby allowances paid by employers to employees. As a result, the problem that section 7B was intended to address still remains as some types of variable remuneration remain outside the ambit of this section.

PROPOSAL

In order to address this anomaly, it is proposed that the current wording of section 7B be changed from applying to specific payments to apply to amounts bearing certain generic characteristics. As a result, it is proposed that section 7B should cater for remuneration that bears the following general characteristics:

(a) The employee is only entitled to the amount once services have been rendered;

(b) The amount the employees is entitled to cannot be determined in advance;

(c) The employees entitled to these amounts cannot be determined in advance;

(d) The payment of said amount is subject to some sort of approval process prior to its payment;

(e) The amount due to the employee varies from month to month.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 March 2020 and apply in respect of any year of assessment commencing on or after that date.

3.2. Retirement Reforms - Aligning the effective date of tax neutral transfers between retirement funds with the effective date of all retirement reforms

[Applicable provisions: Paragraph 6(1)(*a*) of the Second Schedule to the Act)]

BACKGROUND

In 2013, retirement fund reform amendments were effected to the Act regarding the annuitisation requirements for provident funds. The main objective of these amendments was to enhance preservation of retirement fund interests during retirement and to have uniform tax treatment across the various retirement funds, thus resulting in provident funds being treated similar to pension and retirement annuity funds with regard to the requirement to annuitise retirement benefits. These retirement fund reform amendments were supposed to come into effect on 1 March 2015.

However, when Parliament was passing legislative changes to these amendments, Parliament postponed the effective date for the annuitisation requirements for provident funds until 1 March 2016. During the 2016 legislative cycle, Parliament again postponed the effective date until 1 March 2019. Further, during the 2018 legislative cycle, Parliament once more postponed the effective date to 1 March 2021. These postponements were due to continuing negotiations within the National Economic Development and Labour Council ('NEDLAC').

REASONS FOR CHANGE

Each postponement of the effective date requires several consequential amendments to various provisions of the Act. In making changes to the effective dates in relation to the several consequential amendments required, an oversight occurred with regard to paragraph 6(1)(a) of the Second Schedule to the Act, which makes provision for tax neutral transfers between retirement funds. Failure to change the effective date in the above-mentioned provision resulted in the non-taxable treatment of transfers from pension funds to provident or provident preservation funds with effect from 1 March 2019.

The earlier effective date of 1 March 2019 for the tax neutral transfers from pension to provident or provident preservation funds creates a loophole as the intention was to align the effective date of the tax neutral transfers from pension to provident or provident preservation funds with the effective date of retirement fund reform amendments, which is 1 March 2021.

PROPOSAL

In order to include the consequential amendment that was inadvertently left out, it is proposed that changes be made in the Act to align the effective date of the tax neutral transfers from pension to provident or provident preservation funds with the effective date of retirement fund reform amendments, which is 1 March 2021.

EFFECTIVE DATE

The proposed amendments are deemed to have come into operation on 1 March 2019.

3.3. *Retirement Reforms – Exemption relating to annuities from a provident or provident preservation fund*

[Applicable provision: Section 10C of the Act]

BACKGROUND

In 2014, changes were made in the Act allowing the exemption of non-deductible retirement contributions when determining the taxable portion of compulsory annuities received from a pension, pension preservation or retirement annuity fund. However, this exemption is not applicable to provident or provident preservation fund members. The rationale behind excluding provident and provident preservation funds from this exemption was based on the fact that these fund members were not required by the rules of the provident and provident preservation fund to utilise at least two-thirds of their fund benefit upon retirement to acquire or purchase a compulsory annuity (provident or provident preservation fund members were allowed to receive their full retirement benefit as a lump sum upon retirement).

REASONS FOR CHANGE

With effect from 1 March 2016, Government proceeded with the introduction of some of the broader objectives of retirement reforms in the Act to ensure greater equity across income groups. As a result, contributions by both employers and employees to pension, provident and retirement annuity funds will qualify for a tax deduction, subject to a cap. On the other hand, contributions by employers to pension, provident and retirement annuity funds on behalf of employees will become a taxable fringe benefit in the hands of the employee.

Following the above-mentioned amendments in the Act, members of provident or provident preservation funds receiving an annuity found themselves in a position where any non-deductible contributions could only be off-set against the lump sum received. The balance of the non-deductible contributions in excess of the lump sum received are in effect forfeited or lost.

It has come to Government's attention that over the past years, a number of provident and provident preservation funds have, by virtue of amending their plan rules, allowed their retiring members the ability to opt to acquire or purchase annuities with their fund benefits.

PROPOSAL

In order to promote Government's policy of a uniform approach to the tax treatment of all retirement funds, it is proposed that provident and provident preservation fund members who receive annuities are afforded the same exemption status that would be applicable to other retirement fund members (that any non-deductible contributions be allowed as an exemption when determining the taxable portion of annuities received from a provident or provident preservation fund).

The ability to deduct any non-deductible contributions made to a provident or provident preservation fund in determining the taxable annuity received from such fund will apply in relation to annuities received on or after 1 March 2020.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 March 2020 and apply in respect of any year of assessment commencing on or after that date.

3.4. Retirement Reforms – Tax treatment of bulk payments to former members of closed funds

[Applicable provision: New paragraph 2D of the Second Schedule to the Act]

BACKGROUND

In 2007, paragraph 2C was introduced into the Second Schedule to the Act to allow for the income tax exemption in respect of a lump sum benefit or part thereof, received or accrued to a person subsequent to the person's retirement, death or withdrawal or resignation from a fund and in consequence of, or following upon an event contemplated by the rules of the fund. In 2008 changes were made to paragraph 2C of the Second Schedule to the Act to make provision for the Minister of Finance to prescribe an event by notice in the Government Gazette in terms of which the above-mentioned extraordinary payments by the retirement funds will qualify for income tax exemption.

Consequently, in 2009, the Minister of Finance published a notice in Government Gazette No. 32005 (GG 32005) prescribing an event referred to in paragraph 2C of the Second Schedule to the Act in terms of which the following extraordinary lump sum payments by the retirement funds qualified for income tax exemption:

(a) Any amount received by or accrued to a person from a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund in consequence of a payment to such fund by the administrator of such fund as a result of income received by the administrator prior to 1 January 2008 that was not disclosed to such funds (loosely referred to as 'undisclosed secret profits');

(b) Any amount received by or accrued to a person from a pension fund or provident fund contemplated in paragraph *(a)* or (*b*) of the definition of 'pension fund' in section 1 of the Act, to the extent that that amount is similar to a payment in terms of a surplus apportionment scheme contemplated in section 15B of the Pension Funds Act, No. 54 of 1956 ('the Pension Funds Act') (loosely referred to as 'surplus calculations');

(c) Any amount received by or accrued to a person from a pension preservation fund or provident preservation fund to the extent that it was paid or transferred to such a fund:

- As an unclaimed benefit contemplated in paragraph (*c*) of the definition of 'unclaimed benefit' in section 1 of the Pension Funds Act (loosely referred to as 'unclaimed benefits'); or
- As a result of or in consequence of an event contemplated in paragraph (*a*) of GG 32005.

REASONS FOR CHANGE

Paragraph 2C of the Second Schedule to the Act read together with the notice published by the Minister of Finance in GG 32005 prescribing an event referred to in paragraph 2C of the Second Schedule to the Act, makes provision for instances where the extraordinary lump sum payments are made by registered, active retirement funds.

When the notice was published by the Minister of Finance in GG 32005, some retirement funds were no longer registered. These deregistered retirement funds had already paid the above-mentioned extraordinary lump sum payments to the fund administrators. The fund administrators had not yet paid these extraordinary lump sum payments to the affected members and/or beneficiaries. These extraordinary lump sum payments are currently still held by the respective fund administrators.

In view of the fact that paragraph 2C of Second Schedule to the Act read together with the notice published by the Minister of Finance in GG 32005 makes provision for the extraordinary lump sum payments to be made by registered active retirement funds, extraordinary lump sum payments made by fund administrators in this regards will not qualify for income tax exemption.

PROPOSAL

In order to ensure consistent tax treatment in respect of extraordinary lump sum payments it is proposed that changes be made in the Second Schedule to the Act and a revised notice published by the Minister of Finance in the Government Gazette making provision for the payment of extraordinary lump sums currently held by fund administrators on behalf of deregistered funds to qualify for tax exempt treatment, provided that they meet the criteria to be determined by the Minister of Finance in the notice.

EFFECTIVE DATE

The proposed amendments will come into operation on the date to be determined by the Minister of Finance by notice in the Government Gazette.

3.5. *Retirement Reforms – Reviewing the tax treatment of surviving spouse pensions*

[Applicable provision: Paragraph 2 of the Fourth Schedule to the Act]

BACKGROUND

The Act makes provision for members of retirement funds to deduct contributions to their retirement funds from their taxable income when determining their monthly employees' tax liability and annual income tax payable. Upon the death of a spouse, the surviving spouse may be entitled to receive a monthly pension known as the 'surviving spouse's pension', which is paid by the retirement fund of the deceased spouse which the deceased spouse was a member of prior to death. This 'surviving spouse's pension' is taxable in the surviving spouse's hands and is subject to Pay-As-You-Earn (PAYE) withholding by the retirement fund making the payment.

If the surviving spouse also receives a salary or other income, that salary or other income is added to the 'surviving spouse's pension' to determine his or her correct tax liability on assessment. Generally, the result of the assessment is often that the surviving spouse has a tax liability that exceeds the employee's tax withheld by the employer and retirement fund(s) during the year of assessment, since the aggregation of income pushes them into a higher tax bracket.

REASONS FOR CHANGE

It has come to Government's attention that in most cases, the surviving spouse does not foresee the additional tax liability as a result of the aggregation of income which pushes the surviving spouse into a higher tax bracket. This creates a cash flow burden and a tax debt for the surviving spouse. Further, this is becoming financially burdensome for the surviving spouses, and has, in many cases had adverse effects on the surviving spouse's financial capacity.

PROPOSAL

In order to assist with alleviating the financial burden in this regard, the following is proposed:

(a) that the tax rebates applicable to the surviving spouse are not taken into account by the retirement fund(s) when calculating the taxes to be withheld on the 'surviving spouse's pension';

(b) any PAYE excessively withheld will be refunded upon assessment.

The above proposal will only be applicable in instances where recipients of the 'surviving spouse's pension' also receive other employment income. As a result, retirement funds are required to apply for an annual tax directive from SARS, the tax directives will advise the retirement fund whether or not the fund should be disregarding the tax rebates when calculating the taxes due on amounts paid by them.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 March 2020 and apply in respect of any year of assessment commencing on or after that date.

3.6. income tax: business (general) – Addressing abusive arrangements aimed at avoiding the anti-dividend stripping provisions

[Applicable provisions: Paragraph 12A and paragraph 43A of the Eighth Schedule to the Act]

BACKGROUND

The anti-avoidance rules dealing with dividend stripping were first introduced in the Act in 2009. Dividend stripping normally occurs when a shareholder company that intends on disinvesting in a target company avoids income tax (including capital gains tax) that would ordinarily arise on the sale of shares. This is achieved when a shareholder company (that either controls or has a significant influence over a target company) ensures that the target company declares a large dividend to it prior to the sale of shares in that target company to a prospective purchaser. This pre-sale dividend, which is exempt from Dividends Tax (in the case of a resident dividend that declares and pays a dividend to another resident company), decreases the value of shares in the target company. As a result, the shareholder company can sell the shares at the lowered share value thereby avoiding a much larger capital gains tax burden in respect of sale of shares.

In 2017, amendments were made in the Act in order to strengthen the anti-avoidance rules dealing with dividend stripping. As a result of the 2017 changes, exempt dividends that are paid to a shareholder company within 18 months of a disposal of shares held by that shareholder company are currently regarded as extra-ordinary dividends and are treated as proceeds or income that is subject to tax in the hands of that shareholder company. Further, in 2018, amendments making provision for the anti-avoidance rules dealing with dividend stripping rules to override corporate re-organisation rules which were made in 2017 were reversed to ensure that those 2017 amendments do not hinder legitimate reorganisation transactions.

REASONS FOR CHANGE

It has come to Government's attention that certain taxpayers have embarked on abusive tax schemes aimed at circumventing the current anti-avoidance rules dealing with dividend stripping arrangements. These schemes involve millions of Rands and have a potential of eroding the South African tax base. These latest schemes involve, for example, a substantial dividend distribution by the target company to its shareholder company combined with the issuance, by that target company, of its shares to a third party or third parties. The ultimate result is a dilution of the shareholder company's effective interest in the shares of the target company that does not involve a disposal of those shares by the shareholder company. The shareholder company ends up, after the implementation of this arrangement, with a lowered effective interest in the shares it holds in the target company without triggering the current anti-avoidance rules. This is because the current anti-avoidance rules are triggered when there is a disposal of shares while these new structures do not result in an ultimate disposal of the shares but a dilution of the effective interest in the shares of the target company.

PROPOSAL

It was proposed in Annexure C of the 2019 Budget Review that amendments should be made to the current anti-avoidance rules to curb the use of these new dividend stripping arrangements. Furthermore, given the abusive nature of these arrangements, it was proposed that the amendments should come into effect from the date of the announcement, which was on the 2019 Annual National Budget Day, (i.e. 20 February 2019). This means that the proposed amendments to the legislation on anti-avoidance rules dealing with dividend stripping will come into effect from 20 February 2019 and apply to dividend stripping schemes entered into on or after 20 February 2019. These legislative interventions will not apply in respect of dividend stripping schemes entered into before 20 February 2019.

In terms of the proposed amendments the anti-avoidance dealing with dividend stripping rules will operate as follows:

A. The anti-avoidance rules will no longer apply only at the time when a shareholder company disposes of shares in a target company.

For purposes of ensuring that the new avoidance arrangements will also be subject to the dividend stripping rules, a deemed disposal will be imposed on such arrangements. This deemed disposal will be imposed solely for purposes of the dividend stripping rules and will result in an income inclusion or capital gain in the hands of the shareholder company. For this purpose, the deemed disposal rule will operate as follows:

- A shareholder company will, for purposes of the anti-avoidance rules dealing with dividend stripping, be deemed to have disposed of its shares in the target company, if the target company issues shares to another party and after that issuance of shares, it is determined that the effective interest held by the shareholder company in the target company is reduced by reason of that issuance of shares.
- In such an instance, the shareholder company will be deemed to have disposed of a percentage of the shares it holds in the target company immediately after the share issue that results in a

decrease in the effective interest it holds in the shares of the target company. The percentage envisaged is the percentage by which the effective interest held by the shareholder company in the target company has been reduced by as a result of the issuance of shares.

EFFECTIVE DATE

The proposed amendments will be deemed to have come into operation on 20 February 2019 and apply in respect of shares held by a company in another company if the effective interest of those shares held by that company in that other company is reduced by reason of shares issued by that other company, on or after 20 February 2019 to a person other than that company.

3.7. Correcting anomalies arising from applying value-shifting rules – Clarifying the effect of deferred tax on the application of value-shifting rules

[Applicable provision: Section 24BA of the Act]

BACKGROUND

In 2012, value shifting rules were introduced under section 24BA of the Act. The purpose of these rules is to ensure that all asset-for-share transactions are entered into on a value-for-value basis (i.e. an asset must be acquired in exchange for an issue of shares of an equal market value).

Section 24BA of the Act provides that where a company acquires an asset in exchange for the issue of shares by that company and the market value of the asset immediately before the disposal exceeds the market value of the shares immediately after that issue, the amount in excess is deemed to be a capital gain in respect of a disposal by that company of the shares. In addition, the base cost of the shares issued must be reduced in the hands of the person selling the asset by the amount of that excess.

On the other hand, where a company acquires an asset in exchange for an issue of shares by that company and the market value of the shares immediately after that issue exceeds the market value of that asset immediately before the disposal, the amount in excess is deemed to be a dividend that consists of a distribution of an asset in specie that is paid by the company on the date of that issue.

REASONS FOR CHANGE

A company is required to report its financial position in the financial statements to its shareholders as well as in the annual tax return filed to SARS. With regard to the reporting of the financial position in respect of the acquisition, holding and use of an asset, a company will report its financial position in the financial statements in accordance with accounting principles. On the other hand, with regard to the reporting in respect of the acquisition, holding and use of an asset in the annual tax return, a company will report in accordance with the provisions of the Act. For accounting purposes, the write-off periods reflecting the rate of depreciation of an asset may be different from the write-off periods prescribed in the Act.

The difference in the write-off periods of assets in terms of accounting principles and those stipulated in the Act results in what is called in accounting terms 'temporary differences' due to the manner in which assets are reported for accounting purposes and for tax purposes. These temporary differences imply that companies will calculate their tax liability based on different taxable income amounts as a result of different write off periods. As a result, a company will either pay more or pay less tax on its accounting profit as compared to what it would have if these assets were written off in terms of the Act. In instances where temporary differences result in more taxes being payable for accounting reporting, than the taxes that would have been payable if the asset was written of in accordance with the provisions of the Act, a deferred tax asset is recognised as less taxes are expected to be paid in the future. In instances where the temporary differences result in less taxes being payable for accounting purposes, than the taxes that would have been payable if the asset was written of in accordance with the provisions of the Act, a deferred tax liability is recognised as more taxes are expected to be paid in the future.

Concerns have been raised regarding the potential effect of deferred tax and in particular, a deferred tax liability on the market value of shares that were issued in exchange for the asset. The market value of such shares must be compared to the market value of the asset acquired by the company in terms of the value shifting rules. As a point of departure, only instances of value shifting should trigger the application of the value shifting rules. Differences between the market value of the shares issued and the market value of assets acquired, should not trigger the value shifting rules if such a difference is not due to value shifting but as a result of temporary differences that result in a deferred tax liability that affects the value of the shares following the acquisition of an asset.

PROPOSAL

In order to address these concerns, it is proposed that changes be made in the tax legislation so that the value shifting rules are only triggered in instances where high value assets are transferred in exchange for low value shares. The proposed amendments will provide that where differences in the market value of the shares issued differs from the market value of asset acquired solely as a result of temporary differences that give rise to a deferred liability, the value shifting rules should not apply.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2020 and apply in respect of acquisitions made on or after that date.

3.8. *Correcting anomalies arising from applying value-shifting rules – Clarification of the interaction of the value-shifting rules and the deemed expenditure incurral rules for assets acquired in exchange for the issue of shares*

[Applicable provisions: Sections 24BA and 40CA of the Act]

BACKGROUND

The Act contains rules in section 24BA and section 40CA aimed at preventing the transfer of high value assets to a company in return for low value shares issued by the company and the issuance of high value shares for low value assets. Section 40CA provides that a company that acquires an asset in exchange for an issue of shares in itself is deemed to have incurred expenditure in respect of the acquisition of that asset that is equal to the market value of those shares immediately after the acquisition. This means that a company that acquires an asset in exchange for the issue of its shares is deemed to have a base cost in the case of capital asset or a cost of trading stock in the case of trading stock for that asset.

On the other hand, section 24BA provides that where a company acquires an asset from a person in exchange for an issue of shares by that company and the market value of the asset immediately before that disposal exceeds the market value of the shares immediately after that issue, the amount in excess is deemed to be a capital gain in respect of a disposal by that company of the shares and the base cost of the shares issued must be reduced in the hands of the person selling the asset by the amount of that excess. Further, where a company acquires an asset from a person in exchange for the issue of shares and the market value of the shares immediately after that issue exceeds the market value of that asset immediately before the disposal, the amount in excess is deemed to be a dividend that consists of a distribution of an asset in specie that is paid by the company on the date of that issue.

REASONS FOR CHANGE

Currently, the provisions of the Act do not adequately address the interaction of the above-mentioned rules. In particular, it is not clear if a company should adjust the deemed expenditure incurred in terms of section 40CA in respect of an asset acquired in exchange for the issue of its own shares with the amount of the capital gain triggered in terms of section 24BA. This lack of clarity results in potential double taxation. Potential double taxation will arise in the instance that the company subsequently disposes of the asset due to the fact that the company would have paid tax on the capital gain triggered by section 24BA which is currently not deemed to be expenditure incurred.

Example 1: Potential double taxation under current rules

Facts:

Company A acquires an asset with a market value of R150 from Person X and as consideration for the assets, Company A issues shares with a market value of R100 after the transaction.

Results:

In terms of ordinary principles, Person X has a base cost of R150 for the shares issued by Company A as he incurred a cost equal to the market value of his asset in order to acquire the shares. In terms of section 40CA, Company A is deemed to have a base cost of R100 for the assets (i.e. being the market value of the shares it issued immediately after the transaction).

Given the difference in value, section 24BA applies to the transaction. As a result, Company A is deemed to have a capital gain of R50 (i.e. the market value of the assets immediately before the transaction of R150 – the market value of the shares issued immediately they are issued of R100). In addition, Person X must reduce his base cost for the shares R50, therefore not allowing for a base cost increase for shares of a lower value.

This results in a situation where Company A holds assets with a market value of R150 in respect of which shares worth R100 and a capital gain of R50.

PROPOSAL

In order to provide clarification on the interaction between the two set of rules contained in section 24BA and section 40CA, it is proposed that changes be made in the deemed expenditure incurral rule in section 40CA. The proposed changes will provide that the deemed expenditure incurred by a company that acquires an asset in exchange for the issue of its own shares must be equal to the sum of the market value of the issued shares immediately after the acquisition of the asset in respect of the asset and any deemed capital gain which arose in terms of the value shifting rules in respect of the acquisition of that asset.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2020 and apply in respect of acquisitions made on or after that date.

3.9. Refining provisions around the special interest deduction for debt funded share acquisitions – Clarifying the exclusion from claiming interest deduction for debt finance acquisitions for start-up businesses

[Applicable provision: Section 24O of the Act]

BACKGROUND

The Act contains special interest deduction rules in section 24O that make provision for companies to deduct interest in respect of interest-bearing debt used to acquire a direct or indirect controlling share interest in an operating company. The policy rationale for the special interest rules in section 24O was to discourage the use of multiple step debt push down structures used by taxpayers to obtain interest deductions in respect of debt used to acquire shares of income producing business. One of the requirements for these rules is that an operating company must be a company where at least 80 per cent of that company's receipts and accruals constitute income as defined (i.e. gross receipts and accruals less receipts and accruals that are exempt for tax purposes) and that income must have been generated from its business of providing goods and services.

In 2015, changes were made in section 24O to align these rules with the underlying policy objective and to ensure that taxpayers could no longer claim the special interest deduction when the value of the shares of the holding company of an operating company was largely derived from non-income producing fellow subsidiaries of an income producing operating company. As a result, share interests that qualify for the special interest deduction were limited to shares whose value was largely determined with reference to the value of shares of operating companies where at least 90 per cent of their value was derived from an income producing operating company.

REASONS FOR CHANGE

It has come to Government's attention that there are conflicting views regarding the application of these rules and that some taxpayers intend on claiming the special interest deduction in respect of newly established companies. For example, a prospective company shareholder would raise interest-bearing debt to capitalise a newly established company. In turn, the newly established company uses the funding from its now shareholder to acquire income producing assets and embarks on its trade. As a result, the shareholder then claims a special interest deduction in respect of the interest incurred in respect of the interest-bearing debt used to capitalise the newly established company when it subsequently generates income and meets the definition of an operating company (at least 80 per cent of a company's receipts and accruals constitutes income).

The above-mentioned view goes against the policy rationale for the introduction of the special interest deduction. The special interest deduction is meant to provide for a deduction where interest bearing debt is used to acquire shares in established companies with income producing assets that already generate high levels of income.

Consequently, in the Final Response Document on Taxation Laws Amendment Bill, 2018 and Tax Administration Laws Amendment Bill, 2018 (dated 17 January 2019 on page 19), Government stated that the current provisions of the special interest deduction do not support the deduction of interest on interest-bearing debt used to capitalise newly established companies that upon capitalisation do not qualify as operating companies as yet. In addition, the definition of an 'acquisition transaction' envisages an acquisition of a controlling interest in a company that is, upon acquisition, already an operating company or a controlling company in relation to an operating company.

PROPOSAL

The proposed clarification of the exclusion of acquisitions of shares in companies that are not operating companies or controlling companies on the date of the acquisition of shares in an operating company seems to be more of a restatement of the current requirements for claiming the special interest deduction. It is, nevertheless, still proposed that changes be made in section 24O of the Act to explicitly provide that an acquisition transaction envisages a situation where the controlling shares being acquired by a company that is not a part of the same group of companies as the company in which the shares are being acquired are shares in a company that, is on the date of that acquisition, either an operating company or a controlling company in relation to an operating company.

EFFECTIVE DATE

The proposed amendments are deemed to have come on 1 January 2019 and apply in respect of interest incurred during years of assessment ending on or after that date.

3.10. *Refining provisions around the special interest deduction for debt funded share acquisitions – Amending the special interest deduction rules in respect of share acquisitions funded by debt to allow for deductions after an unbundling transaction*

[Applicable provision: Section 24O of the Act]

Background

Since the introduction of section 24O in 2012, a company may qualify for a deduction in respect of interest it incurs on an interest-bearing debt that it issues, assumes or uses to fund an acquisition of a direct controlling share interest in an operating company or an indirect controlling share interest in an operating company held through a controlling group company in relation to that operating company. The companies involved must, however, form part of a domestic group of companies. The acquiring company can continue to claim the special interest deduction as long as it also remains within the same domestic group of companies as that operating company or that holding company in relation to that operating company.

Reasons for change

In some instances, a company may be unable to acquire a direct controlling interest in an operating company but may be able to acquire only an indirect controlling interest by acquiring the shares in a controlling group company in relation to that operating company. The interest incurred in respect of the debt used to fund the acquisition of the shares in the controlling group company will be deductible if the acquisition meets requirements of section 24O. It is uncertain, however, if that company may continue to claim the deduction in respect of such interest should the controlling group company unbundle the shares it holds in the operating company to that company, i.e. if the indirect controlling interest acquired by that company in the operating company is in effect converted to a direct controlling interest in the operating company.

Taxpayers have submitted that certainty should be provided in such an instance the company can still claim a deduction in respect of the interest incurred on the debt as it would in any event have qualified for a deduction had it initially acquired a direct controlling interest in the operating company. Furthermore, following an unbundling there will no longer be any concerns about an indirect shareholding whose value may not be significantly derived from the value of an operating company.

Proposal

Group restructures that result in a company that had acquired an indirect controlling share interest in an operating company, holding a direct controlling share interest in an operating company will be more clearly accommodated in the legislation. It is proposed that the legislation should clearly state that where an unbundling transaction results in a company holding a direct controlling share interest in an operating company, that company may continue to claim the special interest deduction.

Effective date

The proposed amendment is deemed to have come into operation on 1 January 2019 and applies in respect of years of assessments ending on or after that date.

3.11. Clarifying the interaction between corporate reorganisation rules and other provisions of the Act – Clarifying the tax treatment of transfer of interest bearing instruments in terms of corporate reorganisations

[Applicable provisions: Sections 24J and 41 of the Act]

BACKGROUND

The Act contains specific provisions in section 24J that regulates the incurral and accrual of interest in respect of 'instruments'. In this respect, section 24J defines the term instrument to include 'any interest-bearing arrangement or debt'. In the event an 'instrument' is disposed of, section 24J(4) of the Act requires the holder of an instrument to account for an adjusted gain or adjusted loss on transfer or redemption of an instrument in the year of assessment during which the instrument is transferred or redeemed.

The adjusted gain or adjusted loss on the transfer of an instrument for the holder of an instrument equals the 'transfer price' of such instrument plus any payments received by the holder during the accrual period in which it is transferred less the 'adjusted initial amount' at the beginning of that accrual period less the accrual amount for that accrual period less payments made by the holder during that period. The 'transfer price' is defined in section 24J of the Act as 'the market value of the consideration payable or receivable, as the case may be, for the transfer of such instrument as determined on the date on which that instrument is transferred.'

Sections 42, 44, 45 and 47 of the Act provide for the deferral of tax when assets are moved between companies forming part of the same 'group of companies', as defined in section 41 of the Act. However, when the transferor company disposes of an interest bearing instrument, those sections deem a disposal of the interest bearing instrument to be an amount equal to the base cost of such an interest bearing instrument or the amount taken into account in terms of section 11(*a*) or section 22(1) or (2) of the Act.

REASONS FOR CHANGE

As stated above that the Act contains corporate reorganisation rules aimed at providing tax neutral transfer of assets between companies that form part of the same group of companies. However, the current corporate reorganisation rules do not specifically address the interaction of the definition of 'transfer price' in section 24J of the Act which is equal to market value as stated above with the deemed proceeds prescribed by the corporate reorganisation rules of the Act which is equal to the base cost of such an asset or the amount taken into account in terms of section 11(*a*) or section 22(1) or (2) of the Act.

PROPOSAL

In order to ensure accrued interest and a change in market value of an instrument as a result of changes in market interest rates are reflected in the taxable income of the transferor of an instrument it is proposed that the corporate rules should not override the application of section 24J of the Act. As a result, the transferor will realise an adjusted gain or adjusted loss on transfer of an interest bearing instrument in terms of section 24J of the Act despite transferring these interest bearing instruments in terms of the corporate rules.

EFFECTIVE DATE

The proposed amendment will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

3.12. Clarifying the interaction between corporate reorganisation rules and other provisions of the Act – Clarifying the tax treatment of transfer of exchange items in terms of corporate reorganisations

[Applicable provisions: Sections 24I and 41 of the Act]

BACKGROUND

A. Foreign exchange differences

A taxpayer may carry out transactions denominated in a currency other the South African Rand (i.e. a foreign currency). Currencies, including the South African Rand, are volatile and as a result, the price or amount for which the currency of one country can be exchanged for another country's currency, referred to as an exchange rate, fluctuates. For tax compliance purposes, a taxpayer must reflect the transactions entered into by that taxpayer in South African Rands and therefore must translate the foreign currency amounts to South African Rands. When currencies are translated from one to the other, exchange differences (either a gain or loss) will arise depending of the performance of the South African Rand in relation to that of the foreign currency that denominated a taxpayer’s transaction.

Section 24I of the Act determines the exchange differences (foreign exchange gains and losses) in respect of exchange items that must be included in or deducted from a taxpayer's income.

These differences are determined at the end of each year of assessment or on the date that exchange item is realised or transferred. However, in the instance of differences in respect of exchange items between connected parties and companies that form part of the same group of companies, there is a deferral of inclusions and/or deductions in respect exchange differences until the exchange item is realised.

B. Corporate reorganisations

The Act contains corporate reorganisation rules that make provision for roll over relief in respect of the transfer of assets and the assumption of qualifying debt between taxpayers. This, therefore, includes assets or liabilities that may be denominated in foreign currency. Furthermore, for purposes of applying the roll-over provisions, currently the provisions governing the corporate reorganisation rules override (unless specifically indicated to the contrary under those provisions) the other provisions of the Act.

REASONS FOR CHANGE

At issue is that the current corporate reorganisation rules do not provide clarity on the interaction of these rules and the realisation of exchange gains or exchange losses in respect exchange items that are transferred under a reorganisation transaction.

There are conflicting views on whether unrealised and deferred exchange differences on exchange items transferred in terms of corporate reorganisation rules should be deferred under corporate reorganisation rules or whether an exchange difference should be included or deducted (as the case may be) when an exchange item is transferred in terms of a reorganisation rule.

PROPOSAL

In order to clarify the interaction between corporate reorganisation rules and provision governing the inclusion and deduction of exchange gains or exchange losses it is proposed amendments be made in the corporate reorganisation rules to ensure that when an exchange item is transferred, the unrealised and deferred exchange differences on that exchange item should be realised and is not deferred. As a point of departure, these changes are necessary as currently section 41(2) provides that the corporate reorganisation rules override all other provisions of the Act. As such, is it proposed that section 41(2) should be amended to clarify that the corporate reorganisation rules do not override the provisions of section 24I in respect of triggering gains or losses upon the realisation or transfer of an exchange item.

EFFECTIVE DATE

The proposed amendment will come into operation on 1 January 2020 and applies in respect of years of assessment commencing on or after that date.

3.13. Clarifying the interaction between corporate reorganisation rules and other provisions of the Act – Harmonising the timing of degrouping charge provisions for intra-group transactions and controlled foreign company rules

[Applicable provisions: Sections 9D, 9H and 45 of the Act]

BACKGROUND

A. Controlled foreign company rules

A Controlled Foreign Company (CFC) is defined in section 9D of the Act as any foreign company if more than 50 per cent of the total participation rights or voting rights in that company are directly or indirectly held or exercisable by one or more persons that are residents. In 2017, changes were made to the definition of a CFC in section 9D of the Act to regard as a CFC as any foreign company where the financial results of that foreign company are reflected in the consolidated financial statements of any company that is a resident as required under International Financial Reporting Standards (IFRS) 10.

Section 9D(2)(*b*) of the Act makes provision for the determination of a CFC income when a foreign company ceases to be a CFC. When a foreign company ceases to be a CFC at any stage during a year of assessment before the last day of the foreign tax year of that foreign company, section 9D(2)(*b*)(ii) of the Act determines that an amount equal to a proportional amount of the net income of the company must be included in income of residents. The foreign tax year is stated to end on the day the foreign company ceases to be a CFC and the proportional amount is calculated from the first day of the foreign tax year of the CFC to the day before the company ceases to be a CFC.

B. Ceasing to be a controlled foreign company

When a foreign company ceases to be a CFC, section 9H(3) of the Act triggers an exit event for a foreign company that ceases to be a CFC. The CFC is deemed to have disposed each of its assets on the date immediately before the day on which that foreign company ceased to be a CFC and reacquired those assets on the day that the foreign company ceased to be a CFC. Furthermore, the foreign tax year of a foreign company that ceases to be a CFC is deemed to have ended on the date immediately before the day it ceased to be a CFC and the next foreign tax year is deemed to have commenced on the day it ceased to be a CFC.

C. Exiting the group of companies in terms of corporate reorganisation rules

Section 45 of the Act provides for the deferral of tax when assets are transferred between companies forming part of the same 'group of companies', as defined. However, whenever the transferee company exits the group of companies in relation to the transferor, but retains an asset acquired within the last six years under an intra-group transaction, a deemed capital gain is determined for the asset. This is commonly referred to as a de-grouping charge. This de-grouping charge could also be triggered for an asset that constitutes an equity share if the transferee ceases to be a CFC in terms of section 45(4)(bA)(i)(bb) of the Act. In this scenario, the capital gain is taken into account in the determination of the net income of the foreign company in its year of assessment when it ceases to be a CFC. That would be the day after the foreign tax year ends in terms of section 9H(3)(*d*)(i) and the day after the proportional amount of the net income is determined in terms of section 9D(2)(*b*)(ii).

REASONS FOR CHANGE

At issue is the misalignment in the timing of the rules for the determination of net income of a CFC under sections 9D, 9H and 45 of the Act due to the fact that the de-grouping charge provisions in the corporate reorganisation rules deem a capital gain to arise in the year of assessment in which a de-grouping takes place. However, the provisions for determining the net income of CFCs and the provisions for ceasing to be CFCs, when read together, determine that the year of assessment in which the 'de-grouping event occurs' commences and ends on the same day but the period for which the net income should be determined ended on the day before the foreign company ceases to be a CFC.

PROPOSAL

In order to address the above-mentioned misalignment, it is proposed that changes be made in the tax legislation and the capital gain as the exit charge for intra-group transactions in the case of a foreign company ceasing to be a controlled foreign company be triggered on the date before the day the transferee company ceases to be a controlled foreign company. The proposed changes will enable the capital gain to be taken into account in the net income to be imputed to residents when a foreign company ceases to be a CFC.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

3.14. Clarifying the interaction between corporate reorganisation rules and other provisions of the Act – Amending the corporate reorganisation rules to cater for company deregistration by operational law

[Applicable provision: Section 41 of the Act]

BACKGROUND

The Act contains corporate reorganisation rules that make provision for roll over relief in respect of the transfer of assets between companies forming part of the same economic unit as well as their natural person shareholders. Further, in order to qualify for the roll over relief, the corporate reorganisation rules contain certain requirements and anti-avoidance provisions that taxpayers must adhere to. With regard to corporate reorganisation rules dealing with amalgamation transactions and transactions relating to liquidation, winding-up and deregistration, these rules currently contain a requirement for the liquidation, winding-up or deregistration of one of the parties to these transactions.

In the case of an amalgamation transaction, these rules require that an amalgamated company (i.e. the company that disposes of all its asset to another company in respect of an amalgamation transaction) must be terminated soon after that amalgamation transaction. In the case of a transaction relating to liquidation, winding-up and deregistration, these rules require that a liquidation company (i.e. a company that disposes of all its assets to its shareholders in anticipation of or in the course of its liquidation, winding-up or deregistration) should also be terminated soon after that transaction.

Further, these corporate reorganisation rules contain measures that disqualify taxpayers from benefiting from roll over relief if the necessary steps to liquidate, wind-up of register an amalgamated company or a liquidating company have not been taken within 36 months of the transaction. However, a longer period than the above-mentioned 36 months may be allowed if the SARS Commissioner determines that such longer period is justified as envisaged in the Act.

REASONS FOR CHANGE

In the case of two of the corporate reorganisation rules (namely, 'amalgamation transactions' and 'transactions relating to liquidation, winding up and deregistration'), the Act currently contains a requirement for the liquidation, winding-up or deregistration of one of the parties to these transactions. In particular, it is required that an amalgamated company (i.e. the company that disposes of all its asset to another company in terms of an amalgamation transaction) must be terminated soon after that amalgamation transaction. In the case of a transaction relating to liquidation, winding-up and deregistration, it is also required that a liquidation company (i.e. a company that disposes of all its assets to its shareholders in anticipation of or in the course of its liquidation, winding-up or deregistration) should also be terminated soon after that transaction.

In order to ensure that taxpayers comply with the requirement regarding the termination of an amalgamated company and a liquidating company, the income tax act contains rules that disqualify taxpayers from benefiting from tax deferral if the necessary steps to liquidate, wind-up or deregister an amalgamated company or a liquidating company have not been taken within 36 months of the transaction. A longer period may however, be allowed if the Commissioner of the South African Revenue Service determines that a longer period is justified. In this regard, the envisaged steps are specifically listed in the tax legislation.

In this respect, section 116 of the Companies Act, No.71 of 2008 (the Companies Act), requires that a notice detailing the amalgamation or merger must be prepared in the prescribed manner and form after a resolution approving an amalgamation or merger has been adopted by each company that is a party to that arrangement. Furthermore, it is required that the notice should be furnished to the Companies and Intellectual Property Commission (the Commission). Once the Commission has received this notice, section 116(5)(*b*) empowers the Commission to deregister any of the amalgamating or merging companies that did not survive the amalgamation or merger. However, companies which deregister in terms of section 116(5)(*b*) of the Companies Act, pursuant to a statutory amalgamation or merger have not been catered for in the list of steps contained in the Act.

PROPOSAL

In order to ensure that statutory amalgamations and mergers are not unfairly excluded from qualifying for tax deferral, it is proposed that the current list of steps taken for liquidation, winding-up and deregistration should be amended by including instances where companies lodge a notice to the Commissioner as contemplated in section 116 of the Companies Act.

EFFECTIVE DATE

The proposed amendment will come into operation on 1 January 2020 and apply in respect of acquisitions made on or after that date.

