TAX UPDATE

For period: April 2020 to June 2020

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1. INTRODUCTION

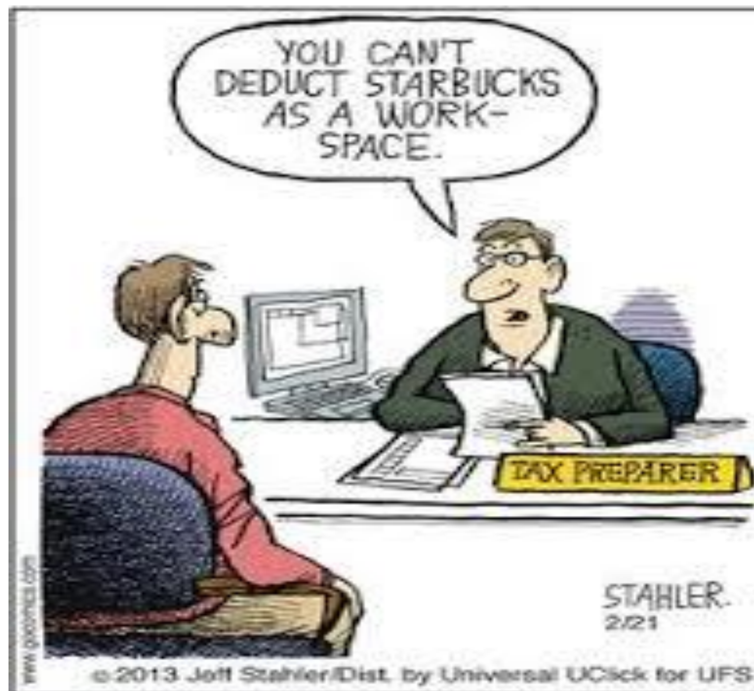
The purpose of this update is to summarise developments that occurred during the second quarter of 2020, specifically in relation to Income Tax and VAT. Johan Kotze, a Tax Executive at Shepstone & Wylie Attorneys, has compiled this summary.

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.

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. MEDIA STATEMENT – FURTHER TAX MEASURES TO COMBAT THE COVID-19 PANDEMIC

Government recognises that the far-reaching lockdown measures to contain the spread of the coronavirus are having a significant impact on our economy. Most households and businesses have suffered a significant loss in their income, as they comply with the regulations giving effect to the National State of Disaster declared on 15 March 2020. Government is committed to helping households and businesses stay afloat during this difficult period, whilst it continues to limit the rate of infection, on a risk-based approach.

The Minister of Finance announced the details of an initial set of measures on 29 March 2020 to assist tax compliant businesses with cash flow assistance and provide an incentive for businesses to retain their lower-income employees. Since the announcement, economic conditions have worsened, and National Treasury and SARS have received a large number of requests for assistance, including requests from large businesses that are also experiencing substantial cash flow difficulty. National Treasury recognises that the short-term interventions announced in the first fiscal package do not go far enough in assisting businesses or households through the crisis – especially as the lockdown has since been extended.

In line with the President's address to the nation on 21 April 2020, the Minister of Finance provides more detail on the second set of measures that aim to assist individuals and businesses through the pandemic. There is a critical need for government interventions to assist with job retention and support businesses that may be experiencing significant distress.

The following set of measures will help businesses focus on staying afloat and paying their employees and suppliers. Assisting businesses now will ensure that our economy is in a better position to recover once the health crisis starts to subside. If businesses survive this testing time, the economy will be better placed

to strive collectively towards economic growth that is inclusive (providing more opportunities for employment) and revenue generating (so that we are able to work towards improving the state of our fiscus). The measures are expected to provide around R70 billion in support, either through reductions in taxes otherwise payable or through deferrals of tax payments for tax compliant businesses. The interventions include:

- Skills development levy holiday:

  From 1 May 2020, there will be a four-month holiday for skills development levy contributions (1% of total salaries) to assist all businesses with cash flow. This provides relief of around R6 billion.

- Fast-tracking of value-added tax (VAT) refunds:

  Smaller VAT vendors that are in a net refund position will be temporarily permitted to file monthly instead of once every two months, thereby unlocking the input tax refund faster and immediately helping with cashflow. SARS is working towards having its systems in place to allow this in May 2020 for Category A vendors that would otherwise only file in June 2020.

- Three-month deferral for filing and first payment of carbon tax liabilities:

  The filing requirement and the first carbon tax payment are due by 31 July 2020. To provide additional time to complete the first return, as well as cash flow relief in the short term, and to allow for the utilisation of carbon offsets as administered by the Department of Mineral Resources and Energy, the filing and payment date will be delayed to 31 October 2020, providing cash flow relief of close to R2 billion.

- A deferral for the payment of excise taxes on alcoholic beverages and tobacco products:

  Due to the restrictions on the sale of alcoholic beverages and tobacco products, payments due in May 2020 and June 2020 will be deferred by 90 days for excise compliant businesses to more closely align tax payments through the duty-at-source system (excise duties are imposed at the point

of production) with retail sales. This is expected to provide short term assistance of around R6 billion.

- Postponing the implementation of some Budget 2020 measures:

  The 2020 Budget announced measures to broaden the corporate income tax base by:

  - restricting net interest expense deductions to 30% of earnings; and
  - limiting the use of assessed losses carried forward to 80% of taxable income.

  Both measures were to be effective for years of assessment commencing on or after 1 January 2021. These measures will be postponed to at least 1 January 2022.

- An increase in the expanded employment tax incentive amount:

  The first set of tax measures provided for a wage subsidy of up to R500 per month for each employee that earns less than R6 500 per month. This amount will be increased to R750 per month at a total cost of around R15 billion.

- An increase in the proportion of tax to be deferred and in the gross income threshold for automatic tax deferrals:

  The first set of tax measures also allowed tax compliant businesses to defer 20% of their employees' tax liabilities over the next four months (ending 31 July 2020) and a portion of their provisional corporate income tax payments (without penalties or interest).

  The proportion of employees' tax that can deferred will be increased to 35% and the gross income threshold for both deferrals will be increased from R50 million to R100 million, providing total cash flow relief of around R31 billion with an expected revenue loss of R5 billion.

- Case-by-case application to SARS for waiving of penalties:

  Larger businesses (with gross income of more than R100 million) that can

show they are incapable of making payment due to the COVID-19 disaster, may apply directly to SARS to defer tax payments without incurring penalties. Similarly, businesses with gross income of less than R100 million can apply for an additional deferral of payments without incurring penalties.

The following tax measures aim to assist individual taxpayers and to provide financial backing from the fiscus to donate to the Solidarity Fund:

- Increasing the deduction available for donations to the Solidarity Fund:

  The tax deductible limit for donations (currently 10% of taxable income) will be increased by an additional 10% for donations to the Solidarity Fund during the 2020/21 tax year.

- Adjusting pay-as-you-earn for donations made through the employer:

  Employers can factor in donations of up to 5% of an employee's monthly salary when calculating the monthly employees' tax to be withheld. An additional percentage that can be factored in of up to 33.3%, depending on the employee's circumstances, will be provided for a limited period for donations to the Solidarity Fund. This will lessen cash flow constraints for employees who donate to the Solidarity Fund.

- Expanding access to living annuity funds:

  Individuals who receive funds from a living annuity will temporarily be allowed to immediately either increase (up to a maximum of 20% from 17.5%) or decrease (down to a minimum of 0.5% from 2.5%) the proportion they receive as annuity income, instead of waiting up to one year until their next contract "anniversary date". This will assist individuals who either need cash flow immediately or who do not want to be forced to sell after their investments have underperformed.

The above measures will be given legal effect in terms of changes to the two bills mentioned in the Media Statement issued on 29 March 2020 – the Draft Disaster Management Tax Relief Bill and the Draft Disaster Management Tax Relief Administration Bill. Together with the Commissioner for SARS, National Treasury

will also monitor developments and the need for any further requirements to assist with COVID-19 relief efforts in lower tax revenue.

3. EXPLANATORY MEMORANDUM – DISASTER MANAGEMENT TAX RELIEF BILL, 2020 (DRAFT)

3.1. Expansion of the Employment Tax Incentive age eligibility criteria and amount claimable

The Employment Tax Incentive (ETI) programme was introduced in January 2014 to promote employment, particularly of young workers. The main aim of the programme is to reduce the cost of hiring young people between the ages of 18 and 29 (also referred to as qualifying employees) through a cost sharing mechanism with Government, by allowing the employer to reduce the amount of employees' tax (PAYE) they pay to the South African Revenue Service (SARS), while leaving the wage received by the qualifying employees unaffected.

The ETI programme makes provision for the employer to claim the ETI in respect of a qualifying employee:

- Who is between the ages of 18 and 29; and
- Has a monthly remuneration of less than R6 500.

The maximum monthly ETI claimable per qualifying employee is limited to R1 000 in the first year of employment and R500 in the second year of employment. Further to the above, the monthly ETI can only be claimed for the first 24 months of the qualifying employee's employment by an employer or associated institutions.

Reasons for change

The outbreak of COVID-19 is likely to result in large scale disruption of work due to illness, selfisolation or quarantine. The impact on employment may be severe as businesses grapple with the impact of reduced demand, disrupted business operations with a large portion of the workforce unable to present themselves for

duty as well as the dealing with the impact of the restricted movement of customers in adherence to health measures aimed at slowing the spread of the virus.

Small and medium sized businesses are the most vulnerable as they are unlikely to have cash reserves and are thus at a higher risk of shedding jobs under these conditions in an attempt to remain going concerns and contain costs while generating very little income.

Moreover, the nationwide lockdown that became effective from 27 March 2020 will mean that, aside from a narrow set of essential services, many workers will not be able to report for work.

During this time, the majority of employers are likely to experience severely reduced revenue, and may have to consider reducing staff numbers. In response to the COVID 19 outbreak, many countries around the world have introduced tax relief measures.

In order to minimize unemployment and the risk of the economy grinding to a halt during this difficult period, Government proposes expanding the current ETI to assist employers retain employees during this critical period of social distancing and lockdown, thus reducing the risk of low income earners losing their employment as a result of the outbreak.

Proposal

In order to minimise the loss of jobs during this critical period, Government proposes expanding the ETI programme for a limited period of four months, beginning 1 April 2020 and ending on 31 July 2020 as follows:

- Increasing the maximum amount of ETI claimable during this four-month period for employees eligible under the current ETI Act from R1 000 to R1 500 in the first qualifying twelve months and from R500 to R1 000 in the second twelve qualifying months.
- Allowing a monthly ETI claim in the amount of R500 during this four-month period for employees from the ages of:
  - 18 to 29 who are no longer eligible for the ETI as the employer has

claimed ETI in respect of those employees for 24 months; and

- 30 to 65 who are not eligible for the ETI due to their age.

- Accelerating the payment of employment tax incentive reimbursements from twice a year to monthly as a means of getting cash into the hands of tax compliant employers as soon as possible.

This expansion will, however, only apply to employers that were registered with SARS as at 1 March 2020. Further to the above, the current compliance requirements for employers under sections 8 and 10(4) of the ETI Act will continue to apply.

Examples:

Example 1

Employer A has 10 workers earning R4 500 per month each. The employer can retain up to an additional R5 000 from the employer's PAYE liability each month between April and July.

Example 2

Employer B has 3 workers. The employer claims the ETI for Employee A, the employer exhausted ETI claims for 27-year-old Employee B two years ago, and Employee C is 34 years old and has never been a qualifying employee. The employees each earn R4 500 per month. Employer B will be able to retain R2 500 per month. Since these are the only 3 workers, the amount will likely be claimed as a reimbursement from SARS.

Effective date

The proposed amendments will apply for a period of four months and are deemed to have come into operation on 1 April 2020 and end on 31 July 2020.

3.2. Deferral of the payment of employees' tax liability for tax comliant small to medium sized business

Paragraph 2 of the Fourth Schedule to the Income Tax Act makes provision for a resident employer or representative employer (in cases where the employer is nonresident) to deduct employees' tax (PAYE) from remuneration paid to its employees. In addition, the employer or representative employer must submit a return and the payment of PAYE withheld and paid to SARS within seven days after the end of the month for which the PAYE was deducted.

Administrative penalties may be imposed in terms of paragraph 6 of the Fourth Schedule to the Income Tax Act for latepayment of PAYE.

Reasons for change

The recent COVID-19 outbreak will have significant and potentially lasting impacts on the economy, with businesses facing the risk of cash flow problems. Tax compliant small to medium sized businesses play an important role in stimulating economic activity, job creation, poverty alleviation as well as the general improvement of living standards, and are expected to be amongst the hardest hit. In order to assist tax compliant small to medium sized businesses, Government proposes measures aimed at assisting to alleviate cash flow problems experienced during this difficult period.

Several countries have implemented measures whereby businesses are allowed to defer the transfer of payroll taxes to the tax authority. This can be in the form of a temporary suspension of payments for a fixed period (for most countries the suspension period is between 3 and 6 months), or by allowing businesses to pay taxes in instalments. The purpose of such measures is to assist businesses with liquidity in a time where business activity is likely to see an unprecedented decline in turnovers. The benefit of the measure is immediate cash flow relief that could enable businesses to survive.

Proposal

In order to assist with alleviating any cash flow burden arising as a result of the

COVID-19 outbreak, Government proposes the following tax measures for tax compliant small to medium sized businesses, for a limited period of four months, beginning 1 April 2020 and ending on 31 July 2020:

- Deferral of payment of 20% of the PAYE liability, without SARS imposing administrative penalties and interest for the late payment thereof.
- The deferred PAYE liability must be paid to SARS in equal instalments over the six month period commencing on 1 August 2020, i.e. the first payment must be made on 7 September 2020.

For the purposes of this proposal, small or medium sized business is defined to mean any business with an annual turnover not exceeding R50 million.

The above-mentioned proposals will not apply to an employer or representative employer that:

- has failed to submit any return as defined in section 1 of the Tax Administration Act, 2011 (TAA) on the basis required by section 25 of the TAA; or
- has any outstanding tax debt as defined in section 1 of the TAA, but excluding a tax debt:
    - in respect of which an agreement has been entered into in accordance with section 167 or 204 of the TAA;
    - that has been suspended in terms of section 164 of the TAA; or
    - that does not exceed the amount referred to in section 169(4) of the TAA.

However, interest and penalties will apply if the employer has understated the PAYE liability for any of the four months.

Effective date

The proposed amendments are deemed to have come into operation on 1 April 2020 and end on 31 January 2021.

3.3. *Deferral of the payment of provisional tax liability for tax compliant small to medium sized businesses*

Paragraph 17 of the Fourth Schedule to the Income Tax Act makes provision for every provisional taxpayer to make provisional tax payments in respect of their annual tax liability. The provisional tax payment for the annual tax liability is based on an estimate by the taxpayer of total taxable income, or is based on an estimate made by SARS in terms of paragraphs 19(2) and 19(3) of the Fourth Schedule to the Act. Under justifiable circumstances the estimate submitted by the provisional taxpayer may to be less than the basic amount applicable to the estimate in question.

Paragraphs 19(1), 21 and 23 of the Fourth schedule to the Act make provision for a provisional taxpayer to submit a return and make provisional tax payment to SARS. The first payment, which is 50% of the total estimated liability, must be made within six months after the commencement of the year of assessment and the second payment, which is the total estimated liability reduced by the first payment, must be made by no later than the last day of that year of assessment.

The following sanction are applicable to provisional tax:

- Paragraph 27 of the Fourth Schedule makes provision for a 10% penalty for late payment of a provisional tax liability for both the first and second tax periods.
- Paragraph 20 of the Fourth Schedule makes provision for a penalty on the underpayment of a provisional tax liability for the second provisional tax period as a result of underestimation, reduced by any section 27 penalty imposed for that period.

Section 89bis of the Act provides for interest on the unpaid portion of a provisional tax liability.

Reasons for change

The recent COVID-19 outbreak will have significant and potentially lasting impacts on the economy, with businesses facing the risk of cash flow problems. Tax

compliant small to medium sized businesses play an important role in stimulating economic activity, job creation, poverty alleviation as well as the general improvement of living standards, and are expected to be amongst the hardest hit. In order to assist tax compliant small to medium sized businesses, Government proposes measures aimed at assisting to alleviate cash flow problems experienced during this difficult period.

Allowing for a deferred payment of provisional liabilities should assist these businesses by providing additional cash flow during the crisis. This could be the difference between pushing a small or medium sized business into liquidation, or providing some space for the business to get through the crisis and add to the economic recovery, hopefully being a source of higher tax revenue in the medium term.

Proposal

In order to assist with alleviating cash flow burdens arising as a result of the COVID-19 outbreak, Government proposes the following tax measures for tax compliant small to medium sized businesses, for a period of twelve months, beginning 1 April 2020 and ending on 31 March 2021:

- Deferral of a portion of the payment of the first and second provisional tax liability to SARS, without SARS imposing administrative penalties and interest for the late payment of the deferred amount;
- The first provisional tax payment due from 1 April 2020 to 30 September 2020 will be based on 15% of the estimated total tax liability, while the second provisional tax payment from 1 April 2020 to 31 March 2021 will be based on 65% of the estimated total tax liability;
- Provisional taxpayers with deferred payments will be required to pay the full tax liability when making the third provisional tax payment in order to avoid interest charges.

For the purposes of this proposal, a small or medium sized businesses is defined as any company conducting a trade with an annual turnover not exceeding R50

million. The eligibility criteria for individuals carrying on a business have yet to be finalised, but one possibility is that they will be eligible if their turnover is less than R5 million and no more perthan 10% of their turnover is derived from interest, dividends, foreign dividends, rental from letting fixed property and any remuneration received from an employer.

The above-mentioned proposals will not apply to a provisional taxpayer that:

- has failed to submit any return as defined in section 1 of the Tax Administration, 2011 (TAA) as required by section 25 of the TAA; or
- has any outstanding tax debt as defined in section 1 of the TAA, but excluding a tax debt:
    - in respect of which an agreement has been entered into in accordance with section 167 or 204 of the TAA;
    - that has been suspended in terms of section 164 of the TAA; or
    - that does not exceed the amount referred to in section 169(4) of the TAA.

However, interest and penalties will apply in instances where, upon assessment, it is discovered that a taxpayer does not qualify for relief under the proposed amendments.

Examples:

The table below provides an illustrative example for two companies with different financial year-ends (FYEs).

- Company A's FYE is 30 June 2020. It would already have paid its first provisional tax payment of approximately 50% (of its estimated total tax liability, say R3 million) by 31 December 2019.
- Its second provisional payment will be due 30 June 2020 – during the period of the temporary relief measure. Instead of paying a further R1.5 million (50%) based on the current legislation, it need only pay R450 000 (15% of R3 million) so that the cumulative total of the first and second

provisional tax payments is 65% of the estimated total tax liability (as opposed to 100%).

- This will provide Company A with a R1 050 000 cash flow benefit during the temporary relief period. Normally, it would have until 31 December 2020 to pay a (usually small) third top-up amount to avoid an interest charge. This relief measure will allow the company to pay the outstanding balance (35% or R1 050 000) by this date.
- Company B has a 28 February 2021 FYE, meaning that its first provisional tax payment will fall during the temporary period. As such, the first provisional tax payment (due by 31 August 2020) will be R120 000 (15% of its estimated total tax liability of R800 000 for the year) instead of R400 000, allowing temporary relief of R280 000. As a further relief measure only 50% of the estimated tax liability (R400 000) will be due by 28 February 2021, so that the cumulative total tax paid at that point is 65% of the estimated total tax liability. The remaining balance of R280 000 (35% of estimated tax liability) will be due by 30 September 2021 in order to avoid interest charges.

Effective date

The proposed amendments are deemed to have come into operation on 1 April 2020 and apply to first provisional tax periods ending on or after 1 April 2020 but before 1 October 2020 and to second provisional tax periods ending on or after 1 April 2020 but before 1 April 2021.

3.4. Streamlined special tax dispensation for funds established to assist with Covid-19 disaster relief efforts

Currently, sections 10(1)(cN), 18A and 30 of the Income Tax Act (Act) read together with paragraph 1(d) of Part I and paragraph 1(d) of Part II of the Ninth Schedule makes provision for a public benefit activity performed by a public benefit organisation (PBO) of providing disaster relief. A donor to such a PBO and the

PBO qualify for the following tax exemptions and income tax deduction, provided that the PBO meets certain criteria prescribed in those sections:

- Receipts and accruals of the PBO (other than from certain business undertakings or trading activities) are exempt from income tax;
- Donations made to or by the PBO are exempt from donations tax; and
- Donations made to the PBO are tax deductible in the hands of the donor.

However,the amount of tax deductible donations allowable in any year of assessment is limited to 10% of the taxable income of that donor.

It is important to note that the above-mentioned special tax dispensation for PBOs is not automatic and is subject to a pre-approval process by SARS.

Reasons for change

The COVID-19 pandemic has had a crippling effect on many health systems and economies around the world. Given the potentially devastating effect it may have on our own health system and economy should the pandemic take stronger hold in South Africa, President Cyril Ramaphosa announced a 21-day national shutdown commencing on midnight on 26 March 2020 in his address: “Escalation of easures to combat Coronavirus COVID-19 pandemic” on 23 March 2020. Under the conditions of the lockdown, many business operations will be disrupted due the closure of businesses operated by nonessential service providers and the prescribed restricted movement of customers.

In response to these concerns, the South African government has sought to counter the economic impact that this pandemic poses to SMMEs and employment, resulting in the President announcing a set of fiscal interventions to be implemented by Government in his address to the nation on 23 March 2020. In the same address, the President also indicated that private donors have also pledged funding with the aim of providing assistance to the public.

The type and manner of funding envisaged by private donors to assist with COVID 19 relief measures take the following form:

- The funding structures take the form of loan funding by a fund to SMMEs on very favourable terms. The terms attached to the loan funding envisaged range from (i) an initial zero interest charge with interest only being charged in later years and (ii) long term repayment periods.
- Other funding structures envisage that financial assistance will be provided to the SMME (approval of funding will be made on a first come basis subject to the necessary due diligence checks), but the amount of the loan by the fund will not be paid directly to the SMME, but payment will be made in terms of weekly allowances directly to the employees of approved SMMEs in order to ensure that jobs are retained, while the loan obligation still remains with the SMME.

Given the different types of funding structures and mechanisms that may be used by private donors to assist with COVID-19 relief measures and to ensure that no tax leakage undermines the intended assistance, Government proposes a streamlined special tax dispensation for funds established to assist with COVID -19 relief measures. The streamlined tax treatment is to ensure amongst other things, transparency and accountability of these different types of funding structures.

Proposal

In light of this, it is proposed that the streamlined special tax treatment for funds established to assist with COVID-19 relief measures should be similar to the current special tax dispensation applicable to PBOs that provide disaster relief as envisaged in sections 10(1)(cN) and 30 read together with Part I and Part II of the Ninth Schedule to the Act. As a result, the following legislative changes are proposed in the Disaster Management Tax Relief Bill:

- COVID-19 disaster relief funds deemed to be PBOs
- COVID-19 disaster relief funds will on application and approval by SARS be deemed to be PBOs as contemplated in sections 10(1)(cN) and 30 of the Income Tax Act, and subject to the same criteria prescribed to all PBOs in terms of those sections.

The approval as a PBO in terms of section 30 of the Act will only apply for a limited period of four months beginning from 1 April 2020 until 31 July 2020.

As a result, during the four-month period, the following tax exemptions will apply:

- Receipts and accruals of COVID-19 disaster relief fund will be exempt from income tax; and
- Donations made to or by the COVID-19 disaster relief funds will be exempt from donations tax.

