TAX UPDATE

For period: July 2020 to September 2020

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1. INTRODUCTION

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

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

Please take some time and consider the tax cases.

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

Enjoy reading on!

2. MEDIA STATEMENT – UPDATE ON THE FILING SEASON (PIT)

1 AUGUST - 31 AUGUST: Filing of returns commence through any of the SARS eChannels, namely eFiling website and MobiApp.

1 SEPTEMBER 2020 - 16 NOVEMBER 2020: Taxpayers who require assistance may call for assistance from our Contact Centres for completing their tax returns with the assistance of an agent.

22 OCTOBER 2020: This is the closing date for taxpayers who elect to file at a SARS office.

16 NOVEMBER 2020: This is the closing date for taxpayers who file online using the eFiling website and MobiApp.

29 JANUARY 2021: This is the final date for Provisional Taxpayers to fulfil all their outstanding filing obligations.

3. MEDIA STATEMENT – PUBLICATION OF THE 2020 DRAFT TAX BILLS

PUBLICATION OF THE 2020 DRAFT TAX BILLS, DRAFT REGULATIONS PRESCRIBING ELECTRONIC SERVICES, VENTURE CAPITAL COMPANY SURVEY TO GIVE EFFECT TO 2020 BUDGET AND EXTENSION OF SOME COVID-19 RELIEF TAX MEASURES

The National Treasury and the South African Revenue Service (SARS) published on 31 July 2020, for public comment, the 2020 draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (2020 draft Rates Bill), the 2020 draft Taxation Laws Amendment Bill (2020 draft TLAB), the 2020 draft Tax Administration Laws Amendment Bill (2020 draft TALAB) and the draft Regulations Prescribing Electronic Services. The 2020 draft Rates Bill was first published on

Budget Day (26 February 2020) but is published for the second time in order to solicit any public comments on the tax proposals contained therein. These draft Tax Bills contain tax proposals made in the 2020 Budget on 26 February 2020.

The draft TLAB and TALAB also include the proposed introduction of an export tax on scrap metals (i.e. ferrous metals, aluminium, red metals and other waste and scrap metals) at the rates as was announced in the 2020 Budget to replace the current price preference system. The proposed export tax rates as recommended by ITAC are shown in the table below.

Scrap metal category	**Equivalent specific tax (Rands per tonne)**
Ferrous metals (including stainless steel)	R1 000 per tonne
Alluminium	R3 000 per tonne
Red metals	R8 426 per tonne
Other (waste and scrap metals)	R1 000 per tonne

These draft Bills are separate from the COVID-19 Tax Bills, which were introduced in Parliament on 24 June 2020 and dealt with exceptional tax measures required to combat the COVID-19 pandemic. This is because the COVID-related lockdown took place after the Budget, and hence the subsequent tax announcements related to COVID are dealt with in separate bills. The draft Tax Bills will be introduced in Parliament later this year. The Notice on Regulations Prescribing Electronic Services will be published in the Government Gazette after taking into account public comments to be received.

For legal reasons, the draft tax amendments continue to be split into two types of bills, namely a money bill (section 77 of the Constitution) dealing with money bill issues and an ordinary bill (section 75 of the Constitution) dealing with issues relating to tax administration.

After receipt of written comments, National Treasury and SARS normally engage with stakeholders through public workshops to discuss the written comments on the draft Tax Bills. However, due to the national lockdown regulations as a result of the COVID19 pandemic, further information will be provided on the manner and platform of public engagement for purposes of discussing the written comments. The Standing Committee on Finance (SCoF) and the Select Committee on Finance (SeCoF) in Parliament are expected to make a similar call for public comment and convene public hearings on the 2020 draft TLAB and TALAB before their formal introduction in Parliament. Thereafter, a response document on the comments received will be presented at the parliamentary committee meetings, after which the draft bills will then be revised, taking into account public comments and recommendations made during committee hearings, before they are tabled formally in Parliament for its consideration.

The 2020 draft Rates Bill contains tax announcements made in Chapter 4 and Annexure C of the 2020 Budget Review that deal with changes to the rates and monetary thresholds and increases of the excise duties. The 2020 draft TLAB and TALAB provide the necessary legislative amendments required to implement the more complex tax announcements made in Chapter 4 and Annexure C of the 2020 Budget Review (and not dealing with a simple change in a rate or threshold of a tax) that requires greater consultation with the public.

Key tax proposals contained in the 2020 draft Rates Bill include the following:

- Changes in rates and monetary thresholds to the personal income tax tables
- Adjustment of transfer duty rates to support the property market
- Increases of the excise duties on alcohol and tobacco

Key tax proposals contained in the 2020 draft TLAB include the following:

- Proposed introduction of export taxes on scrap metals
- Tax measures required as a result of the modernisation of the foreign exchange control system

- Aligning the carbon fuel levy adjustment with the Carbon Tax Act
- Allowing a carbon tax 'pass through' for the regulated liquid fuels sector
- Addressing an anomaly in the tax exemption of employer provided bursaries
- Clarifying rollover relief for unbundling transactions
- Consequential amendments as a result of 2019 changes to section 72 of the VAT Act

Key tax proposals contained in the 2020 draft TALAB include the following:

- Amendments enabling the proposed introduction of an export tax on scrap metals
- Removal of the requirement to prove intent with regard to certain offences listed in the Fourth Schedule to the Income Tax Act, the Value-Added Tax Act and the Tax Administration Act
- Refusal to authorise a refund where returns are outstanding under the Skills Development Levies Act and the Unemployment Insurance Contributions Act
- Withholding of a refund pending a criminal investigation
- Estimated assessments where relevant material requested by SARS has not been supplied

Key tax proposals contained in the draft Regulations Prescribing Electronic Services include the following amendments to the definition of 'telecommunication services'.

Venture Capital Company (VCC) survey:

- All VCCs registered with SARS as at 1 March 2020 are requested to submit to the Minister of Finance information prescribed in the survey as mandated in terms of section 12J(10) of the Income Tax Act, 1962. The information will be considered in determining the extent to which the VCC tax incentive

contributes towards Government's policy objectives of facilitating funding for small businesses that cannot obtain financing from financial institutions, economic growth and job creation. This follows the announcement in Annexure C of the Budget Review 2020 that Government will review the effectiveness, impact and role of this regime to ascertain whether the incentive should be discontinued.

The 2020 draft Tax Bills, the accompanying draft Explanatory Memoranda containing a comprehensive description of the proposed tax amendments contained in the 2020 draft TLAB and TALAB, the draft Regulations Prescribing Electronic Services and the VCC survey can be found on the National Treasury (www.treasury.gov.za) and SARS (www.sars.gov.za) websites. More general information underlying the changes in rates, thresholds or any other tax amendments can be found in the 2020 Budget Review, available on the National Treasury website.

Extension of some COVID-19 Tax Relief measures contained in the COVID-19 Tax Bills

On 24 June 2020, the Minister of Finance tabled the COVID-19 Tax Bills before Parliament for consideration. The COVID-19 Tax Bills provide the necessary legislative amendments required to implement the tax measures to combat the COVID-19 pandemic, following announcements by the Minister of Finance on 29 March 2020, 23 April 2020 and 24 June 2020 in the 2020 Supplementary Budget. The measures in the COVID-1 Tax Bills are proposed to take effect on 1 April 2020 and 1 May 2020 and apply for a limited period of four months, ending on 31 July 2020 and 31 August 2020, respectively. The COVID-19 tax measures proposed in the COVID-19 Tax Bills are over and above the tax proposals made in the 2020 Budget on 26 February 2020 that are contained in the 2020 draft Rates Bill and the 2020 draft TLAB and TALAB that are published today for public comment.

After careful consideration of the written public comments, and presentations made by the stakeholders during the public hearings convened by the SCoF and SeCoF in Parliament on 22 July 2020 on the COVID-19 Tax Bills, as well as the potential

impact on the fiscal framework that has been approved by Parliament, the Minister of Finance will, in terms of the Money Bills Amendment Procedure Act where necessary, make a request to the SCoF for the extension of the following COVID-19 tax relief measures:

- Streamlined special tax dispensation for funds established to assist with COVID-19 disaster relief efforts
  - This tax relief provides a special tax exemption for COVID-19 relief funds for a period of four months from 1 April 2020 to 31 July 2020. It is proposed that the four month period be extended by two months to six months. As a result, this relief will cease to apply on 30 September 2020.
- Deferral of the payment of employees tax liability for tax compliant small to medium sized businesses
  - This tax relief permits tax compliant small to medium sized businesses to defer payment of 35% of the employees' tax they have deducted from their employees in the four months from 1 April 2020 to 31 July 2020. It is proposed that the four month period be extended by one month to five months. As a result of this extension, repayments on the deferred tax will now only begin in October 2020 and run through until March 2021.
- A 90 day deferral for the payment of excise taxes on alcohol and tobacco
  - This relief permits compliant businesses to defer the payment of excise taxes on alcohol and tobacco by 90 days in order to assist them in respect of payments to be made in May and June 2020. It is proposed that a 90 day deferral to assist compliant businesses in respect of payments of excise taxes on alcohol to be made in August and September of 2020 be introduced. It is proposed that the deferral in respect of payments of excise taxes on tobacco originally to be made in May and June 2020 be extended to 150 days. These deferrals will be effected through Customs and Excise

Act Rules to be published by SARS.

Additional tax proposals aimed at mitigating the effects of the COVID-19 pandemic, which have been made by commentators and are not included in the COVID-19 Tax Bills, will be considered based on their potential impact on the fiscal framework that has been approved by Parliament, amongst other criteria. In view of the fact that the tax impact of many of these additional tax proposals will be realised when taxpayers file their tax returns at the end of the year of assessment, it is proposed that any potential consideration of these additional tax proposals be accommodated in a second batch of the 2020 draft TLAB.

4. DRAFT EXPLANATORY MEMORANDUM ON THE DRAFT TAXATION LAWS AMENDMENT BILL, 2020

4.1. Income Tax: Individuals, Savings and Employment – Reimbursing employees for business travel

[Applicable provision: Section 8(1)(a)(ii) of the Income Tax Act, No. 58 of 1962 ('the Act')]

Background

The Act makes provision for advances or reimbursements paid by an employer to the employee in respect of meals and incidental costs, if the employee is obliged to spend a night away from home for business purposes, to be excluded from taxable income. This applies provided that the amount does not exceed the amount published by SARS by Notice in the Government Gazette, and the expenses were incurred in the furtherance of the employer's trade.

Further, if the employee is obliged to be away from the office on a day trip, advances or reimbursements paid by an employer to the employee in respect of meals and incidental costs are not subject to tax, if the employee can prove that they incurred these expenses on the instruction of the employer, in the furtherance of the employer's trade.

Reasons for change

At issue is where an employee is obliged to be away from the office on a day trip, and such employee purchases meals and incurs incidental costs (for example, purchases lunch, utilise an Uber or the Gautrain, utilise airport parking) in the furtherance of the employer's trade, but the employee has not been explicitly instructed by the employer to purchase meals and incur incidental costs. Due to the fact that the employee is not explicitly instructed by the employer to incur such expenses, the reimbursement is subject to tax in the employee's hands.

Proposal

In order to provide clarity on the tax treatment of the reimbursement of expenses incurred by the employee in respect of meals and incidental costs when the employee is obliged to be away from office on a day trip, it is proposed that changes are made to the legislation.

As such, if the employee is obliged to be away from the office on a day trip, the reimbursement of expenses incurred by the employee in respect of meals and incidental costs in the furtherance of the employer's trade should be excluded from taxable income in the hands of the employee. This will apply provided that the employer's policy makes provision for and allows such reimbursement. In addition, as with advances and reimbursements when the employee is obliged to spend a night away from home, the exclusion from taxable income will also apply provided that the amount does not exceed the amount published by SARS by Notice in the Government Gazette.

Effective date

The proposed amendments will come into operation on 1 March 2021 and apply in respect of years of assessment commencing on or after that date.

4.2. Income Tax: Individuals, Savings and Employment – Addressing an anomaly in the tax exemption of employer provided bursaries

[Applicable provisions: Sections 10(1)(q),10(1)(qA) and 23(s) of the Act]

Background

The Act contains provisions that provide exemption in respect of bona fide bursaries or scholarships granted by employers to employees or relatives of qualifying employees, subject to certain monetary limits and requirements stipulated in the Act.

In the case of a bona fide bursary or scholarship granted to a relative of the employee without a disability, paragraph (ii) of the proviso to section 10(1)(q) of the Act make provision for the exemption to apply only if the employee's remuneration does not exceed R600 000 during the year of assessment. In addition, the amount of the bursary or scholarship will only be exempted up to a limit of R20 000 for studies from Grade R to 12 including qualifications at NQF levels 1 to 4, and R60 000 for qualifications at NQF levels 5 to 10.

In the case of a bona fide bursary or scholarship granted to a relative of the employee with a disability, paragraph (ii) of the proviso to section 10(1)(qA) of the Act makes provision for the exemption to apply only if the employee's remuneration does not exceed R600 000 during the year of assessment. In addition, the amount of the bursary or scholarship will only be exempted up to a limit of R30 000 for studies from Grade R to 12 including qualifications at NQF levels 1 to 4, and R90 000 for qualifications at NQF levels 5 to 10.

When these provisions were initially introduced in 1992, the applicability of the exemption was dependent on the fact that the employee's remuneration package was not subject to an element of salary sacrifice. However, in 2006 changes were made to the tax legislation to remove the exclusion of salary sacrifice from the exemption requirements. The policy rationale for the removal of this exclusion was to encourage skills development as a means of addressing the country's skills

shortage. Following the 2006 amendments, the tax exemption was available irrespective of whether a bursary or scholarship scheme contained an element of salary sacrifice.

Reasons for change

It has come to Government's attention that a number of schemes have emerged in respect of employer bursaries granted to the employees or relatives of employees. These bursary schemes are developed by an institution other than the employer and marketed to the employer as a means of providing tax exempt bursaries to their employees or relatives at no additional cost to the employer. These schemes seek to reclassify ordinary taxable remuneration received by the employee as a tax-exempt bursary granted to the relatives of employees. As a result, an employee can cater for their relative's studies by way of a salary sacrifice. The portion of the salary sacrificed by the employee is paid directly by the employer to the respective school and is treated as a taxexempt bursary in the employee's or relative's hands.

The increase in the number of these schemes as well as the tax planning opportunities that result in a loss to the fiscus resulted in Government reviewing its policy position taken in 2006 of making the tax exemption available irrespective of whether a bursary or scholarship scheme contained an element of salary sacrifice.

Proposal

In order to address these concerns, the following changes are proposed in the tax legislation:

- It is proposed that the exemption in respect of a bona fide bursary or scholarship granted by the employer to the relatives of the employee as contemplated in paragraph (ii) of the provisos to section 10(1)(q) and section 10(1)(qA), should only apply if that bona fide bursary or scholarship granted by the employer is not restricted only to the relatives of the employee, but is an open bursary or scholarship available and provided to members of the general public.
- It is proposed that the requirement that the applicability of the exemption is dependent on the fact that the employee's remuneration package is not

subject to an element of salary sacrifice, be reinstated.

- It is further proposed that, as a means of further encouraging employers to grant bursaries to relatives of employees without subjecting such bursary to an element of salary sacrifice, that the employer deduction in relation to said bursaries is only afforded if the bursary to the employee's relative is not subject to an element of salary sacrifice.

Effective date

The proposed amendments will come into operation on 1 March 2021 and apply in respect of years of assessment commencing on or after that date.

4.3. Income Tax: Individuals, Savings and Employment – Clarifying deductions in respect of contributions to retirement funds

[Applicable provision: Paragraph 5(1)(a) and 6(1)(b)(i) of the Second Schedule to the Act]

Background

The Act contains rules in the Second Schedule that deal with the tax treatment of lump sum benefits received from a pension fund, pension preservation fund, provident fund, provident preservation fund and retirement annuity fund as defined in section 1 of the Act. Paragraph 2 of the Second Schedule to the Act makes provision for the calculation of the amount of lump sum benefits to be included in the person's gross income in terms of paragraph (e) of the definition of gross income in section 1 of the Act.