3.15. Reviewing the real estate investment trust (REIT) tax regime – Clarification of the definition of rental income in a reit tax regime in respect of foreign exchange differences

[Applicable provision: Section 25BB of the Act]

BACKGROUND

The special tax dispensation of a listed company that is a Real Estate Investment Trusts ('REIT') or a company that is a subsidiary of a REIT ('controlled company') makes provision for a flow-through principle in respect of income and capital gains to be taxed solely in the hands of the investor and not in the hands of REIT or a controlled company. In turn, a REIT or a controlled company may claim distributions to its investors as a deduction against its income. This deduction may only be claimed if a distribution is a 'qualifying distribution' that is more than 75 per cent of the gross income of a REIT or a controlled company consisting of 'rental income'.

The term 'rental income' is defined in section 25BB(1) of the Act to mean any of the following amounts received by or accrued to a REIT or a controlled company:

(a) an amount received or accrued for the use of immovable property, including any penalty or interest charged on the late payment of such amount;

(b) any dividend, other than a share buy-back contemplated in paragraph (b) of the definition of 'dividend' in section 1(1) of the Act, from a company that is a REIT at the time of the distribution of that dividend;

(c) a qualifying distribution from a company that is a controlled company at the time of that distribution;

(d) a dividend or foreign dividend from a company that is a property company at the time of that distribution;

(e) any amount recovered or recouped under section 8(4) in respect of an amount of an allowance previously deducted under section 11(*g*), 13, 13*bis*, 13*ter*, 13*quat*, 13*quin* or 13*sex* of the Act.

REASONS FOR CHANGE

In order for REITs or controlled companies to diversify and multiply returns for its investors, many South African REITs or controlled companies have embarked on investments in real estate outside South Africa. In order to hedge its exposure to foreign currency fluctuations, as well as secure stable returns to investors in respect of its foreign real estate investments, a REIT or a controlled company may enter into forward exchange contracts (FEC).

At issue is the current tax treatment of any unrealised exchange gains or losses determined on the above-mentioned FECs of a REIT or a controlled company. Any unrealised exchange gains or losses arising from the above-mentioned FECs of a REIT or a controlled company are in terms of paragraph (n) of the definition of gross income in section 1 and in section 24I(3) of the Act taken into account in determining the taxable income of such REIT or such controlled company. This implies that unrealised exchange gains or losses arising from the above-mentioned FECs of a REIT or a controlled company do not qualify as 'rental income' of a REIT or a controlled company, even though they are incurred solely for the earning of such 'rental income'.

PROPOSAL

In order to address this anomaly, it is proposed that changes be made to the definition of 'rental income' in section 25BB of the Act to include any foreign exchange gains and deduct foreign exchange foreign exchange losses arising in respect of an 'exchange item' relating to a 'rental income' of a REIT or a controlled company.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

3.16. Reviewing the real estate investment trust (REIT) tax regime – Clarification of the interaction between corporate reorganisation rules and reits tax regime

[Applicable provisions: Sections 25BB, 42, 44 and 45 of the Act]

BACKGROUND

The Real Estate Investment Trusts (REITs) tax regime, allows for the tax-free earning of rental income and capital gains a REIT. The investor is taxed on dividends declared by the REIT and also on gains from the disposal of shares in the REIT. In order to enable this tax treatment under the REIT regime, the REIT is allowed to claim distributions to its investors as a deduction against its income. This deduction may only be claimed if a distribution is a 'qualifying distribution' that is, more than 75 per cent of the gross income of the REIT consists of rental income including income from property entities.

Further section 25BB(5) of the REITs tax regime in the Act makes provision for a capital gains tax exemption in respect of the following disposals by a REIT or a controlled company:

(a) immovable property of a company that is a REIT or controlled company at the time of disposal;

(b) a share or a linked unit in a company that is a REIT at the time of that disposal; or

(c) a share or a linked unit in a company that is a property company at the time of that disposal.

A disposal by a REIT or controlled company of any asset that is not listed above as envisaged in section 25BB(5) of the REITs tax regime is subject to normal tax, including capital gains tax if applicable.

In turn, the Act contains corporate reorganisation rules aimed at providing for the tax neutral transfer of assets between companies that form part of the same group of companies, provided certain requirements are met. For example, when a transferor disposes of an allowance asset and the transferee company, in turn, acquires that allowance asset as such, the corporate reorganisation rules allow for the tax neutral transfer of such allowance asset. However, the corporate reorganisation rules make provision for certain anti-avoidance measures to be triggered, for example, the rolled over capital gain to be added back to the taxable income of the company, if a company that acquired the asset, disposes of such asset within a period of 18 months of acquisition.

REASONS FOR CHANGE

At issue is the interaction of the above-mentioned anti-avoidance measures contained in the corporate reorganisation rules and the provisions of section 25BB(5) of the REIT tax regime.

In certain instances if the immovable property is disposed of by a REIT within 18 months, the anti-avoidance measures contained in the corporate reorganisation rules require that the rolled over capital gain in respect of such immovable property be added to the taxable capital gain of the REIT for the year of assessment in which the disposal of the immovable property takes place. On the other hand, section 25BB(5) of the REITs tax regime provides for capital gains exemption in respect of disposals of certain immovable property by a REIT. The anti-avoidance measures contained in the corporate reorganisation rules when read with the provisions of section 25BB(5) of the REITs tax regime create a discrepancy because in general, corporate reorganisation rules override the provisions for the taxation of REITs in section 25BB of the Act.

PROPOSAL

In order to ensure that the rules for the REITs tax regime are aligned with the corporate reorganisation rules, it is proposed that amendments be made in the tax legislation so that corporate reorganisation rules do not give rise to capital gains tax on disposal of assets within 18 months after their acquisition by a REIT or controlled company under a corporate reorganisation rule.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

3.17. Reviewing the real estate investment trust (REIT) tax regime – Consequential amendments to the tax treatment of foreign reinsurance business operating a branch in South Africa

[Applicable provisions: Sections 28 and 29A of the Act]

BACKGROUND

The Insurance Act No. 18 of 2017 (the Insurance Act) which was promulgated on 18 January 2018 is aimed at replacing and/or consolidating substantial parts of the Long-term Insurance Act and the Short-term Insurance Act. The Insurance Act also makes provision for foreign reinsurers to operate a reinsurance business in South Africa through a branch, provided that the foreign reinsurer is granted a license, establishes a representative office as well as a trust in South Africa.

Consequently, in 2017, changes were made in section 28 of the Act, dealing with tax treatment of short term insurance business. These changes made provision for a foreign reinsurer that is a long-term or short-term that conducts insurance business through a branch of that foreign reinsurer as envisaged in the Insurance Act to be deemed as a short-term insurer for purposes of the Act.

The above-mentioned 2017 changes in the Act follow changes that were made in the Act in 2015 and 2016, as a result of introduction of Solvency Assessment and

Management (SAM) Framework for a short-term insurer and long-term insurer.

With regard to short-term insurer, the 2015 amendments to section 28(3) of the Act made provision for a short-term insurer to claim deductions in terms of this subsection that is equal to the sum of liabilities on investments contracts relating to short-term insurance business in accordance with International Financial Reporting Standards (IFRS) and amounts recognised as insurance liabilities in accordance with IFRS relating to premiums and claims reduced by the amounts recognised in accordance with IFRS in respect of amounts recoverable under policies of reinsurance and further reduced by deferred acquisition cost.

However, with regard to long-term insurers, the 2016 changes made to section 29A of the Act made provision for the following: (i) introduction of a new definition of value of liabilities, (ii) introduction of a new definition of adjusted IFRS value, as well as (iii) transitional rules aimed at prescribing a phasing in amount and the method and period of phasing in.

REASONS FOR CHANGE

At issue is whether the 2017 changes to section 28 of the Act making provision for a foreign reinsurer that is a long-term insurer that conducts insurance business through a branch of that foreign reinsurer as envisaged in the Insurance Act to fall under the ambit of section 28 also changed the nature of taxation of a foreign reinsurer that is regarded as a long-term insurer in terms of section 29A of the Act.

In particular, it is not clear which of the IFRS liabilities in a long-term insurance business conducted through a branch of a foreign insurer would be allowed as a deduction in terms of section 28(3) of the Act. Further, section 28(3) of the Act due to the fact that a deduction is only allowed for the amount of insurance liabilities recognised in accordance with IFRS, relating to 'premiums' and 'claims'. 29

PROPOSAL

In order to provide clarification on the tax treatment of a foreign reinsurer that is a long-term that conducts insurance business through a branch in South Africa and falls under the ambit of section 28 of the Act, the following changes are proposed in the Act:

A. New section 28(3) of the Act

It is proposed that a new subsection be introduced in section 28 of the Act that allows a foreign reinsurer that is a long-term that conducts insurance business through a branch in South Africa to deduct insurance liabilities based on the concept of 'adjusted IFRS value' as used in section 29A of the Act. This will have the effect that insurance liabilities will be determined net of negative liabilities and the other adjustments under section 29A will create alignment with the taxation of domestic insurers that are conducting the same type of business than the foreign insurer through its South African branch.

B. Section 29A of the Act

In addition, it is proposed that changes be made in section 29A of the Act to clarify that insurance business conducted by a non-resident reinsurer through a South African branch must be taxed only in terms of section 28 of the Act.

EFFECTIVE DATE

The proposed amendment will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

3.18. Reviewing the tax treatment of long-term insurers – Refinement to taxation of risk policy funds of long-term insurers

[Applicable provision: Section 29A of the Act]

BACKGROUND

With effect from 1 January 2016, risk policies issued by the long-term insurer during the year of assessment commencing on or after 1 January 2016 and other policies issued by the long-term insurer before that year of assessment which the insurer elected to be allocated to the risk policy fund are taxed in a fifth fund known as the risk policy fund ('RPF'). Every long-term insurer is required to establish five separate funds and to maintain such funds. The taxable income derived by a long-term insurer in respect of the untaxed policyholder fund, the individual policyholder fund, the company policyholder fund, the corporate fund and the risk policy fund must be determined separately in accordance with the Act as if each such fund had been a separate taxpayer.

In essence, 'risk policy' is defined in Section 29A(1) of the Act as a policy issued by an insurer during the insurer's year of assessment commencing on or after 1 June 2016 under which the benefits payable (i) cannot exceed the amount of premiums receivable, except where all or substantially the whole of the policy benefits are payable due to death, disablement, illness or unemployment; or (ii) excluding benefits due to death, disablement, illness or unemployment cannot exceed the amount of premiums receivable, and excludes a contract of insurance in terms of which annuities are being paid. However, policies under which annuities are being paid are specifically excluded from being classified as a risk policy.

Further, the definition of 'risk policy' includes any policy in respect of which an election has been made to allocate to the risk policy fund all policies or one or more classes of policies that share substantially similar contractual rights and obligations that would have constituted risk policies if they were issued prior to the year of assessment commencing on or after 1 January 2016.

REASONS FOR CHANGE

As stated above, a policy under which annuities are being paid is specifically excluded from being classified as a risk policy. That said, a risk policy may result in the payment of benefits in instalments under certain circumstances that can only be determined at the time that a claim arises. This does not necessarily result in a separate policy that pays annuities.

In instances where a policy is initially allocated to the risk policy fund and the risk policy commence to pay out annuities on the happening of risk event, section 29A(6) of the Act requires the transfer of assets and liabilities pertaining to that risk policy to the untaxed policyholder fund. This transfer of assets and liabilities from the risk policy fund to the untaxed policyholder fund was said to be administratively burdensome and arguably may not result in a different tax consequence if it remained in the risk policy fund as opposed to being transferred to the untaxed policyholder fund.

PROPOSAL

It is proposed that the exclusion of a 'contract of insurance in terms of which annuities are being paid' be removed from the risk policy definition to ensure that the risk policy remains allocated to the risk policy fund even when policy proceeds are paid in a form of an annuity. Consequently, changes should be made to section 29A of the Act so that the application of sections 29A(4)(*a*)(ii) and 29A(6) of the Act should exclude risk policies.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

3.19. Reviewing the tax treatment of long-term insurers – Refinement of the phasing-in transitional rules for long-term insurers

[Applicable provision: Section 29A of the Act]

BACKGROUND

Before 2016, the taxation method for determining taxable profits of a long-term insurer in section 29A of the Act was based on transfers from the Untaxed Policyholder Fund (UPF), Individual Policyholder Fund (IPF), Company Policyholder Fund (CPF) and Risk Policy Fund (RPF) to the Corporate capital Fund (CF). The taxable transfers were determined as the difference between the market value of the assets allocated to the policyholder funds and the value of the liabilities of these funds. The value of liabilities was calculated on the basis determined by the Chief Actuary of the Financial Services Board (FSB) in consultation with the Commissioner of SARS.

In 2016, amendments were made in section 29A of the Act, regarding the tax valuation method for long-term insurers due to the introduction of Solvency Assessment and Management Framework (SAM). These amendments included the following:

(a) definition of 'value of liabilities';

(b) definition of 'adjusted IFRS value';

(c) transitional rules: 'phasing-in amount' and period of phasing-in

In particular, the transitional rules dealing with the 'phasing-in amount and a phasing-in period' of six years were introduced as an interim measure aimed at stabilising tax collections by SARS and reducing the financial impact on certain long-term insurers due to these regulatory proposed changes. The 'phasing-in amount' is the fixed amount representing the difference relating to policies allocated to a fund between the liabilities for tax purposes and the liability disclosed in the insurer's published audited annual financial statements for 2017 adjusted to the manner of disclosure and reporting applied in 2015. The 'phasing-in amount' is applied by including a reducing amount in the calculation of adjusted IFRS value over a period of six years for years of assessment ending after June 2018.

REASONS FOR CHANGE

At issue is the fact that unlike other phasing-in provisions available in the Act, the current phasing-in transitional rules for long-term insurers in section 29A of the Act do not address the treatment of any portion of the 'phasing-in amount' not yet phased-in, if the taxpayer ceases to be in the business of long-term insurer during the six-year period.

PROPOSAL

In order to address this anomaly, it is proposed that the cessation rules be introduced to accelerate the phasing-in of the new IFRS valuation methodology for long-term insurers ceasing to conduct long-term insurance business during the phase-in period of six years.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2020 and apply in respect of years of assessment ending on or after that date.

3.20. *Refining the Special Economic Zone (SEZ) regime – Aligning the provisions of sez with the overall objectives of the SEZ programme*

[Applicable provision: Section 12R of the Act]

BACKGROUND

The SEZ regime was preceded by the Industrial Development Zone (IDZ) programme which was introduced in South Africa in 1993. The IDZ programme was intended to promote new investment in South Africa by providing focused administrative support as well as some indirect tax benefits to enterprises that operated in designated industrial areas. The administrative support included the provision of customs controlled areas located in the IDZs where dedicated SARS officials were situated to provide the enterprises with support for any customs and value-added-tax (VAT) requirements. The indirect tax benefits included no import duty being levied on imports for production-related raw materials, including machinery and assets used in production with the aim of exporting the finished products. In addition, VAT zero-ratings were provided for some supplies procured in South Africa.

Following a review on the effectiveness of the IDZ programme, which indicated that further support for greenfield activities was required, the SEZ regime was introduced in terms of the Special Economic Zone Act, No.16 of 2014, and (SEZ Act) which only came into operation on 9 February 2016. Under the new SEZ regime, existing IDZs were converted into SEZs, as well as allowing the designation of further SEZs. In order to provide further support to the new SEZ regime, income tax benefits were introduced to the Act in 2013 in respect of qualifying companies operating within the SEZ. These income tax benefits included an accelerated depreciation allowance on capital structures (buildings) and improvements and a reduced corporate tax rate of 15 per cent instead of the current 28 per cent for those qualifying companies provided that they meet certain requirements as described in the Act.

REASONS FOR CHANGE

Section 4(1) of the SEZ Act lays out the purpose of SEZs. In this respect, the SEZs are regarded as an economic tool that can be used to promote national economic growth, the exportation of goods and a way of attracting targeted foreign and domestic investments and technology. Furthermore, the policy around the eligibility criteria for entities wishing to operate within the SEZs was set out in a Department of Trade and Industry (DTI) policy document titled 'Policy on the Development of Special Economic Zones in South Africa (2012)' under discussion point 3.3. Eligibility Criteria of SEZ Designation.

In respect to access to SEZs, this policy document provides that access to SEZs will be restricted to new businesses or expansions of existing businesses. In addition, the policy around existing businesses that were already in the IDZs and those operating outside of the IDZs was clearly articulated. In this respect –

'Existing businesses already set up or functioning in an existing IDZ in South Africa before the commencement of the SEZ Act, however their eligibility to the SEZ incentive package will be contingent on them meeting the incentive criteria. Re-locations of existing businesses into SEZs will not be eligible…'

On the other hand, the current income tax provisions for qualifying companies operating within an SEZ does not expressly make a provision for a requirement that only a new company or an expansion of an existing company may qualify for income tax benefits. Lack of this requirement in the tax legislation results in unintended result that old, existing and re-located businesses could unjustifiably benefit for income tax benefits that are only aimed at attracting new and expanded manufacturing businesses.

PROPOSAL

In order to align the provisions of the SEZ tax regime with the overall policy objective of an SEZ programme discussed in the policy document titled 'Policy on the Development of Special Economic Zones in South Africa (2012)' as well as to counter the potential unintended consequence of old, existing and re-located businesses claiming the income tax benefits aimed at attracting new and expanded manufacturing businesses, it is proposed that changes be made in the legislation to clarify the policy intention. As a result, it is proposed that changes be made in the Act to make provision for qualifying companies to only qualify for the income tax benefits provided that the companies are:

(a) newly established businesses; or

(b) expansions of existing businesses of businesses originally operating with an IDZ or outside of an IDZ where such expansions result in an increase in the gross income of a company that amounts to at least 100 per cent of the gross income of that company before any expansion. In order to ensure that companies do not wind down their operations immediately before locating their operations into an SEZ for purposes of undermining this requirement, it is proposed that the required increment in the gross income of the company should be determined with reference to the highest gross income derived by that company during any of the three immediately preceding years of assessment. Furthermore, where a company operated outside an SEZ prior to such an expansion, it will be required that any expansion embarked on by that company should not result in a closure or reduction of the production, number of employees and gross income of the business carried on by that company or a connected person in relation to that company outside an SEZ.

EFFECTIVE DATE

The proposed amendment is deemed to have come into operation on 1 January 2019 and applies in respect of years of assessments ending on or after that date.

3.21. Refining the Special Economic Zone (SEZ) regime – Reviewing the SEZ anti-profit shifting and anti-avoidance measures

[Applicable provision: Section 12R of the Act]

BACKGROUND

The Act contains rules dealing with the special tax incentive for the SEZ regime. Although the income tax rules for the SEZ regime were first introduced in the Act in 2013, they were only intended to take effect when the SEZ Act comes into operation. The SEZ Act only came into operation of 9 February 2016. Despite this delay in the promulgation of the SEZ Act, some companies had already established their businesses within the intended designated SEZs, even before the coming into effect of the provisions of the above-mentioned acts.

In 2015, changes were to the income tax rules for the SEZ regime to introduce the anti-profit shifting anti-avoidance measure that mitigates against the risk that profits of ordinary tax paying companies that do not operate within the designated and approved SEZs and are taxed at a company tax rate of 28 per cent may be artificially transferred to qualifying companies under the SEZ regime that are taxable at a lower rate of 15 per cent in instances that they are connected persons in relation to each other. In its operation, the anti-avoidance measure wholly disqualifies a qualifying company from claiming any of the SEZ income tax benefits (i.e. tax rate of 15 per cent and the accelerated building allowance or 10 per cent of the cost to the qualifying company) if more than 20 per cent of its deductible expenditure incurred or more than 20 per cent of its income arises from transactions with connected persons.

The above-mentioned anti-avoidance measure is important and necessary for South Africa to meet the international minimum standards set by the OECD Forum for Harmful Tax Practices and European Union Code of Conduct Group (Business Taxation).

REASONS FOR CHANGE

At issue is the fact that the above-mentioned anti-avoidance measures to the SEZ tax regime were introduced in 2015, after the introduction of the SEZ tax regime in 2013, after some companies had already established their businesses within the SEZs, but before the coming into effect of the SEZ regime in 2016.

It has come to Government's attention that the current anti-avoidance measure that operates on an all-or-nothing basis may affect some legitimate business models or transactions that were entered into when some companies established their businesses within the SEZs, before the SEZ regime came into effect and before the introduction of these anti-avoidance measures. Their business models require them to transfer goods and products to sales companies that are often connected persons in relation to those SEZ qualifying companies. These sales companies then on-sell the goods to the customers both within the SADC region including South Africa.

PROPOSAL

In order to address this issue, it is proposed that changes be made to the current anti-avoidance measure to remove the all on an all or nothing basis and ensure that a company is not wholly disqualified from claiming the income tax benefits for the SEZ regime. The proposed anti-avoidance measure will make provision for a qualifying company to be treated as carrying on a separate trade outside of the SEZs and be subject to a business tax rate of 28 per cent in respect of taxable income determined by considering income and deductible expenditure that exceeds the set thresholds. With respect to income that is below the set thresholds, the company will still qualify for income tax benefits for the SEZ regime (i.e. be taxed at a rate of 15 per cent and claim the accelerated building allowance).

Based on the above, it is proposed that the rate of 28 per cent will apply to taxable income determined by taking into account the following:

A. Treatment of income derived from transactions with connected persons

So much of the income received by or accrued to a qualifying company in respect of transactions with any connected person in relation to that qualifying company, if that connected person is:

(a) resident; or

(b) not a resident and those transactions are attributable to a permanent establishment of that connected person in the Republic.

as exceeds 20 percent of the total income of that qualifying company.

B. Treatment of deductible expenditure incurred in respect of transactions with connected persons

So much of the deductible expenditure incurred by a qualifying company in respect of transactions with any connected person in relation to that qualifying company, if that connected person is:

(a) a resident; or

(b) not a resident and those transactions are attributable to a permanent establishment of that connected person in the Republic

as exceeds 20 percent of the total deductible expenditure of that qualifying company.

EFFECTIVE DATE

This amendment is deemed to have come into operation on 1 January 2019 and applies in respect of years of assessments ending on or after that date.

3.22. Refining the Special Economic Zone (SEZ) regime – Reviewing the allowable deduction for investors investing in a venture capital company

[Applicable provision: Section 12J of the Act]

BACKGROUND

The venture capital company (VCC) tax incentive regime was introduced in the Act in 2008. The main aim of the VCC tax incentive regime is to raise equity funding in support of the socio-economic development of small business which otherwise would not have had access to market funding due to either or both their size and inherent risk.

When the VCC tax incentive regime was introduced in 2008, the rules contained a very strict investor criterion. As a result, a natural person who invests in the VCC shares was eligible for a 100 per cent deduction of the amount invested, however, the deduction was limited to R750 000 per tax year. In turn, individual investors were also subject to a lifetime deduction limit of R2 250 000.

In 2011, changes were made in the VCC tax incentive regime in order to make it more attractive. General relaxation of requirements of the provisions of the VCC tax incentive regime was made so as to increase the intake in this regard. As a result, ceilings and prohibitions associated with investors seeking a deduction were completely removed. For example, the natural person limitation of deduction to R750 000 per tax year as well as the lifetime deduction limit of R2 250 000 was removed. This implied that all taxpayers, both natural persons and legal entities can now freely obtain a full deduction for investing in a VCC, without any monetary threshold limitation.

In order to get the VCC regime to gain more traction, in 2015, further changes were made in the tax legislation so as to broaden the scope of the VCC regime. As a result, the uptake of the VCC tax incentive regime has grown significantly over the past three years leading to a telling investment into the economy.

REASONS FOR CHANGE

The primary aim of the tax system is to generate sufficient revenue to support government’s funding priorities. By providing relief to taxpayers via targeted tax incentives like exemptions, deductions and credits, Government also encourages socio-economic development.

Over the past two years, Government has endeavored to end abuse within the VCC tax incentive regime by making changes in the provisions of the VCC Tax incentive regime aimed at re-emphasising an incentive for true venture capitalists that saw the same value-add in the VCC tax incentive regime as Government and not just as another method of finance especially of own projects.

Despite Government's efforts to introduce these anti-avoidance measures, it has come to government's attention that some taxpayers are still attempting to undermine the objectives and principles of the VCC tax incentive regime to benefit from excessive tax deductions. Based on administrative data on tax expenditure, the average expenditure per annum incurred by a new VCC shareholder to obtain VCC shares ranged between R1,3 million at its lowest to R2,1 million at its highest over the past 4 years.

PROPOSAL

In an effort to balance the benefit and perceived effectiveness of the VCC tax incentive regime whilst still protecting the bottom-line impact of high tax expenditure (as a measure of revenue forgone) on the fiscus, it is proposed that changes be made in the VCC tax incentive regime to reintroduce a limitation of the amount to be deducted in respect of taxpayers investing in VCC shares.

To consider the effect of inflation and to further balance the intended impact of the VCC tax incentive on both small business and the fiscus, it is proposed that the tax deduction in respect of investment in VCC shares should be limited to R2,5 million per annum per VCC shareholder.

EFFECTIVE DATE

The proposed amendment comes into operation on 21 July 2019 and applies in respect of expenditure incurred by the taxpayer on or after that date.

3.23. *Refining the employment tax incentive regime – Updating the employment tax incentives (ETI) to align with the national minimum wage*

[Applicable provision: Section 4 of the Employment Tax Incentive Act, No 26 of 2013 'the ETI Act']

BACKGROUND

The Employment Tax Incentive (ETI) programme was introduced in January 2014 to promote employment, particularly of young workers. After its initial 3 years, and based on a process of review and consultation with NEDLAC the programme was extended for a further two years. In light of the need to support youth employment, as indicated in the State of the Nation Address (SONA) delivered on 15 February 2018, and following further consultations with NEDLAC, the programme was further extended to 28 February 2029.

The programme aims to reduce the cost of hiring young people between the ages of 18 and 29 (also referred to as qualifying employees) through a cost sharing mechanism with Government, while leaving the wages received by the qualifying employees unaffected. The ETI Act affords employers who are registered for PAYE and hire qualifying employees the ability to decrease their PAYE liability. The amount by which the employer’s PAYE liability can be reduced by is prescribed by a formula, and is calculated based on the wages paid to the qualifying employees. The monthly wages used in applying the formula are categorised as follows:

(a) Wages of R2 000 or less;

(b) Wages of between R2 001 and R4 000; and

(c) Wages of between R4 001 and R6 500.

REASONS FOR CHANGE

During 2018 significant amendments were promulgated to implement the National Minimum Wage. The National Minimum Wage Act, No. 9 of 2018 ('the NMW Act') introduced a national minimum wage of R20 per hour or R3 500 per month. To ensure that Government policies are aligned, some of the provisions relating to wages available in the NMW Act should also be reflected in the category of wages contemplated in the ETI Act.

PROPOSAL

In order to achieve the above-mentioned alignment of Government policies, it is proposed that in addition to the 'wage regulating measures' currently defined in the ETI Act, the national minimum wage should also be included as one of the eligibility criteria for purpose of claiming the ETI. As a result, it is proposed that changes be made to the ETI Act so that the higher of the national minimum wage or the other wage regulating measures should therefore be the applicable minimum wage as contemplated in the NMW Act.

On the other hand, the minimum wage of R2 000 per month available in the ETI Act should remain in place for categories of workers or companies that may be exempt from the national minimum wage. Sectors where a lower minimum wage rate applies, as indicated in the Second Schedule of the NMW Act should still be able to claim the ETI, even if their minimum wage is below R2 000 per month, as is currently the case for many learnerships (as catered for in the ‘R 2000 or less’ wage category mentioned above).

EFFECTIVE DATE

The proposed amendments will come into operation on 1 August 2019.

3.24. Refining the employment tax incentive regime – Clarifying the interaction between the employment tax incentive and the SEZ provisions

[Applicable provisions: Sections 1 in respect of the definition of 'special economic zone' and 6 of the ETI Act]

BACKGROUND

Both the Act and ETI Act contain special tax dispensation for SEZ regime. The Act

SEZ tax rules make provision for qualifying companies that operate within an SEZ to be taxed at a reduced corporate tax rate of 15 per cent instead of the current 28 per cent that is generally applicable to other companies. Furthermore, these companies qualify to claim for accelerated allowances, amounting to 10 per cent of the cost of the building each year over a period of 10 years, on buildings and improvements to buildings owned by them.

On the other hand, the ETI Act makes provision for employers operating within an SEZ to qualify for the ETI. The ETI was introduced by Government as a mechanism to support employment growth in South Africa with a particular focus on the employment of the youth. The ETI tax incentive can only be claimed by any employer in respect of a qualifying employee if that employee is 18 years old and not more than 29 years old. However, if the employer operates through a business located within an SEZ, that employer can claim the ETI in respect of its employee that renders services to that employer with an SEZ without any regard to the age of that employee

REASONS FOR CHANGE

In order to benefit from the income tax incentives contained in the Act, a company carrying on a business within the SEZ area must meet certain requirements to ensure that the SEZ incentives are claimed by acceptable manufacturing businesses (i.e. businesses that are not involved in the disqualified trades listed in the Act or listed by the Minister of Finance by notice in a Government Gazette. In terms of the Act, for a company to be a qualifying company a company must be a company that:

(a) is tax resident in South Africa

(b) operates within a designated SEZ area

(c) carry on business through a fixed place of business situated within a designated SEZ area

(d) derives 90 per cent or more of its income from the carrying on of a business or rendering of services within one or more SEZs; and

(e) is not carrying on a disqualified trade listed in the Act and in terms of the Government Gazette.

In contrast, the ETI Act does not clearly provide a specified criterion for employer companies operating within an SEZ that want to claim the ETI without having the age limit as a restriction. As a result, the ETI Act currently makes provision for all employers operating within an SEZ to claim the ETI in respect of all their employees without any regard for the age limit. Failure by the ETI Act to have a limitation that only allows this extended incentive to only qualifying companies has the potential of resulting in non-qualifying companies and, even more worrying, non-manufacturing companies (such as logistics and warehousing entities) claiming the ETI in respect of all their employees.

PROPOSAL

In order to ensure that Government policy is applied in a uniform manner in both the ETI Act and the Act, it is proposed that amendments should be made ETI Act. In this regard, it is proposed that the definition of the 'special economic zone' in the ETI Act should be amended to align it with the definition contained in the Act. Furthermore, it is proposed that it should be clarified that in order for a company to claim the ETI incentive without any age limit, that company should be a qualifying company as contemplated in the Act for purposes of claiming the income tax incentives under the SEZ regime.

EFFECTIVE DATE

The proposed will be deemed to have come into operation on 1 March 2019.

3.25. Reviewing controlled foreign company rules – Reviewing the comparable tax exemption

[Applicable provision: Section 9D(2A) further proviso (i)(*aa*) and (ii)]

BACKGROUND

The South African controlled foreign company rules contain an exemption known as a comparable tax exemption. This exemption makes provision for CFCs operating in foreign countries where tax payable in that foreign country is at least 75 per cent of what would have been payable in South Africa, had the South African tax rules applied, to exclude the foreign business income from the net income calculation of the CFC. The main aim of this exemption is to reduce the compliance burden of South African multinationals from being taxed on foreign business profits and thereafter claiming credit against South African income tax.

In addition, the comparable -tax exemption seeks to protect the South African tax base whilst providing the need for South African multinational entities to be competitive offshore by disregarding all tainted, passive and diversionary controlled foreign company income if little or no South African tax is payable.

REASONS FOR CHANGE

In the context of the global trend towards lower corporate tax rates, in 2018, the Minister announced in the Budget Review the intention to review the comparable tax exemption in order to determine whether an amendment is warranted. Based on the above-mentioned statement, a review was conducted and it came to light that the current 75 per cent threshold is no longer comparable. As a result, providing little or no assistance to cater for South African CFCs in the current world order.

PROPOSAL

Based on the above, it is proposed that the comparable tax exemption threshold be reduced to 67.5 per cent from the current percentage of 75 per cent.

EFFECTIVE DATE

The proposed amendments will come into effect and apply in respect of the years of assessment ending on 1 January 2020

3.26. Reviewing controlled foreign company rules – Addressing circumvention of controlled foreign company anti-diversionary rules

[Applicable provision: Section 9D(9A) of the Act]

BACKGROUND

The Act contains anti-avoidance provisions in section 9D aimed at taxing South African residents on the net income of a controlled foreign company (CFC). In order to strike a balance between protecting the South African tax base and the need for South African multinational entities to be competitive, the South African CFC rules contains various exemptions. That said, CFC income which is generally regarded as tainted income, for example, passive income and diversionary income does not qualify for any of the CFC exemptions.

Currently, the South African CFC rules contain three sets of anti-diversionary rules in 9D(9A) of the Act, namely, CFC inbound sales, CFC outbound sales and CFC connected person services. These CFC anti-diversionary rules are aimed at ensuring that CFC activities are not being used to shift taxable income offshore through transfer mispricing.

REASONS FOR CHANGE

It has come to Government's attention the current CFC anti-diversionary rules do not adequately address multi-layered structures that fragment the current diversionary transaction link for tax. Certain multinational enterprises are circumventing CFC anti diversionary rules by diverting profits to members of the group that are subject to tax at a lower rate and are not subject to the specific anti-diversionary rules. This is achieved by the imposition of additional CFCs in the supply chain between the South Africa resident connected person and the independent non-resident supplier or customer.

PROPOSAL

In order to prevent the circumvention of the CFC anti-diversionary rules, it is proposed that changes be made in section 9D of the Act to extend the anti-diversionary rules to include both direct and indirect transactions between:

(a) the South African connected person and an independent non-resident customer for the export of goods;

(b) an independent non-resident supplier and the South African connected person for the import of goods; and

(c) the controlled foreign company and the South African connected person for the rendering of services.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

3.27. Reviewing controlled foreign company rules – Reviewing the definition of permanent establishment

[Applicable provision: Section 1 of the Act definition of 'permanent establishment']

BACKGROUND

On 7 June 2017, South Africa signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, commonly referred to as a Multilateral Instrument (MLI). The main aim of the MLI is to modify the application of thousands of bilateral tax treaties concluded to eliminate double taxation. It also implements agreed minimum standards to counter treaty abuse and to improve dispute resolution mechanisms while providing flexibility to accommodate specific tax treaty policies. The MLI applies alongside existing tax treaties. In line with preserving signatory countries sovereignties, signatory countries of the MLI have the right to make reservations and notifications, noted as MLI positions with regards to various provisions of the MLI.

On March 2018, the OECD published amendments in the Report on BEPS Action 7 to Article 5. This Report resolved to expand the threshold of the definition of 'permanent establishment' (PE) in terms of Article 5(5). The amendments made to Article 5, are to address concerns surrounding the potential for companies to engage in BEPS activities by entering into arrangements that artificially avoid the existence of PEs. These arrangements include the use of a dependent agent who does not formally conclude contracts, using commissionaire arrangements and similar strategies.

The pre-March 2018 version of Article 5(5) of the Model Tax Convention (MTC) pre-BEPS version provided the following:

'a person acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise'.

Therefore, if the authority to conclude contracts is not habitually exercised, there is no deemed PE. Contracts concluded with the third party on behalf of the principal but in the name of the agent would also not create a deemed PE. It is possible for a foreign enterprise to have a PE in a Contracting State, despite not having a 'fixed place of business', if a dependent agent has and habitually exercises an authority to conclude contracts on its behalf.

The post March 2018 updated version of Article 5(5) of the MTC provides that an enterprise is deemed to have a PE in a Contracting State.

'where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise'.

In this regard, the person’s actions on behalf of the enterprise will be sufficient to conclude that the enterprise participates in a business activity in the state concerned.

That said, the above March 2018 amendments to the definition of Article 5(5) of the OECD MTC are not regarded as a minimum standard. As a result, countries are allowed to reserve the right not to apply the entirety of Article 5 to its Covered Tax

Agreements (CTAs).

REASONS FOR CHANGE

Currently, 'permanent establishment' is defined in section 1 of the Act to mean a PE as defined in article 5 of the OECD MTC. The reference in the Act definition of PE to a PE as defined in Article 5 of the OECD MTC implies that if changes are made to article 5 of the OECD MTC, then the Act definition of PE changes automatically. Consequently, when changes were made in March 2018 by the OECD to Article 5(5) (dealing with PEs) of the MTC, this automatically updated the Act definition of PE to be similar to the OECD, with effect from March 2018.

That said, when South Africa signed the MLI in June 2017, South Africa took a position in the MLI and reserved its right not to update Article 5(5), dealing with PE. As a result, South Africa’s tax treaties remain in line with the pre-March 2018 version of Article 5(5) of the Model Tax Convention (MTC).

The Act definition of PE, which currently refers to the post March 2018 updated version of Article 5(5) of the MTC and the South Africa MLI position which refers to the pre-March 2018 version of Article 5(5) of the MTC creates a misalignment.

PROPOSAL

In order to address the above-mentioned misalignment and to align the Act definition of PE with South Africa’s MLI position, it is proposed that changes be made in the Act so that the definition of 'permanent establishment' in section 1 of the Act should refer to the pre-March 2018 version of Article 5(5) of the MTC.

EFFECTIVE DATE

The proposed amendment will be deemed to have come into operation on 1 March 2018 and apply in respect of years of assessment commencing on or after that date.

3.28. *Reviewing controlled foreign company rules – Clarification of the qualifying criteria for domestic treasury management company*

[Applicable provision: Section 1 of the Act - definition of 'Domestic Treasury Management']

BACKGROUND

In 2013, Government introduced the DTMC regime. The main objective of this regime was to encourage listed South African multinational companies which are registered with the Financial Surveillance Department (FSD) of the South African Reserve Bank (SARB) to relocate their treasury operations to South Africa. Consequently, changes were made in the Act to insert the definition of DTMC with effect from years of assessment commencing on or after 27 February 2013.

The Act definition provided that a DTMC must be a company that is:

(a) incorporated or deemed to be incorporated in South Africa;

(b) that has its place of effective management in South Africa; and

(c) that is not subject to exchange control restrictions by virtue of being registered with the financial surveillance department of the SARB.

In 2018, changes were made in the Act to remove the requirement that a DTMC be incorporated or deemed to be incorporated in South Africa, due to the fact that this requirement was burdensome for companies that were incorporated offshore but had their place of effective management in South Africa or wanted to move their place of effective management to South Africa.

REASONS FOR CHANGE

Currently, there is misalignment between the definition of DTMC in the Act and in SARB Circular 5/2013. Although amendments were made in the Act in 2018 to delete the requirement that the DTMC must be incorporated or deemed to be incorporated in South Africa, however, no corresponding changes were made in SARB Circular 5/2013.

PROPOSAL

In order to clarify this perceived tension between SARB policy and tax policy, the following is proposed:

(a) that the requirement that a domestic treasury management company be incorporated or deemed to be incorporated in South Africa be re-instated in the Act in respect of new companies that are registered with SARB for the first time on or after 1 January 2019,

(b) that the requirement that a domestic treasury management company be incorporated or deemed to be incorporated in South Africa should not apply to those companies that were already incorporated or deemed to be incorporated offshore if registered with SARB before 1 January 2019.

EFFECTIVE DATE

The proposed amendment will be deemed to have come into operation on 1 January 2019 and apply in respect of years of assessment commencing on or after that date.

