TAX UPDATE

For period: October 2020 to December 2020

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1. INTRODUCTION

The purpose of this update is to summarise developments that occurred during the fourth quarter of 2020, 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.

Please 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!

2. ACTS PROMULGATED

On 5 November 2020 the following Acts were promulgated:

- Disaster Management Tax Relief Act
- Disaster Management Tax Relief Administration Act

3. TAX CASES

3.1. Diageo South Africa (Pty) Ltd v C:SARS – 82 SATC 351

Diageo South Africa (Pty) Ltd (Diageo), who was engaged in the business of the importation, manufacturing and distribution of alcoholic beverages, had entered into an agreement with foreign brand owners for the advertising and promotion of their alcoholic products in South Africa. The brand owners granted Diageo the exclusive rights in respect of the brands distributed by it to use the brand owners' trademarks, intellectual property, equipment, packages and labels in South Africa.

The brand owners invested in advertising and promotions (A & P) to build and maintain brand recognition and perception, with the aim of generating sales and sustainable long-term cash flow, by way of enhanced brand equity. The brand owners, however, did not perform or undertake these activities themselves in respect of their brands as they relied instead on Diageo who rendered these services to the brand owners in return for a fee, which was calculated with reference to the costs and expenditure incurred on advertising and promoting the brand owners' brands.

The advertising and marketing activities consisted of a range of activities such as advertising from various channels, brand building promotions, events, sponsorships and market research. Services which were rendered by Diageo included advertising media cost and digital, website design and build, social networks and sponsorship of, amongst others, sports events. In addition, Diageo made use of promotional merchandise and packaging; alcoholic products for sampling; and branded giveaway items such as glasses, optics, towels, beer mats, lanyards, keyrings, T-shirts, aprons, caps and the like and these were given away free of charge to third parties for use or consumption within South Africa for purposes of promoting the product.

The handing out of the physical goods by Diageo in the course of rendering the A & P services to the brand owners was not an end in itself but simply another means to enhance brand equity and sales. Two categories of goods were used. Firstly, products of the brand owners namely, alcoholic beverages were taken out of the trading stock and used for product sampling or tasting. Secondly, point of sales items such as branded glasses and T-shirts were given to third parties, for no consideration. Similarly, aprons and caps were supplied to employees at no cost to them.

Importantly, it was left to the discretion of Diageo as to how much of the budget was to be spent on, for example, promotional giveaways and samples, which particular items were to be used and in what quantities and manner they were to be used and distributed and this activity was undertaken as part of an integrated and synergetic marketing campaign as the ultimate objective was to build and maintain the brand image.

The fee charged by Diageo to the brand owners represented the cost incurred by Diageo in rendering the A & P services, which comprised the supply of both goods and services, to the brand owners. However, the tax invoices rendered by Diageo to the brand owners reflected a total fee for services rendered and it did not differentiate between goods and services. Although such fee was charged through a South African joint-venture entity, known as Brandhouse Beverages, to which Diageo had outsourced the marketing function, the supply remained one by Diageo to the brand owners and the fee was charged on the basis that it constituted a zero-rated supply of the A & P services in terms of section 11(2)(*l*) of the Value-Added Tax Act.

The brand owners and Diageo split the A & P services expenditure 50:50 up to 15% of net sales value and the brand owners funded the balance of the A & P services expenditure in instances where it exceeded 15%. The portion of the A & P services expenditure funded by Diageo was accordingly limited to a maximum of 7.5% of the net sales values for each brand.

SARS had invoked section 8(15) of the Value-Added Tax Act and maintained that Diageo had made deemed separate supplies of zero rated A & P services and standard rated goods in the form of promotional giveaways and samples that were not exported, but were consumed in the Republic.

Section 8(15) provided at the relevant time:

> 'For the purposes of this Act, where a single supply of goods or services or of goods and services would, if separate considerations had been payable, have been charged with tax in part at the rate applicable under section 7(1)(*a*) and in part at the rate applicable under section 11, each part of the supply concerned shall be deemed to be a separate supply.'

SARS assessed Diageo for additional output VAT on the goods component of the supply of the A & P services rendered by Diageo to the brand owners during the specified periods and Diageo's output VAT was accordingly adjusted by the inclusion of certain further amounts.

Diageo challenged the additional assessment in the Cape Town Tax Court (see *ITC 1922* (2018) 81 SATC 390 *per* Savage J) where it contended that it made a supply only of zero-rated A & P services to the brand owners and that it did not make separate or dissociable supplies of both services and goods.

However, the Tax Court held that the supply of promotional goods, as a portion of the single A & P service was, by virtue of section 8(15), a cognisable supply of goods capable of notional separation from the total A & P services supplied to the brand owners and this local supply of promotional goods, <u>not exported but consumed in South Africa</u>, was accordingly deemed to be a separate supply, and VAT at the standard rate in terms of section 7(1)(*a*) of the Act, was justifiably levied on these goods, with the result that the additional assessments were confirmed.

Diageo was therefore liable for the VAT output tax adjustment under section 8(15) in respect of the A & P services costs incurred by Diageo constituting goods not exported but consumed in the Republic and the present appeal, with the leave of the Tax Court, was against that finding.

This appeal concerned the proper interpretation and application of section 8(15) of the Value-Added Tax Act in the context of a single supply of advertising and promotional goods and services (the A & P services) by Diageo who was a South African VAT vendor to various non-resident entities, being the brand owners.

Diageo contended that section 8(15) was incapable of being applied to the facts of this case as, in order for section 8(15) to apply, it was required that a vendor must make 'separate dissociable supplies of both services and goods' or supplies that are 'economically divisible, independent and hence dissociable' and which constitute 'an end in itself', not a means to achieve that end and in its view, the A & P services concerned in this case were not such a supply as they did not involve an independent supply of goods capable of standing alone for VAT purposes, as something separate from the A & P services and the section did not deem supplies to be separate when they were economically not dissociable.

Diageo further submitted that the sole contractual obligation owed by it to the brand owners was to provide a service for the purposes of the Act, and that it owed no contractual obligation to the brand owners to supply goods at all. In other words, its use and distribution of promotional goods was not an end in itself, but a means to achieve the objective of the preservation and enhancement of the brands, through the provision of the A & P services and the fact that it incurred expenditure in acquiring goods for the purpose of enabling it to supply a service, did not mean that it supplied both goods and services.

Judge Mbha held the following:

(i) That section 8(15) was, as SARS had correctly submitted, a deeming provision and section 8, under which it is located, is headed 'Certain supplies of goods or services deemed to be made or not made' and the effect thereof, in laying down an hypothesis was that the hypothesis shall be carried as far as necessary to achieve the legislative purpose, but no further.

(ii) That the jurisdictional requirements that must be met before the deeming provision can be invoked are, first, a 'single supply' of two or more types of goods or services or a combination of goods and services. Secondly, one consideration must be payable as only a single supply is made and, lastly, the circumstances must be such that if the supply of the goods or services or of the goods and services had been charged for separately, part of the supply would have been standard rated and part zero-rated ('notional separate considerations').

(iii) That, in addition, section 8(15) must be interpreted in the context of the provisions of section 7(1)(*a*) of the Act, in terms of which the supply of goods and services by a vendor, in the course or furtherance of an enterprise, attracts VAT at a standard rate, and section 11(2)(*l*) which constitutes an exception to the provisions of section 7 as goods or services, or goods and services supplied to non-residents in the Republic are zero-rated in terms of section 11(2)(*l*).

(iv) That, simply put, the purpose of section 8(15) was to provide, by way of a deeming provision, for a situation where the provisions of sections 7(1)(*a*) and 11(2)(*l*) of the Act are implicated in a single supply of goods, or services, or goods and services so that the appropriate rate of VAT is charged in respect of the particular goods or services or goods and services supplied.

(iv) That SARS pointed out correctly that the single supply provided by Diageo to the brand owners consisted of both goods and services that were distinct and clearly identifiable from each other. Only one consideration was payable to Diageo in respect of that single supply. Had separate considerations been payable in respect of the goods and of the services, part of the supply (the goods consumed in the Republic) would have been standard-rated and the part consisting of the services supplied to non-residents would have been zero-rated. Thus, by application of section 8(15), each part of the supply was deemed to be a separate supply and the supply of goods forming part of the A & P services rendered by Diageo to the brand owners therefore constituted a standard rated supply.

(v) That Diageo's reliance on foreign authorities was unhelpful because, as SARS correctly submitted, these did not deal with the interpretation of statutory provisions that are the functional equivalent of the deeming provision or an apportionment provision as one finds in section 8(15) of the Act. Thus, formulations such as 'economically not dissociable', 'the supply not being an end in itself' and the question of 'principal and ancillary supplies', which finds expression in those authorities, plays no role whatsoever in the interpretation and application of section 8(15) and, furthermore, the respective statutory provisions have very little in common with section 8(15) of the Act.

(vi) That, for section 8(15) to apply, it only has to be determined whether 'each part of a single supply' properly falls within its ambit for the deeming provisions to be triggered and the meaning of the section was clearly described in *C:SARS v British Airways plc* 67 SATC 167 at paras 10 and 11 and of significance to the present appeal is what was stated at par. 13:'…The section does no more than apportion the rate at which the vendor is required to pay the tax that is levied by section 7 when the vendor has supplied different goods or services as a composite whole.'

(vii) That, having regard to the facts of this case, the provision of the A & P services by Diageo to the foreign based brand owners comprised a single supply of goods and services, which, if they had been supplied separately, would have attracted a different rate of tax and for which a single consideration was payable.

(ix) That the jurisdictional requirements of section 8(15) were therefore satisfied with the result that the deeming provision had the effect of notionally separating the supply of services from the supply of goods, when in fact they were not separate supplies. Furthermore, there could be no justification for importing into section 8(15) a requirement derived from foreign authorities, as Diageo would have it, that the deeming provision may apply only to a single supply of economically divisible, independent and hence dissociable supplies of goods and services.

(x) That, accordingly, Diageo's criticism of the approach of SARS and the Tax Court to the interpretation of section 8(15), that it produced an artificial and insensible result and a commercially unreal outcome, could not be justified. To the contrary, that approach accords with this court's *dictum* in *Natal Joint Municipal Pension Fund* v *Endumeni Municipality* 2012 (4) SA 593(SCA) at par. 18.

(xi) That, as has been shown above, the meaning of section 8(15) of the Act was clear. Its purpose is to ensure that in a case like the present, Diageo and other similarly positioned VAT vendors fulfil their obligation to pay VAT at the standard rate on the goods that they have supplied. Clearly, this cannot be an artificial and insensible result and does not in any way produce a commercially unreal outcome.

(xii) That Diageo was accordingly liable for the VAT output tax adjustments under section 8(15) of the Act in respect of advertising and promotional costs incurred by Diageo constituting goods, not exported but consumed in the Republic.

Appeal dismissed with costs.

3.2. ITC 1932 – Application for postponements – 82 SATC 373

The taxpayer had objected to and then appealed against an assessment issued by SARS on the basis that the assessment was too high.

During the pleading stage of the matter SARS had indicated to the taxpayer that it too was dissatisfied with the assessment in question as, in its view, it was too low and he accordingly had informed the taxpayer that he would be asking for the assessment to be altered upwards at the hearing.

The matter had been set down for hearing in the Tax Court for two weeks, commencing on Monday 18 November 2019 and on that morning the court was informed by counsel, Mr X, claiming to act on behalf of the taxpayer and that he held a brief from M and M Inc, to apply for a postponement of the matter only.

Neither the taxpayer nor M nor Mr X had deemed it necessary to communicate to the taxpayer's attorneys, K Attorneys, or SARS' counsel that M was representing the taxpayer and that the taxpayer had intended to apply for a postponement at the hearing.

In fact, SARS was taken by surprise to find Mr X attending the court and claiming to represent the taxpayer and the only time that SARS had been informed that the taxpayer intended to apply for a postponement was when Mr X communicated such to its counsel at the door of the court.

Mr Z SC, who acted for SARS, stated that he had been unable to get the taxpayer to attend a meeting to finalise all pre-hearing preparations and he had therefore prepared an affidavit in anticipation of an application for postponement which was intended to place facts in opposition to a possible application for postponement by the taxpayer before the court.

Mr Z further pointed out that Mr X's attorneys, M, had failed to place themselves on record and Mr X acknowledged that M was not on record, and, as his brief was from them, he had no right to represent the taxpayer in these proceedings until M had placed itself on record. He was asked if his briefing attorney from M was present in court and his response was that his briefing attorney was Mr M but Mr M was not present at the hearing but had sent a candidate attorney to represent him at the proceedings. He confirmed that the candidate attorney was not fully apprised of the facts and the issues in the matter.

Mr X was informed that such conduct was not amenable to a proper ventilation of the issues and he asked for the matter to stand down for him to clear up the issue and his request was granted.

Upon resumption of the matter, Mr X handed up what purported to be a notice of appointment of M as attorneys of record by the taxpayer, but the said notice was clearly problematic as it stated that M appointed itself as attorneys of record and Mr X was asked to explain the contents of the notice of appointment as well as why there was no accompanying notice of motion, and why the application was brought so tardily at the hearing.

It emerged that the instructing attorney M had only been instructed ‘during the weekend’ before the hearing and that the attorney had a ‘skydiving’ event to attend to that weekend and was therefore unable to prepare and present a proper application to the court.

Despite the problems associated with the manner in which the application for the postponement was brought, Mr Z requested the court that it be entertained and that Mr X be allowed to represent the taxpayer as SARS was anxious to have the matter finalised. He requested that the taxpayer’s affidavit in support of the application be admitted and he informed the court that SARS had no intention to respond specifically to it.

After considering the issues, the court agreed to entertain the application for postponement.

Mr X handed up the affidavit in support of the application and gave a copy thereof to Mr Z who did the same with regard to SARS' affidavit and both affidavits were admitted and argument was entertained and an *ex-tempore* order was issued with a commitment from the court that written reasons for the order would follow in due course.

Mr X had indicated that the taxpayer’s affidavit had contained all the factual averments necessary to support the application and had consisted of fifteen single sentence par..

SARS contended that the contents of the taxpayer’s affidavit were simply false when placed against the facts emanating from its affidavit and it submitted further that the taxpayer’s case had failed to even meet the basic legal requirements for a postponement.

The court’s order was that the application for postponement was dismissed with costs.

As soon as the order was issued, Mr X stood up and asked to be released as his brief had terminated upon the finalisation of the application for postponement and that he had no knowledge of the taxpayer having any other representatives.

The court then gave its reasons for dismissing the application for a postponement.

A further issue dealt with by the court was whether, after Mr X had left the court, SARS would be entitled, as he had requested, to be allowed to lead his evidence on the appeal.

SARS had indicated to the taxpayer that he would be seeking an order setting aside the assessment and having it replaced with one where the amount that it would seek in the order was higher than the assessment that had been issued and to this end it had informed the taxpayer during all the pre-trial processes that it would be adopting this stance.

As the taxpayer had now failed to make an appearance at the hearing, SARS asked that it be allowed to present its evidence.

SARS contended that there was still a live issue before the court and the court, in terms of the powers conferred upon it by the Tax Administration Act and the Rules of the Tax Court, was empowered, if not obliged, to determine its claim regarding the alteration of the assessment.

SARS pointed out that the taxpayer had brought its claim in terms of section 107 of the Tax Administration Act and which appeal had to be dealt with in terms of section 117(1) and the decision had to be made in accordance with section 129 of that Act.

The Tax Court had to decide whether it was obliged to dismiss the taxpayer’s appeal together with a costs order and leave it at that, as the taxpayer, by failing to attend, was not pursuing its appeal.

Judge Vally held the following:

<u>As to the application for a postponement</u>

(i) That a court has a discretion to grant or refuse a postponement, which discretion has to be judicially exercised and a judicial exercising of the discretion must commence with a careful consideration of the facts presented in support thereof by the Applicant, who by seeking the postponement is asking for an indulgence.