Deductible donations made to COVID-19 disaster relief fund:

- In addition, to the approval of a COVID-19 disaster relief fund as a PBO in terms of section 30, the COVID 19 disaster relief fund will also qualify for approval in terms of section 18A in respect of donations made to it. Similar to the approval as a PBO in terms of section 30 of the Act, the approval for section 18A will only apply for a limited period of four months beginning from 1 April 2020 until 31 July 2020.
- During the limited period of four months, donations made to a COVID-19 disaster relief trust will qualify for tax deduction in the hands of the donor, subject to the limitation provided in section 18A. This limitation provides that the donor may deduct in any year of assessment the amount of the donation made by that person, limited to 10% of the taxable income of that donor before a section 18A deduction or section 6quat deduction.

Exclusion from PAYE withholding obligation:

- In cases where a loan is made by the COVID 19 disaster relief fund to the SMME and the amount of the loan is not paid directly to the SMME, but payment is made in terms of weekly allowances directly to the employees of that SMMEs in order to ensure that jobs are retained, the loan obligation still remains with the SMME. The following is proposed:
  - In view of the fact that it will be difficult for the SMME to withhold PAYE in respect of payments paid directly by the COVID-19 disaster relief fund to the employees (due to the fact that the

payment was not made by the SMME) it is proposed that amendments be made to the tax legislation so that these payments do not give rise to PAYE withholding obligation by the SMME. That said, such payments will be treated as income in the hands of the employees and will be subject to tax in the hands of the employees in accordance with applicable tax brackets on assessment.

- The proposed exclusion from PAYE withholding will only apply for a limited period of four months beginning from 1 April 2020 until 31 July 2020.

Transfer of assets of a COVID-19 disaster relief funds:

- At the end of the period of four months, the COVID-19 disaster relief trusts will cease to apply the provisions set out in the Disaster Management Tax Relief Bill.
- In addition, amendments are made in the Disaster Management Tax Relief Bill to deem, at the end of the period of four months, COVID-19 disaster relief trusts that have not dissolved and the assets thereof are not distributed as contemplated in section 30(3)(b)(iii) of the Income Tax Act on or before 31 July 2020, to be a small business funding entities as contemplated in section 30C of the Act.

<u>Effective date</u>

The proposed amendments will come into operation as follows:

- The amendment relating to deeming COVID-19 disaster relief trusts to be PBOs as contemplated in sections 10(1)(cN) and 30 of the Income Tax Act, will apply for a period of four months and will come into operation on 1 April 2020 and apply until 31 July 2020.
- The amendment relating to the donations made to a COVID-19 disaster relief trust to for tax deduction in the hands of the donor in terms of section 18A will apply for a period of four months and will come into operation on 1 April 2020 and apply until 31 July 2020.
- The amendment relating to the exclusion of any amount received or

accrued from a COVID-19 disaster relief trust by an employee of an SMME from PAYE withholding will also apply for a period of four months and will come into operation on 1 April 2020 and applies in respect of any amount received on or after that date but on or before 31 July 2020.

- The amendment relating to transfer of assets upon the dissolution of COVID-19 disaster relief trusts will come into operation on 31 July 2020.

4. REGULATIONS

4.1. Official rate of interest

The term 'official rate of interest' is defined in section 1(1) of the Income Tax Act 58 of 1962 (the Act)

Where a loan is obtained by an employee from his or her employer in terms of which no interest is payable or where the interest payable is less than the 'official rate of interest', the difference between the amount which would have been payable if the loan was granted at the official rate and the amount actually paid by the employee, is taxed as a fringe benefit.

DATE FROM	DATE TO	RATE
1 August 2019	31 January 2020	7.50%
1 February 2020	31 March 2020	7.25%
1 April 2020	30 April 2020	6.25%
1 May 2020	Until change in the Repo rate	5.25%

The 'official rate' as defined in section 1(1) of the Act is linked to the repurchase rate plus one%. The official rate is adjusted at the beginning of the month following

the month during which the Reserve Bank changes the repurchase rate.

5. TAX CASES

5.1. Africa Cash and Carry (Pty) Ltd v C:SARS

Africa Cash & Carry (Pty) Ltd (ACC) operated a cash and carry business which generated substantial amounts of cash.

SARS had, during 2011, raised estimated assessments (the assessments) in relation to ACC in respect of additional income tax and value-added tax (VAT), penalties and interest for the financial years 2003 to 2009, totaling some R600 million.

It was not in dispute that ACC had fraudulently suppressed its sales figures for those years which had resulted in its income tax and VAT liability being under-declared.

ACC, on the version of its own experts, was liable to the fiscus for unpaid taxes of at least R68 million.

ACC had objected to the assessments and when the objections were disallowed, it had appealed to the Tax Court.

During 2007 SARS had become privy to certain information concerning tax evasion in the Jumbo Group of Companies (Jumbo) which had operated in the same cash and carry market as ACC and it shared certain shareholders in common with ACC.

Jumbo had under declared cash sales of approximately R200 million and it had under-reported its sales by using a functionality in its point of sale (POS) system, which allowed manual manipulation of its sales figures and the point of sale system used by ACC was similar to the one used by Jumbo.

SARS thereafter commenced an investigation into the tax affairs of ACC and, according to its annual financial statements, it traded at a negative gross profit margin and only returned a positive profit margin through the earning of rebates and discounts.

SARS' investigation then turned to a scrutiny of ACC's records of its sales and stock and it visited ACC's premises on 19 March 2009 to obtain and copy the relevant financial data to perform its investigation.

A hopelessly inadequate disclosure of ACC's financial records caused SARS to apply for search and seizure warrants and these were executed at ACC's premises on 20 March 2009. Computer equipment was seized, sealed in evidence bags and removed and documents were placed in boxes. About 74 000 documents in pallets were seized comprising sales invoices, supplier invoices, supplier trade agreements and financial records.

Ms Khoosal, a specialist forensic auditor employed by SARS, was present during the visit to ACC's premises on 19 March 2009 and thereafter during the execution of the warrants.

It was not in dispute that the records that could be found and were seized were incomplete and inadequate and ACC's representatives were invited to be present when the seals to the records that were seized would be broken but none of ACC's representatives attended.

The only source data which SARS was able to image, was from the Windows version, which only covered the seven month period from August 2008 to the end of February 2009 (the seven month period). SARS did not find any backup data for this period during its search and seizure operation. Requests for copies of the backup data for the period before August 2009 were met with the response that the DVDs containing the backup data for that period were stolen during a burglary at ACC's premises. No evidence to confirm a theft of the backup data was adduced by ACC before the Tax Court.

SARS requested the relevant customised DOS software application from ACC and ACC alleged that this DOS version was on drives seized by SARS but Ms Khoosal had denied that these drives had been seized by SARS and her evidence stood unchallenged.

The result was that SARS was restricted to the so-called raw data from the Windows version, which only covered the seven month period. Ms Khoosal

analysed this data and discovered that the quantities sold per the stock table exceeded the sales count in the sales table and these quantity variances were caused by ACC suppressing its disclosed sales to below the level of its true sales.

In addition to the raw data for the seven month period, SARS had some records from the Pastel accounting program used by ACC on which data was captured across from the React system, hard copies of some management reports, VAT returns, and annual financial statements for each of the financial years ending February 2003 to 2009 and the manipulated sales figures were carried forward in all these records, thus rendering them unreliable.

Having determined the quantity variance of under-disclosed sales for the seven month period, SARS, by using the pricing field from the sales table in the database it was able to access, calculated the sales value variance for the seven months to be R38 994 851. This amount was added to the fictitious sales figure declared by ACC for that seven month period, resulting in a figure of R1 518 847 563.

The cost of sales for that seven month period was then calculated by extracting the value of the opening stock as at 1 August 2008 and the value of the closing stock as at 28 February 2009 from the stock table in the database.

The gross profit for the seven month period was then calculated and expressed as a percentage of the adjusted sales figure was 3.6%.

SARS applied a gross margin percentage of 3,6% for the seven month period to ACC's 2003 to 2008 and the full 2009 years of assessment and it did so by using the cost of sales figures in ACC's annual financial statements declared for those years, to calculate the sales which would produce a gross profit percentage of 3,6% for each year.

Following that methodology, SARS claimed estimated additional income tax from ACC and SARS applied the same methodology in respect of under-declared sales to claim additional VAT from ACC.

On 19 November 2010 SARS issued a letter of its preliminary audit findings based on the methodology used and claiming the specified amounts, followed by a Letter of Findings and finally it issued the estimated assessments which formed the

subject matter of the dispute before the Tax Court and these assessments were to be regarded as having been issued under ss 95 and 102(2) of the Tax Administration Act.

ACC objected to these estimated income tax and VAT assessments, principally on the grounds that it had not under-declared its income tax or VAT liability, that SARS' approach to establish sales was incorrect, that the Windows version contained certain defects, and that the period within which additional assessments could be issued had lapsed.

The objections were disallowed by SARS and ACC then filed a notice of appeal and thereafter delivered its Letter of Appeal, noting the appeal against such disallowance and that was the appeal that served before the Tax Court.

Preparatory to the hearing before the Tax Court, SARS filed a notice in terms of Rule 37(a) and (b) of the rules promulgated in terms of the Act recording that in preparing for the tax appeal, Ms Khoosal had identified three errors in the previous estimation by SARS which led to the recalculation of the value of the under-declared sales for the seven-month period as R28 020 064 and SARS accepted that the initial R38 million variance was wrong.

The recalculated gross profit expressed as a percentage of sales produced a now reduced gross profit percentage of 2,04%.

As was done previously, the 2,04% gross profit percentage was extrapolated to the 2003 to 2008 and full 2009 years of assessment, to revise the contrived annual sales figures reflected in the annual financial statements submitted for those years, to result in a gross profit expressed as a percentage of sales of 2.04% for each year and the total income tax and VAT liability payable for those years were recalculated.

The methodology adopted in calculating the original R38 million variance, which resulted in a gross profit percentage of 3,6% and gave rise to the estimated assessments, and the methodology adopted in calculating the R28 million variance and resulting in a gross profit percentage of 2,04%, were identical and the difference was caused by two incorrect input values, the understated sales (due to

a lower calculated sales variance) and the purchases figure (due to an incorrect script and the typographical error in the cost of sales figure for 2008).

The original assessments were not withdrawn nor amended, but remained together with the objection to the assessments by ACC, the disallowance of the objections, and the appeal as framed by the pleadings as SARS maintained that it was not obliged to withdraw the assessments.

SARS intended to ask the Tax Court to confirm the reduced calculated margin of 2,04% and hence the Court would be asked to make an order in terms of section 129(2)(b) of the Tax Administration Act 28 of 2011, i.e. that the assessments be altered to give effect to the redetermined understated income and sales.

SARS had adopted the stance during the trial before the Tax Court that the 'amount of the liability' had changed 'at appeal stage' and that it was not required of it to amend the assessments accordingly.

The Tax Court dismissed the appeals and ordered that 'the assessments are altered in accordance with section 129(2)(b) of the Tax Administration Act and it is directed that SARS alter the assessments in respect of the 2003 to 2009 income tax assessments and VAT assessments, forming the subject of this tax appeal accordingly.'

ACC appealed against the Tax Court decision directly to the Supreme Court of Appeal.

ACC on appeal raised the following key issues–

- •That it was not open to SARS to defend the assessments by contending for a materially different tax liability to that reflected in the assessments, in the absence of revised assessments or a valid concession of the appeal, whether in whole or in part;
- •That the Tax Court, by substantially 'altering' the assessments, had exercised the functions of SARS, which it may not do, hence it had acted beyond its powers;

- •That SARS had not discharged the burden of proving the reasonableness of the assessments as effectively revised by the Tax Court.

Judge Koen held the following:

Whether SARS was bound by the assessments

(i) That it was clear that SARS must fix a liability in a certain amount and communicate it to a taxpayer, for such notification to qualify as an 'assessment'. An assessment cannot mean the unexpressed thoughts of an assessing revenue officer. It requires the written representation of those thoughts.

(ii) That, based on the wording of the definition of 'assessment' in section 1 of the Tax Administration Act 28 of 2011, ACC contended that not only must the amount of liability be determined, but that the amount must be determined by SARS, not by the court. ACC consequently contended that an assessment required a 'formal act' where an assessing officer in SARS records the amount of the liability, such as the initial assessments and the amount of the liability cannot change without the assessment being changed by SARS. It was also submitted that an assessment is 'administrative action' for the purposes of the Promotion of Administrative Justice Act 3 of 2000 (PAJA) and that once made, unless challenged successfully, would harden into finality. Finally, in terms of the principle of functus officio, ACC submitted that once an assessment had been made, it may be revisited only within the parameters of prescribed powers in the Act.

(iii) That the argument advanced was that these powers in the Act allow SARS only to either issue additional assessments, reduce assessments in terms of section 93(1)(e)(ii) or withdraw assessments in terms of section 98(1)(d)(i)(bb) if there was 'a processing error by SARS' provided that the jurisdictional requirements are met, or to concede the appeal whether in whole or in part, provided that such concession was made in compliance with the law but ACC contended that none of this happened and hence that the approach of SARS was fatally flawed.

(iv) That SARS did not dispute that the assessments were not reduced or withdrawn but it did maintain that the assessments were conceded in part and the issues arising accordingly were whether there was a valid concession and/or whether the assessments could be lawfully altered as the Tax Court ultimately did.

(v) That in regard to whether there had been a valid concession by SARS, the issue raised was whether there had been a concession of part of the appeal before the Tax Court. Concessions are governed by section 107(7) of Act 28 of 2011 and Rule 46 of the Tax Court Rules. The expert summary of Ms Khoosal made no express reference to a concession and it simply recorded that 'the assessments must be evaluated taking into account what is stated in this expert summary'. The summary of her expert evidence did however pre-warn ACC as to what SARS' approach would be so that it would not be taken by surprise.

(vi) That it was clear that SARS, when faced with the enquiry by ACC as to whether the original assessments would be withdrawn, belatedly resorted to the mechanism of a concession but the belated reliance on section 107(7) was opportunistic and not conscientious. Whether the Tax Court had correctly concluded that the expert summary of Ms Khoosal and the attorney's letter of 23 October 2015, constituted a valid notice of a concession, did not have to be decided because the Tax Court ultimately resorted to an alteration of the assessments in terms of section 129(2)(b) and whether it had the authority to do so and did so correctly, is dispositive of this appeal.

As to the Tax Court's power to alter an assessment in terms of section 129(2)(b) of the Act

(vii) That at the conclusion of the hearing the Tax Court was faced with the original assessments and evidence which did not support the amounts in the assessments, but a tax liability for lesser amounts, based primarily on calculations, applying a gross profit percentage of 2.04% and ACC had contended that the assessments should in those circumstances have been

set aside in toto as they had been altered in a manner not contemplated by section 129(2)(b) of the Act.

(viii) That the Tax Court, however, decided to order the assessments 'to be altered' by relying on section 129 of the Act and the Supreme Court of Appeal approved the Tax Court's interpretation of section 129(2)(b) where it held that 'Subsection (b) envisages that when an assessment is ordered to 'be altered' the assessment is changed or modified in identified respects but the assessment is not completely transmuted or transmogrified into an entirely new entity comprising new DNA. Subsection (c) envisages that the assessment is referred back to the creator thereof, SARS, for a further process of investigation so as to test the subject matter and arrive at a further result.' This interpretation also emphasizes the distinction between instances where a tax court may 'alter' an assessment, and those instances where it needs to refer an assessment back to SARS 'for further examination and assessment.'

(ix) That a Tax Court in principle has this power to alter an assessment cannot be doubted. The clear wording of section 129(2)(b) provides for such an eventuality and it is exactly what happened in ITC 1869 75 SATC 329. ACC had contended in ITC 1869 that the court was faced with an obvious error that did not affect the rest of the assessment and that this was not the position in the present matter. However that submission was incorrect as the reduced tax liability calculated on the 2,04% arose because of an obvious error on the part of SARS in the three limited respects, identified and easily corrected by Ms Khoosal.

(x) That, unlike the facts in C:SARS v Pretoria East Motors (Pty) Ltd and Another 76 SATC 293, in the present matter there is no further evidence requiring further investigation and assessment. All the facts, investigations and assessments underlying the calculation of the tax liability based on the gross profit percentage of 2, 04 had been disclosed timeously to ACC, was placed before the Tax Court and the Tax Court was in a position where it could grant the order it did.

(xi) That in both Avenant v C:SARS 78 SATC 343 and C:SARS v Stepney Investments (Pty) Ltd 78 SATC 86 the Tax Court simply did not have the necessary information before it and the present appeal was plainly distinguishable on that basis as no further information was required by the Tax Court to grant the order it did and there was no need for any such further examination and investigation in the present appeal.

(xii) That the point of departure should always be that a Tax Court is a court of revision and 'not a court of appeal in the ordinary sense.' The legislature 'intended that there could be a re-hearing of the whole matter by the Special Court and that the court could substitute its own decision for that of the Commissioner,' if justified on the evidence before it. A Tax Court accordingly rehears the issues before it and decides afresh whether an estimated assessment is reasonable. It is not bound by what SARS found. In rehearing the case it can either uphold the opinion of SARS or overrule it and substitute it with its own opinion.

(xiii) That the powers of the Tax Court and its functions are unique. It places itself in the shoes of the functionary and re-evaluates the facts and circumstances of the subject matter on which the assessments were based. By its very nature an estimated assessment is subject to change based on an evaluation of the evidence and any information that becomes available. What is important is that the methodology used and the assumptions on the strength of which the estimated estimates were made should remain the same, otherwise the conclusions reached by the Tax Court might not be procedurally fair. The Tax Court must place itself in the shoes of the functionary to determine whether the methodology followed and the assumptions on which the estimated assessment are based, are reasonable and produce a reasonable result.

(xiv) That, being a court of revision, did not mean that a Tax Court is free of restrictions. It too must observe an administratively fair process and that will entail, inter alia, that the dispute must be resolved on the issues raised by the parties and the enquiry confined to the facts placed before court. In this

regard the pleadings are important and the parties will be kept to their pleadings, where any departure from the pleadings would cause prejudice or prevent a full enquiry. But within those limits a Tax Court has a wide discretion, for pleadings are made for the court and not the court for pleadings. Where a party has had every facility to place all the facts before the Tax Court and the investigation into all the circumstances has been thorough, then there is no justification to interfere simply because the pleadings had not been as explicit as they might have been.

(xv) That the taxpayer is entitled to enjoy all the benefits of the audi alteram partem rule and it must not be taken by surprise, and the process must have been conducted fairly. Whether the taxpayer was adequately forewarned to present its case fully, is again a question of fact dependent on the circumstances of each case.

(xvi) That the evidence in this matter had established, inter alia, that ACC had been appraised of the errors in the calculation of the assessments and of SARS' intention to ask for a reduced tax liability to be fixed based on only a 2.04% gross profit margin and this had been communicated to it. Its counsel had prepared fully for trial and were able to cross-examine SARS' witnesses comprehensively on the calculations based on the same methodology employed in respect of the assessments, but now based on the R28 million variance and a 2.04% gross profit margin. ACC was well aware of the details of the case it had to meet and it had confronted that case squarely and with meticulous detail. Moreover, it did not have to deal with a change in the methodology of the assessment, but was confronted merely with an arithmetical recalculation.

(xvii) That a Tax Court does not have inherent jurisdiction. However, if the evidence before it does not sustain the amount determined in an estimated assessment of a taxpayer's liability, or it determines that the amount in the estimated assessment is unreasonable then, subject to constitutional principles and compliance with the audi alteram partem principle, and fairness, provided that the basis for taxation is not now entirely different,

and provided that the court has all the information it requires to decide the matter before it, a Tax Court can alter an assessment, rather than 'refer the assessment back to SARS.'

(xviii) That such an alteration, if in compliance with the aforesaid principles and justified on the facts as reasonable, will fall within the powers conferred in section 129(2)(b) of the Act, accordingly be competent, not offend against the separation of powers doctrine, amount to a proper discharge of the obligation imposed upon a Tax Court, and be entirely consistent with the Tax Court's function in the greater constitutional framework as a court of revision and the Tax Court will simply be discharging one of its core functions.

(xix) That there was no reason why the assessments in issue could not be altered by the Tax Court to give effect to a lesser correct tax liability, calculated by applying input variables which were justified on accepted evidence and the alterations to the tax liability for each of the years of assessment were simply consequential upon the determinations which the court was empowered and enjoined to make as a court of revision.

(xx) That, accordingly, the Tax Court had correctly concluded that section 129(2)(b) of the Act was the appropriate tool to use in the circumstances of this case.

As to the reasonableness of SARS' gross profit percentage methodology

(xxi) That ACC had contended in the alternative that if the Tax Court had the power to alter the assessments, that it had erred in using SARS' gross profit percentage methodology in doing so because it was not reasonable to rely on that methodology. In terms of section 102(2) of the Tax Administration Act 28 of 2011 the burden of proving whether an estimate under section 95 was reasonable or the facts on which SARS had based the imposition of an understatement penalty under Chapter 16 was upon SARS.

(xxii) That the Act did not provide any guidance or criteria to determine whether an estimate made by SARS was reasonable.

(xxiii) That reasonableness would require that SARS strike a balance fairly and reasonably open to it on the facts before it or available to it. Reasonableness requires that a balance must be struck between a range of competing considerations in the context of a particular case. The principal enquiry is whether SARS struck a balance fairly and reasonably open to it on the facts before it, or readily available to it. If the choice of the gross profit percentage method is one that reasonably could be applied, then a court will not interfere with that decision. What is required for a decision to be justifiable is that it should be 'a rational decision taken lawfully and directed to a proper purpose.'

(xxiv) That clearly, if the results of a decision are patently distorted, it cannot be reasonable. An estimated assessment by SARS may also not be an 'arbitrary guesstimate'. If a decision 'is so unreasonable that no reasonable person could have so exercised the power', it will be reviewable. In all instances a discretionmust 'be exercised with care by properly experienced and suitably qualified personnel, since it may otherwise be reduced to an arbitrary guesstimate, with grave consequences for the taxpayer.'

(xxv) That SARS had to consider all reliable information readily available to it in arriving at the assessments and must have acted rationally, in accordance with principles established in Bato Star and Bel Porto School Governing Body. Factors relevant to determining whether a decision is reasonable or not would include amongst others the nature of the decision, the identity and expertise of the decision-maker, the range of factors relevant to the decision, the reasons given for the decision, the nature of the competing interests involved and the impact of the decision on the lives and well-being of those affected and this list is not exhaustive.

(xxvi) That the issue was not whether the decision to adopt the gross profit methodology was necessarily the best decision in the circumstances. What this Court has to decide is whether the decision to apply the gross profit methodology struck a reasonable equilibrium between the applicable principles and objectives sought to be achieved, in the context of the

established facts of this case.

(xxvii) That in its heads of argument ACC maintained that the gross profit percentage methodology used by SARS gave rise to a flawed result, because: (a) its application resulted in distorted figures; (b) the calculation did not take account of rebates; (c) SARS used inaccurate figures for stock; and (d) SARS mixed the data it used.

(xxviii) That the onus was on SARS to show that the methodology used was reasonable and that required no more than satisfying the Tax Court that an acceptable methodology, recognised as an acceptable methodology in the accounting discipline, was used and that there were cogent reasons for doing so. ACC's approach of simply picking away at SARS' methodology in the absence of factual evidence in rebuttal to sustain the criticism levelled, does not, even at the level of an evidentiary onus, demonstrate that the use of the gross profit percentage method was irrational, or not rationally justified, and that the decision to use the gross profit percentage method, was unreasonable.

(xxix) That the Tax Court did not err in concluding that SARS' assessment was reasonable and the criticisms by ACC's expert witnesses, amongst others, failed to take into account that there was a systematic plan in which ACC suppressed its sales and manipulated its records. ACC has elected not to make a full disclosure of its activities in this regard and there was simply no basis to set aside the methodology employed by SARS as being not reasonable.

(xxx) That, accordingly, there was no basis to interfere with the order granted by the Tax Court.

Appeal dismissed.

5.2. C:SARS v Altas Copc SA (Pty) Ltd

Atlas Copco SA (Pty) Ltd (Atlas) was a member of the Atlas Copco Group, with its parent company being in Sweden.