3.29. Reviewing controlled foreign company rules – Reviewing of the 'affected transaction' definition in the arm's length transfer pricing rules

[Applicable provision: Section 31 of the Act definition of 'affected transaction']

BACKGROUND

In 1995, the transfer pricing rules were introduced in the Act. Over the years, changes were made to the South African transfer pricing rules to be in line with international standard. The main aim of the transfer pricing provisions in section 31 of the Act is to prevent a reduction in South African taxable income as a result of mispricing or incorrect characterisation of transactions. As a general matter, a taxpayer is required to adjust its taxable income to reflect arm's length amounts if it enters into transactions with a 'connected person' as defined in section 1 of the

Act, on terms or conditions that are not at arm's length, derives a tax benefit from such terms and conditions and the connected person is tax resident outside South Africa. South Africa like most countries has adopted the OECD and UN 'arm's length principle' as a benchmark for income tax purposes.

REASONS FOR CHANGE

Both the OECD and UN use the concept of 'associated enterprises' when applying the arm's length principle, which is the internationally recognised tax standard for allocating profits resulting from transactions between associated enterprises. The concept of 'associated enterprises' is described in the Commentary on Article 9 of the OECD MTC as parent and subsidiary companies and companies under common control.

The wording of Article 9(1) of both the OECD and UN MTC is as follows:

'Where:

a. an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

b. the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.'

On the other hand, South Africa still uses the concept of 'connected persons' when applying the arm's length principle. The fact that South Africa does not have or use the concept of associated enterprises when applying the arm's length principle presents a challenge in application of the transfer pricing rules in respect of transactions between 'associated enterprises' that are not regarded connected persons.

PROPOSAL

In order to address this anomaly, it is proposed that changes be made in section 31 of the Act so that the scope of the transfer pricing rules be extended to also include transactions between persons that are not connected persons, but that are 'associated enterprises' as described in Article 9(1) of the MTC on Income and on Capital of the OECD.

EFFECTIVE DATE

The proposed amendment will come into operation on 1 January 2020 and applies in respect of years of assessment commencing on or after that date.

3.30. Reviewing controlled foreign company rules – Clarification of the interaction of capital gains tax and foreign exchange transaction rules

[Applicable provisions: Section 24I and paragraph 43 of the Eighth Schedule to the Act]

BACKGROUND

In general, the tax treatment of effects of changes in foreign currency falls under two main provisions, namely section 24I of the Act and paragraph 43 of the Eighth Schedule to the Act. Section 24I of the Act generally recognises foreign exchange gains and losses on an annual basis irrespective of whether the gains or losses are realised.

On the other hand, paragraph 43 of the Eighth Schedule to the Act has two sets of capital gain or loss currency rules that are available when disposing of assets. The first set of capital gains tax rules relates to the method for calculating capital gains and losses for natural persons and non-trading trusts that dispose of an asset in foreign currency after having acquired that asset in the same foreign currency. Therefore, natural persons and non-trading trusts determine the capital gain or loss in the relevant foreign currency followed by a translation to local currency, e.g.

Rand.

In turn, the second set of capital gains tax rules for companies and trading trusts, acquiring or disposing of an asset in foreign currency, requires that both proceeds and the base cost be translated to local currency, e.g. Rand. In short, the capital gain or loss is determined in local currency after translating the base cost and proceeds to local currency using either spot rates or average rates.

REASONS FOR CHANGE

The current rules in paragraph 43(6A) of the Eighth Schedule excludes the application of the second set of capital gains tax rules mentioned above to companies and trading trusts in order to avoid duplication of the currency gains and losses arising under section 24I. In particular, paragraph 43(6A) of the Eighth Schedule to the Act excludes foreign debt which includes foreign bonds that can give rise to a capital gain or capital loss. In general, this exclusion is applicable to the disposal of debt and related derivative instruments such as forward exchange contracts and foreign currency option contracts.

Based on the above, it can be argued that once a company and trading trust are excluded from the application of paragraph 43(1A), that company or trading trust must determine a capital gain or loss under general rules taking into account sections 24I and 25D of the Act. As a result, paragraph 43 of the Eighth Schedule does not apply. This non-application of paragraph 43 of the Eighth Schedule to the Act can be illustrated with the following examples:

Example 1

Facts:

Company B acquired a foreign bond as long-term investments during its first year of assessment for X$100 when the exchange rate was X$1:R1. At the end of the first year of assessment the exchange rate was X$1:R1,40 and at the end of year 2 X$1:R2. On the last day of year 2 Company B disposed of the bond for an amount accrued of X$120.

Example 2

Facts:

Company C advanced a foreign currency loan of X$100 to Company D during its first year of assessment when X$1:R1. At the end of the first year of assessment the exchange rate was X$1:R1,40 and at the end of year 2 X$1:R2. On the last day of year 2 after Company D was liquidated Company C received only X$80 in full and final settlement of the loan.

Based on the above-mentioned examples, paragraph 43 of the Eight Schedule was not applied. Instead section 25D of the Act was applied even though paragraph 43 of the Eighth Schedule should be capable of dealing with the translation of such gains and losses.

In addition, it is unclear how the foreign currency gain and loss provisions interact with capital gains provisions as section 24I of the Act determines exchange gains and losses over the lifetime of an exchange item while paragraph 35(3)(a) eliminates amounts from proceeds on disposal of an asset.

PROPOSAL

In order to clarify the interaction between the currency gains and losses determined under section 24I of the Act that are forming part of a capital gain or capital loss, it is proposed that the rules for companies and trading trusts in paragraph 43 of the Eighth Schedule to the Act be amended by inserting a new proviso to provide an appropriate mechanism for eliminating double taxation.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 January 2020 and apply in respect of years of assessment commencing on or after that date.

3.31. VAT – Clarifying financial services to include the transfer of ownership of reinsurance relating to long-term reinsurance policies

[Applicable provision: Section 2(1)(*i*) of the Value Added Tax Act No. 89 of 1991 ('the VAT Act')]

BACKGROUND

Section 2(1)(*i*) of the VAT Act deems specific activities including the provision or transfer of ownership of a long-term insurance policy or the provision of reinsurance in respect of such policy as financial services. In turn, section 12(1)(*a*) of the VAT Act makes provision for the exemption of financial services. This implies that the actual provision of reinsurance in respect of a long-term insurance policy is an exempt financial service.

REASONS FOR CHANGE

At issue is the fact that the provisions of the VAT Act do not specifically address the VAT treatment of the transfers of ownership of reinsurance relating to long-term insurance to another reinsurer, due to the fact that such transfer is not specifically included under activities regarded as financial services in section 2(1)(*i*) of the VAT Act. In addition, there are conflicting views as to whether the transfer of ownership of reinsurance relating to long-term insurance to another reinsurer is exempt or not. There is a view that since the underlying policy is exempt and the reinsurance of the underlying policy is exempt, then surely it was not the intention of the legislature to omit these transactions from being specifically included under activities regarded as financial services in section 2(1)(*i*) of the VAT Act.

PROPOSAL

In order to provide clarity as to the VAT treatment of the transfer of ownership of reinsurance relating to long-term insurance to another reinsurer, it is proposed that changes be made to section 2(1)(*i*) of the VAT Act to specifically include these as activities falling within financial services.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 April 2020.

3.32. VAT - Refining the VAT corporate reorganisation rules

[Applicable provision: Section 8(25) of the VAT Act]

BACKGROUND

The VAT Act contains rules in section 8(25) that provide for VAT relief by treating the supplier and the recipient of goods or services as the same during corporate reorganisation transactions, between companies that form part of the same group of companies, provided certain requirements are met. This provision is similar to the corporate reorganisation provisions available in the Income Tax Act, which are aimed at providing tax neutral transfer of assets during corporate reorganisations, between companies that form part of the same group of companies.

However, section 8(25) of the VAT Act further provides that if the corporate reorganisation transactions take place in terms of section 42 or 45 of the Act, the VAT relief is only available if the transfer relates to the transfer of an enterprise, or part of an enterprise capable of separate operation, as a going concern.

REASONS FOR CHANGE

Currently, the relief provided in terms of section 8(25) does not apply to corporate reorganisation transactions where the only asset transferred will be fixed property that will be leased back to the supplier once transfer of the property is completed. The supply is not capable of operating separately and the property itself is currently not an income-earning property. This creates adverse cash flow for the group of companies with regards to the input tax credits of the recipient and the output tax liability of the supplier.

PROPOSAL

In order to address this anomaly, it is proposed that changes be made in section 8(25) of the VAT Act so as to provide VAT relief to group companies in instances where a fixed property is transferred in terms of corporate reorganisations as envisaged in section 42 or 45 of the Income Tax Act, dealing with 'Asset-for-share transactions' and 'Intra-group transactions', provided that specific requirements are met.

In order to maintain the policy rationale explained in the Explanatory Memorandum to the 2009 Taxation Laws Amendment Bill and thereby prevent abuse of this provision, it is proposed that the relief in terms of section 8(25) be limited to the transfer of fixed property, only in instances where supplier and the recipient have agreed in writing that, immediately after the sale, the supplier will lease back the fixed property being transferred.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 April 2020.

3.33. VAT – Reviewing section 72 of the VAT Act

[Applicable provision: Section 72 of the VAT Act]

BACKGROUND

When VAT was introduced in South Africa in 1991, the VAT Act contained provisions in section 72 that provides the Commissioner with the discretionary powers to make arrangements or decisions as to the manner in which the provisions of the VAT Act shall be applied or the calculation or payment of tax or the application of any rate of zero per cent or any exemption from tax provided for in terms of the VAT Act, provided that the Commissioner is satisfied that as a consequence of the manner in which any vendor or class of vendors conducts his, her or their business, trade or occupation, difficulties, anomalies or incongruities have arisen or may arise in regard to the application of the VAT Act. The arrangement or decision by the Commissioner as provided under section 72 of the Act must have the effect of assisting the vendor to overcome the difficulty, anomaly or incongruity without having the effect of substantially reducing or increasing the taxpayer’s ultimate liability for VAT.

REASONS FOR CHANGE

In 1996, the Constitution of the Republic of South Africa ('Constitution') came into effect. The introduction of the Constitution in 1996 came after the introduction of the VAT Act in 1991. Over the past years, challenges arose regarding the application of the mandatory wording of the other provisions of the VAT Act versus the discretionary wording of the provisions of section 72 of the VAT Act.

PROPOSAL

In view of the fact that the provisions of the VAT Act are in itself mandatory, in order to address the above-mentioned anomaly, it is proposed that changes be made in section 72 of the VAT Act to align the provisions of this section with the spirit of the other provisions of the VAT Act.

EFFECTIVE DATE

The proposed amendments are deemed to have come into operation on 21 July 2019.

3.34. VAT – Refining the VAT treatment of foreign donor funded projects

[Applicable provision: Section 1(1) definition of 'enterprise', 'foreign donor funded project', 'person', new definition of 'implementing agency', sections 8(5B) and 50(1) of the VAT Act]

BACKGROUND

In 2006, changes were made in tax legislation to make provision for the tax treatment of foreign donor funded projects in terms of the Official Development Assistance Agreement (ODAA). ODAA is an international agreement in terms of section 231(3) of the Constitution of the Republic of South Africa. ODAA's involve support from foreign institutions in the form of grants/funding, technical assistance, provision of assets, etc.

The VAT Act provides that if the project meets the requirements of the definition of

'Foreign Donor Funded Project' ('FDFP') in section 1(1) of the VAT Act, the project is a person as defined and is deemed to have made a zero-rated supply to the foreign donor in terms of section 11(2)(q) of the VAT Act. Accordingly, the project will be required to register for VAT with the South African Revenue Service (SARS) and thereafter claim all VAT incurred on expenses as input tax, thereby ensuring that the funds are not utilised to pay any VAT.

In order to implement the foreign donor funded project in South Africa in terms of the ODAA, a further project agreement flowing from the ODAA may be entered into, which specifically relates to a particular project. This project agreement may appoint a specific government department as being responsible for the implementation of the particular project. In turn, the above-mentioned government department may facilitate the implementation of the project by entering into another agreement with another entity, called the 'implementing agency', thereby sub-contracting the particular project to another 'implementing agency' or 'subcontractor'. Further, the subcontractor may further subcontract parts of the particular project to other vendors. There are also instances where the foreign donor contracts directly with various implementing parties in relation to various parts of the project.

REASONS FOR CHANGE

The above-mentioned scenarios have created confusion regarding who must register the project as a foreign donor funded project for VAT as required in terms of the VAT Act, who is entitled to the input tax claims and who is the actual implementing agency. In view of the fact that the implementing agency is required to facilitate the project and report on the progress of the project as well as ensuring that the funds are used for only the specified project and not to pay taxes or any other unrelated costs, consequently, the implementing agency is the one required to register the foreign donor funded project for VAT purposes and the registered foreign donor funded project is entitled to claim the input tax credits on expenses incurred in relation to the project. However, in instances where the foreign donor has contracted directly with various implementing parties, there may be more than one implementing agency and hence more than one FDFP that is entitled to register for VAT purposes in relation to one main project.

There is further confusion on what requirements need to be met before a project may be registered for VAT with SARS as a FDFP. The current definition in the VAT Act creates uncertainty and does not cater for all the policy requirements that need to be met before SARS will register a project as such. As a result, registrations of foreign donor funded projects for VAT purposes are often delayed due to the need for SARS to constantly seek clarity from National Treasury.

PROPOSAL

In order to address the above-mentioned uncertainty, it is proposed that the definition of 'foreign donor funded project' in section 1(1) of the VAT Act be extended to further clarify what will qualify as a FDFP for VAT purposes. The new definition makes reference to approval by the Minister of Finance. It is proposed that a guideline will be issued by SARS outlining what requirements will need to be met before the Minister of Finance will approve a project as a FDFP. The guideline will further outline a streamlined process to be followed in order to obtain such approval. Once the written approval of the Minister of Finance is obtained, then only will SARS register the project as a FDFP for VAT purposes.

It is further proposed that the definition of 'enterprise' be amended to include the activities of an implementing agency in respect of the FDFP rather than the activities of the FDFP. The 'implementing agency' will be defined to refer to the government of the Republic, any institution or body established and appointed by a foreign government as contemplated in section 10(1)(*b*A)(ii) of the Income Tax Act to perform its functions in terms of the ODAA or any person who has entered into a contract with either of these parties to implement, operate, administer or manage a FDFP.

As a consequence of these amendments, it is proposed that the definition of 'person' be amended to remove FDFP’s from the definition.

Further, in order to ensure that the implementing agency ring-fences the activities relating to the FDFP, it is proposed that section 50(1) be amended to require the project to be registered as a separate entity from the other enterprise activities of the implementing agency.

EFFECTIVE DATE

The proposed amendments will come into operation on 1 April 2020.

4. MEMORANDUM ON THE OBJECTS OF THE TAX ADMINISTRATION LAWS AMENDMENT BILL, 2019

4.1. Income Tax Act – Withholding tax on royalties – Amendment of section 49E – Withholding of withholding tax on royalties by payers of royalties

Section 49E(3) requires a foreign person to or for the benefit of whom a royalty payment is made, to submit to the local person making the payment, a declaration to permit a reduced rate of tax to be applied as a result of the application of an agreement for the avoidance of double taxation. An example would be the case of a beneficial owner of a royalty payment who is a resident in the United States of America, where the Double Tax Agreement between the United States and South Africa provides for a lower withholding tax rate than that prescribed in the Act.

It was submitted that this requirement creates an administrative burden for local persons that enter into multiple transactions with a single foreign person during the year. This would then mean that a declaration would have to be obtained by the local person from the same foreign person with regard to each and every transaction entered into.

The same issue was raised with regards to withholding tax on interest where local persons that have foreign investors need to obtain a declaration in terms of section 50E(3) where a reduced rate of tax has been applied as a result of the application of an agreement for the avoidance of double taxation.

The proposed amendment aims to alleviate this administrative burden by requiring that were more than one payment is made to the same foreign person within a period of two years from the date of the first payment, the written undertaking need only be submitted once, namely before the first payment to that foreign person, provided the conditions affecting the rate at which the royalty tax or withholding tax on interest is paid do not change and the payment of the royalty or interest is still made to or for the benefit of that foreign person. However, a declaration and written undertaking under this section will no longer be valid after a period of 2 years.

The new requirements with regard to the written undertaking have also been extended to royalties or interest payments that are exempt from royalty tax or withholding tax on interest.

4.2. Income Tax Act – Dividend tax – Section 64H – Withholding of dividends tax by regulated inter-mediaries

In order to ensure that dividends tax is not withheld from dividends declared on shares held as a tax free investment in terms of section 12T of the Income Tax Act, the regulated intermediary through which the investments are held will need to be provided with the required declaration and written undertaking as contemplated in section 64H. Failing this, dividends tax will have to be withheld and the investor would need to seek a refund of the dividends tax from the regulated intermediary once the required declaration and written undertaking has been provided. The proposed amendment aims to remove this requirement insofar as tax free investments are concerned as there is no need for an investor to make this declaration in so far as the dividend relates to a tax free investment.

Furthermore, in alignment with the proposed amendments to sections 49E, 50E and 64G, a declaration and written undertaking under section 64H will similarly no longer be valid after a period of 2 years.

4.3. *Income Tax Act – Fourth Schedule – Par. 19 – Estimates of taxable income to be made by provisional taxpayers*

The last day of the year of assessment of a natural person in the year of his or her death is the date of death. At present there is no exemption from the payment of provisional tax by a natural person in respect of the period ending on the date of death, which can result in the imposition of underestimation penalties under paragraph 20 of the Fourth Schedule.

In that regard, paragraph 19(6) of the Fourth Schedule provides that a person that fails to submit an estimate of provisional tax within four months of the end of the second period is deemed to have submitted an estimate of nil. As a result, a deceased person may be subject to the underestimation penalty in paragraph 20 of the Fourth Schedule on assessment if no estimate was submitted by the executor within the four-month period. In order to have this penalty remitted under paragraph 20(2C) of the Fourth Schedule, the executor would have to lodge an objection.

The purpose of the amendment is to exempt the executor from having to submit an estimate of provisional tax on behalf of the deceased person in respect of the period up to date of death. This amendment has no impact on the deceased person's obligation to make a first period estimate where he or she is still alive on 31 August. This proposal will avoid unnecessary administration for SARS and the executor. Any tax owing will be collected on assessment of the final return of income made under section 66(13)*(a)* of the Act.

4.4. *Value-Added Tax Act – Section 20 – Tax invoices*

Section 20(5B) requires the Minister to prescribe the particulars to be contained on a tax invoice issued by a foreign supplier of electronic services, by regulation. This regulation has not been issued but the Commissioner has issued Binding General Ruling No. 28 in this regard. The proposed amendment removes the requirement for the Minister to prescribe these particulars per regulations and now enables the

Commissioner to prescribe them by public notice in the *Gazette*.

4.5. Tax Administration Act – Section 11 – Legal proceedings involving Commissioner

A one week notice period has proven to be impractical in practice to give effect to the rationale for the notice, i.e. to enable SARS an opportunity to investigate the matter further and to decide how to resolve the dispute, for example by exploring a dispute resolution process, thereby avoiding litigation at the public's expense. The proposed amendment increases the current one week period to 21 business days in order to afford SARS sufficient time to investigate the matter to see if it can be resolved without resorting to litigation, unless a competent court directs otherwise, for example in the case of urgency. In comparison, for example, the Institution of Legal Proceedings Against Certain Organs of State Act, 2002, provides that no legal proceedings for the recovery of a debt may be instituted against an organ of state unless the creditor has given the organ of state six months written notice, from the date the debt became due, of his or her or its intention to institute the legal proceedings in question.

5. REGULATIONS

5.1. Prescribed Interest Rate

Interest rates charged on outstanding taxes, duties and levies and interest rates payable in respect of refunds of tax on successful appeals and certain delayed refunds:

Date From:	**Date To:**	**Rate**
1 July 2018	28 February 2019	10.00%
1 March 2019	31 October 2019	10.25%

1 November 2019	Until change in PFMA rate	10.00%

Interest rates payable on credit amounts (overpayment of provisional tax) under section 89*quat* (4) of the Income Tax Act:

Date From:	**Date To:**	**Rate**
1 July 2018	28 February 2019	6.00%
1 March 2019	31 October 2019	6.25%
1 November 2019	Until change in PFMA rate	6.00%

6. TAX CASES

6.1. C:SARS v Big G Restaurants (Pty) Ltd

Big G was a franchisee that operated restaurants in terms of various written franchise agreements with the franchisor, Spur Group (Pty) Ltd and the terms of the franchise agreements were virtually identical.

In terms of clause Q.1.1 of the franchise agreement Big G gave an undertaking in favour of the franchisor that during the currency of the agreement, the main object and sole business carried on by Big G would be the operation of Spur Steak Ranch Restaurants and restaurants specialising in pizza and pasta, under the style of Panarotis.

Big G was obliged, in terms of clause J.2 of the franchise agreement, to pay the franchisor a monthly franchise and service fee of 5% of the gross sales, less VAT attributable to the gross sales, for each of the restaurants that it operated, subject to a minimum fee of R25 000 per month which escalated by the Consumer Price Index (CPIX), compounded annually.

Big G, in terms of clause L.1.4 of the franchise agreement, was required to upgrade and/or refurbish its restaurants at reasonable intervals as determined by the franchisor.

Big G did not receive any advance payment or indeed any income from the franchise agreement, but earned income from each patron contract. Patrons had the right to receive food sold to them by Big G and the corresponding obligation to pay for the food.

Big G's income was derived from payments received from patrons, directly as a result of food sold to them and if it did not sell food to patrons, Big G would not receive any income.

Big G, in respect of its 2011 to 2014 years of assessment, had claimed certain amounts in terms of section 24C of the Income Tax Act in relation to future expenditure to be incurred by virtue of the obligation imposed by the franchise agreements to upgrade and refurbish its restaurants.

The court *a quo* (see *ITC 1905* (2017) 80 SATC 223 *per* Cloete J) was asked to decide two questions of law.

(a) The first was whether the income received by Big G from operating the franchise businesses, were amounts received or accrued in terms of the franchise agreement as envisaged in section 24C of the Act.

(b) The second was whether the expenditure required to refurbish or upgrade restaurants was incurred 'in the performance of the taxpayer's obligations under such contract', as contemplated in section 24C.

The court *a quo* found for Big G and it held that Big G's income was income earned for purposes of section 24C under the same contract as that under which Big G's future expenditure was to be incurred and, consequently, it made an order setting aside the additional assessments raised by SARS for the 2011 to 2014 years of assessment.

SARS submitted that on any interpretation of various provisions of the franchise agreement, Big G did not earn income from the franchise agreement as it merely enabled Big G to earn income. Instead, Big G received income in terms of the *ad hoc* contracts that it concluded with patrons when it sold meals to them, i.e. the patron contract.

Big G contended that it was obliged to provide meals to patrons in terms of the franchise agreement which was not only the source of its income but also spelt out how it was obliged to operate its restaurants.

Big G submitted further that the words 'in terms of' in section 24C(2) should be given a wide meaning, namely that Big G's income was earned 'pursuant to' or 'in accordance with' the franchise agreement.

Judge Schippers held the following:

(i) That section 24C(2) provided that 'if the income of any taxpayer in any year of assessment includes or consists of an amount '*received by or accrued to him in terms of any contract* and the Commissioner is satisfied that such amount will be *utilised in whole or in part to finance future expenditure which will be incurred by the taxpayer in the performance of his obligations under such contract'*, there shall be deducted in the determination of the taxpayer's taxable income for such year such allowance (not exceeding the said amount) as the Commissioner may determine, in respect of so much of such future expenditure as in his opinion relates to the said amount.' (Emphasis added)

(ii) That in view of Big G's submission that the words 'in terms of' in section 24C(2) should be given a wide meaning, namely that the Big G's income had been earned 'pursuant to' or 'in accordance with' the franchise agreement, the court noted that the phrase 'in terms of' had an 'ordinary' (narrow) or 'wide' meaning as appeared from the court's judgment in *Slims (Pty) Ltd and Another* v *Morris NO*. 1988 (1) SA 715 (A) at 744G–H where it was given a narrow meaning as contrasted with the wide meaning given to it in *Oosthuizen and Another* v *Standard Credit Corporation Ltd* 1993 (3) SA 891 (A) at 900J–901B.

(iii) That the next stage of the enquiry was to consider the sense in which the phrase 'in terms of' was used in section 24C(2). The section has two basic requirements. First, there must be income received or accrued in terms of a contract. Second, SARS must be satisfied that such amount, i.e. the income received from the contract, will be used wholly or partially to finance future expenditure that a taxpayer will incur in performing its obligations under that same contract. There is thus a direct and immediate connection between these two requirements. The section does not allow for different income-earning and obligation-imposing contracts.

(iv) That the fact that the income and obligations must originate from the same contract points strongly to the conclusion that the special allowance in section 24C was intended to apply to cases where income earned in terms of (or 'by') a contract is received before expenditure will be incurred to perform obligations under that same contract.

(iv) That the narrow meaning of the phrase 'in terms of' is supported by the context and the background to the provision. Section 24C constitutes an exception to the general prohibition contained in section 23(*e*) of the Act, which provides that no deduction shall in any case be made in respect of income carried to any reserve fund or capitalised in any way. Section 24C was introduced by section 18(1) of the Income Tax Act 104 of 1980. According to the *Explanatory Memorandum* the purpose of section 24C was to address situations where a contract, typically a construction contract, provides for an advance payment to enable the recipient to finance the performance of its obligations under the contract (e.g. to purchase materials). In the situation contemplated by the *Explanatory Memorandum* the same contract creates the right to the income (the advance payment) and the obligation which has to be performed.

(v) That, applying the narrow meaning of the phrase 'in terms of', the question is whether Big G received income under the franchise agreement. The answer is clearly no. None of the rights accorded to Big G under the franchise agreement are rights to income. This is hardly surprising, since a right to receive income by a franchisee is not an element of a franchise agreement. Features generally common to a franchise agreement are the granting of the right by the franchisor to conduct business in exchange for fees; the acquisition by the franchisee of the right to conduct a franchise business within the franchisor's network; and the right and obligation of the franchisee to use the franchisor's trademarks, knowledge and business methods.

(vi) That Big G did not receive any advance payment or indeed any income from the franchise agreement, but earned income from each patron contract. Patrons have the right to receive food sold to them by Big G and the corresponding obligation to pay for the food. Big G's income was derived from payments received from patrons, directly as a result of food sold to them and if it did not sell food to patrons, Big G would not receive any income.

(vii) That Big G had contended that the franchise agreement and the patron contract were inextricably linked and that both these contracts required Big G to serve meals to its patrons in order to earn income, out of which franchise fees were payable to the franchisor. However Big G's contention was unsound. It was simply another way of putting the argument for the wide interpretation of the phrase 'in terms of'. The argument acknowledged that the contract creating the right to the income was the patron contract but placed reliance on the fact that the patron contract was able to be concluded because of the existence of the franchise agreement. The fact that a contract is useful or even necessary to enable a taxpayer to earn income does not mean that its income is earned 'in terms of' such contract. A taxpayer's income is not earned 'in terms of' the lease under which it occupies its commercial premises or 'in terms of' the overdraft agreement which provides it with the necessary working capital.

(ix) That a similar argument was essayed- and rejected– in *ITC 1667* 61 SATC 439. In that case a taxpayer claimed a section 24C allowance, contending that although it received the income under a different contract than the one under which it was obliged to perform an obligation, the income transaction formed an integral part of a scheme that obliged it to incur future expenditure in carrying out its obligations. In dismissing the taxpayer's appeal, that court correctly, in the view of the present court, held that section 24C(2) required that the taxpayer incur the expenditure in the performance of its obligations in terms of the same contract as the contract under which it received income. The legislature did not use the term 'scheme' or 'transaction' as the operative concept was 'contract.'

(x) That the court's conclusion on the first question of law was dispositive of the appeal and, consequently, it was unnecessary to decide the second question and it followed that the appeal must be upheld and the order of the court *a quo* set aside.

Appeal upheld with costs.

6.2. Milnerton Estates Ltd v C:SARS

Milnerton Estates Ltd (Milnerton Estates) was a property developer and the proceeds of sales of stands in its developments constituted income in its hands, forming part of its gross income and ultimately attracting a liability to pay income tax.

Sometimes an agreement of sale in respect of a stand was concluded in one tax year, while transfer of the property to the purchaser and payment of the purchase price occurred in the following tax year.

In such cases a question may arise whether the purchase price is to be brought to account in the earlier year, rather than the later year when it is received. The reason is that the definition of gross income in section 1 of the Income Tax Act provided that gross income included 'the total amount, in cash or otherwise, received by or accrued to or in favour of' the taxpayer in relation to that tax year and the Supreme Court of Appeal has held that 'accrued to' means that the taxpayer has become entitled to the amount in question, even though its right thereto may not be immediately enforceable and those circumstances arose in the present case.

SARS contended that the purchase price of certain stands was to be included in the earlier tax year, when the agreements of purchase and sale were concluded, while Milnerton Estates contended that it should only be included after it was received in the following year.

Milnerton Estates in 2013 had concluded twenty-five sale agreements of erven in the Parklands Residential Estate. The purchasers were required to pay a nominal deposit of R5 000 and the balance of the purchase price was payable against transfer. In sixteen instances, where the purchaser had to raise finance and furnish a guarantee, the contracts contained a suspensive condition providing for the eventuality of the finance not being obtained. In all of them the suspensive condition was fulfilled before the end of the 2013 tax year. In the other nine sales the purchaser either deposited the purchase price in cash with the conveyancers or provided a guarantee from a financial institution for the payment of the price and the net result was that in all twenty-five cases the purchase price was fully secured before the end of the 2013 tax year.

Before Milnerton Estates could give possession of an erf to the purchaser it had to obtain the approval of the local authority, the City of Cape Town Municipality, by way of what was referred to as a section 31 certificate, to permit the passage of vehicular traffic on the completed roads in the development. In all but five instances that certificate had been obtained before conclusion of the sale agreement and in the remaining instances it was obtained shortly afterwards. In respect of each erf the section 31 certificate was obtained before the end of the 2013 tax year and Milnerton Estates was, therefore, able to give possession to the purchaser, and in some instances had done so, before the end of that tax year.

Milnerton Estates was obliged to give possession of the erven to each purchaser, either once the purchase price had been secured and the section 31 certificate obtained, or within sixty days of the date of signature of the sale agreement, whichever was the later. Once possession was given, Milnerton Estates was obliged, within thirty days, to register transfer of the stands into the names of the purchasers, provided that the latter had complied with all their obligations in terms of the agreements. By the end of the 2013 tax year purchasers had in eighteen instances been given possession of their stands. In several cases rates certificates had been obtained and conveyancing documents had either been prepared or were in the course of preparation and the costs of effecting transfer had either been paid or secured.

Milnerton Estates contended that at the end of the 2013 tax year its entitlement to the purchase price remained conditional on its performance of the remaining tasks necessary to effect transfer of the stands into the names of the purchasers and it accordingly omitted the purchase prices of these twenty-five stands from its gross income for that year.

SARS contended that the purchase price in each instance had accrued to Milnerton Estates in the 2013 tax year, or alternatively that it was deemed to have done so by virtue of the provisions of section 24(1) of the Income Tax Act 58 of 1962.

SARS had accordingly issued an assessment in which it included amounts totalling nearly R6.8 million in Milnerton Estates' taxable income, attracting a liability for income tax of slightly less than R1.9 million.

Milnerton Estates had then noted an appeal to the Income Tax Court, Cape Town (see ITC 1900 (2017) 79 SATC 341 per Binns-Ward J and assessors) which was dismissed on the alternative ground relied on by SARS and, but for that, would have failed in part on the first ground.

The court a quo gave leave to appeal directly to the Supreme Court of Appeal.

SARS had contended that the requirements of section 24(1) of the Act had been met in that Milnerton Estates had entered into agreements with other persons, i.e. the purchasers of erven, in respect of immovable property and the effect of which agreements was that transfer would be passed from Milnerton Estates to the purchasers upon or after the receipt by Milnerton Estates of the whole of the amount payable to it under the agreements and on that basis SARS contended that the whole amount was deemed to have accrued to Milnerton Estates on the date on which the agreements were entered into.

Milnerton Estates contended further that section 24(1) was not concerned with cash sale agreements of this type, but only with agreements for the sale of immovable property on credit and it drew a distinction between cash sales and sales of immovable property, where the purchase price was to be paid in instalments over time, with transfer only being given once the full purchase price had been paid. While not confined to such sales, broadly speaking the distinction for which Milnerton Estates contended was that between cash sales of immovable property and alienations of land in terms of a contract as defined in section 1 of the Alienation of Land Act 68 of 1981, where the price would be paid in two or more instalments over time.

The appeal raised two issues:

- Whether Milnerton Estates' right to receive the purchase price under these sale agreements accrued to it during the 2013 tax year;
- In any event, whether the deeming provision in section 24(1) of the Act deemed those amounts to have been received by Milnerton Estates during the 2013 tax year.

Judge Wallis held the following:

(i) That there was no need for SARS to rely on the deeming provision in section 24(1) of the Act if in fact the purchase price of the stands in question had accrued to Milnerton Estates during the 2013 tax year. In that sense, the question whether there was an actual accrual was anterior to the application of the deeming provision.

(ii) That, however, in the light of the court's conclusion that the previous judgment of the Supreme Court of Appeal in SIR v Silverglen Investments (Pty) Ltd 30 SATC 199 on the effect of section 24(1) was binding authority on the point, it was unnecessary to canvas the potentially complicated question of whether there was an accrual in accordance with ordinary principles.

(iii) That the court was unconvinced that the arguments advanced by Milnerton Estates, even taken collectively, would suffice to permit a restrictive interpretation of the language of section 24(1) to confine its application to credit agreements properly so called, as opposed to all sale agreements, where ownership passes from seller to purchaser ‘upon or after receipt by the taxpayer of the whole or a certain portion of the purchase price.’ Saying that ownership passes on or after receipt of the whole purchase price is an apt description of cash sales, while saying that ownership passes upon or after receipt of a certain portion of the purchase price encompasses sales on credit.

(iv) That Milnerton Estates had seized upon the requirement that ownership should only pass ‘on or after’ receipt of the purchase price. It pointed out that, for ownership to pass in respect of immovable property, it is necessary for the transfer of the property from seller to buyer to be registered in the Deeds Registry. In the ordinary course, and certainly as applied in these twenty-five cases, that would occur before the seller received the purchase price. The common and almost inevitable practice, as happened here, is that a guarantee is provided for payment that is only payable on proof of registration into the name of the purchaser. There may be cases where a stakeholder, such as the conveyancer or possibly an estate agent, holds the purchase price in trust until registration and then pays the seller, but the occasions on which a seller receives the purchase price prior to transfer will be rare. Payment simultaneously with transfer is physically impossible. Milnerton Estates relied on this, both to buttress its argument that section 24(1) is only concerned with credit agreements, and also as a separate argument that the particular transactions in this case did not fall within the section.

(iv) That whatever appeal this argument might otherwise have had, it was incompatible with the decision of the Supreme Court of Appeal in SIR v Silverglen Investments (Pty) Ltd 30 SATC 199.

(v) That it was a well-known expedient of our law to treat the provision of a guarantee for payment against transfer, or the lodging of the purchase price with a suitable stakeholder, as discharging the purchaser’s obligation to pay the purchase price pari passu with transfer. It is clear that, in saying that in regard to immovable property it was inappropriate to speak of the suspension of the passing of ownership, as ownership could not pass before transfer, the court had in mind that expedient. In law the guarantees provided by the purchasers of erven from Milnerton Estates constituted payment of the purchase price, such payment being concurrent with transfer of ownership by registration in the Deeds Registry. The agreements accordingly provided for Milnerton Estates to pass ownership to the purchasers upon or after receipt of the whole of the purchase price in terms of section 24(1).

(vi) That the purchase price was therefore deemed to be received in its entirety in the 2013 tax year, not the 2014 year, when payment was in fact made and that is what was decided in Silverglen Investments and it applied equally to the present case.

(vii) That, as a last resort, Milnerton Estates sought to contend that Silverglen Investments had been wrongly decided but the court was not only unpersuaded that this was a proper case for it to depart from its previous decisions but was of the view that Silverglen Investments had been correctly decided. Milnerton Estates' strongest point in favour of the contention that the court had fallen into error, was that the consequence of upholding the interpretation in Silverglen Investments would be to bring all sales of immovable property subject to suspensive conditions within the ambit of section 24(1). The consequence, so it submitted, was that sellers of immovable property might be liable to pay income tax on amounts the recovery of which was uncertain and in circumstances where, if the worst happened and the transaction failed for any reason, they might not be able to recover the tax they had paid. Also instanced was the potential for the sale to give rise to a capital gain in the first year and a capital loss in the second in circumstances where the taxpayer might have no corresponding gain against which to offset that loss.

(ix) That the court was not convinced that these points, even if valid, were sufficient justification for departing from a considered judgment of this court. If there are such anomalies and they are as serious as was suggested the remedy lay in the hands of the legislature. However, the court was not convinced that either point was valid.

(x) That in Corondimas v Badat 1946 AD 548 at 551 this court held that when a contract of sale is subject to a true suspensive condition 'there exists no contract of sale unless and until the condition is fulfilled.' While that decision has been subject to fierce academic criticism, it has not been overruled. The agreements with which section 24(1) is concerned will in the ordinary course be agreements of purchase and sale. If subject to a true suspensive condition then, until the condition is fulfilled, on a proper interpretation of the section there may well be no binding agreement that ownership be passed upon or after receipt of the amount payable to the taxpayer. The court made no definite finding on a point that did not arise for decision.

(xi) That, as regards the other concern with capital gains, the determination of the amount of any capital gain falling to be included in the taxpayer's taxable income is a matter dealt with in the Eighth Schedule to the Income Tax Act. It was not apparent to the court that the provisions of section 24(1) apply in determining when an accrual occurs for the purpose of par. 3 of the Eighth Schedule. There was no reference back to section 24(1) and on its face the Schedule seems to provide a self-contained method for determining whether a capital gain or loss has arisen. Again the court refrained from any definitive decision on the point, but it may be an answer to the concern expressed by Milnerton Estates.

(xii) That for present purposes both points raised in criticism of the decision in Silverglen Investments were not sufficiently weighty to justify the court departing from the decision of its predecessors.

(xiii) That the Tax Court was accordingly correct to dismiss the appeal on the grounds that it was bound by Silverglen Investments and this appeal must suffer the same fate.

Appeal dismissed with costs.

6.3. *Purlish Holdings (Pty) Ltd v C:SARS*

Purlish Holdings (Pty) Ltd (Purlish), during the relevant years of assessment, had:

(a) paid provisional tax to SARS and

(b) had then submitted returns that either had reflected no income or expenditure or had reflected the status of the company as dormant and the words 'never traded' were printed in the space reserved for the details of the company.

The evidence revealed that tax returns that reflect that a taxpayer had neither received income nor incurred expenses were, in tax parlance, referred to as 'nil returns' and all the tax returns submitted by Purlish were thus considered to be 'nil returns.'

At the time of the rendition of the 'nil returns' Purlish had already paid provisional tax in the amount of R13 777 347.74 and Purlish's submission of 'nil returns', if properly assessed as such, would have resulted in this amount being reflected as a credit in its tax account.