(ii) That the facts must establish that the Applicant has true and genuine reasons (show good cause) for seeking the indulgence and to establish this the Applicant should at the very least be open and candid with the court and the application must be made in good faith.

(iii) That the Applicant should place the full facts of its non-preparedness for the hearing before the court and the facts must constitute a satisfactory reason for the non-preparedness.

(iv) That the postponement must not result in SARS having to endure a prejudice which cannot be cured by an order of costs and the application must be brought timeously so that any prejudice that SARS may suffer can be mitigated.

(iv) That the sum total of the averments do not address even the most basic and fundamental of requirements for a postponement.

(v) That it was known as a matter of objective fact that the attorneys for the taxpayer had filed a notice of withdrawal on 17 October 2019 and the withdrawal was therefore one month before the hearing date. Yet Mr X asked the court to accept the averment that the taxpayer only came to learn of the withdrawal ten days prior to the hearing date. On the probabilities this simply could not be true and the court had to decline his invitation to accept it as being true. But even if the court were to accept the averment at face value, it would still require the taxpayer to furnish some explanation as to why this knowledge only came to it so late in the day. However, it did not make an effort to provide one.

(vi) That, furthermore, it would have had to show that the withdrawal was unforeseen, was not a consequence of its own actions and that it was not engineered to justify the postponement of the hearing. This is necessary for it to show that it had true and genuine reasons for the postponement and that it was *bona fide* in seeking the indulgence. The taxpayer made no effort to even respond to SARS' concern which was that the matter had dragged on for so long that any further delay would cause it prejudice that could not be cured by a costs order.

(vii) That it was on the basis of the above reasoning that the application for postponement was dismissed with the costs of two counsel.

(ix) That the court concluded on this issue by recording its displeasure at the conduct of the taxpayer, its present attorney and the two officers of the court. The manner in which the application was brought by the taxpayer and its attorney was not consistent with their duty of respect to the court and the two attorneys allowed themselves to become enmeshed in an unenviable position, causing themselves and this court great embarrassment.

(x) That a court should be able to accept affidavits and letters from attorneys in the confidence that the averments contained therein are beyond reproach. It is a recognised principle that attorneys should never place themselves in a situation where they are forced to be less than candid with the court. In this case, one of the attorneys, Ms F, is an employee of a party, but she is an attorney nevertheless, and her duty of candour to the court is no less applicable than it would have been if the party before the court was her client. In the same vein, the other attorney, Mr G, voluntarily decided to act for a client in whose affairs he was intimately involved and by so doing he exposed himself to a conflict of interest, and soon enough the conflict became real when his partners in the law firm asked him to terminate his relationship as a legal representative of the taxpayer.

<u>As to the tax appeal</u>

(xi) That the taxpayer had brought its claim in terms of section 107 of the Tax Administration Act and whose appeal had to be dealt with in terms of section 117(1) of the Act and the decision had to be made in accordance with section 129 of the Act.

(xii) That section 107 of the Tax Administration Act only allowed for an appeal from the taxpayer and this was beyond doubt or debate and, understandably, there was no allowance for an appeal by SARS against its own assessment.

(xiii) That section 129(1) specifically restricted the court's jurisdiction to hearing 'the taxpayer's appeal' lodged in terms of section 107 and it was clear from this that it was the taxpayer's appeal that had to be before the court.

(xiv) That section 129(2) empowered the court to either 'confirm' the assessment, order that it be 'altered' or 'refer the assessment back' to SARS for re-evaluation and this could only mean that once this court has examined the taxpayer's appeal, it can exercise either one of the three powers but it does not exercise the powers in a vacuum. It only acquires them once the taxpayer has exercised his/her/its rights to appeal against the assessment in terms of section 107.

(xv) That, hence, section 129(1) specifically highlights that the 'decision' of the court is taken 'after hearing the 'appellant's appeal' and section 129(2) cannot be divorced from these two sections as it provides the court with remedial powers, but these remedial powers exist in the context of sections 107 and 129(1).

(xvi) That, while it is true that section 129(2)(*b*) empowers the court to 'alter' the assessment, the immediate issue is, when can the alteration take place? Reading sections 107, 129(1) and 129(2) conjunctively, the court concluded that the alteration can only take place once the taxpayer's appeal has been heard. This conclusion is fortified by the fact that section 129(1) provides that the taxpayer bears the *onus* of proof to show that the assessment is wrong and it alone should show that the assessment is wrong and the Act does not anticipate SARS challenging its own assessment.

(xvii) That Rule 44(7) allows the court to continue with the proceedings in the absence of an appellant and further allows the court to either 'confirm' the assessment, 'alter' it or 'refer' it back to SARS for re-evaluation. The Rule, in the court's view, overlooked the fact that when an appellant does not appear, his/her/its appeal is not heard and, more importantly, the Rule does not provide a basis to overlook or disregard the provisions of sections 107 and 129(1).

(xviii) That the Rule does not override the statute. On the contrary, the statute as primary legislation remains predominant, whereas the rules as delegated legislation are subordinate.

(xix) That, at the same time, it is important to bear in mind that the Tax Court does not possess inherent powers as it is purely a creature of statute. The provisions of the statute lay down the parameters of its jurisdiction and it has no powers outside the statute. Consistent with sections 116 and 107, section 129(1) makes it clear that the decision of the Tax Court is one that can only be arrived at 'after hearing the taxpayer's appeal' and those are the parameters that this court is confined to and the provisions of Rule 44(7) cannot alter these parameters.

(xx) That, accordingly, once Mr X had withdrawn from the proceedings and no representative from the taxpayer was present, the appeal was effectively withdrawn: the taxpayer was aware of the proceedings and sent a representative to seek a postponement. On the basis of these two facts it is appropriate to infer that it deliberately chose not to participate in the proceedings. Ideally, it should have withdrawn the appeal, but its failure to do so is no bar for this court to come to the conclusion that its conduct indicated exactly that.

Appeal dismissed.

Application for postponement of the hearing by the taxpayer was dismissed.

3.3. ITC 1933 – VAT input tax allocation – 82 SATC 388

The taxpayer, under the style and name of X Exchange, supplied and exchanged traveller's cheques and currencies to inbound and outbound travellers and it consisted of three divisions, being its Head Office, Treasury and Branch Network, each with separate operational functions.

The taxpayer's business consisted of 52 branches with a staff compliment of approximately 240 members in total.

The Treasury division was responsible for setting exchange rates for buying and selling foreign currencies to the customers and it set the rate of the currency and added a margin thereon and thereafter the rate, inclusive of the margin, was displayed on the board in the branch to enable customers to buy and sell the currency.

The margins were not known to the customers and were known only to the taxpayer and they represented the taxpayer's profit from the transaction which was built into the rate of exchange used by the taxpayer.

The branch network was responsible for the exchange and sale of foreign currencies to customers and when the customer bought or sold the currency, the branch processed the transaction and charged the customer a commission or fee for its services and the transaction was concluded when the customer entered the branch and bought or sold the currency.

The taxpayer, for many years, had applied the apportionment method in determining the input VAT that it claimed on the basis that it provided both standard-rate supplies and exempt supplies and, at the time, this was considered to be the appropriate method of dealing with its VAT. As a result, for the VAT periods July 2008 to August 2013 the VAT incurred on all goods and services supplied by the taxpayer was apportioned based on the standard turn-over-based method of apportionment, but thereafter during the September 2013 VAT period when the taxpayer accounted for VAT in its returns on the basis of the direct attribution method, matters came at a head.

The taxpayer, in its VAT return for the September 2013 tax period, claimed a refund of R24 389 036.58, which was the portion of input tax which it previously had not claimed in full and reversed the portion of input tax previously claimed for the tax periods June 2008 to August 2013.

The taxpayer had informed SARS, that it had since reviewed its apportionment methodology and was then of the view that it could directly attribute the VAT incurred to specific divisions within its business and this was due to the fact that it was in a position to identify segments of its business generating standard-rate supplies and those generating exempt supplies and allocate expenditure to the different segments.

The taxpayer submitted that it was more appropriate to claim input VAT on all expenditure of the segments of the business that produced standard-rate supplies and not claim any input VAT for expenditure of those segments of the business that produced exempt supplies.

Although SARS had refunded the amount of R24 389 036.58 to the taxpayer, on 6 April 2016 SARS raised additional assessments against the taxpayer in terms of section 92 of the Tax Administration Act and had disallowed the input VAT claimed by the taxpayer's branches to the extent that such VAT related to the making of exempt supplies or other non-taxable purposes and, in addition, a percentage-based penalty and interest were imposed by SARS.

The capital amount of the assessment amounted to R24 389 036.56, a penalty adjustment was imposed as well as interest thereon.

The taxpayer thereafter raised an objection to the assessment on 18 May 2016 and on 14 November 2016 SARS partially disallowed the objection to the additional assessment and only the part of the objection that related to the percentage-based penalty was allowed and SARS had made the relevant adjustment to the assessment.

The taxpayer thereafter filed a notice of appeal against the partial disallowance of the objection.

SARS opposed the appeal on the basis that the taxpayer in its business made supplies that were partly taxable and partly exempt and it was SARS' case that the apportionment method ought to have been applied in respect of the return submitted during the relevant VAT period and had rejected the taxpayer's direct attribution self-assessment method in dealing with VAT.

SARS was of the view that the exchange of currency was a financial service, the supply of which was exempt from the provisions of section 12(*a*) read with section 2(1)(*a*) of the Act, whereas the taxpayer contended that the correct interpretation of the proviso to section 2(1)(*a*) of the Act was that the activity of financial services was no longer deemed to be financial services where the consideration payable is a fee or commission.

The dispute between the parties in these proceedings concerned the deductibility, for VAT purposes, of the VAT paid by the taxpayer in respect of the 52 branches in which it traded with its customers.

The taxpayer maintained that this VAT paid by it was, in its entirety, 'input tax' as defined in section 1 of the Value-Added Tax Act and therefore fully deductible from the 'output tax' levied by it.

In other words, the court had to determine whether the taxpayer was correct in applying direct attribution as opposed to the apportionment method in respect of VAT incurred by its branches.

Judge Maluleke held the following:

(i) That to determine this dispute the court had to have regard to the applicable legislative framework and provisions of the Value-Added Tax Act and, in particular, the determination of this case turns on the correct interpretation of the proviso to section 2(1) of the Act.

(ii) That the question to be answered was whether the exchange of currency in this case fell within the definition of 'financial services' in terms of section 12(*a*) of the Value-Added Tax Act, which provided that the supply of any financial services shall be exempt from the tax imposed under section 7(1)(*a*) of the Act.

(iii) That the court was inclined to agree with previous authorities cited herein (see *C:SARS* v *Respublica (Pty) Ltd* 81 SATC 175 at par.. 12–13) that when assessing the VAT consequences of a supply, that must be assessed by reference, first and foremost, to the contractual arrangement under which the supply was made and what was crucial was the ascertainment of the legal rights and duties which are contractually created by the transaction into which the parties entered.

(iv) That before the court there were underlying contracts between the taxpayer and its customers underpinning the transactions, which were at the heart of the current dispute and the features of which were:

- the agreement to exchange specified currencies
- at a particular rate of exchange nominated by the taxpayer and
- the payment by the customers of a commission.

It was clear that the so-called margin (notional or otherwise) was not part of this agreement as it was not known by either the taxpayer's Treasury department/branch and the customer when the transaction was closed at the branch.

(v) That we have learnt in this case that the so-called margin was something that happened much later when trades were closed between the bank and the taxpayer's Treasury division at the end of the day.

(vi) That it would be very absurd and untenable to decide the VAT consequences of transactions with reference to margins/profits earned by vendors as opposed to relying on the true nature of the rights and obligations arising from a particular contract in deciding whether a supply is taxable or exempt and that logic was foreign to our jurisprudence and the court could not reconcile itself with it.

(vii) That without undermining the legal and financial significance of this case to the parties, the issue for the court was a simple matter of what the facts tell us. On the facts and the evidence before the court it was dealing with an agreement between the taxpayer and its customers in terms of which the former sells currency to the latter for a commission or fee. The court then asks the question whether the payment of commission or a fee is 'consideration' as contemplated in the proviso to section 2(1) of the Act ? The court was inclined to respond in the affirmative.

(viii) That on the facts and evidence before the court this was the only payment that the customer made to the taxpayer for the exchange of currency and the issue of a notional margin does not detract from the fact that the commission paid by the customer was the only payment that was made for the exchange of currency and was, quite frankly, irrelevant for purposes of deciding this case.

(ix) That the court was with the taxpayer on the approach which it wishes the court to follow, namely, that the court must adopt the same meaning as that stipulated in the defined word 'consideration' but with reference to an 'exchange of currency' or 'financial services' rather than 'goods' or 'services' because the word 'consideration' is used in the proviso otherwise than in relation to 'goods' or 'services.'

(ix) That in the court's view SARS should therefore not have had difficulty with this proposition because it had accepted that the taxpayer was obliged to levy VAT on the commissions charged by it.

(x) That the court was therefore satisfied that the consideration in the form of a commission removed the activity of the 'exchange of currency' from being deemed financial services and required the vendor concerned to charge VAT as output tax which was payable to SARS, of course subject to any input tax that may be deductible.

(xi) That SARS' argument that the taxpayer in the manner in which it had organised its business made mixed supplies had no factual or legal basis on the facts of this case and accordingly had to fail.

(xii) That, consequently, the taxpayer had met its *onus* of proof in terms of section 102 of the Tax Administration Act in that a proper case had been made out by it for an order as set out in its Rule 32 statement of its grounds of appeal.

(xiii) That in the circumstances SARS' grounds of assessment and decision were unreasonable and especially for insisting that the taxpayer reverts to and must continue to use the apportionment method and not the direct attribution method without any legal justification in circumstances where it was reasonable to expect it to do so.

Appeal upheld.

3.4. Big G Restaurants (Pty) Ltd v C:SARS (Constitutional Court) – 82 SATC 403

Big G Restaurants (Pty) Ltd (Big G), was a franchisee operating a number of Spur and Panarottis restaurants in terms of written franchise agreements concluded with a franchisor, the Spur Group (Pty) Ltd (Spur Group).

Big G had claimed from SARS a section 24C(2) allowance for the 2011-2014 years of assessment for the future costs of revamping its restaurant premises as these costs were the direct result of a stipulation in the franchise agreements that Big G periodically revamp the premises.

Big G had claimed the allowance on the basis that for purposes of section 24C(2) of the Income Tax Act income received from customers in terms of individual contracts of sale between it and its customers was income received in terms of the franchise agreements between it and the Spur Group and costs of revamping the premises constituted 'future expenditure' as envisaged in section 24C of the Income Tax Act.

Big G's stance was that the income from customers had to be used in whole or in part to finance the inevitable future revamping expenditure which would be incurred by it in the performance of its obligations under the franchise agreements.

SARS had disallowed the allowance and had raised an additional assessment for the 2011–2014 years of assessment and the substance of why he did so was because the income in respect of which an allowance was claimed must have accrued in terms of the same contract that imposed the future expenditure in respect of which the allowance is being claimed.

SARS, however, submitted that the income in respect of which Big G was claiming the allowance was income that had accrued in terms of contracts concluded by it with individual customers at its restaurants and the future expenditure was not imposed by those contracts and hence that the future expenditure had been imposed by different contracts and these were the franchise agreements between Big G and the Spur Group.

Big G's objection to the aforementioned additional assessment was unsuccessful and Big G appealed to the Tax Court (see *ITC 1905* (2017) 80 SATC 223 *per* Cloete J) where, in a stated case, the parties asked the Tax Court to determine two issues, namely – (*a*) whether the income received by Big G from operating the franchise businesses included or consisted of any amount received or accrued to Big G in terms of the franchise agreements as envisaged in section 24C of the Income Tax Act and (*b*) whether the expenditure required to refurbish or upgrade was incurred by Big G 'in the performance of the taxpayer's obligations under such contract' as envisaged in section 24C.