Atlas' main business was to sell or lease and thereafter service machinery and equipment including spare parts and consumables that was imported mainly from Sweden for use in the mining and related industries in South Africa.

Atlas' parent company had conceived a policy known as the Finance Controlling and Accounting Manual (FAM) or The Way We Do Things (WAY), which was implemented and applied by all companies within the group and in terms of this policy Atlas was to write down the value of its closing stock by 50%, if such closing stock had not sold in the preceding 12 months, and by 100% if it had not sold in 24 months.

Atlas had applied this policy by writing down its closing stock by the fixed percentages reflected in the policy and it included in its 2008 and 2009 tax returns the amounts it claimed that the value of its trading stock had diminished by during those years of assessment.

SARS, took the view that the write down of stock by Atlas did not comply with the provisions of section 22(1)(a) of the Income Tax Act 58 of 1962 and he accordingly added back R30 191 000 for 2008 and R33 402 000 for 2009 and had assessed Atlas to tax in respect of those amounts on the ground that 'there was no diminishing in value at year end for a deduction to be claimed as a result of damage, deterioration, change of fashion, decrease in the market value in respect of stock.'

SARS had also levied interest in terms of section 89quat of the Income Tax Act

Atlas had successfully noted an appeal to the Johannesburg Tax Court (Case No 13626 of 17 May 2018 per Opperman J) which had set aside SARS' additional assessments for the 2008 and 2009 tax years.

The Tax Court had identified what it described as 'the crisp legal dispute between the parties' as being 'whether the nett realisable value ('NRV') of the Atlas' closing

stock, calculated in accordance with IAS2, IFRS, South African Statements of Generally Accepted Accounting Practice ('SA GAAP') and the policy, may and should, where it is lower than the cost price of such trading stock, be accepted as representing the value of trading stock held and not disposed of at the end of the relevant years for purposes of section 22(1)(a) of the Income Tax Act.'

The Tax Court found that the NRV of Atlas' closing stock for 2008 and 2009, calculated in accordance with IAS2, IFRS, SA GAAP and the policy which was in line with IAS2 and IFRS may and should, where it is lower than the cost price of such trading stock, be accepted as representing the value of trading stock held and not disposed of at the end of the relevant years for purposes of section 22(1)(a) of the Income Tax Act.

The Tax Court, moreover, was of the view that the NRV as determined in accordance with IAS2, IFRS and SA GAAP and the policy 'provides an acceptable and appropriate method for purposes of section 22(1)(a) for the determination of the actual value of trading stock at the end of the year of assessment, the application of which leads to a sensible and business-like result and it constitutes a just and reasonable basis for valuing Atlas' closing stock for 2008 and 2009, as contemplated in such section.'

During the tax years relevant to this appeal, section 22(1)(a) provided:

'(1) The amount which shall, in the determination of the taxable income derived by any person during any year of assessment from carrying on any trade (other than farming), be taken into account in respect of the value of any trading stock held and not disposed of by him at the end of such year of assessment, shall be–

(a) in the case of trading stock other than trading stock contemplated in paragraph (b), the cost price to such person of such trading stock, less such amount as the SARS may think just and reasonable as representing the amount by which the value of such trading stock, not being any financial instrument, has been diminished by reason of damage, deterioration, change of fashion, decrease in the market value or for any other reason

satisfactory to the SARS.'

Atlas had contended (and it had found favour with the Tax Court) that the reference to market value in section 22(1)(a) of the Act was the same as the term 'net realisable value' (NRV) as employed in the Statement of Generally Accepted Accounting Practice (AC 108) or International Accounting Standard 2 (IAS 2).

The Tax Court took the view that:

> 'the NRV as set out in IAS2 is an appropriate method by which to determine the actual value of trading stock in the hands of the taxpayer at the end of the year of assessment. It provides a sensible and businesslike result which accords with the purpose of section 22(1) being that the cost deduction deferred should be limited to what the taxpayer can reasonably expect to recover as at the end of the relevant tax year.'

NRV is defined in IAS2 as the estimated selling price of inventory in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.

The Tax Court had sought support for its approach in Volkswagen South Africa (Pty) Ltd v C:SARS (see ITC 1901 80 SATC 58) where Eksteen J had found for the taxpayer, in the main, on the reasoning that:

> 'The nett realisable value (NRV) as determined in accordance with IAS2 provides an appropriate method by which to determine the actual value of trading stock in the hands of Atlas at the end of the years of assessment for the purposes of section 22(1) of the. . . Act.'

However, SARS had successfully appealed the judgment of Eksteen J in ITC 1901 (supra) to the Supreme Court of Appeal and in that court (see C:SARS v Volkswagen South Africa (Pty) Ltd 81 SATC 24) it was held that Eksteen J had 'erred in failing to recognise that section 22(1)(a) is not concerned with contrasting cost price with the value determined by 'an appropriate method by which to determine the actual value of trading stock in the hands of the taxpayer at the end of the year of assessment."

The Supreme Court of Appeal (per Wallis JA) had concluded:

> ‘In looking for a sensible and business-like manner of valuation of trading stock at year end [Eksteen J) answered a question other than the one posed by the facts and formulated by the parties in the stated case. That question was whether NRV should be used to determine the value of trading stock at year end for the purposes of claiming an allowance against cost price under section 22(1)(a). Whether it was a sensible and business-like manner of valuing trading stock from an accounting perspective was neither here nor there. The concern was whether it accurately reflected the diminution in value of trading stock contemplated in the section.’ (81 SATC 24 at para [54]).'

The correct position as stated by the Supreme Court of Appeal in C:SARS v Volkswagen was that:

> ‘SARS may only grant a just and reasonable allowance in respect of a diminution in value of trading stock under section 22(1)(a), in two circumstances. The first is where some event has occurred in the tax year in question causing the value of the trading stock to diminish. The second is where it is known with reasonable certainty that an event will occur in the following tax year that will cause the value of the trading stock to diminish. . . Both scenarios are consistent with the basic proposition that the assessment of income tax relates to events that have already occurred rather than events that may occur in the future.’ (81 SATC 24 at para [18]).'

The court in the present case had to determine whether the value of Atlas' trading stock had diminished, thereby entitling SARS to make a just and reasonable allowance under section 22(1)(a) of the Act and, in particular, whether the reference to market value in section 22(1)(a) was the same as NRV as employed in the accounting statements and whether NRV was an appropriate method by which to determine the actual value of trading stock in the hands of Atlas at the end of the relevant years of assessment.

Judge Ponnan held the following:

(i) That section 22(1)(a) was concerned with the value of the trading stock of a taxpayer as trading stock at year end and it empowered SARS to allow a deduction from the cost price, by way of a just and reasonable allowance, in the four circumstances specified, namely, damage, deterioration, change of fashion or decrease in market value or for any other reason satisfactory to the SARS. The rationale for the existence of these provisions 'is neither far to seek nor difficult to comprehend.' The section is couched in the past tense and it is concerned with an enquiry as to whether a diminution in value has already occurred. In other words, the cost price must already have diminished. The circumstances expressly mentioned in the section relate to a diminution of value as a result of events occurring prior to the rendition by the taxpayer of its tax return and the exercise is thus one of looking back at what happened during the tax year in question.

(ii) That the thrust of Atlas' case, which found favour with the Tax Court, was that the reference to market value in section 22(1)(a) of the Act was the same as the term 'net realisable value' (NRV) as employed in the Statement of Generally Accepted Accounting Practice (AC108) or International Accounting Standard 2 (IAS2).

(iii) That the court a quo had sought support for its approach in ITC 1901 80 SATC 58 but SARS had successfully appealed the judgment of Eksteen J in that case to the Supreme Court of Appeal where in C:SARS v Volkswagen South Africa (Pty) Ltd 81 SATC 24 Wallis JA had held that Eksteen J had 'erred in failing to recognise that section 22(1)(a) is not concerned with contrasting cost price with the value determined by 'an appropriate method by which to determine the actual value of trading stock in the hands of the taxpayer at the end of the year of assessment.'

(iv) That the Supreme Court of Appeal in C:SARS v Volkswagen South Africa (Pty) Ltd, supra, had established that 'SARS may only grant a just and reasonable allowance in respect of a diminution in value of trading stock under section 22(1)(a), in two circumstances. The first is where some event has occurred in the tax year in question causing the value of the trading

stock to diminish. The second is where it is known with reasonable certainty that an event will occur in the following tax year that will cause the value of the trading stock to diminish and both scenarios are consistent with the basic proposition that the assessment of income tax relates to events that have already occurred rather than events that may occur in the future.' (81 SATC 24 at para [18])

(v) That in C:SARS v Volkswagen South Africa (Pty) Ltd, supra, Wallis JA made the following important observations:

- Whilst annual financial statements prepared in accordance with a group's accounting handbook serve a valuable purpose in providing a true picture about the financial affairs of the company, they are not necessarily equally applicable to the determination of liability to tax under the Income Tax Act.
- Whilst there is obvious scope for an overlap between the provisions of section 22(1)(a) and those of IAS2, not all of the elements to which the latter refers relate to the same matters as the section.
- The determination of NRV is firmly based on an assessment of future market conditions. The use of NRV is thus inconsistent with two basic principles that underpin the Income Tax Act. The first is that taxable income is determined and taxation levied from year to year on the basis of events during each tax year. By contrast, NRV is explicitly forward looking. The second is that using NRV has the effect that expenses incurred in a future tax year in the production of income accruing to or received by the taxpayer in that future tax year, become deductible in a prior year.
- The Income Tax Act's provisions do not necessarily accord with current accounting principles. Thus, whether NRV reflects a diminution of value of trading stock for the purposes of section 22(1)(a) depends, not on its acceptance as part of GAAP, but on its conformity to the requirements for such a diminution in value as

determined on a proper interpretation of that section.

- While understandable from an accounting point of view, from a taxation perspective there were problems with the taxpayer's approach. The fiscus is concerned with the value of trading stock as a whole. For tax purposes the question is whether the taxpayer's trading stock as a whole had suffered a diminution in value.

(vi) That it followed that, like Eksteen J in the Volkswagen matter (ITC 1901, supra), the Tax Court in this matter also erred.

(vii) That, accordingly, the court turned to consider whether on the principles laid down by this Court in C:SARS v Volkswagen, supra, the trading stock of Atlas, which comprised six categories, namely: (i) slow-moving stock; (ii) overstock; (iii) demostock; (iv) Dynapac stock; (v) standard cost items and (vi) goods in transit, suffered a diminution in value.

(viii) That it was difficult to discern the basis on which Atlas contended for a diminution of the value of its trading stock. Atlas did not suggest that there had been a diminution by reason of 'damage, deterioration, change of fashion [or] decrease in the market value.' It appeared to be simply contending that because the items in question had remained on its shelves for a particular length of time, it was entitled to write down those items by fixed percentages by applying IAS2 to determine a new NRV and create provision for obsolescence.

(ix) That the evidence revealed that Atlas' approach was simply a time-based approach which was not entirely consonant with the requirements of section 22(1)(a) of the Act. In the light of the approach to NRV by this Court in C:SARS v Volkswagen, supra, the evidence of Ms Towlson, who led Atlas' external audit team, was by and large irrelevant, because the audit did little more than apply Atlas' group policy and the NRV in accordance with IAS2.

(x) That it followed, despite the Tax Court's acceptance of Ms Towlson's evidence, that her evidence did little to advance Atlas' case. If anything, Ms Towlson's evidence served to fortify the view that Atlas' employment of a

fixed and rigid company policy was arbitrary and did not present the most reliable evidence available at the time in respect of any diminution in value. Moreover, although fleeting references were made to market value, no proper explanation or evidence was proffered, other than reliance on the group policy and the application of NRV.

(xi) That, significantly, during the audit, Ms Towlson and her team had also identified products that had been sold below cost in order to determine whether they should be written down and by what percentage. In this regard, she only identified three product lines that had been sold below cost and on average those products were sold at approximately 24 to 26% less than their cost. The true factual position is thus a far cry from the application of a fixed 50 or 100% write off in terms of the group policy.

(xii) That this historical evidence ought to have featured in the determination of whether or not there was any diminution in value of the trading stock as contemplated by section 22(1) of the Act. But it did not. Instead, Atlas chose the application of a fixed percentage based policy grounded on an aging analysis. What is more, Ms Towlson's audit team recorded that Atlas' group policy was 'a very aggressive policy' and for that reason, the risk of inventories being carried at more than their NRV was deemed low 'considering the aggressive write down policy.'

(xiii) That it must follow from what has thus far been stated that Atlas' approach to the valuation of its trading stock was flawed. That, ordinarily at any rate, ought to be dispositive of the appeal against it. However, in the light of the objections raised, explanations proffered and the circumstances giving rise to the appeal, it was necessary to turn to a consideration of each of the six categories that made up Atlas' closing stock.

(xiv) That Atlas' treatment of all six categories of closing stock suffered from a lack of adherence to section 22(1) of the Income Tax Act in that it appeared to have taken no account of any diminution in value in respect of such stock.

(xv) That it was apparent when the evidence relating to all six categories is considered, that Atlas' approach essentially boiled down to this: because it held thousands of items of stock at year end, it was not feasible for it to individually value each item. For that reason, it applied its policy with reference to item descriptions. This evidence was accepted by the Tax Court in support of the proposition that the legislature could not have intended that a trader assess each individual item of closing stock in circumstances where they hold thousands of items of trading stock. But this was misplaced. SARS never contended that Atlas had to assess each individual item of stock. On the contrary, as SARS accepted, the practice of sampling in these situations was a well-recognised method of dealing with the challenges of high volume trading stock but that was not what Atlas did in this instance.

(xvi) That it followed, for all the reasons given, that the judgment of the Tax Court could not stand and, in the court's view, it could not be said that SARS had failed to exercise the discretion conferred on it by section 22(1)(a) reasonably and properly.

(xvii) That, insofar as the imposition of section 89quat(2) interest was concerned, no warrant existed for a remittal in terms of section 89quat(3) of the Income Tax Act 58 of 1962.

Appeal upheld with costs, including those of two counsel.

5.3. ITC 1925

Some time prior to September 2006, the South African Government took the decision to significantly change the corporate tax structure of the country and the decision was made to substitute the existing secondary tax on companies, which was payable by a resident company when it paid a dividend to a shareholder to one known as dividends tax in terms of which the tax liability at a rate of 20% was that of the shareholder who received the dividend. To facilitate the collection of the tax, a system providing for a withholding tax mechanism, was to be introduced and

this policy decision was intended to bring the South African corporate tax regime into line with other countries and, in so doing, the country was creating a new tax which would affect foreign companies operating and or investing in South Africa.

The aforesaid policy change in South Africa required the implementation of new terms in international agreements so that South Africa could recover its portion of taxation from foreign shareholders.

Accordingly, a number of agreements were concluded or, more specifically, existing agreements were amended by protocols. The stated objective was to conclude agreements in terms of which the tax rate payable in South Africa would be 5% if the South African company was wholly owned by a foreign resident and this was in line with the prevailing norm.

South Africa identified ten countries with whom it needed to revise double taxation agreements and those that were relevant to this matter were the Netherlands, Sweden and Kuwait and negotiations took place with each individual country and each agreement was individually negotiated and contained individual terms and therefore, to determine the rights and obligations of each contracting country, consideration has to be given to the individual terms of each agreement.

Moreover, each country, including South Africa, had its own procedures to ratify and finally bring into being an enforceable, binding agreement and the time line of when each agreement came into force was important to an understanding of the dispute between the parties herein.

The appellant both resided in and was a registered taxpayer in South Africa, but the owner of all its shares was a company both resident and a taxpayer in the Kingdom of the Netherlands. The taxpayer had declared dividends in April 2012 and October 2012 and the shareholder made declarations and undertakings, which were provided to the SARS on 22 March 2012 to the effect that the taxpayer was liable to pay 5% tax on the dividends in accordance with Article 10 (2) of the DTA (as amended by protocol) between South Africa and the Netherlands.

The taxpayer had paid the said amounts to SARS but, subsequently, the taxpayer and its shareholder took the view that the aforesaid declarations and undertakings

had been incorrect and on 12 August 2013 a declaration and undertaking given by the shareholder was presented to SARS recording that the liability for a subsequent dividend in March 2013 was 0% in accordance with the provisions of Article 10(10) of the DTA.

The taxpayer, thereafter, had addressed correspondence to SARS seeking a refund of the tax paid on the previous dividends declared since 1 April 2012 in terms of s 64L(3) of the Income Tax Act 58.

SARS had rejected the aforesaid claim for a refund and had also rejected the revised interpretation of the DTA which the taxpayer now sought to advance.

The taxpayer thereafter filed a formal objection to each of the rejections of the respective claims which SARS refused to refund which objections, in turn, were disallowed in full and which led to the taxpayer's notice of appeal against the disallowance of its objection.

The taxpayer contended that it was not liable to pay tax to South Africa on dividends paid to its Netherlands shareholder in accordance with the terms of the double taxation agreement between South Africa and the Netherlands and it had relied on Article 10(10) of the DTA.

The taxpayer's case was founded on principles referred to as 'most favoured nation treatment' and hereinafter referred to as 'MFN' and Article 10(10) contained such a MFN clause.

A MFN clause essentially provided that if, in any convention for the avoidance of double taxation concluded with a third party after the date of conclusion of the SA-Netherlands DTA, South Africa limits its taxation rights on dividends to a lower rate (including an exemption from taxation) then the more favourable reduced rate or exemption was equally applicable to the SA-Netherlands DTA.

The taxpayer submitted accordingly that it was not liable to pay dividends tax in South Africa because it was exempted therefrom by the provisions of Article 10(10).

The taxpayer contended further that, subsequent to South Africa concluding the

DTA with the Netherlands (ie after 8 July 2008) it had also entered into an agreement with Sweden to vary an existing DTA by protocol in terms of which it had agreed to a lower rate of dividends tax, including exemption from taxation or taxation on a reduced taxable base than the rate of 5% provided for in the South Africa-Netherlands DTA and the agreement with Sweden came into force on 18 March 2012.

The DTA between South Africa and Sweden was concluded after the South Africa-Netherlands DTA and it had its own MFN clause that provided that the lower rate of dividends tax applies 'if any agreement or convention between South Africa and a third state' provides that South Africa shall be exempt from tax or limit the tax charged in South Africa, on a more favourable basis.

The taxpayer contended further that the MFN provision in Article 10(6) of the DTA between South Africa and Sweden was, immediately upon its coming into being, applicable because of a prior provision in the DTA between South Africa and Kuwait and that when this occurred it had then triggered the provision in the South Africa-Netherlands DTA.

The taxpayer, therefore, stated that the DTA between South Africa and the Netherlands provided that if any other contracting state is in the future given better terms, then those better terms also applied to the Netherlands. In so far as the contract with Sweden provided that if any other contracting state had better terms (whether existing or in the future) then those also applied to Sweden. In so far as Kuwait did have better terms, then Sweden was also entitled to the same terms and because Sweden had been benefitted by better terms after the South Africa-Netherlands DTA was concluded, the Netherlands must also be given the better benefit.

The taxpayer submitted that the terms of the DTAs were clear, unambiguous and that there was no scope to look at the intention of the parties or the consequences of its interpretation or reading of the DTAs and they were clear and there was no justification not to enforce them in accordance with their written terms.

SARS contended, inter alia, that the court must ascertain the true intention of the

parties and if the written words do not mirror that intention, the words should either be ignored, augmented or supplemented to give effect to the true intention. The court must then consider whether the words result in absurd or unanticipated consequences or consequences that were contrary to what all contracting parties aimed to achieve.

SARS contended that in interpreting the South Africa-Netherlands DTA the court must impute a provision in terms of which any other DTA and, specifically, the South Africa-Sweden DTA referred to only a 'future' better deal or treatment for its resident taxpayers.

SARS further contended that the taxpayer was now exploiting what was an entirely unanticipated, unforeseen and unfortunate occurrence to refuse to pay tax in South Africa despite the fact that the contracting parties (South Africa and the Netherlands) never meant this to happen. The consequences were potentially financially disastrous for South Africa and it needed to persuade the court that it needed to emphasise the true intentions of South Africa in entering into the agreements and act to prevent the consequences of what had or will occur as a result of the failure of Kuwait to ratify the protocol.

Judge Hack held:

(i) That the court should not consider the evidence that was led by SARS in regard to the intention of South Africa, Netherlands, Sweden and, for that matter, Kuwait in considering whether the taxpayer was liable to pay dividends tax in South Africa.

(ii) That the provisions of the Netherlands-South Africa DTA were clear and provided that in the event of another State receiving preferential treatment from South Africa in the future, the Netherlands resident must be given the same preference.

(iii) That it was equally a clear fact that when the DTA was subsequently concluded with Sweden, the provision in that agreement that the residents of Sweden should receive the same preferential treatment as any other party contracting with South Africa applied regardless of when such other

State's residents obtained such preference, ie irrespective of whether it was before the agreement was concluded with Sweden or afterwards. When the agreement was concluded with Sweden the residents of Kuwait already had preferential treatment and therefore the residents of Sweden were entitled to the same treatment.

(iv) That is what the three agreements say and there is no denying that. That having been determined, there are therefore no grounds upon which this Court can find that certain words were missing from the Netherlands agreement unless the court jettisons the parol evidence rule and this Court cannot do so.

(v) That this Court was bound by the parol evidence rule and the prevailing decision of the Supreme Court of Appeal. The foundational principles set out in KPMG Chartered Accountants (SA) v Securefin Ltd and Another 2009 (4) SA 399 (SCA) where the court confirmed that the parol evidence rule remained part of our law, do apply and, as found in The City of Tshwane Metropolitan Municipality v Blair Atholl Homeowners Association [2019] 1 All SA 291 (SCA), there was no ground upon which they could be abandoned. Those principles continue to be applicable and, as the court stated in Blair Atholl, supra, the court in Natal Joint Municipal Pension Fund v Endumeni Municipality 2012 (4) SA 593 (SCA) reaffirmed those principles and did not detract from them.

(vi) That, sitting as a court in South Africa, it was difficult but necessary to refrain from expressing views at the unfortunate consequences to the country's fiscal wellbeing of what had occurred. However the court will say that the taxpayer's criticism of the tone of SARS, as set out in its note on argument and pursued in court, was not justified. The court did understand that the tone was a justified reflection of the frustration of SARS. However, it was the role of the executive and, or, the legislature to remedy the problem as the court cannot rewrite the international treaties concluded between South Africa and other countries to remedy a problem that has occurred.

(vii) That the taxpayer had placed significant reliance on decisions that had already been taken in courts in the Netherlands. This Court has made its decision on South African domestic law which, in the court's view, was the appropriate course, and there was no purpose served, on the merits of the decision, in referring further to either international law or the prior decisions of a foreign court or the principles of comity. The parties are ad idem that the principles applicable to the interpretation of international tax treaties in South African and International Law are the same as those applied by our courts in construing statutes and agreements.

(viii) That this was also in accordance with the principles enunciated in Krok and Another v C:SARS 78 SATC 1, in particular at para [27]. Only in respect of one issue does this Court need to refer to the decisions of the Dutch courts in the Netherlands and that is in regard to the issue of costs. The taxpayer had submitted that it would be appropriate to order SARS to pay its costs on the basis of his persistence with his opposition to the appeal in the face of the prior judgments in the Netherlands which included a decision of its highest court and this Court agreed with the taxpayer's submission.

(ix) That, accordingly, SARS was ordered to refund to the taxpayer the amount of dividends tax that it had overpaid in terms of s 64L of the Income Tax Act 58 of 1962 and he was also ordered to pay to the taxpayer interest on the aforesaid amount calculated in accordance with ss 187, 188 and 189 of the Tax Administration Act 28 of 2011 from the date that the amount was paid by the taxpayer until the date of repayment.