Purlish had applied for a refund of the provisional tax paid on the basis that it had not yet commenced trading and had not traded in the tax years in question.

At that stage Purlish had not registered as a vendor in terms of the Value-Added Tax Act and consequently had not submitted VAT returns for the period in question.

SARS then decided to perform audits in respect of both corporate income tax (CIT) and value-added tax (VAT) on Purlish, which was essentially prompted by the magnitude of the refund sought by Purlish.

SARS conducted a CIT audit for the period 2011 to 2014 and a VAT audit for the period 2010 to 2012 and during the audit processes that followed, Purlish was requested to submit its tax computations and financial statements for the tax years in issue.

The evidence revealed that Purlish had concluded consultancy agreements in terms of which it had earned substantial income in the period 2011 to 2014 and despite earning this income, Purlish had filed ‘nil returns.’

Furthermore, despite the consultancy agreements clearly stipulating that the fees payable to Purlish were inclusive of VAT, it had not rendered any VAT returns for the 2010 to 2012 years of assessment.

SARS, pursuant to the tax audit, had issued assessments in respect of CIT and VAT and had thereafter levied understatement penalties and interest.

The understatement penalties were imposed on Purlish at a rate of 100% in respect of both CIT and VAT.

Purlish, having been aggrieved by the aforementioned decisions, had lodged objections as contemplated in the Tax Administration Act and the SARS committee that considered the objections had confirmed the imposition of understatement penalties, but had applied lower rates, thereby reducing the quantum of the understatement penalties, i.e. the rates of the understatement penalties were reduced to 25% for CIT and 50% for VAT.

SARS proffered the following reason for the reduction of penalties in respect of income tax: ‘Based on your grounds of objection submitted, the behaviour with regards to the understatement penalty raised was revised from ‘gross negligence’ (100%) to ‘reasonable care not taken when completing the return’ (25%)’. The reason for the reduction of the VAT understatement penalty was stated as follows: ‘Based on your grounds of objection submitted, the ‘behaviour’ with regards to the understatement penalty raised was revised from ‘gross negligence’ (100%) to ‘no reasonable grounds for tax position taken (50%).’

Purlish then lodged appeals against those decisions to the Tax Court (see ITC 1908 (2017) 80 SATC 299 per Nkosi-Thomas AJ) who dismissed the appeals and increased the rate of the understatement penalties to 100% of the assessed tax in respect of both CIT and VAT.

The court a quo had found that Purlish had been grossly negligent in its tax affairs and had accordingly increased the understatement penalties to 100%.

The issue before the Supreme Court of Appeal was whether SARS was entitled to payment of the aforesaid understatement penalties by Purlish in accordance with the provisions of section 222(1) of the Tax Administration Act 28 of 2011.

Judge Molemela held the following:

<u>As to whether SARS was entitled to impose understatement penalties</u>

(i) That it was evident from the definition of 'understatement' in section 221 of the Act that for an understatement to arise, any of the actions or omissions referred to in item (a) to (e) of that definition must result in some prejudice to SARS or the fiscus. In this matter it was common cause that Purlish did not render VAT returns and Purlish's admitted failure to submit VAT returns clearly falls within the category of conduct set out in item (a) of the definition of 'understatement.'

(ii) That considering that SARS had clearly stated in its statement of grounds of assessment and opposing appeal filed in terms of Rule 31 that the 'nil returns' and the non-rendition of the correct CIT returns were the reasons why understatement penalties were imposed, one would have expected Purlish to have adduced some evidence in refutation, especially in relation to the alleged submission of 'nil returns' and it is thus inescapable that Purlish had indeed filed 'nil returns.'

(iii) That the submission of incorrect information in returns falls squarely within the provisions of item (c) of the definition of 'understatement.' The court also agreed with SARS' submission that a failure to declare income constitutes conduct listed in item (b) of the definition of 'understatement.' Indeed, even on the acceptance of Purlish's version that it did not submit tax returns to SARS, item (a) of the definition would still have been triggered. What now remained was to evaluate whether the aforesaid conduct, being conduct envisaged in items (a), (b) and (c) of the 'understatement' definition stipulated in section 221 of the Tax Administration Act, caused any prejudice to SARS.

(iv) That in terms of section 102(2) of the Tax Administration Act, the burden of proving the facts on which SARS based the imposition of an understatement penalty rests on SARS. Furthermore, the Tax Court is, in terms of section 129(3) of the Act, enjoined to decide an appeal against an understatement policy on the basis that the burden of proof is upon SARS.

(iv) That, given the aforesaid burden of proof, the court was inclined to find merit in Purlish's contention that SARS must not only show that the taxpayer committed the conduct set out in items (a) to (d) of the definition of 'understatement' in section 221 of the Tax Administration Act, but also that such conduct caused it (SARS) or the fiscus to suffer prejudice.

As to whether the Commissioner had suffered prejudice

(v) That Purlish had denied that SARS had suffered any prejudice but this contention in the court's view was without any foundation and required no further consideration because SARS did indeed assert prejudice as was evident from an averment made in SARS' Rule 31 Statement in relation to CIT.

(vi) That another point raised by Purlish was that, given the fact that Purlish had indeed paid provisional tax due to SARS in excess of its assessed tax liability by about R1.3 million, it could simply have been set off against the amount standing to its credit in its tax account, such payment meant that there was no prejudice to SARS.

(vii) That in considering whether SARS had showed that it suffered prejudice as contemplated by section 221 of the Act, the court noted that SARS' witness had identified its prejudice as the time, resources and costs incurred in considering Purlish's request for a refund and she had explained that an upfront payment of provisional tax is credited to the taxpayer's tax account and it was only once the relevant tax returns were submitted that SARS could do an assessment to determine whether there was an amount owing by or due to the taxpayer. She pointed out that the submission of 'nil returns', if assessed as such, would have had the effect of conferring on Purlish an entitlement to a refund and this would have resulted in all the funds paid in by Purlish being reflected as a credit in Purlish's account with SARS, as a result of which SARS was unable to channel such funds for the relevant governmental activities and this evidence had not been challenged under cross-examination.

(viii) That the evidence had also revealed that the resource allocation in the form of additional time and human capital necessitated by the extensive audit also constituted prejudice to SARS, as such resources could have been utilised for other matters. Hence, given the circumstances of this matter, the court agreed that the use of additional SARS resources for purposes of auditing Purlish's tax affairs indeed prejudiced SARS and that prejudice was not only determinable in financial terms.

<u>As to the presence of bona fide inadvertent error</u>

(ix) That the court was accordingly satisfied that SARS had proven that there were understatements as contemplated in section 221 of the Act but was unable to find that the understatements were as a result of a bona fide inadvertent error, as Purlish did not adduce any evidence to that effect. There was nothing, in the evidence, that suggested an error of that nature and it followed that the Tax Court had correctly found that SARS had discharged its onus of proving Purlish's 'understatement' of its CIT and VAT within the contemplation of section 221 of the Act.

<u>As to whether the Tax Court was entitled to increase the understatement penalties</u>

(x) That section 129(3) of the Act empowered the Tax Court to increase an understatement penalty but that only arises if the issue has been properly raised for adjudication before that court and this is determined by Rule 34 of the Tax Court Rules which provides that 'the issues in an appeal to the tax court will be those contained in the statement of the grounds of assessment and opposing the appeal read with the statement of the grounds of appeal and, if any, the reply to the grounds of appeal.'

(xi) That SARS had never raised the issue of the increase of the reduced penalties for adjudication before the Tax Court and in its Rule 31 statement

SARS had only sought to justify the reduced penalties and it followed that it was incompetent for the Tax Court to have increased the reduced penalties and to that extent the appeal against the decision of the Tax Court must succeed.

(xii) That it followed that the understatement penalties of 100% imposed by the Tax Court in respect of both income tax and VAT for the relevant periods must be set aside and SARS' understatement penalty of 25% in respect of income tax and 50% in respect of VAT must be reinstated.

6.4. ITC 1915 – Section 24C

The taxpayer had owned and operated the ABC retail business which entailed selling, through ABC stores nationwide, merchandise under various categories.

The taxpayer had conducted a loyalty programme in terms of which it awarded points to members on presentation of an ABC loyalty card when making purchases.

The loyalty programme did not apply automatically to all ABC customers as a customer had to apply either in writing, online or telephonically to become a member of the loyalty programme.

Upon acceptance of the customer's application, the taxpayer issued an ABC loyalty card to the customer.

The taxpayer and the customer entered into an agreement upon acceptance of the customer's application and was referred to as 'the loyalty card contract'.

In terms of the loyalty card contract a customer earned points when making purchases above R10 at any of the ABC stores. In order to earn such points, a customer must present his or her loyalty card at checkout when making the said purchase and no points are earned by the customer who does not present his or her loyalty card at checkout when making a purchase, despite the fact that the customer is a member of the loyalty programme.

It is further provided that a customer must spend at least R10 in order to earn points and, thereafter, for every R5 spent, one point is earned.

Customers qualify for vouchers by earning at least 100 loyalty card points during a qualification period. A qualifying period is a cycle of three months and there are four qualification periods in a year during which the minimum points have to be earned. At the end of each qualifying period, the taxpayer issues vouchers to all members who have earned 100 points or more during that qualifying period.

Every 100 points earned by a customer will entitle that customer to a voucher to the value of R10 which can be used in payment or part payment of a future purchase at one of the taxpayer's stores. The value of the reward, in turn, equates to 2% of the customer's actual spend, i.e. one point is earned for every R5 spent and this is subject to a minimum transaction value of R10.

Vouchers may be redeemed by the customer for merchandise in any of the ABC stores, i.e. when the customer makes a subsequent purchase and presents his or her loyalty card and voucher at checkout. The voucher cannot be redeemed for cash. Thus, if a member presents a voucher at checkout, the taxpayer is obliged to supply the member with selected goods that have a retail value up to the value of the reward.

When a customer presents his or her loyalty card at checkout, the customer's loyalty card membership number and the number of loyalty points he or she has earned as a result of that transaction are reflected on the till slip. When a customer does not present his or her loyalty card, the till slip merely reflects the number of points that the customer could have earned had the customer presented the loyalty card.

The taxpayer had included in its gross income for tax purposes in the 2009 tax year amounts received of R58 550 602 and such amounts had been disclosed as 'Loyalty card deferred income' on the taxpayer's balance sheet for accounting purposes.

The taxpayer had also claimed an allowance of R44 275 965 for future expenditure in terms of section 24C of the Income Tax Act ('the section 24C claim') and such claim was calculated on the value of loyalty card points that the taxpayer expected to convert into free or discounted purchases in future.

SARS had disallowed the taxpayer's section 24C claim and had raised an additional assessment contending that section 24C was not applicable in respect of the loyalty programme in issue.

The taxpayer had objected to the assessment and SARS had disallowed the objection and in response thereto the taxpayer lodged its appeal to the Tax Court against the disallowance of its objection.

The parties had agreed that the only issue to be determined by the court was whether the taxpayer was entitled to an allowance of its section 24C claim, having regard to the basis on which SARS had raised the assessment and had disallowed same.

SARS contended that the transaction whereby a customer purchased goods at an ABC store and in terms of which income was received gave rise to a separate contract to the loyalty programme and the loyalty programme itself did not directly give rise to any income in the taxpayer's hands. The taxpayer's obligation to award the member points based on qualifying sales and to issue rewards when the specified number of points had been earned arose under the loyalty programme.

SARS contended that the taxpayer was likely to incur future expenditure when a customer redeemed a reward and it supplied the customer with goods equal to the value of the reward at no cost to the customer and this obligation to perform arose under the loyalty programme which was a different contract to that under which the income was received.

SARS contended further that section 24C only permitted an allowance when income and the obligation to perform which will result in the taxpayer incurring future expenditure, arose under the same contract but in the present matter the income and the obligation to perform arose under different contracts.

The taxpayer contended that it was entitled to a deduction under section 24C as, in applying section 24C, it was artificial to regard the future expenditure it would incur when a customer redeemed a voucher as arising under a 'different contract' to the first purchase and sale contract concluded with the same customer and pursuant to which the points concerned were generated.

Moreover, the first purchase and sale contract entered into pursuant to the loyalty card contract, on presentation of the loyalty card, could not be treated as a completely separate contract from the loyalty card contract, given the close and inextricable connection between these two contracts.

Judge Nuku held the following:

(i) That the interpretation given by the courts to the provisions of section 24C was that for any allowance to qualify as a deduction under section 24C, the income must have been earned under the same contract as that from which the obligation to incur future expenditure arose and a line of authorities upheld this interpretation, *ITC 1667* 61 SATC 439, *ITC 1697* 63 SATC 146 and *ITC 1890* 79 SATC 62.

(ii) That whilst there was consensus in the authorities referred to above that the income must be earned from the same contract from which the obligations to incur future expenditure arose, this court in *ITC 1905* 80 SATC 223 upheld the taxpayer's appeal in circumstances where the income was not earned from the same contract giving rise to the obligation to incur future expenditure and the court found there to be an 'inextricable link' between the contracts from which the income was earned and the contract giving rise to the obligation to incur future expenditure.

(iii) That the taxpayer submitted *in casu* that the loyalty card contract and the first purchase and sale contract were so 'inextricably linked' that one could not meaningfully separate the two – either factually or legally. The taxpayer submitted further that the fact that the two contracts were between the same parties and were directed at the same performance or sets of performance, meant that the taxpayer's case in this matter was significantly stronger than the successful taxpayer's case in *ITC 1905*, *supra*, where the two contracts were between different parties, and that this was *par excellence* a case for the application of section 24C.

(iv) That SARS submitted that on the facts of this matter three different contracts could be discerned, namely:

(a) the loyalty card agreement, concluded free of charge, from which no income is derived and from which no obligation to incur future expenditure arises (the loyalty card contract);

(b) the first sale agreement from which income is derived but from which no liability to incur future expenditure arises (the first purchase and sale contract); and

(c) the third contract of purchase and sale which simultaneously earns income for the taxpayer and creates a liability on the taxpayer to grant the customer a predetermined credit or discount (the second purchase and sale contract).

(v) That the textual analysis of section 24C of the Income Tax Act was set out as follows in the heads of argument filed on behalf of the taxpayer, namely: 'a particular deduction is allowed if two requirements are met. If:

1.1 the income of the taxpayer in a year of assessment includes or consists of an amount received by or accrued to him in terms of any contract; and

1.2 the Commissioner is satisfied that such amount will be utilised in whole or in part to finance future expenditure which will be incurred by the taxpayer in the performance of his obligations under such contract, then, in determining the taxpayer's taxable income for such year, there shall be deducted an allowance in respect of so much of the future expenditure as relates to the said amount.'

(vi) That, thus, from a textual reading of section 24C of the Income Tax Act, a taxpayer will be able to claim a deduction under section 24C where income is earned under a contract that obliges the taxpayer to incur expenditure in future years.

(vii) That, factually, no income is earned upon the conclusion of the loyalty card contract. Also no obligation to incur future expenditure arises upon the conclusion of the loyalty card contract and the loyalty card contract merely records the terms upon which the taxpayer is to reward the loyalty card holders in respect of their future purchases.

(viii) That SARS, however, maintained that no obligation to incur future expenditure arose when the first purchase and sale contract was concluded. SARS' view was that only income is earned at this stage without any concomitant obligation to incur future expenditure. This, in the court's view, was not factually correct. As will be recalled when the customer concludes the first purchase and sale contract with a spend of R10 or more the taxpayer awards the customer points which the customer may redeem in the future.

(ix) That, in the court's view, the conclusion of the first purchase and sale contract resulted in two things, namely:

(a) the taxpayer earned income, and

(b) the taxpayer incurred an obligation to incur future expenditure towards the customer. The obligation to incur future expenditure arose from the fact that the taxpayer will in future be obliged to provide goods to the customer when the customer redeems his or her voucher. At this stage the taxpayer is aware of its obligation to the customer and, thus, the court could not agree that no obligation to incur future expenditure arose from the first purchase and sale contract.

(x) That what SARS referred to as 'the third agreement of purchase and sale which simultaneously earns income for the appellant and creates a liability on the appellant to grant the customer a predetermined credit or discount' appeared to be the transaction by which the customer redeems the voucher and which the court has referred to as the 'second purchase and sale contract.' If the second purchase and sale contract comprises of only the redemption of a voucher, the taxpayer does not earn an income and in this scenario the taxpayer only incurs the actual expenditure in respect of the obligation which arose upon the conclusion of the first purchase and sale contract.

(xi) That the taxpayer's section 24C claim was not based on the expenditure it incurred upon the conclusion of the second purchase and sale contract. That was so because section 24C is only available in respect of future expenditure. In this instance where the actual expenditure has been incurred, the taxpayer can only rely on section 11 to claim such a general deduction.

(xii) That it is artificial to regard the future expenditure that the taxpayer will incur when a customer redeems a voucher as arising under a 'different contract' to the first purchase and sale contract concluded with the same customer (i.e. and pursuant to which the points concerned were generated). In fact, it is not only artificial to do so but it is factually incorrect. The first purchase and sale agreement incorporated the terms of the loyalty card contract. Despite that the first purchase and sale contract remained the contract that triggered both the earning of income by the taxpayer as well as an obligation by the taxpayer to incur future expenditure.

(xiii) That, based on the finding that the income is earned on the same contract that gives rise to the obligation to incur future expenditure, it followed that the taxpayer's section 24C claim met the requirements of section 24C of the Act.

(xiv) That it was impermissible for SARS to argue that the appeal should fail because the obligation to incur future expenditure was a contingent liability. This was not the basis upon which SARS had disallowed the taxpayer's section 24C claim and this was also not pleaded in SARS' Rule 31 statement and the *quantum* was not in dispute.

Appeal upheld and there was no order as to costs.

6.5. *ITC 1916*

The taxpayer was established in 1999 and was a 100% state owned company and it was mandated with the key role to develop and operate 11 500 hectares of industrial land in the XYZ Special Economic Zone ('SEZ') and XYZ Industrial Development Zone ('IDZ').

The taxpayer, on 8 June 2009, had concluded an agreement of lease with DF (Pty)Ltd ('DF') whereby it had leased to DF its property in the IDZ ('the property'). The initial lease period for the property was 12 years with 2 renewal periods thereafter of twelve years and 5 years respectively ('the DF Lease Agreement').

The taxpayer's first major client with an international imprint was DF and in terms of the DF Lease Agreement DF required the taxpayer to build it a rental facility on the property which was expected to be ready for occupation by 1 July 2010, being the effective date of the DF lease agreement which was then registered as a long-term lease in terms of section 77 of the Deeds Registries Act 47 of 1937 on 1 December 2010.

The taxpayer then commenced construction of the DF rental facility and in the second month of the building the taxpayer ran into financial difficulties and could not afford to pay JK Construction who had been granted a tender to build the facility.

The taxpayer then on 8 December 2010 concluded an agreement to lease the identical property to MN Properties (Pty)Ltd ('MN') for a period of 50 years subject to DF's tenancy in terms of the DF Lease Agreement.

The following clauses in the MN Agreement were pertinent:

- MN would pay to the taxpayer a monthly rental in the nominal amount of R1 per month until the expiry of an initial lease period of 12 years ('the first period');
- MN would pay to the taxpayer a monthly turnover equal to 10% of the gross rental received in respect of the property for a lease period of 25 years commencing immediately after the first period ('the second period');

- the taxpayer ceded and assigned the DF Lease Agreement to MN and in consideration for the MN Cession and Assignment Agreement (1) MN would pay the taxpayer an amount of R125 million upon the Rental Date, (2) the taxpayer would be substituted by MN as landlord, in terms of the DF Lease Agreement, and (3) DF would pay all amounts due in terms of the DF Lease Agreement to MN.

The taxpayer assigned its rights, title and obligations in terms of the DF Lease Agreement to MN with effect from 1 August 2010.

Subsequently on 7 April 2011 MN and ST Limited ('ST') concluded an agreement of sale of rental enterprise to ST and an agreement to pay the lease premium arising therefrom. It should be noted that the amount of R125 million had been referred to as a 'lease premium' by the parties and in the documentation.

As agreed, the amount of R125 million was paid to the taxpayer by ST and it was not in dispute that when the taxpayer filed its income tax return for the 2012 year of assessment, it did not include therein the whole lease premium amount of R125 million received as gross income but, instead, it amortised the premium in its tax return.

SARS had made enquiries in regard to the taxpayer's omission of the aforesaid lease premium in its return and, being dissatisfied with the taxpayer's explanation, proceeded to issue a finalisation of audit letter to the taxpayer and then raised an additional assessment levying income tax on the lease premium of R125 million as revenue and also imposed a 10% understatement penalty.

The taxpayer then objected to the additional assessment, which objection was disallowed by SARS.

The taxpayer contended that the payment in issue was of a capital nature, being proceeds in respect of the disposal by the taxpayer of an asset comprising of its rights, title and interests in and to the DF Lease Agreement and therefore it did not fall within the taxpayer's gross income as contemplated in par. (g) of the definition of 'gross income' in section 1 of the Income Tax Act.

The taxpayer contended in the alternative that, in the event that the court found that the receipt in issue was not of a capital nature, the taxpayer should be entitled to the deduction in terms of section 11(h) of the Income Tax Act 58 of 1962.

Judge Mali held the following:

(i) That section 102(1)(a) and (f) of the Tax Administration Act provided that a taxpayer bore the burden of proving that an amount, transaction, event or item was exempt or otherwise not taxable, or that a 'decision' that is subject to objection and appeal under a tax Act is incorrect.

(ii) That in the present case the taxpayer bore the burden of establishing that the Cession and Assignment of Lease Agreement to MN relieved it of the status and the rights of a landlord over DF and thereby resulting in the lease premium from DF not being taxed in the hands of the taxpayer.

(iii) That, from the evidence given by two of the taxpayer's employees, it emerged that the term or concept lease premium did not mean a lease per se as almost everyone involved in the taxpayer's organisation used the term lease premium loosely as the cession and assignment of the DF lease was never meant to be a lease as in a rental lease but rather a sale or disposal of rights. However, the court was of the view that the evidence of the two employees was inadmissible.

(iv) That in an enquiry as to whether the receipt of the lease premium was of a capital or revenue nature, the starting point is the intention of the taxpayer and in the present case the taxpayer's objective was to attract investment by utilising its land through rental income and it was not in dispute that the taxpayer never and was never mandated to sell assets.

(iv) That the submissions to the Executive Management and the Board of the taxpayer referred to the offer of MN as being one that constituted an upfront payment of rental income and, furthermore, the evidence that the amount of the lease premium was as close as possible to the amount of the DF Lease Agreement demonstrated the close ties with the DF Lease Agreement and the argument that there was no correlation between the monthly rental for twelve years and the R125 million lump sum payment could not be accepted.

(v) That if it is accepted that all the members of the taxpayer used the term lease agreement or lease premium loosely, as per the employee D's testimony, it is however baffling that an experienced commercial lawyer and certain attorneys did not see anything wrong in drafting contracts in that fashion. This makes it clear that all other role players knew that they were really dealing with a rental and not the sale of any asset. The court was inclined to believe that this was the reason the lawyer or attorneys involved were not called to give evidence. The other parties, except for D, knew precisely that they were dealing with a pure lease agreement and not a sale of assets.

(vi) That the nature of a premium for the use or occupation or the right of use or occupation of land or buildings is specifically included in the definition of 'gross income' in the Income Tax Act and the taxpayer's action was not aimed at achieving a legitimate commercial purpose.

(vii) That consistency in the accounting treatment supports SARS' argument in the present matter. The Audited Annual Financial Statements ('AFS') for the 2012 and 2013 financial reporting period do not show the accounting policy of how such a sale of the assets would be treated by the taxpayer. The Investment Property Asset note did not show any evidence of such asset being sold and the cash flow and income statements did not show such evidence of proceeds from sale of assets.

(ix) That, from the above, it was apparent that the intention of the taxpayer was always to enter into a rental agreement, fully knowing that the receipt flowing therefrom is of a revenue nature. While the lease agreement with DF was highly lucrative for the taxpayer at the time and it guarded the deal jealously, in the process however it crossed the line in an attempt to attain an undue tax benefit.

(x) That, from the above, it was apparent that the agreement between the taxpayer and MN was intended to provide the true intention of the parties.

The cession and/or sale of a bundle of rights is not viewed, as purported by the taxpayer, to be a sale of assets. It was intended for the taxpayer to earn a lease premium and, accordingly, the court found that the receipt of R125 million by the taxpayer was of a revenue nature and therefore taxable in its hands.

(xi) That the taxpayer was not entitled to the deduction in terms of section 11(h) of the Income Tax Act as that section applied only in instances where a premium or the value of improvements to leased property was included in gross income in the determination of a taxpayer's taxable income but in the present case it was common cause that the amount of R125 million had not been included in the taxpayer's gross income.

(xii) That SARS' reduction of the understatement penalty from 25% to 10% was in order in view of the fact that the higher percentage would have caused the taxpayer significant hardship.

Appeal dismissed.

SARS assessment in respect of the 2012 year of assessment was confirmed.

6.6. Benhaus Mining (Pty) Ltd v C:SARS

Benhaus Mining (Pty) Ltd (Benhaus) had evolved from being a construction company to being what it called a contract miner.

The evidence revealed that Benhaus had entered into contracts with third parties that held mining rights to render various services to them for a predetermined fee but Benhaus did not itself trade in the mineral extracted from the ground.

The services that Benhaus had rendered included establishing sites for open cast mining, and fencing them off; constructing workshops; constructing and maintaining access roads, and primary and secondary haul roads; removing topsoil and stockpiling it in designated areas; excavating and stockpiling material extracted from the ground; removing waste; constructing storm water drainage; blasting mineral-bearing ore; delivering the ore to the client's premises for processing; and rehabilitating the mining area after extraction.

The essence of the contracts between Benhaus and its clients was to extract the mineral-bearing ore (the mineral being chrome) on behalf of the client in return for a fee calculated at a rate per ton of chrome-bearing ore that was delivered to the client's processing plant.

Benhaus, in its income tax returns, and on the advice of its auditors, had claimed that it was mining the ore, and had claimed deductions in each year of the capital expenditure on the machinery used in extracting the mineral-bearing ore.

SARS had issued additional assessments for the years in question, on the basis that Benhaus was not engaged in mining as it did not itself process the mineral bearing ore nor trade in it and it was not engaged in the entire process of mining chrome.

Benhaus has not contended that it was responsible for the entire process, but it did maintain that it did extract the mineral-bearing ore from the ground and was thus mining for the purpose of the Income Tax Act.

Benhaus had explained that there were three stages in chrome mining using the open cast method of mining. The first stage was the removal of topsoil and overburden (material overlying a mineral deposit), blasting the rocks to expose the mineral reef, extracting the ore, crushing and screening it, and delivering it to the processing plant of the client and Benhaus had attended to that whole process.

The second stage involved the milling of run of mine chromotite ore and subjecting it to a washing process. The third stage entailed melting the higher concentrate ore in a furnace to separate waste from metal to produce ferrochrome.

Benhaus had not been involved in the second and third stages of the mining process but it was penalised if the chrome-bearing ore delivered to its clients was not of the same quality as that of the sample agreed.

Benhaus, in the years of assessment in question, had worked on seven mines, in terms of eight different agreements with clients. In its income tax returns it did not separate out the income earned in respect of each mine under each contract but it had reflected the income earned as a composite sum, a factor that SARS relied on.

The principal issue in this appeal was whether Benhaus had derived income from mining operations in the tax years 2005 to 2009, such that it was entitled to claim deductions of capital expenditure in terms of section 15 read with section 36(7C) of the Income Tax Act in the tax years from 2005 to 2009.

SARS had, since 1998, assessed Benhaus for income tax on the basis that it did fall within the ambit of section 15 but in September 2013 SARS had issued additional assessments for the years in question on the basis that Benhaus was not a mining company.

Benhaus had objected to these additional assessments, but the objection was not upheld and it then appealed to the Johannesburg Tax Court (see *ITC 1913* (2017) 80 SATC 455 *per* Weiner J) who dismissed the appeal and then, with the leave of the court *a quo*, Benhaus appealed to the Supreme Court of Appeal.

The court *a quo* followed the reasoning of Sutherland J, also in the Johannesburg Tax Court (see *ITC 1907* (2017) 80 SATC 271) in a judgment that dealt with the same question concerning contract mining.

In the court *a quo*, Weiner J, following the decision in *ITC 1907*, *supra*, found that the work that Benhaus did to extract mineral bearing ore from the earth did not amount to 'mining operations.' Sutherland J had held that a contractor such as Benhaus was not in the 'trade' of mining but it was rather 'in the trade of servicing a miner's requirement by the extraction of material' (at par. 26).

Sutherland J stated in *ITC 1907*, *supra*, at par. 26:

> 'Mere extraction is not enough to render a contractor who earns a fee for extraction as a person eligible to fall into the class of persons who are engaged in 'mining operations' as defined. The contractor is not in the 'trade' of mining; rather it is in the trade of servicing a miner's requirements by the extraction of material.'

The Income Tax Act defined 'mining operations' and 'mining' as including 'every method or process by which any mineral is won from the soil or from any substance or constituent thereof' (section 1) and section 15 stated:

'*Deductions from income derived from mining operations* – There shall be allowed to be deducted from the income derived by the taxpayer from mining operations –

(a) an amount to be ascertained under the provisions of section 36, in *lieu* of the allowances in sections….'

Section 36(7C) provided at the relevant time:

> 'Subject to the provisions of subsections (7E), (7F) and (7G), the amounts to be deducted under section 15(*a*) from income derived from the working of any producing mine shall be the amount of the capital expenditure incurred.'

Judge Lewis held the following:

(i) That the question that arose in this appeal was whether Benhaus had carried on mining operations for the purpose of making capital expenditure deductions in the years of assessment in which the capital expenditure was incurred and that depended on what was meant by 'mining' in section 1 and in section 15(*a*) read with section 36(7C) of the Income Tax Act.

(ii) That the court *a quo* had found that Benhaus was not engaged in mining within the meaning of sections 1 and 15(*a*) of the Income Tax Act, and had thus not been entitled to deduct the capital expenditure in respect of the equipment that it used for extracting mineral-bearing ore from the ground and its other findings all flowed from this. Thus the essential question was whether the first stage of the process of mining for chrome constituted mining under the Act.

(iii) That the court *a quo*, following the decision in *ITC 1907* 80 SATC 271, had found that the work that Benhaus did to extract mineral bearing ore from the earth did not amount to 'mining operations' and in *ITC 1907* it was held that a contractor such as Benhaus was not in the 'trade' of mining but that it was rather 'in the trade of servicing a miner's requirement by the extraction of material'.

(iv) That the court *a quo*, following *ITC 1907*, *supra*, was of the view that the contract miner was, in effect, an outsourced service, remunerated by the risk-taker, whereas in a joint venture the 'non-owner' of the mining right shared the risk in the whole venture.' Benhaus submitted that there were two fundamental flaws in this approach: that the trade of mining should entail commercial risk; and that the taxpayer must be involved in the process of separating the mineral from the rock.

(iv) That the decision in *ITC 1907*, *supra*, pointed out in par. [27] that the taxpayer in *Gloucester Manganese Mines* (*Postmasburg*) *Ltd* v *CIR* 12 SATC 229 had taken risks because it would share in the profits of the mining operations being undertaken by the mineral lessee. That may be so, but the court did not refer to risk as an element in determining whether the lessor had conducted mining operations and it was not evident to the court why the question whether an entity was conducting mining operations was dependent on the miner bearing risk.

(v) That, in any event, as Benhaus had pointed out, it did bear commercial risk as it bought mining equipment at considerable cost (some R391 million over the relevant years of assessment) and had to incur labour costs and losses caused if there were strikes, the cost of equipment breakages, and to be paid a lesser fee if the quality of the chrome-bearing ore was below that of the sample agreed.

(vi) That the court in *ITC 1907*, *supra*, rejected the proposition that any part of the process of winning minerals from the earth could constitute mining operations. The definition of mining and mining operations refers to a process 'by which any mineral is won from the soil or from any substance or constituent thereof.' This could be construed in such a way that both the entity that dug the mineral bearing ore from the earth, and the entity that operated the process of separating the mineral from the ore or rock, would be involved in mining the same mineral. That construction, he held, was incorrect.

(vii) That the court referred to *Richards Bay Iron and Titanium* (*Pty*) *Ltd* v *CIR*

58 SATC 55 and *C:SARS* v *Foskor* (*Pty*) *Ltd* 72 SATC 174 as both of them dealt with the question whether ore extracted by one entity and delivered to another for processing, constituted trading stock in the hands of the latter for the purposes of sections 1 and 22 of the Act. This court found that the entity that extracted the ore was the miner and that the entity that processed it into an entirely different state was not.

(ix) That in *Foskor*, *supra*, Navsa JA stated at par. [43] 'it is true that when a mining house extracts gold ore and then subjects it to processes including refinement one would be hard-pressed not to concede that the mining house in question has mined the gold.' This *dictum* should be equally applicable when entity A extracts the mineral from the earth, and entity B engages in other processes including refinement.

(x) That SARS had contended that *Richards Bay*, *Foskor* and *Marula* were distinguishable from this matter in that they had dealt with a different legal question and that was true but their importance lay in the fact that this court had long recognized that the process of extraction amounted on its own to a mining operation and the processing of the ore was a different one.

(xi) That Benhaus had contended that it qualified for a deduction in terms of section 15(*a*) read with section 36(7C) of the Act in that its income had been derived from a producing mine. Section 36(7C) had provided in the relevant years of assessment that, subject to other subsections, the amounts to be deducted under section 15(*a*) from income derived 'from the working of any producing mine shall be the amount of capital expenditure incurred.' Discussing this subsection in *Western Platinum*, Conradie JA stated at par. [6]: 'this expression (arguably more focused than the expressions 'mining' and 'mining operations') leaves no doubt that to be mining income its source must be minerals taken from the earth.'

(xii) That SARS had argued that because the income earned by Benhaus was derived from fees for services provided and not from the sale of minerals, the income was not from mining operations at a producing mine. However, Benhaus, on the other hand, had correctly pointed to the passage in *Broken*

Hill referred to by Harms J in *ITC 1455*, *supra*, that work done on mineral bearing property in preparation for winning of the mineral, is covered by the expression 'mining operations.' That must be so, or miners would not be able to recover expenditure on capital assets laid out before, even long before, a mine started producing.

(xiii) That Benhaus, in its returns, for the relevant years, did not separate out, or ringfence, its income earned in respect of any mine and had claimed for all capital outlays in one sum, not distinguishing between equipment used on different mines and hence SARS argued that Benhaus did not comply with the provisions of section 36(7E) and (7F) of the Act and for that reason too should not be entitled to deductions. However, this ground of assessment was not pleaded by SARS, who pleaded only that the business carried out by Benhaus did not constitute mining, or mining operations, as defined in section 1 of the Act, and that it did not earn any income from mining operations as contemplated in section 15(*a*) of the Act and it therefore did not qualify for deductions of capital expenditure in terms of section 15(*a*) read with section 36(7C).

(xiv) That SARS cannot raise new grounds of assessment without pleading them in express terms. SARS did not raise non-compliance with sections 36(7E) or (7F) in opposing Benhaus' appeal and therefore the argument on non-compliance with sections 36(7E) and (7F) must thus fail.

(xv) That Benhaus had correctly submitted that it did the mining work, extracting the mineral-bearing ore from the ground and that it was entitled to deduct the capital expenditure on mining machinery from income earned from doing so. The client is not required to spend funds on any equipment for the purpose of mining. Any possibility that both client and miner would be entitled to the special deductions given for miners is remote.

(xvi) That the mining operations commenced when Benhaus moved on to site and started the preparation for digging the mineral-bearing ore out of the earth. It mattered not that it was paid a fee for delivering the chrome bearing ore to the client: that is the work from which it earned its income. It was of no relevance that the contract miner immediately begins to earn an income from mining, and does not have to wait for the mine to produce over many years.

(xvii) That Benhaus was conducting mining operations and was entitled to the benefits conferred by section 15(*a*) and section 36(7C). This conclusion followed the approach adopted by this court in *Western Platinum* and gives effect to the clear meaning of mining as defined in section 1 of the Income Tax Act – 'every method or process by which any mineral is won from the soil' and that is precisely what Benhaus did by conducting the first stage in chrome mining using the open-cast system as described above.

(xviii) That, accordingly, in the circumstances the appeal must be upheld and the question of recoupment fell away, and Benhaus should not have been ordered to pay penalties and interest, nor should it have been ordered to pay the costs of the appeal in the Tax Court.

Per Mocumie JA, concurring

(xix) That existing case law is clear regarding the beneficiaries of the CAPEX scheme: contract miners and miners are equally entitled to benefit from the accelerated depreciation scheme subject to their participation in significant phases of the mining process. However, in my view, the scheme was designed to incentivise mining as opposed to components thereof which is what contract miners do.

(xx) That to the extent that there is no clear and unambiguous definition of mining, the class not intended to benefit from the dispensation will continue to benefit and be entitled to the accelerated tax deductions which clearly is to the detriment of the *fiscus* coffers and this calls for the amendment of the Income Tax Act as the courts cannot promote this objective without invading the terrain of the legislature. This is evidently a case where we must defer to the legislature to ensure the requisite change.

Appeal upheld with the costs of two counsel.

6.7. ITC 1917 – Employment Tax Incentive

The taxpayer had conducted business in the consumer goods industry to which Sectoral Determination 9 (SD9) applied.

SD9 established conditions of employment and minimum wages for employees in the wholesale and retail sector and was regarded as a 'wage regulating measure' applicable to the taxpayer in terms of section 4(1)(*a*) of the Employment Tax Incentive Act 26 of 2013.

Section 4(1)(*a*) of that Act provided at the relevant time –

'4. *Compliance with wage regulating measures*.– (1) An employer is not eligible to receive the employment tax incentive in respect of an employee in respect of a month if the wage paid to that employee in respect of that month is less than –

(a) the amount payable by virtue of a wage regulating measure applicable to that employer;..'

Section 6(*f*) of the Act provided at the relevant time –

'6. *Qualifying employees*.– An employee is a qualifying employee if the employee –

(*f*) is not an employee in respect of whom an employer is ineligible to receive the incentive by virtue of section 4.'

The taxpayer's staff complement consisted of two categories: management and non-management employees. Within the category of non-management employees the taxpayer employed permanent full-time employees who receive monthly remuneration and permanent part-time employees who were paid on a weekly basis for the hours worked and approximately 30% of employees of non-management employees were members of the X Union (X).

The SD9 is published in January of each year and is applicable from 1 February until 31 January of the following year.

A three-year collective agreement, valid for the period from 2012-2015, was concluded between the taxpayer and X on 24 August 2012, prior to the promulgation of the Employment Tax Incentive Act and, as had historically been the practice, in terms of the agreement negotiated wage increases were paid effective from 1 May of each year.

The taxpayer has at all relevant times treated all non-management employees, whether members of X or not, alike and paid annual increases agreed with the union with effect from 1 May, together with backpay in respect of the SD9 increase backdated to February.

SARS had disallowed the taxpayer's Employment Tax Incentive (ETI) claims for the months of February, March and April in 2014 and 2015 on the basis that the amount paid to qualifying employees with effect from 1 February was less than the stipulated minimum amount payable in terms of SD9.

The taxpayer had raised an objection to the aforementioned decision and, in response, SARS had allowed the ETI amount claimed only in relation to those of the employees who were members of the trade union.