In turn, paragraphs 5(1)(a) and (6)(1)(b) of the Second Schedule to the Act makes provision for contributions to pension funds, provident funds and retirement annuity funds, that did not qualify for a deduction in terms of section 11F of the Act, to be allowed as deductions in calculating the amount of lump sum benefits to be included in the person's gross income.

With effect from 1 March 2016, section 11F of the Act made provision for deductions in relation to contributions to a pension, provident or retirement annuity fund to be allowed when calculating the taxable income of a person and the calculation of the amount to be deducted is prescribed in the formula and is subject to a cap

Reasons for change

The policy rationale comprised in paragraphs 5(1)(a) and 6(1)(b) of the Second Schedule to the Act for deducting amounts that did not qualify for an income tax deduction in terms of section 11F of the Act is to prevent double taxation of amounts contributed. However, paragraphs 5(1)(a) and 6(1)(b) of the Second Schedule to the Act only refer to 'the person's own contributions', which inadvertently prevents employer retirement fund contributions on behalf of employees (made on or after 1 March 2016) from qualifying for a deduction when calculating the taxable portion of retirement lump sum benefits.

Proposal

In order to ensure that both employer and employee contributions to pension, provident funds and retirement annuity funds qualify for a deduction in terms of paragraphs 5(1)(a) and 6(1)(b) of the Second Schedule to the Act, it is proposed that changes be made to the above-mentioned paragraphs and the reference to 'a person's own contributions' is replaced with a reference to 'any contributions'.

In order to ensure that the proposed changes cater for all employer contributions to pension, provident funds and retirement annuity funds on behalf of employees made since the introduction of section 11F, it is proposed that the effective date for the proposed amendments be aligned with the effective of section 11F, which is 1 March 2016.

Effective date

The proposed amendments are deemed to have come into operation on 1 March 2016.

4.4. Income Tax: Individuals, Savings and Employment – Withdrawing retirement funds upon emigration

[Applicable provisions: Section 1 of the Act, the definitions of 'Pension Preservation Fund', 'Provident Preservation Fund' and 'Retirement Annuity Fund']

Background

Currently, the definitions of 'pension preservation fund', 'provident preservation fund' and 'retirement annuity fund' in section 1 of the Act make provision for a payment of lump sum benefits when a member of a pension preservation, provident preservation or retirement annuity fund withdraws from the retirement fund due to that member emigrating from South Africa, and such emigration is recognised by the South African Reserve Bank (SARB) for exchange control purposes.

Reasons for change

As outlined in Annexure E of the 2020 Budget Review, Government will be modernising the foreign exchange control system. As a result, a new capital flow management system will be put in place. This new system will move from a 'negative list' system to one where all foreign-currency transactions, other than those contained on the risk-based list of capital flow measures, being allowed.

In respect of individuals, one of the changes to be implemented during modernisation of the foreign exchange control system is the phasing out of the concept of 'emigration' for exchange control purposes. The phasing out of this concept will have a direct impact on the application of the tax rules as the tax legislation makes provision for a payment of lump sum benefits when a member emigrates from South Africa and such emigration is recognised by the SARB for exchange control purposes.

Proposal

In order to ensure efficient application of the tax legislation, it is proposed that the definitions of 'pension preservation fund', provident preservation fund and 'retirement annuity fund' in section 1 of the Act be amended to remove the

reference to payment of lump sum benefits when a member emigrates from South Africa and such emigration is recognised by the SARB for exchange control purposes. As such, a new test should be inserted which will make provision for the payment of lump sum benefits when a member ceases to be a South African tax resident (as defined in the Act), and such member has remained non-tax resident for at least three consecutive years or longer.

Effective date

The proposed amendments will come into operation on 1 March 2021.

4.5. Income Tax: Individuals, Savings and Employment – Addressing an anomaly in the rollover of amounts claimable under the employment tax incentive

[Applicable provision: Section 9(3) of the Employment Tax Incentive Act, No 26 of 2013 (the ETI Act)]

Background

The Employment Tax Incentive (ETI) programme was introduced in January 2014 to promote employment, particularly of young workers. The ETI programme aims to reduce the cost of hiring young people between the ages of 18 and 29 (also referred to as 'qualifying employees') through a cost sharing mechanism with Government, while leaving the wages received by the qualifying employees unaffected. The ETI programme makes provision for employers to reduce the amount of employees' tax (PAYE) they pay to SARS for the first two years, in respect of qualifying employees with a monthly remuneration of less than R6 500, subject to certain limitations.

The ETI programme contains certain limitations aimed at encouraging tax compliance, and prevents non-tax compliant employers from claiming the ETI reduction of PAYE. Sections 8 and 10(4) of the ETI Act contain provisions that prevent a non-tax compliant employer from claiming the ETI if the employer has

failed to submit any tax return as required in terms of the Tax Administration Act (TAA), or has any outstanding tax debt as defined in the TAA.

In turn, section 9 of the ETI Act makes provision for the ETI allowable to be claimed by the employer to be rolled over to the following month under any of the following conditions:

- The incentive amount available to a compliant employer exceeds the PAYE otherwise due in a month;
- The compliant employer fails to reduce the PAYE payable to SARS despite being eligible to receive the incentive; or
- The non-compliant employer was not allowed to claim the ETI to reduce the PAYE payable to SARS due to tax returns outstanding, or an outstanding tax debt with SARS.

That said, in respect to tax compliant employers, any unclaimed monthly ETI must be claimed by the last month of each PAYE reconciliation period (namely August or February). In particular, section 9(3) of the ETI Act provides that any unclaimed amounts at the said time will be forfeited, on the first day of the month following the end of the PAYE reconciliation period (either 1 September or 1 March). As a result, the excess ETI on either 1 September or 1 March will be deemed to be nil.

Reasons for change

In instances where an employer is not tax compliant as described above, such employer is in terms of the ETI Act unable to claim the ETI for qualifying employees until such time that the employer becomes compliant. Any amounts not claimed while the employer is non-tax compliant will be an excess ETI subject to roll over into the next month. This roll over will continue until such time that said employer becomes tax compliant and the excess ETI will be allowed as a reduction against their PAYE liability in the first month the employer is tax compliant.

The above-mentioned provisions result in an anomaly as tax compliant employers are worse off in terms of tax treatment as compared to non-tax compliant employers. The excess ETI amounts of tax compliant employers is forfeited at the

end of the PAYE reconciliation period, while non-tax compliant employers are able to roll over their excess ETI amounts irrespective of whether the roll over goes beyond the PAYE reconciliation period.

Proposal

In order to address this anomaly and encourage tax compliance, it is proposed that changes be made in the ETI legislation making non-tax compliant employers subject to the above-mentioned forfeiture rule applicable to tax compliant employers in instances where any excess ETI amounts are not utilised by the end of the PAYE reconciliation period. As a result, the excess ETI amounts of non-tax compliant employers will not be rolled over at the end of the PAYE reconciliation period.

Effective date

The proposed amendment will be deemed to have come into operation on the date of publicationof the 2020 Draft Taxation Laws Amendment Bill for public comment.

4.6. Income Tax: Individuals, Savings and Employment – Addressing the circumvention of anti-avoidacne rules for trusts

[Applicable provision: Section 7C of the Act]

Background

Scope of the anti-avoidance measure over the years.

The Act contains anti-avoidance measures aimed at curbing the tax-free transfer of wealth to trusts through the use of low interest or interest-free loans, advances or credit. These anti-avoidance measures were first introduced in 2016 to target schemes under which taxpayers transfer assets to a trust and allow for the purchase price that the trust owes in respect of the assets to be left outstanding as a loan, advance or credit in favour of that taxpayer on which no interest or very low interest is charged. Alternatively, taxpayers would advance a low interest or

interest-free loan, advance or credit upfront to a trust in order for the trust to use the money to acquire assets.

Following the introduction of these anti-avoidance measures in 2016, taxpayers devised further schemes aimed at undermining these measures. For example, taxpayers would advance interest free or low interest loans to companies whose shares are held by trusts. By advancing the loan to the company rather than the trust, the anti-avoidance measure introduced in 2016 did not apply as, at that time, the anti-avoidance measure only applied in respect interest free or low interest loans, advances or credit that were made by a natural person or a company (at the instance of a natural person) to trusts. In order to curb the abovementioned abuse, changes were made in the tax legislation in 2017 to strengthen these rules. As a result, interest free or low interest loans, advances or credit that are made by a natural person or a company (at the instance of a natural person) to a company that is a connected person in relation to a trust are also subject to the antiavoidance measure.

Deemed donation on applicable avoidance structures

Prior to the introduction of these anti-avoidance measures in 2016, the use of low interest or interest free loans to facilitate the transfer of assets in terms of the schemes described above avoided Donations Tax because when assets are transferred in exchange for a low interest or interest free loan, advance or credit, such transfers are treated as sale transactions and not donations. Furthermore, in some instances, the amount that is owed to the taxpayers (i.e. the loan claim) would remain outstanding with no real intention of settlement. Coupled with the above, taxpayers reduce or waive the loan which is supposed to be paid back to him or her. This way, the waived amounts will not form part of his estate for purposes of Estate Duty but the assets will be the property of the trust in which taxpayers can make their children and/or spouses beneficiaries.

In order to limit the abuse, changes were made in the tax legislation to make provision for the annual donation to be triggered in the hands of a natural person who advances the loan or credit or the natural person at whose instance a company advances the loan or credit. In every year of assessment of the trust that

the interest free or low interest loan remains outstanding, the amount of the deemed donation made by the natural person to the trust is determined as the difference between the interest charged on the loan, advance or credit and the interest that would have been payable by the trust had the interest been charged at the official rate of interest, as defined in the Seventh Schedule to the Act.

Reasons for change

It has come to Government's attention that taxpayers are continuing to implement other variations of these structures in order to avoid the deemed annual donation triggered by the anti-avoidance measure. In this instance, the application of the anti-avoidance measure is being avoided by natural persons that subscribe for preference shares with no or a low rate of return in a company owned by a trust that is a connected person to those individuals. The use of preference share funding avoids the application of the anti-avoidance rules as the 2017 changes only apply in respect of loans that are advanced or credit that is made available to a company that is owned by a trust that is a connected person in relation to the natural person advancing that loan or credit.

Proposal

In order to curb this abuse, it is proposed that changes be made in the tax legislation. As a result, the subscription price of preference shares used will be deemed to be a loan advanced. In addition, any dividends in respect of those preference shares shall, for purposes of these provisions, be deemed to be interest in respect of such a deemed loan. In this respect, the deeming provision will apply, if:

- a natural person; or

at the instance of a natural person, a company that is connected in relation to that natural person in terms of paragraph (d)(iv) of the definition of connected person subscribes to preference shares in a company if:

- at least 20% of the equity shares in that company are held (whether directly or indirectly) or the voting rights in that company can be exercised by a trust that is a connected person in relation to the subscribing natural person or

company (as the case may be), whether alone or together with any person who is a beneficiary.

Effective date

The proposed amendments will come into operation years of assessments commencing on or after 1 January 2021.

4.7. Income Tax: Business (General) – Addressing anomalies on the acquisition of assets in exchange for debt issued

[Applicable provision: Section 40CA of the Act]

Background

Establishing base cost in asset-for-share and asset-for-debt transactions

The rules that establish base cost in respect of asset-for-share and asset-for-debt transactions were first introduced in the Act in 2012 and amended in 2013. These rules were necessitated by the decision of the Supreme Court of Appeal in C: SARS v Labat Africa Ltd (669/10) [2011] ZASCA 157 in which the Court had to determine whether the issuing of shares by a company as consideration for the acquisition of a trademark amounts to 'expenditure actually incurred' by the issuing company. In view of the fact that the term 'expenditure' is not defined in the Act, the Court relied on its ordinary meaning which encompasses the action of spending funds, disbursement or consumption and hence, requires a diminution of the assets by the person who expends. As a result, the Court held that the issue of shares does not give rise to any diminution in the assets of the issuing company and that the shares issued as consideration for the acquisition of the trademark accordingly do not amount to 'expenditure'. This meant that for tax purposes, taxpayers had a zero base cost in respect of assets acquired in exchange for the issue of shares by the acquiring company.

A policy decision was subsequently made that a base cost should be granted in respect of assetfor-share exchanges as these were generally entered into for economic purposes and the zero base cost had adverse effects by not reflecting that the shares received by the party disposing of assets to the issuing company would have received value. Although, the exchange of assets for debt issued did not give rise to a zero base cost as 'expenditure' arises in the case of debt issued due to the fact that a diminution of the assets of the issuing party arises, a similar base cost rule was included in the same provision.

Consequently, the tax rules that determine a base cost for assets acquired in exchange for the issue of shares or debt currently make provision for a company that acquires an asset in exchange for the issue of shares by that company to be deemed to have incurred expenditure in respect of the acquisition of such asset, which is equal to the market value of those shares immediately after the acquisition. Similarly, a company that acquires an asset in exchange for the issue of debt is deemed to have incurred expenditure in respect of the acquisition of such asset, which is equal to the amount of that debt.

Anti-value shifting rules applicable to asset-for-share transactions

Anti-value shifting rules were introduced in the Act to ensure that all asset-for-share transactions should be entered into by taxpayers on a value-for-value basis (i.e. an asset must be acquired or disposed of in exchange for an issue of shares of an equal market value). Under these rules, where a company acquires an asset in exchange for the issue of shares by that company and the market value of the asset immediately before the disposal exceeds the market value of the shares immediately after that issue, the amount in excess is deemed to be a capital gain in respect of a disposal by that company of the shares and the base cost of the shares issued must be reduced in the hands of the person selling the asset by the amount of that excess. In the instance that a company acquires an asset in exchange for the issue of shares and the market value of the shares immediately after

that issue exceeds the market value of that asset immediately before the disposal, the amount in excess is deemed to be a dividend that consists of a distribution of an asset in specie that is paid by the company on the date of the issue of those shares.

Tax treatment of disposals between connected person

Taxpayers that are connected persons in relation to each other can often structure their transactions in a manner that avoids tax. For capital gains purposes, the Act contains a provision that deems a market value consideration where an asset is disposed of in a transaction that involves connected persons for a consideration that does not reflect an arm's length consideration.

Reasons for change

It has come to Government's attention that the rules that establish base cost in respect of assetfor-share and asset-for-debt transactions enable taxpayers to avoid the application of the market value deeming rule in respect of transactions between connected persons that are not entered into at an arm's length price. This is due to the fact that currently, the market value deeming rule in respect of transactions between connected persons provides that the market value deeming rule will not apply if the rules that establish base cost in respect of asset-for-share and asset-fordebt transactions have been applied to the transaction. This exclusion is justified in the case of asset-for-shares transactions as these transactions are subject to anti-value shifting rules where an asset-for-share transaction is not entered into on a value-for-value basis.

However, asset-for-debt transactions are not subject to any anti-avoidance rule but are granted the same exclusion when considering the application of the market value deeming rule in respect of transactions between connected persons. This results in some taxpayers misusing asset-fordebt transactions to achieve asset transfers in exchange for debt consideration that is not at arm's length without tax consequences. Further, it is, in any case, not necessary that a specific base cost rule should be provided for in respect of asset-for-debt transactions as in terms of

normal principles, expenditure is actually incurred when an asset transferred in exchange for debt.

Proposal

In light of the above, it proposed that the specific asset-for-debt rule contained in the provision that deals with rules that establish base cost in respect of asset-for-share and asset-for-debt transactions should be deleted. It is envisaged that going forward, taxpayers will apply normal tax principles for the determination of base cost in respect of assets acquired in exchange for debt (i.e. base cost will be determined as expenditure actually incurred). Further, such transactions will be subject to the market value deeming rule in respect of transactions between connected persons in the instance that inadequate consideration is given for the asset by a connected person.

Effective date

The proposed amendments will come into operation on 1 January 2021 and apply in respect of acquisitions made on or after that date.