5.4. ITC 1226

The taxpayer had taken an exception to SARS' statement of grounds of assessment issued by him in terms of Rule 31 of the Tax Court Rules.

The exception had been framed in the alternative in that it stated in the first instance that the statement issued in terms of Rule 31 (the Rule 31 statement) had lacked averments necessary to sustain a finding of gross negligence against the

taxpayer and the imposition of an understatement penalty at the rate of 100%. In the alternative the exception complained that the Rule 31 statement was vague and embarrassing in that it failed to explain the basis upon which SARS had opposed the taxpayer's appeal against the imposition of the understatement penalty at a rate of 100%.

The taxpayer's exception was directed at those portions of the Rule 31 statement which dealt with the understatement penalties and those were dealt with in paragraphs 21 to 22 of the Rule 31 statement.

The aforesaid paragraphs, after stating the relevant provisions under the Tax Administration Act, and in particular s 222, then dealt with the fact that SARS had levied an understatement penalty of 100% and then set out the bases upon which SARS had done so.

The substance of the grounds relied upon by SARS in explaining how it had come to levy an understatement penalty of 100% were contained in paragraphs 22.1–22.4 of the Rule 31 statement as follows:

'22.1 The appellant neglected to provide complete and accurate information together with the submission of his annual income tax returns for the tax year in dispute;

22.2 The facts uncovered during the audit fell in the sole knowledge of the appellant, these facts the appellant failed to disclose to SARS;

22.3 It is SARS' contention that there was no bona fide inadvertent error on the part of the appellant when he completed and submitted his tax returns;

22.4 SARS deems the conduct of the appellant as stipulated above to fall under the category of gross negligence in completing a return as listed in the understatement penalty percentage table of s 22(3)(1) of the Tax Administration Act.'

It was common ground between the parties that the onus rested upon SARS in respect of the imposition of an understatement penalty as provided for in s 102(2) of the Tax Administration Act 28 of 2011.

Judge Unterhalter held the following:

(i) That it was clear that SARS must ultimately satisfy the court that there were facts that sufficed for the imposition of the understatement penalty that SARS wished to impose.

(ii) That the real question for the court to determine was whether the averments that were contained in paragraph 22 of the Rule 31 statement sufficed for the purposes of Rule 31. It was clear that the Rule 31 statement must set out a clear and concise statement of the material facts and legal grounds upon which SARS relied in opposing the appeal, in particular Rule 31(2)(c). That provision in the Rule is of course wholly consistent with the purpose of the Rule 31 statement and the Rule 32 statement because as Rule 34 explains, and as has been indicated, these two statements set out the issues that go on appeal to the Tax Court.

(iii) That the Rule 32 statement had a similar requirement which was that in Rule 32(2) the statement must set out clearly and concisely, amongst other things, which of the facts or the legal grounds in the statement under Rule 31 are admitted and which of those facts and legal grounds are opposed. The very exercise that this therefore contemplated in the Rule 31 and Rule 32 statements is that there are facts and legal grounds that are sufficiently clearly and concisely specified so as to know what issues proceed to an appeal.

(iv) That the question that then must be asked was whether the matters that were raised in paragraph 22 of the Rule 31 statement sufficed to meet the requirement that the facts were set out in compliance with Rule 31 to be sufficient to define the issues that were to proceed on appeal.

(v) That in Transnet Limited t/a Portnet v Owners of the NB Stella Tingas and Another 2003 (2) SA 473 (SCA) at paragraph 7 Scott JA stated, inter alia, that 'to qualify as gross negligent the conduct in question, although falling short of dolus eventualis, must involve a departure from the standard of the reasonable person to such an extent that it may properly be categorised as

extreme. It must demonstrate where this is found to be conscious risk-taking, a complete obtuseness of mind or where there is no conscious risk taking a total failure to take care. If something less were required the distinction between ordinary and gross negligence would lose its validity.'

(vi) That the Understatement Penalty Percentage Table set out in section 223 of the Tax Administration Act makes it clear that there is a distinction between different kinds of behaviour and the penalty percentages that flow from the different behaviour. Thus, reading the table, the understatement penalty percentages differentiate substantial understatement from reasonable care not being taken in completing a return and gross negligence.

(vii) That the penalty percentages increase with the differentiation in the behaviour; and gross negligence in the standard case is visited with a penalty percentage of 100% and it is precisely that percentage that SARS alleges in the Rule 31 statement and that the taxpayer here has committed gross negligence.

(viii) That the question was then whether paragraph 22 of the Rule 31 statement made sufficient averments of fact consistent with Rule 31 so as to sustain the claim of gross negligence and differentiate it from ordinary negligence as in the Transnet case, supra.

(ix) That the Rule 31 statement did not go far enough to make out the requirements of a Rule 31 statement and, in particular, the facts that are relied upon and need to be pleaded as stipulated for in Rule 31(2)(b) and (c).

(x) That it is of the essence of the behaviour that is tabulated in section 223 of the Act that there are differentiated forms of culpability and in order to differentiate the behaviour it was necessary to understand by reference to some facts why the deviation that SARS had uncovered was so great from the standard of reasonable care that it amounted to gross negligence, rather than ordinary negligence or indeed simply a substantial

understatement.

(xi) That it seemed to the court was not purely a matter of evidence but was something where certain facts would have to be proved to show that gross negligence is present and that gross negligence must have something to do with what facts were not disclosed and why SARS believes that failure to disclose those facts is constitutive of gross negligence rather than mere negligence or indeed innocent understatement.

(xii) That, absent the essential facts that SARS relied upon as to why there was gross negligence, the pleadings will simply be a bare denial of gross negligence and that will not be helpful for the purposes of explaining the true dispute that must be resolved on appeal.

(xiii) That, accordingly, the Applicant's exception was well taken and it was a true exception in the sense that the Rule 31 statement lacked averments necessary to sustain a finding of gross negligence and the imposition of an understatement penalty at the rate of 100%.

The Commissioner was granted fifteen days in order to remedy the defect in its Rule 31 statement.

5.5. C:SARS v Clicks Retailers (Pty) Ltd

Clicks Retailers (Pty) Ltd (Clicks), owned and operated the well-known Clicks retail business at stores nationwide.

Clicks, some years ago, had instituted a Loyalty Programme in terms of which it awarded points to members on presentation of a Clicks ClubCard when making purchases.

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

Upon acceptance of the customer's application, Clicks issued a ClubCard to a

customer and the terms and conditions of the ClubCard contract regulated the relationship between Clicks and the customer under the loyalty programme and customers in possession of a ClubCard were under no obligation to shop at Clicks.

In order to become entitled to points under the loyalty programme, a customer must purchase goods and present his or her ClubCard at the checkout point in respect of that transaction. For every R5.00 spent one earns one loyalty point and in order to qualify for vouchers customers must accumulate at least 100 club card points by a qualification date.

At the end of each reward cycle, Clicks issues vouchers to all ClubCard members who have earned 100 or more points during the cycle. Every 100 points earned by a customer will entitle that customer to a voucher to the value of R10.00 that can be used in payment or part payment for his or her future purchase.

Vouchers may be redeemed by the customer when he or she makes a subsequent purchase and presents his or her club card and voucher at the checkout point. The voucher cannot be redeemed for cash and, in practice, the vouchers will in almost all instances be used in part payment of a basket of goods, so that the customer acquires those goods at a discounted price.

Clicks, during the 2009 financial year, claimed an allowance of R44 275 965 to be deducted from its gross income calculated on the basis of the cost of sales to it in honouring vouchers that it expected customers to redeem in the following tax year, based on s 24C of the Income Tax Act.

SARS had disallowed the claim to the allowance and Clicks objected to the disallowance and thereafter it lodged an appeal against the disallowance of its objection against the assessment for the 2009 tax year.

The Cape Town Tax Court (see ITC 1915 (2018) 81 SATC 214 per Nuku J) upheld the appeal and directed SARS to partially allow Clicks' claim in terms of s 24C and revise the allowance.

Clicks succeeded on appeal to the Tax Court for the following reasons:

- It was artificial and factually incorrect to regard Clicks' expenditure that it

would incur when a customer redeemed a voucher, as arising from a 'different contract' to the first purchase and sale contract concluded with the same customer and pursuant to which the points concerned were generated;

- The first purchase and sale agreement incorporated the terms of the ClubCard contract, but despite this the first purchase and sale contract remained the contract that triggered both the earning of income by Clicks as well as an obligation by Clicks to incur future expenditure;
- The obligation to incur future expenditure was therefore incurred under the same contract from which the income was earned and the expenditure would be incurred in the performance of that contract and, consequently, the claim of Clicks in terms of section 24C of the Act met the requirements of this section.

Section 24C provided in 2009 that for the allowance for future expenditure to be allowed as a deduction from income SARS must be satisfied that an amount of expenditure 'will be incurred' after the end of the year and in a manner that the amount will be deductible in a subsequent year of assessment; or in respect of the acquisition of an asset in respect of which any deduction will be admissible under the Act. Moreover, the income of a taxpayer in any year of assessment includes or consists of 'an amount received by or accrued to him 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 Clicks 'in the performance of his obligations under such contract'. Furthermore, the allowance must be added back to income in the following year of assessment.

SARS submitted that the section 24C allowance had been correctly disallowed by him for the following reasons:

- The contract of purchase and sale, whereby a customer purchased merchandise at a Clicks store, in terms of which income was received, was separate from the ClubCard contract;
- The ClubCard contract itself did not give rise to any income in the hands of

Clicks, because it was issued free of charge and there were no hidden charges to members;

- The obligation of Clicks to award the member points, based on qualifying sales and to issue vouchers, when the specified number of points had been earned, arose under the ClubCard contract;
- •Clicks was likely to incur future expenditure, when a member redeemed a voucher and Clicks supplied the member with goods equal to the value of the voucher, at no cost to the member and this obligation would arise under the ClubCard contract, which was a different contract from the contract of purchase and sale, under which the income was received.

On the above basis SARS contended that at least three different contracts were discernible:

- The ClubCard contract, from which no income was derived as it was issued free of charge and gave rise to no income in Clicks' hands;
- The first contract of purchase and sale, which earned income for Clicks, when the customer bought merchandise from Clicks and triggered the award of points under the ClubCard contract; and
- The second contract of purchase and sale, which earned income for Clicks, when the customer bought merchandise and was entitled to redeem the voucher.

SARS therefore contended that Clicks had not succeeded in discharging the onus resting upon it, to satisfy the court, that the first contract of sale, from which the income was derived, was the same contract that imposed the obligation on Clicks to incur future expense by redeeming a customer's vouchers.

Clicks contended that the only issue for determination was whether or not the qualifying purchase, i.e. the first contract of sale, was also obligation-imposing, as found by the Tax Court. Clicks submitted that it plainly was and moreover that there was a 'direct and immediate connection' between each qualifying contract of sale, on the one hand, and the obligation on Clicks to issue rewards to the

customer pursuant to that contract of sale, on the other.

Clicks submitted that the Tax Court had correctly found that its obligation to incur future expenditure did not arise from the ClubCard contract itself because, as the Tax Court found, the ClubCard contract did not itself create or impose on Clicks any exigible obligation to grant any form of rewards to a customer. On the contrary, in terms of the express provisions of the ClubCard contract itself, that obligation only arose when a qualifying contract of sale was made.

Clicks therefore submitted that each qualifying purchase not only brought into existence, but also determined the content of, an exigible obligation on Clicks, to issue rewards.

Accordingly, on each occasion that Clicks issued rewards, there was a 'direct and immediate connection' between Clicks' obligation to do so and the qualifying purchase concerned and hence each qualifying purchase was both 'income-earning and obligation-imposing' as found by the court a quo and therefore the 'same contract' requirement of the section was met.

Dlodlo JA held the following:

(i) That the ClubCard contract between the customer and Clicks established the right of the customer to receive points and thereafter vouchers as well as the obligation on Clicks to award points and thereafter vouchers to the customer, redeemable against subsequent purchases. This was how Clicks itself described the position on 29 July 2012 when it replied to SARS' query sheet. It said that to earn points that could be converted into a Rewards voucher the customer had to make purchases and present their ClubCard at the checkout. Clicks explained that under these purchases income accrued to it as Clicks. Contrary to its present submissions it then said that this revenue was 'a direct result of the contract entered into when the ClubCard member joins the loyalty programme.'

(ii) That Clicks' grounds shifted somewhat when it came to its objection to the assessment. It continued to say that the expenditure incurred by it was incurred 'in performing its obligations under the Loyalty Programme', but

started to equivocate in regard to the relationship between this and the contracts of purchase and sale that generated the rewards under the Loyalty Programme. It said that under the Loyalty Programme members were rewarded with points, but 'there is no separate contract of purchase and sale relating to the goods purchased– the customer's presentation of the ClubCard when paying at the till-point being inextricably interwoven with and an integral part of each purchase and sale of goods transaction entered into by the ClubCard customer.'

(iii) That the difficulty with this was that this court in C:SARS v Big G Restaurants (Pty) Ltd 81 SATC 185 expressly rejected the notion that the section [24C] applies where there are different contracts but they are 'inextricably linked.' Consequently, the fact that the ClubCard contract may be inextricably linked to the first contracts of sale concluded between a customer and Clicks for the purchase of merchandise, and that the loyalty programme could not function without these sales, matters not. In any event, even if the court were minded to adopt Clicks' approach and hold that the ClubCard contract, together with the first sale of merchandise, gave rise to the income, this would not bring the case within section 24C. The reason is that this income would be used to finance the acquisition of stock for future sales, so that the expenditure would be incurred in performing Clicks obligations under the ClubCard contract and the second sale agreement and even on a linked basis the contract is not the same contract.

(iv) That the contract that created the right to income by Clicks was the first contract of sale. However, the contract that obliges Clicks to honour the vouchers and thereby incur expenditure, when a customer concludes the second contract of sale with Clicks, is neither that contract, nor the second contract of sale, but the ClubCard contract. Consequently, the expenditure incurred by Clicks in honouring the vouchers does not arise in terms of the same contract ie the first contracts of sale, but in terms of the separate and distinct ClubCard contract.

(iv) That the distinction that Clicks sought to draw between the ClubCard contract concluded between the customer and Clicks, in terms of the loyalty programme on the one hand, and contracts of sale concluded for the purchase of merchandise, on the other, was artificial. Clicks sought to minimise the obligations imposed upon it in terms of the ClubCard contract, to the extent that no exigible obligations were imposed upon Clicks at all, in terms of this contract. To borrow the terminology of Clicks, when a qualifying contract of sale is concluded, the obligation on Clicks either to issue vouchers or to honour them, as the case may be, in terms of the ClubCard contract, becomes exigible. In the absence of the ClubCard contract, a customer acquires no right to acquire points and thereafter vouchers and Clicks incurs no obligation, to do so.

(v) That the argument of Clicks has as its object the reduction of the contractual relationship between a customer and Clicks, to a single qualifying contract of sale, which is 'income-earning' for Clicks and 'obligation-imposing' because Clicks is obliged to award points to the customer. That the aforementioned argument ignores the reality of the arrangement, in which three contracts are operative, namely the first and second contracts of sale, as well as the ClubCard contract. All of these contracts are required in order for the customer to acquire vouchers and for Clicks to receive income and be obliged to award vouchers and supply merchandise to the customer in return, as submitted by SARS.

(vi) That, as a result, the income received and the future expense sought to be deducted, did not arise from the same contract and SARS correctly refused to grant a section 24C allowance.

Appeal upheld with costs including the costs of two counsel.

Judge Wallis held the following:

(vii) That there was no dispute in C:SARS v Big G Restaurants (Pty) Ltd 81 SATC 185 that in terms of section 24C the future expenditure in relation to which the allowance was sought had to be incurred in the performance of

the same contract as that under which Clicks had earned the income.

(ix) That the reason section 24C was introduced was not to afford a means whereby Clicks could take account of expenses foreseen but not yet incurred, but to alleviate the tax burden that would otherwise rest on builders and other taxpayers engaged in manufacturing businesses, where it is the practice to obtain a deposit or other payment in advance of work being undertaken.

(x) That the issue in Big G was not whether, in order to claim an allowance, the expenditure had to be incurred in performing the same contract as that in terms of which the income was earned. It was whether the income was earned under the franchise contract, either alone or in conjunction with the sale of meals to restaurant patrons, so that it could be said that the expenditure Big G would incur under the franchise agreement in respect of refurbishment would be incurred under the same contract as that under which the income was earned. This court stated that it was not the same contract because the income was derived from the sale of meals, while the expenditure would be incurred under the franchise agreement and for that reason the income-earning and the expenditure-incurring contracts were different and the claim to the allowance failed.

(xi) That there was no doubt that the income-earning contracts in this case were the initial sale contracts. The ClubCard contract is not a source of income and Clicks no longer contends that it is. Yet, as the main judgment says, the initial sale contracts on their own do not result in Clicks incurring any obligation to the customer. Absent a Clubcard contract and the presentation of a ClubCard at the point of sale, the sale agreements are complete when the customer leaves the store having paid for the goods. Clicks has no further obligation to fulfil under the sale contract. If the customer has concluded a ClubCard contract and presents the card at the point of sale, Clicks incurs an obligation under the ClubCard contract to award them points.

(xii) That it was appropriate to say something about the concept of expenditure

in relation to Clicks' claim to the allowance. The 'expenditure' on which Clicks relied was nothing more than its conventional purchases of stock in the ordinary course of its business. It does not purchase any item of stock specifically for the purpose of satisfying its obligations under the loyalty programme. Instead it acquires stock for the purpose of its ordinary trading activities. When customers purchase items and present a rewards voucher in payment for the goods, the value of the voucher is deducted from the overall price and the customer pays the balance. In other words the goods are sold at a discount represented by the amount of the voucher and no expense item is shown in Clicks' accounts.

(xiii) That the court had considerable difficulty in seeing how perfectly conventional stock purchases– which do involve expenditure– are directly financed by earlier sales, as opposed to being financed out of general revenue. There is no direct connection between the two.

(xiv) That if one viewed the matter from the perspective that the loyalty programme is no more than an undertaking in certain circumstances to afford to customers who present a rewards voucher a discount on the goods they happen to have purchased, this can hardly count as expenditure as contemplated by section 24C. However, in view of the concession in the stated case and the fact that as a result this was not fully argued it is undesirable that the court go further than expressing these reservations.

(xv) That the interpretation of section 24C is straightforward. First, it requires the conclusion of a contract under which revenue is received by Clicks. Second, it requires Clicks to undertake obligations under that contract to be performed in the following tax year. Third, the performance of those obligations must oblige Clicks to incur expenditure in the future. Fourth, the revenue received from the contract must be used to finance the performance of Clicks's obligations under the contract. Whether in certain circumstances the requirement of the same contract may be satisfied by two or more connected contracts is not a question that needs to be

resolved in this case.

5.6. *C:SARS v Spur Group (Pty) Ltd*

Spur was a member of the Spur Group of companies and it was the group's chief operating arm and was a wholly owned subsidiary of the group's holding company ('HoldCo').

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

It was common cause that:

- the selected employees were all key managerial staff of Spur;
- the purpose of the scheme was to incentivise these employees;
- the contribution of R48 million paid by Spur was for purposes of the scheme;
- the employees indeed benefited from the scheme;
- the contribution was not expenditure of a capital nature; and
- the scheme was legitimate and the transactions comprising it were neither simulated nor a sham.

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

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

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

other eligible employees.

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

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

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

On 20 December 2004, once NewCo's share capital was altered to create 1000 preference shares, the trust subscribed for them by utilising the contribution of R48 million paid to it by Spur.

NewCo thereafter applied the funding received from the preference share issue to purchase 8 274 043 HoldCo shares at the prevailing market price at that time.

The preference shares issued to the trust were only redeemable after five years and carried an accumulated annual market-related coupon rate to 75% of the South African prime rate. NewCo paid no dividends during the 5-year period. The result was that Spur's employees, as shareholders of NewCo, became entitled to the incremental value of their shares by virtue of NewCo's investment in HoldCo.

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

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

declared by NewCo.

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

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

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

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

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

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

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

SARS' essential premise was that Spur had made the contribution to the Trust of which HoldCo was the sole beneficiary and HoldCo was the only party to have

benefited directly from the contribution made by Spur to the Trust and hence its employees were not the beneficiaries of the contribution.

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

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

The evidence in the Tax Court (see ITC 1919 (2018) 81 SATC 308 per Cloete J) revealed that Spur had accepted that the employees did not benefit directly from the R48 million paid to the trust, but it emphasised that this had never been the purpose of the scheme.

The contribution was a funding mechanism only and in paying the contribution it was Spur's purpose, as chief operating arm of the S group, to incentivise its key management personnel by enabling them to participate indirectly in the growth of HoldCo's shares.

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

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

The Tax Court found that Spur had established a sufficiently close causal connection between the expenditure, represented by the R48 million contribution, and its income earning operation.

The essence of SARS' case before the Tax Court was that were the contribution to have been made by Spur solely to incentivize the participants, then the participants would have been the beneficiaries of the contribution (made to the Trust) and not Spur HoldCo as was the case. This contribution would have necessitated Spur parting with the contribution in favour of the participants as the beneficiaries thereof, which was not the case. In addition, the participants did not have any connection to the Trust to whom the contribution was made. The Share Scheme entailed the participants becoming shareholders in NewCo.

SARS accordingly contended that there was no direct causal link between the contribution and the production of Spur's income and, consequently, the production was not incurred in the production of income.

In a nutshell the case for SARS was accordingly that unless the R48 million contribution was given directly to the participating employees, it did not, and could not constitute an expense incurred by Spur in the production of income.

Judges Ndita and Sher held the following:

(i) That the crucial issue in this appeal turned on whether the expenditure in issue was sufficiently closely linked to Spur's income earning operations so as to qualify for deduction under section 11(a) of the Income Tax Act.

(ii) That for the expenditure to meet the 'in the production of income' test and satisfy the requirements of section 11(a) of the Act, there must be a sufficiently close connection or link between it and the income earning operations of the taxpayer. The degree of closeness required for the expenditure to be deductible is determined on the particular facts and circumstances of each taxpayer. It does not need to be shown that expenditure produced any part of the income in a particular year of assessment for it to be deductible for tax purposes and the critical enquiry was whether the expenditure was incurred for the purpose of earning

income as defined in section 1 of the Income Tax Act, whether in the current or future year of assessment.

(iii) That the Tax Court in its judgment placed much reliance on the case of Warner Lambert SA (Pty) Ltd v C:SARS 65 SATC 346 where Warner Lambert was the South African subsidiary of the US pharmaceutical giant and in terms of the Sullivan Code principles developed during the apartheid era, local operations of US companies had to conform to the United States Sullivan Code which provided for racial integration in the workplace, equal and fair employment, training programmes and affirmative action and the subsidiary launched a social responsibility programme that cost it a substantial amount of money and the company then claimed the expenses as deductions from income in the relevant years of assessment in terms of section 11(a) read with section 23(g) of the Income Tax Act. The court in that case found that the expenditure was incurred for the purposes of trade and for no other, because without access to the products and formulas of the US parent its income would have dried up.

(iv) That it was common cause that the contribution to the Trust in this case in the sum of R48 million was for purposes of the share incentive scheme. It also was common cause that the purpose of the share incentive scheme was to motivate and incentivize Spur's employees and it was also placed on record that it was not SARS' case that the scheme should have been a different scheme, but that Spur should not have claimed a deduction in respect of a contribution to the Trust. It was also common cause that the contribution constituted 'expenditure' by Spur and that the expenditure of R48 million was not 'of a capital nature.'

(iv) That what the High Court had to determine, as the Tax Court did, was whether the expenditure was incurred in the production of income derived by the taxpayer from carrying on with its business as contemplated in section 11(a) of the Income Tax Act. SARS had contended that the participants to the Scheme were not incentivised by the contribution itself but by the Scheme that the contribution funded. Furthermore, a clear

distinction must be drawn between the Scheme (which the parties accept was designed to incentivise the employees to grow the share price of Spur HoldCo) and the R48 million contribution, which the participants did not benefit from.