The Tax Court had answered the aforementioned questions in Big G's favour and, paraphrased, its reasoning was that the franchise agreements had imposed an obligation on Big G to actively provide and sell meals to customers and although customers were not parties to those agreements, the proximate cause of those sales was this obligation. In each case this obligation appeared in the same contract that contained the obligation to refurbish the premises. The potential to refurbish is the future expenditure envisaged in section 24C(2) and, consequently, the Tax Court set aside the additional assessments raised by SARS.

SARS, with the leave of the Tax Court, appealed to the Supreme Court of Appeal (*see C:SARS* v *Big G Restaurants (Pty) Ltd* 81 SATC 185).

The Supreme Court of Appeal upheld the appeal and set aside the decision of the Tax Court on the basis of the reasoning that Big G had received income as a result of the contracts it concluded with individual patrons who came into its restaurants to buy food and that income did not accrue in terms of the franchise agreements.

Big G thereafter sought leave from the Constitutional Court to appeal against the judgment of the Supreme Court of Appeal.

Big G had based its contention that the Constitutional Court had jurisdiction to hear the appeal on section 167(3)(*b*)(ii) of the Constitution in that the matter raised an arguable point of law of general public importance which ought to be considered by that court.

The issue before the court was whether income derived from patrons of certain Spur and Panarottis restaurants was deductible by the Spur or Panarottis restaurateur in terms of section 24C(2) of the Income Tax Act.

Big G submitted in the Constitutional Court that the matter turned on the interpretation of the words 'in terms of' in section 24C of the Act. It contended that the general principles of interpretation require a 'unitary exercise' of interpretation, which whilst loyal to the text of a document, must make commercial sense. It submitted that the interpretation it proffered was the only interpretation that was business-like, consistent with the language of the section and did not undermine the purpose of section 24C.

Big G also engaged in an interpretation of the franchise agreements and the contracts of sale of food to customers in an attempt to demonstrate that section 24C did, indeed, find application.

SARS argued that Big G's case was unsustainable and, in this regard, he supported the reasoning of the Supreme Court of Appeal.

SARS, on the issue of jurisdiction, took issue with the submission that the Constitutional Court's jurisdiction under section 167(3)(*b*)(ii) was engaged and, in his view, this matter did not transcend the narrow interests of Big G and did not implicate the interests of a significant part of the general public.

Held Per Madlanga J (Jafta J, Khampepe J, Mhlantla J, Theron J, Tshiqi J and Victor AJ concurring):

<u>As to the jurisdiction of the Constitutional Court to hear the matter</u>

(i) That the Constitutional Court did have jurisdiction to hear the matter. This matter involved the interpretation of the franchise agreements and the individual contracts of sale of food. In this regard, the question was whether the franchise agreements and the contracts of sale of food are so interlinked that the sale of food income may be held to be income that accrues in terms of each franchise contract; each franchise agreement, of course, being the contract that imposes the obligation to revamp in future and thus creates the future expenditure. This interpretative question is a quintessential point of law. This question is also closely bound up with the interpretation of section 24C(2): what is the nature of the contract envisaged in the section? This element of interpretation adds to the legal character of the question to be determined.

(ii) That the next issue was whether the question was arguable. In *Paulsen v Slip Knot Investments 777 (Pty) Ltd* 2015 (5) BCLR 509 (CC) at par. 26 the Constitutional Court held that the notion that a point of law was arguable entailed some degree of merit in the argument but the argument need not, of necessity, be convincing at this stage, it must have a measure of plausibility. The word 'arguable' is used 'in the sense that there is substance in the argument advanced.'

(iii) That Big G's point met this test and the well-reasoned judgment of the Tax Court was indication enough in this regard.

(iv) That the point was of general public importance. It was hardly likely that within the Spur Group Big G's franchise agreements were unique. Also, the court can take judicial notice of the obvious fact that Spur restaurants in particular – not so much Panarottis restaurants – are spread across the length and breadth of South Africa. So, a determination of the contested issue is likely to affect Spur franchisees throughout South Africa. The issue 'transcends the narrow interests of the litigants and implicates the interest of a significant part of the general public.' That general public is the several other Spur franchisees spread across South Africa.

(iv) That certainty was required on this point of law and the point bears reasonable prospects of success and, for those reasons, the matter ought to be considered by this court.

(v) That the court carefully and specifically linked the relevance of interpreting section 24C(2) of the Income Tax Act to the legal question of interpreting the contracts so that this judgment should not be read to say that it is now open season for appeals on the interpretation of any provision of the Income Tax Act to be brought to this court.

(vi) That leave to appeal to the Constitutional Court was accordingly granted.

As to the applicability of section 24C of the Income Tax Act

(vii) That, at the time, section 24C(2) provided that 'the income…includes or consists of an amount received by or accrued to [the taxpayer] in terms of any contract and SARS 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 [her or] his obligations under such contract.' On the court's interpretation, it was a requirement of the section that the contract in terms of which the income that is to finance future expenditure is received or accrues must be the same contract under which the expenditure is incurred. So, there is a requirement of 'sameness' but the sameness requirement cannot be read to connote that there must, for example, in the case of a written contract, be one piece of paper stipulating for the earning of income and the imposition of future expenditure. Two or more contracts may be so inextricably linked that they may satisfy this requirement.

(ix) That, for a number of reasons, in particular those proffered by the Tax Court, Big G had submitted that the sale of food contracts did satisfy this requirement of sameness. Do they? In answering that question this court had to deal with the Tax Court's reasoning and it had to do so because Big G had placed strong reliance on it.

(x) That the Tax Court had relied on a number of terms of the franchise agreement including clause T.16 in terms of which the franchisor may cancel the franchise agreement if the franchisee fails to actively operate the franchise business. The Tax Court and Big G read this to mean that the franchise agreement itself imposes an obligation on the franchisee to sell food and the Tax Court concludes this point by saying 'the income generated from the sale of those meals is of course the same income that accrues to the taxpayer.' At first blush this was compelling but it did not bear scrutiny. A useful way of demonstrating this was using, as comparators, restaurateurs who were not operating under a franchise agreement (unattached restaurateurs).

(xi) That if an unattached restaurateur did not sell food, the business would fail. If serious about the business, the unattached restaurateur had an obligation – call it self-imposed – to make sure that the business succeeds. At the centre of that obligation was selling sufficient volumes of food and in substance this obligation was exactly the same as that of a Spur or Panarottis franchisee.

(xii) That the business of both would fail if they did not sell food. Without question, income derived from the sale of food by the unattached restaurateur did not entitle him or her to the section 24C(2) allowance and this was so for the simple reason that there was no contract in terms of which the unattached restaurateur has to fund future expenditure from income derived from that same contract. Must a franchisee derive the benefit of the allowance purely because there is the interposition of a franchise agreement which tells the franchisee to do something she or he would have had to do anyway? The court did not think so. An unattached restaurateur faced the same fate as the franchisee if she or he does not run her or his restaurant in a business-like manner: the business will fail. The two are similarly placed and have the same obligation.

(xiii) That the franchisor wants to guarantee returns for itself on the franchise agreement and a badly run franchise business may well mean less or no income for the franchisor. It makes sense, therefore, that the franchisor must insist on certain minimum or tried and tested standards and requirements. All things being equal, what benefits the franchisor must redound to the benefit of the franchisee as well. After all, the franchisee is in the business to make money and the franchisee's income will also be affected negatively if the franchise business is badly run.

(xiv) That from the perspective of the two categories of restaurateurs – whether unattached or operating in terms of franchise agreements – the purpose of operating restaurants in a business-like manner is the same. It escaped the court why – just because of terms imposed by franchisors in the one category – the situation of the two categories should be any different for purposes of section 24C and in substance the court saw no difference at all.

(xv) That the Tax Court and Big G also relied on clauses that oblige the franchisee to allow the franchisor access to the franchisee's financial information and to information on the franchisee's computer system. That reliance is misplaced. The aim of these clauses is less about the generation of income by the franchisee but more about the protection of the franchisor's interest. In any event, even if this had something to do with the franchisee's generation of income, that is still not income of a nature envisaged in section 24C of the Act.

(xvi) That the magnitude and frequency of expenditure relating to upkeep of a restaurant will depend on a variety of factors. A few examples of these are the level at which the restaurant is operating, the size of the restaurant and how busy it is. An unattached so-called fine dining restaurant may even have standards that are more exacting and costly than those of a Spur or Panarottis restaurant. Thus in substance, the court saw no principled basis which sets apart restaurants operated under Spur or Panarottis franchise agreements.

(xvii) That it would be absurd in the extreme to allow Big G to enjoy the benefit of an allowance under section 24C of the Act whilst denying it to unattached restaurateurs who, as the court found, are similarly placed. Likewise, an interpretation that gives rise to that differential treatment of unattached restaurateurs would be unjust. An interpretation that avoids an injustice should be preferred to one that does the opposite.

(xviii) That, in sum, the court was not satisfied that Big G had been able to place the contracts in terms of which it earned an income from its customers within the ambit of the income-earning contract envisaged in section 24C of the Act and, quite clearly, the obligations that Big G had to perform were imposed, not by the sale of food contracts, but by the franchise agreements and this lack of correlation between the income-earning contracts and obligation-imposing contracts plainly made section 24C inapplicable.

(xix) That it was not as though Big G will not derive a benefit from expending monies towards its upgrade or refurbishment obligations under the franchise agreements. It will be entitled to a deduction in terms of section 11 of the Income Tax Act but it is just that it will not be able to make an upfront deduction under section 24C of the Act.

(xx) That, accordingly, the questions in the stated case had to be answered in SARS' favour.

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

<u>Per Majiedt J, dissenting (Froneman J concurring)</u>

(xxi) That the test for jurisdiction in section 167(3)(*b*) of the Constitution is twofold. I restrict myself here to the question whether this court had jurisdiction in terms of section 167(3)(*b*)(ii) of the Constitution, that is, whether this matter raises an arguable point of law of general public importance. In the absence of a constitutional issue that arises in the interpretation of legislation, this court's jurisdiction will not be engaged. It is well-established that jurisdiction must be determined on the pleadings. In relation to the other leg that engages this court's jurisdiction, an arguable point of law postulates a dual enquiry: is the point one of law and is it arguable and then follows the next enquiry: is it of general public importance?

(xxii) That here the facts were not in issue and the case was presented and argued in the Tax Court as a stated case on common cause facts. It was patently obvious that there was no law involved in determining (*a*) from which contract the income was derived and (*b*) whether the two contracts were so inextricably linked that it mattered not from which one the income was derived. These were purely factual enquiries and nothing more. The attempt to dress them up as questions of law is untenable and ought to be rejected without more and that leaves the enquiry regarding the interpretation of section 24C of the Act.

(xxiii) That what required determination was whether a fact-specific interpretation of an unambiguous term in the tax statute engaged the court's jurisdiction. I think not. The meaning of the phrase 'in terms of' is plain and it can only, in its ordinary meaning, refer to a single contract.

(xxiv) That the phrase 'any contract' and 'such contract' self-evidently only refer to a single contract and, ultimately then, what we are called to determine, on the facts, is which contract applied here.

(xxv) That it cannot be that an enquiry into (*a*) which of two contracts give rise to the income, or (*b*) whether they can be regarded as a single contract for the purpose of interpreting the phrase 'in terms of', amounts to a constitutional issue or an arguable point of law of general public importance. The meaning of that phrase seems to me to be quite obvious. It plainly equated to 'concerning', 'regarding', 'relating to', 'pertaining to' or 'with regard to.'

(xxvi) That the Supreme Court of Appeal's reasoning and conclusion on this meaning cannot be faulted. The main judgment also accepts that reasoning and conclusion, preferring it over the contrary finding of the Tax Court. Once that finding is made, there is no basis on which it can be contended that an enquiry into a narrow or wide interpretation of the phrase constituted a jurisdictional basis for hearing the matter. I therefore conclude that, as is the case with the interpretation of the two agreements, the interpretation of 'in terms of' in section 24C(2) involved no law, but simply facts.

(xxvii) That the Tax Court was routinely seized with the need to determine whether a particular factual *matrix* fitted within the ambit of a tax provision. But it cannot, without more, engage this court's jurisdiction under section 167(3)(*b*)(ii) as an arguable point of law of general public importance, as concluded in the main judgment.

(xxviii) That the main judgment found that determining whether the income that accrued was income in respect of which the section 24C(2) allowance may be deducted, was a legal question and it stated that the ensuing question of the interlink between the contracts 'interpretative question is a quintessential point of law.' I respectfully disagree. These are plainly questions of fact and that approach will, with respect, result in a deluge of litigants claiming that this court has jurisdiction in matters which involve purely factual determinations.

(xxix) That, last, even if this issue is one of law, it cannot be said to be of general public importance. In my view, it matters not that we are dealing here with a taxpayer (Big G) who is a Spur franchisee. No evidence was adduced that all franchisee agreements with the franchisor are identical. There clearly cannot be a 'one size fits all' approach.

(xxx) That, in conclusion, save for arguability, this matter falls short in every respect of the jurisdictional standard set out in section 167(3)(*b*)(iii). It can be said to be arguable, due to the conflicting judgments of the Tax Court and the Supreme Court of Appeal, but even if it does entail a point of law, it is not one of general public importance.

(xxxi) That the application for leave to appeal should therefore be dismissed on the basis that this matter does not engage this court's jurisdiction and issue a concomitant costs order.

3.5. C:SARS v United Manganese of Kalahari (Pty) Ltd – 82 SATC 444

United Manganese of Kalahari (Pty) Ltd (UMK) was a major manganese miner in South Africa and it conducted its mining operations in the Northern Cape and sold manganese as an unrefined mineral resource both locally and overseas.

In respect of local sales purchasers took delivery of the manganese at the mine and no issues arose in relation to such sales. However, its sales to foreign purchasers were made on either an FOB or CIF basis and these sales gave rise to the present dispute between UMK and SARS.

UMK had rendered royalty returns to SARS in respect of the 2010 and 2011 tax years and in 2012 SARS had commenced an audit of those returns during the course of which it appeared that UMK and SARS had different approaches to the determination of the amount of UMK's gross sales for the purpose of calculating the royalties due by it.

UMK, in 2016, had approached the Gauteng Division of the High Court, Pretoria (see *United Manganese of Kalahari (Pty) Ltd* v *C:SARS* 80 SATC 192) seeking declaratory relief in regard to the proper method of determining the amount of its gross sales.

The High Court granted a declaratory order and refused leave to appeal but such leave was granted on application to the Supreme Court of Appeal.

The High Court held that UMK was entitled to calculate its gross sales in terms of sections 6(2) and 6(3) of the Royalty Act in respect of manganese transferred by it in the relevant years of assessment by deducting any expenditure incurred by it in respect of transport, insurance and handling of the manganese and that such expenditure could be deducted irrespective of whether any such expenditure was specifically and/or consciously considered in the determination of UMK's gross sales.

Both parties had correctly accepted that the expression 'received or accrued' in section 6(2)(*a*) of the Royalty Act bore the same meaning as the corresponding expression in the definition of 'gross income' in section 1 of the Income Tax Act 58 of 1962 and, accordingly, gross sales included every amount actually received by UMK, or to which UMK became entitled, in each of the years with which the court was concerned. The parties also agreed at what point the manganese ore was brought to the condition specified in Schedule 2 of the Royalty Act.

Mining companies, in exchange for the right to extract portion of the country's mineral wealth from the soil and dispose of it for their own profit, pay royalties to the National Revenue Fund in terms of section 2 of the Mineral and Petroleum Resources Royalty Act 28 of 2008 (the Royalty Act).

The royalty payable is determined in accordance with the formula in section 4(2) of the Royalty Act and one of the elements in calculating the formula is the mining company's gross sales and these are to be determined in accordance with section 6 of the Royalty Act.

Section 6(3)(*b*) of the Royalty Act provided, *inter alia*, that 'gross sales is determined without regard to any expenditure incurred in respect of transport, insurance and handling of an unrefined mineral resource after that mineral resource was brought to the condition specified in Schedule 2 for that mineral resource or any expenditure incurred in respect of transport, insurance and handling to effect the disposal of that mineral resource.'