4.8. Income Tax: Business (General) – Refining the interaction between the anti-avoidance provisions for intra-group transactions

[Applicable provision: Section 45 of the Act]

Background

The Act contains corporate reorganisation rules that allow taxpayers to transfer their business assets on a tax neutral basis by allowing for a deferral of the tax consequences that would have otherwise been triggered on asset disposals. These corporate reorganisation rules contain a provision dealing with intra-group transactions in section 45 of the Act. An intra-group transaction is a transaction between two companies where one company transfers an asset to the other company and both companies form part of the same group of companies at the

end of the day ofthat transaction.

The intra-group transaction rules also contain anti-avoidance measures aimed at limiting or discouraging abuse by taxpayers of the tax neutral transfer of assets, namely, (a) de-grouping charge rule applicable to the group of companies that entered into intra-group sale, and (b) zero base cost rule applicable to transfer of assets and assumption of related debt.

De-grouping charge rule applicable to the group of companies that entered into intra-group sale

> The de-grouping charge rule was introduced to mitigate against the risk that taxpayers may enter into an intra-group transaction, benefit from tax deferral and then cease to form part of a group of companies soon after the said transaction. The de-grouping charge rule is triggered when a transferor company (i.e. the company that disposes of its asset) ceases to form part of any group of companies as the transferee company (i.e. the company that acquires the asset) within six years of the original intra-group transaction. In the instance that the de-grouping rule is triggered, any deferred tax consequences from the original intra-group transaction are triggered in the hands of the transferee which in effect reverses the tax benefit of that original intra-group transaction.

Zero base cost rule applicable to transfer of assets in exchange for debt or non-equity shares

> This anti-avoidance rule applies to intra-group transactions where assets are transferred in exchange for debt or non-equity shares issued by another company that forms part of the same group of companies as the transferor of those assets. Section 45(3A) of the Act makes provision for the holder of the debt to be deemed to have acquired the debt or non-equity shares for an amount of expenditure of nil. This implies that debt and non-equity shares issued as consideration under intra-group transaction are deemed to have a zero base cost in the hands of the transferor as the holder of such instruments acquired in exchange for assets transferred. However, any gain

or income from the repayment of such debt or non-equity shares are tax neutral if the repayment thereof by the issuer to the holder forms part of the same group of companies. The policy rationale for this anti-avoidance rule was to limit the use of debt or non-equity shares by taxpayers to transfer market value consideration for assets transferred under an intra-group transaction which could further be abused by transferring the debt or non-equity shares outside of the group by the transferor.

Reasons for change

The interaction between the de-grouping charge rule applicable to the group of companies that entered into intra-group asset sales and the zero base cost rule applicable to transfer of assets in exchange for debt or non-equity shares gives rise to anomalous results. Where an asset transfer in terms of an intra-group transaction is funded by debt or a non-equity share issued by a fellow group company, the transferor is regarded as having a zero base cost for that debt note or nonequity share. Should a de-grouping occur in respect of that intra-group transaction, the degrouping charge rule will apply to reverse the tax deferral of that intra-group transaction. However, as a result of the zero base cost rule, the holder of the debt still remains without base cost in respect of the debt or non-equity shares. The latter gives rise to an anomalous outcome as base cost would have been allowed had the provisions of section 45 not applied.

Proposal

In order to address this anomaly, it is proposed that changes be made in the tax legislation to ensure that in the instance that a de-grouping charge rule has been triggered in respect of an intra-group transaction under which the zero base cost rule was applied, the tax attributes of the debt or non-equity shares should be re-instated to reflect those that would have existed on the date of that de-grouping had tax deferral not applied at all.

As such, it is proposed that a debt or non-equity share in respect of which the zero base cost rules applied, should be deemed to have a base cost equal to its market value on the date of the intragroup transaction less any repayments made prior to

the de-grouping.

Effective date

The proposed amendments will come into operation on 1 January 2021 and apply in respect of years of assessment commencing on or after that date.

4.9. Income Tax: Business (General) – Clarifying rollover relief for unbundling transactions

[Applicable provision: Section 46(7) of the Act]

Background

The corporate reorganisation rules were first introduced in the South African tax legislation in 2001. These rules are aimed at facilitating transactions between group companies or between shareholders and their companies on a tax neutral basis. The South African corporate reorganisation rules contain a provision dealing with unbundling transactions. This rule makes provision for tax deferral where shares of a resident company (unbundled company) that are held by another resident company (unbundling company) are distributed to the shareholders of that unbundling company in accordance with the effective interest of those shareholders. As a result, distribution of shares in terms of unbundling transactions are disregarded for purposes of determining the taxable income, assessed loss or net income of an unbundling company and are disregarded for Dividends Tax purposes and there is no consideration for reduction of contributed tax capital. These unbundling rules also contain anti-avoidance measures aimed at limiting or discouraging abuse by taxpayers from distributing shares on a tax neutral basis if the shareholders are not in the tax net. These anti-avoidance measures make provision for roll-over relief not to be granted if immediately after the distribution of shares in terms of an unbundling transaction, 20% or more of the shares in the unbundled company are held by disqualified persons either alone or together with any connected persons (who is a disqualified person) in relation to that disqualified person.

For purposes of this anti-avoidance measure, the initial shareholding threshold for disqualified persons was set at 5%. However, in 2008 this shareholding threshold was increased to 20% in order to allow widely held companies to benefit from tax neutral unbundling transactions. In addition, 'disqualified persons' is defined to include a person that is regarded as a non-resident in terms of the South African tax legislation or exempt persons in terms of South African tax legislation (for example, the government of South Africa in the national, provincial or local sphere contemplated in section 10(1)(a), a public benefit organisation as defined in section 30, a recreational club as defined in section 30A, a mining rehabilitation company or trust contemplated in section 37A, a pension fund, a provident fund, a retirement annuity fund, a benefit fund contemplated in section 10(1)(d)(i) or (ii) or a person contemplated in section 10(1)(cA) or (t)).

Reasons for change

The policy rationale for allowing tax deferral in unbundling transactions is based on the principle that where the economic group or the shareholders have retained a substantial interest in the assets transferred, it is appropriate to permit the transfer of assets to the entity where they can be most efficiently used for business purposes without immediate adverse tax consequences that usually apply in respect of asset transfers by way of a disposal or distribution. Therefore, a tax deferred distribution of the equity shares of an unbundled company in terms of an unbundling transaction to exempt persons or non-residents means that after deferral, capital gains or taxable income from subsequent disposals or distributions will fall outside of the South African tax net.

Government has noticed the increased use of the unbundling transaction provisions to erode the tax base in structures that use unbundling transactions to distribute shares of unbundled companies tax free to non-resident investors. In particular, the current anti-avoidance measure in unbundling transactions creates a loophole in that the 20% exclusionary rule may not apply as intended to limit such transactions where non-residents shareholders are not connected persons in relation to each other. This implies that non-residents may collectively hold 20% or more of the shares in the unbundled company, but to the extent that they are not

connected, the anti-avoidance rule in unbundling transactions may not apply. The result is that in aggregate, the shareholding of disqualified persons immediately after an unbundling transaction may exceed the 20% threshold that aims to curb the erosion of the South African tax base.

Proposal

In order to close this loophole, it is proposed that the anti-avoidance rule in unbundling transactions dealing with the 20% limitation of the shareholding of disqualified persons should be amended to ensure that these rules apply without regard to whether disqualified persons are connected persons or not.

As such, it is proposed that the reference to 'connected persons' should be removed and that the anti-avoidance rule should provide that deferral in terms of an unbundling transaction should not be allowed if, immediately after any distribution of shares in terms of an unbundling transaction, 20% or more of the shares in the unbundled company are held by disqualified persons.

Effective date

The proposed amendment will be deemed to have come into operation on the date of publication of the 2020 Draft Taxation Laws Amendment Bill for public comment.

4.10. Income Tax: Business (Financial institutions and products) – Clarifying the meaning of 'market value' for the taxation of longterm insurers

[Applicable provision: Section 29A of the Act]

Background

Section 29A of the Act makes provision for the tax treatment of long-term insurance companies based on a five-funds approach, namely, the untaxed policyholder fund, the individual policyholder fund, the company policyholder fund, the risk policy fund and the corporate fund. The application of this five-fund approach requires long-term insurers to allocate their assets to the

abovementioned five different tax funds. The assets should be allocated to each of the five funds if they relate exclusively to business conducted by the long term-insurer in the fund or in a way that is consistent with and appropriate to the manner in which the long-term insurer's business is conducted.

The excess of assets in each policyholder fund or risk policy fund, which represents the long-term insurer's shareholders interest and that should be transferred to the corporate fund, is calculated by deducting the adjusted International Financial Reporting Standards (IFRS) value of liabilities relating to the fund from the market value of assets allocated to that fund.

Section 29A(7) and (12) of the Act provides for the allocation of assets and other items to the funds and the requirements for the calculation of excess assets to be transferred to the corporate fund. In summary, section 29A(7) of the Act provides that the insurer should re-determine the value of its policyholder liabilities for each of the policyholder funds and its risk policy fund as at the last day of a year of assessment. To the extent that the market value of assets allocated to and held by the fund exceeds the value of its policyholder liabilities, the insurer is required to transfer assets equal to the surplus from that fund to the corporate fund. Also, in the case where the market value of assets allocated to and held by the policyholder fund or risk policy fund is less than the value of its policyholder liabilities, the insurer is required to transfer assets equal to the shortfall from the corporate fund to the relevant fund.

Reasons for change

While section 29A(7) of the Act makes provision for the allocation to be determined with reference to the market value of assets in the policyholder funds and risk policy fund, it is not clear what should happen with assets that do not have a 'market value' as defined. For example, assets such as prepayments or intangible assets may in some instances not have a 'market value' as defined, although they are treated as assets for financial reporting purposes.

Proposal

In order to clarify the current rules regarding assets that do not have a 'market

value' as defined, such as prepayments or some intangible assets, for purposes of section 29A(7) of the Act, it is proposed that the definition of 'market value' in section 29A be amended to make provision for the value of assets that can only be disposed of as part of a going concern to be the amount as disclosed in the financial statements at the end of the year of assessment.

Effective date

The proposed amendment will come into operation on the date of promulgation of the Taxation Laws Amendment Act of 2020.

4.11. Income Tax: Business (Financial institutions and products) – Reviewing the interaction between rules for the taxation of benefits received by short-term insurance policyholders and the tax treatment of related expenses

[Applicable provisions: Sections 23(c) and 23L of the Act]

Background

The Act contains provisions in relation to limitation of deductions in respect of certain short-term insurance policies. Section 23L of the Act makes provision for limitation of deduction by disallowing the deduction of any premiums incurred by a taxpayer on short-term insurance policies, unless that taxpayer is recognising the insurance premiums as an expense for the purposes of financial reporting pursuant to IFRS in either the current or future year of assessment. This limitation of deduction is aimed at policies that are disguising an investment in the wrapper of short-term insurance, resulting in policyholder profits not being reduced by these insurance premiums because the insurance premiums are recognised as an asset (i.e. an investment of the policyholder).

Therefore, in terms of section 23L of the Act, policyholders may not deduct premium payments in respect of short-term policy contracts that are not viewed as an expense. Upon maturity or termination of the policy, the policyholder of an

'investment contract' is subject to tax on ordinary revenue when receiving or accruing policy benefits less non-deductible premiums in respect of that investment. However, in instances where the premiums were and are fully taken into account as expenses for purposes of financial reporting pursuant to IFRS the full amount of the policy benefits received is included in gross income.

In contrast the above, in terms of section 23(c) of the Act, expenditure and losses that would otherwise be allowed as deductions, for example under section 11(a) of the Act, is not allowed to the extent that it is recoverable under any contract of insurance, guarantee, security or indemnity. This leads to insurance benefits being fully taxed for policyholders of short-term insurance 'investment contracts' and on the other hand any related expenditure that is recovered being disallowed as a deduction under section 23(c) of the Act.

Reasons for change

As illustrated above, the interaction between section 23(c) and section 23L of the Act is not clear where on one hand, insurance benefits are being taxed in full and on the other hand, any related expenditure recovered being disallowed as a deduction.

Proposal

In order to clarify the interaction between the limitation of deductions in terms of section 23(c) of the Act and the inclusion in income of short-term insurance policy benefits in terms of section 23L of the Act, it is proposed that changes be made in the tax legislation to clarify that the rules in section 23L of the Act override the limitation provision of section 23(c) of the Act.

Effective date

The proposed amendment will come into operation on 1 January 2021 and apply in respect of years of assessment commencing on or after that date.

4.12. Income Tax: Business (Financial institutions and products) – Clarifying the tax treatment of secured non IFRS 9 doubtful debts

[Applicable provision: Section 11(j) to the Act]

Background

In 2018, amendments were made to section 11(j) of the Act to provide specific criteria for determining the doubtful debt allowance. These amendments provide specific doubtful debts allowance provision for taxpayers applying IFRS 9 for financial reporting purposes and for taxpayers not applying IFRS 9 for financial reporting purposes.

In summary, taxpayers that apply IFRS 9 for financial reporting purposes are required for purposes of section 11(j) of the Act to deduct an allowance amount that is equal to a percentage of a loss allowance relating to impairment as contemplated in IFRS 9. IFRS 9 requires recognition of impairment losses on a forward-looking basis, which means that impairment loss is recognized before the occurrence of any credit event. These impairment losses are defined in IFRS 9 as the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive discounted at the original effective interest rate.

The 2018 tax amendments to section 11(j) of the Act require taxpayers that apply IFRS 9 to be allowed a deduction of (i) 40% of the loss allowance relating to impairment that is measured at an amount equal to the lifetime expected credit loss and (ii) 25% of the difference between the IFRS 9 loss allowances relating to impairment and the IFRS 9 loss allowance in respect of which the 40% tax allowance is determined. Therefore, taxpayers that apply IFRS 9 take into account any estimated cash flows that are expected from the realisation of collateral that is part of the contractual terms of the secured financial asset (debt).

However, for taxpayers not applying IFRS 9, the Act makes provision for an age analysis of debt be used to determine the doubtful debt allowance. The following

allowances are allowed as a deduction: (i) 40% of the face value of doubtful debts that are at least 120 days past due date, and (ii) 25% of the face value of doubtful debts that are at least 60 days past due date, but excluding doubtful debts that are at least 120 days past due date. That said, this age based allowance used by taxpayers not applying IFRS 9 does not take cognisance of security given in respect of the debt.

Reasons for change

At issue is the fact that the tax legislation does not result in parity between taxpayers that apply IFRS 9 and those that do not apply IFRS 9 when determining the doubtful debt allowance under section 11(j) of the Act because the current 25% and 40% allowances for taxpayers not applying IFRS 9 does not take cognisance of security given in respect of the debt.

Proposal

In order to address this anomaly, it is proposed that changes be made in in section 11(j) of the Act to make provision for the amount of debt to be reduced by security that is available in respect of that debt before the 25% and 40% are applied by taxpayers that do not apply IFRS 9 for financial reporting purposes.

Effective date

The proposed amendments will come into operation on 1 January 2021 and apply in respect of years of assessment commencing on or after that date.

4.13. Income Tax: Business (Financial institutions and products) – Clarifying the tax treatment of doubtful debt in respect of certain impairments for banking regulated taxpayers

[Applicable provision: Section 11(jA) to the Act]

Background

In 2017, section 11(jA) of the Act dealing with doubtful debt allowance was introduced to provide an allowance for the debts that are considered to be doubtful

for persons referred to in paragraphs (c)(i) to (iii) and (d) of the definition of 'covered person' in section 24JB of the Act, that are subject to prudential banking regulation. This doubtful debt allowance was formulated using impairment requirements in IFRS 9 that are based on an expected credit loss and contains terminology that is derived from IFRS 9.

In turn, section 11(j) of the Act dealing with doubtful debt allowance, generally applying to taxpayers that are not subject to prudential banking regulation i.e. other than covered persons that value the financial assets at fair value, makes provision for a doubtful debt allowance to be claimed, provided that the following requirements are met, namely that there is an amount of a debt due to a taxpayer and had that debt become bad it would have been allowed as a deduction under Part I of Chapter II of the Act (i.e. section 11(a) or 11(i)). In addition, such amount must be included in the taxpayer's income in the current year of assessment or must have been included in a previous year of assessment.