(v) That it was difficult to draw a line between the contribution and the Scheme because that in essence defeated the very purpose for which the contribution was, according to the evidence, created. Stated differently, one cannot look at the contribution apart from its intended purpose and effect. SARS argued that the Tax Court failed to consider that the purpose of the contribution could just as easily have been to retain the money within the Spur Group but there was no basis for this criticism.

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

(vii) The Tax Court further stated that, put somewhat differently, the purpose of the expenditure was to incentivise the taxpayer's key staff through a scheme which facilitated the acquisition of an indirect investment in the shares of HoldCo for scheme participants. The purpose of such incentivisation, in turn, was to encourage these employees to grow or increase the value of their indirect investment in HoldCo by contributing to the success and profitability of the taxpayer's business and to encourage employees with the required skills, knowledge and experience to remain in the taxpayer's employ and thereby to enhance the income earning capacity of the taxpayer's business.

(ix) That the court in this matter fully aligned itself with the above remarks made

by the Tax Court and, in addition, it stated that it must be acknowledged that indeed the bulk of the benefit inured to the Spur Group but that did not detract from the actual purpose of the expenditure as affirmed in the evidence. As rightly found by the Tax Court, it has not been suggested in these proceedings that the Spur Group, by making the R48 million contribution was shamming or that the transaction was dressed or disguised to make it appear to be something that it was not, especially, with the purpose of evading tax or avoiding a peremptory rule of law.

(x) That it was, in fact, quite clear that maintaining a content and motivated workforce formed part of the costs of performing the income producing operations and was crucial to the Spur Group's commercial success and profitability. Stated differently, the money was disbursed in order indirectly to facilitate the carrying on of the taxpayer's trade.

(xi) That even if the contribution did not directly benefit the employees, the overwhelming evidence supported the fact that it incentivised and motivated the participating employees, albeit indirectly. The court also did not understand it to be a requirement that employees benefit directly from the contribution.

(xii) That what seemed to be paramount, at least in the court's view, was the purpose of the expenditure and what it affected. In line with the test propounded in Port Elizabeth Electric Tramway Co Ltd v CIR 8 SATC 13, the court was satisfied that the Spur Group had discharged the onus of proving that the expenditure was incurred in the production of income and that there was a sufficiently close nexus between the expenditure in question and the production of income as found by the Tax Court.

Appeal dismissed with costs.

Judge Salie-Hlophe dissenting:

(xiii) That the appeal should succeed on the ground that the contribution by Spur to the Trust in the sum of R48 471 714 did not qualify as expenditure in the production of income for the purposes of section 11(a) of the Income Tax

Act.

(xiv) That although the scheme, albeit indirectly, could be said to incentivise employees, the contribution did not amount to an expenditure as contemplated by section 11(a) as it was in fact not expended as contemplated by the section. The contribution by Spur to the Trust acted as a ‘funding mechanism’. The contribution had always been contemplated and engineered to return to the Spur family. A loan would have achieved the same purpose but this would have attracted tax consequences and would not have qualified as a deductible expense. Though the contribution had been spent by the taxpayer, it was however controlled in such a manner that it would revert to Spur’s parent company. The R48 million was never destined for the pockets of the participants, it stayed in the pocket of the taxpayer’s family.

(xv) That the share scheme was designed in such a manner that Spur HoldCo would be the ultimate recipient of the investment in the NewCo preference shares resulting from Spur’s contribution. The participants (employees) are not the beneficiaries of the contribution. That Spur had thus not parted with the contribution, cannot be viewed as an expenditure in order to qualify having been spent in the production of income. The expenditure must be one that had been spent, not held in trust for the taxpayer, for it to be seen to be expended in the production of income.

(xvi) That the accounting treatment of the contribution as per the KPMG Accounting Report dated 6 December 2004 supported this view. The contribution made by the Spur to the Trust was from a group perspective, recognised as not representing an expense to the group. The trustees had no independent discretion and was dominantly controlled by the parent company. The contribution was therefore exclusively for the benefit of the group. The distance created by the various legal instruments in the formation of the trust, the contribution, the incentive scheme et al is a masquerade to appear as a section 11(a) expenditure.

(xvii) That Spur had ring fenced this money for itself. That it is the sine qua non

for the incentive scheme cannot be sufficient to pass the test whether the R48 million had been spent in terms of the provisions of section 11(a). The payment was a vehicle through which to create the dividends, which in turn is the incentive. The payment, per se, never left the pockets of the family.

(xviii) That the Spur Group did not discharge, on a balance of probabilities, the onus which rested upon it and the judge was not persuaded that the expense by the taxpayer was an expense in the production of income and accordingly the additional assessment raised by SARS ought to be upheld.

5.7. Peter v C:SARS

SARS had issued the Applicant ('Peter') with additional assessments for the years of assessment 2005 to 2011 for various incidences of non-compliance and alleged under-declaration of his income.

Subsequent to Peter drawing SARS' attention to errors in the additional assessments, SARS issued a revised reduced assessment.

Peter, on 25 June 2013, had objected against these assessments and, a few days later, made his first request for suspension of payment of his tax liability pending the finalisation of his objection and further appeal.

SARS, on 17 October 2013, had informed Peter of his decision to refuse his request for suspension and Peter then took the decision on review.

On 20 June 2014 Weiner J handed down an order reviewing and setting aside the decision of SARS and remitted it to SARS for reconsideration.

Subsequent to the order being handed down, SARS invited Peter to make a new request for suspension of payment given that the information contained in the first request had become outdated.

Peter, on 24 January 2017, filed a new request for suspension of payment and this request was considered by SARS' Tier Two Committee who recommended that the request be denied. The request and this recommendation served before the Tier

Three Debt Committee which ultimately adopted the recommendation and refused Peter's request to suspend payment.

Peter raised various grounds of review including, amongst others, the following key grounds:

- That the relevant SARS Committee that made the decision was not authorised to do so given that it did not have the requisite authority and was not empowered to do so;
- That the SARS Committee acted irrationally in finding that Peter's tax appeal was frivolous and vexatious and being employed for dilatory purposes. It failed to consider Peter's prospects of success in the tax appeal;
- In taking into account that Peter failed to offer payment of security, the SARS Committee acted irregularly in that Peter was demonstrably unable to provide security;
- It was irrational for the Committee to indicate that Peter's disclosure of its assets and liabilities was incomplete given that Peter had repeatedly submitted the financial information required which included lists of assets and liabilities.

Section 164 of the Tax Administration Act deals with payment of tax pending an objection or an appeal. In terms of s 164(1), unless a senior SARS official directs otherwise in terms of s 164(3), the obligation to pay tax and the right of SARS to receive and recover tax, will not be suspended by an objection or appeal or pending the decision of a court of law pursuant to an appeal under s 133 of the Act.

Section 164(2) provides that a taxpayer may request a senior SARS official to suspend the payment of tax or a portion thereof due under an assessment if the taxpayer intends to dispute or disputes the liability to pay that tax under Chapter 9.

Section 164(3) empowers a senior SARS official to suspend the payment of tax and sets out the factors that should be taken into account in deciding whether to suspend or not.

Judge Pillay held the following:

As to the Tier Three Debt Committee's lack of authority

(i) That in terms of s 164(3) of the Tax Administration Act a decision as to whether or not to suspend tax liability has to be taken by a senior SARS official and Peter contended that while the record reflected that the impugned decision taken under section 164(3) was made by the Tier Three Debt Committee, the record of decision did not include a delegation from SARS to the Committee which complied with section 10 of the Tax Administration Act. Section 10 required that, in order to be valid, a delegation from SARS must be in writing and signed by SARS.

(ii) That in the present matter there was no express or clear delegation from SARS of a duly delegated official to the Three Tier Committee as required by section 164 and nor was the Three Tier Committee expressly mentioned in the designation document.

(iii) That the Tier Three Committee sat as a committee to consider and decide on the request to suspend under section 164(3) of the Tax Administration Act and it was evident that the Committee was a complex structure which included a number of members, permanent invitees and specialist advisors and it even had its own secretariat. It was described by SARS as being 'the highest decision-making body within SARS concerning, inter alia, taxpayers' requests for suspension of payment.'

(iv) That, given that the Committee not only performs an advisory function but also a decision-making one, it stands to reason that the Committee (being distinct from its individual members) must be properly empowered to do so and this is precisely what the doctrine of legality requires.

(iv) That SARS has not put up any information to support the contention that the Tier Three Committee was empowered to take the decision to grant or refuse to suspend payment and, accordingly, it lacked the authority to do so.

As to the request by SARS to lodge a new application to suspend

(v) That Peter had contended that the request by SARS that it submit a new application amounted to a reviewable error of law given that Weiner J had remitted the previous application to SARS and SARS was therefore obliged to decide that application. The effect of the judgment by Weiner J was that the old application was remitted to SARS and had to be redetermined taking into account the content of Weiner J's judgment. However, what Peter's argument failed to explain was how the request by SARS for a fresh application (even if assumed to be based on an error of law) vitiated or tainted the decision impugned in this application, being the refusal of the new and distinct request to suspend tax liability.

(vi) That the administrative decision challenged in the present matter is the refusal of the latest application for suspension and Peter has not challenged the failure by SARS to determine the previous application or the request by SARS that he submit a fresh application for suspension of payment. Instead, he had confined himself to only challenging the latest decision not to suspend payment.

(vii) That Peter had fallen short of demonstrating that the request by SARS that he bring a fresh application for suspension tainted the decision taken by SARS in respect of the application which formed the subject-matter of this review.

As to full disclosure and provision of security

(ix) That Peter had stated that it would deny him his right to a fair trial if he were required to provide security but he had conceded that the long term liabilities reflected in certain documents submitted included long term loans to related entities in which Peter owned shares and no explanation was proffered for why these loans were listed as Peter's personal liabilities and it was also conceded that the financial information of the related entities was not supplied to SARS.

(x) That the aforementioned demonstrated that Peter did not provide a full and accurate reflection of his financial position to SARS and, in the

circumstances, SARS could not be faulted for taking this into account in deciding whether or not to grant the application to suspend payment.

(xi) That, given Peter's incomplete and innacurate financial statements, SARS was entitled to view with scepticism his assertion that he could not afford to provide security for the tax debt and the ground of review relating to full disclosure and provision of security must accordingly fail.

As to whether the tax appeal had been frivolous and vexatious

(xii) That one of the reasons given by SARS for its decision to refuse to suspend was that the appeal was frivolous and vexatious and, in this regard, while section 164(5)(a) of the Tax Administration Act empowered a senior SARS official to deny an application to suspend if the objection or appeal was 'frivolous or vexatious', the Act did not provide any guidance in lending meaning to the term 'frivolous or vexatious.' However, our courts have equated this term with an abuse of process.

(xiii) That SARS has fallen far short of demonstrating that the appeal instituted by Peter was frivolous and vexatious. Furthermore, SARS did not refer to any evidence contained in the record of decision which supported such a conclusion. Instead, it sought to demonstrate that the appeal was lacking in merit but this was not sufficient to demonstrate that the appeal was frivolous and vexatious. Moreover, SARS was required to demonstrate that the appeal constituted an abuse of process and this it has failed to do.

(xiv) That, accordingly, there was no rational connection between the conclusion reached by the Committee that the tax appeal was frivolous and vexatious and the material placed before it and in the circumstances this ground of review was upheld.

SARS' decision not to suspend payment was set aside and remitted to SARS for reconsideration, and SARS was ordered to pay the costs of the review application, save in relation to an application to amend its notice of motion brought by Peter.

5.8. *ITC 1927*

The taxpayer, during October 2014, had been diagnosed with multiple sclerosis and peripheral polyneuropathy and he claimed medical tax credits in terms of section 6B(1) of the Income Tax Act (ITA) 58 of 1962 for expenses that he contended he had incurred when treating his disability.

The taxpayer, in his Income Tax Return for Individuals (ITR12) which he had submitted for the 2015 year of assessment, had claimed additional medical tax credits for expenditure that allegedly related to his disability.

As a result, he was due for a tax refund in the amount of R103 358.62.

SARS had subjected the taxpayer's assessment to an audit process and issued a revised assessment disallowing the additional medical tax credits claimed by the taxpayer in the amount of R95 571.

The taxpayer lodged his Notice of Objection (NOO), in which he disputed the disallowance on the same basis that he disputed the assessment.

SARS considered the objection and partially allowed it by allowing R5 594 and disallowing R89 977.

The taxpayer then lodged his notice of appeal (NOA) wherein he reiterated his original claim for the aforementioned medical tax credits.

The Tax Board heard the appeal and upheld the assessment which led the taxpayer to refer the appeal to the Tax Court on 16 March 2017.

The taxpayer had remained adamant that he was entitled to the medical tax credits claimed as he had incurred the relevant expenses to treat mercury poisoning which caused his disability.

The additional medical expenses incurred by the taxpayer included the costs of purchasing the X machine in order to self-treat the mercury poisoning and therefore his disability and he also claimed the costs of consultations with a homeopath and a herbalist.

SARS contended that the taxpayer was not entitled to the additional medical

expenses tax credit for the 2015 year of assessment as he did not meet the requirements of section 6B(1)(a)(i) and (iii) of the Act in respect of qualifying medical expenses in that the relevant medical expenses were not paid to a duly registered medical practitioner, homeopath or herbalist and further, they did not relate to medical treatment prescribed by a duly registered medical practitioner, homeopath or herbalist.

In other words, none of the persons consulted by the taxpayer in respect of the services and treatment for which he was claiming medical tax credits were registered with the Allied Professional Health Professions Council of South Africa ('AHPCSA').

SARS contended further that the taxpayer did not meet the requirements of section 6B(1)(b) in respect of his disability in that the blood test report referred to by the taxpayer was related to mercury poisoning, which was not the certified cause of his disability.

The taxpayer stated in evidence in the Tax Court that investigations made by him led him to conclude that his disability was caused by mercury poisoning and blood tests conducted by a UK-based laboratory confirmed that his blood contained mercury and this had prompted him to acquire the X Machine.

The taxpayer contended that the X Machine conducted homeopathic diagnosis and prescribed treatment in the same way that a homeopath would, thus saving him considerable money that he would spend by consulting a homeopath.

The taxpayer contended that his expenses incurred towards acquiring the X Machine ought to be allowed- firstly, because it is a qualifying expense and that he had incurred it to treat his disability.

The taxpayer relied on invoices purportedly issued by a homeopath and herbalist which he had submitted to SARS in support of the relevant tax return as proof that he had consulted these persons in respect of the services specified therein.

Judge Modiba held the following:

(i) That to administer section 6B(1) of the Income Tax Act SARS required

taxpayers who wish to claim an additional medical expenses tax credit related to the treatment of a disability to submit a Confirmation of Diagnosis of Disability (ITR–DD) form, completed and signed by a registered medical practitioner. The taxpayer's diagnosis was confirmed in the ITR–DD form that he submitted to SARS, completed and signed by his medical doctor, certifying him to be physically disabled and wheelchair bound as a result of multiple sclerosis.

(ii) That to meet the requirement of 'disability' in section 6B(1) of the Act, the taxpayer's disability must be diagnosed by a duly registered medical professional and, further, the diagnosis must have lasted or have a prognosis of more than a year.

(iii) That, based on the definition of 'qualifying medical expenses' under section 6B(1), the following factors below ought to be considered when assessing a claim for the additional medical expenses tax credit:

- The relevant amounts must be paid to any duly registered medical practitioner, a homeopath and/or a herbalist for professional services rendered or for medicines supplied by a duly registered pharmacist for medication prescribed by any of the abovementioned persons;
- Relevant professionals must be registered with the Professional Health Professions Council of South Africa ('HPCSA')and/or the AHPCSA;
- The expenditure must be prescribed by SARS as necessarily incurred and paid by a taxpayer in consequence of any physical impairment or disability suffered by the person or any dependant of the person is allowed.

(iv) That the taxpayer, in terms of section 102(1)(b) of the Tax Administration, bore the onus to prove that the amounts he was contesting were deductible but he failed to present medical reports by a duly registered medical practitioner, homeopath or herbalist that concluded that his disability was

caused by mercury poisoning and neither did he call the relevant persons to testify during the appeal.

(iv) That the aforementioned was of concern given that it appeared that not only did the taxpayer dispute the scope of his onus before the Tax Board but he had also failed to submit affidavits by these persons on invitation by SARS. The taxpayer had contended, on the basis of CIR v Goodrick 1942 OPD 1; 12 SATC 279, that the invoices that he had submitted were sufficient to shift the onus to SARS to show that the invoices were rendered by professionals who fell outside the purview of section 6B of the Income Tax Act.

(v) That, in the absence of corroborating evidence, the court found that such invoices did not constitute affirmative evidence. Invoices can never serve as evidence of the renderer's registration as a medical professional. At the most, invoices evidence the amount charged by a specified service provider for a specified service and, for that reason, they do not prove compliance with section 6B(1) and therefore they are insufficient to discharge the onus that the taxpayer bore.

(vi) That, therefore, the taxpayer had failed to establish that the purchase of the X machine was an expense that was claimable under section 6B(1)(a)(i) and (iii) of the Act.

(vii) That even if the taxpayer had relied on section 6B(1)(c), the appeal would still not have succeeded. He did not purchase the X Machine from a duly registered medical practitioner or homeopath and it was not his case that he used the X Machine to function or perform his daily activities. And in this regard too, there was no evidence before this court to prove that the X Machine was prescribed to enable the taxpayer to function effectively when performing his daily activities.

(viii) That in terms of section 130(1)(b) and (c) of the Tax Administration Act the Tax Court may grant an order for costs in favour of a party in the event that the taxpayer's grounds of appeal are held to be unreasonable and also in

the event that the Tax Court substantially confirms the decision of the Tax Board. The facts in this case justify such an order against the taxpayer. Lack of evidence was the primary reason why the taxpayer did not succeed before the Tax Board and he ought to have anticipated that hurdle but he failed to do so and this rendered his grounds of appeal unreasonable. As a result, the Tax Board's outcome was substantially confirmed in the Tax Court and under these circumstances a cost order against the taxpayer was justified.

The taxpayer's appeal was dismissed and SARS' assessment was confirmed.

6. INTERPRETATION NOTES

6.1. Wear & Tear or Depreciation – No. 47 (Issue 3)

This Note provides guidance on the circumstances in which the wear-and-tear or depreciation allowance in section 11(e) may be claimed as a deduction.

This Note also provides guidance on the application and interpretation of section 11(e) in relation to the determination of:

- the 'value' of a qualifying asset on which the allowance is based; and
- the acceptable write-off period of a qualifying asset.

The Annexure to this interpretation note contains a schedule of write-off periods for various qualifying assets which are acceptable to SARS.

This Note is a binding general ruling made under section 89 of the Tax Administration Act on section 11(e) in so far as it relates to the determination:

- of the value of an asset for purposes of section 11(e); and
- the amount that will qualify as an allowance.

This ruling applies to any qualifying asset brought into use on or after 24 March 2020.

Section 11(a) allows a deduction for expenditure and losses actually incurred in the production of income, provided such expenditure and losses are not of a capital nature. Over many years South African courts have developed or adopted a number of principles for determining whether expenditure is of a capital or revenue nature. Although capital expenditure may be incurred in the production of income and in carrying on a trade, it is nevertheless excluded from deduction under the general deduction formula in section 11(a).

The Act addresses this issue by granting a deduction for specific types of capital expenditure incurred in carrying on a trade, usually in the form of an allowance spread over a number of years based on the cost or value of an asset.

Section 11(e) is one such specific provision and provides for an allowance on the value of any machinery, plant, implements, utensils and articles used by the taxpayer as owner in the carrying on of a trade.

6.2. Unclaimed benefits – No. 99 (Issue 3)

In this Note, unless the context indicates otherwise, a 'fund' means a 'pension fund', 'provident fund', 'pension preservation fund', 'provident preservation fund' and 'retirement annuity fund' as defined in section 1(1) of the Income Tax Act.

This Note explains the treatment of lump sum benefits classified as unclaimed benefits that accrued to members (both before and from 1 March 2009) for income tax purposes.

Historically some members of a fund did not, after exiting the fund, claim the lump sum benefit to which they became entitled under the rules of the fund. These lump sum benefits were classified as an 'unclaimed benefit' if they were not claimed after a reasonable period. The legislation did not regulate when and how a lump sum benefit should be classified as an 'unclaimed benefit'. Fund administrators, as a result, applied different rules to determine when a lump sum benefit was classified as an 'unclaimed benefit'.

In many instances, fund administrators applied for a tax directive for an unclaimed

benefit only when the member or the member's beneficiaries claimed the unclaimed benefit, as opposed to when the lump sum benefit accrued.

The tax treatment of a lump sum benefit, classified as an 'unclaimed benefit', depends on the date on which the benefit accrued to the member.

6.3. Rebate and deduction for taxes on income – No. 18 (Issue 4)

This Note explains the scope, interpretation and application of section 6quat which provides for a rebate or deduction for foreign taxes on income.

Section 6quin previously provided for a rebate for foreign taxes paid on South Africansource service income included in South African taxable income. Section 6quin(1) to (4) were deleted with effect from years of assessment commencing on or after 1 January 2016. Section 6quin is not discussed in this Note, but a detailed discussion of the section is contained in Issue 3 of this Note which is available on the website under "Legal Counsel » Legal Advisory » Interpretation Notes".

Section 64N, which provides for a rebate for foreign taxes on dividends against dividends tax payable, is not discussed in this Note. The Comprehensive Guide to Dividends Tax contains a detailed discussion in this regard.

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

- The Taxation Laws Amendment Act 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).

Residents are subject to income tax on their worldwide taxable income regardless of the source of the income. Foreign-source amounts derived by a resident may

under specific circumstances be taxed by the country of source and by South Africa, resulting in international juridical double taxation. International juridical double taxation refers to the imposition of similar taxes by two or more sovereign countries on the same item of income (including capital gains) of the same person.

Relief from double taxation resulting from the imposition of tax by a residence country and a source country on the same amount is normally granted by the residence country. Thus, the source country's right to tax generally has priority over the residence country's right to tax. In many instances, countries provide for relief from international juridical double taxation under a tax treaty, although many countries (including South Africa) also provide unilateral tax relief in their domestic law.

South Africa provides relief from double taxation to its residents in its domestic law mainly by rebate methods4 or by a deduction5 for foreign taxes payable on income that is subject to South African normal tax. The rebate and deduction methods are supplemented by certain exemptions for foreign-source amounts received by or accrued to residents.

Section 6quat(1) provides for a rebate of foreign taxes on income to be deducted from normal tax payable by a resident. The amount of the rebate is determined under section 6quat(1A).

A resident is entitled to claim such a rebate only to the extent that the amount of the foreign tax is proved to be payable to a sphere of government of a foreign country without a right of recovery by any person, other than a right of recovery under any entitlement to carry back losses arising during any year of assessment to any year of assessment before such year of assessment.

A resident will not qualify for a rebate under section 6quat(1) for foreign tax proved to be payable to a foreign country on a South African-source amount.

To the extent that the amount of qualifying foreign taxes proved to be payable exceeds the amount of the rebate determined under section 6quat(1A) and (1B), the excess amount is carried forward to the immediately succeeding year of assessment. The amount so carried forward will potentially qualify for set-off

against the normal tax payable on taxable income derived from foreign sources in the immediately succeeding year of assessment [paragraph (ii) of the proviso to section 6quat(1B)(a)].

Any balance of excess foreign taxes may not be carried forward for more than seven years, calculated from the year of assessment in which the balance was carried forward for the first time [paragraph (iii) of the proviso to section 6quat(1B)(a)].

Section 6quat(1C)(a) provides for the deduction of foreign taxes from the income of a resident taxpayer (as opposed to the claiming of a tax rebate). Its application is limited to foreign taxes other than taxes contemplated in section 6quat(1A). Section 6quat(1) considers income and capital gains from a foreign source and the deduction under section 6quat(1C)(a) is limited to foreign taxes levied on South African-source income derived from trade operations.