The court's focus turned to the expression 'without regard to any expenditure incurred in respect of transport, insurance and handling' after the manganese ore was brought to the specified condition. The dispute related to the proper meaning and effect of that provision in determining UMK's gross sales for royalty purposes.

SARS contended that where the price charged by UMK to its customers specified separate amounts for transport, insurance and handling (TIH costs) of the ore in arriving at the global price to be paid, the amounts so specified should be deducted in determining the amount of gross sales on which royalties would be paid.

UMK contended that it was irrelevant whether the TIH costs were specified as separate line items in the determination of the price and what mattered was not the price charged to customers, but whether such costs had in fact been incurred by it in either of the circumstances described in section 6(3)(*b*) and, if they had been incurred, then a deduction fell to be made for such costs in calculating its gross sales for royalty purposes.

Judge Wallis held the following:

(i) That it was unnecessary to rehearse the established approach to the interpretation of statutes as it was an objective unitary process where consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. The approach is as applicable to taxing statutes as to any other statute. The inevitable point of departure is the language used in the provision under consideration.

(ii) That no difficulty arose in determining the amounts received or accrued by UMK from sales of manganese in the condition specified in Schedule 2 to the Royalty Act. This was its income from disposing of the minerals it extracted. The problem lay with the requirement to 'have regard to any expenditure incurred in respect of transport, insurance and handling' of the mineral. An immediate difficulty arose because TIH costs are expense items, not part of the receipts or accruals constituting gross sales. Receipts and accruals and expenditure on TIH costs fell on opposite sides of the ledger. Despite this, section 6(3)(*b*) directed the taxpayer to determine its gross sales without regard to these three items of expenditure. This was not optional. It was part of the section's prescription of the manner in which gross sales were to be determined for royalty purposes. It could not be disregarded. How then was the taxpayer to have regard to TIH costs in determining its gross sales? The answer, as SARS accepted, was that, when disregarding the specified expenditure, the taxpayer was obliged to make a deduction from the receipts and accruals constituting its gross sales.

(iii) That SARS had accepted that UMK had incurred expenditure in respect of TIH costs and, purely linguistically therefore, it was difficult to understand on what basis it had contended that UMK was not entitled to deduct the TIH costs it had actually incurred from its receipts and accruals. SARS said that the expression 'without regard to' meant that they should be disregarded by deducting them from the receipts and accruals. That being so, it seemed to follow naturally from the words of section 6(3)(*b*) that the TIH costs fell to be deducted from UMK's receipts and accruals.

(iv) That it was impossible to find any basis for SARS' qualification in its stance in the language of section 6(3)(*b*) of the Royalty Act. The section said that 'any expenditure' incurred in respect of TIH costs should be disregarded. It said nothing about the manner in which UMK should determine the prices to be paid by its customers, much less did it require that those prices should specify separately amounts to be charged for transport, insurance and handling of the mineral. All it said was that expenditure incurred in respect of TIH costs should be disregarded. That wording may have been clumsy and inapt to perform the intended function, because it required expenditure to be disregarded when dealing with receipts and accruals, but once it was accepted, as SARS did, that this involved deducting the expenditure in question from the receipts and accruals, any difficulty arising from the wording evaporated.

(iv) That SARS' approach was not a sensible construction of the section and a consideration of the context of the Royalty Act and its provisions in regard to payment of royalties pointed decisively away from the construction advanced by SARS. Context is fundamental in approaching the interpretation of all written instruments, but there are differences in context with different documents including the nature of the document itself. Legislation is different in character from contracts, and a contract formulated carefully by lawyers after lengthy negotiations will differ from one scribbled by laypeople on a page torn from a notebook.

(v) That the background to the Royalty Act is that South Africa is a country with vast mineral wealth, which is exploited primarily by private enterprise in a heavily regulated environment. The mining industry has always formed a major part of the South African economy. Royalties are payable in return for the right to exploit these mineral resources. As emerges from the two schedules to the Royalty Act, while some commodities are refined in this country, others are exported after only limited beneficiation. Most of this is shipped in bulk. The sample contracts put up by UMK, which were not suggested to be unrepresentative of contracts for the sale of bulk minerals, reflect trading denominated in an international currency, the US Dollar. These contracts were concluded on FOB or CIF terms and there is no reason not to accept that this would be common practice. The choice of one or the other allocates responsibility for transporting the mineral from country of origin to the country of the purchaser. Prices are fixed in dollars per ton FOB or CIF. Under such contracts the purchaser will not be interested in the TIH costs to be incurred by the seller, but will want to fix a global price to be paid for the minerals up to the point of delivery.

(vi) That it was proper then to approach the interpretation of section 6 of the Royalty Act on the basis that those responsible for drafting the legislation did so in the light of their knowledge of common, if not invariable, trading patterns. It can be accepted that they were aware that many contracts for the sale of minerals would be concluded at fixed prices on FOB or CIF terms, without the cost of transport, insurance and handling being separately specified. There was nothing to indicate why then, in providing that expenditure on TIH costs should be disregarded in determining the amount of gross sales, they would have in mind only those contracts – potentially very few in number – in which the price was divided into an amount for the mineral in question and separate amounts for transport, insurance and handling. No sensible reason existed, and none has been advanced in the affidavits or argument, for distinguishing between the two situations.

(vii) That the purpose of the Royalty Act was to secure the payment of royalties on the value of minerals extracted. Even if there are situations in which mineral extraction and transfer to a third party, which is the event attracting the royalty, occurs without incurring TIH costs, in very many if not the vast majority of cases, such costs are incurred in order to dispose of the minerals. The evident purpose of section 6(3)(*b*) was that the extractor would not be burdened by paying royalties on amounts expended on TIH costs and recovered as part of the price paid for the minerals. On SARS' case that is what happens when these costs are specified as separate components of the price of the mineral. It has provided no explanation for interpreting the section as meaning that where the same minerals are sold at the same global price, without a separate specification of TIH costs as components of the price, those costs should not be deducted.

(ix) That, lastly, SARS' contentions disregard the statutory history. The section was amended to the wording before the court with effect from March 2010. Since then it has been further amended in 2019 by the deletion of the words 'without regard to expenditure incurred' and their replacement by 'after deducting any expenditure actually incurred.' In argument SARS conceded that the effect of this was that all TIH costs incurred would be deductible in determining the amount of gross sales, irrespective of whether they had been separately specified as components of the price.

(x) That where Parliament has clearly shown by later amending legislation what was meant by the earlier legislation under amendment and the amending legislation is passed explicitly for the purpose of clarifying that meaning, it is permissible as an aid in interpretation to have regard to the meaning ascribed by the later legislation to its predecessor. That is not to say that the court is not exercising its proper function of interpreting the legislation. Counsel for SARS correctly said that if the prior version of section 6(3)(*b*) could not bear the meaning ascribed to it in the *explanatory memoranda* quoted above then it was not open to this court to remedy the legislature's earlier deficiencies. However, given that, without referring to the *memoranda*, the court had arrived at the conclusion that the section must bear that meaning, the subsequent amendment lends force to that conclusion.

(xi) That for the above reasons the appeal had to fail and UMK was entitled to calculate its gross sales (in terms of sections 6(2) and 6(3) of the Royalty Act) in respect of manganese transferred by it in the 2010 and 2011 years of assessment, by deducting (1) any expenditure incurred by it in respect of transport, insurance and handling of the manganese after the manganese had been brought to the condition specified in Schedule 2 of the Royalty Act, as well as (2) any expenditure incurred by it in respect of transport, insurance and handling to effect the disposal of the manganese irrespective of whether, in the price charged by it to purchasers of manganese, any amount was separately specified for expenditure incurred by it in respect of transport, insurance and handling under either of par. (1) and (2).

3.6. ITC 1934 – Understatement Penalties – 82 SATC 457

First Appellant, being Mr A, was the sole proprietor of a business known as XYZ, until the close of the tax year 2010.

Second Appellant, being XYZ CC, was the sole proprietor of XYZ, until the end of the 2012 tax year.

However, the First Appellant was the sole member of the Second Appellant and there was accordingly continuity of control over the affairs of XYZ for all of the tax periods involved in the present proceedings.

These tax appeal proceedings involved two appellants and four appeals, two relating to income tax assessments and two relating to VAT assessments.

It was common cause that the First Appellant had failed to submit income tax returns and VAT returns for the relevant tax years and VAT periods.

<u>It was common cause that the Second Appellant had failed to submit an income tax return for the 2011 tax year and the relevant VAT periods</u>.

The aforementioned circumstances led to audits of the tax affairs of both taxpayers in connection with their conduct of the business of XYZ and the assessments which resulted from the audit included substantial penalties.

Appellants had accepted that the taxes reflected in the assessments were correctly calculated and raised <u>and only the penalties were challenged in these appeals</u>.

In the case of the First Appellant, he was first notified of the 'current' audit relating to income tax in June 2012, and of the audit relating to VAT in October 2012. In the case of the Second Appellant, it was first notified of audits relating to both income tax and VAT by letter dated 29 January 2013.

The Second Appellant's income tax liability for the 2012 year was nevertheless investigated during the course of the audit and became part of the audit findings and for that reason that tax year also features in these appeal proceedings.

Two auditors were appointed in respect of the affairs of each of the taxpayers and Ms T was the auditor common to both audits and she was the only witness who testified in the appeal proceedings.

It emerged from Ms T's evidence and surrounding circumstances that if financial statements for the tax years in question had existed when the First Appellant was first informed of the audit, then they had been withheld from SARS. The initial audit findings letter relating to the First Appellant's income tax reflected amounts which were estimated otherwise than with reference to any annual financial statements produced by the First Appellant. The questions as to whether financial statements were withheld from Ms T, and as to when she received such statements if her recollection that she never received any was faulty, did not need to be resolved.

Ms T had submitted the audit findings to the committee dealing with penalties and that generated a decision that understatement penalties should be charged under Chapter 16 of the Tax Administration Act at 150%, upon the basis that the behaviour of the First and Second Appellants fell to be classified as 'intentional tax evasion'. Each of the cases was classified as 'standard' and that meant that it fell under the third column of the table of understatement penalty percentages appearing in section 223 of the Tax Administration Act.

In the case of both Appellants, the income tax years which followed the first one which was the subject of the audit, and the VAT periods which followed the first one which was the subject of the audit, were not classified as 'repeat cases.'

The finalisation of the audit generated assessments in respect of income tax and penalties thereon for both the First and Second Appellants, and assessments in respect of VAT and penalties thereon in respect of the Second Appellant.

The Appellants made objections thereto and they were dismissed by the SARS and thereafter both Appellants notified an intention to appeal.

The appeals by both Appellants against the penalties imposed on income tax and the penalties imposed on VAT were referred to alternative dispute resolution of the appealed assessments and the result thereof was a reclassification by SARS of the conduct and accordingly a reconsideration of the penalties to be imposed.

SARS decided that this was not a case of intentional tax evasion, but one of gross negligence and it also sought to reclassify each income tax year except the first, and each VAT period except the first, as a ‘repeat case’ as set out in the fourth column of the table in section 223 of the Tax Administration Act.

In effect, therefore, at the commencement of the appeal hearing SARS contended for reduced penalties in respect of the so-called first offences of 100% and in the case of the so-called ‘repeat cases’ of 125%.

SARS, however, during the course of the appeal, abandoned the contention that this appeal concerned any ‘repeat cases’ and stated that it would argue for penalties of 100% for gross negligence under the ‘standard case’ column of the table in section 223 of the Act.

In regard to the assessment of VAT and penalties payable by the First Appellant, SARS stated during argument that the claim for these penalties was reduced to 100%.

Appellants contended that the worst categorisation of their conduct or behaviour was that they had failed to take reasonable care, which in terms of section 223 of the Act resulted in a penalty of 25%.

Appellants based their submission on the fact that the administrative capacity of XYZ was not up to standard and, as a result of which, XYZ could not render returns. They referred to the ‘late’ rendition of returns, presumably intending to show consistency with the proposition that there was no intention to evade tax altogether.

Appellants further contended that:

(i) no gross negligence on their part had been proven,

(ii) the failure to render a return when it was required by law to be done was not 'default in rendering a return' as required in par. (*a*) of the definition of 'Understatement' in section 221 of Act and that, accordingly no understatement penalties could be charged in the present matters,

(iii) SARS never 'accepted' a failure to submit a return and that for that reason also there cannot be a 'shortfall' as defined in section 222(3) and (4) of the Act, with the result that no understatement penalty needs be paid for a default in rendering a return, and

(iv) the application of administrative penalties under Chapter 15 of the Tax Administration Act coupled with the charging of interest, extinguished any prejudice which might otherwise be caused by failing to submit a return and, secondly, it was argued that SARS had failed to discharge the *onus* of establishing that prejudice to SARS or the *fiscus* has occurred as a result of the Appellants' defaults in rendering their returns.

Judge Olsen held the following:

<u>As to the failure by the Appellants to submit income tax and VAT returns</u>

(i) That, while no witnesses were called by the Appellants, there was also no attempt through evidence from the Appellants either to state or support the alleged factual proposition that XYZ lacked the administrative capacity necessary to render its VAT returns once every two months, and to state its contribution to the income of its sole proprietor once a year.

(ii) That section 102(2) of the Tax Administration Act was to the effect that the burden of proving the facts, on which SARS had based the imposition of an understatement penalty under Chapter 16, was upon SARS, as the Appellants sought to remind the court more than once.

(iii) That, however, the question of the administrative capacity of XYZ during the years in question was a matter peculiarly within the knowledge of the two Appellants, its first and second sole proprietors.

(iv) That, without in any way wishing to suggest that the court should accept the proposition that an absence of administrative capacity justified not submitting tax returns, it seemed to the court that SARS had established a *prima facie* case from which the only inference to be drawn was that these tax returns were withheld intentionally throughout, and that without any discernible excuse.

(iv) That in the absence of evidence tendered by the Appellants to counter SARS' *prima facie* case, it ripened into evidence sufficient to discharge the burden of proof placed upon SARS.

(v) That in the circumstances it must also be found as a fact that no shortfall in administrative capacity on the part of XYZ had caused or justified the failures of the two Appellants to submit income tax or VAT returns.

<u>As to whether gross negligence on the part of the Appellants had been proven</u>

(vi) That the *onus* on SARS in this case was to prove the facts upon the basis of which the penalties were said to be justified. To say of conduct that it was grossly negligent is to classify it on a scale of blameworthiness and the *onus* was on SARS to prove the conduct in question. Having done that, SARS must classify it, for the purposes of Chapter 16, selecting the appropriate description of the behaviour from the options provided in section 223 of the Tax Administration Act.

(vii) That the duty of this court is to consider whether the conduct of the Appellants, proved by SARS, was properly classified by SARS under the table set out in section 223 of the Act and the question in this case was whether SARS was correct in branding the conduct of the Appellants as grossly negligent.

(ix) That in resisting the conclusion of gross negligence, the Appellants had found it unavoidable to fall back on the proposition that administrative incapacity on the part of the Appellants justified a lesser form of blameworthiness being attached to the failure of the Appellants to render their returns but the court had already dealt with the issue and had found that there was no such administrative incapacity.

(x) That the court had no difficulty in concluding that the failures of the two Appellants to render their returns had been properly classified as grossly negligent, and the only conclusion to be drawn was that the withholding of the returns in this matter was intentional.

(xi) That the best that could be said regarding the First Appellant's culpability was that it was characterised by a 'complete obtuseness of mind'. It was difficult to imagine what different state of mind on the part of the First Appellant could have subsisted, which would justify a conclusion other than that in his personal capacity, and in his capacity as the directing mind of the Second Appellant, was grossly negligent, or worse.