The taxpayer, in respect of unpaid leave, had calculated the monthly remuneration of an employee who had taken unpaid leave so as to determine whether the taxpayer was entitled to the ETI benefit in respect of such employee, and if so, in what amount. The ETI was then claimed based on the pro-rated wages paid to the employee for the days worked.

SARS had disallowed the taxpayer's ETI claims in full for employees who had taken unpaid leave and the same occurred in respect of employees who had worked for less than a month on the basis that the ETI was available to 'a qualifying employee in respect of a month' in terms of section 2(2) of the Employment Tax Incentive Act and that to qualify the minimum wage had to be paid to the employee for the month worked.

SARS accordingly determined that an assessed amount of R34 123 836,15 be imposed on the taxpayer together with a penalty in the amount of R31 784 376, 69.

The issue to be determined by the Tax Court was whether the taxpayer was eligible to claim the ETI, in terms of section 4(1)(*a*) read with section 6(*f*) of the Employment Tax Incentive Act, for the 2014 and 2015 years of assessment, being the tax periods in dispute, when:

- Wage increases prescribed in the applicable wholesale and retail sector Sectoral Determination 9 (SD9) were paid to non-union member employees on 1 May of each year, backdated to 1 February, rather than on 1 February from which date SD9 was applicable annually;
- A qualifying employee's employment commenced and/or terminated midway through the month; and
- Qualifying employees were paid less than the minimum prescribed wage, as a result of unpaid leave taken during the month.

Further issues before the court were whether the taxpayer had correctly calculated the ETI for each qualifying employee in terms of section 7(5) of Act for the 2014 and 2015 tax periods and whether 100% penalties imposed on the taxpayer in terms of section 4(2) of the Act, with interest, were justified.

The taxpayer contended, *inter alia*, that the collective agreement, as a 'wage regulating measure', applied to it in terms of the Act given that such wage regulating measure was 'applicable to that employer.' It contended that it was permitted to apply the agreement across the whole bargaining unit regardless of trade union membership, as had been its past practice for reasons of commercial necessity to treat all of the employees equally and avoid labour discord. Furthermore, the calculation of monthly remuneration to determine eligibility and allow remuneration to be pro-rated was an appropriate manner to calculate the ETI where employees had taken unpaid leave or had worked for a portion of a month.

SARS contended, *inter alia*, that the ETI entitlement was determined in respect of qualifying employees on a month-to-month basis and not retrospectively months later; the amount paid on 1 February to non-trade union members was less than the minimum prescribed by the wage regulating measure applicable to those employees, being SD9.

He contended further that the ETI Act did not make provision for a retrospective application of the payment of a minimum wage and employees who took unpaid leave or did not work a full month were not paid the prescribed minimum wage in a month and, it followed that the taxpayer was not entitled to claim the ETI allowance in respect of such employees and for these reasons SARS sought that the appeal be dismissed and that the additional assessments, penalties and interest imposed on the taxpayer be confirmed.

Judge Savage held the following:

(i) That the ETI was a tax incentive provided to employers to encourage job creation for employees under 30 years of age and it allowed, in terms of section 2(2) of the Act, an eligible employer to receive an ETI 'in respect of a qualifying employee in respect of a month' in accordance with section 7(1) and (2) by withholding a portion of the employee tax payable or being reimbursed an amount as set out in section 10(2) of the Act.

(ii) That an employer was not eligible in terms of section 4(1) of the Act to receive the ETI 'in respect of an employee in respect of a month if the wage paid to that employee in respect of that month is less than (*a*) the amount payable by virtue of a wage regulating measure applicable to that employer…'

(iii) That a wage regulating measure is defined in section 4(3) to mean a collective agreement in terms of section 23 of the Labour Relations Act 66 of 1995 (LRA); a sectoral determination as contemplated in section 51 of the Basic Conditions of Employment Act 75 of 1997; or a binding bargaining council agreement as contemplated in section 31 of the LRA. Both the collective agreement entered into between the taxpayer and X and SD9 are wage regulating measures applicable to the taxpayer as employer.

<u>As to the entitlement to claim ETI in respect of non-members of the trade union</u>

(iv) That the three-year collective agreement entered into between the taxpayer and X was not one concluded in a bargaining council and could not have been extended to non-parties to the bargaining council in terms of section 32 of the LRA. However, while the collective agreement entered into with X, in terms of section 23(1)(*d*) of the LRA, was not binding on non-trade union employees, there was no bar on the extension of its terms to the benefit of all employees being undertaken voluntarily by the taxpayer.

(v) That the historical election which had been made by the taxpayer to extend the application of the collective agreement concluded with X to all non-management employees, which appeared to have been accepted without objection by all employees, was aimed at avoiding workplace discord and achieving commercial efficiency. There was no legal bar on this voluntary extension of the terms of a collective agreement concluded with the trade union to all employees beyond those employees represented by it.

(vi) That had only non-trade union members received a wage increase on 1 February in line with SD9, the different treatment of non-trade union and trade union members would undoubtedly have created the risk of workplace conflict.

(vii) That, furthermore, there was no dispute that SD9 was applicable to the employer from 1 February in relation to all employees, including members of X. SARS accepted that the 1 February increase prescribed by SD9 could be paid retrospectively on 1 May to trade union members by virtue of the terms of the collective agreement entered into with the trade union. From this it was apparent that administratively it was accepted to be possible for SARS and the taxpayer to determine the ETI retrospectively and that the Act did not require, as an immutable rule, that the ETI be granted only to qualifying employees calculated on a monthly basis during or immediately following the actual month worked.

(viii) That the ETI Act did not make provision for a retrospective application of the payment of a minimum wage but since an accrued right to remuneration is a right to remuneration which is not paid but is payable, it is apparent that retrospective payment of wages was expressly contemplated by the Act and there is consequently no merit in the contrary contention made on behalf of SARS.

(ix) That, for the reasons given, given that the collective agreement was 'applicable to the employer', that it was voluntarily extended by the taxpayer to non-trade union members and despite the fact that the agreement was entered into by the trade union on behalf of its members, the taxpayer was entitled to apply its terms and to extend the application of the agreement to all employees regardless of trade union membership.

(ix) That, accordingly, the taxpayer was entitled to apply the collective agreement which was applicable to it to all employees alike, whether trade union members or not. As a result, the refusal by SARS of the objection raised by the taxpayer in relation to the payment of the ETI to non-trade union employees was without merit and it followed that Appellant was entitled to claim the ETI in respect of all employees for the months of February, March and April 2014 and 2015.

__As to ETI and unpaid leave and employment for less than a month__

(x) That in regard to whether the taxpayer was entitled to claim the ETI in respect of employees who had taken unpaid leave or who had not been employed for a full calendar month, the relevant starting point was the definition of 'monthly remuneration' in section 1(1) of the Act which applied at the time that the assessments were made.

(xi) That from the aforementioned definition and from the provisions of section 7(5) of the Act, it was apparent that the Act expressly contemplated that an employer may employ a qualifying employee for part of a month and that the calculation of an employee's notional monthly remuneration, had he or she worked a full month, was necessary to determine whether the employee was a 'qualifying employee in respect of a month' in terms of section 2(2) of the Act.

(xii) That it was plainly apparent that the ETI was applicable to employees who have not worked a full calendar month where their remuneration, had they notionally have done so, fell within the prescribed ETI threshold and in such a case it would then have been permissible for the ETI claimed to have been pro-rated on the basis of the days actually worked.

(xiii) That the reference to ‘any amount’ in the definition of ‘remuneration’ in para 1 of the Fourth Schedule to the Income Tax Act allows an interpretation of ‘monthly remuneration’ in the Employment Tax Incentive Act as one of any amount paid or payable to an employee in respect of a month and the fact that this may have the result that an amount less than the minimum wage is paid to the employee does not in these circumstances negate the employer’s entitlement to receive the ETI.

(xiv) That the contentions made by SARS to the contrary were without merit as to find so would have had the effect that an employer may be disentitled to receive the ETI where an employee who is paid the monthly minimum wage takes unpaid leave for one day and such a finding would not be to give a sensible and business-like interpretation to the statute or have appropriate regard to its purpose.

Appeal upheld.

Additional assessments raised by SARS against the taxpayer for the relevant tax periods were set aside, together with the penalties and interest imposed.

6.8. ITC 1918 – Gross Income receipts

The taxpayer had carried on business as a high street retailer of clothing, comestibles and general merchandise.

As part of the facilities offered to its customers, it ‘sold’ gift cards which could be redeemed for goods at any of its stores.

Notwithstanding the reference in common parlance to the ‘sale’ of gift cards, it was clear that the transactions in terms of which the taxpayer’s customers acquire them are actually not contracts of sale properly so characterised. They entail the customer making a prepayment in respect of the supply by the taxpayer of as yet unidentified goods when the gift card is redeemed later. Neither the identity of the goods to be supplied when the gift card is presented, nor their price, is determined in the transaction in terms of which the card is issued. It is a term of the transaction that the beneficiary of the prepayment is whomsoever happens to be the bearer of the card when it is redeemed. The bearer is entitled to the benefit of the prepayment in *lieu* of payment of the whole or part of the purchase price if he or she presents the card when purchasing goods at any of the taxpayer's stores. A sale in the true sense only takes place when the card is presented in partial or complete redemption of the purchase price of goods selected by the consumer who is the bearer of the card at the time. The card is nothing more than a piece of paper that vouches for the existence of the bearer's personal right against the taxpayer for the redemption of the prepayment and it is not a thing (*res vendita*) that is the subject of a sale.

The taxpayer had transferred the revenue generated from the 'sale' of gift cards to a separate banking account that was conducted solely to hold the proceeds of its gift card transactions until the cards were redeemed or became expired. Comparative research revealed that the taxpayer's practice of holding the revenue from the 'sale' of gift cards in a separate bank account that was not drawn on to service the company's requirements did not appear to have been unique and the Law Commission (England and Wales) report, *Consumer Prepayments on Retailer Insolvency* [2016] EWLC 368 (14 July 2016), testified to an identical practice by a number of retailers in the United Kingdom.

The evidence revealed that the receipts in respect of the 'sale' of gift cards will invariably be intermingled with the taxpayer's own money when the transaction is effected. This will either be by way of cash going into the till, or in the case of payment by credit card or EFT transactions by way of the crediting of the taxpayer's operational banking account.

It was common ground that the receipts remained so intermingled with the taxpayer's own funds until there was a reconciliation and transfer of the unredeemed card receipts to the segregated funds account and that took place monthly.

In the present matter it had been the taxpayer's practice since 2007 to segregate its receipts in respect of unredeemed gift cards. But, until the 2013 tax year, it had nonetheless declared all of the revenue generated by the 'sale' of gift cards as part of its gross income in the year in which such revenue was received. Neither side adduced any oral evidence at the hearing of the appeal but it could safely be inferred that the change in the taxpayer's approach, which made it exclude the consideration received in respect of the issue of unredeemed cards from its declared gross income in the 2013 year, was inspired by its understanding of the effect of the Consumer Protection Act 68 of 2008 ('CPA') which came into effect on 31 March 2011 and which dealt, *inter alia*, with receipts in respect of gift cards.

SARS had issued an additional assessment on the taxpayer, following an audit on it by SARS, in respect of the taxpayer's return of income for the 2013 tax year.

SARS, in its finalisation of audit letter, dated 22 May 2017, had characterised an amount of R140 984 321, being the taxpayer's receipts in that year in respect of unredeemed gift cards, as part of the taxpayer's gross income, and had recognised a related section 24C allowance, in the amount of R94 123 389 and this had resulted in the taxpayer's assessed income tax liability being increased by R13 121 060 in terms of the additional assessment.

The question to be resolved in this appeal, from the additional assessment by SARS of the taxpayer's taxable income in the 2013 fiscal year, was whether the revenue from the 'sale' of the taxpayer's gift cards during that year constituted part of its 'gross income' for the purposes of the Income Tax Act as soon as it was received by the taxpayer, as contended by SARS, or would become such only when the card was redeemed, or having not been redeemed, expired, as was contended by the taxpayer.

The provisions of the CPA that were relevant for the purposes of this income tax appeal came into operation on 31 March 2011, probably during the taxpayer's 2012 year of assessment.

It was also common ground that the 'sale' by the taxpayer of gift cards was regulated by the pertinent provisions of the CPA, being sections 63 and 65, respectively and the taxpayer was a 'supplier' within the meaning of that word as defined in section 1 of the CPA.

Section 63 of the CPA provided *inter alia* at the relevant time that 'any consideration paid to a supplier in exchange for a prepaid certificate, card, credit voucher or similar device…is the property of the bearer of that…device to the extent that the supplier has not redeemed it in exchange for goods or services…'

Section 65 of the CPA provided at the relevant time that when a supplier has possession of any prepayment, deposit, membership fee, or other money, or any other property belonging to or ordinarily under the control of the consumer, the supplier must not treat that property as being the property of the supplier and 'in the handling, safeguarding and utilisation of that property, must exercise the degree of care, diligence and skill that can reasonably be expected of a person responsible for managing any property belonging to another person…'

The taxpayer's contention that the receipts in respect of the 'sale' of unredeemed gift cards did not constitute part of its gross income was advanced on two levels. The first was that, as a matter of principle, and irrespective of the incidence of the CPA, the fact that the monies received by it in respect of the 'sale' of gift cards were held in a separate bank account, and were not applied in the conduct of the taxpayer's business, until the cards were redeemed or expired, and that they were discretely accounted for in its financial records as an unredeemed gift card liability, rendered it inconsistent with it being 'income' within the ordinary meaning of the word until such time as it was appropriated. The second level of the taxpayer's argument was premised on what it contended was the legal effect of the characterisation of its receipts in respect of unredeemed gift cards in sections 63 and 65 of the CPA, coupled with its treatment in practice of those receipts consistently with the statute.

The taxpayer, in regard to the second level of its argument, submitted that the effect of sections 63 and 65 of the CPA was to constitute the taxpayer's receipts in respect of gift cards as 'trust money' in the taxpayer's hands until such time as the cards were redeemed or expired, or a refund was made and that followed because the Act required the taxpayer to hold the consideration received for the cards not for itself, but, on a fiduciary basis, for someone else.

The taxpayer contended further that the receipts were not 'received' by the taxpayer within the accepted meaning of that word in the definition of 'gross income' in the Income Tax Act because of the CPA's provision that the taxpayer was not entitled to treat the prepayment as its own property or apply it for its own benefit until the card had been redeemed or expired.

SARS' first line of attack on the taxpayer's stance that its receipt of the proceeds of the 'sale' of gift cards as income in its hands was deferred until the cards were redeemed or expired, whichever occurred later, was to characterise the transactions in terms of which the gift cards were issued as sales. On that argument the taxpayer would be the seller, the customer paying for the gift card would be the purchaser, the *merx* would be the gift card and the price would be the consideration paid for the issuance of the card.

SARS contended that the object of the CPA 'is the protection of consumer rights in the context of goods and or services', and not to defer liability for income tax. The implication was that the CPA's provisions were to be treated discretely from those of the Income Tax Act in a manner that the former could not derogate from the latter.

SARS also contended that, regardless of the effect of the CPA, the facts showed that the taxpayer had become the owner of the moneys received for the gift cards by *commixtio* when the moneys were mixed with its other receipts and a subsequent segregation of the funds to comply with the entrustment provisions of the CPA did not detract from the reality that the monies had, by then, already been 'received' by the taxpayer within the meaning of the Income Tax Act.

Judge Binns-Ward held the following:

<u>As to when the gift card revenue was received by the taxpayer</u>

(i) That, notwithstanding the reference in common parlance to the 'sale' of gift cards, it was clear that the transactions in terms of which the taxpayer's customers acquired them were actually not contracts of sale properly so characterised. A sale in the true sense only took place when the card was presented in partial or complete redemption of the purchase price of goods selected by the customer who was the bearer of the card at the time. The card was nothing more than a piece of paper that vouches for the existence of the bearer's personal right against the taxpayer for the redemption of the prepayment and it was not a thing (*res vendita*) that was the subject of a sale.

(ii) That the words 'received by' in the setting of the definition of 'gross income' in the Income Tax Act have been construed to be limited to amounts received by the taxpayer 'on his own behalf for his own benefit' or 'received by him in such circumstances that he becomes entitled to it' – see *Geldenhuys* v *Commissioner for Inland Revenue* 14 SATC 419.

(iii) That in the lead judgment in *Van der Merwe* v *Sekretaris van Binnelandse Inkomste* 39 SATC 1 Rabie JA referred to the judgments in *Geldenhuys* and *Secretary for Inland Revenue* v *Smant* 35 SATC 1 and remarked that they served to demonstrate that when it fell to be determined whether a taxpayer was liable for tax in respect of one or other amount that he had received, the question whether or not he had personally derived any benefit from it may in certain cases be a relevant consideration. The qualification expressed by Rabie JA served to highlight that the usefulness of the 'benefit' test implied in *Geldenhuys* as a determinant consideration arises when the enquiry in issue is whether the receipt in question formed part of the taxpayer's income or whether it was received not for its benefit, but for that of somebody else, in which case it would not be part of the taxpayer's gross income.

(iv) That, in regard to the taxpayer's first level of argument, it postulates that the moneys are received and, pending the redemption or expiry of the cards, were held under some form of entrustment for the benefit of the cardholders. If the money were indeed received by the taxpayer *qua* trustee, it would not form part of its gross income. It is an argument that was advanced with success in the context of the treatment of prepayments in the English courts in the matter of *Kayford* mentioned earlier, but in that case, which was about whether the unredeemed prepayments remained vested in the supplier company when it was placed into liquidation, the result turned on the court being persuaded that the receipts in respect of prepayments by a mail order business had been sequestered from the company's operational accounts in a manner consistent with the effective creation of a trust in the formal sense of the concept.

(iv) That although there were some differences between our law and that of England and Wales in respect of the establishment of trusts, and as to their character, the court was of the view that the essential determinant of whether there was validity in the taxpayer's first level argument was the same as it was in *Kayford's* case. That is, were the payments received and held in a manner that, in a legally effective way, distinguished the funds segregated in the separate bank account from the taxpayer's property? As with English law, so too with us, merely segregating the funds, as the taxpayer did in the current matter, would not, by itself be enough. A cognisable legal context, such as the establishment of a trust, the terms of a will, or the existence of a principal-agent relationship, is necessary to give the segregation of the funds the effect of putting them outside the holder's estate, avoiding the ordinary incidence of *commixtio*.

(v) That, absent such a context, the court was unable to conceive of how a prepayment to the taxpayer for goods to be sold by it later could differ in its proprietary effect from a contemporaneous payment in the context of a cash sale. The money becomes that of the contemplated or actual seller as soon as it is paid over and it does not matter where it keeps it, or how it accounts for it in its books and it may spend it or save it as it wishes.

(vi) That the court was not persuaded that the mere segregation of the receipts in respect of unredeemed gift cards in a separate banking account identified for that purpose gave rise to a cognisable legal context that would sustain a determination that they had not been received by the taxpayer for itself and its own benefit. The taxpayer might see itself as some sort of trustee but, ignoring for present purposes the possible effect of the CPA, there was no evidence that it had bound itself in a legally effective manner to hold the receipts in a fiduciary capacity and the first level argument advanced on behalf of the taxpayer therefore fell to be rejected.

(vii) That the court then considered the matter of the ownership of the moneys paid over to the taxpayer by its customers when they acquired gift cards from it. That the gift card receipts were intermingled at the till point with the monies received in respect of the sales that the taxpayer made in the ordinary course of its business operation, and that the 'sale' of gift cards was part of its business operation was of course correct and money is a fungible. But those factors are not, without more, in any way determinative of the question whether the taxpayer had received the gift token receipts on its own behalf in the sense of the test stated in *Geldenhuys*.

(viii) That a comparable situation presented itself for consideration in *Holley* v *Commissioner for Inland Revenue* 14 SATC 407 where Davis AJA had concluded that the part of the business income received by the taxpayer that he was obliged to use to pay the annuity was, in the circumstances, received by him as a 'trustee' within the meaning of that term in the then Income Tax Act, and not in his personal capacity and thus did not form part of his gross income, notwithstanding that he had been the owner of the money when it passed through his hands.

(ix) That in the court's judgment, depending on the effect of the CPA, the position with regard to the payments received by the taxpayer for gift cards in the current matter may be analogous to that of the taxpayer in *Holley*, as found by the court in that case. The significance of the *Holley* case in the context of the argument advanced by [counsel for SARS], however, was that assuming that the existence of a *fideicommissum* had been established in that matter, as held by Davis AJA, the fact that the taxpayer had received the money mixed up together with money generated for his own benefit did not constitute an obstacle, when it came to calculating the taxpayer's gross income, to treating that amount of it intended for the testator's widow discretely from the amount of it that the taxpayer was entitled to keep for himself. The initial actual receipt, in the ordinary sense of the word, of all of the money, did not prevent its discriminatory treatment when it came to deciding, for the purposes of calculating his gross income, what the taxpayer had received for his own benefit and what he had received, as 'trustee' within the meaning of the Income Tax Act, for the benefit of somebody else.

As to the application of the Consumer Protection Act 68 of 2008 ('CPA')

(x) That were it not for the effect of the CPA, in regard to which the court would deal with next, the court would, however, have been inclined to uphold SARS' argument that the gift card receipts had been received by the taxpayer in respect of sales of goods to be executed later, and therefore part of its gross income when the payments were taken. That much really followed as a corollary to the court's earlier rejection of what it had labelled as the taxpayer's first level argument and the court was accordingly of the view that the taxpayer was correct to have included its receipts in respect of unredeemed gift cards in its accounting for its gross income in the period before the commencement of the CPA.

(xi) That, however, the court was compelled in the circumstances to consider the effect of the provisions in the CPA that provided that 'any consideration paid by a consumer to a supplier in exchange for a prepaid…card…or similar device…is the property of the bearer of that…card…or similar device to the extent that the supplier has not redeemed it in exchange for goods…' and 'when a supplier has possession of any prepayment…or any other property belonging to…a consumer, the supplier…must not treat that property as being the property of the supplier….' and which impacted on the ordinary consequences of a transaction in which a gift card is issued by a supplier and they certainly suggested that the introduction of the CPA meant that it was no longer business as usual.

(xii) That the taxpayer had submitted compelling arguments stating that the effect of these provisions was to constitute its receipts in respect of gift cards as 'trust money' in its hands until such time as the cards were redeemed or had expired, or a refund was made and that followed because the CPA required the taxpayer to hold the consideration received for the cards not for itself, but, on a fiduciary basis, for someone else. That the receipts were not 'received' by the taxpayer within the accepted meaning of the word in the definition of 'gross income' in the Income Tax Act was confirmed submitted the taxpayer relying on the CPA's provision that the taxpayer was not entitled to treat the prepayment as its own property or apply it for its own benefit until the card had been redeemed or expired.

(xiii) That SARS contended, *inter alia*, that the object of the CPA 'is the protection of consumer rights in the context of goods and or services' and not to defer liability for income tax. The implication was that the CPA's provisions were to be treated discretely from those of the Income Tax Act in a manner that the former could not derogate from the latter and this would necessarily entail applying the Income Tax Act as if the CPA did not exist. SARS also argued that, regardless of the effect of the CPA, the facts showed that the taxpayer had become the owner of the moneys received for the gift cards by *commixtio* when the moneys were mixed with its other receipts and a subsequent segregation of the funds to comply with the entrustment provisions in the CPA did not detract from the reality that the amounts had, by then, already been 'received' by the taxpayer within the meaning of the Income Tax Act.

(xiv) That the court was obliged to give the provisions of the CPA practical effect and construe their language purposively to that end. On that approach the legislature's intention to provide consumer protection by requiring the segregating of the supplier of its receipts from the 'sale' of gift cards from the other revenue generated in its business activities appears reasonably clear. The taxpayer does that in this case by crediting its receipts in respect of unredeemed gift cards monthly to a separate appropriately designated account. When it comes to money, that is the only way in which a supplier could keep the receipts in a manner that would practically achieve the statute's requirement that they be treated as property separate from that of the supplier itself. And how else would a supplier charged with such an obligation discharge it by handling, safeguarding and utilising the property with a degree of care, diligence and skill that can reasonably be expected of a person responsible for managing any property belonging to another person?

(xv) That the effect of the legislation is the creation of some form of statutory trust, even if it might not conform in all respects with the trust forms recognised in our common law. The taxpayer is placed by virtue of the statute's prescripts under a fiduciary duty to the bearer of the card to ensure that the funds are kept available until the prepayment is redeemed. The statutory conjuring of a proprietary interest by the cardholder in the receipts must be seen for what it is: a legal fiction. The evident intention being that the bearers of gift cards should be able to recoup their value in full in the event of the issuer being sequestrated or liquidated before the cards were redeemed.

(xvi) That it was common ground that the receipts from the 'sale' of gift cards remained so intermingled with the taxpayer's own funds until there is a reconciliation and transfer of the unredeemed card receipts to the segregated funds account and this took place monthly. The method of monthly segregation used by the taxpayer necessarily implied that the affected monies were identifiable and traceable in the taxpayer's accounting system from the moment that they were taken in, and there should therefore be no difficulty with their practical identification as 'trust money' from the moment of their receipt in the taxpayer's hands which was how the CPA characterised such moneys irrespective of segregation.

(xvii) That the question in this case was simply this, did the taxpayer's method of dealing with the gift card receipts in apparent compliance with the requirements of the CPA entail that it received them for itself, or for the gift card bearers? The CPA required it to take and hold the receipts for the card bearers, and to refrain from applying them as if they were its own property, and its method of dealing with the receipts was directed to doing just that. The applicable legal framework forbade the taxpayer from receiving the moneys taken in for gift cards for itself until the cards were redeemed. This impelled the answer that the gift card receipts were 'received' by the taxpayer, not for itself, but to be held for the card bearer.

(xviii) That the questions of conflict between the Income Tax Act and the CPA and any hierarchical claim to precedence by the one set of legislation over the other posited by SARS were lacking in any foundation. The Income Tax Act requires the taxpayer to include all the amounts 'received' by it in the assessment period in the calculation of its gross income…The taxpayer is legally permitted in terms of the CPA to take the receipts for itself only when the cards were redeemed, and its business was ordered so as to comply with that statutory constraint. The taxpayer takes beneficial receipt of the revenue from gift card sales only when the funds are transferred from the specially designated 'Gift Voucher' bank account *pari passu* the redemption or expiry of the card. Indeed, it was only when the card was redeemed or expired that the proceeds of its 'sale' accrue to the taxpayer, for it is only then that it legally becomes entitled to them.

(xix) That the object of the CPA was the protection of consumers, and not the deferral of tax liability. But if the manner in which the CPA protected consumers entailed the deferral of beneficial receipt of revenue by suppliers as a matter of fact, then the knock-on effect on the determination of the suppliers' taxable income was only to be expected. Were it otherwise, the necessary implication would be that suppliers fall to be taxed on income they have not yet received, and which has not yet accrued to them. The CPA does not express any such intention and any such effect would be at odds with the scheme of the Income Tax Act. A conflict between the two sets of legislation arises only if it is construed in the manner contended for by SARS and it does not arise on the approach contended for by the taxpayer.

(xx) That the pertinent provisions of the CPA create a legal construct that results in the taxpayer initially taking the gift cards receipts not for itself, but for the card bearers… The effect of the peculiar legal contexts in those cases has never, to my knowledge, been perceived as giving rise to a conflict with the Income Tax Act; and there is no reason to distinguish the effect merely because the pertinent legal context for the receipt of the monies by the taxpayer not for itself, but for someone else, is afforded in the current matter by statutory provisions, rather than testamentary or contractual ones.

(xxi) That, accordingly, for all the reasons set out above, there was no merit in SARS' argument and that the taxpayer's second level argument, *ie* that the provisions of sections 63 and 65 of the CPA, coupled with its treatment of the receipts in conformity with the statute, characterised the receipts as amounts received on behalf of or for the benefit of the cardholder and not as beneficial receipts of the taxpayer, was to be upheld.

Appeal upheld.

The additional assessment, dated 22 May 2017, in respect of the taxpayer's taxable income for the 2013 tax year was set aside.

6.9. Lifman and others v C:SARS

The Western Cape Division of the High Court heard an application to stay the execution process against SARS' VAT and tax assessments in a court battle between the First Applicant, businessman Mark Lifman and the First Respondent, being SARS, in order to prevent the revenue authority from carrying out warrants of execution against his assets in order to recover R352 million in outstanding taxes.

SARS, in October 2015, had issued income tax and VAT assessments against the applicants as well as letters of assessment explaining the basis and stating the grounds upon which the assessments had been raised.

The applicants did not initiate any of the dispute resolution procedures provided for in the Tax Administration Act and therefore the assessments raised pursuant to the submitted returns and those raised pursuant to a section 50 enquiry under Part C, Chapter 5 of the Act became final and conclusive.

The section 50 enquiry had been launched against the applicants by SARS.

The First Applicant had held an interest in each of the entities that made up the second to thirty-sixth applicants.

A court order had authorised the enquiry to investigate suspected non-compliance and/or offences committed by the applicants in the assessment periods described in the order and the offences related to contraventions of the Tax Administration Act.

SARS, on 1 April 2015, had obtained civil judgments and warrants of execution against the moveable property of the affected applicants and on 2 April 2015 SARS executed on the warrants.

The applicants, on 7 April 2015, had launched an urgent application in which they sought the setting aside of the civil judgments, alternatively their suspension and interdicting SARS from proceeding with the execution process embarked upon.

On 17 June 2015, Mantame J dismissed the application and SARS proceeded with the execution process by arranging sales in execution.

On 19 June 2015 the affected applicants served a notice of application for leave to appeal the dismissal and the applicants failed to prosecute the appeal. SARS intervened and the application for leave to appeal was set down for 9 November 2015 but the applicants withdrew the application for leave to appeal two days before the hearing.

SARS resumed execution steps which led to the second urgent application in which the applicants sought to stay the execution process pending an application for leave to appeal the judgment handed down in the first urgent application and in November 2015 that application was dismissed with a punitive costs order.

In the current application the applicants alleged that exceptional circumstances existed in that SARS had undertaken to conduct an internal review and reconsider the assessments referred to above.

It was common cause that the applicants did not avail themselves of any of the procedures provided for in the Tax Administration Act to dispute the assessments raised and hence the assessments were final.

The First Applicant alleged that he had 'on more than one occasion complained that SARS officials are acting in an untoward and subjective manner.'

Pursuant to the First Applicant's allegations of unfair treatment during the investigation, one Gavin Cairns, a specialist forensic auditor at SARS, was 'tasked to attend to the review of the audit'.

In correspondence Cairns said the following about the review:

> 'Please note (and as clarified) the purpose of the review is to compile an internal report. Therefore, it is unlikely that the details of our review findings will be communicated to yourself. However, SARS will communicate its decision to revise, or not, the current assessment for each taxpayer within the group structure.'

However, on 12 February 2018, Ms Makola, chief officer SARS enforcement, communicated the following decision in respect of the Cairns review:

> 'SARS has considered its position. The notion of an internal 'review' of an assessment with the express purpose of revising such assessments, is neither contemplated nor countenanced in terms of the provisions of the Tax Administration Act. Accordingly, there exists no statutory basis for it. A 'review' of this nature is neither a power conferred on SARS nor a right to which a taxpayer is entitled in terms of the provisions of the Tax Administration Act. Accordingly, the 'decision' communicated by Mr Cairns to Mr Lifman was erroneous, was based on an error of law and was consequently a nullity.'

She then continued:

> 'In my capacity as a senior SARS official, have accordingly decided, in terms of the provisions of section 9(1)(*b*) of the Tax Administration Act, to withdraw, to the extent necessary, the decision to conduct such 'review.' Accordingly, the assessment raised against the First Applicant and the companies are final and conclusive.'

Section 106 of the Tax Administration Act 28 of 2011provided at the relevant time –

'106. *Decision on objection*.– (1) SARS must consider a valid objection in the manner and within the period prescribed under this Act and the 'rules'.

(2) SARS may disallow the objection or allow it either in whole or in part.

(3) If the objection is allowed either in whole or in part, the assessment or 'decision' must be altered accordingly.'

Section 92 of the Tax Administration Act provided at the relevant time –

'92. *Additional assessment.*– If at any time SARS is satisfied that an assessment does not reflect the correct application of a tax Act to the prejudice of SARS or the *fiscus*, SARS must make an additional assessment to correct the prejudice.'

Section 93 of the Tax Administration Act provided, *inter alia*, at the relevant time –

'93. *Reduced assessments*.– (1) SARS may make a reduced assessment if –

(*a*) the taxpayer successfully disputed the assessment under Chapter 9;

(*b*) . . . . . .

(*c*) . . . . . .

(*d*) SARS is satisfied that there is a readily apparent undisputed error in the assessment by –

(i) SARS; or

(ii) the taxpayer in a return; or

(*e*) a senior SARS official is satisfied that an assessment was based on –

(i) . . . . . .

(ii) a processing error by SARS;'

Judge Baartman held the following:

(i) That the First Applicant had complained about the treatment the applicants had received at the hands of SARS officials. The applicants cannot elevate a complaint about 'treatment received' to a ground of review and it followed that the relief sought has become moot.

(ii) That even if the court was wrong, the Tax Administration Act made no provision for the reconsideration of an assessment contended for in this application. The applicants have not indicated where they laid the complaint that would have initiated the complaint mechanism provided for in the Tax Administration Act. Each assessment was preceded by letters of finding issued to the relevant applicant in 2015–16, indicating the tax debt that SARS intended to raise and the facts relied upon for its conclusion. The amounts totalling R352 235 074.28 were such that one would have expected the applicants to have availed themselves of any opportunity to dispute the proposed assessments.

(iii) That the applicants did not lodge any objection to initiate any of the mechanisms referred to in the Tax Administration Act, *eg* disputed the assessments through the mechanisms in Chapter 9 of the Tax Administration Act or used the objection and appeal process provided for in section 104(1) and (2) of the Tax Administration Act. Instead, it seemed that the initial dissatisfaction was about treatment received which the applicants have belatedly and opportunistically sought to raise an objection against the assessments. That is not permissible; it followed that on this ground, the application must also fail. The assessments are undisputed, final, due and payable.

(iv) That even if the court was wrong, SARS cannot exercise any power other than that conferred upon it by law. The applicants had relied on sections 93(1)(*d*) and 92 of the Tax Administration Act for the submission that SARS may reduce an assessment even in the absence of an objection or an appeal as provided for in the Tax Administration Act.

(iv) That section 92 did not assist the applicants, but, instead, it protected the *fiscus*. SARS was not prejudiced by the assessment and, quite the opposite, it was apparent from the amount due and payable. Similarly, section 93 (Reduced assessments) did not find application in the circumstances of this matter. The court was of the view that the circumstances of this matter did not justify invoking the provisions of sections 92 or 93.

(v) That the applicants finally contended that there were exceptional circumstances present in this matter which justified a stay of the execution process and to which the court concluded that SARS is a special body with extensive powers and can legitimately intrude on the rights of taxpayers. However, the power SARS exercised is circumscribed and the applicants have been unable to indicate any flouting or abuse of those powers. The applicants have had ample opportunity to engage the dispute or appeal mechanisms available and have chosen not to. In the exercise of the court's wide discretion, it had considered the particular facts of this matter and was persuaded that the applicants did not establish grounds of justice and fairness to stay the execution proceedings and there was no indication that an injustice will result from a failure to suspend the execution.

(vi) That it followed that there were no exceptional circumstances to justify a stay of the execution proceedings.

Application dismissed with costs incurred after 12 February 2018.

6.10. C:SARS v Amawele Joint Venture CC

Amawele was a contracting firm with a single client, the KwaZulu-Natal Provincial Department of Human Settlements.

Amawele, during the period from July 2008 to September 2010 undertook three projects for the Department and two of these, known as the Umsunduzi Project and the Mooi River Project, involved the 'revitalisation and rectification' of housing projects undertaken between 1994 and 2002, where the workmanship was inadequate, the houses defective and extensive remedial work, including in some instances demolition and reconstruction, was necessary.

The third project, known as the Emnambithi Project, involved the rehabilitation and repair of 610 houses damaged by a storm in the Emnambithi (Ladysmith) municipal area in December 2008.

The issue for determination by the court was whether Amawele was liable to charge, collect and pay VAT to SARS at the then standard rate of 14%, on the amounts that it was paid for this work.

Amawele contended that it was not so liable for the reason that the services that it was supplying were zero rated in terms of the provisions of section 11(2)(s) read with section 8(23) of the Value-Added Tax Act (the VAT Act) and it sought a refund of amounts that it claimed it had paid in error by way of VAT.

SARS in response to Amawele's claim, had conducted an audit and had issued an additional assessment in an amount of some R38 million.

Amawele had appealed to the Tax Court against this additional assessment where its contentions were upheld and the Tax Court set aside the additional assessment and ordered SARS to refund R38 162 303.07 to Amawele.

SARS' subsequent appeal to the Full Court of the Gauteng Division of the High Court, Pretoria, was also dismissed and a cross-appeal in respect of the payment of interest on the refund was upheld.

SARS then appealed to the Supreme Court of Appeal with the special leave of the Supreme Court of Appeal.

The sole issue for decision was whether Amawele was correct in contending that the services it supplied under the contracts referred to earlier were zero rated.

The provisions of the VAT Act on which Amawele had relied in claiming that its services were zero rated was section 11(2)(s), read with section 8(23).

Section 11(2)(s) provided that services deemed to be supplied to a public authority under section 8(23) of the VAT Act would be zero rated.

Section 8(23) provided:

> 'For the purposes of this Act a vendor shall be deemed to supply services to any public authority or local authority to the extent of any payment in terms of the Housing Subsidy Scheme referred to in section 3(5)(a) of the Housing Act, 1997 (Act No 107 of 1997), made to or on behalf of the vendor in respect of the taxable supply of goods and services by the vendor.'

The Housing Subsidy Scheme was not identified either in the VAT Act or the Housing Act 107 of 1997 (the Housing Act) in that it referred to the Scheme but did not define or circumscribe that description in any way.

Judge Wallis held the following:

(i) That prior to 2003 there was no provision of the VAT Act providing for services rendered in terms of any national housing programmes to be zero rated. The provisions of the VAT Act on which Amawele relied in claiming that its services were zero rated was section 11(2)(s) read with section 8(23) which were initially enacted in 2003 but not put into operation until 2006.

(ii) That because the VAT Act did not identify the scheme it referred to as the Housing Subsidy Scheme and nor did section 3(5)(a) of the Housing Act 107 of 1997, it became a matter of identifying something or someone referred to in these provisions, in this case the Housing Subsidy Scheme and the authorities show that the court is entitled to look to evidence extrinsic to the document itself in order to identify that to which it refers.

(iii) That in March 1994 a scheme, called the Housing Subsidy Scheme, was instituted as the primary housing assistance measure to consolidate all existing government subsidy schemes, other than instances where commitments had already been made. By 1995 it consisted of five component schemes, namely, an individual subsidy, a consolidation subsidy, an institutional subsidy, a project linked subsidy and relocation assistance.