Taxes must, for purposes of section 6quat(1C)(a), be paid or proved to be payable by the resident to any sphere of government of any country other than South Africa, without any right of recovery by any person other than under a mutual agreement procedure in terms of an international agreement or a right of recovery under any entitlement to carry back losses arising during any year of assessment to any previous year of assessment.

Section 6quat(1C)(b) provides that when, during any year of assessment, any amount was deducted under section 6quat(1C)(a) and the person receives a refund for the amount so deducted or is discharged from any liability for that amount in any subsequent year of assessment, so much of the amount received or so much of the amount of that discharge as does not exceed the amount of the deduction, must be included in the person's income in that subsequent year.

Any foreign taxes proved to be payable for purposes of section 6quat(1) or any foreign taxes paid or proved to be payable for purposes of section 6quat(1C) in respect of any amount which is included in taxable income in any year of assessment must be translated to rand on the last day of that year of assessment in which the amount is required to be included in a person's taxable income by

applying the average exchange rate for the year of assessment. The average exchange rate which must be used in translating the foreign tax liability is the average exchange rate for the year of assessment in which the amount received or accrued is included in the taxpayer's taxable income.

Section 6quat(5) provides that notwithstanding sections 99(1) or 100 of the TA Act, an additional or reduced assessment may be made within six years from the date of the original assessment under which the taxpayer was entitled to the rebate under section 6quat(1) to give effect to an increased or reduced foreign tax credit for the year.

7. DRAFT INTERPRETATION NOTES

7.1. Associations: Funding requirement

This Note provides guidance on the interpretation and application of the 'funding' requirement in section 30B(2)(b)(ix) for an entity to be approved by SARS, and to retain such approval for its receipts and accruals to qualify for exemption from normal tax under section 10(1)(d)(iii) or (iv).

The 'funding' requirement is only one of a number of requirements, for purposes of section 30B, that must be included in the founding document. The other requirements are not addressed in this Note.

The entities referred to in section 30B fall outside the scope and income tax rules for public benefit organisations and recreational clubs. The entities contemplated in section 30B are membership based and exist for the benefit of their members.

The definition of 'entity' in section 30B(1) provides for two distinct categories, Comprising:

- mutual loan associations, fidelity or indemnity funds, trade unions, chambers of commerce or industry and local publicity associations; and
- professional bodies.

The respective entities are diverse in nature but have in common that they usually

do not have a profit motive nor do they provide any monetary gain or material advantage for their individual members. Even though these entities are established to conduct their activities with and for the benefit of their members, they are not prohibited from dealing with non-members within certain parameters.

These entities are usually funded:

- by membership fees, subscriptions, or contributions paid by members for the right to belong to the entity, to enjoy the benefits and privileges attached to such membership, as well as products and services integral and directly connected to the sole or principal object for which the particular entity is established as set out in its founding document, or
- from an appropriation by the government.

The approval under section 30B(2) is limited to those entities that can demonstrate that substantially the whole of their activities are undertaken for the benefit of their members and not undertaken for gain as a trade or business.

In order to be approved under section 30B(2), an entity must satisfy SARS that, amongst other things, substantially the whole of its funding is derived from its annual or other long-term members or from an appropriation by the government.

An entity bears the onus of proving that it complies with the requirements relative to the approval as discussed in this Note and must retain the necessary evidence to support the view taken. The burden may be discharged by way of supporting evidence submitted by the entity, provided such evidence is reasonable.

It is a factual enquiry whether an entity complies with the 'funding' requirement and since the facts and circumstances pertaining to each entity differ, each case will be considered on its own merits.

7.2. *Taxation of amounts received by or accrued to missionaries*

In this Note unless the context indicates otherwise, 'missionary organisation' includes a missionary society, agency, association, fellowship or similar organization.

This Note provides clarity on the tax treatment of amounts received by or accrued to missionaries who are performing religious or related activities in South Africa.

A missionary is a member of a religious mission. A religious mission comprises a group of people sent by a religious body to perform religious and social work, educational or hospital work, or to spread that religious body's faith.

Often, missionaries operate under the 'banner' of a missionary society, agency, association, fellowship or some denominational body.

Typically, a missionary is not employed by a specific congregation, religious organisation or missionary organisation, and is dependent on contributions to meet costs related to both the missionary work undertaken as well as expenditure of a personal nature. The contributions are normally made by a community, members of a religious congregation, or members of a missionary organisation, of which the missionary is a member. Often these amounts are paid directly by the donors to the missionary or similar organisation, which controls and administers the amounts received for its own benefit and on its own behalf, and then on-pays all or part of the donations to the relevant missionary. In other instances, the contributions are made directly to the missionary, or the missionary organisation simply acts as a conduit for the amounts received.

This Note clarifies the correct income tax treatment of the donations received by missionaries. The donations tax implications of donations made to missionaries are beyond the scope of this Note.

Amounts received by or accrued to missionaries for missionary services rendered in South Africa must be included in the missionary's 'gross income.'

7.3. *Value-Added Tax consequences of points-based loyalty programmes*

This Note clarifies the VAT implications resulting from the participation in loyalty programmes based on the current provisions of the VAT Act. This Note does not attempt to list and analyse all the loyalty programmes available. Loyalty programmes differ from each other, evolve and change because of continuous changes in market conditions, competition etc. For this reason, the general VAT principles applicable to loyalty programmes as contained in this Note must be analysed and subsequently applied to each transaction in a loyalty programme in accordance with that specific loyalty programme's characteristics or nature.

Notwithstanding that this Note may highlight the VAT implications of other benefits generally associated with loyalty programmes, the main focus of this Note is to address the VAT implications of points-based loyalty programmes.

The policies and further applications associated with vouchers, tokens or stamps are not discussed in detail in this Note.

This Note sets out the VAT treatment of the most common transactions in loyalty programmes currently in operation in South Africa. Whilst there may be other types of loyalty programmes, the focus of this Note is to provide legislative certainty to the stakeholders participating in a loyalty programme on the VAT consequences of pointsbased loyalty programmes. It is the responsibility of each participant in a loyalty programme to establish the nature of its involvement (or role) in a specific loyalty programme in order to determine the VAT treatment of each transaction.

7.4. *Vesting of income in a resident beneficiary by a non-resident trust: Interaction between section 25B(1) and section 7(8)*

This Note provides clarity on the interpretation and application of the words "subject to the provisions of section 7" in section 25B(1) and, more specifically,

whether section 7(8) or section 25B(1) applies when income received by or accrued to a nonresident trust by reason of or in consequence of a donation, settlement or other disposition by a resident, is vested in a resident beneficiary by the trustees of the nonresident trust.

Under section 25B(1) if any amount2 is received by or accrues to a trust during a year of assessment, and during the same year of assessment the amount:

- does not vest in a beneficiary, it is deemed to accrue to the trust; and
- vests in a beneficiary, it is deemed to accrue to that beneficiary.

Section 25B(1) overrides the principle that income cannot be disposed of after accrual.3 For example, if income accrues to a trust on 1 July of year 1, and the trustees vest the income in a beneficiary on 30 November of year 1, under common law principles the income would accrue to the trust, but under section 25B(1) it is deemed to accrue to the beneficiary.

Both the outcomes described in the above bullet points are "subject to the provisions of section 7". This Note considers the implications of this "subject to" clause in relation to section 7(8).

The Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004 states the following on the rationale for the introduction of section 7(8):

> "Foreign trusts have been a focus of concern for quite some time. South African taxpayers continue to artificially shift assets offshore via foreign trusts, thereby excluding income from the South African tax net. In 2001 and 2002 (as part of the shift to worldwide taxation), Government enacted further anti-avoidance measures to prevent this form of artificial exclusion from the South African tax net. Section 7(8) is a key anti-avoidance measure in this regard".

In applying section 7(8), the words "subject to the provisions of section 7" in section 25B(1) must be interpreted to mean that to the extent that both section 7(8) and section 25B(1) potentially apply, only section 7(8) must be applied. Section 25B(1) will apply to the balance of any income not derived in consequence of a donation, settlement or other disposition.

8. BINDING PRIVATE RULINGS

8.1. BPR 341 – Distribution of a bank account as dividend in specie

This ruling determines whether the disposal of the co-applicant's only asset, a bank account, to the applicant as a dividend in specie in anticipation of the co-applicant's winding-up, will constitute a liquidation distribution.

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 11 November 2019.

Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 47; and
- paragraph 43A.

Parties to the proposed transaction

The applicant: A listed company and a resident

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

Description of the proposed transaction

The co-applicant was an investment holding company that invested in listed and unlisted real estate, as well as directly in fixed property that was developed and sold, or leased out prior to being sold.

The co-applicant disposed of its investments and ceased all trading activities during 2018 and declared an extraordinary dividend to the applicant during March 2019.

The co-applicant will, within a period of 18 months from the mentioned dividend

payment dispose of its rights, title and interest in its bank account to the applicant as a dividend in specie in anticipation of its liquidation.

Conditions and assumptions

This binding private ruling is subject to the additional condition and assumption that the co-applicant will comply with the steps contemplated in section 41(4) within 36 months from the date of the liquidation distribution, or such further period as the Commissioner may allow under section 47(6)(c)(i).

Ruling

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

- The proposed transaction will qualify as a "liquidation distribution" as defined in paragraph (a) of the definition of that term in section 47(1).
- The co-applicant will be entitled to the relief provided for in section 47(2)(a).
- The applicant will be entitled to the relief provided for in section 47(5).
- Paragraph 43A will not apply to the proposed transaction due to the proposed transaction constituting a "deferral transaction" as defined in paragraph 43A(1).

8.2. BPR 342 – Donation by a resident to a foreign trust of property received from another foreign trust

This ruling determines the income tax consequences and the application of the attribution rules of a distribution by a non-resident discretionary trust of an award to a resident beneficiary and the subsequent donation by the resident of the award to another non-resident trust.

In this ruling references to sections and paragraphs are to sections of the Act Income Tax and paragraphs of the Eighth Schedule to the Act applicable as at 3 December 2019.

Unless the context indicates otherwise any word or expression in this ruling bears

the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definition of "gross income";
- section 25B(2A) and (2B);
- section 26A;
- section 56(1)(g)(ii); and
- paragraph 80.

Parties to the proposed transaction

The applicant: A resident natural person

Trust A: A discretionary trust resident in Country X

Trust B: A discretionary trust to be settled by the applicant in Country Y

Description of the proposed transaction

The applicant's son settled trust A in 2012. The beneficiaries on the date of settlement were the applicant's son, the applicant's daughter-in-law, as well as any children or grandchildren of the applicant's son and such other persons or class of persons or any charitable institution which the trustees may add under the trust deed. The applicant was not a beneficiary from when the trust was settled, but was added as a beneficiary in 2019.

Trust A will make an award out of its capital to the applicant in an amount equal to the sum of (a) the settled capital of the trust, and (b) the excess of the market values of the assets over their costs, less (c) the liabilities of the trust, but without awarding the assets or an interest in the assets themselves. The award will be credited to a loan account in favour of the applicant in the books of Trust A. The applicant will donate the subject matter of the award to Trust B.

Conditions and assumptions

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

Ruling

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

- The award by Trust A will not constitute "gross income" as defined in section 1(1) for the applicant, as it will constitute a receipt of a capital nature.
- In respect of the award of the amount by Trust A to the applicant, no amount must be included in the taxable income of the applicant in terms of section 26A read with the Eighth Schedule, as the applicant will not have disposed of any asset.
- In respect of the donation by the applicant to Trust B, no amount must be included in the taxable income of the applicant in terms of section 26A read with the Eighth Schedule, as the disposal of the applicant's right to receive the award will not result in any capital gain, as the market value of the claim will be equal to its base cost.
- Section 25B(2A), read with section 25B(2B), will not be of application in relation to the award to the applicant.
- No asset of Trust A will have been disposed of, nor will any asset or right to any asset have been vested in the applicant, so that neither paragraph 80(1) nor paragraph 80(2) will be of application with regard to the award made to the applicant.
- Paragraph 80(3), read with paragraph 80(4), will not be of application in relation to the award made to the applicant.
- The donation by the applicant to Trust B will be exempt from donations tax under section 56(1)(g)(ii).

8.3. *BPR 343 – Donations tax implications of subscribing for shares at a discount*

This ruling determines that there are no donations tax implications resulting from a broad-based black economic empowerment trust subscribing for shares at a discount.

In this ruling references to sections are to sections of the Act applicable as at 9 December 2019. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 55(1); and
- section 58(1).

Parties to the proposed transaction

The applicant: A resident company

The trust: A trust to be established by the Applicant to comply with codes published under legislation regulating black economic empowerment

Company A: A resident company that owns all the shares in the applicant

Company B: A resident company to be incorporated by Company A

Description of the proposed transaction

The applicant wishes to introduce a minority shareholder, the trust, in order to enhance its broad-based black economic empowerment status. The object of the trust will be to facilitate the education, training, development and/or upskilling of the eligible beneficiaries.

The trust will be entirely funded by the applicant. Eligible beneficiaries of the trust will be black women under the age of 35 who are studying or will be studying at higher-education or tertiary institutions in South Africa.

The trust is not a public benefit organisation as envisaged in section 30(1).

The transaction will be implemented as follows:

Disposal of the applicant's export business

- Company A will subscribe for 100% of the ordinary shares in company B.
- The applicant will dispose of its export business to company B at market value in terms of an intra-group transaction as contemplated in section 45, with the purchase consideration left outstanding on loan account. The loan will be repaid from available cash reserves.

The trust and subscription for ordinary shares in the applicant

- The applicant will settle the trust and fund it by way of a donation.
- The trust will subscribe for a minority interest in the applicant at a nominal value compared to the current market value of the shares.

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 that the subscription for shares at a discount by the trust will not constitute a "donation" as defined in section 55(1) and will not be deemed to have been disposed of under a donation by the Applicant as envisaged in section 58(1).

8.4. BPR 344 – Transfer of listed financial instruments to collective investment schemes in exchange for participatory interests

This ruling determines tax consequences of a transfer of listed financial instruments to collective investment schemes in exchange for participatory interests in those schemes.

In this ruling references to sections are to sections of the relevant Act and references to paragraphs are to paragraphs of the Eighth Schedule to the Income Tax Act applicable as at 30 January 2020. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of:

Income Tax Act:

- section 42;
- paragraph 20; and
- paragraph 61(3).

STT Act:

- section 8(1)(a).

Parties to the proposed transaction

The applicant: A resident licensed discretionary investment manager

The co-applicants: Resident individuals and resident trusts

The funds: Resident collective investment schemes as defined in the Collective Investment Schemes Control Act 45 of 2002

Description of the proposed transaction

The applicant acts as the fund manager for the co-applicants on whose behalf it manages a segregated portfolio of investments comprising JSE listed financial instruments, foreign mutual funds and collective investment schemes in securities (the investments) with the aim of building long-term wealth for each co-applicant.

The co-applicants are the beneficial owners of the investments. The applicant's mandates with each of the co-applicants, in terms of which the investments are managed, have been in place for a number of years. The applicant is empowered to buy and sell the investments in each co-applicant's portfolio, in order to ensure that the portfolios remain in alignment with the mandate and achieve the purpose

of building long-term wealth.

The applicant wishes to consolidate the respective mandates by transferring, on behalf of the co-applicants, the investments to the funds, in exchange for participatory interests issued by the funds to the co-applicants. This will be done after procuring the requisite authorisation and consent from each co-applicant.

Subsequent to the disposal of the investments by the co-applicants to the funds, the funds may be obliged by their investment mandates to rebalance their portfolios by disposing of some assets, which may include some of the investments acquired from the co-applicants under the proposed transaction. This will be undertaken in accordance with the normal investment authority and mandate of the portfolio.

Those subsequent disposals might take place within 18 months of the proposed transaction.

Conditions and assumptions

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

- The market values of the investments exceed their base costs.
- The investments are held as capital assets by the co-applicants and will be acquired by the funds as capital assets.
- The funds will not hold more than 25% of the equity shares in the listed companies that issued the investments comprising listed shares.

Ruling

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

- The proposed transaction will qualify as an "asset-for-share transaction" in terms of paragraph (a) of the definition of that term in section 42(1)(a).
- The co-applicants will be deemed to have disposed of their investments for amounts equal to their base costs and to have acquired the participatory interests in the funds on the dates of acquisition of the original investments

and for such costs, equal to expenditure incurred by the co-applicants, as are allowable under paragraph 20 of the Eighth Schedule and to have incurred such expenditure on the dates of original incurral by each person concerned.

- No capital gains will be realised for the applicant or co-applicants in respect of the proposed transaction in accordance with section 42(2).
- The co-applicants will be deemed to have acquired the participatory interests in the funds on the dates that the co-applicants acquired their investments and for a cost equal to any expenditure incurred in respect of the investments by the co-applicants that is allowable in terms ofparagraph 20 of the Eighth Schedule. In particular:
  - For purposes of section 42(2), to the extent that the investments constitute “pre-valuation date” assets, the market values thereof on “valuation date” may be included in the expenditure incurred by each co-applicant that is allowable in terms of paragraph 20 in determining the cost at which that co-applicant will acquire the participatory interests in the funds;
  - For purposes of section 42(2), to the extent that the investments do not constitute “pre-valuation date” assets, the actual costs incurred in respect of the acquisition of the investments may be included in the expenditure incurred by each co-applicant that is allowable in terms of paragraph 20 in determining the cost at which that coapplicant will acquire the participatory interests in the funds.
- Section 42(7)(a) will apply to the subsequent disposal of the investments by the funds, but the effect of its application will be nil, due to the application of paragraph 61(3).
- The proposed transfers of investments comprising listed shares will qualify for exemption from STT under section 8(1)(a)(i) of the STT Act.
- The requirement in section 8(1)(a) of the STT Act will be complied with if

the public officers of the funds provide sworn affidavits or solemn declarations stating that the transfer of the securities complies with the provisions of section 8(1)(a).

General note

The relief available in terms of this ruling does not preclude the subsequent application, if appropriate, of any general anti-avoidance provisions to the proposed transaction.

8.5. BPR 345 – Asset-for-share transactions followed by an unbundling transaction and a sale of shares to a third party

This ruling determines the tax relief for the parties involved in an internal restructuring involving corporate rules (section 42) followed by an unbundling (section 46) and a sale of shares to a third party.

In this ruling references to sections are to sections of the Act and the STT Act applicable as at 25 February 2020. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of:

Income Tax Act:

- section 24BA;
- section 42; and
- section 46.

STT Act:

- section 1; and
- section 8(1)(a)(i) and (iv).

Parties to the proposed transaction

The applicant: A resident listed company

Listco: A resident company and a wholly-owned subsidiary of the applicant before the proposed transaction, which is to be listed

Company A: A resident company which is a wholly-owned subsidiary of the applicant

Company B: A resident company which is a subsidiary of the applicant

Company C A non-resident company owned by members of the senior management of company B

Description of the proposed transaction

The applicant comprises of three principal business units. The purpose of the proposed transaction is to demerge and separately list one of these.

Listco will have a primary listing on the JSE.

The listing of the applicant will be retained.

To implement the transaction, the applicant will take several transaction steps:

Step	Description	Timing
1	The applicant establishes Listco.	6 months before Last Day to Trade (LDT).
2	The applicant holds 80% of the shares in company B. It will transfer circa 26.78% of those shares to company A, in exchange for the issue of at least one share by company A to the applicant in terms of section 42 of the Act.	LDT-1 will be the effective date of the sale.
3	The applicant transfers its remaining shares in company B to Listco in exchange for shares issued by Listco,	LDT-1 will be the effective date of the sale.

	also in terms of section 42 of the Act.	
4	The applicant will distribute all its shares in Listco to its shareholders (applicant shareholders) as a distribution in specie in terms of section 46 of the Act.	After market close on LDT.
5	Company A will transfer circa 26.78% of the shares in company B to Listco at market value in exchange for shares issued at market value by Listco to Company A.	The effective date of the sale will be during the weekend between LDT and LDT +1.
6	The creation of a dual listed company (DLC) structure will take place. Special DLC shares in Listco will be issued to a South African trust.	The indicative date is the Listing Date.
7	Listco will be admitted to trade on the JSE and will make an initial public offering of shares. Company A will sell circa 11.69% of the Listco shares to the underwriters.	Listing Date (LDT+1) The effective date of the sale to the underwriters is anticipated to be the Listing Date.
8	The applicant will distribute its shares in Listco to the applicant shareholders.	Record Date (RD).
9	Company C will transfer its 20% (less one share) shareholding in company B to Listco in exchange for shares in Listco.	RD +2.

The distribution of unbundled shares in Listco to the applicant shareholders will in certain instances result in fractional entitlements for shareholders (fractional

shareholders). The fractional entitlements will be rounded down to the nearest whole number and the aggregated excess fractions of the unbundled shares to which a shareholder would otherwise have been entitled will not be transferred to it following the unbundling, but will be sold on its behalf and with its consent in the market.

In addition, certain foreign shareholders of the applicant will not be entitled to receive the shares in Listco (restricted shareholders). The restricted shareholders will receive a cash amount corresponding to the net proceeds from the sale of their applicant shares which they would otherwise have been entitled to receive following the unbundling, but which will be sold on their behalf and, with their consent, in the market.

(The rulings for the applicant shareholders are set out in BCR 070.)

Conditions and assumptions

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

- No single non-resident shareholder to whom shares will be unbundled will, either alone or together with a non-resident who is a connected person, hold an interest of 20% or more in the applicant.
- The parties to the proposed transaction will not elect that section 42 of the Act does not apply.

Ruling

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

Transaction Steps 2, 3, 5 and 7:

- Each transaction will qualify as an "asset-for-share transaction" as defined in paragraph (a) of the definition in section 42(1) of the Act. Specifically:
    - On the basis that the transferor holds the shares in question as capital assets, in terms of section 42(2)(a)(i)(aa), that person will be deemed to have disposed of the shares to the transferee for

amounts equal to the base costs of those shares. Accordingly, no capital gain will arise in the relevant transferor's hands in respect of the disposal.

- In terms of section 42(2)(a)(ii)(aa) the transferor's base costs in the shares so transferred will be transferred to the shares issued to it in exchange.
- In terms of section 42(2)(b)(ii), for the purposes of determining any capital gain or loss in respect of a disposal of the relevant asset, that person (transferor) and the company (transferee) which acquired the asset in terms of an "asset-for-share transaction", must be deemed to be one and the same person with respect to the date of acquisition of the asset and the amount and date of incurral by that person of any expenditure in respect of that asset allowable in terms of paragraph 20 of the Eighth Schedule.

- The provisions of section 24BA of the Act will not apply in respect of these steps.
- The transfer of shares in terms of the "asset-for-share transaction" set out in steps 2, 3 and 5 will be exempt from STT under section 8(1)(a)(i) of the

STT Act.

- The issue of shares in terms of the "asset-for-share transactions" set out in steps 2, 3 and 5 do not constitute a "transfer", as defined in section 1 of the STT Act. Therefore, no STT liability will arise as a result of the issue of shares.
- When the applicant ceases to hold a qualifying interest in Listco on LDT when it distributes its shares to the applicant shareholders, this will be in terms of an "unbundling transaction" and therefore the provisions of section 42(6) will not apply.
- When company A transfers the company B shares to Listco acquired under step 2, the provisions of section 42(7) will apply as the disposal by

company A of the company B shares will take place within 18 months of the acquisition of those shares in terms of the "asset-for-share transaction". No gain will, however, arise.

- The disposal to the third party buyer by company A of circa 11.69% of the shares in Listco which it acquired in terms of section 42 within 18 months, will not result in sections 42(5) and (6) applying.
- Section 42(7) will apply to the capital gain realised when company A disposes of circa 11.69% of the Listco shares to the third party buyer. Such taxable capital gain may therefore not be set off against any assessed loss or balance of assessed loss of company A.