<u>As to the meaning of 'a default in rendering a return'</u>

(xii) That the court saw no merit in the proposition that a failure to submit a return is not a default in rendering a return. The language of, and the intention behind, the definition of 'understatement' in section 221 of Act is clear. Items (*a*), (*b*) and (*c*) of the definition deal with the case of returns. If you omit something from the return (par. (*b*)) or make a false statement in it (par. (*c*)), there is no doubt that you have made an 'understatement'. No other default with respect to a return appeared to the court to be possible, except that embodied in the failure to submit the return at all. A default in rendering a return (par. (*a*)) must be a failure to render one when it is due.

(xiii) That section 95(1) of Act empowers SARS to make assessments based in whole or in part on an estimate, not only when a taxpayer has submitted a return or information that is incorrect or inadequate, but when the taxpayer 'fails to submit a return as required.' There is accordingly no room to misinterpret the term 'default in rendering a return' as not covering a failure to submit a return which is due, i.e. 'as required'.

<u>As to whether there was a 'shortfall' on withholding a return</u>

(xiv) That section 222(2) of the Act then provided that the understatement penalty was the amount resulting from:

> 'applying the highest applicable understatement penalty percentage in accordance with the table in section 223 to each shortfall determined under subsections (3) and (4) in relation to each understatement in a return.'

Appellants contended that there was no understatement 'in a return' when the understatement was constituted by a default in rendering a return and that accordingly their conduct did not qualify for the imposition of understatement penalties.

Appellants contended further that SARS never 'accepts' a failure to submit a return and for that reason also there cannot be a shortfall as defined, with the result that no understatement penalty needs to be paid for a default in rendering a return.

(xv) That if, as is concluded above, 'a default in rendering a return' means a failure to render a return that is due, then in terms of section 222(1), save for the case of a *bona fide* inadvertent error, the default must attract a penalty, to be derived, in terms of section 222(2), from the table which appears in section 223 of the Act.

(xvi) That the apparent anomaly arising from section 222(2) is solved if one reads the word 'in', where it appears in the phrase 'in a return', to denote an understatement 'in or in connection with' a return. In the court's view a reading of the whole of Part A of Chapter 16 (the sections in question all form part of Part A) justified the resolution of the apparent anomaly in that fashion.

(xvii) That insofar as the use of the word 'accepted' in section 222(3) was concerned, the Appellants erred in isolating a failure to submit a return as the only 'understatement' (as defined), which SARS did not 'accept.' The position is that SARS may not accept understatements of any kind and it cannot overlook an understatement by regarding as true what it knows to be false.

(xviii) That the word 'accepted' in the context of section 222(3)(*a*) means the circumstance that SARS proceeds upon the assumption that there has been no 'understatement' as defined. It 'accepts' as correct the apparent position, whether that involves a mis-stated return or the absence of one altogether. Once the understatement is discovered and acted upon, the resultant tax position must be compared to the one which would have obtained if the 'understatement' had not been acted upon.

(xix) That in the case of a return not rendered when it was due, the shortfall on which the penalty is charged is the difference between the tax found due and the position which would have obtained if SARS had not realised and acted upon the fact that the taxpayer had failed to render a return at all: i.e. a zero tax position and in the court's view SARS had proceeded upon a correct understanding of the legislation, imperfect as it may have been.

<u>As to whether there had been prejudice to SARS or the fiscus</u>

(xx) That the primary feature of an understatement was that there is prejudice to SARS or the *fiscus* as reflected in the definition of 'understatement' in section 221 of the Tax Administration Act.

(xxi) That a penalty was by definition punishment and it may also be compensatory in effect, but that is not why it exists. The *quantum* of an understatement penalty is determined by the nature of the wrongdoing for which the taxpayer is responsible and, expressed as a percentage, that factor is then applied to the amount of tax concerned. For a given amount of tax in effect withheld, the penalty will be higher or lower, depending not on the prejudice suffered by SARS or the *fiscus*, but on the level of blameworthiness attributed to the conduct.

(xxii) That there was no room for an argument that monetary compensation, sufficient to compensate for the financial prejudice caused by the default (assuming such a calculation could be made) and provided through interest augmented by an administrative penalty, would render conduct originally constituting an 'understatement' something other than what is hit by Chapter 16 of the Act.

(xxiii) That, turning to the question of proof of prejudice, the court took the view that, save in regard to the Second Appellant's income tax return for the 2012 tax year, prejudice to SARS and the *fiscus* was implicit in the failure of the Appellants to render returns, and the consequent failure of the Appellants to pay the tax due under those returns at the time when it was supposed to be paid.

(xxiv) That the State's budgeting process is based upon the proposition that taxes will be paid at the time when they are due to be paid. In the case of a failure to render a return upon which tax would have been assessed as payable, the State is prejudiced by being kept out of the contribution to its year's expenditure which would have been available if there had been no default in the rendition of the return in question.

(xxv) That the court was in respectful agreement with the views of Nkosi-Thomas AJ in *ITC 1908* 80 SATC 299 at 306–7 as in the context of that case the question arose as to whether SARS had suffered the prejudice which is the criterion for liability for understatement penalties under Chapter 16.

(xxvi) That the application of resources to audits of the affairs of taxpayers like the Appellants was in itself prejudice to SARS. In terms of section 221 'understatement' means any prejudice to SARS or the *fiscus*. The word 'any' is 'a word of wide and unqualified generality' and there was nothing in the context of the provisions of the Act relating to understatement penalties to suggest that the word was used in a limited sense in section 221. On the contrary, the insertion of the word 'any' indicates that the broadest range of prejudice must be taken into account when considering whether any of the stated defaults have resulted in prejudice to SARS or the *fiscus*.

(xxvii) That, accordingly, each of the understatement penalties of 150% imposed in respect of the assessed income tax and assessed VAT for the relevant tax years and periods were set aside and replaced with an understatement penalty of 100%.

3.7. Commissioners for her Majesty's Revenue and Customs v M Fowler – 82 SATC 475

Mr Fowler was a qualified diver, resident of South Africa and during the 2011/2012 and 2012/2013 tax years undertook diving engagements in the UK Continental Shelf waters.

Mr Fowler was a resident of South Africa for the purposes of the Convention between the Government of the United Kingdom and the Government of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains (*GG* 24335 of 31 January 2003), with date of entry into force being 17 December 2002 (the ‘Double Tax Treaty’).

The Double Tax Treaty had been incorporated into English law by the Double Taxation Relief (Taxes on Income) (South Africa) Order 2002, S.I.2002 No 3138.

The Commissioners for Her Majesty’s Revenue and Customs (HMRC) had sought to tax Mr Fowlert’s income from his diving activities in the relevant tax years on the ground that this income was from employment within Article 14 of the Double Tax Treaty (‘Income from Employment’) rather than business profit within Article 7 of the Double Tax Treaty (‘Business Profits’).

It was common ground that <u>if</u> Mr Fowler was self-employed in the relevant tax years, then his diving income was not taxable as he had no permanent establishment within the UK. What was <u>not</u> common ground was Mr Fowler’s self-employed status.

Mr Fowler contended that he was self-employed in the relevant tax years, but that was disputed by HMRC who contended that he was an employee.

For the purposes of this appeal the parties had assumed that Mr Fowler was an employee.

In the UK section 15 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005) provided ('Divers and diving supervisors') that the section applied if a person performed the duties of employment as a diver or diving supervisor in the United Kingdom or in any area designated by Order in Council under section 1(7) of the Continental Shelf Act 1964 and the duties consisted wholly or mainly of seabed diving activities and section 15(2) provided that the performance of the duties of employment was instead treated for income tax purposes as the carrying on of a trade in the United Kingdom.

Mr Fowler's primary contention was that he was self-employed and so exempt from tax.

His alternative case was that, even if he was an employee for the relevant tax years, section 15 of ITTOIA 2005 treated the performance of the duties of his employment for income tax purposes as the carrying on of a trade in the UK and he contended that the effect of section 15 was to bring his income within Article 7 of the Double Tax Treaty, even if that income was otherwise from employment within Article 14.

Mr Fowler's case was based on a 'deeming provision' in section 15 which provided that an employed seabed diver is 'treated' as self-employed for the purposes of UK income tax.

Mr Fowler contended that since he was treated as self-employed for income tax purposes, he must be treated as self-employed under the DTA and was therefore only taxable in South Africa.

HMRC contended, however, that ITTOIA 2005 did not affect whether someone was an employee, but only regulated the manner in which an employee was taxed.

The first decision in this matter was handed down by the FTT on 9 March 2016 when Judge Guy Brannan held that the preliminary issue should be decided in favour of Mr Fowler and he held that, for the reasons given in the decision, Mr Fowler's income from his diving activities in the UK or UK Continental Shelf for the years in question fell within Article 7 of the Double Tax Treaty.

With the permission of the Judge, HMRC then appealed to the Upper Tribunal and the determination of that appeal was reported as *Commissioners for Her Majesty's Revenue and Customs v M Fowler* [2017] UKUT 0219 (TCC) and reported in 79 SATC 355.

The issue had divided the courts below as the Upper Tribunal had allowed HMRC's appeal.

However the Court of Appeal was divided on the question, with the majority agreeing with Mr Fowler (see [2018] EWCA Civ 2544, [2019] 1 All ER 717) and this led to HMRC now appealing to the Supreme Court.

The Supreme Court set out the relevant provisions of the Double Tax Treaty which included Article 3 (General Definitions), e.g. definitions of 'enterprise' and of 'business', Article 3(2) which sets out a general rule of interpretation for undefined terms, Article 7 entitled 'Business Profits' and Article 14 entitled 'Income from Employment.'

Article 3(2) provided at the relevant time:

> 'As regards the application of the provisions of this Convention at any time by a Contracting State, any term <u>not</u> defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which this Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.'

Lord Briggs held the following:

(i) That, as regards the general approach to the interpretation of Double Tax Treaties, the UK-SA Double Tax Treaty was to be interpreted in accordance with Articles 31 and 32 of the *Vienna Convention on the Law of Treaties 1969* (the Vienna Convention) and in OECD commentaries on the *OECD Model Tax Convention* on which the Treaty was based, and the court then referred to statements of the law in *Anson* v *Commissioners for HM*

Revenue and Customs [2015] UKSC 44 at [54] and *HMRC v Smallwood* [2010] EWCA Civ 778 which both concerned different double tax treaties.

(ii) That in *Smallwood* Patten LJ at paras [26] to [29] provided a useful summary of the correct approach to interpretation in that the language of an international convention had not been chosen by an English parliamentary draftsman and it was neither couched in the conventional English legislation idiom nor designed to be construed exclusively by English judges. It was addressed to a much wider and more varied judicial audience than was an Act of Parliament which dealt with purely domestic law

(iii) That, as was further stated by Patten LJ, the DTA is not concerned to alter the basis of taxation adopted in each of the Contracting States as such or to dictate to each Contracting State how it should tax particular forms of receipts. Its purpose is to set out rules for resolving issues of double taxation which arise from the tax treatment adopted by each country's domestic legislation by reference to a series of tests agreed by the Contracting States under the DTA.

(iv) That section 15 of ITTOIA, dealing with the income of certain divers and diving supervisors, was central to this appeal. Section 15 only applied to a particular class of employed divers, whose employment income would otherwise be taxable under ITEPA (Income Tax (Earnings and Pensions) Act 2003 regulating tax on the earnings of employees). Secondly, the types of divers covered are defined by reference to a particular kind of diving, and only if undertaken in UK or related waters. Thirdly, it may therefore apply only to part of the activities of divers under a particular contract of employment, since they might also be engaged to do other types of diving as well, or diving of the specified type in other waters.

(v) That it was clear that it was not a purpose of the deeming provision in section 15(2) of ITTOIA to resolve some legal or factual uncertainty about whether such divers were genuinely employed or self-employed and, on the contrary, section 15 applies only to employed divers.

(vi) That there were useful but not conclusive *dicta* in reported authorities about the way in which, in general, statutory deeming provisions ought to be interpreted and applied. They are not conclusive because they may fairly be said to point in different directions, even if not actually contradictory. <u>The extent of the fiction created by a deeming provision is primarily a matter of construction of the statute in which it appears and for that purpose the court should ascertain, if it can, the purposes for which and the persons between whom the statutory fiction is to be resorted to, and then apply the deeming provision that far, but not where it would produce effects clearly outside those purposes.</u>

(vii) <u>That, however, the court should not shrink from applying the fiction created by the deeming provision to the consequences which would inevitably flow from the fiction being real.</u>

(viii) That the starting point is that the question which of articles 7 and 14 of the Treaty applies to Mr Fowler's diving activities depends upon the true construction of those articles, in the context of the Treaty as a whole and its purposes, with the meaning of terms within those articles ascertained as required by Article 3(2) by reference to UK income tax law.

(ix) That the relevant terms are, in Article 7, 'profits' and 'enterprise of a contracting state' and, in Article 14, 'salaries, wages and other similar remuneration' and 'employment.'

(ix) That nothing in the Treaty required Articles 7 and 14 to be applied to the fictional, deemed world which may be created by UK income tax legislation. Rather they are to be applied to the real world, unless the effect of Article 3(2) is that a deeming provision alters the meaning which relevant terms of the Treaty would otherwise have.

(x) That this much was confirmed by par. 8(11) of the *OECD Commentary* already quoted and it would be contrary to the requirement to treat the Treaty as a bilateral international agreement to do otherwise, as required by the *dicta* in the *Anson* case.

(xi) That were it not for section 15 of ITTOIA, there would be no doubt that Article 14, not Article 7, would apply to Mr Fowler's diving activities, at least on the necessary but as yet untested assumption that he really was an employee.

(xii) That the meaning of 'employment' is laid down in section 4 of ITEPA, and Mr Fowler's remuneration plainly constitutes employment income within sections 6 and 7. UK tax law would not regard him as making profits from a trade, or his business as being that of an establishment.

(xiii) That the question was whether section 15 of ITTOIA gave a different meaning to the relevant terms. That is not how a deeming provision works generally, not does section 15(2) in particular. Section 15(1) uses 'employment' and 'employment income' in exactly the same way as is prescribed by sections 4, 6 and 7 of ITEPA, and the phrase 'performance of the duties of employment' in section 15(2) again uses 'employment' in the same way. Section 15 is about the taxation of income arising from the performance of those duties of employment but, introduced by the word 'instead', provides that the income is to be taxed as if, contrary to the fact, it was profits of a trade.

(xiv) That section 15 also used 'trade' in its conventional sense and did not therefore alter the meaning of 'enterprise' in Article 7, it being common ground that enterprise is descriptive of a business, and that business includes trade. In short, nothing in section 15 purported to alter the settled meaning of the relevant terms of the Treaty, viewed from the perspective of UK tax law. Rather it took the usual meaning of those terms as its starting point, and erected a fiction which, applying those terms in their usual meaning, led to a different way of recovering income tax from qualifying divers.

(xv) That, furthermore, section 15 created this fiction not for the purpose of deciding whether qualifying employed divers are to be taxed in the UK upon their employment income, but for the purpose of adjusting how that income is to be taxed, specifically by allowing a more generous regime for the deduction of expenses. This appeared clearly from the express language of section 6(5) of ITEPA, which recognised that the income being charged to tax under section 15 was indeed employment income.

(xvi) That, if one asked, as was required, for what purposes and between whom was the fiction created, it was plainly not for the purpose of rendering a qualifying diver immune from tax in the UK, nor adjudicating between the UK and South Africa as the potential recipient of tax. It was for the purpose of adjusting the basis of a continuing UK income tax liability which arose from the receipt of employment income. Therefore, to apply the deeming provision in section 15(2) so as to alter the meaning of terms in the Treaty with the result of rendering a qualifying diver immune from UK taxation would be contrary to its purpose and it would also produce an anomalous result.

(xvii) That, nor should Article 3(2) of the Treaty be construed so as to bring a qualifying diver within Article 7 rather than Article 14. To do so would be contrary to the purposes of the Treaty. This is because, as is recognised by Article 2(1), the Treaty is not concerned with the manner in which taxes falling within the scope of the Treaty are levied. Section 15, understood in the light of section 6(5) of ITEPA, charged income tax on the employment income of an employed diver, but in a particular manner which included the fiction that the diver was carrying on a trade.