It therefore follows that the application of doubtful debt allowance rules contained in section 11(jA) relating to taxpayers subject to prudential banking regulation should be in line with the requirements provided in section 11(j) of the Act dealing with doubtful debt allowance.

Reasons for change

It has come to Government's attention that, unlike doubtful debt allowance rules relating to taxpayers generally not subject to prudential banking regulation contained in section 11(j) of the Act, the current doubtful debt allowance rules contained in section 11(jA) applicable to taxpayers subject to prudential banking regulations do not restrict the allowance to be granted to a debt that would have been deductible if it had become a bad debt in terms of section 11(a) or 11(i) of the Act.

For instance, certain impairments, which relate to financial assets under IFRS 9 that would not be deductible in terms of the provisions dealing with doubtful debt deduction in section 11(j) of the Act, are deductible in terms of IFRS 9. An example of such a financial asset is a financial guarantee contract, which in terms of IFRS 9

is a contract that arises where a provider of a loan obtains a guarantee from a third party for a potential loss because a borrower may fail to pay the debt. As a result, a taxpayer subject to prudential banking regulation that applies IFRS 9 to fair value a debt for financial reporting would be able to claim a doubtful debt allowance under section 11(jA) in respect of the impaired financial guarantee. However, for other taxpayers the requirements of section 11(j) that provide for a deduction of doubtful debts would not have been met because the cost or value of the impaired financial guarantee would not have been deductible under section 11 had it become bad.

Proposal

In order to address this anomaly, it is proposed that loss allowances relating to impairments of financial assets under IFRS 9 that would not have been allowed as a deduction under section 11(a) or 11(i) of the Act had they become bad, should not qualify for a doubtful debt allowance in terms of section 11(jA) of the Act.

Effective date

The proposed amendments will come into operation on 1 January 2021 and apply in respect of years of assessment commencing on or after that date.

4.14. Income Tax: Business (Financial institutions and products) – Clarifying the tax treatment of doubtful debts for taxpayers conducting leasing business and applying IFRS 9 for financial reporting

[Applicable provisions: Sections 11(j) and 11(jA) to the Act]

Background

The Act sets out different rules for the tax treatment of doubtful debt in respect of taxpayers subject to prudential banking regulation for debt that is fair valued for financial reporting (section 11(jA) of the Act) as well as in respect of other taxpayers and other debt (section 11(j) of the Act).

Currently all taxpayers conducting leasing operations and applying IFRS 9 for

financial reporting purposes cannot claim a doubtful debt allowance because lease receivables are specifically excluded. IFRS 9 lease receivables include future lease payments as well as lease payments that have accrued to the lessor but remain outstanding and are in arrears if the lessee has defaulted on its obligation to pay these amounts ('arrear lease payments').

Reasons for change

One of the reasons for excluding lease receivables from doubtful debt allowance is that IFRS 9 lease receivables also include all lease receivables that have not yet been received by or accrued to the lessor. It would therefore be inappropriate to grant a doubtful debt allowance in respect of those amounts that have not yet been received by or accrued to the lessor, even if they have been impaired for accounting purposes.

At issue is that in arrears lease payments are not different from any other amounts that qualify for a doubtful debt allowance in terms of the provisions of section 11(j) or section 11(jA) of the Act. In addition, taxpayers not applying IFRS 9 for financial reporting purposes are able to claim a doubtful debt allowance in respect of these arrear lease payments, depending on the period that it has remained unpaid.

However, taxpayers applying IFRS 9 for financial reporting purposes cannot claim a doubtful debt allowance in respect of in arrears lease payments due to the fact that lease receivables in IFRS 9 include both lease receivables that have not yet been received by or accrued to the lessor and in arrears lease payments.

Proposal

In order to address these concerns, it is proposed that changes be made in the tax legislation to both sections 11(j) and 11(jA) so that taxpayers applying IFRS 9 for financial reporting purposes are allowed doubtful debt allowances in respect of lease receivables that have accrued to them but not in respect of future lease amounts.

Effective date

The proposed amendments will come into operation on 1 January 2021 and apply

in respect of years of assessment commencing on or after that date.

4.15. Income Tax: Business (Financial institutions and products) – Curbing potential tax avoidance caused by dividend deductions

[Applicable provision: Section 24JB(2) to the Act]

Background

In general, section 24JB of the Act requires every 'covered person' (that is, banks and brokers) for tax purposes to include in, or deduct from, their income all amounts in respect of financial assets and financial liabilities that are recognised for accounting purposes in profit or loss in the statement of profit or loss and other comprehensive income.

In relation to a bank, the concept of a ‘covered person’ includes, amongst others, any company or trust that forms part of a banking group as defined in section 1 of the Banks Act, 1990.

Therefore, in accordance with the principles of section 24JB of the Act covered persons must, subject to exclusions, include in or deduct from their statement of comprehensive income all amounts from qualifying financial assets and financial liabilities that are recognised as profits or losses in the statement of profit or loss and other comprehensive income. However, one of the exclusions of section 24JB is a dividend or foreign dividend received by or accrued to a 'covered person'.

Reasons for change

It has come to Government’s attention that some 'covered persons' as defined in section 24JB are devising schemes with the aim of providing investment opportunities to investors by forming a special purpose vehicle that is part of a banking group and interpose this special purpose vehicle between a 'covered person' and an investor. This special purpose vehicle issues shares (financial instruments) to the investors that yield dividends while it receives interest or other

income on its financial assets. The special purpose vehicle effectively converts income to dividends for the benefit of investors.

This structure of interposing a special purpose vehicle between an investor and a bank yields an undesirable mismatch in that the investor's underlying income is distributed as a dividend, while the special purpose vehicle may arguably be in a tax neutral position. That is against the policy rationale of section 24JB.

Proposal

In order to close this loophole, it is proposed that changes be made in the tax legislation so that the exclusions from the rules for the taxation of 'covered persons' in section 24JB(2)(b) be extended to cover dividends declared.

Effective date

The proposed amendments will come into operation on 1 January 2021 and apply in respect of dividends declared on or after that date.

4.16. Income Tax: Business (Financial institutions and products) – Clarifying the meaning of a share in the definition of REIT

[Applicable provision: Section 1 to the Act, definition of a Real Estate Investment Trust (REIT)]

Background

A special tax dispensation of REITs was introduced in the Act in 2012 with effect from 1 April 2013. Prior to the introduction of this special tax dispensation, the tax legislation dealt with two forms of formal property investment entities, namely, property loan stock companies and property unit trusts. The property unit trust operated as a trust, while a property loan stock company operated in the form of a company.

When this REITs special tax dispensation was introduced, the policy rationale was for it to apply to both the company and trust REITs that comply with the Johannesburg Stock Exchange Limited (JSE) Listings Requirements, and are

listed and publicly traded on the JSE. These requirements were based on the premise that the shares in a company or a trust which is deemed to be a company for tax purposes must be listed as shares in a REIT as defined in paragraph 13.1(x) of the JSE Listings Requirements and the company or trust will then qualify as a REIT for income tax (including capital gains tax) purposes.

With the introduction of other recognised exchanges as defined in the Financial Markets Act, 2012 in South Africa, the requirement that shares in a REIT should be listed on such recognized exchange and the listing requirements of such recognised exchange should be approved as stipulated in the Act still remains.

In general, the definition of a share, which must be listed in the case of a REIT, is in section 1(1) of the Act and means, in relation to any company, any unit into which the proprietary interest in that company is divided.

Reasons for change

It has come to Government's attention that some REITs are considering issuing and listing preference shares on a recognised exchange. This is against the policy rationale of REITs tax dispensation as holders of preference shares were never intended to benefit from the REITs tax dispensation because preference shares are mainly used for financing, and not to provide full equity exposure to investors.

Proposal

It is proposed that clarification be provided in the tax legislation and that non-equity shares be specifically excluded from the shares that must be listed on a recognised exchange for purposes of the REITs special tax dispdispensation.

Effective date

The proposed amendment will come into operation on 1 January 2021 and apply in respect of years of assessment ending on or after that date.

4.17. Income Tax: Business (Financial institutions and products) – Amending the taxation of foreign dividends and foreign gains received by REITs

[Applicable provisions: Sections 10B(2) and 25BB(2A) of the Act and paragraph 64B of the Eighth Schedule to the Act]

Background

Section 25BB of the Act contains provisions dealing with REITs' special tax dispensation. The main feature of the REITs special tax dispensation is that income and capital gains are taxed solely in the hands of the investor and not in the REIT or controlled company. In order to achieve that result, a REIT or a controlled company may claim distributions to its investors as a deduction against its income. This deduction may only be claimed if a distribution is a 'qualifying distribution' (i.e. at least 75% of the gross income of the REIT consists of rental income or other amounts received or accrued from property companies, as defined).

The Act contains participation exemptions in section 10B(2) which exempts from income tax any foreign dividends declared by non-resident companies to a South African tax resident holding at least 10% of the equity shares and voting rights in such companies, and paragraph 64B of the Eighth Schedule to the Act which exempts from capital gains tax any disposal of equity shares held by a South African tax resident holding a least 10% of the equity shares in a nonresident company. This implies that a REIT or a controlled company holding at least 10% of the equity shares in a non-resident company qualifies for a participation exemption in respect of foreign dividends received from that non-resident company and qualifies for participation exemption in respect of capital gains on any disposal of equity shares in a non-resident company.

Reasons for change

At issue is the mismatch in the application of rules dealing with REITs' special tax dispensation in section 25BB of the Act as well as the participation exemptions for

foreign dividends in section 10B(2) and capital gains in paragraph 64B of the Eighth Schedule to the Act. A REIT or controlled company holding at least 10% of the equity shares in a non-resident company qualifies for a participation exemption in respect of foreign dividends received from that non-resident company and capital gains on any disposal of equity shares in a non-resident company. In addition to the foreign dividends and capital gains tax participation exemption, that REIT or controlled company also gets a full deduction when it on-distributes profits from those foreign dividends or capital gains, thereby shielding other taxable income from tax.

Proposal

In order to address this mismatch, in view of the fact that a REIT or controlled company also gets a full deduction when it on-distributes profits from foreign dividends or capital gains (that qualify for participation exemption), it is proposed that a REIT or controlled company should not qualify for participation exemption in respect of foreign dividends in terms of section 10B(2) and foreign gains in terms of paragraph 64B of the Eighth Schedule to the Act.

Effective date

The proposed amendment will come into operation on 1 January 2021 and apply in respect of years of assessment ending on or after that date.

4.18. Income Tax: Business (Financial institutions and products) – Addressing tax avoidance involving lending and collateral arrangement provisions

[Applicable provision: Section 64EB(2) of the Act]

Background

The Act and the Securities Transfer Tax Act No. 25 of 2007 ('STT Act') contain rules that provide relief in respect of an outright change in beneficial ownership of specific financial instruments for both collateral arrangements and lending

arrangements, hereafter collectively referred to as 'securities arrangements'. As a result, if a listed share is transferred as a part of a security arrangement, there are no income tax (including capital gains tax) and securities transfer tax implications, provided that identical shares are returned to the borrower by the lender within a limited period of time from the date on which the security arrangement was entered into.

Since the introduction of this relief in 2015 changes were made to these provisions in 2016 and 2017 to extend the scope of the relief. The anti-avoidance provisions in section 64EB of the Act were expanded in 2018 to also apply to dividend conversion schemes using collateral arrangements.

Reasons for change

Despite the anti-avoidance measures introduced in 2018, Government has identified certain dividend conversion transactions that are circumventing these anti-avoidance measures. The conversion is essentially structured to avoid dividends tax by entering into a number of transactions between different parties during the period when a dividend is announced and the dividend is paid. The adjustment to previously identified schemes of adding more parties to the scheme, than catered for in the anti-avoidance measure, has the effect that the party paying a manufactured dividend to the party avoiding dividends tax is no longer holding a share in the company declaring the dividend and falls outside the ambit of the anti-avoidance measures.

Example:

A foreign shareholder transfers listed shares in South African company A to South African company B under a securities lending arrangement after company A announced a dividend declaration but before the dividend is paid. Company B shortly thereafter enters into a collateral arrangement with South African company C as security for a loan granted by company C to company B and the listed shares are transferred to company C. Company C receives the dividends from company A free from dividends tax (companyto-company exemption) and then, per the collateral agreement, pays a contractual amount (manufactured dividend) based on

the dividends received to company B. Company B in turn pays a manufactured dividend to the foreign shareholder, which is not subject to dividends tax as company B is not holding a share in company A when the manufactured dividend is paid. The current anti-avoidance measures of section 64EB(2) of the Act do not apply to the manufactured dividends paid by companies C and B.

Proposal

In order to counter the avoidance of dividends tax, it is proposed that the current provisions of section 64EB(2) of the Act be amended to adjust the anti-avoidance trigger that currently requires the person paying a manufactured dividend to a person that is subject to dividends tax, to hold a share in the company declaring the dividend. The holding of a share requirement is to be deleted.

Effective date

The proposed amendments will come into operation on 1 January 2021 and apply to amounts paid on or after that date in respect of shares that are borrowed or acquired in terms of a collateral arrangement.

4.19. Income Tax: Business (Incentives) – Reviewing the sunset date of the special economic zone tax incentive regime

[Applicable provisions: Sections 12R and 12S of the Act]

Background

In 2013, the Special Economic Zone (SEZ) tax regime was introduced in the Act. Tax benefits for this regime are contained under two separate provisions of the Act. The first provision contained in section 12R deals with the criteria determining what constitutes a qualifying company that qualifies to be taxed at 15% instead of the statutory 28% corporate tax rate. The second provision contained in section 12S provides for an accelerated capital allowances for buildings owned and used by a qualifying company in the production of its income within SEZ.

When the SEZ tax regime was first introduced in the Act, it was intended to come

into effect on the date on which the Special Economic Zones Act (Act No.16 of 2014) (SEZ Act) came into operation. The SEZ Act was anticipated to come into operation during the course of 2014. However, this only occurred in 2016, while the gazette notices approving specific SEZs in terms of section 12R were later published in July 2018.

The SEZ tax regime, like most tax incentives, has a sunset date. The sunset date is intended to allow Government the opportunity to review the effectiveness of the tax incentive regime. Qualifying companies were initially intended to have the incentives available to them for a period of 10 years. As a result, a sunset date was introduced to make provision for this tax regime to cease to apply in respect of any year of assessment commencing on or after 1 January 2024. This sunset date was intended to be aligned between sections 12R and 12S of the Act.

Reasons for change

At issue is the misalignment in the sunset dates of the two provisions dealing with the SEZ tax regime with their original intent. The sunset date contained in section 12R of the Act dealing with the criteria for the determination of what constitutes a qualifying company that qualifies to be taxed at 15% was subsequently amended in 2017 due to the delay of the ratification of the SEZ Act which only came into operation on 9 February 2016. Due to the delay in the coming into operation of the SEZ Act, the section 12R sunset date provision currently states that the provisions applicable to qualifying companies under the SEZ tax regime will cease to apply in respect of any year of assessment commencing on or after 1 January 2024 or, if later, 10 years after the commencement of the carrying on of a trade in a special economic zone. Similarly, the sunset date contained in section 12S of the Act dealing with the claiming of accelerated allowance in respect of building remained unchanged and section 12S will ceases to apply in respect of any year of assessment commencing on or after 1 January 2024. These sunset dates referencing January 2024 are no longer appropriate as they would not allow qualifying companies the intended 10-year period over which the incentives would be available to them. As indicated, government gazettes approving the first SEZs in terms of section 12R were only published in July 2018.

Government's fiscal position has deteriorated in recent years, and this situation has worsened significantly due to the impact of the COVID-19 pandemic and economic lockdown. The benefits of the SEZ tax regime, like other spending programmes, have been reduced to take account of the fiscal implications for the State.

Proposal

In order to provide clarity and certainty, it is proposed that amendments be made to the legislation in order to provide for a single date for the end of the application of the SEZ tax regime. As such the legislation will be amended to provide that the provisions of the SEZ tax regime will cease to apply in respect of any year of assessment commencing on or after 1 January 2028.