Transaction Step 4

- The transaction will constitute an "unbundling transaction" as defined in section 46(1)(a) of the Act and in particular:
    - The applicant will be regarded as having distributed "all" the shares in Listco, notwithstanding the fact that the:
        - shares held by restricted shareholders may, subsequent to the unbundling, have to be disposed of on behalf of and with the consent of the restricted shareholders; and
        - the "standard rounding convention" prescribed by the JSE Listings Requirements will be applied to the allocation of securities held by fractional shareholders.
    - Listco shares will be distributed by the applicant to its shareholders in accordance with each shareholder's effective interest in the unbundling company, notwithstanding the fact that the "standard rounding convention" in the JSE Listing Requirements will be applied to the fractional shareholders.
- The tax relief specified in sections 46(2), (3A), (5), and (5A) of the Act will therefore apply in respect of such transaction and in particular:

  - The applicant must disregard the distribution of the Listco shares for purposes of determining its taxable income or assessed loss in terms of section 46(2).
  - The contributed tax capital of the applicant and Listco immediately after the distribution will be deemed to be the amounts as set out in section 46(3A).
  - The distribution by the applicant in terms of the unbundling transaction will be disregarded in determining any liability for dividends tax in terms of section 46(5).
  - In terms of section 46(5A) of the Act, paragraph 76B of the Eighth Schedule will not apply in respect of the distribution.
- Section 46(7) will not find application as company C (a non-resident) will not hold shares in Listco immediately after such distribution as it will only acquire shares in Listco on RD+2.
- The distribution of the Listco shares by the applicant will be exempt from STT in terms of section 8(1)(a)(iv) of the STT Act.
- The transfer of the shares in Listco to the applicant shareholders or realisation agent, on behalf of the restricted shareholders or the shareholders with a fractional entitlement, as the case may be, will be exempt from STT under section 8(1)(a)(iv) of the STT Act, as the distribution will be an "unbundling transaction" as referred to in section 46.
- No rulings are issued in relation to steps 1, 6, and 8.

9. BINDING CLASS RULINGS

9.1. BCR 70 – Recipients fo shares in an 'unbundled' company

This ruling determines tax consequences for the recipients of listed shares in a company, following an unbundling transaction of that company's shares by its

listed holding company.

In this ruling references to sections are to sections of the Income Tax Act and the STT Act applicable as at 25 February 2020. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of:

- section 46 of the Income Tax Act; and
- section 8(1)(a)(iv)of the STT Act.

Class

The class members to which this ruling applies are all resident and non-resident shareholders of listed shares in the applicant, as reflected on the applicant's securities register on the last day to trade (LDT).

Parties to the proposed transaction

The applicant: A resident listed company

Listco: A resident company and a wholly-owned subsidiary of the applicant which is to be listed

Class members: The members of the class described above

Description of the proposed transaction

The applicant comprises of three principal business units. The purpose of the proposed transaction is to demerge and separately list one of these.

Listco will have a primary listing on the JSE.

The listing of the applicant will be retained.

To implement the transaction, the applicant will take several transaction steps. (See BPR 345 where the steps are set out in full). For purposes of this binding class ruling, the following steps are applicable:

Step	Description	Timing
1	The applicant establishes Listco.	Six months before LDT.
4	The applicant will distribute all its shares in Listco to its shareholders (class members) as a distribution in specie as contemplated in section 46 of the Act.	After market closure on LDT.
7	Listco will be admitted to trade on the JSE and will make an initial public offering of shares.	Listing Date.
8	The applicant will distribute its shares in Listco to the class members.	Record Date.

The distribution of shares in Listco (unbundled shares) to the class members will, in certain instances, result in fractional entitlements for shareholders (fractional shareholders), which will be rounded down to the nearest whole number. The aggregated excess fractions of the unbundled shares to which a shareholder would otherwise have been entitled will not be transferred to it following the unbundling, but will be sold on its behalf and with its consent in the market.

In addition, certain foreign shareholders of the applicant will not be entitled to receive the shares in Listco (restricted shareholders). The restricted shareholders will each receive a cash amount corresponding to the net proceeds from the sale of the unbundled shares to which they otherwise would have been entitled following the unbundling. Those shares will also be sold on their behalf and, with their consent, in the market.

Conditions and assumptions

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

Ruling

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

- Notwithstanding the disposal of shares on behalf of the restricted shareholders and fractional shareholders with entitlements to unbundled Listco shares, the distribution of the Listco shares to the class members will constitute an “unbundling transaction”, as defined in paragraph (a) of the definition of that term in section 46(1) of the Act.
- Provided that no single class member who is a “disqualified person”, either alone or together with any connected person, in relation to that class member that is or are a “disqualified person or persons”, holds or hold more than 20% of the Listco shares immediately after the distribution in terms of the “unbundling transaction”, section 46(7) of the Act will not apply to the unbundling.
- The tax consequences set out in section 46(3) of the Act will therefore apply in respect of this transaction and in particular:
    - Under section 46(3)(a)(i) the class members must allocate a portion of the expenditure and market value attributable to the applicant shares to the Listco shares acquired and reduce the expenditure and market value attributable to the applicant shares by the amount so allocated to the Listco shares.
    - The class members will, in terms of section 46(3)(a)(iii) and (iv), be regarded as having acquired the Listco shares on the same date as the applicant shares and with the same intention (that is, where the applicant shares were held as capital assets, the Listco shares must be regarded as acquired as capital assets and where their applicant shares were held as trading stock, the Listco shares must be regarded as acquired as trading stock).
    - For the purposes of section 46(3)(a)(v) and with reference to the market values of the unbundling shares (applicant shares) and unbundled shares (Listco shares), the phrase “as at the end of the day after that distribution” means, in relation to the shares

unbundled under section 46 by the applicant and acquired by the class members:

the closing price of the unbundling shares (applicant shares) on LDT+1; and

the closing price of the unbundled shares (Listco shares) on LDT+1.

Therefore, each class member that holds applicant shares must allocate a portion of the expenditure and any market value attributable to the applicant shares to the acquired Listco shares. The proportionate amount of the expenditure and market value to be allocated to the Listco shares must be determined in accordance with the ratio that the market value of the Listco shares, using the closing price on LDT+1, bears to the sum of the market value, using the closing price on LDT+1, of the applicant shares and Listco shares.

- Each class member must also reduce the expenditure and market value attributable to its applicant shares by the amount so allocated to the Listco shares.
- The distribution of the Listco shares in terms of the unbundling by the applicant will, under section 46(5), be disregarded in determining any liability for dividends tax.
- Under section 46(5A), paragraph 76B of the Eighth Schedule to the Act will not apply in respect of the distribution.
- The transfer of the Listco shares to the class members or realisation agent, on behalf of restricted shareholders or fractional shareholders, where relevant, will be exempt from STT under section 8(1)(a)(iv) of the STT Act, as that distribution will be an “unbundling transaction” as referred to in section 46.
- The transfer of Listco shares, by a realisation agent on behalf of restricted shareholders or fractional shareholders to purchasers in the market, will

notbe exempt under section 8(1)(a)(iv) of the STT Act.

10. BINDING GENERAL RULINGS

10.1. VAT treatment of specific supplies in the short-term insurance industry – No .14 (Issue 3)

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

- 'bordereau' means a document issued by an insurer or intermediary in the form of a memorandum, statement or invoice, which contains detailed information such as:
  - insurance premiums collected;
  - commission and fees payable in respect of intermediary services supplied; and
  - claims paid;
- 'inbound insurance policy' means a travel policy that provides insurance cover in respect of a passenger transported from an export country into the Republic or between two places in the Republic as part of an international journey;
- 'indemnity payment' means a cash payment made by the insurer under an insurance policy to indemnify the insured on the occurrence of the insured event;
- 'insurer' means any vendor supplying 'insurance' as defined in section 1(1);
- 'intermediary' means any broker or agent supplying intermediary services to an insurer or insured;
- 'intermediary services' has the meaning assigned thereto in section 1 of the Financial Advisory and Intermediary Service Act 37 of 2002 and includes the management and administration of a policy as well as the collection of

premiums and processing of claims;

- 'international journey' means a journey commencing from the 'point of departure' in the Republic to a destination outside the Republic (and vice versa), including (where applicable) stopovers en route to the destination, time spent in the destination country and the return journey;
- 'outbound insurance policy' means a travel policy that provides insurance cover in respect of a passenger transported from the Republic to a destination 2 in an export country or from a place outside the Republic to another destination outside the Republic as part of an international journey;
- 'policy document' means a document which is evidence of a contract of insurance, including any renewal notice, premium notification or endorsement in respect thereof;
- 'temporary presence' means a period of six months or less;
- 'third party supplier' means a supplier of goods or services receiving trade payments from insurers; and
- 'trade payment' means a payment made under a contract of insurance by an insurer to a third party supplier to replace or repair the insured's goods which were lost, damaged or destroyed;

This BGR is updated as a result of the amendments to section 72 made in terms of section 73 of the Taxation Laws Amendment Act 34 of 2019, which came into effect on 21 July 2019, and is based on the wording of section 72 as it read before 21 July 2019.

<u>Purpose</u>

This BGR sets out the VAT treatment of the issues listed below:

- The time of supply in relation to the supply of insurance and related intermediary services
- International transport insurance including stock throughput, goods in transit and marine insurance policies

- Hull and associated liability insurance
- Insurance cover provided in respect of fixed property and movable property located in an export country
- Excess payments
- Indemnity payments
- Third party payments
- Recoveries
- Group accident claims
- Intermediary services
- Documents accepted as alternatives to tax invoices in respect of the supply of insurance and related intermediary services
- Approval to issue recipient-created tax invoices, debit and credit notes

Ruling

This ruling constitutes a BGR issued under section 89 of the Tax Administration Act 28 of 2011.

Time of supply

Insurance An insurance policy, renewal notice or endorsement that does not notify the insured of an obligation to make payment is not regarded as an invoice and will therefore not trigger the time of supply. In instances where the insurer (or its intermediary) does not issue an 'invoice', the supply of insurance is deemed to be on the date the insurer (or the insurer's intermediary) receives the insurance premium in respect of that supply.

International transport insurance

The supply of insurance under any inbound or outbound insurance policy, including insurance cover during periods in which 'ancillary transport services'1 are supplied, may be zero-rated under section 11(2)(d).

Stock throughput insurance

The supply of stock throughput insurance is regarded as international transport insurance o the extent that insurance cover is provided in respect of goods transported from an export country to South Africa (and vice versa) as part of an international journey.

Insured goods transported or stored in South Africa

The supply of insurance under a stock throughput policy which provides cover for insured goods whilst the goods are transported between places in South Africa (including periods during which 'ancillary transport services' are supplied in respect of those goods) is subject to VAT at the zero rate under section 11(2)(d). The zero-rating is only applicable if the transport service (including any 'ancillary transport services') is supplied by the same supplier providing the international transport services as envisaged by section 11(2)(c).

Insured goods in South Africa but not transported or stored

Insurance cover provided while insured goods are in South Africa and not being transported (or stored) as part of an international journey does not qualify for zerorating under section 11(2)(d).

Single insurance premium

Insurers that levy a single premium in respect of the single supply of stock throughput insurance relating to both standard and zero-rated supplies are, under section 8(15), required to allocate the premium to the various risk components which were used to determine the premium and to apply the applicable VAT rate to each component. The same ratio must be used in respect of subsequent adjustments to the premium, unless the insurer can determine the allocation more accurately. The insurer is required to notify the insured and, where applicable, the intermediary of the original allocation of the premium between the standard and zero-rated portions as well as any subsequent adjustments in respect thereof. The insurer is required to retain proof of such notification.

Hull insurance

The supply of hull insurance is regarded as a service provided in connection with the operation or management of a 'foreign-going aircraft' or 'foreign-going ship', and may therefore be zero-rated under section 11(2)(h)(ii) if supplied directly (that is, not through an agent or other person) to a non-resident that is not a vendor. The temporary presence of the underlying insured foreign-going ship or aircraft in South Africa will not disqualify the supply from being zero-rated.

Insurance cover for fixed property situated in an export country

Insurance is regarded as being supplied directly in connection with the insured land, or any improvement to it, situated in an export country and is therefore subject to VAT at the zero rate under section 11(2)(f).

Insurance cover for movable property situated in an export country

Insurance is regarded as being supplied directly in respect of the insured movable property and is subject to VAT at the zero rate under section 11(2)(g)(i), provided that the insurer obtains and retains proof that the movable property is situated outside South Africa during the period for which the insurance cover is provided. Such proof may be reflected in the insurance contract or a declaration provided by the insured. The temporary presence of the movable property in South Africa will not disqualify the supply of insurance relating to the property from being zero-rated.

Excess payments

Insured pays excess directly to third party supplier

The third party supplier must issue two tax invoices, that is, one to the insured to the extent of the excess payment and one to the insurer to the extent of the trade payment.

Insurer pays full amount to third party service provider and recovers excess from insured

An excess payment received by an insurer from the insured does not constitute 'consideration' as the payment is not received in respect of any taxable supply made by the insurer. The insurer is, however, required to

issue documentation to the insured in respect of the receipt of the excess payment which must include the following minimum information:

- The insurer's name, VAT registration number and address.
- The insured's name, VAT registration number (where applicable) and address.
- The third party supplier's name and VAT registration number (where applicable).
- A full description of the goods or services supplied by the third party service provider.
- The date on which the supply was made by the third party service provider.
- The amount of the excess paid or payable by the insured reflecting either the VAT amount separately or a statement that the amount payable includes VAT and the rate at which VAT was charged.

The insurer is, under section 16(3)(a), entitled to deduct input tax on the goods or services acquired from the third party supplier. The deduction must be calculated as follows:

(Total VAT inclusive amount paid to the third party supplier less excess received from insured) × tax fraction.

The insured may deduct the VAT incurred in relation to the excess payment made to the insurer. The deduction is calculated as follows:

Excess payment × tax fraction.

Decision made under section 72

A decision is hereby made under section 72 to regard the document referred to above, which is issued by the insurer to the insured in respect of excess received or due to be a 'tax invoice' for the purposes of section 16(2)(a). This arrangement is only applicable if:

(i) the insured is a registered vendor;

(ii) the third party supplier is a registered vendor; and

(iii) the insured and insurer obtains and retains the document issued by the insurer in respect of the excess payment.

Indemnity payments

The input tax deduction allowed under section 16(3)(c) applies not only to indemnity payments made in respect of 'indemnity insurance' cover, but also in respect of 'nonindemnity insurance' such as personal accident and third party liability cover that may be included in an insurance policy. An insurer making an indemnity payment which gives rise to a deduction under section 16(3)(c) must issue a document to the insured informing the insured of a potential output tax liability that may arise under section 7(1)(a) read with section 8(8). This requirement applies irrespective of whether the insured is a vendor or not.

Recoveries

An insurer is not liable to account for output tax on amounts recovered from a third party or the third party's insurer under a subrogation claim, irrespective of whether the whole or only a portion of the claim is recovered.

Group personal accident insurance

Insurer

An insurer may deduct VAT under section 16(3)(c) in respect of indemnity payments made to the insured under group personal accident insurance.

Employer acting as principal

An employer, being a vendor, may deduct input tax in respect of the taxable supply of group personal insurance acquired to the extent it is acquired for the purpose of making taxable supplies. Any indemnity payments received by the employer (as principal) under a contract of insurance will result in the employer being liable to account for output tax under section 8(8). The employer will not be entitled to deduct any VAT in respect of amounts

subsequently paid to the employee.

Employer acting as agent on behalf of employees

The employer, when acting as the agent of its employees in entering into a group personal accident insurance contract with an insurer, will not be entitled to deduct input tax in respect of that contract. The employer will not be required to account for output tax under section 8(8) if the employee receives an indemnity payment from the insurer, irrespective of whether the payment is made through the employer or directly to the employee.

Intermediary services

The zero rate may be applied to services consisting of the arranging of:

- the insurance of goods or passengers transported internationally under section 11(2)(d); or
- hull insurance in respect of a foreign-going aircraft or ship under section 11(2)(i)(ii) if the arranging service is supplied to a non-resident who is not a vendor.

An intermediary arranging stock throughput insurance may however only zero rate the supply of intermediary services to the extent that the underlying stock throughput insurance qualifies for zero-rating under section 11(2)(d).

Tax invoices, credit and debit notes

Supply of insurance

SARS directs, under section 20(7)(a) and 21(5)(a), that the policy document, although not an invoice, is regarded as a tax invoice, debit note and credit note which need not contain the words 'tax invoice', 'VAT invoice', 'invoice', 'debit note' and 'credit note' provided:

- the insurer retains proof that the insured paid premiums in accordance with the policy document; and
- the policy document reflects all the other information as required by section 20(4); and

- the policy document contains the following statement (or substantially similar wording):

  'In terms of Binding General Ruling 14 this document constitutes a tax invoice, debit note and credit note as contemplated in sections 20(7)(a) and 21(5)(a) of the VAT Act.'

Supply of intermediary services

SARS directs, under sections 20(7)(a) and 21(5)(a), that the document (generally known as a bordereau) issued by the intermediary to the insurer in respect of the supply of intermediary services does not have to contain the words 'tax invoice', 'VAT invoice', 'invoice', 'credit note' or 'debit note' (as the case may be). However, the bordereau must reflect the other information as prescribed in sections 20(4) and 21(3) respectively.

Recipient-created tax invoices, credit and debit notes

An insurer that is required to determine the consideration payable in respect of intermediary services may, under sections 20(2) and 21(4), issue recipient-created tax invoices, credit or debit notes in respect of the supply of intermediary services.

This approval is subject to:

- the recipient-created tax invoice, credit or debit note complying with sections 20(4), (5), 21(3) or the special approval set out in 2.12, as applicable; and
- the insurer complying with all other requirements listed in Interpretation Note 56 'Recipient-created tax invoices, credit and debit notes'.

In addition, permission is granted under sections 20(7)(a) and 21(5)(a) that the bordereau issued by the insurer to the intermediary in respect of the supply of intermediary services does not have to contain the words 'tax invoice', 'VAT invoice', 'invoice', 'credit note' or 'debit note' (as the case may be).

Conditions

Zero-rating

The zero-rating of supplies contained in this BGR is conditional upon the insurer and intermediary (as applicable) obtaining and retaining the documentary proof as provided for under section 11(3) read with Interpretation Note 31 'Documentary Proof Required for the Zero-Rating of Goods and Services' (Interpretation Note 31). Failure to obtain and retain the required documentary proof within the required time period will result in the vendor being required to make the relevant adjustments as stipulated in Interpretation Note 31.

Input tax and other deductions

The statements contained in this BGR regarding input tax and other deductions are conditional upon the vendor obtaining and retaining the documentary proof contemplated in section 16(2) (including the bordereau) by the time the relevant VAT return is submitted. The deductions are subject to section 16 and 17. Failure to obtain and retain the required documentary proof will result in the vendor not being entitled to make the deduction.

10.2. Wear & Tear or depreciation allowance – No. 7 (Issue 3)

For the purposes of this ruling:

- 'allowance' means the wear-and-tear or depreciation allowance granted under section 11(e); and
- 'qualifying asset' means machinery, plant, implements, utensils and articles qualifying for the allowance;

Purpose

This BGR reproduces the parts of Interpretation Note 47 (Issue 4) 'Wear-and-Tear or Depreciation Allowance' dated 24 March 2020 that comprise a BGR under section 89 of the Tax Administration Act.

Background

The Note is a BGR on section 11(e) in as far as it relates to:

- the determination of the value of an asset for purposes of section 11(e) (paragraph 4.2 of the Note); and
- the determination of the amount that will qualify as an allowance (paragraph 4.3 and the Annexure of the Note).

Ruling

The following parts of the Note, which comprise a BGR, are reproduced in the Annexure:

- Paragraph 4.2 – Value of an asset for purposes of section 11(e).
- Paragraph 4.3 – Policies on the determination of the amount of the allowance.
- Annexure – Schedule of write-off periods acceptable to SARS.

10.3. *Timeframe for the export of goods by vendors and qualifying purchasers affected by the global Covid-19 pandemic – No. 52*

For purposes of this ruling:

- 'Export Regulations' means the regulations published in GN R.316 Government Gazette 37580 of 2 May 2014;
- 'IN 30' means Interpretation Note 30 (Issue 3) dated 5 May 2014;
- 'direct exports' means an export in terms of which any vendor consigns or delivers the movable goods to the recipient in an export country, as contemplated in paragraph (a) of the definition of 'exported' in section 1(1), read with section 11(1)(a)(i) and (3) and IN 30;
- 'indirect exports' means an export in terms of which the qualifying purchaser or the qualifying purchaser's agent is responsible for exporting

the movable goods from the Republic as contemplated in paragraph (d) of the definition of 'exported' in section 1(1), read with section 11(1)(a)(ii) and (3) and the Export Regulations;

- 'Part One' refers to procedures prescribed under the Export Regulations for granting refunds to qualifying purchasers residing in, or conducting business in, export countries;
- 'Part Two Section A' refers to procedures prescribed under the Export Regulations for any vendor that elects to supply movable goods to a qualifying purchaser at the zero rate, when the goods are initially delivered to a harbour or airport, being a designated commercial port, or supplied by means of a pipeline or electrical transmission line in the Republic, before being exported;
- 'Part Two Section B' refers to procedures prescribed under the Export Regulations for any vendor that elects to supply movable goods to a qualifying purchaser at the zero rate, when the goods are to be exported by way of road or rail; and
- 'qualifying purchaser' is as defined in the Export Regulations and generally refers to a person that is not a resident

Purpose

This BGR extends, under the circumstances in 3, the prescribed periods to:

- export movable goods;
- apply for a refund from the VAT Refund Administrator; and
- obtain the relevant documentary proof of export,

stipulated in the Export Regulations and IN 30 respectively.

Background

The Export Regulations and IN 30 respectively prescribe the time periods to export movable goods, apply for a refund from the VAT Refund Administrator and obtain the relevant documentary proof of export.

The Export Regulations and IN 30 respectively allow for an extension of the aforementioned time periods, where these periods cannot be met, because of circumstances beyond the control of the qualifying purchaser or the vendor.

These circumstances include a natural or human-made disaster, and a serious illness of the vendor, qualifying purchaser, or the person duly authorised to represent the qualifying purchaser.

In light of the COVID-19 pandemic, and the measures put in place by the President of the Republic, regarding the pandemic, qualifying purchasers and vendors will have a difficulty in meeting the aforementioned prescribed time periods set out in the Export Regulations and IN 30 respectively. This situation is considered to be beyond the control of the vendor, qualifying purchaser, or the person duly authorised to represent the qualifying person, as contemplated in the Export Regulations and IN 30 respectively.

Ruling

This ruling constitutes a BGR issued under section 89 of the Tax Administration Act insofar as it relates to the items listed under indirect exports to direct exports, and only applies to supplies of movable goods in respect of which, at the date of issue of this BGR, the original prescribed timelines referred to in the Export Regulations and IN 30 respectively, have not yet been exceeded.

Indirect exports

Time period to export movable goods under Part One

The time period prescribed under Regulation 3(a) of the Export Regulations to export movable goods is extended by an additional three months.

Time period to apply for a refund under Part One

The time period to apply for a refund prescribed in Regulation 3 of the Export Regulations, is extended to six months from the date of export, in respect of the circumstances contemplated in Regulation 6(a) of the Export Regulations.

Time period to export movable goods under Part Two Sections A and B

The time period to export movable goods prescribed under Regulation 15(1) and (2)(a) to (e) of the Export Regulations, is extended by an additional three months.

Direct exports

Time period to export movable goods under direct exports

The time period prescribed in paragraph 5 of IN 30, to export movable goods, is extended by an additional three months.

Period for which this ruling is valid

This BGR applies from date of issue and will apply until it is withdrawn, amended or the relevant legislation is amended.