Appeal allowed.

3.8. Nyalunga v C:SARS – 82 SATC 489

Nyalunga, having been arrested for the second time, was refused bail and was eventually released on 24 March 2014, some two years later. The money and the vehicles were forfeited to the State in terms of proceedings brought by the Asset Forfeiture Unit (AFU) in accordance with the Prevention of Organised Crime Act 121 of 1998 (POCA).

Whilst still incarcerated and on 3 April 2013 an employee of SARS hand delivered to Nyalunga a notification of its intention to audit him, known as an audit letter. This notification named the SARS official who would be conducting the audit and the scope of such audit.

The scope of the audit, as described, was for ‘possible under-declaration of taxable income’, in respect of 2009–2012.

The investigations into the tax affairs of Nyalunga commenced on 4 April 2013 and an audit findings letter dated 3 September 2013 was subsequently delivered to Nyalunga personally on 4 September 2013 by a SARS official.

The aforesaid letter did not constitute an assessment as contemplated in the Tax Administration Act, but merely notified Nyalunga of SARS’ intention to raise an assessment. However, Nyalunga was also told that if no further documentation was forwarded to SARS within 21 business days from the date of delivery of this letter, SARS would then proceed to raise an estimate assessment in terms of sections 91 and 92, read with section 95 of the Tax Administration Act.

Nyalunga had failed to respond to the notification of audit in spite of the caution sounded in the audit finding letter. He also failed to provide any relevant material, which resulted in the finalisation of audit letter dated 24 February 2014 being delivered to him.

The finalisation of audit letter advised Nyalunga that ‘this letter constitutes an assessment as contemplated in the Tax Administration Act 28 of 2011 (‘the Act’)’ and that he had 30 business days to deliver his objection.

Nyalunga, on receipt of the aforesaid letter, confirmed same and endorsed it by stating that he would be unable to respond to SARS within the stated time as he was still in prison and had been there since 2012 and accordingly would not be able to object within 30 days as requested.

The aforementioned letters, i.e. the notification of audit, the audit finding and the finalisation of audit were handed to Nyalunga personally whilst he was incarcerated.

Nyalunga was released from prison on 24 March 2014 and an objection was due to be filed by 8 April 2014, but SARS had conceded that the 30 day period to file an objection had commenced from the date of Nyalunga's release from prison, and hence Nyalunga had until 7 May 2014 to file an objection.

In terms of the recovery process instigated by SARS it had obtained a tax judgment against Nyalunga on 23 June 2014 in terms of section 172 of the Tax Administration Act for recovery of the outstanding tax in the amount of R15 166 511.89 and subsequently a warrant of execution was issued on 21 January 2016 and instructions were given to the sheriff to execute on the judgment on 2 February 2016.

Ultimately, on 18 September 2018 the sheriff successfully attached goods belonging to Nyalunga and proceeded to advertise a sale by public auction of the goods.

Nyalunga thereafter brought an urgent application to the High Court to stay the auction and hence the present review application was launched.

Nyalunga, in challenging SARS' audit findings, contended that he was not able to comply with the requests and time limits imposed by SARS as would a normal taxpayer as he had been incarcerated when the assessment was conducted.

Nyalunga challenged the procedure and the process followed by SARS as being unfair and highlighted procedural irregularities. He also attacked the audit and calculations conducted and arrived at by SARS.

Nyalunga contended that the only remedy that was available to him was by way of his review application to the High Court.

Nyalunga also submitted that he had not been aware of the civil judgment taken against him by SARS and that he only came to know of it on 18 September 2018.

Nyalunga further contended that the decision by SARS was unconstitutional and had infringed on his constitutional rights and the rule of law.

SARS contended, *inter alia*, that Nyalunga's review application was out of time to the extent of four years and this court did not have jurisdiction to hear the application for review as only the tax court had jurisdiction in these circumstances.

Judge Hudges held the following:

(i) That in terms of the relief sought by Nyalunga, he ought to have sought to review SARS' decision contained in his letter of audit findings within 180 days of the date thereof in terms of section 7(1) of the Promotion of Administrative Justice Act 3 of 2000 (PAJA).

(ii) That Nyalunga could not have been under any misapprehension as he had received the finalisation of audit letter personally and his note thereon had confirmed this and had indicated that he knew what was required and that if he was aggrieved, he could object. Consequently, by 24 February 2014, Nyalunga had been well aware that he had to object within 30 days, which he had failed to do.

(iii) That, notably, Nyalunga on his own accord had noted that this review application was 'extremely late' and the fact that he had been incarcerated did not detract from the fact that he had understood which process SARS had been engaged in and hence, under the circumstances, his reasons advanced for the delay in bringing this review had to fail.

(iv) That, in answer to the question 'Was the delay reasonable in the circumstances and can it be condoned in the interests of justice?' SARS was correct in its assertion that on the papers Nyalunga had failed to address the requirements of the legality challenge, that being that the explanation for the delay was unreasonable, the delay was undue and did not warrant being overlooked. Moreover, it cannot be said that it would be in the interests of justice to overlook the delay as under the circumstances no clear or persuasive argument had been advanced by Nyalunga and hence the legality challenge also had to fail.

(iv) That section 105 of the Tax Administration Act provides that a taxpayer may only dispute an assessment or 'decision' as described in section

104 of the Act in proceedings under the dispute resolution Chapter in the Act, unless a High Court otherwise directs. Hence, it is imperative to understand that 'unless a High Court otherwise directs' an assessment may only be challenged by means of an objection and appeal process and the operative words being 'unless a High Court otherwise directs.'

(v) That in view of the fact that more than three years have elapsed since the assessment of Nyalunga by SARS and in light of the fact that according to Nyalunga he is entitled to deductions in terms of the Income Tax Act, this assessment falls within the realm of section 104 of the Tax Administration Act. Hence, in terms of section 105 of the Act, this court will only have jurisdiction if leave is sought to direct otherwise and/or a legal issue is raised, and not as it is in this instance, where Nyalunga seeks a determination as to whether SARS' assessment was right or wrong.

(vi) That, in the court's view, in terms of section 105 of the Act, this court would not have jurisdiction if Nyalunga was challenging the assessment and decision by SARS. In addition, Nyalunga had not made out a case on the papers for this court to 'otherwise direct' that it be heard.

(vii) That, further to the issue of this court's lack of jurisdiction as raised by SARS, was the fact that Nyalunga had acknowledged that in terms of the Tax Administration Act 28 of 2011 he ought to have first exhausted all internal processes before he proceeded with this review application. Nyalunga had contended that he was time barred from engaging in those internal processes and consequently only had the option to launch the review application. However, his explanation was not plausible as in terms of the Promotion of Administrative Justice Act 3 of 2000 the review application was also time-barred as that had been launched later than the prescribed limit of 180 days as provided for in section 7(1) of Act 3 of 2000 and this was accordingly an unacceptable and unreasonable reason proffered by Nyalunga.

(ix) That, in the result, this court did not have jurisdiction to entertain this review application.

(x) That section 100(1) of the Tax Administration Act made provision for the finality of an assessment and, in this particular case, sections 100(1)(*a*) and (*b*) were relevant. It was also common cause that no objection was raised by Nyalunga to the assessment raised in terms of section 95(1) of the Act, i.e. if a taxpayer has not submitted any returns, SARS would be entitled to make an original, additional, reduced or jeopardy assessment based in whole or in part on an estimate.

(xi) That in this instance, Nyalunga having failed to submit tax returns to SARS, and having failed to lodge an objection in respect of the assessments, it was thus evident that finality of the assessment in issue had been reached in terms of sections 100(1)(*a*) and (*b*). Moreover, the time period in which to raise an objection in terms of section 104(5) had come and gone, especially so in terms of section 104(5)(*b*) which curtails the period of objection if more than three years have lapsed from the date of assessment or the 'decision.' In this case four years have passed.

(xii) That SARS has correctly contended that the relief sought by Nyalunga in this matter was not competent as the civil judgment lawfully given in favour of SARS in terms of section 174 of the Tax Administration Act 28 of 2011 and the writ of execution still stands and is not set aside in spite of Nyalunga's seeking to review the assessment in issue.

(xiii) That, in the result, Nyalunga's challenge to review SARS' assessment in this matter must fail and ought to be dismissed.

The review application was dismissed with costs.

4. INTERPRETATION NOTES

4.1. Year of assessment of persons other than companies: Accounts accepted to a date other than the last day of February – No. 19 (Issue 5)

This Note provides guidance on the application of section 66(13A) and the discretionary power vested in SARS to grant permission to a person other than a company, for example, a natural person or trust, to submit accounts for a period that differs from the year of assessment ending on the last day of February. The Note deals primarily with natural persons and trusts carrying on a trade. A brief discussion is also included on the application of section 66(13A) to share purchase arrangements, public benefit organisations (PBOs), small business funding entities (SBFEs), the estate of a deceased person and insolvent estates. The position of companies is not dealt with in the Note.

Interpretation Note 90 "Year of Assessment of a Company: Accounts Accepted to a Date other than the Last Day of a Company's Financial Year" deals with the discretionary power vested in SARS to accept financial accounts of a company for a period ending on a day that differs from the last day of the company's financial year under section 66(13C).

Under section 66(1) SARS must issue a public notice each year prescribing which persons are required to furnish income tax returns. For example, not all natural persons are required to submit a return, while a trust that is a resident1 is required to submit a return regardless of whether income is generated.

Save for a few exceptions (for example, when a person dies or a trust is terminated), the return for normal tax of a person (other than a company) must be for the whole period of twelve months ending on the last day of February.2 In most instances, therefore, the year of assessment runs from 1 March of a year to the last day of February of the succeeding year.

Section 66(13A), however, provides that a person other than a company may apply to SARS for permission to draw up accounts to a date other than the last day of

February. If SARS is satisfied that the whole or some portion of the taxpayer's income cannot be conveniently returned for any year of assessment, SARS may approve the application.

Under section 66(13A) a taxpayer who cannot conveniently return income from a business or profession to the last day of February may apply at a SARS branch office for permission from SARS to draw up accounts to a closing date other than the last day of February. Any request of this nature is subject to conditions that SARS may impose. Generally, the closing date so approved will determine into which year of assessment the results for the accounting period must be included and the dates on which provisional tax payments must be made.

4.2. Year of assessment of a company: Accounts accepted to a date other than the last day of a company's financial year – No. 90 (Issue 2)

This Note provides guidance on the application of section 66(13C) and the discretionary power vested in the Commissioner to accept financial accounts of a company for a period ending on a day that differs from the last day of the company's financial year.

The Note does not deal with the position of persons other than companies, for example, natural persons or trusts. Interpretation Note No. 19 "Year of Assessment of Persons other than Companies: Accounts Accepted to a Date other than the Last Day of February" provides guidance on the Commissioner's discretionary power to grant permission to a person other than a company to submit financial accounts for a period which differs from the year of assessment ending on the last day of February.

A company's year of assessment is its financial year.

Companies are occasionally required to close their financial accounts earlier or later than the last day of their financial year for various reasons. Section 66(13C) was introduced into the Act with effect from 3 July 2008 to allow companies to align reporting for tax purposes with the period ending on the day their financial accounts are closed.

A company intending to close its financial accounts either within 10 days before or after the end of a year of assessment must submit an application to a SARS branch office for permission to draw up financial accounts to a closing date other than the end of its financial year.

Section 66(13C) relates only to a situation in which a company obtains approval from the Commissioner to close its accounts on a date other than the last day of its financial year. This approval does not result in a change in the company's financial year-end and therefore does not change its year of assessment.

4.3. Taxation of REITs and controlled companies – No. 97 (Issue 2)

This Note:

- provides guidance on the interpretation and application of section 25BB, which deals with the taxation of REITs and controlled companies;
- considers other selected provisions of the Act that are particularly relevant to REITs, controlled companies and the holders of shares or linked units in these companies;
- does not discuss all the sections which apply to REITs and controlled companies which, while not specifically referring to REITs and controlled companies, are nevertheless applicable to REITs and controlled companies; and
- reflects the amendments introduced by the Taxation Laws Amendment Act 34 of 2019.

South African REITs own several kinds of commercial property such as shopping centres, office buildings, factories, warehouses, hotels, hospitals and residential property in South Africa. REITs may also invest in property in other countries. The objective of a REIT is to provide investors with steady rental income and capital growth in the underlying properties.

A REIT may be a company as commonly understood or may be deemed to be a company for taxation purposes. A portfolio of a collective investment scheme in property that qualifies as a REIT as defined in the listing requirements is deemed to be a “company”.

Both corporate and trust (collective investment schemes in property) REITs that comply with the listing requirements are listed and publicly trade on an exchange. Once the shares in a company or a trust which is deemed to be a company for tax purposes are listed as shares in a REIT as defined in the listing requirements, the company or trust will qualify as a REIT for income tax and CGT purposes.

A REIT, and a “controlled company” as defined, are subject to a specific tax regime under section 25BB. In essence, a REIT and a controlled company are treated as conduits for the income they derive, with the REIT or controlled company being granted a deduction, subject to various limitations, for distributions made by it. A resident investor is subject to normal tax on distributions derived from a REIT or controlled company. By contrast, a non-resident investor is liable for dividends tax (as opposed to normal tax) on such distributions.

A REIT and a controlled company must also consider dividends tax, transfer duty, securities transfer tax and VAT.

4.4. Provisions of the Tax Administration Act that did not commence on 1 October 2012 under proclamation 51 in Government Gazette 35687

The TA Act came into operation on 1 October 2012, except for certain provisions relating to interest.

This Note identifies those interest provisions that have come into operation and those that have not yet come into operation. It reflects the relevant legislation at the date of publication and considers the various amendments effected since the introduction of the TA Act.

Under section 272 the President must by proclamation in the Government Gazette determine the date on which the TA Act comes into operation and may determine different effective dates for different provisions.

The Proclamation was published on 14 September 2012 and provided that the TA Act came into operation on 1 October 2012 except for:

- sections 187(2), (3)(a) to (e) and (4), 188(2) and (3), and 189(2) and (5); and
- any provision of Schedule 1 that amended or repealed a provision of a tax Act relating to interest under that tax Act, to the extent of that amendment or repeal.

Other than those provisions contained in Schedule 1, the provisions that have not commenced form part of Chapter 12, which introduced a new regime for the purposes of interest on tax debts and refunds, and comprise:

- section 187 – general interest rules;
- section 188 – period over which interest accrues; and
- section 189 – rate at which interest is charged.

Schedule 1 sets out the provisions of various Acts administered by SARS that have been amended or repealed by the TA Act. The Acts affected and the paragraphs that apply include the following:

- Diamond Export Levy (Administration) Act 14 of 2007 (paragraphs 167 to 171)
- Estate Duty Act 45 of 1955 (paragraphs 12 to 22)
- Income Tax Act 58 of 1962 (paragraphs 23 to 106)
- MPRRA Act (paragraphs 183 to 192)
- Securities Transfer Tax Administration Act 26 of 2007 (paragraphs 172 to 179)

- South African Revenue Service Act 34 of 1997 (paragraph 147)
- Skills Development Levies Act 9 of 1999 (paragraphs 148 to 156)
- Transfer Duty Act 40 of 1949 (paragraphs 1 to 11)
- Unemployment Insurance Contributions Act 4 of 2002 (paragraphs 157 to 166)
- Value-Added Tax Act 89 of 1991 (paragraphs 107 to 146)
- A number of amending Acts (paragraphs 180 to 182 and 193 to 196)

Since the new interest regime under Chapter 12 necessitates substantial changes to SARS's existing systems which have not been finalised, the Proclamation maintained the interest regime before the promulgation of the TA Act by excepting from coming into operation most of Chapter 12 and the provisions of Schedule 1 amending or repealing sections of the other tax Acts relating to interest.