The rationale for deciding on 1 January 2028 as the sunset date is that it allows the incentive to apply for a ten-year period from the approval of designated SEZs by the of Minister of Finance in terms of section 12R(3) of the Act.

As a result, all qualifying companies will no longer be guaranteed to have the incentive available for 10 years. The proposed amendments are aimed to incentivise potential qualifying companies to accelerate their investments and meet the criteria for qualification in terms of section 12R within a shorter time period, with early movers enjoying a greater benefit.

Effective date

The amendments are deemed to have come into operation on 9 February 2016.

4.20. Income Tax: Business (Incentives) – Clarifying administrative proisions of venture capital companies tax incentive regime

[Applicable provision: Section 12J of the Act]

Background

In 2008, Government introduced the Venture Capital Company (VCC) tax regime as one of several measures to encourage the establishment and growth of Small,

Medium and Micro-Enterprises (SMME), as a tool to address job creation and inequality and more specifically to assist SMMEs to obtain funding that would not otherwise be available. Taxpayers investing in a VCC are allowed an upfront deduction for their investment in that VCC (whereas most equity investments are nondeductible) with a recoupment upon withdrawal if the investment is not held for a minimum period of five years.

Unfortunately, over the last few years questionable VCC structures, advertised as tax investment solutions, started appearing. These structures deviate from the spirit and original intention of the VCC incentive without making a meaningful contribution to the SMME funding universe. In response to this, Government introduced anti-avoidance measures over the past two years. One of the anti-avoidance measures introduced in 2018 had the policy intent that no shareholder may hold, directly or indirectly, more than 20% of the shares of any class in a VCC. This measure is aimed at closing to close the structural base around which certain abusive schemes were created.

Reasons for change

It has come to Government's attention that the anti-avoidance measures introduced in 2018 regarding the 20% shareholding limitation on VCC shares have unintended consequences.

For example, the VCC shareholders could unintentionally breach the more that 20% ownership of any class of share measure within a VCC structure, especially upon the legitimate unwinding of the underlying investment into a qualifying company related to that class of share.

Proposal

In order to address this anomaly, it is proposed that the legislation be amended to allow for an exclusion of the application of the 20% ownership provisions, if that VCC, in writing, notifies SARS of the intent to the cancel a class of shares within that VCC.

To ensure the continued protection of the fiscus against abusive structures on an open-ended termination ability, an anti-avoidance measure is proposed where a

maximum period of 6 months, from the date of notification to SARS, is allowed for the cancellation of any class of shares. In addition, should that allowable termination period be breached then normal provisions as contemplated in section 12J(3B) be applied.

Effective date

This amendment is deemed to have come into operation on the date that the 2020 Draft Taxation Laws Amendment Bill is published for public comment and applies in respect of years of assessment ending on or after that date.

4.21. Income Tax: Business (Incentives) – Changing the Minister of Finance discretion in lifting ring-fencing per mine

[Applicable provision: Section 36(7F) of the Act]

Background

Section 36(7F) of the Act, which was introduced in 1985, makes provision for the tax-deductible capital expenditure incurred in relation to a mine not to be used to reduce taxable income of another mine, unless the Minister of Finance, in consultation with the Minister of Mineral Resources and Energy and having regard to the relevant fiscal, financial and technical implications, otherwise directs. This limitation of tax-deductible capital expenditure is colloquially referred to as the 'capex per mine ring-fence'.

The above-mentioned section was introduced in the Act to prevent the reduction of taxable income from matured and profitable mines, given that those mines enjoyed an accelerated capital expenditure regime during their earlier years. In the absence of ring-fencing, taxpayers could deduct the cost of new developments against the tax base of mines that are profitable after long lead times, and shield tax that would otherwise have become payable.

Although section 2 of the Act makes provision for SARS to carry out the provisions of the Act, it is only the Minister of Finance who can exercise powers with regard to

the provisions of section 36(7F) of the Act dealing with the relaxation of the 'capex per mine ringfence'.

Reasons for change

Over the past years, the Minister of Finance has received a limited number of applications for the exercise of the discretion under section 36(7F) of the Act. At issue is whether the relaxation of ring-fencing, which is dependent on the Minister's discretion should be restructured in order to ease administration.

Proposal

In order to enhance efficiency, the following is proposed:

- The Minister's discretion available in section 36(7F) in ring-fencing capital expenditure per mine fence be removed;
- SARS be responsible for deciding on the non-application of ringfencing capital expenditure per mine by applying specific criteria; and
- Specific criteria for lifting ring-fencing of capital expenditure per mine be introduced in the Act.

As a result, it is proposed that SARS may on application by a taxpayer carrying on mining operations on two or more mines, issue a directive in terms of section 36(7F) that the said mines shall for the purposes of that section be deemed to be one mine and capex per mine ring-fencing would not apply after taking into account the following proposed set of criteria:

- contiguity of the two or more mining operations;
- activity and operations of the two or more mining operations;
- services rendered by the employees and support services performed for the two or more mining operations;
- financial statements and management accounts of the two or more mining operations;
- the criteria applied by the taxpayer in classifying the two or more mining

operations as a single mining operation; and

- any other considerations as SARS may deem relevant

Effective date

The proposed amendment will come into operation on 1 January 2021 and apply in respect of years of assessment commencing on or after that date.

4.22. Income Tax: Business (Incentives) – Addressing the tax treatment of allowance mining capital expenditure

[Applicable provisions: Sections 15 and 36 of the Act]

Background

The Act contains rules in section 15 and section 36 that entitle taxpayers that are engaged in mining operations to a full upfront deduction of any capital expenditure actually incurred during any year of assessment against income derived from mining operations. Consequently, mining operations are defined in section 1 of the Act to include every method or process by which any mineral is won from the soil or from any substance or constituent thereof. Thus, in order for the taxpayer to qualify for accelerated capital expenditure deductions in terms of sections 15 and 36 of the Act, such taxpayer must be engaged in mining operations.

Reasons for change

The change in mining business models has led to the increase of what is called 'Contract Mining'.

In general, 'Contract Mining' comprises the service of independent contractors with the required plant and machinery (contract miners) to excavate minerals from the soil on behalf of the mineral rights holder for a fee. The current provisions of the tax legislation do not adequately address the tax treatment of capital expenditure incurred by taxpayers carrying on activities of 'Contract Mining'. At issue is the definition of 'mining operations' for purposes of claiming the capital expenditure deductions, and whether both a contract miner that excavates minerals for a fee

and a mineral rights holder, should qualify for accelerated capital expenditure deductions on expenditure incurred by them in terms of sections 15 and 36 of the Act.

Proposal

It is proposed that clarification be made in the tax legislation and that only the taxpayer that holds a mining right as defined in section 1 of holder issued under the Mineral and Petroleum Resources Development Act in respect of the mine where those mining operations are carried out on the mine in respect of which the mining right was issued should qualify for accelerated capital expenditure deductions in terms of sections 15 and 36 of the Act.

Effective date

The proposed amendments will come into operation 1 January 2021 and apply in respect of expenditure incurred on or after that date.

4.23. Income Tax: Business (Incentives) – Refining the tax treatment of foreign donor-projects

[Applicable provision: Section 10(1)(yA) of the Act]

Background

In 2006, changes were made in the tax legislation to make provision for the uniform tax treatment of support (for example grants, loans, technical assistance) granted in terms of an Official Development Assistance Agreement (ODAA). An ODAA is an international agreement in terms of section 231(3) of the Constitution of South Africa.

Consequently, section 10(1)(yA) of the Act makes provision for exemption in respect of amounts received by or accrued to any person in terms of an ODA agreement which is binding under section 231(3) of the Constitution of South Africa Act 108 of 1996 (the Constitution), provided that the following requirements are met, namely, (a) that amount is received or accrued in relation to projects that are

approved by the Minister and (b) the agreement provides that those receipts and accruals of that person must be exempt.

Reasons for change

It has come to Government's attention that some ODAAs were entered into a long time ago and the wording in those ODAAs does not specifically make provision for the outright exemption. As a result, those ODAAs may not qualify for exemption in terms of section 10(1)(yA) of the Act as they do not meet the requirement under section 10(1)(yA)(bb) of the Act that the ODAA agreement must provide that the amounts received by or accrued to the person are exempt.

For example, some of the wording in the old ODAAs makes provision for the grant amount to be used to fund the activities of the project itself and cannot be used to pay any taxes. In other instances, the wording in the old ODAA envisages a situation where the foreign donor procures goods and services directly for the benefit of the South African government and does not envisage a situation where those procurement duties can be allocated to a local contractor. Further, such ODAA makes provision for the foreign donor to be exempt from indirect taxes and duties in respect of procurements financed under the ODAA, and that exemption is not granted to the local contractor who has been allocated the duties, and secondly, there is no provision for income tax exemption as it was not envisaged that the foreign donor can allocate funds to the local contractor to procure those goods and services in terms of the ODAA.

Proposal

In view of the fact that at the time when South Africa entered into these ODAAs, there was a clear intention that foreign donors offering this support often seek to ensure that their support packages remain free from South African tax as a precondition for funding, it is proposed that changes be made in the tax legislation as follows:

- With regard to ODAAs entered into until 2006, the requirement under section 10(1)(yA)(bb) that the ODAA agreement must provide that the amounts received by or accrued to the person are exempt should not apply.

- With regard to ODAAs entered into after 2006, the requirement under section 10(1)(yA)(bb) that the ODAA agreement must provide that the amounts received by or accrued to the person are exempt should apply.

Effective date

The proposed amendments are deemed to come into operation on 1 January 2007 and apply in respect of years of assessment ending on or after that date.

4.24. Income Tax: Business (Incentives) – Aligning immunity from taxation of international organisations

[Applicable provision: Section 10 of the STT Act]

Background

South Africa is a member of several internationally recognised organisations and has entered into numerous international agreements in this regard. In order to enable the recognised international organisations to fulfil their entrusted functions and conduct their operations uninterrupted in South Africa, the international agreements underpinning these memberships make provision for the international organisations to be granted certain privileges and immunities. In particular, these international agreements often contain an article which outlays the status, immunities and privileges of the said international organisation. This article makes provision for the exemption from taxation of any kind and description in respect of the international organisation and its activities in South Africa. Consequently, in order to ensure that the South Africa tax legislation aligns with the intention of these international agreements, the tax Acts currently contains a provision for immunities from taxation.

Reasons for change

It has come to Government's attention that some provisions of the tax Acts are not aligned with the intention of these international agreements. For example, the current provisions of section 10 of STT Act provide that no exemption provided for

by any other law will apply to the tax payable under the STT Act. This implies that the provision for exemption from taxation of any kind and description granted to the international organisation in terms of the above-mentioned international agreement will be nullified by the provisions of section 10 of the STT Act.

Proposal

In order to ensure that South Africa upholds the intention of these international agreements, it is proposed that changes be made in the STT Act to make provision for this immunity from taxation.

Effective date

The proposed amendments will come into operation on date of promulgation of the Taxation Laws Amendment Act of 2020.

4.25. Income Tax: International – Introducing an anti-avoidance provision regarding change of residence

[Applicable provisions: Sections 9H, section 10B of the Act and paragraph 64B of the Eighth Schedule to the Act]

Background

In 2001, South Africa like many other countries introduced capital gains tax aimed at levying capital gains tax on the gain made from the disposal of certain assets. When a South African tax resident company redomiciles abroad and changes the tax residency to another tax jurisdiction, such company ceases to be tax resident for South African income tax purposes (regardless of whether the assets of such company are still located in South Africa or whether the company still continues to do business in South Africa or not). Generally, the cessation of South African tax residence is deemed to be a disposal for capital gains tax purposes and triggers capital gains tax.

The Act deems the South African tax resident company to have disposed all the assets for a consideration equal to their market value. As a result, the deemed

disposal is subject to CGT at the prevailing tax rates.

Subsequently, in 2003, South Africa introduced a participation exemption in section 10(1)(k)(ii)(aa) to (dd) which moved to 10B(2) of the Act which exempts from income tax any foreign dividends declared by non-resident companies to a South African tax resident holding at least 10% of the equity shares and voting rights in such companies. And in paragraph 64B of the Eighth Schedule to the Act which exempts from capital gains tax any disposal of equity shares held by a South African tax resident holding a least 10% of the equity shares and voting rights in a non-resident company.

The policy rationale for participation exemption in section 10B(2) which exempts foreign dividends

from income tax where a South African tax resident has a meaningful interest in the non-resident company paying the dividend was to encourage capital inflows and to provide an incentive for South African tax residents to repatriate foreign dividends to South Africa.

On the other hand, the policy rationale for participation exemption in paragraph 64B of the Eighth Schedule to the Act which exempts from capital gains tax any disposal of equity shares held by a South African tax resident holding a least 10% of the equity shares and voting rights in a non-resident company follows the notion behind the participation exemption in section 10B(2) for foreign dividends. The understanding is that the profits realised from the sale of shares represent unrealised dividends and that such profits would in any event have qualified for the participation exemption in section 10B(2) for foreign dividends had they been declared as a dividend to the South African tax resident shareholder.

Reasons for change

The interaction between the current rules aimed at taxing capital gains in the hands of the South African tax resident shareholders on the disposal of the shares in a South African company and the rules providing a participation exemption from capital gains tax on the disposal of equity shares held by a South African tax resident holding a least 10% of the equity shares and voting rights in a non-

resident company creates a loophole.

Government has noticed an increased use of participation exemption by South African tax resident shareholders. These erode the South African tax base in instances where a South African tax resident company changes its tax residency to another tax jurisdiction and shares in that company are subsequently sold by South African shareholders, which qualify for a participation exemption.

For example, on day 2, a South African tax resident company changes its tax residence to another tax jurisdiction (foreign Newco) and triggers a deemed disposal of its assets on day 1. On day 3, after exit, the South African tax resident shareholders dispose of the equity shares in foreign Newco and qualify for participation exemption in respect of the gain on disposal of the shares, even though the unrealised growth in the value of the shares occurred while the company was a South African tax resident.

Allowing South African resident shareholders to benefit from a participation exemption on disposal of the shares in a non-resident company that was a resident company when the shares were acquired is against the intended purpose of the participation exemption. It was aimed at encouraging capital inflows and to provide an incentive for South African tax residents to repatriate foreign dividends or capital gains back to South Africa on a tax neutral basis.

Proposal

It is proposed that changes be made in section 9H of the Act to deem a South African tax resident shareholder who hold shares in a South African tax resident company that changes its tax residence to another tax jurisdiction to be deemed to have disposed of all its assets at market value on the day before it ceased to be a South African tax resident and to have reacquired the assets at market value on the day of the exit.

Effective date

The proposed amendments will come into operation on 1 January 2021 and apply in respect of the holder of shares in a company that ceases to be a resident on or after that date.

4.26. Income Tax: International – Introducing an anti-avoidance provision regarding taxation of foreign dividends received by residents

[Applicable provision: New section 10B(6A) of the Act]

Background

In general, a dividend is defined in section 1 of the Act as an amount transferred or applied by a company for the benefit of any person in respect of any share in that company. A foreign dividend is defined in section 1 of the Act as an amount that is paid or payable by a foreign company in respect of a share in that foreign company. Dividends and foreign dividends received by or accrued to a person are included in that person's gross income under paragraph (k) of the definition of 'gross income' in section 1(1) of the Act and qualify for potential exemption under section 10(1)(k)(i) or 10B of the Act.

Section 10(1)(k)(i) of the Act makes provision for dividends received or accrued from resident companies to be exempt from normal tax, subject to certain exceptions. The exceptions included under section 10(1)(k)(i) of the Act are aimed at limiting tax avoidance. These exceptions include a rule in paragraph (hh) of the proviso to section 10(1)(k)(i) referring to a scenario where a company incurs an obligation to pay deductible expenditure that is determined directly or indirectly with reference to dividends in respect of an identical share to the share from which the company received or accrued a dividend. The amount of the dividend is taxable to the extent of the deductible expenditure.

The rule in paragraph (hh) has a proviso stating that the deductible expenditure referred to must be reduced by any amount of income accrued to the company in respect of any distribution in respect of any other share that is an identical share to that share. This implies that the expenditure incurred with reference to the local dividend must be reduced by local dividends or distributions from identical shares that form part of income, as defined.