(iv) That the Housing Act required the responsible Minister to publish a National Housing Code (the Code) containing national housing policy and this was done in 2000. Under the general heading of National Housing Programmes, it identified general rules for the Housing Subsidy Scheme and then, in separate chapters, it dealt with seven different subsidiary schemes which it described as forming part of the Housing Subsidy Scheme and these were the original five component schemes and two further component schemes, namely, rural subsidy and Peoples' Housing Process. All of the component schemes of the Housing Subsidy Scheme were based on the entitlement of individuals to receive a housing subsidy in terms of these criteria, albeit that in certain instances they would not receive the subsidy in cash.

(v) That when the Code was revised in 2009, it ceased to use the expression Housing Subsidy Scheme, but listed a number of separate national housing programmes which were all said to fall under the Housing Subsidy Scheme.

(vi) That none of the services rendered by Amawele in terms of the Umsunduzi Project, the Mooi River Project and the Emnambithi Project fell within any of the seven components of the Housing Subsidy Scheme identified above. All three were undertaken in terms of two new national housing programmes. The first of these in point of time was the Emergency Assistance Programme (EAP) formulated in April 2004 and inserted as Chapter 12 of the Housing Code. It was the scheme relevant to the Emnambithi Project and the second new national housing programme was the RRP, being the rectification and revitalisation programme (RRP) on the basis of which the other two projects were funded.

(vii) That the EAP provided assistance in emergency housing circumstances and the assistance provided under the EAP fell short of formal housing as provided in 'other Programmes of the Housing Subsidy Scheme' and the RRP was instituted because many low cost houses erected pursuant to the RDP policy after 1994 were poorly built and structurally unsound.

(viii) That the legislative history traversed revealed that, when the VAT Act was first amended in 2003 to provide for zero rating of the deemed provision of services to public authorities and municipalities funded by the Housing Subsidy Scheme, it did not apply to the EAP and the RRP for the simple reason that they were not in existence at the time.

(ix) That in order for payments to vendors in respect of projects falling under either the EAP or the RRP to enjoy the zero rating on payments to them, it needed to be demonstrated that after their creation something occurred to bring them within the scope of the Housing Subsidy Scheme and a failure to show that would be fatal to Amawele's contentions.

(ix) That in determining whether either the EAP or the RRP was introduced on a basis that brought them within the Housing Subsidy Scheme as identified in section 8(23), there were a number of obstacles to that conclusion in the case of both the EAP and RRP. Moreover, in both cases there was no indication of an intention that the EAP or RRP be incorporated in the Housing Subsidy Scheme and payments made to or on behalf of vendors thereunder be zero rated. Such a significant extension of the right to zero rate supplies would have required input from National Treasury and could not have been done inadvertently or without discussion and careful consideration. At the very least it would be expected that the Department of Human Settlements would have sought clarification and consent from Treasury before embarking on such a course. There is no evidence in the documents in the record of that occurring, and the court's own researches have not disclosed any material suggesting an intention to incorporate the EAP or RRP into the Housing Subsidy Scheme.

(x) That in regard to the RRP it was clear from the correspondence in regard to Amawele's claim for a refund that SARS had adopted a consistent stance that the RRP did not form part of the Housing Subsidy Scheme. The endeavour to invoke the subsequent amendment of section 8(23) to support Amawele's contentions also did not stand up to scrutiny. The issue of zero rating was determined by the Minister of Finance after consulting the Minister of Human Settlements and resulted in it being stated expressly that it did not cover payments made for the rehabilitation of existing housing stock.

(xi) That, for the reasons given, it was the court's view that Amawele's case had foundered at the first hurdle. All the evidence showed that the Housing Subsidy Scheme referred to in section 8(23) of the VAT Act, from 2003 until 2010, covering the entire period with which the court was concerned, was the Scheme that had existed since 1994 as incorporated in the Housing

Code in 2000 with two additional components. Neither the EAP nor the RRP formed part of the Housing Subsidy Scheme as so identified and there was no evidence to show that either of them had, after their creation, been incorporated in some way into the Housing Subsidy Scheme.

(xii) That in the circumstances the provision of zero rating of supplies under the Housing Subsidy Scheme was not applicable to the EAP and the RRP.

(xiii) That the services rendered in respect of the three projects in issue in this case were rendered directly to the Department of Housing, KwaZulu-Natal and had attracted an obligation to charge, collect and account for VAT at the standard rate under section 7 of the VAT Act.

Appeal upheld with costs.

6.11. ITC 1919 – Deduction, Contribution to share incentive scheme

The taxpayer was one of the S group of companies and it was the group's chief operating arm and was a wholly owned subsidiary of the group's holding company ('HoldCo').

During 2004 it was resolved that the taxpayer would adopt and implement a share incentive scheme for its key management personnel.

It was common cause that:

(*a*) the selected employees were all key managerial staff of the taxpayer;

(*b*) the purpose of the scheme was to incentivise these employees;

(*c*) the contribution of R48 million paid by the taxpayer was for purposes of the scheme;

(*d*) the employees indeed benefited from the scheme;

(*e*) the contribution was not expenditure of a capital nature; and

(*f*) the scheme was legitimate and the transactions comprising it were neither simulated nor a sham.

On 30 November 2004 HoldCo established a discretionary trust and HoldCo was its sole beneficiary until 13 December 2010. The trust acquired a shelf company ('Newco') and the employees were offered ordinary shares in NewCo ('the NewCo shares') at par value in proportions determined by HoldCo.

The employees duly paid cash for these shares, and acquired them, when they were issued on 15 December 2004.

It was a term of the NewCo shares acquisition that the employees could not deal freely with them prior to the expiration of at least seven years from date of acquisition (i.e. at the earliest, 15 December 2011). Those employees who left the taxpayer during this period in fact forfeited their shares which were then re-allocated to other eligible employees.

On 7 December 2004 the trust and the taxpayer concluded a contribution agreement whereby it contributed R48 million to the trust and it was this contribution which was the Commissioner's focus in the subsequent dispute.

It was, *inter alia*, provided for in the contribution agreement that the taxpayer wished to maintain a happy and contented managerial team and, in particular, to incentivise and retain its senior managerial and executive staff who make a key contribution to the business of the Group.

The taxpayer accordingly wished to appoint the trust to provide a valuable incentive to the Eligible Participants in the form of an indirect interest in the listed shares of HoldCo by implementing the NewCo Scheme in accordance with the Rules.

On 20 December 2004, once NewCo's share capital was altered to create 1000 preference shares, the trust subscribed for them by utilising the contribution of R48 million paid to it by the taxpayer. NewCo thereafter applied the funding received from the preference share issue to purchase 8 274 043 HoldCo shares at the prevailing market price at that time.

The preference shares issued to the trust were only redeemable after five years and carried an accumulated annual market-related coupon rate to 75% of the South African prime rate.

NewCo paid no dividends during the 5-year period. The result was that the taxpayer's employees, as shareholders of NewCo, became entitled to the incremental value of their shares by virtue of NewCo's investment in HoldCo.

Upon expiry of the 5-year period the HoldCo shares had appreciated in value such that the investment (and hence the value of NewCo) significantly exceeded the preference share liability. A resolution was passed by the board of directors of NewCo on 18 December 2009 that the 1 000 preference shares be redeemed for a total consideration of R48 471 714.

It was also resolved that dividends accruing on the preference shares from date of issue (18 December 2004) to date of redemption, amounting to R22 562 254, be paid to the Trust. In terms of the same resolution a dividend of R28 627 000 was declared by NewCo.

Having discharged its preference share redemption obligation to the trust in this manner, and given that the employees concerned were now the only shareholders, NewCo was at liberty to deal freely with its remaining 1 585 345 HoldCo shares and it disposed of these shares for approximately R16.8 million cash in December 2009. The dividend declared by NewCo of some R28.627 million was paid to the employees as participants in the scheme in accordance with the resolution.

On 13 December 2010, after early termination of the scheme, its participants were included as beneficiaries of the trust and given the manner in which the scheme was structured and implemented, the taxpayer's contribution of R48 million was not repaid to it by the trust.

It was not challenged that the taxpayer's objective was to incur the expense of the contribution and that taxpayer was never repaid that contribution.

After termination of the scheme NewCo was deregistered on 10 December 2012.

The taxpayer had claimed the contribution of R48 million as a deduction against its taxable income in terms of section 11(*a*) of the Income Tax Act and the deduction was spread over the period of the anticipated benefit to be derived (7 tax years from 2005 to 2012) in terms of section 23H of the Income Tax Act (‘the deductions’).

SARS had initially allowed the deductions claimed but had subsequently, by way of additional assessments raised in 2014 and 2015, had disallowed them on the basis that ‘…the expenditure was not incurred in the production of [the taxpayer’s] income in that there is no direct, causal link between the contribution and the production of income.’

However, during the proceedings it was accepted by SARS that this was not the test, which was rather that there must be a sufficiently close connection between the expense and the income in order for the expense to qualify as a deduction for purposes of section 11(*a*).

SARS' essential premise was that the taxpayer had made the contribution to the Trust of which HoldCo was the sole beneficiary and HoldCo was the only party to have benefited directly from the contribution made by the taxpayer to the Trust and hence its employees were not the beneficiaries of the contribution.

Although SARS itself had alleged that the contribution was paid by the taxpayer as part of its policy to incentivise its key managerial staff ‘so as to enable the Trust to subscribe for preference shares in NewCo’ it was contended that, if the taxpayer’s sole purpose had been to incentivise the participants, then they should have been the beneficiaries of the contribution itself.

SARS had only relied on section 11(*a*) of the Income Tax Act in disallowing the deductions and it thus placed no reliance on the ‘negative test’ contained in section 23(*g*) of the Act and, accordingly, the taxpayer was not obliged to show that the contribution had been laid out or expended for the purposes of its trade and hence SARS had accepted, by necessary implication, that it was.

The evidence in the Tax Court revealed that the taxpayer had accepted that the employees did not benefit directly from the R48 million paid to the trust, but it emphasised that this had never been the purpose of the scheme. The contribution was a funding mechanism only and in paying the contribution it was the taxpayer’s purpose, as chief operating arm of the S group, to incentivise its key management personnel by enabling them to participate indirectly in the growth of HoldCo's shares.

It was also the taxpayer's view that the contribution enabled it to retain dedicated employees, with an incentive to maintain their allegiance to their employer, and from which they ultimately benefited from the dividends paid to them *via* the share scheme mechanism.

The issue to be determined by the court was whether, as the taxpayer contended, there was a sufficiently close connection between the contribution of R48 million ('the expense') paid by it to a certain trust in respect of its own employee management share incentive scheme ('the scheme') and its production of income during the 2005 to 2012 years of assessment ('the income') for purposes of section 11(*a*) of the Income Tax Act.

Judge Cloete held the following:

(i) That section 11(*a*) of the Income Tax Act provided *inter alia* that in the determination of taxable income, a taxpayer is entitled to the deduction of expenditure (save for capital expenditure) actually incurred in the production of income from any trade.

(ii) That what was thus required was an assessment of the closeness of the connection between the expense and the income. Where there is a clear and close causal connection, the assessment should be relatively simple. What was important for present purposes was that the causal connection was not necessarily established by reference only to the incurring of the expense and the initial use to which it was put. It is the purpose of the expenditure – from the taxpayer's perspective – that must be considered, together with what that expenditure actually effects, *i.e.* causes to happen or brings about.

(iii) That in *CIR* v *Genn & Co* (*Pty*) *Ltd* 20 SATC 113 the court held that 'it would be proper, natural or reasonable to regard the expenses as part of the cost of performing the operation…Whether the closeness of the connection would properly, naturally or reasonably lead to such treatment of the expenses must remain dependent on the court's view of the circumstances of the case before it.'

(iv) That, also relevant in the context of the present matter, was that it was not necessary for the taxpayer to show that the particular item of expenditure produced any part of the income for the given year of assessment but what the court was concerned with was whether that item of expenditure was incurred for the purpose of earning income.

(iv) That provided that the taxpayer can show that the purpose of the expense was to produce income, any incidental benefit to a third party or the realisation of other possibilities does not serve to preclude the legitimate deduction of the expense.

(v) That in the present matter it was not SARS' case that the purpose of the contribution paid by the taxpayer was to further the interests of the S group. On the contrary, there was no suggestion of this in the rule 31 statement, where it was clearly alleged that the taxpayer paid the contribution to incentivise and compensate key members of its own staff. Accordingly, the principle established in *Solaglass*, confirmed in *Warner Lambert*, and relied upon by SARS during argument, did not assist it.

(vi) That it was trite that a taxpayer may organise its financial affairs in such a way as to pay the least tax permissible, provided that the transaction did not disguise its true purpose of tax evasion or the law. In the present matter SARS has not contended that any of the transactions comprising the scheme were simulated or a sham, or that the parties did not intend that each transaction would have effect according to its tenor.

(vii) That, on the evidence, the dominant purpose in the establishment and implementation of the scheme was to protect and enhance the business of the taxpayer and its income, by motivating its key staff to be efficient and productive and remain in the taxpayer's employ. The fact that the incentive offered to, and in fact received by, the employees was the financial benefit that would flow from the success of the taxpayer's business and the growth in the value of the shares in HoldCo, cannot detract from a finding that the expenditure was incurred by the taxpayer for the purpose of earning income.

(ix) That, put somewhat differently, the purpose of the expenditure was to incentivise the taxpayer's key staff through a scheme which facilitated the acquisition of an indirect investment in the shares of HoldCo for scheme participants.

(x) That the contribution paid actually effected this purpose, by providing the necessary funds to the trust (which lacked significant capital prior to payment of the contribution) to capitalise NewCo. In terms of the Trust Deed and the Contribution Agreement, the contribution could not be utilised for any purpose other than the Trust's preference share subscription in NewCo, which was in turn applied to purchase shares in HoldCo. The preference share funding was similarly limited in terms of the Preference Share Subscription Agreement, and could only be used for purposes of acquiring shares in HoldCo, in alignment with the intention of the taxpayer for the scheme to facilitate indirect investment for participants in HoldCo.

(xi) That the mere fact that the taxpayer foresaw that HoldCo would potentially also benefit from the redemption of the NewCo preference shares could not negate the taxpayer's purpose and intention, which was actually effected by the scheme insofar as the value of the NewCo shares increased significantly, and this benefit, together with the dividends declared by NewCo on the remaining HoldCo shares following the preference share redemption, actually accrued to the scheme participants. The increase in the value of the HoldCo shares was directly attributable to the increase in the turnover and profits of the taxpayer, being the main operating subsidiary of HoldCo.

(xii) That it was common cause that 26 key staff were participants in the scheme and that only three left the taxpayer's employ during the period of the scheme. It was thus not unreasonable to infer that the employees were indeed incentivised.

(xiii) That, in the circumstances, the taxpayer had established the existence of a sufficiently close causal link between its expenditure of the contribution and its income producing operation and the other members of the court were in agreement with this conclusion.

Appeal upheld.

The additional assessments raised by the Commissioner for the taxpayer’s 2005 to 2012 years of assessment were set aside.

No order was made as to costs.

6.12. ITC 1920 – Public Benefit Organisation

The taxpayer operated as a private sector, non-profit company that rented out remodelled or developed units in buildings for residential accommodation to *inter alia* low and medium income households.

The taxpayer’s main objects are set out in its Memorandum of Incorporation where the relevant object is contained in Clause 3.1.1 and provides for ‘the development, holding, letting or other disposal of affordable residential accommodation to and for the benefit of low to medium households.’

The taxpayer had been approved in terms of the Social Housing Act 16 of 2008 as a ‘social housing institution’ and approval to qualify as a social housing institution followed a process and it was required from such institution to operate within the parameters set out in the Regulations of the Social Housing Act.

The Social Housing Regulations published on 26 January 2012, *inter alia*, enumerated the qualifying criteria for accreditation of social housing institutions to be granted by the Social Housing Regulator Authority (‘the SHRA’) and it was common cause that the The taxpayer had achieved ‘full accreditation’ status from the SHRA and had been accredited every year since the SHRA had been established in 2012.

The Social Housing Act provided that in order for a social housing institution to comply with the criteria of good governance, the social housing institution must have a business strategy with the object of supporting its main object of providing social housing. Its strategic plan must include a purpose which links to the broader policy; strategic goals that link to the performance indications; an annual or business operation plan; a budget; and provision for an annual review.

In its preamble the Social Housing Act recognised that there was a dire need for affordable rental housing for low to medium income households which could not access rental housing in the open market and there was a need for social housing to be regulated.

Regulation 3(5)(*a*) provided that in order to comply with the criteria of good governance, social housing institutions' main object must be the provision of rental or co-operative housing options for the low to medium income households and section 1 of the Social Housing Act defined low to medium income households as 'those households falling within the income categories as determined by the Minister from time to time' but the Minister had not published any determination to date.

Furthermore, social housing institutions benefit from public funds paid over in the form of capital grants, thereby subsidizing development costs and reducing the debt to be recouped through rental. In turn, social housing institutions must maintain rental rates at levels that are affordable to low and medium income households.

The taxpayer had applied for approval as a Public Benefit Organisation (PBO) in terms of section 30(3) of the Income Tax Act in 2013.

SARS had rejected the application on 30 March 2015 and the taxpayer had then objected to SARS' decision and who subsequently disallowed the taxpayer's objection.

The taxpayer then appealed SARS' decision to the Johannesburg Tax Court and sought an order setting aside SARS' rejection of the taxpayer's PBO application and for the taxpayer to be recognised as a PBO with effect from the June 2013 year of assessment.

The crisp issue for determination by the court was whether the taxpayer was entitled to be approved as a 'public benefit organisation' (PBO) in terms of section 30(3) of the Income Tax Act58 of 1962, and whether it consequently qualified for a tax exemption under section 10(1)(*c*N)(ii) of the said Act.

In terms of section 30(1) of the Act a company qualifies as a PBO if:

(*a*) it is a non-profit company as defined in the Companies Act 71 of 2008;

(*b*) its 'sole or principal object' is to carry on 'one or more public benefit activity', as defined in Part 1 of the Ninth Schedule to the Income Tax Act or by the Minister of Finance by notice;

(*c*) it conducts its activities in a non-profit manner or with an altruistic and philanthropic intent, and where such activity is not intended to promote, directly or indirectly, the economic self-interest of any employee or fiduciary of that company.

Part 1 of the Ninth Schedule to the Act sets out a list of approved public benefit activities including 'Land and Housing' and in par. 3(*a*) 'one or more public benefit activity' includes the following:

> 'The development, construction, upgrading, conversion or procurement of housing units for the benefit of persons whose monthly household income is equal to or less than R15 000 or any greater amount determined by the Minister of Finance by notice in the *Gazette* after consultation with the Minister of Housing.'

The Minister of Finance has not since determined an amount greater than R15 000.

In 2012 par. 3(*a*) was amended to make provision for the limitation of R15 000 and was deemed to have come into effect on 1 March 2012.

In other words, in order to qualify as a PBO, the taxpayer's sole or principal object must be the development, construction, upgrading, conversion or procurement of housing units for the benefit of persons whose monthly household income is equal to or less than R15 000.

The central issue in dispute is whether it could be said that the sole or principal object of the taxpayer was to carry on the public benefit activity as listed in par. 3(*a*) above, namely, the development, construction, upgrading, conversion or procurement of housing units for the benefit of persons whose monthly household income is equal to or less than R15 000.

The taxpayer's main contention was that par. 3(*a*) encapsulates the principal object of any accredited social housing institution that complies with the requirements of the Social Housing Act and the Housing Code and that social housing institutions that fulfil the requirements of the Social Housing Act and which are accredited therefore automatically qualify for PBO status.

SARS, however, contended that although the requirements of the Social Housing Act and of par. 3(*a*) may overlap, they are not the same. In consequence, not all social housing institutions will qualify for PBO status.

Moreover, although the taxpayer in fact provides substantial housing within the meaning of par. 3(*a*), that is not always the case and was not required by the taxpayer's Memorandum of Incorporation.

SARS further contended that the phrase 'low to medium income households' in the taxpayer's principal object did not have the same meaning as, and did not fall wholly within the meaning of, the public benefit activity described in par. 3(*a*).

Judge WIndell held the following:

<u>As to whether the taxpayer automatically qualified for PBO status</u>

(i) That the taxpayer contended that par. 3(*a*) recognised that social housing institutions that fulfil their statutory obligations perform a public benefit activity within its terms but it was, however, not for SARS to determine whether a social housing institution fulfilled this function. That assessment fell to the SHRA which was an expert body expressly empowered to regulate and accredit social housing institutions and once the SHRA had accredited a social housing institution, SARS was not entitled to disregard this decision and was obliged to register the social housing institution as a PBO.

(ii) That in terms of section 30 of the Income Tax Act58 of 1962 SARS is empowered and in duty obliged to decide the approval of an applicant as a PBO. If the taxpayer is correct in contending that its accreditation automatically qualified it as a PBO, it would confer on SRHA the power to decide whether an entity is a PBO when it accredits the institution under the Social Housing Act. It surely cannot be the intention to confer the power pursuant to tax legislation upon a body established under the housing legislation. The consequence would be, as correctly argued by SARS, to deprive SARS of its statutory power and duty under the Income Tax Act, and to confer that power on the SHRA – and then notably, only by inference. The court concluded that there was no basis for such an interpretation.

(iii) That the Income Tax Act under par. 3(*a*) confers on the Minister of Finance the power to determine the ambit of PBO status. In discharging the duty, the Minister of Finance must act 'after consultation' with the Minister of Human Settlements, but the decision remains his decision. Consultation with the Minister of Human Settlements, and the need to consider his views expressed are required, but the decision-making power is held by the Minister of Finance. If the taxpayer's approach was correct, the Minister of Human Settlements would be entitled to determine the entitlement to tax exemption status under par. 3(*a*), in determining the meaning of 'low to medium income households' under the Social Housing Act, and by deciding which institutions will be accredited as social housing institutions. The Minister of Human Settlements does not have the power, by making regulations dealing with the qualification of social housing institutions, to decide on behalf of the Minister of Finance which organisations qualify for PBO status under the Income Tax Act.

(iv) That the main purpose of accreditation of social housing institutions under the Social Housing Act was to determine which housing organisations qualified to claim social housing subsidies. The purpose of tax exemption is fundamentally different, which is, to relieve the taxpayer of the obligation to pay income and other taxes to the *fiscus*. SARS submitted that there was nothing inherently contradictory in an organisation receiving certain benefits from the State, albeit being required to pay income tax on its profits.

(iv) That the taxpayer had relied on policy statements in terms of which social housing institutions ought to be able to claim tax benefits. That undoubtedly is correct: accredited social housing institutions are entitled to claim tax exemption having been approved as a PBO as long as they bring themselves within the ambit of par. 3(*a*). The taxpayer contended that the fact that it is accredited as a social housing institution meant that its beneficiaries met the income qualifications of the regulations under the Social Housing Act; and that those qualifications 'dovetail' with the threshold in par. 3(*a*).

(v) That there was no basis for reading 'accredited social housing institution' into the definition of a PBO or public benefit activity. An accredited social housing institution that complies with the Social Housing Act and its Regulations does not automatically qualify for PBO status.

<u>As to whether the taxpayer qualified as a PBO</u>

(vi) That section 30(1) of the Income Tax Act58 of 1962 provided that a company qualified as a PBO if its sole or principal object is to carry on one or more public benefit activity as defined in par. 3(*a*).

(vii) That in order for the taxpayer to succeed, it must prove that its 'sole or principal object' in terms of its Memorandum of Incorporation was to carry on one or more public benefit activities and that sole or principal object must fit the definition of 'public benefit activity' and it in fact carries on principally a public benefit activity.

(viii) That SARS correctly contended that if the taxpayer's sole or principal object does not fall within the exemption, the non-compliance with the first requirement brings the matter to an end and it is only in the event of compliance with the first requirement that its actual activities must be reviewed in order to establish entitlement.

(ix) That the question requiring determination was whether the meaning of 'low and medium income households' in clause 3.1.1 was the same as the meaning 'for the benefit of persons whose monthly income is equal to or less than R15 000' as provided for in par. 3(*a*), and/or does the taxpayer's principal object fall wholly within the meaning of the public benefit activity described in par. 3(*a*)?

(x) That a plain reading of the phrase 'low to medium income households' bears a meaning clearly distinguishable from 'R15 000 or any greater amount determined by the Minister of Finance.' The two concepts are fundamentally different. A 'low to medium income household' is a household which has an income of a kind which is determined by reference to other incomes. Its meaning calls for the exercise of judgment in assessing the factual question and it does not involve the exercise of any discretion. The question whether a household's income is 'R15 000 or any greater amount determined by the Minister of Finance' falls in a completely different realm. It does not call for the exercise of judgment, because it refers to a specific amount and the amount is fixed until the Minister decides to change it. In determining the par. 3(*a*) amount, the Minister is not bound to embark upon a process of attempting to approximate the income of a 'low to medium income' household: his discretion is unfettered.

(xi) That the court was in agreement that the explanations which the taxpayer gave as to how it arrived at its figures provided no basis at all for the determination of the meaning of 'low to medium income.' The phrase 'low to medium income households' is inherently imprecise and that is why the phrase 'low and medium income' in Appellant's Memorandum of Incorporation cannot be equated with the fixed amount determined under the Income Tax Act. The two qualifications are fundamentally different in their nature: one is an amount of Rand per month, and the other is an imprecise and changing classification of sectors of the population.

(xii) That, in regard to the taxpayer's practice, it was clear from the evidence that the phrase 'low to medium income households' in clause 3.1.1 of the Memorandum of Incorporation did not require the taxpayer to follow the amount determined by the Minister of Finance in respect of the par. 3(*a*) public benefit activity. And this is precisely the issue: the phrase 'low to medium income households' does not have the same meaning as the household income determined under the Income Tax Act. It permits a main activity which falls outside the public benefit activity determined by the Minister of Finance. It followed logically that also in 2014, when application was made for PBO approval, clause 3.1.1 of the taxpayer's Memorandum of Incorporation did not mean that Appellant was required to comply with the amount determined by the Minister of Finance in respect of the par. 3(*a*) public benefit activity and it permitted a main activity which fell outside the public benefit activity determined by the Minister of Finance.

(xiii) That the aforementioned facts unavoidably lead to the conclusion that the phrase 'low to medium income households' in the taxpayer's principal object does not have the same meaning as, and does not fall wholly within the meaning of, the public benefit activity described in par. 3(*a*). They may coincide sometimes, but as a matter of fact they have not always so coincided and there is no reason to assume that they will coincide in the future.

Appeal dismissed and no order as to costs.

7. INTERPRETATION NOTES

7.1. Rebate and deduction for foreign taxes on income – No. 18 (Issue 4)

This Note explains the scope, interpretation and application of section 6quat which provides for a rebate or deduction for foreign taxes on income. Section 6quin previously provided for a rebate for foreign taxes paid on South African-source service income included in South African taxable income.

Section 6quin(1) to (4) were deleted with effect from years of assessment commencing on or after 1 January 2016. Section 6quin is not discussed in this Note, but a detailed discussion of the section is contained in Issue 3 of this Note which is available on SARS' website.

Section 64N, which provides for a rebate for foreign taxes on dividends against dividends tax payable, is not discussed in this Note. The Comprehensive Guide to Dividends Tax contains a detailed discussion in this regard.

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 23 of 2018 which was promulgated on 17 January 2019 (as per Government Gazette 42172).
- The Tax Administration Laws Amendment Act 22 of 2018 which was promulgated on 17 January 2019 (as per Government Gazette 42169).
- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 21 of 2018 which was promulgated on 17 January 2019 (as per Government Gazette 42171).

Residents are subject to income tax on their worldwide taxable income regardless of the source of the income. Foreign-source amounts derived by a resident may under specific circumstances be taxed by the country of source and by South Africa, resulting in international juridical double taxation. International juridical double taxation refers to the imposition of similar taxes by two or more sovereign countries on the same item of income (including capital gains) of the same person.

Relief from double taxation resulting from the imposition of tax by a residence country and a source country on the same amount is normally granted by the residence country. Thus, the source country's right to tax generally has priority over the residence country's right to tax.

In many instances, countries provide for relief from international juridical double taxation under a tax treaty, although many countries (including South Africa) also provide unilateral tax relief in their domestic law. South Africa provides relief from double taxation to its residents in its domestic law mainly by rebate methods or by a deduction for foreign taxes payable on income that is subject to South African normal tax. The rebate and deduction methods are supplemented by certain exemptions for foreign-source amounts received by or accrued to residents.

Section 6quat(1) provides for a rebate of foreign taxes on income to be deducted from normal tax payable by a resident. The amount of the rebate is determined under section 6quat(1A). A resident is entitled to claim such a rebate only to the extent that the amount of the foreign tax is proved to be payable to a sphere of government of a foreign country without a right of recovery by any person, other than a right of recovery under any entitlement to carry back losses arising during any year of assessment to any year of assessment before such year of assessment. A resident will not qualify for a rebate under section 6quat(1) for foreign tax proved to be payable to a foreign country on a South African-source amount. To the extent that the amount of qualifying foreign taxes proved to be payable exceeds the amount of the rebate determined under section 6quat(1A) and (1B), the excess amount is carried forward to the immediately succeeding year of assessment. The amount so carried forward will potentially qualify for set-off against the normal tax payable on taxable income derived from foreign sources in the immediately succeeding year of assessment [paragraph (ii) of the proviso to section 6quat(1B)(a)].

Any balance of excess foreign taxes may not be carried forward for more than seven years, calculated from the year of assessment in which the balance was carried forward for the first time [paragraph (iii) of the proviso to section 6quat(1B)(a)]. Section 6quat(1C)(a) provides for the deduction of foreign taxes from the income of a resident taxpayer (as opposed to the claiming of a tax rebate). Its application is limited to foreign taxes other than taxes contemplated in section 6quat(1A). Section 6quat(1) considers income and capital gains from a foreign source and the deduction under section 6quat(1C)(a) is limited to foreign taxes levied on South African-source income derived from trade operations. Taxes must, for purposes of section 6quat(1C)(a), be paid or proved to be payable by the resident to any sphere of government of any country other than South Africa, without any right of recovery by any person other than under a mutual agreement procedure in terms of an international tax agreement or a right of recovery under any entitlement to carry back losses arising during any year of assessment to any previous year of assessment. Section 6quat(1C)(b) provides that when, during any year of assessment, any amount was deducted under section 6quat(1C)(a) and the person receives a refund for the amount so deducted or is discharged from any liability for that amount in any subsequent year of assessment, so much of the amount received or so much of the amount of that discharge as does not exceed the amount of the deduction, must be included in the person's income in that subsequent year. Any foreign taxes proved to be payable for purposes of section 6quat(1) or any foreign taxes paid or proved to be payable for purposes of section 6quat(1C) must be translated to rand on the last day of the year of assessment in which the amount is required to be included in a person's taxable income by applying the average exchange rate for the year of assessment.

The average exchange rate which must be used in translating the foreign tax liability is the average exchange rate for the year of assessment in which the amount received or accrued is included in the taxpayer's taxable income. Section 6quat(5) provides that notwithstanding sections 99(1) or 100 of the TA Act, an additional or reduced assessment may be made within six years from the date of the original assessment under which the taxpayer was entitled to the rebate under section 6quat(1) to give effect to an increased or reduced foreign tax credit for the year.

8. BINDING PRIVATE RULINGS

8.1. BPR 321 – Surplus retirement fund assets

This ruling determines the tax consequences of transferring surplus retirement fund assets between funds and allocating assets from employer surplus accounts to the retirement accounts of members as provided for by the Pension Funds Act 24 of

1956 (the PFA).

Unless expressly indicated otherwise in this ruling references to sections are to sections of the Act applicable as at 28 February 2019. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definition of 'gross income'; and
- section 11(*a*).

Parties to the proposed transaction

The applicants: Resident companies who are participating employers in relation to the co-applicants

Co-applicant 1: A defined benefit pension fund which administers the retirement entitlements of certain employees

Co-applicant 2: A defined contribution pension fund which administers the retirement entitlements of certain employees

Co-applicant 3: A defined contribution provident fund which administers the retirement entitlements of certain employees

Members: Qualifying current and former employees or dependents of deceased employees of the applicants

Description of the proposed transaction

The employees of the applicants are entitled to, and the applicants are liable to fund, their post-retirement medical aid benefits. The applicants, with the agreement of the employees, wish to eliminate these liabilities towards the employees by:

- allocating assets in the employer surplus account of co-applicant 1 to the retirement accounts of employees who are members of co-applicant 1 as contemplated by section 15E(1)(*b*), read with section 15E(1)(*d*), of the PFA;
- transferring a portion of the assets of the employer surplus account of co-

applicant 1 to the employer surplus accounts of co-applicants 2 and 3 as contemplated by section 15E(1)(*e*) of the PFA; and

- allocating assets in the employer surplus accounts of co-applicants 2 and 3 to the retirement accounts of employees who are members of co-applicant 2 and 3 as contemplated by section 15E(1)(*b*), read with section 15E(1)(*d*), of the PFA.

<u>Conditions and assumptions</u>

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

<u>Ruling</u>

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

- Pursuant to the transfer of a portion of the assets from the employer surplus account of co-applicant 1 to the employer surplus accounts of co-applicants 2 and 3:
  - no amount will be included in the gross income of the applicants; and
  - no amount will be included in the gross income of co-applicants 2 and 3.
- The applicants will not be entitled to deductions under section 11(*a*) in the determination of their respective taxable incomes in respect of:
  - any lump sum and ongoing transfers from co-applicant 1 to co-applicants 2 and 3; and
  - the allocations to the respective members' retirement accounts.

8.2. BPR 322 – Equity linked note

This ruling determines the nature of an amount received or which accrues as a redemption amount of an equity linked note (ELN), as well as the nature of the amount paid to acquire the ELN. It further determines that the ELN is not an instrument as defined in section 24J(1).

In this ruling references to sections are to sections of the Act and references to a paragraph are to a paragraph of the Eighth Schedule to the Act applicable as at 13 March 2019. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definition of 'gross income';
- section 11(*a*);
- section 23(*g*);
- section 24J(1);
- paragraph 1 – definitions of 'disposal' and 'base cost';
- paragraph 20(1); and
- paragraph 35(1).

Parties to the proposed transaction

The applicant: A resident company

Company A: A resident company

Policy holders: The beneficiaries of long-term equity linked insurance policies

Description of the proposed transaction

The applicant will issue long-term equity linked insurance policies to the policy holders. The applicant invests an amount, the 'subscription amount', to obtain an ELN from company A in each case in which it issues such a policy.

The ELNs are assets which cover the applicant against its liability arising from the issuing of the long-term equity linked insurance policies to the policy holders. Each ELN is a financial asset held by the applicant, the value of which determines the value of the maturity benefit or liability the applicant anticipates it will pay to the policy holder.

On the maturity date of the ELN, the applicant will receive the redemption amount in terms of the ELN from company A. This amount is in each case determined with reference to a specified index or indices, or basket of shares, subject to a minimum redemption payment equal to a significant percentage of the subscription amount.

The maturity benefit due to the policy holder under the linked policy is determined with reference to the value of the ELN at maturity. The proceeds of the ELN are payable to the policy holder on maturity.

The applicant charges a fee to the policy holder for the administration of the policy. This is the only return the applicant derives from the linked policy.

Conditions and assumptions

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

Ruling

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

- The receipt or accrual of the redemption payment to the applicant on the maturity date will not form part of the 'gross income' of the applicant. The receipt or accrual will be of a capital nature.
- Redemption will constitute a disposal of the ELN as contemplated in paragraph 1.
- Any fee the applicant charges the policy holder for administering the linked policy will be of a revenue nature.
- The subscription amount for the ELN will not be deductible. It will be expenditure of a capital nature.
- The amount received by or accruing to the applicant on disposal of the ELN will constitute 'proceeds' as defined in paragraph 1, read with paragraph 35(1).

- The subscription amount will constitute the base cost of the ELN as defined in paragraph 1 read with paragraph 20(1)(*a*).
- The ELN will not constitute an 'instrument' as defined in section 24J(1).

8.3. BPR 323 – Debt reduction by means of set-off

This ruling determines the tax consequences for the applicant of a proposed settlement of a shareholder's debt and the subsequent issue of ordinary shares.

In this ruling a reference to a section is to a section of the Act and to a paragraph is to a paragraph of the Eighth Schedule to the Act applicable as at 10 April 2019. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 19; and
- paragraph 12A.

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

The applicant: A resident company

Co-applicant: A resident company which holds 100% of the shares in the applicant

<u>Description of the proposed transaction</u>

The applicant is indebted to the co-applicant. The major portion was incurred before 1 January 2011.

The applicant's liabilities which are material to the proposed transaction are interest-free and arose under the following circumstances:

- The co-applicant advanced the proceeds of a rights issue to the applicant on loan account (Liability 1).
- The co-applicant disposed of a going concern to the applicant on loan account (Liability 2).

- The applicant declared dividends to the co-applicant during the 2008 and 2009 financial years which were left outstanding on loan account. The applicant will settle a portion of this amount under the proposed transaction (Liability 3).

Under the proposed transaction, the applicant will reduce its total balance sheet liabilities by settling the specified liabilities by way of set-off, as follows:

- The applicant will issue shares to the co-applicant for an amount equal to the market value of those shares and will leave the liability for the share subscription outstanding on loan account.
- The liability to be owed by the co-applicant to the applicant for the share subscription will be set-off against the specified liabilities owed by the applicant to the co-applicant.

Conditions and assumptions

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

- The market value of the effective interest held by the co-applicant in the shares of the applicant after the set-off of the liabilities will exceed the market value of the effective interest of the shares before the set-off, and the difference between the two market values will be less than the cumulative face value of Liabilities 1 and 2 prior to the set-off.
- The amounts in respect of Liabilities 1 and 2 were used, either directly or indirectly, to fund expenditure for which deductions or allowances were granted in terms of the Act.

Ruling

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

- Section 19 and paragraph 12A will not apply to the proposed set-off of Liabilities 1 and 2 owed to the co-applicant, against the share subscription liability owed by the co-applicant in the same amount, because of section

19(8)(*e*) and (*f*) and paragraph 12A(6)(*f*) and (*g*) respectively.

- Liability 3 does not constitute 'debt' as defined in section 19(1) and paragraph 12A(1). Section 19 and paragraph 12A will therefore not apply to the set-off in respect of this liability.

8.4. BPR 324 – Disposal and acquisition of shares by a PBO

This ruling determines the tax implications arising from the acquisition by a public benefit organisation (PBO) of listed Black Economic Empowerment (BEE) shares funded by:

- the proceeds from the disposal of listed ordinary shares held by the PBO;
- dividends received by the PBO in respect of the listed ordinary shares held; and
- cash received by the PBO as a beneficiary of certain trusts.

In this ruling references to sections and paragraphs are to sections of the Income Tax Act and paragraphs of the Eighth Schedule to the Act applicable as at 25 April 2019. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 10(1)(*c*N);
- section 25B;
- section 30;
- section 64F;
- paragraph 20(1)(*a*); and
- paragraph 63A.

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

The applicant: A resident trust approved as a PBO in accordance with section

30(3)

Company A: A resident company listed on the JSE in which the applicant holds ordinary shares

The trusts: Four resident trusts which will be dissolved. The applicant is a beneficiary of each

Description of the proposed transaction

The applicant holds ordinary shares in company A in respect of which it receives dividends which it uses to make donations to other PBOs as envisioned in paragraph 10(*a*) of Part I of the Ninth Schedule to the Act.