Consequently, baring subsequent amendments, these sections remain in force as they read before their amendment or repeal by Schedule 1 until the commencement of the entire TA Act. In order to facilitate the eventual commencement of the new regime, section 272 additionally provides that the Minister may by public notice determine the dates on which Chapter 12 and the provisions relating to interest in Schedule 1 come into operation per tax type.

5. DRAFT INTERPRETATION NOTES

5.1. Concession or compromise of a debt – No. 91 (Issue 2)

This Note provides guidance on the interpretation and application of section 19 and paragraph 12A which deal with the concession or compromise of debt in respect of years of assessment commencing on or after 1 January 2018.

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

- The Taxation Laws Amendment Act 34 of 2019 which was promulgated on

15 January 2020 (as per Government Gazette 42951).

- The Tax Administration Laws Amendment Act 33 of 2019 which was promulgated on 15 January 2020 (as per Government Gazette 42952).
- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 32 of 2019 which was promulgated on 15 January 2020 (as per Government Gazette 42950).

Issue 1 of this Note should be consulted for a comprehensive discussion of the debt reduction provisions applicable for years of assessment commencing before 1 January 2018.

The Note does not address section 22 of the VAT Act dealing with irrecoverable debt.

Debt relief occurs in, for example, insolvency, business rescue, similar statutory proceedings or informal workouts, 1 and can occur within and outside of a group of companies.

Before 1 January 2013 various taxes were imposed upon persons receiving the benefit of debt relief that may have effectively undermined the economic benefit of the relief. A uniform system that provides relief to persons under financial distress in certain circumstances was introduced in the form of section 19 and paragraph 12A with effect from years of assessment commencing on or after 1 January 2013.

The new rules aim to ensure that debt relief is subject to only one of the following taxes:

- Estate duty
- Donations tax
- Income tax on a fringe benefit received by an employee
- Income tax on income
- CGT

Section 19 and paragraph 12A were subsequently amended by the 2017, 2018 and 2019 Taxation Laws Amendment Acts.

Section 19 and paragraph 12A were substituted by sections 32 and 70 of the Taxation Laws Amendment Act 17 of 2017. Further amendments were made by sections 36 and 77 of the Taxation Laws Amendment Act 23 of 2018 most of which, barring two mentioned below, were backdated to 1 January 2018. These backdated amendments were largely aimed at lessening the impact of the debt relief rules which could have had harsh consequences, for example, as a result of the terms of a loan being changed.

Further amendments to section 19(8)(b) and paragraph 12A(4) and (6)(b) and the introduction of section 19(6A) by the Taxation Laws Amendment Act 23 of 2018 came into effect for years of assessment commencing on or after 1 January 2019. The introduction of section 19(6A) and the amendments to paragraph 12A(4) deal with a debt benefit that arises in a year of assessment subsequent to that in which the asset was disposed of. Previously the only consequence for a debtor under the latter circumstances was a reduction in an assessed capital loss. However, with effect from years of assessment commencing on or after 1 January 2019, a recoupment or capital gain may occur in the year of assessment in which the debt benefit arises. The amendments to section 19(8)(b) and paragraph 12A(6)(b) deal with the exclusion of a debt benefit arising by donation which now applies only in respect of the portion of the donation on which donations tax is payable. Section 19 or paragraph 12A will therefore apply to the extent that the debt benefit arises by means of a donation which qualifies for exemption from donations tax under, for example, the annual donations tax exemption of R100 000.

Section 54 of the Taxation Laws Amendment Act 34 of 2019 deleted two obsolete definitions (allowance asset and capital asset) from paragraph 12A(1).

Section 19 and paragraph 12A deal with the concession or compromise of a debt. These provisions apply to trading stock, deductible expenditure, allowance assets and capital assets financed by debt that is subsequently cancelled, waived, extinguished or settled, in the case of a company, by being converted to or exchanged for shares in that company or applying the proceeds from shares issued by the company.

The application of section 19 and paragraph 12A depends on the nature of the expenditure that was funded by the debt. Specific ordering rules apply to a debt benefit in respect of debt owed in respect of or that was used to fund expenditure incurred in respect of the following assets:

- Trading stock that is held and not disposed of at the time the debt benefit arises

  Any deduction under section 11(a) or the value of opening stock or closing stock is reduced by the debt benefit under section 19(3). Any excess amount is deemed under section 19(4) to be an amount recovered or recouped for purposes of section 8(4)(a).

- Trading stock disposed of and other deductible expenditure excluding allowance assets

  The debt benefit is deemed under section 19(5) to be an amount recovered or recouped for purposes of section 8(4)(a)].

- Assets not disposed of in a year of assessment prior to that in which the debt benefit arises

  The base cost of the asset is reduced under paragraph 12A(3) by the amount of the debt benefit. After the base cost of an allowance asset has been reduced to Rnil, any excess amount is deemed under section 19(6) to be an amount recovered or recouped for purposes of section 8(4)(a). Future capital allowances are limited under section 19(7) to the cost of the asset less the amount of the debt benefit and any previous allowances claimed on the asset.

- Assets disposed of in a year of assessment prior to that in which the debt benefit arises

  Under section 19(6A) and paragraph 12A(4) respectively, the debt benefit triggers a re-determination of the recoupment of allowances or the capital gain or loss recognised in that earlier year of assessment. The difference between the re-determined recoupment and the amount of recoupment in the earlier year of assessment is treated as an amount recovered or recouped for purposes of section 8(4)(a) in the year of assessment in which the debt benefit arises. The absolute difference between the re-determined capital gain or loss and the capital gain or loss determined in the earlier year of assessment is treated as a capital gain in the year of assessment in which the debt benefit arises.

A special rule applies to debt that financed the acquisition of a pre-valuation date asset. The effect of the rule in paragraph 12A(5) is to treat the asset as a post-valuation date asset by re-establishing its base cost as expenditure which can be reduced by the amount of a debt benefit.

Special rules apply to a debt benefit in respect of a debt that funded expenditure incurred by persons carrying on mining.

Section 19 and paragraph 12A do not apply to a debt benefit in respect of any debt owed by a person:

- that is an heir or legatee of a deceased estate to the extent that the debt is owed to, and reduced by, the deceased estate and the amount by which the debt is reduced forms part of the property of the deceased estate for purposes of estate duty under the Estate Duty Act [section 19(8)(a) and paragraph 12A(6)(a)];
- to the extent that the debt is reduced by way of a "donation", as defined in section 55(1) or any transaction to which section 58 applies, in respect of which donations tax is payable [section 19(8)(b) and paragraph 12A(6)(b)];
- to an employer to the extent that the debt is reduced in the circumstances contemplated in paragraph 2(h) of the Seventh Schedule, the so-called fringe benefits tax provisions [section 19(8)(c) and paragraph 12A(6)(c)];
- to another company forming part of the same domestic group of companies and the debtor company did not carry on a trade during the year of assessment in which the debt benefit arises and during the immediately preceding year of assessment, unless certain provisions apply [section

19(8)(d) and paragraph 12A(6)(d)];

- to another company forming part of the same domestic group of companies and the debtor company reduces or settles the debt directly or indirectly by means of issuing shares, unless certain provisions apply [section 19(8)(e) and paragraph 12A(6)(f)]; or
- to the extent that the debt so owed is settled, directly or indirectly, by being converted to or exchanged for shares in the debtor company or by applying the proceeds from shares issued by that company and does not consist of or represent an amount owed in respect of interest incurred by that person during any year of assessment [section 18(8)(f) and paragraph 12A(6)(g)].

In addition, paragraph 12A does not apply to any debt owed by a company to a connected person if the debt is reduced in the course, or in anticipation, of the liquidation, winding up, deregistration or final termination of the existence of that company under specified circumstances [paragraph 12A(6)(e) and (7)].

Consequential amendments to prevent double taxation have been made to sections 8(4)(a), 9C(5), 24J(4A)(b) and paragraphs 3(b)(ii), 20(3)(b)(i) and (iii) and 56(2)(a).

The amount of a debt benefit in respect of a debt that is denominated in a currency other than the currency of the Republic must be translated to the currency of the Republic (the rand) on the date on which the debt benefit arises by applying the applicable exchange rate under section 25D.

A foreign exchange loss may have been claimed as a deduction under section 24I(3)(a) and a foreign exchange gain included in income in one or more earlier years of assessment upon annual translation of the outstanding debt to rand or upon realisation of the debt in the current year of assessment. Foreign exchange losses must be included in income under section 24I(4)(a)(ii) when a debt benefit arises. Foreign exchange gains included in the income of a debtor before the debt benefit arises must be deducted from income under section 24I(4)(a)(i).

The amount of expenditure contemplated in section 19(2) or paragraph 12A(2) that was funded by a debt that is cancelled, waived, extinguished or settled must be determined:

- exclusive of VAT for a debtor that is a vendor and that is or was entitled to a deduction of input tax under section 16(3) of the VAT Act; and
- inclusive of VAT for a debtor that is not a vendor.

6. BINDING PRIVATE RULINGS

6.1. BPR 354 – Cash grants to an employee incentive trust and the transfer of share awards to qualifying employees

This ruling determines the income tax and capital gains tax consequences arising from cash grants made by an employer to an employee share incentive trust and the receipt thereof by the share incentive trust, and the vesting of shares in qualifying employees.

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 14 August 2020.

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 23H;
- par. 11(1)(d); and
- par. 64E.

Parties to the proposed transaction

The applicant: A listed resident company

The co-applicant: A resident share incentive trust

Qualifying employees: Senior management who will participate in a share incentive scheme

Description of the proposed transaction

The applicant will make cash grants to the co-applicant that will be used to purchase shares of the applicant on the open market. The shares will be awarded in tranches to the qualifying employees over time and at the relevant vesting dates the coapplicant will transfer these shares to them.

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:

- Ruling in respect of the applicant
  - The cash contributions paid by the applicant to the co-applicant will be deductible under section 11(a).
  - Section 23H will be applicable to the deductions.
- Ruling in respect of the co-applicant
  - The cash contributions received by the co-applicant from the applicant will not be included in the gross income of the co-applicant.
  - The vesting of the shares by the co-applicant in the qualifying employees will be a disposal under par. 11(1)(d) and the provisions of par. 64E will find application in respect of any gains determined as a result of such disposals.

6.2. *BPR 355 – Accrual of pension payments to a resident from a foreign pension fund*

This ruling determines the tax consequences of the accrual of pension payments to a resident from a foreign pension fund in respect of services rendered both in South Africa (SA) and outside SA.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 22 October 2020. 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 10(1)(gC)(ii).

Parties to the proposed transaction

The applicant: A resident individual but a citizen of country X

Company A: A company resident in country X

The Fund: A pension fund resident in country X

Company B: A resident company to which the applicant was seconded whilst employed by Company A

Description of the proposed transaction

The applicant was employed in country X for 15 years by Company A prior to taking up employment and residence in SA. The applicant rendered services solely to Company A for the first 12 years of his employment. From year 13 to 15 he was seconded to Company B in SA whilst employed by Company A.

The applicant’s secondment and his employment with Company A came to an end at the conclusion of year 15 and he became permanently employed by Company B. He also became ordinarily resident in SA after year 15.

Company A made pension contributions in respect of the applicant to the Fund for the first 12 years for services rendered.

Company B made pension contributions in respect of the applicant to the Fund from year 13 to 15 during his secondment period for services rendered.

The applicant made no contributions to the Fund as it was a non-contributory fund.

The applicant has reached the retirement age as stipulated by the rules of the Fund, but pension payments have not yet accrued to or been paid to him because he has not yet made an election to receive the pension payments.

The applicant proposes to make the necessary notification to the Fund in order to commence receiving the pension payments from the Fund.

The proposed transaction is the accrual of pension payments from the Fund as they fall due.

Conditions and assumptions

This binding private ruling is subject to the additional condition and assumption that the applicant is ordinarily resident in SA and not deemed to be exclusively a resident of country X or another country for purposes of the application of any Convention between the Government of SA and that of another country for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains.

Ruling

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

- The pension amounts that will accrue to the applicant from the Fund must be included in the applicant's gross income subject to the exemption under section 10(1)(gC) applying proportionally.
- The portion of each pension amount that will accrue from the Fund that is in respect of past employment services rendered outside of SA will be exempt from normal tax under section 10(1)(gC).

The formula to determine the exempt amount is:

Period of services rendered outside the Republic / Total period during which services were rendered × Amount of lump sum or pension received or accrued =

Amount exempt under section 10(1)(gC)

6.3. BPR 356 – Preference share: hybrid equity instrument and third-party backed share

This ruling determines whether the preference shares issued by the applicant are hybrid equity instruments or third-party backed shares.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 19 November 2020. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definitions of "equity share", "controlling group company" and "group of companies";
- section 8E(1) – definitions of "equity instrument", "financial instrument" and "hybrid equity instrument";
- section 8EA(1) – definitions of "enforcement right", "operating company", "preference share", "qualifying purpose" and "third-party backed share";
- section 8EA(2); and
- section 8EA(3).

Parties to the proposed transaction

The applicant: A resident company

Company A: A resident company

Company B: A resident company

Description of the proposed transaction

The applicant carries on no trade and its sole purpose is to act as a conduit for dividends. The applicant entered into an agreement with Company A, in terms of which the applicant issued preference shares to Company A in order to fund the acquisition of shares in Company B.

A trust is the 100% shareholder of the applicant and the trust beneficiaries are the members of a specified community.

In terms of the agreement any distributions made by Company B to the applicant must be on-distributed as follows:

- 90% of the amount to Company A; and
- 10% to the trust.

These dividend distribution ratios remain in place for as long as the preference shares are in issue.

As security for the applicant's obligations under the agreement, the trust has provided Company A with:

- A first ranking share pledge over the trust's shares in the applicant;
- A cession of the trust's loans to the applicant; and
- A limited guarantee by the trust in favour of Company A.

Company A has a tax indemnity in respect of any tax that may arise in the hands of the company on dividends paid to it in respect of the preference shares.

The indemnity period is aligned with the terminal redemption date, being 17 years from the issue date of the preference shares even if the agreement is terminated or the preference shares are redeemed earlier.

The applicant will declare a preference share dividend to Company A in the near future.

Conditions and assumptions

This binding private ruling is subject to the additional condition that the terms of the preference shares remain unchanged.

Ruling

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

- The preference shares are not hybrid equity instruments as defined in section 8E. Accordingly, section 8E will not apply in respect of future preference dividends declared and paid by the applicant; and
- The preference shares do not constitute third-party backed shares as defined in section 8EA. Accordingly, section 8EA will not apply in respect of future preference dividends declared by the applicant.

7. BINDING CLASS RULINGS

7.1. BCR 75 – Settlement of post-retirement medical aid and retirement gratuity benefits

This ruling determines the tax consequences for the employers and the qualifying employees due to their relinquishment of post-retirement medical aid benefits and gratuity benefits.

In this ruling references to sections are to sections of the Act applicable as at 3 August 2020. 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) – par. (c), (d), (e), (f) and (i) of the definition of 'gross income'; and par. (a) of the definition of 'severance benefit';
- section 11(a) read with section 23(g);
- section 11F;
- par. 1 of the definition of 'remuneration' in the Fourth Schedule; and
- par. 2(l) of the Seventh Schedule.

<u>Class</u>

The class members to whom this ruling will apply are the employers and the employees referred to in below.

Parties to the proposed transaction

The applicant: A resident listed company

The employer companies: The employers of the provident fund class members and the pension fund class members. The employers comprise the applicant and a subsidiary of the applicant, that is also a resident company

The provident fund class members: Qualifying employees of the employer companies and members of a provident fund. Some are older than 55 years of age and others are not

The pension fund class members: Qualifying employees of the employer companies and members of a pension fund. Some are older than 55 years of age and others are not

Description of the proposed transaction

The employer companies concluded a Sale of Business Agreement with a purchaser, selling the assets (together with a concomitant assumption of the liabilities) of a part of the business (the business) of the group to which the employer companies belong. The implementation of the Sale of Business Agreement is subject to suspensive conditions.