10.4. Rule for the taxation of interest payable by SARS under section 7E (Income Tax) – No. 53

For the purposes of this ruling:

- "interest" means interest payable by SARS under a tax Act;
- "section" means a section of the Act;
- "TA Act" means the Tax Administration Act 28 of 2011; and
- "the Act" means the Income Tax Act 58 of 1962; and

Purpose

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

- a deemed accrual of interest occurs under section 7E on or after 1 March 2018; and
- before that date either the whole or a part of that interest was included in the taxpayer's gross income on the accrual basis.

Background

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

Section 7E was introduced to address the time of accrual of interest payable by SARS to a taxpayer.

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

Discussion

Taxpayers are required to include in their gross income for a year or period of assessment the total amount, in cash or otherwise, received by or accrued to them or in their favour, other than receipts or accruals of a capital nature but subject to specified inclusions, whether or not of a capital nature. Residents must account for their worldwide receipts or accruals while non-residents must account only for receipts or accruals from a source within South Africa. The general rule is that an amount is included in a taxpayer's gross income at the earlier of receipt or accrual and there is no right of election in this regard.

A consequence of the introduction of section 7E is that double taxation may arise if interest payable by SARS was included in gross income when it actually accrued based on general principles before the introduction of section 7E, and the same amount is included again in gross income in a subsequent year of assessment when it is deemed to accrue under section 7E.

Since there is a necessary implication against double taxation in a statute, the view is held that section 7E should not be interpreted as applying to interest that actually

accrued under general principles before 1 March 2018 and was included in gross income before that date.

A taxpayer that did not include interest in gross income that accrued under general principles before 1 March 2018 and which is paid by SARS on or after that date must include such interest in gross income in the year of assessment in which it is paid under section 7E. SARS will not seek to assess interest that actually accrued in earlier years of assessment in those earlier years if that interest was paid on or after 1 March 2018 and has been taxed as a deemed accrual under section 7E.

Ruling

For purposes of section 7E, interest paid to any person under a tax Act by SARS on or after 1 March 2018 must be included in that person's gross income to the extent that the amount has not previously been included in gross income when it actually accrued to the person under general principles.

A taxpayer bears the burden of proving that an amount of interest or a portion of such amount previously included in gross income corresponds with an amount of interest paid on or after 1 March 2018 such that section 7E will be interpreted as not applying to that amount or portion of that amount.

10.5. Unbundling of unlisted company: Impact of non-qualifying shareholders (Income Tax) – No. 54

For the purposes of this BGR:

- "non-qualifying shareholder" means a shareholder of the unbundling company that does not form part of the same group of companies as the unbundling company;
- "unbundled company" means the company whose equity shares are distributed to the shareholders of an unbundling company;
- "unbundling company" means the company that distributes all the equity shares it holds in an unbundled company to its shareholders; and

- "unbundling transaction" means an unbundling transaction as defined in section 46(1).

Purpose

This BGR provides clarity on what constitutes an unbundling transaction when an unbundling company having non-qualifying shareholders unbundles shares in an unlisted unbundled company.

Background

Section 46 provides roll-over relief when an unbundling company distributes all of its equity shares in an unbundled company to its shareholders under an unbundling transaction. The definition of "unbundling transaction" contains requirements relating to the unbundling company, unbundled company and shareholders of the unbundling company. This BGR examines the qualifying shareholders requirement in paragraph (a)(i)(bb) of the definition of "unbundling transaction" in the context of a resident unbundling company holding shares in a resident unlisted unbundled company. The applicable part of the definition reads as follows:

"46. Unbundling transactions.—(1) For the purposes of this section, 'unbundling transaction' means any transaction—

(a) (i) in terms of which the equity shares in a company (hereinafter referred to as the "unbundled company"), which is a resident that are held by a company (hereinafter referred to as the "unbundling company"), which is a resident, are all distributed by that unbundling company to any shareholder of that unbundling company in accordance with the effective interest of the shareholders in the shares of that unbundling company, and if—

(aa) all of the equity shares of the unbundled company are listed shares or will become listed shares within 12 months after that distribution;

(bb) that shareholder to which that distribution is made by that unbundling company forms part of the same group of

companies as that unbundling company; or

(cc) that distribution is made pursuant to an order in terms of the Competition Act, 1998 (Act No. 89 of 1998), made by the Competition Tribunal or the Competition Appeal Court; and"

Subitems (aa) and (cc) of the definition do not stipulate any shareholder requirements for the unbundling company when the shares in the unbundled company are listed or will be listed within 12 months after the distribution or when they are distributed pursuant to an order under the Competition Act. However, under subitem (bb) when the unbundled company is unlisted, the shareholder must be part of the same group of companies as defined in section 41 as the unbundling company.

The issue arises as to what effect the wording of subitem (bb) has on an unbundling transaction when the unbundling company has non-qualifying shareholders. More specifically, does the presence of non-qualifying shareholders mean the whole transaction or only part of it does not meet the definition of "unbundling transaction".

Discussion

The words in paragraph (a)(i) require the unbundling company to distribute all the shares it holds in the unbundled company to any shareholder of that unbundling company in accordance with the effective interest of the shareholders in the shares of that unbundling company. These words make it clear that the unbundling company may not retain any shares in the unbundled company and also contemplate that all holders of shares in the unbundling company must participate in the distribution in accordance with their effective interests. Such shareholders include all shareholders holding equity shares in the unbundling company regardless of the size of their holdings. The further requirement in subitem (bb) is that "that shareholder" to which "that distribution" is made must be part of the same group of companies as the unbundling company. This wording may create some uncertainty because the opening words contemplate all shareholders of the unbundling company while subitem (bb) contemplates only shareholders of the

unbundling company that form part of the same group of companies as the unbundling company.

The intention of subitem (bb) is to make the distribution to shareholders forming part of the same group of companies as the unbundling company an unbundling transaction, while excluding from an unbundling transaction distributions to shareholders not forming part of that group of companies. In other words, the presence of non-qualifying shareholders does not invalidate the entire unbundling transaction but only that portion relating to the non-qualifying shareholders. Consequently, the part of the distribution to the non-qualifying shareholders must be dealt with outside section 46 under general principles, while the part of the distribution to shareholders forming part of the same group of companies as the unbundling company must be dealt with under section 46, assuming the other requirements of that section are met.

The exact tax treatment for the unbundling company and its non-qualifying shareholders, for the part of the distribution to the non-qualifying shareholders, will depend on the facts of the particular case but is generally likely to be as follows for a resident unbundling company and its resident non-qualifying shareholders:

- If the unbundling company holds the shares on capital account, or as trading stock but the shares have been held for at least three years and section 9C(2) applies, it must determine a capital gain or loss under paragraph 75(1)(a) on the portion of the unbundled company shares disposed of to the non-qualifying shareholders, with the proceeds being equal to the market value of the unbundled company shares on the date of distribution. Alternatively, if the shares in the unbundled company are held as trading stock falling outside section 9C(2), the market value of the equity shares distributed to the nonqualifying shareholders must be included in the income of the unbundling company under section 22(8), with the cost price of the unbundled company shares being deducted under section 11(a) (if acquired in the same year of assessment as the disposal) or section 22(2) (opening stock). In addition, a distribution taking the form of a dividend in specie will potentially result in the imposition of dividends tax on the

unbundling company, subject to any applicable exemptions in section 64FA.

- Resident non-qualifying shareholders holding their unbundling company shares as capital assets or as trading stock but the shares have been held for at least three years and section 9C(2) applies, must include the distribution in gross income if it takes the form of a dividend and consider whether it qualifies for exemption under section 10(1)(k). If in the form of a return of capital, the distribution must be dealt with under paragraph 76B by reducing the base cost of the unbundling company shares and treating any excess as a capital gain. The base cost of the unbundled company shares will be established under paragraph 75(1)(b), being equal to their market value on the date of distribution.
- Resident non-qualifying shareholders holding their unbundling company shares as trading stock falling outside section 9C(2) must include the distribution in their gross income, regardless of whether the distribution takes the form of a dividend or a return of capital. If the distribution takes the form of a dividend, it may be exempt from normal tax under section 10(1)(k). If the unbundled company shares are acquired as trading stock, they will have a cost price under section 22(4) equal to the current market price on the date of acquisition. For purposes of paragraph 20(1) the unbundled shares will have an expenditure determined under paragraph 75(1)(b) equal to their market value on the date of distribution. Resident non-qualifying shareholders that have included a return of capital in gross income will not be required to reduce the expenditure incurred in respect of their shares in the unbundling company under paragraph 76B.
- The distribution to non-qualifying shareholders will not qualify for the exemption from securities transfer tax available for an unbundling transaction referred to in section 46 which is provided for in section 8(1)(a)(iv) of the Securities Transfer Tax Act 25 of 2007.

Paragraph (a)(i) of the definition of “unbundling transaction” does not require other

holders of shares in the unbundled company, that is, shareholders other than the unbundling company, to distribute their shares.

Ruling

When an unbundling company distributes unlisted unbundled company equity shares to a company forming part of the same group of companies as the unbundling company as well as to non-qualifying shareholders, the distribution to shareholders forming part of the same group of companies as the unbundled company will comprise an unbundling transaction, while the distribution to the non-qualifying shareholders will not comprise an unbundling transaction.

11. GUIDES

11.1. Guide on Mutual Agreement Procedures (Issue 3)

This is a general guidance on the mutual agreement procedure (MAP) that allows competent authorities from the governments of contracting jurisdictions to interact with the intent to resolve international tax disputes.

DTAs or tax treaties, as they may be referred to, are international agreements between the governments of two jurisdictions aimed at eliminating double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance. Most tax treaties typically include the following broadly defined sections:

- A preliminary part on the scope of the tax treaty, for example, setting out the taxes on income and capital covered in the tax treaty and defining terms used.
- The main part of the tax treaty that settles the extent to which each of the contracting jurisdictions may tax income, that is determined based on the different types of income and whether the jurisdiction is a source jurisdiction or resident jurisdiction. It further determines how double taxation is to be eliminated.

- A key part on special provisions such as the MAP article, which establishes the mutual agreement procedure for eliminating double taxation and resolving conflicts of interpretation of the tax treaty.
- Finally, a part on the implementing provision such as the entry into force and termination provision of the tax treaty.
- Tax treaties concluded between South Africa and other jurisdictions generally contain Article 25 on MAP based on the Convention. The Convention is an OECD model tax treaty, which has been developed by the OECD. Article 25 of the Convention provides that the competent authorities shall endeavour, by mutual agreement, to resolve the situation of taxpayers subjected to taxation not being in accordance with the provisions of the Convention. It also invites and authorises the competent authorities of the two jurisdictions to resolve, by mutual agreement, problems relating to the interpretation or application of the Convention and, furthermore, to consult together about the elimination of double taxation in cases not provided for in the Convention.

Article 25, in treaties that provide for MAP, is aimed at resolving disputes arising from juridical and economic double taxation, as well as inconsistencies in the interpretation or application of a treaty. International juridical double taxation refers to the imposition of income taxes in two (or more) jurisdictions on the same taxpayer in respect of the same income. An example of juridical double taxation is when a resident of one jurisdiction derives income from sources in the other jurisdiction, and both jurisdictions' domestic tax legislation would tax that income. It can also arise when each jurisdiction considers the taxpayer to be resident in that jurisdiction under domestic tax laws. Transfer pricing cases are a good example of circumstances that may lead to economic double taxation. For example, a tax administration adjusts a price charged between related parties with a resulting tax charged on the additional income in the hands of one related party, where tax has already been charged in another jurisdiction on that same income in the hands of the other related party.

With regards to the practical operation of the MAP procedure, Article 25 authorises the competent authorities to communicate with each other directly, without going through the diplomatic channels. Article 26 of the Convention applies to the exchange of information for the purposes of the provisions of this Article. The confidentiality of information exchanged for the purposes of an MAP is thus ensured. The South African DTAs and Protocols can be accessed through the path www.sars.gov.za > Legal Counsel > International Treaties & Agreements > Double Taxation Agreements & Protocols.

<u>What is a mutual agreement procedure?</u>

Generally, in South African DTAs, Article 25 of the Convention provides a remedy for a taxpayer that considers that the actions of one or both of the contracting jurisdictions result or will result in taxation of the taxpayer not in accordance with the provisions of the tax treaty. The taxpayer may, irrespective of the remedies provided by the domestic law of the jurisdictions, present its case in the first instance to the competent authorities of the jurisdiction of residence. The taxpayer may also present its case to both competent authorities of both jurisdictions. The taxpayer should notify both competent authorities that it submitted the MAP request to the competent authority of the applicable jurisdiction. The MAP article in the DTA empowers the competent authority to consider the taxpayer's case and to resolve the case by mutual agreement. This is a process of consultation, not litigation, between the two competent authorities. The taxpayer is not a party to this process, but is invited to participate informally, by providing all required information. If there is no DTA between South Africa and the other jurisdiction, there can be no mutual agreement procedure.

Article 25 of the Convention, in summary, consists of the following paragraphs:

- Paragraph 1 – Makes available to taxpayers a MAP when taxation is not in accordance with the Convention, without depriving them of the ordinary legal remedies available. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

- Paragraph 2 – A MAP case that has been accepted will only move to the second, bilateral state of the MAP if it meets two requirements, namely:
    - the taxpayer's objection to the competent authority to which it has been presented appears to be justified, for example, if the taxation contrary to the provisions of the Convention is due in whole or in part to a measure taken in the jurisdictions to which the taxpayer has presented its MAP case; and
    - that competent authority is not able to arrive at a satisfactory unilateral solution.
- Paragraph 3 – Provides for competent authorities to resolve, if possible, difficulties of interpretation or application of the treaty by means of mutual agreement.
- Paragraph 4 – Determines how the competent authorities may consult each other for the resolution by mutual agreement, either of an individual case coming under the procedure defined in paragraphs 1 and 2 or of general problems relating in particular to the interpretation or application of the Convention. It authorises competent authorities to communicate with each other directly without going through the diplomatic channels.
- Paragraph 5 – Provides for an arbitration process in cases where competent authorities are unable to reach an agreement.

The MAP is a special procedure that complements domestic dispute resolution procedures. It follows that it can be set in motion solely in cases where tax has been charged, or is going to be charged, despite the provisions of the Convention.

A MAP article provided for in a treaty then allows competent authorities from the governments of the contracting jurisdictions to interact with the intent to endeavour to resolve international tax disputes if the objection appears to be justified. The determination of whether the objection appears to be justified, requires the competent authority to which the case was presented to make a preliminary assessment of the taxpayer's request in order to determine whether the taxation in

both contracting jurisdictions is consistent with the terms of the Convention.

The purpose is to ensure that taxpayers entitled to the benefits of the Convention are not subject to taxation by either of the contracting jurisdictions that is not in accordance with the terms of the Convention.

If the competent authority approached by the taxpayer determines that the complaint is justified and considers that the taxation complained of is due wholly or in part to a measure taken in that jurisdiction, it must make such adjustments or allow such relief as appears to be justified. In this situation, the issue can be resolved without moving beyond the first (unilateral)

stage of the MAP. However, if it appears to that competent authority that the taxation complained of is due wholly or in part to a measure taken in the other jurisdiction, it will set in motion the second (bilateral) stage of MAP and submit the case to the competent authority of the other jurisdiction. A MAP case for this purpose is not considered to include a request for an APA and does not include a 'protective' MAP filing.

Typical examples of taxation not in accordance with a tax convention when a taxpayer may make a MAP request include the following:

- A taxpayer is considered to be a resident of two treaty countries under each jurisdiction’s domestic law, and each jurisdiction claims that the taxpayer is a resident of its jurisdiction for purposes of the tax Convention, which could lead to the taxpayer being liable for tax in both countries on the same income.
- Withholding tax is levied beyond what is allowed within an applicable tax Convention by one treaty jurisdiction on a payment to a resident of the other jurisdiction.
- A taxpayer subject to tax as a resident in one jurisdiction on income, including income from carrying on a business in the other treaty jurisdiction, is taxed in terms of that other treaty on the business income earned there, despite not having a permanent establishment in that jurisdiction under the

tax Convention.

- A taxpayer operating a branch in one treaty jurisdiction is subject to additional tax because of an adjustment by that treaty jurisdiction of the income allocated to the branch.
- A taxpayer is subject to additional tax in one jurisdiction because of a transfer pricing adjustment to the price of goods or services transferred to or from a related party in the other jurisdiction.

A taxpayer can also contact the competent authority for clarification as to the interpretation and application of a Convention.

A MAP article in a DTA does not compel competent authorities to actually reach an agreement and resolve a tax dispute. Competent authorities are obliged only to use their best endeavours to reach an agreement. Arbitration will only be available if the relevant treaty allows arbitration.

In seeking mutual agreement, the competent authorities must first determine their position in light of the rules of their respective taxation laws and the provisions of the Convention, which are as binding on them as much as they are binding on the taxpayer. While the status under domestic law of a mutual agreement reached pursuant to Article 25 may vary between jurisdictions, the principles of international law for the interpretation of treaties, as embodied in Articles 31 and 32 of the Vienna Convention of the Law of Treaties (1961), allow domestic courts to take account of such an agreement.

The MAP is available to the taxpayer in addition to the normal legal remedies under the domestic law. Mutual agreements resolving general difficulties of interpretation or application are binding on administrations as long as the competent authorities agree not to modify or rescind the mutual agreement. If a domestic court reached a decision in the case at issue, the competent authority is bound by the decision of the domestic court (and may not provide unilateral relief).

South Africa, amongst other countries, endorsed the OECD/G20 BEPS Action Plan that identified 15 Action Items to address BEPS in a comprehensive manner. BEPS refers to tax avoidance strategies that exploit gaps and mismatches in tax

rules to artificially shift profits to low or no-tax locations. Under the inclusive framework, over 100 countries and jurisdictions are collaborating to implement the BEPS measures and tackle BEPS. Recognising that the actions to counter BEPS must be complemented with actions to ensure certainty and predictability for business, one of the BEPS actions includes the Making Dispute Resolution Mechanisms More Effective, Action 14 – 2015 Final Report (the Action 14 Report).

The minimum standard in the Action 14 Report consists of three core elements, namely, to ensure:

- that treaty obligations related to the MAP is fully implemented in good faith and that MAP cases are resolved in a timely manner;
- the implementation of administrative processes that promote the prevention and timely resolution of treaty-related disputes; and
- that taxpayers can access the MAP when eligible.

Through the adoption of the Action 14 Report, countries have agreed to important changes in their approach to dispute resolution by implementing a minimum standard to ensure that they resolve treaty-related disputes in a timely, effective and efficient manner. Jurisdictions also committed to have their compliance with the minimum standard reviewed by their peers. The peer review and monitoring are conducted with all OECD and G20 countries and any committed jurisdictions participating in this work on an equal footing. The first peer reviews commenced in December 2016.

Legal basis for mutual agreement procedure

The National Executive may, under section 108(1), enter into an agreement with the government of any other jurisdiction. These agreements are made with such government with a view to the prevention, mitigation or discontinuance of the levying, under the laws of South Africa and of such other jurisdiction, of tax in respect of the same income, profits or gains, or tax imposed in respect of the same donation. An agreement is further entered into for the rendering of reciprocal assistance in the administration of and the collection of taxes under the laws of

South Africa and of such other jurisdiction.

Under section 108(2), approval of Parliament of an agreement, as contemplated in section 231 of the Constitution of the Republic of South Africa, 1996 (Constitution), must be obtained and the agreement will have effect as if enacted in the Act upon publication in the Government Gazette. Section 108(1) read with section 231 of the Constitution therefore provides that as soon as the DTA is ratified and has been published in the Government Gazette, its provisions are effective as if they had been incorporated into the Act. It follows that Articles in DTAs therefore become part of South Africa's domestic law.

DTAs generally contain an article on MAP. In interpreting the MAP Article, reference should be made to the Convention read with the OECD Commentaries on the concept used in the Convention and the UN Guide to the Mutual Agreement Procedure under Tax Treaties. Reference is also made in this guide to the Manual on Effective Mutual Agreement Procedures (MEMAP) and the Action 14 Report, which are available to both tax administrators and taxpayers on the OECD website. The Action 14 Report provides basic information on the operation of MAP under bilateral tax treaties and to identify best practices for MAP.

Multilateral Instrument

The 'Multilateral Instrument' or 'MLI' is intended to transpose results from the OECD/G20 BEPS Project into more than 3 000 treaties worldwide. It will implement minimum standards to counter treaty abuse and to improve dispute resolution mechanisms while providing flexibility to accommodate specific tax treaty policies. It will also allow governments to strengthen their tax treaties with the other tax treaty measures developed in the OECD/G20 BEPS Project.

The substance of these tax treaty-related BEPS measures was agreed upon as part of the final BEPS Package approved by the OECD's Committee on Fiscal Affairs and endorsed by G20 Leaders in November 2015. Recognising that bilaterally renegotiating each of the more than 3 000 worldwide tax treaties would take years, if not decades, one of the other items in the Package (Action 15) called for the development of a multilateral instrument to swiftly modify bilateral tax

treaties to implement BEPS tax treaty-related measures.

On 24 November 2016, the members of the adhoc Group on the Multilateral Instrument concluded the negotiations on the text of the Multilateral Instrument. Article 16 of the Multilateral Instrument contains the wording of the MAP article, that is, one of the treaty-related minimum standards that was agreed as part of the Final BEPS package. Jurisdictions can therefore, through the adoption of the Multilateral Instrument, modify the bilateral tax treaties in instances where the wording of Article 25 of the treaty is not in line with the wording of the agreed minimum standards to improve dispute resolution mechanisms under the Action 14 Report. South Africa is also a signatory and party to the Multilateral Instrument, which will take effect for South Africa’s treaties once ratified.

A party to the Multilateral Instrument may reserve the right not to apply certain specific sentences of Article 16 of the Multilateral Instrument. More information on the Multilateral Instrument can be accessed on the OECD website.

<u>The role of a competent authority</u>

DTAs or treaties are usually concluded between the governments of two or more countries. These countries are then referred to as the contracting jurisdictions to such an agreement. The term 'competent authority' is used in DTAs and in the Multilateral Instrument to identify a position, person or body within a contracting jurisdiction to whom issues may be addressed.

The role of the competent authority includes the exchange of information and providing assistance in collection of taxes based on the following exchange instruments: DTAs, Tax Information Exchange Agreements (TIEAs) and multilateral treaties. The competent authority is further charged with the responsibility to interact with its counterparts in any matters arising between the different contracting jurisdictions pertaining to the interpretation or the application of a DTA, and to resolve any international tax disputes that might arise. A competent authority is generally committed to ensure a good faith application of DTAs. The competent authority endeavours to resolve requests from its counterparts in accordance with the provisions of a particular DTA’s Article on

MAP.

The competent authority in South Africa is SARS and MAP duties have been delegated to designated representatives. These designated representatives have the authority to endeavour to resolve MAP cases and are committed to timely implementation of agreements reached, based on the objective and consistent application of treaty provisions to the specific facts and circumstances of a taxpayer's case. In resolving a MAP case, the designated representatives do not require the approval or direction of the tax administrative personnel who made the adjustments at issue to resolve the MAP case, and they are not influenced by considerations of the policy that the jurisdiction would like to see adopted and reflected in future amendments to treaties. The designated representatives may, however, consult with the tax administration personnel in order to obtain an understanding of the issues at hand.

South Africa mutual agreement procedure profile and website

Jurisdictions' MAP profiles can be found on a shared public platform on the OECD website, which provides the competent authority or duly authorised representatives contact details, links to domestic MAP guidance and other useful jurisdiction-specific information regarding the MAP process. The MAP profile is updated by the revenue authorities from time-to-time. The competent authority also notifies the treaty partners of administrative or statutory processes and expressly addresses the effects of those processes with respect to the MAP in its public guidance and provides a link to such guidance on its MAP profile.

12. INDEMNITY

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