The applicant intends to replace these shares held in company A with BEE shares in company A. The BEE shares are considered a better investment as they rank *pari passu* with the ordinary shares with respect to dividends, but trade at a discounted price to them and yield higher dividends in comparison to them. The disposals will extend over several years due to market conditions.

The trusts will be dissolved and will make cash distributions to the applicant out of:

- Dividends received, retained and capitalised by the trusts during previous years of assessment; and
- Interest accrued on cash balances held by the trusts.

The applicant will use the cash distributions received from the trusts as well as the proceeds from the disposal of listed ordinary shares held by the applicant in company A and dividends received to purchase BEE shares in company A.

Conditions and assumptions

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

Ruling

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

- The proposed disposals of the ordinary shares from time to time when BEE shares become available in the market and the use of the proceeds from those disposals to purchase BEE shares will not, in and of themselves, constitute a 'business activity' or 'trading activity' conducted by the applicant. Paragraph 63A will apply to the disposals so that any capital gain derived from them must be disregarded.

- The disposals will not, in and of themselves, adversely affect the applicant's status as an approved PBO for purposes of section 30(3).
- The dividends received by the applicant in respect of its ordinary shares in company A and its BEE shares in company A will be exempt from normal tax under section 10(1)(*c*N) and exempt from dividends tax under section 64F(1)(*c*).
- The interest distributed by the trusts to the applicant in the same year of assessment will retain its character as interest by virtue of section 25B(2), and will therefore also be exempt from normal tax under section 10(1)(*c*N).
- Any capital gain derived from the distributions of trust capital by the trusts to the applicant in accordance with their dissolution processes must be disregarded under paragraph 63A.
- The base cost of each of the BEE shares to be acquired by the applicant will be equal to the subscription price paid by the applicant for such share under paragraph 20(1)(*a*).
- Nothing in this ruling precludes the Commissioner from exercising the powers under section 30(5), or any amendment or substitution of that provision.

8.5. BPR 325 – Liquidation distribution and amalgamation

This ruling determines whether the proposed mergers under foreign law will constitute a liquidation distribution and an amalgamation transaction.

In this ruling references to sections and paragraphs are to sections of the Income

Tax Act and paragraphs of the Eighth Schedule to the Act applicable as at 16 May 2019.

Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 9D(2A);
- section 9H;
- section 44;
- section 47; and
- paragraph 43A.

Parties to the proposed transaction

The applicant: A resident company

Partnership A: A foreign registered limited partnership

Partnership B: A foreign registered limited partnership

Company A: A non-resident company, which is wholly-owned by Partnership B

Company B: A non-resident company, which is wholly-owned by Partnership B

Company C: A non-resident company, which is wholly-owned by Company A

Description of the proposed transaction

The applicant is a 100% limited partner in Partnership A, a limited partnership.

Partnership B is a limited partnership. Partnership A is a 100% limited partner in Partnership B.

Partnership B has two wholly-owned subsidiaries, Company A and Company B.

Company A holds all of the shares in Company C.

Company A is a services company. Companies B and C carry on manufacturing activities.

Partnerships A and B each constitutes a 'foreign partnership' as contemplated in paragraph (a) of the definition of that term in section 1(1). This means that they are fiscally transparent for South African tax purposes and income received by or accruing to them is therefore taxable in the applicant.

Companies A, B and C are controlled foreign companies (CFCs) in relation to the applicant.

The applicant intends to rationalise its offshore investments so that it will only have one operating company in the jurisdiction concerned. It proposes the following transaction steps:

Step 1: Liquidation Distribution

- Company A will dispose of its shareholding in Company C and its own business undertaking as a going concern to Partnership B in terms of a 'liquidation distribution' as contemplated in paragraph (b) of that definition in section 47(1). All its assets and liabilities will be transferred to and assumed by Partnership B. No other consideration will be paid in respect of the disposal. For South African tax purposes, the disposal is made to the applicant.
- Company A will be wound-up and dissolved as a consequence of the liquidation distribution and its shares will be cancelled.

Step 2: Amalgamation Transaction

- Company B will dispose of its business undertaking as a going concern to Company C in terms of an 'amalgamation transaction' as contemplated in paragraph (c) of that definition in section 44(1). All its assets and liabilities will be transferred to and assumed by Company C. No other consideration will be paid in respect of the disposal of the assets.
- Company B will be wound-up and dissolved as a consequence of the amalgamation transaction and its shares will be cancelled.

The restructuring will take place in accordance with the statutory law governing mergers in the foreign jurisdiction.

Following the transactions contemplated above, the applicant will continue to holdca 100% interest in Company C via its partnership interests in Partnership A andcPartnership B. Company A and Company B will cease to exist.

The market values of the shares held by Company A in Company C exceed thecbase costs of those shares.

From the foreign jurisdiction's tax perspective, the consequence of the liquidationcdistribution under section 47 is a deemed profit distribution and a deemed capitalcdistribution in Partnership B. The deemed profit distribution will be taxed as acdividend under the law of the foreign jurisdiction.

Conditions and assumptions

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

assumptions:

- The shares held in Companies A, B and C are all held as capital assets bycthe respective shareholders of these companies.
- The shares in Company C that will be acquired in transaction step 1 will becacquired as capital assets.
- The base costs and tax costs of assets that will be transferred by Company A in transaction step 1 (other than the shares held in Company C) will not be less than the market values of the assets at the time of the implementation of the transaction.
- The liabilities assumed in transaction steps 1 and 2 will consist of qualifying debt only, as contemplated in sections 44(4) and 47(3A)(b).
- The deemed profit distribution that will arise under the foreign jurisdiction's law between Company A and Partnership B will not be deductible by Company A in the determination of its tax on income.
- Company A will, within a period of 36 months after the date of the liquidation distribution, or such further period as the Commissioner may allow, take the steps as contemplated in section 41(4) to liquidate, wind-up

or deregister.

- Company B will, within a period of 36 months after the date of the amalgamation transaction, or such further period as the Commissionernmay allow, take the steps as contemplated in section 41(4) to liquidate, wind-up or deregister.

Ruling

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

Transaction step 1

- The disposal by Company A of all its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade) to the applicant will constitute a 'liquidation distribution' as contemplated in paragraph (b) of that definition in section 47(1).
- The roll-over relief afforded in section 47(2) and (3) will apply to Company A and the applicant in respect of the disposal of assets by Company A.
- Section 47(5) will apply to the transaction so that there will be no tax consequences for the applicant in respect of the disposal of the shares of Company A.
- Any foreign dividend deemed to be received by the applicant will be exempt from tax in terms of section 10B(2)(a).
- Section 9D(2A) will not apply to the transaction. There will therefore not be an imputation of net income in the applicant.
- Section 9H(3)(b) will not apply to the transaction when Company A ceases to be a CFC.
- Paragraph 43A(2) will not apply to the transaction.

Transaction step 2

- The disposal of assets by Company B to Company C will constitute an 'amalgamation transaction' as contemplated in paragraph (c) of that definition in section 44(1).

- The roll-over relief provided for in section 44(2) and (3) will apply in respect of the disposal of assets by Company B to Company C.
- Section 9D(2A) will not apply to the transaction. There will therefore not be an imputation of net income in the applicant.
- Section 9H(3)(a) will not apply to the transaction when Company B ceases to be a CFC.
- Paragraph 43A(2) will not apply to the transaction.

8.6. BPR 326 – Group restructuring transactions in a foreign jurisdiction

This ruling determines certain tax consequences of a proposed group restructuring.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 14 January 2019. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definition of 'trading stock';
- section 42(1) – paragraph (b) of the definition of 'asset-for-share transaction';
- section 47(1) – paragraph (b) of the definition of 'liquidation distribution'; and
- section 47(2).

Parties to the proposed transaction

All the mentioned companies are in the same group of companies.

The applicant: A listed resident company and the parent company

Co-applicant A: A company and resident of country B. Its shares are owned by the applicant

Co-applicant B: A company and a resident of country B. Its shares are 99.6% held by co-applicant A and 0.4% by company A

Co-applicant C: A company and resident of country A. Its shares are owned by co-applicant B

Company A: A company and resident of country B

Company D: A company and resident of country A. Its shares are owned by the applicant

Newco: A company to be incorporated in country A. It will serve as the new holding company in country A

Holdco: A company and resident of country A. Its shares are owned by the applicant. It is the holding company of one of the applicant's operations in country A

Description of the proposed transaction

The applicant has decided to simplify the holding structure of its foreign operating companies in country A. It currently holds its investments in its operating companies in country A through multiple intermediate investment holding companies, some of which are resident in foreign countries other than country A. It proposes to establish Newco as its holding company for its investments in country A.

The proposed transaction concerns the restructuring of the applicant's investment in Opco, which it indirectly holds through its wholly owned subsidiaries, coapplicant C and company D. Opco's shares are 88% held by co-applicant C and 12% by company D. As already mentioned, co-applicant A holds 99.6% of coapplicant B which, in turn, holds all the shares in co-applicant C.

The proposed transaction steps are as follows:

Phase 1

Step 1: Co-applicant B will capitalise amounts payable to company A and coapplicant A by issuing additional shares to them in proportion to the values of their respective debts.

Step 2: Company A will sell its 0.4% interest in co-applicant B to the applicant at a market value price that will be left outstanding on loan account.

Step 3: Co-applicant A will distribute its assets, comprising its 99.6% interest in co-applicant B, to the applicant as a liquidation distribution.

Step 4: Company D will sell its 12% interest in Opco to the applicant for market value consideration, which will be settled by the applicant ceding a loan claim of equivalent value against Holdco to company D.

Step 5: The applicant will incorporate Newco.

Step 6: The applicant will sell its 100% interest in company D to Holdco at market value and the purchase price will be paid in cash.

Step 7: The applicant will transfer its 100% interest in Holdco to NewCo at market value. The consideration will be given by way of an issue of new ordinary shares in NewCo.

Step 8: The applicant will transfer its 12% interest in Opco to Newco at market value in exchange for an issue of additional ordinary shares in NewCo.

Phase 2

Step 9: Co-applicant B will sell its assets, comprising its 100% interest in coapplicant C, to the applicant for a market value purchase price that will be left outstanding on loan account.

Step 10: The applicant will transfer its 100% interest in co-applicant C to Newco for a market value consideration, by way of an issue of additional ordinary shares in Newco.

Step 11: Co-applicant B will distribute its remaining assets, comprising the balance of its loan claim against the applicant, as a liquidation distribution, and will be wound-up. This balance will be made up of the loan claim acquired in step 9 less a prior loan balance which was payable by co-applicant B to the applicant which will be set off against the loan claim.

Phase 3

Step 12: Co-applicant C will distribute its assets, which will include its 88% interest in Opco, to NewCo in anticipation of its liquidation. Co-applicant C's existence will be terminated in due course.

<u>Conditions and assumptions</u>

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

- All the relevant shares are at the commencement of the proposed transaction held on capital account, and it will at all material times not be the intention of any of the parties to the proposed transaction to dispose of any of their shares to the relevant parties as part of a scheme of profitmaking.
- All the co-applicants, as well as Holdco, Newco and company A, are controlled foreign companies in relation to the applicant.
- The disposal by the applicant of its 100% interest in co-applicant A, when its existence is terminated, will occur after the coming into effect of section 80(1)(b), (e), and (f) and section 54(b) of the Taxation Laws Amendment Act 23 of 2018.

<u>Ruling</u>

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

- Co-applicant A must be regarded as having acquired the additional shares in co-applicant B on capital account for purposes of section 47(2), notwithstanding that co-applicant A will be disposing of those shares within a short period to the applicant.

- The applicant will acquire a 99.6% interest in co-applicant B on capital account for purposes of section 47(2), notwithstanding that the applicant will be disposing of its shares in co-applicant B within a short period when co-applicant B is wound up.
- The applicant will acquire the 12% interest in Opco from company D on capital account for purposes of paragraph (b) of the definition of an 'assetfor-share transaction' in section 42(1), notwithstanding that the applicant will be disposing of that interest within a short period to Newco.
- The applicant will acquire a 0.4% shareholding in co-applicant B and the remaining 99.6% of the shares in co-applicant B in terms of the liquidation distribution on capital account for purposes of paragraph (b)(ii) of the definition of 'liquidation distribution' in section 47(1), notwithstanding that the applicant will be disposing of its 100% interest in co-applicant B within a short period by operation of law when co-applicant B's existence is terminated.
- The applicant will acquire its 100% interest in co-applicant C on capital account for purposes of section 47(2) and paragraph (b) of the definition of an 'asset-for-share transaction' in section 42(1), notwithstanding that the applicant will be disposing of that interest to Newco within a short period in terms of an 'asset-for-share transaction' under section 42.
- The disposal by co-applicant B of its remaining assets, including its 100% interest in co-applicant C, to the applicant in the form of a sale in anticipation of co-applicant B's winding-up, resulting in the latter acquiring a loan claim against the applicant, will constitute a 'liquidation distribution' as defined in paragraph (b) of the definition in section 47(1).
- Co-applicant B will acquire the loan claim against the applicant on capital account and the applicant will acquire the balance of the loan claim against itself on capital account for purposes of section 47(2)(a), notwithstanding

that co-applicant B will be disposing of it to the applicant within a short period, after which it will be extinguished by operation of law.

- The distribution by co-applicant B of the balance of the loan claim against the applicant, still in anticipation of co-applicant B's termination, will also constitute a 'liquidation distribution', as defined in paragraph (b) of the definition in section 47(1).
- Newco will acquire a 100% interest in co-applicant C on capital account for purposes of paragraph (b)(ii) of the definition of 'liquidation distribution' in section 47(1), notwithstanding that it will be disposing of its interest in coapplicant C within a short period when the existence of co-applicant C is terminated.

8.7. BPR 327 – Tax implications of a group restructuring

This ruling determines the tax consequences of a group restructuring which includes liquidation distributions.

In this ruling references to sections and paragraphs are to sections of the Income Tax Act and paragraphs of the Eighth Schedule to the Act as at 7 November 2018. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 10(1)(k)(i);
- section 45(3A);
- section 64F(1)(a);
- section 64G(2)(b);
- paragraph 3;
- paragraph 20(1); and
- paragraph 35(3)(a).

Parties to the proposed transaction

The applicant: A resident company and the parent company of a group of companies

The co-applicant: A resident company. Its shares are held by the applicant (97.36%) and company C (2.64%)

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

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

Company C: A resident company. Its shares are held by the coapplicant (51.30%) and company B (48.70%)

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

Description of the proposed transaction

The applicant and its subsidiaries would like to restructure in order to eliminate certain entities within the group, namely:

- The co-applicant;
- Company A;
- Company B;
- Company C; and
- Company D.

Part of the restructuring will involve the applicant acquiring a portfolio of investments in operating companies held by company D that includes shares in Company X, Company Y, and Company Z.

The co-applicant and Company A also hold N ordinary shares in the three abovementioned companies. The N ordinary shares track an economic interest in the operating company's operations.

The economic interest of the co-applicant in company D equals 49.87% consisting of:

- 100% of the ordinary shares in company D;
- 100% of the N ordinary shares in company Z; and
- 17.6% of the N ordinary shares in company Y.

The economic interest of company A in company D equals 50.13% consisting of:

- 100% of the N ordinary shares in company X; and
- 82.4% of the N ordinary shares in company Y.

Any dividends declared by the three above-mentioned companies to Company D will be distributed by the latter to its ordinary and special class dividend shareholders, i.e. the co-applicant and Company A.

The proposed transaction will be effected through the implementation of the proposed transaction steps set out below:

Step 1 Company B will dispose of its shares in Company C to the co-applicant at market value in terms of a 'liquidation distribution', as defined in paragraph (a) of that term in section 47(1).

Step 2 Company C will dispose of its shares in the co-applicant to the co-applicant at market value in terms of a 'liquidation distribution', as defined in paragraph (a) of that term in section 47(1).

Step 3 The applicant will purchase the portfolio of shares in the operating companies from company D at market value in terms of an 'intra-group transaction', as defined in paragraph (a) of the definition of that term in section 45(1). The purchase consideration will be left outstanding on loan (Loan Obligation 1) via the creation of a loan claim (Loan Claim 1). It will be interest free and repayable on demand.

Step 4 Company D will distribute its assets, including Loan Claim 1, to its shareholders, namely the co-applicant and company A, in accordance with their different classes of shares and respective shareholding percentages, as a 'liquidation distribution', as defined in paragraph (a) of the definition of that term in section 47(1).

Loan Claim 1 will be distributed to its shareholders based on the value of the relevant underlying investments taking into account investments in N ordinary shares in Company X, Y and Z. As a result a portion (54%) of Loan Claim 1 against the applicant is distributed to company A, and the balance (46%) of Loan Claim 1 is distributed to the co-applicant along with other assets attributable to the ordinary shares in company D.

Step 5 Company A will distribute all its assets (including the portion of Loan Claim 1 distributed to it under proposed transaction step 4) to the co-applicant (its sole shareholder) as a 'liquidation distribution', as defined in paragraph (a) of the definition of that term in section 47(1). As a result, the co-applicant will hold the total loan claim in respect of Loan Claim 1.

Step 6 The co-applicant will declare a dividend equal to the amount of Loan Claim 1 to the applicant, which will be left outstanding as Loan Obligation 2, which will result in Loan Claim 2 in favour of the applicant.

Step 7 Loan Obligation 2, due by the co-applicant, will be set off against Loan Obligation 1, due by the applicant.

Conditions and assumptions

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

Ruling

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

- The dividend declared by the co-applicant to the applicant and settled via the creation of Loan Claim 2 in favour of the applicant in proposed transaction step 6–

- o will be exempt from income tax under section 10(1)(k)(i); and
- o will be exempt from dividends tax under section 64F(1)(a) read with
- o section 64G(2)(b).

- Loan Claim 2 will, for purposes of paragraph 20(1)(a), have a base cost equal to the amount of the dividend declared by the co-applicant.
- Section 45(3A)(c) will be applicable to the settlement of Loan Claim 1 in proposed transaction step 7 and therefore no capital gain will be realised by the co-applicant in respect of the settlement of Loan Claim 1 under the set-off transaction under proposed transaction step 7

8.8. BPR 328 – Consecutive asset-for-share transactions

This ruling determines the income tax consequences of consecutive asset-forshare transactions within a period of 18 months.

In this ruling references to sections are to sections of the Act applicable as at 3 June 2019. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 42(1) – paragraph (a)(ii) of the definition of 'asset-for-share transaction';
- section 42(2)(a) and (b); and
- section 42(7).

Parties to the proposed transaction

The applicant: A resident company

BEE participant: A resident company

Company A: A resident company

Fund Manager: A black-owned private equity fund

InvestCo: A special purpose vehicle, which is a resident company

Original shareholders: Those shareholders who hold 100% of the equity shares, in equal proportions, in Company A prior to the implementation of the transaction

Description of the proposed transaction

Company A will introduce a new BEE participant by implementing the following transaction steps:

- Company A will allot and issue shares to the BEE participant giving it a single-digit equity interest in company A. This transaction will take place for market value consideration which will be discharged by way of a loan account in favour of company A. The Original Shareholders retain the majority of the shares in company A.
- The BEE participant will transfer the equity interest in Company A to InvestCo at market value for a 100% stake in InvestCo.
- The original shareholders will dispose of an 18.69% interest in Company A to the applicant by way of an asset-for-share transaction contemplated in section 42. These shares have a market value which exceeds their base cost. In exchange, the original shareholders will receive shares in the applicant giving them 100% of the economic interest, but only 49% of the voting interest, in the applicant. The fund manager will retain 51% of the voting interest in the applicant.
- The applicant will dispose of the recently acquired 18.69% stake in company A to InvestCo by way of an asset-for-share transaction contemplated in section 42. After this transaction the Applicant will hold 75% of the issued share capital of InvestCo.

Conditions and assumptions

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

<u>Ruling</u>

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

- The shares in company A will be regarded as having been acquired and held by the applicant on capital account even though these shares will be disposed of to InvestCo shortly after acquisition. The facts and circumstances of this matter, taking into account the proposed steps before and after the acquisition of the shares in company A by InvestCo, are very specific and, in the context of the corporate rules, indicate that the applicant and the group as a whole will not deal with the shares in Company A as trading stock.
- Section 42(7) will apply to the proposed transaction, but will have no tax implications.
- The base cost of the shares in company A, on the date of their disposal to the Applicant and InvestCo, will remain the same as the base costs of those shares for the original shareholders.

9. DRAFT BINDING GENERAL RULINGS

9.1. Determination of the threshold for applying the higher rate of donations tax

This BGR provides clarity on the rate of donations tax chargeable for the value of any property disposed of under a donation, and the determination of the R30 million threshold to be applied to such value.

Section 54 provides that, subject to section 56, donations tax must be paid on the value of any property disposed of (whether directly or indirectly and whether in trust or not) under any donation by any resident. Section 56 sets out the exemptions from donations tax.

Section 64(1)(a) sets out the rate at which donations tax is chargeable.

Section 5(1) of the Rates and Monetary Amounts and Amendment of Revenue Laws Act 21 of 2018 substituted section 64(1)(a) and, in the process, introduced a dual rate of donations tax. The amendment came into operation on 1 March 2018.

Section 64(1)(a) provides as follows:

'**64. Rate of donations tax.**—(1) The rate of the donations tax chargeable under section 54 in respect of the value of any property disposed of under a donation shall be—

(a) (i) 20 per cent of that value if the aggregate of that value and the value of any other property disposed of under a donation until the date of that donation does not exceed R30 million; and

(ii) 25 per cent of that value to the extent that that value is not taxed under subparagraph (i); or'

Discussion

The following issues arise in relation to the R30 million threshold, which impact on whether a donations tax rate of 20% or 25% applies:

- Over what period must the sum of all donations preceding the current donation be determined?
- Does the 'value' of all donations preceding the current donation include exempt donations?

Period over which sum of all donations must be determined

Section 64(1)(a) requires the aggregate of the value of any property disposed of by donation to be determined. This aggregate value comprises:

- the current donation; and
- any other property disposed of under a donation until the date of the current donation.

The Act is silent on the period over which the aggregate of donations referred to in the second bullet point is to be determined. Donations tax is not tied to a year of assessment, and the cumulative total can therefore potentially extend over many years.

There is uncertainty as to when donations made by a donor must commence to be aggregated in order to arrive at the R30 million threshold, below which the donations tax rate of 20% applies, and above which the rate of 25% applies.

To aggregate all donations made by a donor since that donor came into existence, even donations prior to the effective date of the amendment introducing the dual rates, 1 March 2018, would be to give retrospective effect to the amendment. A retrospective statute is 'one that operates for the future only. It is prospective, but it imposes new results in respect of a past event … A retrospective statute operates forwards, but it looks backwards in that it attaches new consequences for the future to an event that took place before the statute was enacted.2' There is a general presumption against statutes having retrospective operation3, unless there are clear indications in the statute, express or by necessary implication, that retrospectivity was intended4.

Although section 64 does not stipulate a period over which the aggregate of all donations must be determined, there is no indication that the amendment is intended to apply retrospectively. Donations prior to 1 March 2018 should therefore not be taken into consideration in calculating the aggregate R30 million threshold.

Exclusion of exempt donations

Section 64(1) refers to 'the value of any property disposed of under a donation' under section 54 in determining the donations tax chargeable. Section 64(1)(a)(i) refers to the 'aggregate of that value' (being the 'value' referred to in section 64(1) of the current donation) and 'the value of any other property disposed of under a donation until the date of that donation'.

2 National Director of Public Prosecutions SA v Carolus and others 2000 (1) SA 1127 (SCA) at paragraph 34.
3 Veldman v Director of Public Prosecutions (Witwatersrand Local Division) 2007 (3) SA 210 (CC) at para 26; Mahomed v Union Government 1911 AD 1 at page 8.
4 Workmen's Compensation Commissioner v Jooste (1997) 3 All SA 157 (A).

There are two factors that indicate that exempt donations must be excluded. The first is that under section 64(1) the rate of 20% or 25% must be imposed on the 'value' of property disposed of under a donation. Donations tax can not be imposed on exempt donations, and therefore 'value' in section 64(1) must of necessity exclude exempt donations. The word 'value' in section 64(1)(a)(i) must have the same meaning as it has in the opening words of section 64(1), and therefore exempt donations are not included in the 'value' used to calculate the R30 million threshold.

The second is that section 64(1) refers to the rate of donations chargeable under section 54. The 'value' referred to in section 54 is subject to section 56. The 'value' under section 56 excludes the value of exempt donations.

<u>Ruling</u>

- The value of property disposed of under a donation prior to 1 March 2018 must not be taken into account in calculating the R30 million threshold for purposes of imposing donations tax at the rates set out in section 64(1)(a).
- The value of exempt donations must not be taken into account in calculating the R30 million threshold for purposes of imposing donations tax at the rates set out in section 64(1)(a).

10. BINDING CLASS RULINGS

10.1. BCR 68 – Surplus retirement fund assets

This ruling determines the tax consequences of transferring surplus retirement fund assets between funds and allocating assets from employer surplus accounts to the retirement accounts of members as provided for by the Pension Funds Act 24 of 1956 (the PFA).

Unless expressly indicated otherwise in this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Seventh Schedule to the Act applicable as at 28 February 2019. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – paragraphs (*c*), (*f*) and (*i*) of the definition of 'gross income';
- section 11F; and
- paragraph 2(*l*).

Class

The class members to whom this ruling will apply are the employees, former employees or dependents of former employees.

Parties to the proposed transaction

The applicants: Resident companies who are participating employers in relation to the co-applicants

Co-applicant 1: A defined benefit pension fund which administers the retirement entitlements of certain class members

Co-applicant 2: A defined contribution pension fund which administers the retirement entitlements of certain class members

Co-applicant 3: A defined contribution provident fund which administers the retirement entitlements of certain class members

The class members: Qualifying members of the co-applicant funds, who are employees, former employees or dependents of deceased employees of the applicants

Description of the proposed transaction

The class members are entitled to, and the applicants are liable to fund, their post-retirement medical aid benefits. The applicants, with the agreement of the class members, wish to eliminate these liabilities towards the class members by:

- allocating assets in the employer surplus account of co-applicant 1 to the retirement accounts of class members who are members of co-applicant 1 as contemplated in section 15E(1)(*b*), read with section 15E(1)(*d*), of the

PFA;

- transferring a portion of the assets of the employer surplus account of co-applicant 1 to the employer surplus accounts of co-applicants 2 and 3 as contemplated in section 15E(1)(*e*) of the PFA; and
- allocating assets in the employer surplus accounts of co-applicants 2 and 3 to the retirement accounts of class members who are members of co-applicant 2 and 3 as contemplated in section 15E(1)(*b*), read with section 15E(1)(*d*), of the PFA.

<u>Conditions and assumptions</u>

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

<u>Ruling</u>

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

- The ongoing contributions by the applicants to the co-applicants for the benefit of the class members:
  - will constitute a fringe benefit as contemplated in paragraph 2(*l*); and
  - will be deductible by the class members in the determination of their respective taxable incomes in accordance with the provisions of section 11F.
- The transfer of assets from the employer surplus account of co-applicant 1 to the employer surplus accounts of co-applicants 2 and 3, and lump sum allocations from the co-applicants to the respective retirement accounts of the class members:
  - will not constitute a taxable fringe benefit under paragraph 2(*l*) for the class members and as a result do not have to be included in the gross income of the class members, as required by paragraph (*i*) of the definition of 'gross income';

- will not constitute an amount received by or accrued to the class members, as contemplated in paragraphs (*c*) and (*f*) of the definition of 'gross income'; and
- will not be deductible by the class members under section 11F in the determination of their taxable income.

- The class members will be taxable on payments to them from the co-applicants in accordance with the definitions of 'gross income', 'income', 'taxable income' and the Second Schedule irrespective of whether the amounts payable to them are considered to result from routine contributions to the co-applicants, or to arise out of surplus amounts allocated to the class members in due course from the co-applicants, as the case may be.

11. GUIDES

11.1. VAT – Frequently Asked Questions re. Supplies of Electronic Services

The Minister of Finance published the regulations prescribing electronic services for the purpose of the definition of 'electronic services' in section 1(1) of the VAT Act in Government Notice 429 of 18 March 2019 (Updated Regulations).

These regulations came into effect from 1 April 2019 and update the regulations published in Government Notice R.221 of 28 March 2014 (Original Regulations). In addition, various amendments have been made in the Rates and Monetary Amounts and Amendment of Revenue Laws Act 21 of 2018 in respect of electronic services (the amendments). These amendments (including those relating to intermediaries) came into effect on 1 April 2019.

The Frequently Asked Questions (FAQs) in this document have been compiled on the basis of questions that vendors and the public at large are likely to have about the implications of the Updated Regulations and the amendments.

The FAQs are drafted purely to assist foreign electronic services suppliers, intermediaries, vendors and the public at large to obtain clarity and to ensure consistency on certain practical and technical aspects relating to the Updated Regulations and amendments. The FAQs are therefore not intended to be used as legal reference. You can find more information about some of the aspects discussed in this document in the *VAT 404 – Guide for Vendors*.

The FAQs are also intended to solicit further questions regarding the Updated Regulations and amendments. The FAQs will therefore be updated periodically to address these questions, as well as any changes in the Updated Regulations. In light hereof, it is not envisaged that VAT Rulings in relation to the Updated Regulations and relevant amendments will be issued. A dedicated mailbox, **VATElectronic@sars.gov.za**, has been set up to field any queries not answered below.

Question		Answer
1	What is value-added tax (VAT)?	VAT is an indirect tax based on consumption in the South African economy. VAT is charged by persons that carry on an enterprise in the Republic (South Africa), or are specifically included in the definition of 'enterprise', on the taxable supplies made by them. Any person that is registered or liable to register for VAT in the Republic is called a 'vendor'. Also refer to **Questions 23**, **26**, **27** and **29**.
2	What is VAT charged on?	VAT is charged on the taxable supply of goods or services (including electronic services) by a vendor, at either the standard or the zero-rate. With effect from 1 April 2018, the VAT rate increased from 14% to 15%. Refer to the *Frequently Asked Questions: Increase in the VAT Rate from 1 April 2018*. VAT is also payable on the importation of goods, and 'imported services'. Certain importations and supplies are exempt from VAT. The supply of electronic services is subject to VAT at the standard rate. Refer to **Questions 51** and **52**.

3	What are electronic services?	These are services as prescribed by the Minister in a regulation (hereinafter referred to as the Original Regulations as well as the Updated Regulations). In simple terms, 'electronic services' refers to electronic or digital **content** that is supplied by electronic means, for example, via the internet, or other telecommunications service. Also refer to **Questions 7**, **14** and **21**.
4	When will the regulation on electronic services become effective?	The Original Regulations came into effect on 1 June 2014. These Regulations have since been updated by the Updated Regulations, which will be effective from 1 April 2019.
5	What was the reason for the Updated Regulations?	The Original Regulations limited the scope of services that qualified as electronic services and which must be charged with VAT at the standard rate. The intention of the Updated Regulations is to substantially widen the scope of services that qualify as electronic services, so that **all services** supplied for a consideration (subject to a few exceptions), which are provided by means of an electronic agent, electronic communication or the internet, are electronic services and must be charged with VAT at the standard rate.
6	Do the Updated Regulations make a distinction between Business-to-Business (B2B) and Business-to-Consumer (B2C) supplies?	**No**, there is no distinction between B2B and B2C supplies, therefore, B2B supplies will be charged with VAT at the standard rate. This outcome was intentional as the South African VAT system does not fully subscribe to the B2B and B2C concepts. Refer, however, to certain supplies for a consideration, by means of an electronic agent, electronic communication or the internet within the same group of companies in **Questions 19** and **20**, which are excluded from the ambit of

		'electronic services' in the Updated Regulations.
7	What are 'electronic services' according to the Updated Regulations?	Electronic services mean any services supplied by a non-resident for a consideration by means of: • an electronic agent; • an electronic communication; or • the internet as defined in the Electronic Communications and Transactions Act 25 of 2002 (the ECT Act). Electronic services are therefore services, the supply of which: • is dependent on information technology; • is automated; and • involves minimal human intervention. Simply put, this means that from 1 April 2019, you will have to pay VAT on a much wider scope of electronic services (that is, digital content supplied by electronic means as set out above). The Updated Regulations now include **any services** that qualify as 'electronic services' (other than a few exceptions) whether supplied directly by the non-resident business or via an 'intermediary'. Refer to **Questions 23** and **28**. Electronic services should be distinquished from those services that, by their nature, are not electronic services, but the product has merely been delivered or communicated by electronic means. For example, if research was done outside of the Republic by a non-resident business, then the service concerned does not become an electronic service merely because the final report was sent to the South African client

		by e-mail. Instead. The recipient will have to consider whether the research services acquired from the non-resident qualify as 'imported services' or not. Refer also to **Question 21** and **22**.
8	What is an 'electronic agent'?	'Electronic agent' means a computer program or an electronic or other automated means used independently to initiate an action or respond to data messages or performances in whole or in part, in an automated transaction.
9	What does 'electronic communication' mean?	'Electronic communication' means a communication by way of data messages.
10	What are 'data messages'?	'Data message' means data generated, sent, received or stored by electronic means and includes: • voice, where the voice is used in an automated transaction; and • a stored record.
11	What is the meaning of 'internet'?	'Internet' means the interconnected system of networks that connects computers around the world using the Transmission Control Protocol Internet Protocol (TCP/IP) and includes future versions thereof.
12	What does 'consideration' mean?	'Consideration' is the VAT-inclusive price that you pay, or are required to pay for a supply of goods or services. The amount of consideration is therefore the final amount of money that you need to pay for a supply. If the consideration is not payable in money, then the open market value of the goods or services received in exchange for the supply is the consideration.