On the other hand, section 10B of the Act makes provision for exemptions for foreign dividends from South African listed shares; for foreign dividends received by or accrued to a South African residents holding at least 10% of the equity shares and voting rights in the foreign company; and to reduce the effective rate of tax on foreign dividends to 20%.

Reasons for change

Currently, section 10B of the Act (participation exemption) does not have an anti-avoidance rule similar to paragraph (hh) of the proviso to section 10(1)(k)(i), that denies the exemptions for foreign dividends on foreign shares if the amount of a deductible expense is determined with reference to the foreign dividends. This anti-avoidance rule is required where the reference shares are shares in unlisted foreign companies or especially where the reference shares are listed on any of the South African exchanges, where taxpayers are getting a deduction for amounts determined with reference to dividends in respect of identical shares to those foreign shares.

Proposal

In order to address this anomaly, it is proposed that foreign dividends received by or accrued to a person on a share in a non-resident company be taxed in full if that person incurs deductible expenditure that is determined directly or indirectly with reference to a foreign dividend in respect of an identical share in relation to the share in that foreign company.

Effective date

The proposed amendments will come into operation on 1 January 2021 and apply in respect of foreign dividends received or accrued on or after that date.

4.27. Income Tax: International – Refining the scope of the transfer pricing rules applying to CFCs

[Applicable provision: Section 31(2) of the Act]

Background

The Act contains transfer pricing rules aimed at preventing the reduction in South African taxable income as a result of mispricing or incorrect characterisation of transactions. In particular, the definition of 'affected transaction' in section 31 of the Act includes transactions between a person that is not a resident and any other person that is a controlled foreign company in relation to a resident.

In turn, a Controlled Foreign Company (CFC) is defined in section 9D of the Act as any foreign company if more than 50% of the total participation rights or voting rights in that company are directly or indirectly held or exercisable by one or more persons that are residents.

An amount equal to the net income of a CFC is attributed to and included in the taxable income of South African resident shareholders in proportion to that resident's participation right or voting rights in the CFC.

Reasons for change

Government has identified certain instances, where the current scope of transfer pricing rules presents a limitation in its application. For example, in the case of a transaction between a controlled foreign company in relation to a resident and a non-resident connected person, a tax benefit may not be derived by the foreign company, but may be derived by a South African resident shareholder as a result of a lower inclusion of an amount equal to a portion of the controlled foreign company's net income for the resident.

Proposal

In order to address this anomaly, it is proposed that changes be made to section 31(2)(b)(ii) of the Act by referring to a tax benefit that may be derived by any resident in relation to a controlled foreign company.

Effective date

The proposed amendments will come into operation on 1 January 2021 and apply in respect of years of assessment commencing on or after that date.

4.28. Income Tax: International – Limiting the application of dividend and capital gain exemptions in loop structures

[Applicable provisions: Section 9D of the Act and paragraph 64B of the Eighth Schedule to the Act]

Background

Under the current Exchange Control Regulations of 1961, regulation 10(1)(c) provides that no person shall, except with permission granted by the National Treasury and in accordance with such conditions as the National Treasury may impose, enter into any transaction whereby capital or any right to capital is directly or indirectly exported from South Africa.

In summary, regulation 10(1)(c) implies that residents may not enter into a transaction or a series of transactions with the purpose or effect of directly or indirectly exporting capital from South Africa.

Currently it is a contravention of the Exchange Control Regulations for a resident to set up an offshore structure that re-invests into the Common Monetary Area (CMA) by acquiring shares or other interest in a CMA company or CMA asset. This is known as a 'loop structure'. The CMA countries are South Africa, Namibia, Lesotho and Eswatini.

The Financial Surveillance Department of the SARB regards this type of transactions as a contravention of the Exchange Control Regulations in that they result in or have the potential to result in the direct or indirect export of capital abroad to a non-resident company or other relevant non-resident trust or entity for the ultimate benefit of a resident. The export of capital could be in the form of dividends arising from increased profits, revenue reserves or capital reserves from

CMA growth assets of the CMA company.

However, as an exception to the above, private individuals and South African companies are permitted to acquire up to 40% equity or voting rights in a foreign target company which may in turn hold investments (including loans) in any CMA country. Loop structures where the 40% shareholding is exceeded require approval from the Financial Surveillance Department of SARB with due consideration to transparency, tax, equivalent audit standards and governance.

In general, loop structures are created as follows:

- a South African resident individual, trust or company transfers authorised or unauthorized funds from South Africa (could also be existing offshore funds or a combination thereof) to, for example, set up a foreign trust or foreign company. Authorised funds are those foreign funds held in a manner that does not contravene the Regulations;
- the foreign trust or company would then directly or indirectly (via another offshore entity) invest the authorised or unauthorised funds in South Africa, thereby creating a loop structure. The investment could be in the form of South African shares, loans or other assets;
- returns accruing to the foreign company or trust on the South African investments could be in the form of dividends, interest or other amounts; and
- the result of the loop structure could be that profits from investments by the offshore trust or company into South Africa could be accumulated offshore.

For example, where a South African resident individual invests cash and acquires the shares in a non-resident company which then acquires shares in a resident company, a loop structure will be created and the current tax rules will apply to:

- the resident company with respect to its taxable income and dividends tax will apply to dividends paid to the non-resident company, subject to the relevant double taxation treaty;
- the non-resident company, which may be taxed on South African sourced

income. The current CFC rules require an amount equal to the non-resident company's passive income, such as interest earned on loans granted to the resident company in a loop structure, to be taxed in the resident individual. However, under CFC rules dividends accrued by the non-resident company from the resident company would be exempt under section 10(1)(k) of the Act. In addition, when the non-resident company distributes the amount of the exempt dividend to the South African resident individual as a foreign dividend, the foreign dividend will be exempt for the South African resident individual under the participation exemption in section 10B of the Act. The existence of the non-resident company in the loop structure may provide tax planning opportunities for the South African individual with respect to dividends tax as the dividend flowing through the structure may not be taxed at the current dividends tax rate of 20%, but at a reduced rate or in some instances at be exempt to favourable double taxation treaties;

- a non-resident trust that is part of the loop structure. Section 25B(2A) and (2B) of the Act will tax a resident beneficiary on vesting of the capital of the trust in the resident. In addition, under paragraph 80 of the Eighth Schedule, when a non-resident trust vests an asset or an amount derived from a gain in a resident beneficiary, a capital gain that would have been determined had the trust been a resident is taken into account in the tax calculation of that resident;
- any donation, settlement or other disposition by a resident to an entity in a loop structure resulting in amounts accruing to that entity that would have been income if that entity had been a resident. The application of section 7(8) of the Act would give rise to income for the resident.

That said, the current tax rules have the effect that gains on the sale of shares in a non-resident company to a non-resident are not taxed because of the participation exemption in section 10B(2)(a) of the Act. This exemption creates tax planning opportunities.

Reasons for change

As indicated in Annexure E of the 2020 Budget Review, Government proposes to review the current exchange control rules and move towards a new capital flow management framework that is aimed at promoting investment, reducing unnecessary burdensome approvals by SARB and providing a modern, transparent and risk-based approvals framework for cross-border flows. One of the changes to the current exchange control rules envisaged above is the relaxation of the approval that is required for loop structures where the 40% shareholding is exceeded. It is stated in Annexure E of the 2020 Budget Review that the relaxation of exchange control rules in respect of loop structures will implemented after the tax amendments are implemented to address the effect of reducing South Africa's tax base by an offshore company in a loop structure.

As stated above, the Act contains some rules that may reduce the risk of loop structures. However, increased tax planning opportunities may arise as a result of the relaxation of the approval by the Financial Surveillance Department of SARB that is required for loop structures where the 40% shareholding is exceeded. These tax planning opportunities may arise from the current participation exemptions available for foreign dividends and capital gains derived from the disposal of shares in foreign companies to non-residents.

Proposal

In order to reduce tax planning opportunities that may emerge from loop structures as a result of the relaxation of the current approval requirement, the following measures are proposed:

A. Dividend exemption

In view of the fact that dividends are included in gross income under paragraph (k) of the definition of 'gross income', but may qualify for exemption under section 10(1)(k)(i), such dividends would therefore not be included in the net income of the CFC. It is proposed that changes be made in the CFC legislation so that a non-resident company that is a CFC include a portion of a dividend that is received or accrued from a resident company in net income. To determine the portion of a

dividend that is not exempt, it is proposed that the non-resident CFC include in net income an amount equal to the ratio of the number 20 to 28 of the dividend that is received or accrued from a resident company.

B. Disposal of shares in a controlled foreign company

As stated above, gains on the disposal of shares in a non-resident company to a non-resident are not taxed because of the participation exemption in paragraph 64B of the Eighth Schedule. It is proposed that the participation exemption should not apply to the disposal of shares in a CFC to the extent the value of the assets of the CFC are derived from South African assets. This will create equal tax treatment of residents holding South African assets directly versus assets held directly or indirectly by a CFC. It is further proposed that the 'look-through' rule for capital gains in paragraph (f) of the proviso to section 9D(2A) be removed. The reason is that the attribution of an amount of net income of a CFC to residents does not retain the character or nature of the underlying elements of net income for the residents.

Effective date

The proposed amendments will come into operation on 1 January 2021 and apply in respect of dividends received or accrued to any controlled foreign company during any foreign tax year commencing on or after that date, and in respect of the disposal of shares in controlled foreign companies on or after that date

4.29. Income Tax: International – Taxation of the transfer of listed securities to an offshore exchange

[Applicable provision: New section 9K of the Act]

Background

Under the current exchange control rules, a resident individual or company that owns a listed domestic security is not permitted to migrate that listed security abroad to an exchange outside South Africa without prior approval from the SARB.

This approval requirement before the transfer of a listed domestic security is imposed and administered by the financial surveillance department of SARB. The financial surveillance department of SARB has an emigration form called MP336(b) that needs to filled by any person who wants to emigrate from South Africa upon receipt of that person of a SARS Tax Clearance Certificate for emigration. This emigration form also requires the person emigrating from South Africa to include any JSE listed security that person holds that will be migrated to any exchange outside South Africa.

In general, for the financial surveillance department of SARB to approve the transfer of the securities, the following procedure needs to be met:

- an account of that person migrating needs to be opened with the exchange that is outside South Africa (exchange where securities are migrating to);
- the shares currently held on the JSE register will have to be re-materialised and removed from JSE register;
- the security, in physical form, will have to be endorsed 'non-resident' by the Authorised Dealer; and

thereafter, the security will be dematerialised directly to that person's account on the exchange that is outside South Africa.

Reasons for change

As indicated in Annexure E of the 2020 Budget Review, Government proposes to review the current exchange control rules to be replaced by implementing a new capital flow management framework that is aimed at promoting investment, reducing unnecessary burdensome approvals by SARB and providing a modern, transparent and risk-based approvals framework for crossborder flows. One of the changes to the current exchange control rules is the phasing out of the approval requirement by SARB when a resident individual or company that owns a listed domestic security is exporting that listed domestic security abroad.

Proposal

In order to ensure efficient application of the law, it is proposed that changes be

made in the tax legislation by introducing a new rule that triggers a deemed disposal and reacquisition of a security when a domestic listed security is removed from the JSE register and is listed on an exchange that is outside South Africa. In addition, if the person holding the security remains a South African tax resident, such person will be liable for income tax on further gains when the security is subsequently sold.

Effective date

The proposed amendments will come into operation on 1 January 2021 and apply in respect of any security listed on an exchange outside of South Africa on or after that date.

4.30. VAT – Reviewing the VAT accounting basis option available for an intermediary

[Applicable provision: Sections 15(2)(a)(vii) and 54(2B) of the VAT Act.

Background

In 2018, amendments were made to the Regulations Prescribing Electronic Services. The main aim of the amendments to the Regulations was to widen the scope of the Regulations to apply to all 'services' as defined in the VAT Act that are provided by means of an electronic agent, electronic communication or the internet for any consideration.

Consequently, changes were made to section 54 of the VAT Act by introducing subsection (2B) which makes provision for certain supplies made by an underlying foreign electronic service supplier to be deemed to be made by the intermediary, who is then required to levy and account for South African VAT on these supplies.

Further, section 15(2)(a)(vii) of the VAT Act permits vendors that are foreign electronic service suppliers to apply to SARS to account for VAT on a payments basis. In terms of the payments basis of accounting for output and input tax credits, the vendor will account for output tax only when payments are actually received (as

opposed to when an invoice is issued). On the other hand, such vendor will only be entitled to input tax credits when payment is made (as opposed to when an invoice is received).

Reasons for change

At issue is the fact that section 15(2)(a)(vii) of the VAT Act which allows a vendor that is a foreign electronic service supplier to apply to SARS to account for VAT on a payment basis does not however, allow a vendor that is an intermediary to account for VAT on the same payment basis. This creates an inconsistency in the VAT treatment in respect of suppliers of the same services, namely, foreign electronic services.

Proposal

In order to address this, it is proposed that changes be made in section 15(2)(a)(vii) to permit vendors that are deemed as suppliers for purposes of supplying foreign electronic services in terms of section 54(2B) to apply to SARS to register for VAT on the payments basis.

Effective date

The proposed amendments will come into operation on 1 April 2021.

4.31. VAT – Changing the VAT treatment of transactions under the corporate reorganization rules

[Applicable provision: Sections 8(25) and 11(1)(e) of the VAT Act]

Background

Section 8(25) of the VAT Act makes provision for VAT relief during corporate reorganization transactions between companies that form part of the same group of companies. This is achieved by treating the supplier and the recipient of the goods or services as the same person, provided that the relevant rollover relief provisions of the Income Tax Act are met. The proviso to section 8(25) of the VAT Act states that with respect to supplies between group companies contemplated in

sections 42 (asset for share transactions - company formations) or section 45 (intragroup transaction) of the Income Tax Act, the VAT relief is only available if the transfer relates to the transfer of an enterprise, or part of an enterprise capable of separate operation, as a going concern.

In turn, section 11(1)(e) of the VAT Act dealing with zero rating of certain supplies makes provision for the supply of an enterprise or part of an enterprise capable of separate operation to be subject to VAT at the zero rate, provided that certain requirements are met. In order for the supply of a going concern to qualify as a zero-rated supply in terms of section 11(1)(e) of the VAT Act as clarified by SARS Interpretation Note 57 (dated 31 March 2010), the following requirements must be met:

- The seller and purchaser must be registered vendors.
- The supply must consist of an enterprise or part of an enterprise which is capable of separate operation.
- The parties must agree in writing that the supply is a going concern.
- The seller and purchaser must, at the conclusion of the agreement, agree in writing that the enterprise will be an income-earning activity on the date of transfer thereof.
- The assets necessary for carrying on the enterprise must be disposed of to the purchaser.
- The parties must agree in writing that the consideration for the supply includes VAT at the zero rate.

Reasons for change

At issue is that the relevant Income Tax roll over relief provisions may not apply to the transfer of certain assets and hence that transfer will also not qualify for the VAT relief, even though the assets form part of the entire transaction. For example, Group Company A wishes to transfer an entire going concern to Group Company B. However, some of the assets being transferred do not qualify for the section 45 roll over relief of the Income Tax Act due to the base costs of those assets

exceeding their market value. As a consequence of this, the VAT relief provided for in section 8(25) will also not apply, rendering the supply of those assets subject to VAT at the standard rate. The assets on their own do not constitute the transfer of a going concern or part thereof capable of separate operation.

This limitation of relief creates unintended consequences for VAT. The entire transaction could qualify for VAT relief under the going concern provisions of section 11(1)(e) of the VAT Act but are excluded because the transaction falls within the ambit of the corporate reorganisation rules, which automatically require that the provisions of section 8(25) of the VAT Act apply.

Proposal

In order to address this limitation, it is proposed that amendments be made to section 8(25) of the VAT Act. It is proposed that vendors be permitted to elect to agree in writing that the provisions of section 8(25) of the VAT Act will not apply to the transfers contemplated in section 42 or 45 of the Income Tax Act, and instead the provisions of section 11(1)(e) of the VAT Act will be applicable to the transfer between the group companies.