The terms of the sale include that all employees of the business will be transferred to the purchaser in accordance with section 197 of the Labour Relations Act 66 of 1995 (the LRA).

The employer companies are participating employers in the group's pension fund (the pension fund) and provident fund (the provident fund), (collectively referred to as the retirement funds). The retirement savings of the transferring employees held in the retirement funds of the business will be transferred to appropriate retirement funds in which the purchaser is a participating employer. This transfer will take place in accordance with section 14 of the Pension Funds Act 24 of 1956 (the PFA).

The pension and provident fund class members are also currently entitled to postretirement medical aid (PRMA) and retirement gratuity benefits (RGB), collectively referred to as 'legacy benefits'. The purchaser does not offer similar benefits to its employees and therefore it is envisaged that any rights to the legacy benefits will be extinguished if the suspensive conditions are fulfilled and the sale of business is implemented.

Separately, and pursuant to the sale of business agreement, the employer companies have made offers to the pension and provident fund class members prior to the conclusion of the sale of business.

In terms of the offer and in accordance with the rules of the pension fund, the full enhanced PRMA subsidy of the pension fund class members will be allocated to the pension fund class members' fund credits (retirement savings) in the pension fund (under section 15E(1)(d) of the PFA) on an equitable and on a 'no-worse off' basis and then transferred to the new fund of the purchaser subsequent to the sale of business being implemented. The pension fund class members will be entitled to elect that in respect of the full enhanced RGB, either:

- a portion of assets held in the pension fund Employer Surplus Account (ESA) must be allocated to the pension fund class members' fund credits in the pension fund (under section 15E(1)(d) of the PFA) on an equitable and on a 'no-worse off' basis and then transferred to the new fund of the purchaser subsequent to the sale of business being implemented; or
- to have an amount paid out in cash (after the required tax has been deducted) by the employer companies to the pension fund class members; or
- to receive a portion of an amount (net of tax) paid in cash and for the balance to be allocated from the pension fund ESA to the pension fund class members' fund credits in the pension fund (under section 15E(1)(d) of the PFA) on an equitable and on a 'no-worse off' basis and then for that balance to be transferred to the new fund of the purchaser subsequent to the sale of business being implemented.

In respect of the provident fund class members, the rules of the provident fund do not allow for an allocation of any ESA to member's retirement fund credits and therefore the provident fund class members will be entitled to elect one of the following:

- to receive an amount (net of tax) in cash;
- to have an amount (net of tax) paid into the provident fund, where it will be added to the member's fund credit and transferred along with the member's retirement savings to a retirement fund in which the purchaser is a participating employer;
- to receive a portion of the amount (net of tax) in cash and to have the balance (net of tax) paid into the provident fund for their benefit.

Conditions and assumptions

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

- all the requirements of section 15 of the PFA must be adhered to; and
- the suspensive conditions set out in the sale of business agreement must be fulfilled.

Ruling

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

- The cash payments to the provident fund class members under the age of 55 will:
    - constitute amounts received by or accrued to the provident fund class members, as contemplated in par. (d) of the definition of 'gross income'; and
    - fall within the definition of 'remuneration' in par. 1 of the Fourth Schedule, with the requisite amount of employees' tax to be deducted by the employer companies.
- In relation to the PRMA subsidy, allocations from the pension fund ESA to the pension fund class members' retirement savings accounts (member

fund credits) will not –

- constitute taxable fringe benefits under par. 2(l) of the Seventh Schedule and will, as a result, not have to be included under par. (i) of the definition of 'gross income';
- constitute amounts received by or accrued to the pension fund class members, as contemplated in par. (c) and (f) of the definition of 'gross income'; and
- be deductible by the pension fund class members in the determination of their taxable income under section 11F.

- Payments made by the employer companies directly to the provident fund class members in relation to the PRMA subsidy to members who are over the age of 55 at the time the payment is made, will constitute 'severance benefits' as defined in section 1(1) and will be included in the gross income of the provident fund class members under par. (d) of the definition of 'gross income'.
- Provident and pension fund class members who elect to receive all or part of the RGB in cash and who are over the age of 55 years at the time the election is made, will constitute 'severance benefits' as defined in section 1(1) and will be included in the gross income of the provident and pension fund class members under par. (d) of the definition of 'gross income'.
- Pension fund class members who elect for the full or part of their RGB to be allocated from the pension fund ESA to the pension fund class members' retirement savings account, who are over the age of 55 years at the time the election is made will –
  - constitute 'severance benefits' as defined in section 1(1) and will be included in the gross income of the pension fund class members under par. (d) of the definition of 'gross income';
  - not constitute taxable fringe benefits under par. 2(l) of the Seventh Schedule and will, as a result, not have to be included under par. (i)

of the definition of 'gross income'; and

- o be deductible by the pension fund class members in the determination of their taxable income under section 11F.

- Payments to pension fund class members from the pension fund, (or its successor fund in respect of which the purchaser is a participating employer), must be included in the gross income of those members under par. (e) of the definition of 'gross income' and read with the Second Schedule as and when a pension fund class member becomes entitled thereto, whether due to death, retirement, resignation or dismissal; irrespective of payments being originated from normal contributions to the pension fund (or its successor fund in relation to the purchaser) or the allocation of amounts from the employer's pension fund ESA to the retirement savings accounts of the pension fund class members.

- The employer companies will not be entitled to a deduction under section 11(a) read with section 23(g) in the determination of their taxable income, in respect of the transfer from the pension fund ESA to any pension fund class members' retirement savings account.

7.2. BCR 76 – Cancellation of units in foreign collective investment schemes pursuant to their corporate re-domiciliation

This ruling determines the capital gains tax implications arising out of the exchange of units issued by an undertaking for collective investment schemes in transferrable securities in country A for units issued by an undertaking for collective investment schemes in transferrable securities in country B as part of the process of redomiciling the applicant's investment business from country A to country B.

In this ruling references to paragraphs are to paragraphs of the Eighth Schedule to the Act applicable as at 4 November 2020. 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:

- paragraph 1 – definition of "disposal";
- paragraph 11(1)(b);
- paragraph 20(1); and
- paragraph 35(1).

Class

The class members to whom this ruling will apply are the investors.

Parties to the proposed transaction

The applicant: A company incorporated in and a resident of country A which is the appointed manager of the country A fund

The country A fund: An undertaking for collective investment schemes in transferrable securities incorporated in and a resident of country A

The country A sub-funds: Seven collective investment schemes in property and securities managed under the country A fund

The country B fund: A new undertaking for collective investment schemes in transferrable securities established in country B

The country B sub-funds: Seven new collective investment schemes in property and securities established in country B and managed under the country B fund

The investors: The South African investors of the country A subfunds, comprising companies and individuals who invest directly into the sub-funds by way of subscriptions for units

Description of the proposed transaction

The applicant is re-domiciling the country A fund to country B by means of a merger of each of the existing sub-funds with a corresponding equivalent or mirror sub-fund that has been established in country B.

The procedure by which the proposed transaction will be effected is undertaken in accordance with Directive 2009/65/EC of the European Parliament and of the

Council of 13 July 2009.

The proposed implementation steps are as follows:

- The investment assets held and the liabilities of the country A sub-funds will be transferred to the country B sub-funds and the country B sub-funds will directly issue units to the former investors of the country A sub-funds.
- The country A sub-funds will cancel the units which were previously held by investors.

The result will be that the class members will hold units in the country B sub-funds and the country B sub-funds will hold the assets and undertake the liabilities which were previously for the account of the country A sub-funds. The country A subfunds will be terminated.

<u>Ruling</u>

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

- The exchange by each class member of an interest in a country A sub-fund for an equivalent interest in a country B sub-fund, in accordance with the merger process as determined by the relevant Undertaking for Collective Investment in Transferrable Securities regulation, will constitute a disposal of an asset as defined in paragraph 1 read with paragraph 11(1)(b).
- The proceeds from the disposal of a unit in the country A sub-fund by each investor will, in accordance with paragraph 35(1), be equal to the market value of the equivalent unit in the country B sub-fund received by each investor.
- The base cost for a class member of a unit in the country B sub-fund will, in accordance with paragraph 20(1), be equal to the market value of the equivalent unit in the country A sub-fund on the date of disposal.

8. GUIDES

8.1. Guide on the Taxation of Professional Sports Clubs and Players (Issue 2)

This guide is a general guide regarding the taxation of professional sports clubs and sports players in South Africa. It also refers briefly to the position of visiting professional sports players.

The professional sports industry is a fast growing industry internationally. The main aim of this guide is to explain the South African tax consequences for professional sports clubs and sports players in South Africa

This guide is meant to provide clarity on some of the issues and situations experienced by sports clubs and sportspersons in South Africa. Since not every situation can be addressed, the guide seeks to provide guidance on those matters most commonly experienced. Note that each case has to be considered independently and on its particular facts when deciding on the taxability of a specific activity or income source.

8.2. Comprehensive Guide to Capital Gains Tax (Issue 9)

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

This guide is **not an 'official publication'** as defined in section 1 of the Tax Administration Act and accordingly does not create a practice generally prevailing under section 5 of that Act. It is also not a binding general ruling under section 89 of Chapter 7 of the Tax Administration Act. This work reflects the law as at 15

January 2020 as amended by the Taxation Laws Amendment Act 34 of 2020. The 2020 tax rates have generally been used in this guide. The 2020 rates apply to companies with years of assessment ending between 1 April 2019 and 31 March 2020 and to persons other than companies with years of assessment commencing on 1 March 2019.

Besides some minor changes, this issue addresses the following new topics:

- Proceeds from short-term insurance (9.1.7)
- Capital losses arising from loans, advances or credit to which s 7C applies (12.5A)
- Disregarded capital gains and par. 80 (14.11.6A)
- Life rights (16.4.10)
- Other similar interests (24.1.4)
- Government grants (24.15)

8.3. Practitioner Connect – Issue 19: November 2020 - Unlawful for tax practitioners to approve online PoAs on behalf of client

There seems to be some misunderstanding regarding the approvals of tax type transfers by means of Powers of Attorney (PoAs) on eFiling, granted to tax practitioners by taxpayers.

SARS has implemented a new functionality on eFiling, which allows taxpayers or their registered representatives to authorise the transfer or any movement of Personal Income Tax eFiling profiles via the online Power of Attorney (PoA). It forms part of a number of digital enhancements that are meant to make it easy to comply.

This new, streamlined digital process of transferring a taxpayer's tax affairs per tax type from one practitioner to another, requires the taxpayer to accept and digitally approve an online PoA. This includes approval and provision of a PoA to a new practitioner, thus a taxpayer is obliged to complete the online PoA to enable a tax practitioner to have access to the client's eFiling profile.

Tax practitioners may not approve a PoA on behalf of a client, pretending to be the taxpayer or their representatives is a misrepresentation of the facts, hence unlawful.

The requirement that a taxpayer must approve a PoA is embedded in the legal principle that a person can only act (including submit a tax return on eFiling) on behalf of another if the latter person has authorised the former to do so. Such authorisation is given in the form of a PoA and misuse of that would be seen as unlawful.

Non-compliance

For example, some practitioners update a taxpayer's records and approve transfers fraudulently by changing the taxpayer's cell number to their own, in order to receive an OTP. This is equivalent to imitating a taxpayer's signature, thereby exceeding the PoA given to the tax practitioner, and constitutes an unlawful practice.

We have started to track IP addresses to identify possible unlawful tax type transfers by means of PoAs approved by tax practitioners, in order to put an end to this practice. In cases where changes or transfers are requested and the approval comes from the same computer (IP address), there is a high probability that it originates from the same person, i.e. the tax practitioner, and SARS will follow the matter up.

SARS has already written a number of Cease and Desist letters to tax practitioners in this regard. Should SARS find that practitioners continue to request transfers and approve their own PoAs, SARS will register cases of fraud and of the statutory offences under section 234 of the Tax Administration Act, as well as lodge a complaint with the relevant controlling body (RCB). This may also result in the suspension of a tax practitioner from eFiling.

8.4. *Venture Capital Companies (VCC) per SARS' website*

What are Venture Capital Companies?

One of the main challenges to the growth of small and medium-sized businesses and junior mining exploration is access to equity finance. To assist these sectors in terms of equity finance, Government has implemented a tax incentive for investors in these enterprises through a venture capital company (VCC) regime.

VCCs are intended to be a marketing vehicle that will attract retail investors. An investor is any taxpayer who qualifies to invest in an approved VCC. They have the benefit of bringing together small investors as well as concentrating investment expertise in favour of the small business sector. There are no special tax benefits for the VCC itself, only standard tax rules will apply.

Who are they for?

From 1 January 2009, investors can claim amounts incurred on acquiring VCC shares as a deduction from income. However, from 21 July 2019, investments made by a natural person and trusts will be capped at R2.5 million and for companies, investments will be capped at R5 million. This cap is per tax year. This deduction will not be subject to recoupment if the VCC shares are held for longer than five years.

A company must meet all of the following preliminary requirements to be able to get a SARS approved VCC status:

- The company must be a resident;
- The sole object of the company must be the management of investments in qualifying companies (i.e. investees);
- The company's tax affairs must be in order; and
- The company must be licensed in terms of section 8(5) of the Financial Advisory and Intermediary Services Act, 2002.

Persons who intend to or do make investments into a SARS approved VCC, may under no circumstances request a tax directive for purposes of section 12J under par. 11 of the Fourth Schedule to the Income Tax Act, in order to reduce his or her tax liability; or accept any advice from persons who indicate that such tax directives may be issued.

The VCC regime is subject to a 12 year sunset clause that ends on 30 June 2021.

How do I apply?

Email a completed application form together with supporting documents proving that the preliminary requirements have been met to vcc@sars.gov.za (Venture Capital Companies Office) or send by post to:

SARS Large Business Centre - Venture Capital Companies

Private Bag X170, Rivonia, 2128

Assistance with the application can be requested by addressing an email to vcc@sars.gov.za.

You will be contacted once your application has been processed. SARS will assess the application to determine if the company meets the preliminary requirements and if the application is successful, a Venture Capital Company reference number will be given and an approval letter will be sent to the applicant. If the application is not successful, a rejection letter will be sent to the applicant stating the reason(s) for the rejection.

The standard turnaround time of approval of applications is 21 business days. The period may vary depending on the application.

SARS can withdraw the approved VCC status for non-compliance with the following:

- If, during any year of assessment, after the approval of the Venture Capital Company status, the company fails to comply with the preliminary requirements as listed above;

- The company must satisfy the following additional requirements at the end of each year after the expiry of 48 months from the first date of the issue of VCC shares by the VCC;
    - A minimum of 80% of the expenditure incurred by the VCC to acquire assets must be for qualifying shares, and each investee company must, immediately after the issuing of the qualifying shares, hold assets with a book value not exceeding:
        - R500 million in any junior mining company; or
        - R50 million in any other qualifying company
    - The expenditure incurred by the VCC to acquire qualifying shares in any *one* qualifying company must not exceed 20% of any amounts received by the VCC in respect of the issue of VCC shares.

SARS will issue a written notification to the VCC stating the requirements that have not been met and provide a grace period for the VCC to meet the requirements. If the approved VCC does not take the acceptable corrective steps within the period specified in the written notice, the approved VCC status will be withdrawn from:

- the commencement of that year of assessment if the VCC does not meet the preliminary approval requirements; or
- the date of approval of the VCC status, if the approved VCC does not take the acceptable corrective steps to rectify the connected person requirement within the period specified in the written notice from SARS. In the case of a holding of more than 20% of a class of VCC shares, the withdrawal of the VCC will be from the commencement of that year of assessment during which the 20% holding is exceeded; or
- the commencement of that year of assessment where the VCC does not meet the additional requirements after the expiry of 36 months from the date of first issue of VCC shares.

If the approval of a VCC status is withdrawn, an amount equal to 125% of the aggregate amount contributed by the investor(s) in exchange for VCC shares must be included in that VCC's income in the year of assessment in which such approval has been withdrawn.

9. INDEMNITY

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