13	What is specifically excluded from the ambit of 'electronic services' in the Updated Regulations?	Specifically excluded from the Updated Regulations are: • telecommunications services (refer to **Question 14**); • educational services supplied from an export country (a country other than South Africa), which services are regulated by an education authority under the laws of the export country (refer to **Question 15**); and • certain supplies of services where the supplier and recipient belong to the same group of companies (refer **Questions 19** and **20**).
14	What are telecommunications services?	In order to give effect to the policy intent, the phrase 'telecommunications services' is interpreted to mean any service relating to the transmission, emission or reception, and the transfer and assignment of the right to use capacity for the transmission, emission or reception of signals, writing, images, sounds or information of any kind by a telecommunications system, and includes access to global information networks, but does not include the content of the telecommunications. Examples are internet access (including access to the World Wide Web), videophone and fixed and mobile telephone services. A telecommunications service does not include the electronic or digital content (including broadcasting content) that is transmitted by way of the telecommunications service, for example, voice, sound, data, text, videos, animation, visual images, pictures etc. Refer to **Questions 14**, **21**, **22**, and **36**.
15	What is an example of educational services supplied	On-line learning provided by a university in an export country (a country other than South Africa), governed by an education authority under the law of that export country which

	from an export country that are not 'electronic services'?	is similar to educational services provided by a similar institution (for example, university) in the Republic, which is exempt under section 12(*h*). Also refer to **Question 13**.
16	What does the term 'exempt supplies' mean?	A supply of goods or services on which VAT (either at the standard rate or zero rate) may not be charged. Any activity involving the making of an exempt supply does not form part of your enterprise in South Africa. You cannot register as a vendor to the extent that you make exempt supplies. This means that you will not charge VAT on any exempt supplies made and no deduction of VAT may be made on any goods or services acquired for purposes of making those exempt supplies. Refer to **Question 17**.
17	What are examples of exempt supplies?	The supply of financial services (such as the provision of credit, life insurance, the services of certain benefit funds, for example, medical schemes and retirement annuity funds, the buying or selling of cryptocurrency) and certain educational services supplied by recognised educational institutions such as primary and secondary schools, technical colleges and universities. The supply of certain financial services (such as the exchange of currency, the payment or transfer of ownership of a cheque or letter of credit, the provision of credit, the buying or selling of cryptocurrency) is not exempt if any consideration is payable in the form of a fee, commission, merchant's discount or similar charge, (excluding discounting cost). Such additional amount is subject to VAT. For example, if you buy foreign currency, the price of the foreign currency (based on the exchange rate) is exempt, but any additional fee or commission charged for services rendered

		to facilitate that transaction is subject to VAT. Refer to **Questions 16**, **18** and **40**.
18	What are the consequences when 'electronic services' also constitute exempt supplies?	The supplies will not be taxable, as you are not conducting an enterprise in the Republic. You cannot register as a vendor in respect of exempt supplies. Refer to **Questions 13**, **15**, **16** and **17**.
19	What does 'group of companies' mean?	'Group of companies' means two or more companies in which one company (the **'controlling group company'**) directly or indirectly holds shares in at least one other company (the **'controlled group company'**) to the extent that: • 70% of the equity shares in each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and • the controlling group company directly holds 70% of the equity shares in at least one controlled group company. Note that the minimum shareholding requirement is 70%. A shareholding of less than 70% (for example, 69.9%) does not meet this requirement. The term 'company' is defined in the VAT Act, with reference to its definition in the Income Tax Act 58 of 1962 and includes: • an association, corporation or company incorporated in under the laws of South Africa; • a body corporate formed or established under the laws of South Africa; • an association, corporation or company incorporated in

		under the laws of an export country; • a body corporate formed or established under the laws of an export country; • a co-operative; • certain associations; • a close corporation; • certain portfolios in an investment scheme or of a collective scheme, but does not include a 'foreign partnership', as defined in that Act. A trust is separately defined in that Act, and is not a 'company' as defined. Also refer to **Question 20**.
20.	What is the impact of the Updated Regulations on a 'group of companies'?	A supply of services for a consideration by means of an electronic agent, electronic communication or the internet, by a company from a place in an export country (non-resident company), to a company being a resident of South Africa (resident company), is excluded from the ambit of 'electronic services' if: • the non-resident and resident companies form part of the same group of companies; and • the non-resident company itself supplies the services exclusively for purposes of consumption by the resident company (the word 'consumption' in this context means that the resident company is the end-user of the services). Services that are: • procured by the non-resident company on behalf of, or for the benefit of resident companies; or • acquired partially for consumption by the resident company,

		are not excluded from the ambit of 'electronic services'. **Example 1** A non-resident company supplies internet-based data services to its wholly-owned subsidiaries situated in South Africa. As these services are supplied by the non-resident company itself, for purposes of consumption by the resident companies, such services are not 'electronic services' for purposes of the Updated Regulation. **Example 2** A non-resident company enters into an internet-based data services contract for the entire group of companies, with a third-party non-resident supplier. The non-resident company on-supplies the data services to each subsidiary and charges a fee based on the use of the services. These services qualify as 'electronic services'. **Example 3** Assume the same facts as in **Example 2**. However, the non-resident company enters into a separate contract with its group of companies in terms of which the internet-based data services procured from the third-party non-resident supplier, as well as other related electronic services, are packaged together and supplied to the group companies for a single consideration. As the services are not exclusively discovered, devised, developed, created or produced by the non-resident company itself and involves the supply of procured electronic services, the supply falls within the ambit of 'electronic services'. The basis for the distinction in the above examples is that in the first example, the non-resident company is supplying the

		actual services itself, whereas in the second and third examples, the non-resident company procures the supply of services from a third party, on behalf of the group entities. **Example 4** Refer to the diagram in **Question 19**. Company A supplies on-line data services for a consideration, to Companies B and D, for exclusive consumption by these companies. Company A also supplies on-line data services to Company H for a consideration which services Company H on-supplies to Companies C and F. Company C in turn on-supplies these services to Company G for a fee. The supplies by Company A to companies B and D are excluded from the ambit of 'electronic services', as these supplies are made within the same group of companies, and Company A itself supplies these services to the resident controlled group companies for their exclusive use. The supply by Company H to Company F falls within the ambit of 'electronic services' as Company F is not part of the same group of companies. The supply by Company H to Company C is also included in the ambit of 'electronic services' as these services are not consumed exclusively by Company C; Company C on-supplies these services to Company G. **Example 5** Assume the same facts as in **Example 2**. However, in this instance, the non-resident company bundles the electronic services with certain services it physically performs in South Africa monthly, for a single consideration. The non-resident qualifies as an 'enterprise' in respect of its

		supply of electronic services, as well as the services continuously and regularly supplied in South Africa. The non-resident must register for VAT to the extent that the value of its taxable supplies exceeds the registration threshold (refer to **Question 27**). The non-resident will only register once in respect of all its enterprises (refer to **Question 31**). **Example 6** Assume the same facts as in **Example 1**. However, in this instance, the non-resident company bundles the electronic services with certain accounting services, which are neither electronic services, nor physically performed in the Republic. These bundled services are supplied for a single consideration. Under section 10(22), where a taxable supply is not the only matter to which a consideration relates, the consideration must be properly attributed to the respective matters. Part of the consideration relating to the supply of electronic services will therefore be subject to VAT at the standard rate, whilst the balance relating to the accounting services will be out of scope for South African VAT purposes. To the extent that section 10(22) applies and a portion of the consideration relates to services not subject to VAT, the recipient may be liable for VAT on imported services. Refer to **Questions 68** to **70**. Section 10(4) provides for special valuation purposes in the case of connected persons such as a non-resident controlling group company and its resident controlled group companies where: • a supply is made for no consideration, or for a consideration in money less than the open market value of the supply; and

		• the recipient would not be entitled to a full deduction of the input tax, had a consideration equal to the open market value of the supply been paid. In this instance, the consideration for the supply is deemed to be the open market value (the consideration in money which would generally be charged for the supply, being a supply freely offered and made between two persons that are not connected). Should the supplier not be able to apply section 10(22) in such a case, the total amount of the consideration will be ascribed to the making of a taxable supply of 'electronic services', which is subject to VAT at the standard rate. **Example 7** A resident group company supplies a complete hardware and software solution to its customers. In order to supply these solutions, it obtains various elements (some being supplied by electronic means and some other services) from different non-resident group companies (within the same group of companies). As the resident group company does not acquire the electronic services exclusively for its own consumption (as it on-supplies the services to its customers), each non-resident group company must determine the extent to which it supplies 'electronic services' and whether it is liable to register as a vendor. In this regard, each non-resident group company exceeding the registration threshold will be registered as a vendor. **Example 8** A non-resident group company purchases a software

		application, customises it in accordance with specific needs, and supplies the application to its resident group company. As the services are not exclusively discovered, devised, developed, created or produced by the non-resident company itself and involves the supply of procured electronic services, the supply falls within the ambit of 'electronic services'.
21	What are some examples of electronic services?	Examples of electronic services supplied by means of an electronic agent, electronic communication or the internet include, among others, the following: • Certain educational services such as distance teaching programmes, educational webcasts, courses or education programmes, and webinars (excluding educational services referred to in **Questions 13** and **15**) • Games and games of chance such as electronic games, interactive games, electronic betting or wagering • Auction services • On-line advertising or provision of advertising space • On-line shopping portals • Web-based broadcasting (refer to **Question 14**) • Access or download of E-books (refer to **Question 41**), audio visual content, still images (for example, desktop themes, photographic images, screensavers), music (for example, ringtones, songs, live streaming performance); films (refer to **Question 39**) • Access to blogs, journals, magazines, newspapers, games, publications, social networking, webcasts, webinars, websites, web applications, web series • Website hosting, data warehousing, application hosting

		(refer to **Question 38**) • Download or access of software • Software applications ('apps') downloaded by users on mobile devices • Software applications allowing users to provide sharing services such as ridesharing and accommodation • Supplies of electronic services where the non-resident company supplies procured services to the resident company, and the non-resident and resident company forms part of the same 'group of companies' (refer to Questions **19** and **20**) • On-line booking services (refer to **Question 42**) • On-line automated maintenance of programmes • Cloud computing The scope of electronic services now includes **any services** supplied electronically as explained in **Question 7**. The above list of services is not exhaustive and these FAQs may be updated to provide further examples.
22	What are some examples of supplies that are **not** electronic services?	• Certain educational services (refer to **Question 13**) • Certain financial services for which a fee is charged (refer to **Questions 17** and **40**) • Telecommunications services (refer to **Question 14** and **36**) • Certain supplies made in a group of companies (refer to **Questions 19** and **20**) • The online supply of tangible goods such as books or clothing (refer to **Questions 35** and **41**) • Telephonic helpdesk services (not being automated

		responses by an 'electronic agent' – refer to **Question 6**) • Certain supplies of services that are not electronic services by their nature, but where the output and conveyance of the services is merely communicated by electronic means (refer to **Questions 7 and 43**), for example: a legal opinion prepared in an export country (refer to **Question 24**), sent by e-mail; and an architect's plan drawn up in an export country, and sent to the client by e-mail.
23	When is a non-resident supplier of electronic services conducting an enterprise for South African VAT purposes?	A non-resident supplier of electronic services is conducting an enterprise if the electronic services are supplied from a place in an export country (refer to **Question 24**), and any two of the following three circumstances are present: 1. The recipient of the services is a resident of South Africa (refer to **Question 25**) ; 2. The payment for the services originates from a bank registered under the Banks Act 94 of 1990 (the Banks Act); or 3. The recipient of the services has a business, residential or postal address in South Africa. In these FAQs reference is made to a supplier meeting the above requirements as a 'foreign electronic services supplier'. A foreign electronic services supplier that exceeds the VAT registration threshold (refer to **Question 27**) and meets the above 2 out of 3 requirements (hereinafter referred to as the '2 out of 3 test') will be required to register as a vendor (refer to **Question 1**) and account for VAT only in respect of its electronic services supplied to South African customers.
24	What is an export	A country other than the Republic of South Africa (South

	country?	Africa).
25	What is a resident for South African VAT purposes?	A 'resident' as defined in the Income Tax Act, or any other person or company, to the extent that such person or company carries on an enterprise or activity in South Africa and has a fixed or permanent place in South Africa relating to such enterprise or activity. For more information refer to the following INs: • IN 3 'Resident: Definition in relation to a Natural Person – Ordinarily Resident' • IN 4 'Resident: Definition in relation to a Natural Person – Physical Presence Test • IN 6 (Issue 2) 'Resident – Place of Effective Management (Companies)'
26	Who must register as a vendor and collect VAT on electronic services?	Generally, vendors (refer to **Question 1**) are required to levy and collect VAT. In the case of electronic services, this will be the foreign electronic services supplier or in certain instances, the intermediary (which may be a resident or a non-resident) (refer to **Questions 28** to **30**). Just like any other vendor, foreign electronic services suppliers and intermediaries have to perform certain duties and take on certain responsibilities, such as ensuring that VAT is charged and collected on taxable transactions, returns are submitted, payments are made on time and tax invoices (and other specifically prescribed documents) are issued. Refer to **Questions 44** to **57**. Electronic services supplied to persons in South Africa may therefore be subject to VAT, either because – • the foreign electronic services supplier is required to register

		as a vendor in its own name, if the supplies made to persons in South Africa exceed the R1 million registration threshold; or; • the foreign electronic services supplier voluntarily registered for VAT; or • the intermediary, being a vendor, will be required to account for VAT on supplies made by the foreign electronic services supplier (refer to **Questions 29, 30** and **34**) because that electronic services supplier is not registered for VAT. The reason that a foreign electronic services supplier is not registered for VAT may be due to the foreign electronic services supplier – • not having applied to register for VAT (notwithstanding that the registration threshold has been exceeded and it is mandated to register as a vendor); or • has not exceeded the registration threshold, in which case it is not required to register as a vendor. The foreign electronic services supplier (principal) that exceeded the registration threshold, but failed to register as a vendor, may be guilty of an offence, and remains liable to register and account for VAT on electronic services in the supplier's VAT return. This remains the case even if the VAT on those supplies has been accounted for on a return by an intermediary (agent). Should the value of supplies made on behalf of non-VAT registered principals by an intermediary result in the intermediary exceeding the VAT registration threshold, that intermediary is liable to register and account for such VAT on its own VAT return. Failure by the intermediary to register as

		a vendor is an offence. The intermediary is liable to account for VAT on supplies of electronic services made by the non-VAT registered principal (refer to **Questions 29** and **30)**, until such time as the principal confirms that it is registered for VAT and the principal will commence accounting for such supplies on their own VAT return. Also refer to **Questions 46** to **47** relating to VAT registration, and **Question 34** relating to the issuing of tax invoices by an intermediary.
27	When must a foreign electronic services supplier or intermediary register as a vendor?	From 1 April 2019, the foreign electronic services supplier or intermediary must register as a vendor at the end of any month where the total value of taxable supplies made by that supplier exceeds R1 million in any consecutive 12-month period. The 12-month period is calculated from 1 April 2019 in respect of supplies of electronic services which became taxable from 1 April 2019 under the Updated Regulations. Newly affected foreign electronic services suppliers will therefore not become liable to register as a vendor before 1 May 2019. The exclusions contemplated in section 23(1) (for example, the registration threshold is exceeded because of abnormal circumstances of a temporary nature) do not apply to foreign electronic services providers and intermediaries. Foreign electronic service suppliers that were liable to account for VAT on electronic services under the Original Regulations, will continue to be liable from the date that the registration threshold was exceeded, that is, between 1 June 2014 and 1 April 2019. (The rule before 1 April 2019 was that such foreign electronic services suppliers were liable to

		register at the end of any month where the value of taxable supplies exceeded R50 000). Foreign electronic services suppliers need to add the value of electronic services supplied under the Original Regulations as well as the Updated Regulations in order to determine the liability date for VAT registration. You can also register voluntarily if you have made taxable supplies exceeding R50 000 in a preceding period of 12 months.
28	What is an 'intermediary' in the context of electronic services?	An intermediary is a person that facilitates the supply of electronic services by a foreign electronic services supplier in circumstances where that person is responsible for: • the issuing of invoices; and • collecting payment in respect of the supply of electronic services. An intermediary is also known globally as a 'platform' or 'electronic marketplace' that enables, by electronic means, transactions between buyers and sellers. The phrase 'facilitating the supply' may include a range of services in addition to being responsible for the issuing of invoices and the collection of payment as mentioned above. For example, it could include advertising or listing the electronic services for sale on the platform or electronic marketplace with or without making it known that the sale of the electronic services are being sold on behalf of the principal. However, a person cannot qualify as an intermediary if that person is not responsible for the: • issuing of invoices; and

		• collection of payment. An intermediary (whether resident or non-resident) is conducting an enterprise to the extent of its own activities in the Republic and its activities in facilitating the supply of electronic services as set out above.
29	When is an intermediary required to register as a vendor?	The intermediary must register as a vendor at the end of any month where the total value of taxable supplies made and deemed to be made by that intermediary exceeded R1 million in any consecutive 12-month period. If you are an intermediary, you must determine the sum of the value of all your own South African taxable supplies and the value of all electronic services made by non-VAT-registered foreign electronic service suppliers on your platform. If the sum of these amounts exceeds R1 million in any consecutive period of 12 months, then you are required to register for VAT as an intermediary. Also refer to **Questions 26** and **30**.
30	When is a supply deemed to be made by an intermediary?	A supply of electronic services is deemed [under section 54(2B)] to be made by the intermediary and not the principal, if the electronic services are supplied through an intermediary platform or online marketplace on behalf of the principal and: • the intermediary is a vendor; • the principal is not a resident and not a registered vendor; and • the electronic services are supplied or to be supplied to a person in South Africa (that is the supplies made in the course of an enterprise for South African VAT purposes as discussed in **Question 23**).

		An intermediary that qualifies to register and account for VAT in respect of supplies made on behalf of the foreign electronic services supplier, will be required to periodically check that all of the conditions referred to above still apply. Should one of the conditions no longer apply, the intermediary can no longer account for supplies made on behalf of the foreign electronic services supplier, and such foreign electronic services supplier itself may be required to register and account for VAT on such supplies (refer to **Question 26**). ***Example 1*** *I am a registered vendor conducting my business in South Africa, which entails the supply of various digitised products for download on my website, for example, electronic books. South-African users can also download various ringtones and screensavers from my website. However, the ringtones and screensavers are supplied by foreign electronic services suppliers, that use my website as a platform or online marketplace to advertise and sell their digitised content. These foreign electronic services suppliers are not registered for VAT, and are non-residents.* *Users pay a separate fee per download, and I issue invoices and collect the payments for all supplies (that is, my own supplies, as well as those of the foreign electronic services suppliers). After collecting the full price from the customer in respect of the foreign electronic services suppliers' products, I deduct a 10% commission based on the value of the products and remit the balance due to the suppliers.* *In this example, you will be an 'intermediary' as defined in the Regulations. You will therefore be required to account for VAT on the supplies of electronic services made by the*

		foreign electronic services suppliers in your VAT return, in addition to your own supplies. *The reason for this is that all the following conditions are met:* *• The ringtones and screensavers constitute 'electronic services';* *• The suppliers are non-residents carrying on a business in an export country and they are not registered as vendors (refer to* ***Question 1****);* *• You are a registered vendor (refer to* ***Question 1****) and the electronic services are facilitated by you as they are made available for sale (download) on your website, which is an online marketplace or platform; and* *• You are responsible for the issuing of invoices and collecting of payment in respect of the electronic services supplied on behalf of the foreign electronic services suppliers. This will still be applicable even if you outsource the payment function to another service provider. The policy rationale for this is that you will still be 'responsible' for collecting the payment. Through your platform, you will not authorise the release of the product to the consumer if payment has not been made.* ***Example 2*** *I am a non-resident, conducting my business outside of South Africa, which entails allowing various businesses in export countries to use my platform to sell their digitised content. These foreign electronic services suppliers are not registered for VAT, and are also non-residents. I am not a*

		registered vendor for South African VAT purposes. *The combined value of supplies made by these foreign electronic services suppliers to customers in South Africa exceeds R1 million.* *In this example, you will also be an 'intermediary' as defined in the Updated Regulations. You will therefore be required to register and account for VAT on the supplies of electronic services made by the foreign electronic services suppliers to customers in South Africa in your VAT return. Also refer to **Questions 26**, **28** and **29**.* ***Example 3*** *Assume the same facts as in **Example 1**, except that some of the foreign electronic services suppliers are registered as vendors in South Africa.* *In this case, you will still be regarded as an 'intermediary' as defined in the Updated Regulations, but you will only be liable to account for VAT on the supplies of the foreign electronic services suppliers that are not registered as vendors in South Africa. (Refer to **Question 1**.) In such a case, you will account for the supplies of those foreign electronic service suppliers in your VAT return, in addition to your own supplies.* *You will not be liable to account for the VAT payable in the case of VAT-registered foreign electronic services suppliers that use your platform to make their supplies to South African customers (refer to **Question 23**). As agent, you will still be required to show the VAT charged on tax invoices issued on behalf of both the registered and non-VAT-registered foreign electronic services suppliers (refer to section 54(1) and **Question 34**). However, the foreign electronic services suppliers in this case will be liable to account for the VAT on*

		electronic services supplied to South African customers in their own VAT returns (refer to ***Questions 23*** *and* ***26****).*
31	I am a resident supplier of digitised products via my website. I am a registered VAT vendor as well as an 'intermediary'. Must I register separately as a vendor in this regard?	You are only required to register once in respect of all the enterprises/activities that you carry on, unless you meet the requirements of section 50, which permits separate enterprises to be registered as separate branch VAT registrations.
32	I am responsible for facilitating the supply of electronic services on behalf of foreign electronic services suppliers. However, I outsource the invoicing and payments function to a third party. Must I still register as a vendor in respect of the intermediary activities?	**Yes**, even if the payment, collection and invoicing functions are outsourced, as long as you are responsible to the foreign electronic services suppliers to ensure that the invoices are issued and the payments are made, then you will be liable to register for VAT and account for those transactions. Also refer to **Questions 28** to **30**.
33	I am a foreign electronic services supplier. I supply	You will be required to register as a vendor should you exceed the registration threshold. However, if you do not register as a vendor, or do not meet the registration

	services to persons in South Africa by means of an intermediary. Must I also register as a vendor?	threshold, your supplies of electronic services to persons in South Africa are deemed to be made by the intermediary, if the conditions set out in **Question 30** apply. In that case, the intermediary will account for your supplies. Also refer to **Questions 23**, **26** and **27**.
34	I am a VAT-registered foreign electronic services supplier (principal), but I only make supplies to persons in South Africa by means of an intermediary. May I deregister for VAT?	**No, with one exception.** An intermediary will only be deemed to supply services as a principal if certain conditions are met. Refer to **Questions 26**, **30** and **33**. One of the requirements is that the principal is not a resident and not a registered vendor. If you exceed the registration threshold you are required to remain registered as a vendor and account for your supplies of electronic services to customers in South Africa. In this case, the intermediary (that is acting as your agent) will still show the VAT charged on the tax invoices issued on your behalf [see section 54(1)]. However, the VAT indicated on those invoices must be accounted for in your VAT return as you are the principal making those supplies. Also refer to **Question 30**.
35	I supply and export machinery directly to customers world-wide from my premises in an export country. I also provide online customer support services relating to the use of the	**No**, the supply of the machinery (being goods) does not fall within the ambit of 'electronic services' (refer to **Question 22**) in the Updated Regulations. The reason is that because you do not charge any consideration for your supply of online customer support services delivered via an electronic agent, such services do not constitute electronic services. You will, however, supply electronic services if the customers pay a fee (whether once-off, periodically etc.) for the online customer support services. You will be required to register and account for VAT in respect of these services supplied to

	machinery for free to my customers via an electronic agent. Do I provide 'electronic services' to my South African customers?	South African customers (refer to **Question 23**) if you meet the registration threshold (refer to **Question 27**).
36	I am a non-resident internet service supplier and charge users worldwide a fee for accessing the internet via my servers. A user uses a telephone line (supplied directly by a third party non-resident to the user) to connect to the internet using a modem. Am I supplying electronic services?	**No**, the supply is that of telecommunications services being a connection to allow for the transmission and reception of data over the internet, which does not constitute electronic services. The supply of the telephone line by the third party also constitutes 'telecommunications services', which is excluded from the ambit of 'electronic services'. Refer to **Questions 14** and **22**.
37	I am a non-resident and provide on-line access to market data by means of a subscription. Am I supplying electronic services?	**Yes,** subscription services to a web application were already included as electronic services in the Original Regulations. You should already have registered as a vendor, if you have exceeded the registration threshold. Refer to **Question 27**.

38	I allow customers space on my server to create and maintain blogs. I am a non-resident and supply this service to customers worldwide for a fee. Am I supplying electronic services?	**Yes**, the service is that of web hosting, which is an electronic service. Refer to **Question 21**. You will be required to register if you are an enterprise, and exceed the registration threshold. Refer to **Questions 23** and **27**.
39	I have a website where music and films are made available to customers worldwide via live streaming for a fixed monthly fee. Am I supplying electronic services?	**Yes**, the live streaming of the music and films via electronic means constitutes an electronic service. Refer to **Question 21**. You will be required to register if you are an enterprise, and exceed the registration threshold. Refer to **Questions 23** and **27**.
40	I am a non-resident, providing instant electronic money transfer services from an export country. This allows customers globally to pay for goods or services from anywhere in the	**Yes**, the fee that you charge for your services constitutes consideration for the supply of an electronic service and does not constitute consideration for the supply of exempt financial services. You will therefore be liable to register for VAT if you exceed the VAT registration threshold. However, the amount of money that you exchanged in order to make the money transfer to the other country constitutes a financial service that is exempt from VAT if that supply was made in South Africa. Also refer to **Questions 17 and 22**. You will be required to register if you are an enterprise, and exceed the

	world. I charge a service fee per transfer. Am I supplying electronic services?	registration threshold. Refer to **Questions 23** and **27**.
41	I take online orders for books, which are shipped directly to recipients world-wide, including South Africa. My business is conducted from an export country. Am I supplying electronic services under the Updated Regulations?	The supply of tangible goods (that is the physical books being exported), does not constitute electronic services. This should be differentiated from the supply of digitised products (for example, electronic books, purchased on the internet or used online), which falls within the ambit of 'electronic services'. Refer to **Questions 21** and **22**.
42	I am a non-resident and list various suppliers of accommodation worldwide on my website. Customers can book accommodation on-line for which I charge a booking fee. Suppliers of accommodation also pay me a fixed fee	**Yes**, the supply of on-line advertising (for the suppliers of accommodation) and booking services (to customers in South Africa) for a consideration constitute the supply of electronic services (refer to **Question 21**). You are required to register to the extent you are conducting an enterprise for VAT purposes in South Africa. In other words, you meet the 2 out of 3 test in **Question 23** and you exceed the registration threshold. (refer to **Question 27**.) The supply of the accommodation itself, however, is not an electronic service. Accommodation is usually subject to VAT, GST or a similar indirect tax in the country in which the accommodation is situated (provided the supplier is required

	for listing them on my site. Am I supplying electronic services under the Updated Regulations?	to charge any indirect tax thereon). This is on the basis that the actual 'use' or 'enjoyment' or 'consumption' of the accommodation occurs in the country in which the accommodation is situated and VAT/GST is a consumption tax.
43	I am an architect in an export country. I design a plan for a house and e-mail it to a person in South Africa. Am I supplying electronic services?	**No**, the service involves substantial human intervention carried out in an export country and the product is supplied from an export country. The supply is therefore not dependant on information technology or automated. The e-mail is merely the means of communication. Refer to **Questions 7** and **22**.
44	How do I go about registering as a vendor?	Download the VAT application form (VAT101). The completed and signed form must be e-mailed together with the relevant supporting documents to eCommerceRegistration@sars.gov.za. For more details, refer to the *External Guide VAT Registration Guide for Foreign Suppliers of Electronic Services*.
45	Do I need a South African bank account in order to register as a vendor?	**No**, a foreign electronic services supplier or non-resident intermediary (refer to **Question 25**) is not required to open a South African bank account. However, an intermediary being a resident of South Africa will be required to open a bank account with any bank, mutual bank or other similar institution registered under the Banks Act for the purpose of the enterprise carried on in South Africa.
46	Do I need to appoint a representative vendor in South	**No**, a foreign electronic services supplier or non-resident intermediary (refer to **Question 25)** is not required to appoint a representative vendor contemplated in section 46 in South

	Africa?	Africa. However, in order for your registration application to be processed, the particulars of the person (non-resident or resident) accountable/responsible for the business activities must be completed under 'representative vendor' part on the VAT101 form. An intermediary, being a resident of South Africa, must appoint a natural person residing in South Africa as a representative vendor. A foreign electronic services supplier or intermediary not carrying on a business through a company in South Africa, or having an office in South Africa, is also not required to appoint a public officer contemplated in section 246 of the Tax Administration Act 28 of 2011.
47	What records must I keep if I register as a vendor and how long must I keep those records for?	A record of all the goods and services supplied by or to you in sufficient detail to determine the rate of tax applicable to the supply, and the supplier or agents must be kept. This includes, for example, all invoices, tax invoices, credit and debit notes, bank statements, deposit slips etc. Records must generally be kept for five years. The records may be kept in electronic form. Records maintained in electronic form must be physically located in South Africa. Approval may however be granted to allow the retention of the electronic documents at a location outside South Africa, subject to certain requirements. Refer to Public Notice 787 of 1 October 2012 for more detail.
48	When must I issue a tax invoice?	You must issue a tax invoice within 21 days of the date of the supply. Also refer to **Questions 49** and **50**.
49	What is the date of the supply (time of	The time of supply is generally the earlier of the time an invoice is issued, or payment is received [see section 9(1)].

	supply) for purposes of accounting for output tax?	Generally, for suppliers of electronic services, the issuing of the invoice and the payment will be on the same date. Output tax (that is, tax charged on the supply of electronic services) must be accounted for in the tax periods allocated to you. Refer to **Question 48** and **53**. ***Example 1*** *I am a non-resident and enter into a contract on 2 January 2019 with a customer in South Africa to provide electronic services from 1 June 2019 to 31 August 2019 for a single consideration. I issue the invoice on 1 May 2019, and will receive payment of the full amount subsequently.* *A contract does not generally trigger the time of supply, unless it constitutes an 'invoice' being a document notifying an obligation to make payment. The time of supply will therefore be triggered by the invoice issued on 1 May 2019.* *As the consideration relates to the making of taxable supplies of electronic services to be performed from 1 June 2019 to 31 August 2019, you will need to take into account the value of these supplies in order to determine your registration liability date (also refer to **Question 66**). Should you already be registered, you will be required to declare and account for VAT on these services whether or not you have included VAT in your contract price (refer to **Question 64**).* Transitional rules also apply in certain instances. Refer to **Question 66**. Furthermore, specific time of supply rules apply in the case of connected persons. See ***Example 2*** below. ***Example 2*** *I am a non-resident controlling group company and supply electronic services to resident controlled group companies*

		(being 'connected persons'). In certain instances [as set out in section 10(4)], special time of supply rules will apply to transactions between connected persons. For example, in the case of services supplied (including electronic services), the special time of supply rule is triggered at the time the services are performed/delivered. In that case, you will be required to issue a tax invoice within 21 days of the services being performed/delivered. *The general time of supply rule and not the special time of supply rule will, however, apply when:* *• an invoice is issued or payment is received on or before the date that a return was submitted relating to the tax period in which the electronic services were electronically delivered/ performed; or* *• the last day for submitting a return for that tax period.* *In addition, the special time of supply rule for connected persons will not apply in a case where –* *• the consideration could not be determined at the time the electronic services were electronically delivered/performed; and* *• the recipient is entitled to deduct the VAT charged on those electronic services as input tax in full.* *Foreign electronic services providers registered on the payments-basis will only account for the supply when payment is received (refer to* ***Question 57****), provided the consideration in money in respect of the supply does not exceed R100 000. Should the consideration exceed that amount, you will be required to account for the supply on the*

		invoice basis.
50	What are the requirements for the issuing of a tax invoice?	The tax invoice must contain certain particulars. Refer to Binding General Ruling (BGR) 28 'Electronic Services', which sets out the following: • Information that must be contained in a tax invoice, debit or credit note • Exchange rate that must be applied to the amount of the VAT charged in South African Rand • The manner in which prices must be quoted or advertised
51	What VAT rate must I charge on my supplies of electronic services?	The supply of electronic services is subject to the VAT rate of 15%. Also refer to **Question 2** and **52**.
52	Can I zero-rate my supply of electronic services to a person in South Africa?	**No**, you are required to levy VAT at the standard rate on your supplies to persons in South Africa. The law does not provide for the zero-rating of electronic services supplied by foreign electronic services suppliers under any circumstances. Also refer to **Questions 2** and **51**.
53	When must I account for VAT?	You are required to account for VAT and submit returns according to the tax periods allocated to you. Tax periods end on the last day of a calendar month. You may change your cut-off dates in certain instances. Refer to BGR 19 'Approval to end a Tax Period on a Day other than the Last Day of the Month', for further information. Vendors are generally registered on a two-monthly basis, being : • Category A ending on the last day of January, March, May, July, September and November;

		• Category B ending on the last day of February, April, June, August, October and December. You will be required to submit monthly VAT returns under Category C if the value of your taxable supplies exceeds R30 million in a consecutive period of 12 months. Generally, VAT returns must be furnished and payments made by the 25th day of the first month commencing after the specific tax periods. However, vendors submitting returns electronically may submit their returns and make payments on the last business day of the month during which the 25th day falls.
54	How do I pay the VAT due?	Payments must be made electronically using the SWIFT MT103 payment method. Refer to the *External Guide VAT Registration Guide for Foreign Suppliers of Electronic Services* for more detail.
55	How do I submit and complete my VAT201 return?	It is compulsory for suppliers of electronic services and intermediaries to submit their VAT201 returns electronically. You must request the VAT201 return for the relevant tax period via eFiling, and complete all the relevant information. Also refer to the *External Guide VAT Registration Guide for Foreign Suppliers of Electronic Services* for more detail.
56	What VAT on expenses incurred may I deduct as input tax?	You may deduct the VAT incurred on goods or services (input tax), where VAT at the standard rate has been charged to you by South African vendors, and these goods or services are acquired for the purpose of supplying the electronic services to customers in South Africa. For example, consulting or accounting fees paid to South African vendors.
57	On which accounting basis	Most vendors (refer to **Question 1**) are registered on the invoice basis. This means that you must account for VAT on

	must I account for the VAT amount payable/refundable?	all invoices issued during a tax period (value of supply), whether you have received payment or not. You may also deduct VAT on tax invoices received in respect of goods or services acquired during the tax period. Also refer to **Question 56**. The Commissioner may allow certain vendors to register on the payments-basis. This means that you only account for VAT in respect of payments received in a tax period. Similarly, you may only deduct VAT on goods or services acquired from South African vendors, to the extent that payment has been made in a tax period concerned. Foreign electronic services suppliers are automatically registered on the payments-basis. SARS is in the process of amending the system, and foreign electronic services providers will be notified as soon as the invoice basis option becomes operational. Where the consideration in money in respect of a supply of electronic services exceeds R100 000, that supply must be accounted for on the invoice basis by vendors registered on the payments-basis. Refer to **Example 1** in **Question 49**. Foreign electronic services suppliers already registered on the invoice basis may apply to be registered on the payments-basis from a future date. Intermediaries (resident and non-resident), however, are registered on the invoice basis, and cannot apply to account for VAT on the payments-basis.
58	Can I apply for a ruling to confirm that I am supplying electronic services	Whether or not a person is supplying electronic services is a question of fact. SARS generally does not rule on questions of fact. However, should your situation not be covered in the FAQs, you may submit your question to

	(either under the Original Regulations or the Updated Regulations)?	**VATElectronic@sars.gov.za**. The FAQs will be updated periodically to incorporate frequently asked questions received via the dedicated e-mail address. Should the nature of your enquiry require further guidance, we will engage with you accordingly, and determine whether it is necessary to apply for a VAT Ruling.
59	I previously obtained a VAT Ruling relating to electronic services. Can I still rely on that ruling?	**No.** VAT Rulings cease to be effective when the provisions of the tax laws that are the subject of the VAT Ruling are repealed or amended. Also refer to **Question 58**.
60	I am a non-resident supplier of on-line training to employees of companies in South Africa. Am I supplying electronic services?	**Yes**, and you are required to register if the requirements in **Questions 23** and **27** are met.
61	I supply on-line training as referred to in **Question 60**. I customise the training depending on the needs of each company. I therefore consult with the South African companies via e-mail during the	**No**, although there is substantial human intervention during the design and creation phase, these steps are necessary to supply the on-line training programmes. The supply of the on-line training programmes itself is: • dependant on information technology; • not dependant on human intervention; and • automated.

	design and creation phase of the training programmes. Are my services excluded from the ambit of 'electronic services' due to the designing and creation phase involving substantial human intervention?	
62	I am a non-resident company that supplies on-line vocational training to the employees of resident companies. I am a connected person to the resident companies but do not form part of the same group of companies. Am I supplying electronic services?	**Yes**, the supply of vocational training to employees of a connected person is not excluded from the ambit of 'electronic services', unless such supply constitutes 'educational services' as contemplated in **Questions 13** and **15**.
63	What happens if I am liable to register with effect from 1 May 2019, but I apply for registration after that date?	Your liability date remains 1 May 2019 and you must levy and account for VAT on electronic services supplied to South African customers from that date. If as a result of the late registration you end up paying your VAT late, then penalties and interest for any tax periods

		covering the period from 1 May 2019 onwards will be payable. You can apply for the penalty to be waived if you have a good reason why payment was late. The waiving of interest will only be considered if you did not pay on time due to exceptional circumstances that were beyond your control. In either case, your application for remission of penalty and/or interest should be in writing.
64	Will a foreign electronic services supplier be able to increase the price that is charged to South African customers under existing ongoing contracts for the supply of electronic services concluded before these supplies became taxable (that is, 1 April 2019 under the Updated Regulations, or 1 June 2014 under the Original Regulations)?	*Contract prices agreed by the parties* – Generally, the electronic services supplier (being a vendor) may increase the contract price and recover the additional VAT from the customer under an existing contract concluded before 1 April 2019 (or 1 June 2014 under the Original Regulations) if the supplies of electronic services will continue after that date. This rule applies even if any other law states otherwise. The supplier will, however, not be able to increase the price or recover the increase from the customer if the parties have specifically agreed in writing in the contract that it may not be increased. Whether the additional amount is recoverable from the customer or not, the foreign electronic services supplier must account for VAT on any supplies of electronic services that became taxable on or after 1 April 2019 (or 1 June 2014, in the case of the Original Regulations) at the standard rate, subject to that supplier's liability date (refer to **Question 27**). *Prices set under an Act or regulation* – As mentioned above, the supplier may increase the contract price even if any other law states otherwise. However, if the Act or regulation concerned actually sets the price and contains an explicit statement that the amount may not be increased, then the

		price will stay the same and may not be increased until that other Act or regulation that sets the price is amended accordingly.
65	Do the transitional rules in section 67A apply to supplies of electronic services?	**Yes**. Section 67A contains transitional rules that apply to services, which became taxable under the Updated Regulations with effect from 1 April 2019. (These rules also applied in respect of electronic services under the Original Regulations, which became taxable from 1 June 2014). The transitional rules do not change the time of supply (refer to **Question 49**), but determine whether the supplies are taxable at the rate of 15%, or out of scope. The transitional rules apply in the following instances where the time of supply under section 9 is triggered on or after 1 April 2019: • Supplies performed before 1 April 2019 • Supplies commencing before 1 April 2019 and ending on or after 1 April 2019 • Supplies commencing and ending on or after 1 April 2019 ***Example 1*** *I am a non-resident and supplied on-line advertising services to a South African customer during March 2019. I only issue the invoice and receive payment for the advertising services on or after 1 April 2019.* *Although the time of supply is triggered after 1 April 2019, the supply is not subject to VAT, as the supply was performed before the date on which VAT was imposed on a wider scope of 'electronic services' under the Updated Regulations.*

		Example 2 *I am a non-resident and enter into contracts with different customers in South Africa to provide electronic services (under the Updated Regulations), which supplies were not covered in the Original Regulations, for a single consideration for the following periods:* *• 2 January 2019 to 31 March 2019* *• 1 March 2019 to 31 May 2019* *I issue the invoices to the respective customers on 1 May 2019, and will receive payment of the full amount subsequently.* *Refer to **Question 49** for the general time of supply rules.* *In terms of the transitional rules, the following apply:* *• Services supplied from 2 January 2019 to 31 March 2019:* *You are not required to account for services performed before 1 April 2019, even if the time of supply is triggered on or after 1 April 2019. The services performed from 2 January 2019 to 31 March 2019 are therefore out-of-scope for VAT purposes;* *• Services supplied from 1 March 2019 to 31 May 2019:* *You are required to apportion the value of the supplies on a fair and reasonable basis over the period 1 March 2019 to 31 May 2019. For example, assume you charge R300 000 for the period, a fair and reasonable basis would be to allocate R100 000 to each month. R100 000 for the period 1 March 2019 to 31 March 2019 would represent consideration in respect of out-of-scope supplies, whereas R200 000 for the period 1 April 2019 to 31 May 2019 would represent*

		consideration in respect of taxable supplies of 'electronic services'. However, as you are likely to only be required to register as a vendor from 1 May 2019, only the R100 000 representing consideration for electronic services provided during May 2019 will be subject to tax at 15%.
66	What does the term 'imported services' mean?	It is a supply of services by a non-resident conducting a business outside South Africa, to a recipient in South Africa, to the extent that the services are used or consumed in South Africa, otherwise than for the purposes of making taxable supplies. 'Electronic services' do not fall within the ambit of 'imported services' to the extent that the supplier is conducting an 'enterprise' in South Africa, and is required to register as a vendor. Refer to **Questions 23** and **27**. ***Examples*** • A private individual downloads music from a non-resident supplier using the internet. • A long-term insurer receives software maintenance services electronically from a non-resident supplier to update the calculation of the premiums on certain life products. Also refer to **Questions 67** and **68**.
67	How do I pay VAT on imported services?	You have to declare and pay the VAT on imported services to the extent that the value of the supply exceeds R100. A non-vendor must furnish a return and pay VAT on the 'imported services' within 30 days calculated from the earlier of the date an invoice is issued or payment is made. A VAT215 must be completed and submitted, together with the payment of the applicable VAT, or in the case of eFiling, the proof of payment, at the nearest SARS branch office.

		A recipient that is a vendor must calculate and declare the VAT on the 'imported services' on the VAT201 return in Field 12. Also refer to **Questions 66** and **68**.
68	On what value is VAT payable on imported services?	The value to be placed on imported services is the greater of the amount paid or the open market value thereof. Also refer to **Questions 66** and **67**.
68	Can I deregister as a vendor if I no longer exceed the registration threshold?	**Yes**. A General Binding Ruling (BGR) was issued allowing foreign electronic services suppliers that will have taxable supplies of a value not exceeding R1 million in a 12-month period, to have their VAT registration cancelled. Refer to BGR 51 'Cancellation of Registration of a Foreign Electronic Services Supplier'. Applications for deregistration must be directed to **eCommerceRegistration@sars.gov.za**.

11.2. Comprehensive Guide to Dividends Tax (Issue 3)

The purpose of this guide is to assist users in gaining a more in-depth understanding of dividends tax. While this guide reflects SARS' interpretation of the law, taxpayers who take a different view are free to avail themselves of the normal avenues for resolving such differences. The foundation for this guide can be found in the various Explanatory Memoranda which supported the dividends tax legislation. The explanations contained in these Explanatory Memoranda have been expanded with additional explanations and examples.

Contents:

Chapter 3	Levy of dividends tax, liability for dividends tax and transitional arrangements (ss 8F(2), 8FA(2), 9H(3), 12Q(3), 24BA(3)(b), 25BB(6), 26B(2), 31(3), 64E, 64EA and 64EB)
Chapter 4	Exemption from dividends tax and relief from double taxation (ss 64F, 64FA and 108)
Chapter 5	Withholding of dividends tax (ss 64G, 64H and 64I)
Chapter 6	STC credit (s 64J) (1 April 2012 – 31 March 2015)
Chapter 7	Payment and recovery of dividends tax and recordkeeping (s 64K; and ss 25, 29, 91(2) and (4), 92, 95(1), 99(1), 157, 180, 189, 210 and 222 of the TA Act)
Chapter 8	Refund of dividends tax (ss 64L, 64LA and 64M; and s 190 of the TA Act)
Chapter 9	Rebate against normal tax or dividends tax in respect of foreign taxes on dividends (ss 6quat and 64N)
Chapter 10	Company reorganisation rules – CTC and dividends tax [ss 42(3A), 44(4A), 44(6)(c), 44(6)(e), 44(9)(a), 44(10), 46(3A) and 46(5)]

12. 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.