Effective date

The proposed amendments will come into operation on 1 April 2021.

4.32. VAT – Clarifying the VAT treatment of irrecoverable debts

[Applicable provision: Proviso (ii) to section 22(3) of the VAT Act]

Background

Vendors that account for VAT on the invoice basis generally claim input tax credits in the tax period in which a valid tax invoice was received, irrespective of whether payment was actually made or not. Payments for such supplies may be due at a later date or be payable over a period of time.

The input tax credit claimed would be on the full VAT payable in terms of that tax invoice. In turn, section 22(3) of the VAT Act provides that where such payment is

not made in full within a period of 12 months after the expiry of the tax period in which the deduction was made, the vendor that claimed the input tax credit is required to make an adjustment in the VAT return whereby the vendor declares output tax to SARS calculated on the unpaid amount. Further, proviso (ii) to section 22(3) of the VAT Act provides that where such a vendor is sequestrated, declared insolvent, enters into a compromise in terms of section 155 of the Companies Act, 2008 (typically business rescue scenarios) or ceases to be a vendor, the vendor must within 12 months after the expiry of the period in which a deduction was made, declare the output tax on the unpaid amount at the time of occurrence of the sequestration, declaration of insolvency or compromise arrangement, or immediately before ceasing to be a vendor.

Reasons for change

The current provisions of the VAT Act provide clarity on the time of supply within which such output tax is to be declared. However, where proviso (ii) to section 22(3) applies, there is uncertainty regarding the application of the value of supply rule as it seems to indicate that the value of the output tax payable is equal to the unpaid amount. This is against the intention of the legislation as the intention was that the output tax be calculated by applying the tax fraction to the unpaid amount.

Proposal

In order to remedy the anomaly, it is proposed that the provisions of proviso (ii) to section 22(3) be amended to state clearly that the output tax due must be calculated by applying the tax fraction (at the rate applicable when the input tax deduction was made) to the unpaid amount.

Effective date

The proposed amendments will come into operation on 1 April 2021.

4.33. VAT – Reviewing the section 72 decision with regard to the VAT treatment of telecommunication services

[Applicable provision: Section 11(2) of the VAT Act]

Background

In 2019 changes were made to section 72 of the VAT Act, which provides SARS with the discretionary powers to make arrangements or decisions as to the manner in which the provisions of the VAT Act shall be applied or the calculation or payment of tax or the application of any rate of zero per cent or any exemption from tax provided for in terms of the VAT Act, provided that SARS is satisfied that as a consequence of the manner in which any vendor or class of vendors conducts his, her or their business, trade or occupation, difficulties, anomalies or incongruities have arisen or may arise in regard to the application of the VAT Act.

These changes have an impact on the arrangements or decision made in terms of this section before 21 July 2019. One of the arrangements and decisions made in terms of section 72 of the VAT Act before 21 July 2019, which is impacted by these changes refers to the VAT treatment of telecommunication services.

Reasons for change

South Africa is a signatory to the International Telecommunications Regulations that were concluded at the World Administrative Telegraph and Telephone Conference, Melbourne 1988 (the Melbourne ITR) as well as the International Telecommunication Regulations that were concluded at the World Conference on International Telecommunication held in Dubai in 2012 (effective 2015) (Dubai ITR). In terms of these ITRs, the SA vendors may only levy VAT on these charges if the customer has a South African billing address. SA vendors supplying roaming and other services to non-resident telecommunications suppliers are thus obliged, in terms of the Dubai ITR, to zero-rate these charges levied to their non-resident counterparts.

SARS had, before 21 July 2019, issued rulings in terms of section 72 of the VAT Act to vendors in the telecommunications industry to zero-rate the charges levied

to their non-resident counterparts so as to give effect to the Dubai ITR, in respect of transactions between resident telecommunications service suppliers and non-resident telecommunications services suppliers.

In view of the fact that the 2019 changes to section 72 of the VAT Act imply that all the rulings issued by SARS before 21 July 2019 that relate to the VAT treatment of telecommunication services will no longer be valid after 31 December 2021, at issue is whether these rulings should be discontinued or extended in accordance with the new provisions of section 72 of the VAT Act.

Proposal

In order to ensure that the provisions of the Dubai ITR are upheld, it is proposed that changes be made in section 11 of the VAT Act dealing with zero ratings. As such, it is proposed that a new subsection be inserted which deals with zero rating of supplies between resident telecommunications services suppliers and non-resident telecommunications services suppliers in terms of the Dubai ITR Agreement.

Effective date

The proposed amendments will come into operation on 1 April 2021.

4.34. VAT – Reviewing the section 72 decision with regard to the VAT treatment of cross border leases of foreign-owned ships, aircraft and other equipment for USA in South Africa

[Applicable provision: Definition of 'enterprise' in section 1(1) and section 23(2) of the VAT Act]

Background

In 2019 changes were made to section 72 of the VAT Act, which provides SARS with the discretionary powers to make arrangements or decisions as to the manner in which the provisions of the VAT Act shall be applied or the calculation or payment of tax or the application of any rate of zero per cent or any exemption

from tax provided for in terms of the VAT Act, provided that SARS is satisfied that as a consequence of the manner in which any vendor or class of vendors conducts his, her or their business, trade or occupation, difficulties, anomalies or incongruities have arisen or may arise in regard to the application of the VAT Act.

These changes have an impact on the arrangements or decisions made in terms of this section before 21 July 2019. One of the arrangements and decision made in terms of section 72 of the VAT Act before 21 July 2019, which is impacted by these changes refers to the VAT treatment of cross border leases of foreign owned ships, aircraft and other equipment for use in South Africa.

Reasons for change

Section 1(1) of the VAT Act defines an 'enterprise' in the case of any vendor, to generally mean any enterprise or activity which is carried on continuously or regularly by any person in or partly in South Africa and in the course or furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit. In turn, a 'vendor' is defined in section 1(1) of the VAT Act to mean any person who is or is required to be registered for VAT in South Africa.

In instances where foreign-owned ships, aircraft or other equipment are leased for use in South Africa, and the lessor of such goods has no physical or business presence in South Africa (other than the leased goods), and the lessee is obliged in terms of the lease agreement to import the goods into South Africa, uncertainty existed regarding whether the foreign lessor is conducting an enterprise in South Africa.

In order to address this uncertainty, SARS had, before 21 July 2019, issued rulings in terms of section 72 of the VAT Act to lessors stating that the foreign lessors are not required to register as vendors and requiring the lessee in South Africa to declare and pay the VAT on the importation of the goods, the value of which was determined having regard to the term of the lease agreement in order to ensure that the lessors do not import these goods into South Africa and have no commercial intention to operate in South Africa.

In view of the fact that the 2019 changes to section 72 of the VAT Act imply that all

the rulings issued by SARS before 21 July 2019 that relate to the VAT treatment of cross border leases of foreign-owned ships, aircraft and other equipment for use in South Africa will no longer be valid after 31 December 2021, at issue is whether these rulings should be discontinued or extended in accordance with the new provisions of section 72 of the VAT Act.

Proposal

In order to address the uncertainty with regard to cross border lease agreements in instances where the lessee imports the goods for use in South Africa and the lessor of such goods is not a resident of South Africa and is not a registered vendor, it is proposed that changes be made in the VAT legislation. It is proposed that the definition of an 'enterprise' in section 1(1) of the VAT Act should be amended to exclude such lessor from the requirement to register for VAT in South Africa in instances where the lessee imports the goods for use in or partly in South Africa and the lessor of such goods is not a resident of South Africa and is not a registered vendor. That said, further changes should be made to compel the lessee to declare the VAT on the importation of the goods.

Effective date

The proposed amendments will come into operation on 1 April 2021.

4.35. VAT – Reviewing the section 72 decision with regard to the VAT treatment of the management of superannuation schemes

[Applicable provisions: Sections 2(1)(i) and 10(22A) of the VAT Act]

Background

In 2019 changes were made to section 72 of the VAT Act, which provides SARS with the discretionary powers to make arrangements or decisions as to the manner in which the provisions of the VAT Act shall be applied or the calculation or payment of tax or the application of any rate of zero per cent or any exemption

from tax provided for in terms of the VAT Act, provided that SARS is satisfied that as a consequence of the manner in which any vendor or class of vendors conducts his, her or their business, trade or occupation, difficulties, anomalies or incongruities have arisen or may arise in regard to the application of the VAT Act.

These changes have an impact on the arrangements or decisions made in terms of this section before 21 July 2019. One of the arrangements and decision made in terms of section 72 of the VAT Act before 21 July 2019, which is impacted by these changes refers to the VAT treatment of the management of superannuation schemes.

Reasons for change

Suppliers of long-term insurance policies, including superannuation schemes generally levy a consolidated charge for both the insurance cover and the fees or commissions charged. In 1996, a special valuation rule was introduced in section 10(22A) of the VAT Act, in order to assist the above-mentioned vendors to determine the value on which to declare the VAT on the fees / commission portion of the supplies. In terms of this section, such vendors are required to use the higher of the cost of making such supply or any consideration for such supply which would be embedded in the premium charged.

The application of the valuation rule available in section 10(22A) of the VAT Act has been challenging, especially to the suppliers of long-term insurance policies, including superannuation schemes that generally levy a consolidated charge for both the insurance cover and the fees or commissions and are also not able to correctly determine the costs involved in managing the superannuation scheme. As a result, SARS had, before 21 July 2019, issued a Binding General Ruling BGR (No. 34) to the industry in terms of section 72 of the VAT Act prescribing a method for the calculation of the cost of making such supplies.

In view of the fact that the 2019 changes to section 72 of the VAT Act imply that all the rulings issued by SARS before 21 July 2019 that relate to the VAT treatment of the management of superannuation schemes will no longer be valid after 31 December 2021, at issue is whether these rulings should be discontinued or

extended in accordance with the new provisions of section 72 of the VAT Act.

Proposal

In order to ensure that such vendors do not encounter difficulty in determining the cost of making such supplies, it is proposed that changes be made in the VAT legislation. As such, it is proposed that section 10(22A) of the VAT Act be deleted. This will have the effect that, where there is no fee embedded in the premium charged by the long-term insurer, the entire premium will be exempt under section 2 of the VAT Act.

Should a long-term insurer wish to embed a fee in the premium charged, such premium will constitute a consolidated charge and section 10(22) of the VAT Act will be applicable. Section 10(22) requires a vendor to attribute that portion of the consideration received (being a consolidated charge for more than one supply) to the making of taxable supplies as is properly attributable to it. Although the fee / commission part of any superannuation scheme is not separately reflected in any tax invoice, the vendor, in the normal course of business, would still be in a position to determine what this fee amount is.

Effective date

The proposed amendments will come into operation on 1 April 2021.

5. DRAFT MEMORANDUM ON THE OBJECTS OF THE TAX ADMNISTRATION LAWS AMENDMENT BILL, 2020

5.1. Income Tax – Replacing 'mentally disordered' and 'defective person' with 'mentally disabled'

Amendment of section 1

The terms 'mentally disordered' and 'defective person' are inappropriate. It is proposed that these terms be replaced with a modern term of more general

application, namely, 'mentally disabled'.

5.2. *Income Tax – Section 18A subject to SARS' discretion, subject to objection and appeal*

Amendment of section 3

The proposed amendment to section 18A(1)(bA) to specify that the approval for purposes of section 18A is subject to the discretion of SARS, should be subject to objection and appeal. Section 3(4)(b) should therefore be amended to include section 18A(1)(bA)(dd).

5.3. *Income Tax – Section 18A conduit PBOs*

Amendment of section 18A

Currently a conduit public benefit organisation (PBO) approved under section 18A(1)(b), can only provide funds and assets to a PBO or an institution, board or body approved by SARS under section 18A(1)(a) carrying on public benefit activities (PBAs) in Part II of the Ninth Schedule, in South Africa. The proposed amendment aims to ensure that a conduit PBO can also provide funds and assets to any department of government of South Africa contemplated in section 10(1)(a) which has been approved by SARS under section 18A(1)(c).

The amendment intends to align section 18A(1)(bA) with sections 18A(1)(a), (b) and (c) to clarify that an application for approval by SARS is required.

The proposed amendments to section 18A(1)(2A)(b)(ii) and 18A(2D) as consequential to the amendment to section 18A(1)(b) allowing a conduit PBO to also provide funds or assets to a department contemplated in section 18A(1)(c). The proposed amendment furthermore, affects some textual changes, clarifies existing wording and aligns the current wording with that of section 18A(1)(b) that provides for a conduit PBO to provide funds as well as assets.

It is a requirement that a public benefit organisation, an institution, board or body or

a department approved by SARS for purposes of section 18A carrying on a combination of PBAs in Parts I and II of the Ninth Schedule, must obtain and retain an audit certificate confirming that all donations received or accrued in the year of assessment for which section 18A receipts were issued were used solely in carrying on PBAs in Part II in South Africa. In the case of a department the audit certificate must be submitted annually to the Commissioner.

In the case of a conduit PBO, it is a requirement to obtain and retain an audit certificate to confirm that at least 50% of the donations will be distributed within 12 months and that the funds or assets will be used to fund a PBO, institution, board or body or a department carrying on PBAs in Part II.

It is proposed that the audit certificate requirement be added to the listed requirements where non-compliance may give rise to the taxation of donations and ultimately the invalidity of section 18A receipts.

5.4. Income Tax – Withholding tax on royalties refund

The withholding tax on interest provisions provide for a refund of excess withholding tax on interest withheld if the required declaration was not submitted in time (a refund to the person entitled to the interest) or the interest subsequently proves to be irrecoverable (a refund to the person who withheld and paid over the tax when it became due and payable).

However, the withholding tax on royalties provisions only provide for a refund if the declaration is not submitted.

It is proposed that provision be made for a situation where the withholding tax on royalties that was due and payable (in other words, it triggered a withholding tax on royalties) subsequently becomes irrecoverable, to be aligned with the withholding tax on interest provisions.

5.5. *Income Tax – Exempt Associations*

Amendment of paragraph 1 of Fourth Schedule

Although receipts and accruals of entities as defined in section 30B(1) and approved by SARS under section 30B(2) are currently fully exempt from payment of income tax, there may be instances where such entities fall within the ambit of the definition of 'provisional taxpayer' by virtue of them being companies.

It is proposed that these entities be excluded from the definition of 'provisional taxpayer'.

5.6. *VAT – Imported services, VAT215*

Amendment of section 14

Where a recipient is required to pay tax in terms of section 7(1)(c), and the exceptions and exclusions listed under section 14(5), inter alia, do not apply, the recipient is required to furnish a return to SARS, i.e. a Form VAT215.

However, as a consequence of the VAT modernisation initiative, the channel to furnish SARS with a return, i.e. the VAT215, was removed.

Consequently, the recipient of the imported services will not be able to file the return as required by legislation and it is proposed that this requirement be substituted with a requirement to obtain, complete and retain the VAT215.

5.7. *TA Act – Estimation of assessments*

Amendment of section 95

SARS may currently issue an assessment based on an estimate to a taxpayer who does not file a return. The assessment may not be disputed until the relevant return is filed and SARS has failed to revise the assessment in the light of the return. This ensures that all the facts are available when the assessment is revisited and that the dispute resolution timelines that would otherwise apply may be relaxed in

appropriate circumstances.

It is proposed that this approach be extended to cases where specific relevant material was requested from a taxpayer on more than one occasion, without an adequate response.

6. EXPLANATORY MEMORANDUM – MEMORANDUM OF OBJECTS OF THE DISASTER MANAGEMENT TAX RELIEF ADMINISTRATION BILL, 2020

6.1. Purpose of the BIll

The recent COVID-19 pandemic will have significant and potentially lasting impacts on the economy, with businesses facing the risk of cash flow problems. Tax compliant micro, small and 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 micro, small and 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 gross income. The benefit of the measure is immediate cash flow relief that could enable businesses to survive.

Furthermore, allowing for a deferral of interim payment and provisional tax liabilities should assist these businesses by providing additional cash flow during the crisis. This could be the difference between pushing a micro, 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.

A provision to increase the percentage of donations to be considered as tax-deductible donations when determining employees' tax, seeks to alleviate the cash flow difficulties of employees where their employers contribute to the Solidarity Fund on their behalf.

A provision is included to permit vendors currently registered under either Category A or Category B, i.e. vendors currently required to submit value-added tax (VAT), returns bi-monthly, to temporarily file their returns on a monthly basis, thereby being able to submit their VAT returns more frequently and expediting any refunds that may be due to the vendor.

Provision is also made for the extension of certain time periods prescribed under the tax Acts or the Customs and Excise Act, 1964, to allow taxpayers or traders more time to comply with obligations under these Acts.

6.2. Clause 1: Definitions

The definition of ''lockdown'' seeks to provide clarity on the origin and time period of the lockdown.

The definition of ''qualifying micro business'' seeks to provide clarity on the micro businesses that qualify for the relief.

The definition of ''qualifying taxpayer'' seeks to provide clarity on the taxpayers that qualify for the relief under employees' tax and provisional tax.

The definition of ''Solidarity Fund'' seeks to provide clarity on which fund is intended for this purpose.

6.3. Clause 2: Deferral of employees' tax

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 non-resident) to deduct employees' tax, Pay-As-You-Earn (PAYE), from remuneration paid to its employees. In addition, the employer or representative employer must submit a return and the payment of PAYE withheld to the South African Revenue Service (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 Act for late payment of PAYE.

In order to assist with alleviating any cash flow burden arising as a result of the COVID-19 pandemic, the following tax measures are proposed for qualifying employers, for a limited period of four months, beginning 1 April 2020 and ending on 31 July 2020:

Deferral of payment of 35% of the PAYE liability, commencing with the payment due by 7 May 2020 and ending with the payment due by 7 August 2020, without SARS imposing administrative penalties and interest for the late payment thereof.

The deferred PAYE liability must be paid to SARS in six equal instalments commencing with the payment due by 7 September 2020 and ending with the payment due by 5 February 2021.

For the purposes of this proposal, a small or medium-sized business means a business conducted by a company, partnership, individual or trust with a gross income not exceeding R100 million for the year of assessment ending on or after 1 April 2020 but before 1 April 2021, where such gross income does not include more than 20% in aggregate of interest, dividends, foreign dividends, royalties, rental from letting fixed property, annuities, and any remuneration received from an employer. Rental from letting fixed property is not considered for the purposes of this test if the primary trading activity of the company, trust, partnership or individual is the letting of fixed property and substantially the whole of the gross income is rental from fixed property. The requirement that the gross income of the

business must not exceed R100 million for the year of assessment will be deemed to have been met if SARS is satisfied that the taxpayer's estimate of the gross income for the year of assessment, when relying on a deferral under the Act during the year of assessment, was seriously calculated with due regard to the factors having a bearing thereon and was not deliberately or negligently understated.

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 (the TA Act) on the basis required by section 25 of the TA Act; or

has any outstanding tax debt as defined in section 1 of the TA Act, but excluding a tax debt

in respect of which an agreement has been entered into in accordance with section 167 or 204 of the TA Act;

that has been suspended in terms of section 164 of the TA Act; or

that does not exceed the amount referred to in section 169(4) of the TA Act.

However, penalties and interest will apply if the employer has understated the PAYE liability for any of the four months or if it is discovered that the employer does not qualify for relief under this clause. The usual procedures for requests for remittance of such penalties will be available in such cases.

6.4. Clause 3: Deferral of provisional tax

Paragraph 17 of the Fourth Schedule to the Income Tax Act, requires 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 within stipulated parameters, or is based on an estimate made by SARS in terms of paragraph 19(2) or 19(3) of the

Fourth Schedule to the Income Tax Act.

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 should be 50% of the total estimated liability, must be made within six months after the commencement of the year of assessment. The second payment, which is the total estimated liability for the year of assessment, reduced by the first payment, must be made by no later than the last day of that year of assessment.

In order to assist with alleviating cash flow burdens arising as a result of the COVID-19 pandemic, the following tax measures are proposed for qualifying provisional taxpayers, 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 liabilities to SARS, without SARS imposing 9 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, reduced by the first provisional tax payment.
>
> Provisional taxpayers will be required to pay deferred provisional tax payments by the effective date, referred to in section 89quat of the Income Tax Act, by when additional provisional tax payments (generally referred to as the third 'top up' provisional tax payment) may be made under paragraph 23A(1) of the Fourth Schedule, for the year of assessment to which the deferred payments relate.

For the purposes of this proposal, small or medium sized business means a business conducted by a company, individual or trust with a gross income not exceeding R100 million for the year of assessment ending on or after 1 April 2020 but before 1 April 2021, where such gross income does not include more than 20%

in aggregate of interest, dividends, foreign dividends, royalties, rental from letting fixed property, annuities and any remuneration received from an employer. Rental from letting fixed property is not considered for the purposes of this test if the primary trading activity of the company, trust or individual is the letting of fixed property and substantially the whole of the gross income is rental from fixed property. The requirement that the gross income of the business must not exceed R100 million for the year of assessment will be deemed to have been met if SARS is satisfied that the taxpayer's estimate of the gross income for the year of assessment, when relying on a deferral under the Act, during the year of assessment, was seriously calculated with due regard to the factors having a bearing thereon and was not deliberately or negligently understated.

The following sanctions are applicable to provisional tax:

Paragraph 27 of the Fourth Schedule to the Income Tax Act makes provision for a 10% penalty for late payment of a provisional tax liability for both the first and second provisional tax periods. Relief from this penalty will be provided in respect of the deferred amounts of provisional tax.

Paragraph 20 of the Fourth Schedule to the Income Tax Act makes provision for a penalty on the underpayment of a liability in respect of the second provisional tax period as a result of underestimation of taxable income for the year of assessment, reduced by any penalty imposed in terms of paragraph 27 of the Fourth Schedule. This penalty will still apply as the estimation of the provisional tax liability must still be correct, although only in respect of the reduced amount that needs to be paid if the deferral is used. The normal provisions in respect of an underestimation penalty will apply.

Section 89bis of the Income Tax Act provides for interest on the unpaid portion of a provisional tax liability. Relief from this interest on the deferred amounts will be provided.

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 TA Act, as

required by section 25 of the TA Act; or

has any outstanding tax debt, as defined in section 1 of the TA Act, but excluding a tax debt

in respect of which an agreement has been entered into in accordance with section 167 or 204 of the TA Act;

that has been suspended in terms of section 164 of the TA Act; or

that does not exceed the amount referred to in section 169(4) of the TA Act.

However, penalties and interest will apply in instances where, upon assessment, it is discovered that a taxpayer does not qualify for relief under the proposed amendments. The usual procedures for requests for remittance of such penalties will be available in such cases.

The proposed amendments are deemed to have come into operation on 1 April 2020. They 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.

6.5. Clause 4: Deferral of interim payments by micro businesses

Similar relief to the 15% and 65% relief with regard to provisional tax payments is provided for qualifying micro businesses with regard to interim payments payable in terms of paragraph 11 of the Sixth Schedule to the Income Tax Act.

In terms of paragraph 11(6) of the Sixth Schedule to the Income Tax Act, penalty relief will be granted on the deferred interim payments and no interest under paragraph 11(3) or (5) of the Sixth Schedule will be levied on deferred interim payments that are payable on assessment.

The above-mentioned proposals will not apply to a micro business that

has failed to submit any return, as defined in section 1 of the TA Act, as required by section 25 of the TA Act; or

has any outstanding tax debt, as defined in section 1 of the TA Act, but excluding a tax debt:

in respect of which an agreement has been entered into in accordance with section 167 or 204 of the TA Act;

that has been suspended in terms of section 164 of the TA Act; or

that does not exceed the amount referred to in section 169(4) of the TA Act.

However, penalties and interest will apply in instances where, upon assessment, it is discovered that a micro business does not qualify for relief under the proposed amendments. The usual procedures for requests for remittance of such penalties will be available in such cases.

6.6. Clause 5: Donations to Solidarity Fund

The COVID-19 pandemic has led to the establishment of the Solidarity Fund to provide relief focused on the impact of COVID-19. The Solidarity Fund is an approved Public Benefit Organisation that has also been approved under section 18A of the Income Tax Act. Donations to this fund, therefore, qualify for a deduction in determining the donor's taxable income. Due to the exceptional circumstances presented by the COVID-19 pandemic South Africans have been called upon to contribute to the Solidarity Fund.

The President stated, in his address to the nation on 9 April 2020, that a range of office bearers would take a one-third cut in their salaries for three months and that this portion of their salaries would be donated to the Solidarity Fund. A number of private sector entities have subsequently indicated that they would be following suit. While it is often open to employers and employees to renegotiate employment contracts, so that the relevant amounts do not accrue to the employees for tax purposes, this is not always possible. Where this is not possible, donations to the Solidarity Fund for which a section 18A receipt has been issued may be taken into account on assessment.

In order to assist with payroll giving initiatives, paragraph 2(4)(f) of the Fourth Schedule to the Income Tax Act currently permits donations of up to 5% of remuneration to be taken into account for employees' tax purposes where an employer deducts and pays over donations on the employees' behalf.

To alleviate the cash flow difficulties of employees where their employers deduct and pay over their donations to the Solidarity Fund on their behalf, Government is proposing a special relief measure by temporarily increasing the current 5% deductibility limit in the calculation of monthly PAYE of the employee. An additional limit of up to a maximum of 33.3% for three months or 16.66% for six months, depending on an employee's level of donations, will be available over and above the current 5% deductibility limit.

This will ensure that the employee gets the deduction that is in excess of 5% much earlier than under normal circumstances and the employee will therefore not have to wait until final assessment to claim a potential refund, provided the donation is made to the Solidarity Fund. It is, however, important to note that a final determination must still be made upon assessment as the employee may have other income, deductions or losses that impact the final taxable income before the deduction of donations.

The proposed amendments are deemed to have come into operation on 1 April 2020 and apply until 30 September 2020.

6.7. Clause 6: Change in Value-Added Tax category

Vendors are required to submit VAT returns and account for VAT according to the tax period that has been allocated to the vendor by SARS. In terms of section 27 of the Value-Added Tax Act, 1991 (the VAT Act), vendors are generally required to register for VAT under Category A or B which provide for returns to be submitted bi-monthly i.e. the vendor submits one return for every two calendar months.

The exceptions are vendors that fall under Category C, D or E. Vendors registered under Category C file returns and account for VATn a monthly basis. This category

is generally applicable to vendors making taxable supplies of over R30 million per annum.

In terms of section 27(3)(b) of the VAT Act a vendor may apply in writing to SARS to be registered under Category C, thereby permitting such vendor to file and account for VAT on a monthly basis. This change in category must be effected via an application that must be made to SARS by the vendor in writing. This approach provides vendors with the option of changing their filing category to monthly.

In order to assist businesses, the proposal is to temporarily permit vendors to file their returns monthly (without the need to apply in writing to SARS), while still technically remaining under Category A or B. This option will be made available to all Category A and B vendors who may choose to temporarily file their VAT returns monthly or continue to file bi-monthly returns. The purpose of the measure is to assist businesses with liquidity by filing VAT returns more frequently to expedite potential refunds.

It is proposed that this filing option be effective for a limited maximum of four tax periods. After this period, vendors registered under Category A or B will no longer be able to file returns on a monthly basis, unless such vendor makes an application to SARS for a change in category in terms of section 27(3)(b) of the VAT Act.

Category A vendors will be permitted to file monthly returns for the April and May tax periods and June and July 2020 tax periods, should such vendor choose to do so. Category B vendors will be permitted to file monthly returns for the May and June tax periods and July 2020 tax period, should such vendor choose to do so. Should a Category B vendor choose to file a monthly return for July 2020, a monthly return for August 2020 will be required to return the vendor to the normal bi-monthly return cycle.

The proposed amendments are deemed to have come into operation on 1 April 2020 and relate to the tax periods discussed above.

6.8. *Clause 7: Extension of time periods*

Clause 7(1) — this clause provides which time periods prescribed under the tax Acts are affected by the COVID-19 lockdown period. In respect of the listed periods, the lockdown period will be regarded as dies non, i.e. a day that has no legal effect and which will not be counted for purposes of the calculation of the listed time periods. This is intended to provide individuals and businesses impacted by COVID-19 with additional time to comply with selected tax obligations or due dates that are affected by or fall within the lockdown period but does not extend to return filing or payments. The processes made available by SARS must be followed for requests for instalment payment agreements in terms of section 167 of the TA Act.

The woring of the clause is the following:

'**7.** *(1) For purposes of the calculation of a time period prescribed under a tax Act, as defined in section 1 of the Tax Administration Act, the period of the lockdown must be regarded as dies non for a time period prescribed—*

(a) under section 49G(1), section 50G(1), section 64L(1) and section 64M(1) of the Income Tax Act, for purposes of calculating the three-year period for submitting the prescribed documentation;

(b) in respect of a notice under section 47 of the Tax Administration Act if the notice requires a taxpayer to attend an interview on a date within the lockdown period;

(c) in respect of a notice under section 48(1) of the Tax Administration Act if the date of the field audit in the notice is on a date within the lockdown period;

(d) for a notice to appear at an inquiry under section 53 of the Tax Administration Act if the date of appearance is on a date within the lockdown period;

(e) under section 60(3) in respect of a warrant of search and seizure issued under section 60 of the Tax Administration Act;

(f) *in respect of an application for a ruling under Chapter 7 of the Tax Administration Act;*

(g) *under section 99(1) of the Tax Administration Act;*

(h) *in relation to section 100 of the Tax Administration Act, except for section 100(1)(a)(i);*

(i) *in respect of dispute resolution under Chapter 9 of the Tax Administration Act, including the dispute resolution rules under section 103;*

(j) *in respect of the application for the remittance of penalties under section 215(3) of the Tax Administration Act; (k) in respect of a penalty incorrectly assessed under section 219 of the Tax Administration Act;*

(l) *in respect of the extension of deadlines under section 244(3) of the Tax Administration Act;*

(m) *for the appointment of a public officer under section 246(2)(d) of the Tax Administration Act; and*

(n) *in respect of revoking third party access under section 256(6) of the Tax Administration Act.'*

7. REGULATIONS

7.1. Interest rates

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

DATE FROM	DATE TO	RATE
1 May 2020	30 June 2020	9,75%
1 July 2020	31 August 2020	7,75%
1 September 2020	31 October 2020	7,25%

1 November 2020	Until change in PFMA rate	7,00%

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

DATE FROM	DATE TO	RATE
1 May 2020	30 June 2020	5,75%
1 July 2020	31 August 2020	3,75%
1 September 2020	31 October 2020	3,25%
1 November 2020	Until change in PFMA rate	3,00%

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

A taxable benefit (fringe benefit) arises if an employee incurs a debt in favour of the employer, any other person by arrangement with the employer, or an associated institution in relation to the employer, if no interest is payable or if the interest payable is less than the 'official rate of interest'. The difference between the amount which would have been payable if the debt had incurred interest at the official rate, and the interest actually paid by the employee, is taxed as a fringe benefit:

DATE FROM	DATE TO	RATE
1 May 2020	31 May 2020	5,25%
1 June 2020	31 July 2020	4,75%
1 August 2020	Until change in Repo rate	4,50%

8. DRAFT REGULATIONS

8.1. Regulations prescribing electronic services for purposes of definition of 'electronic services' in section 1 of the VAT Act

Definitions

1. In these Regulations, 'the Regulations' means the regulations published by Government Notice No. R.221 of 28 March 2014, as amended by Government Notice No. R.429 of 18 March 2019.

Amendment of regulation 1 of the Regulations

2. Regulation 1 of the Regulations is hereby amended—

(a) by the insertion of the following definition:

'content' means the signals, writing, images, sounds or information of any kind that are transmitted, emitted or received by a telecommunications service.

(b) by the substitution for the definition of 'telecommunications services' of the following definition:

'telecommunications services' means the transmission, emission or reception, and the transfer or assignment of the right to use capacity for the transmission, emission or reception, of signals, writing, images, sounds or information of any kind by wire, cable, radio, optical or other electromagnetic system, or by a similar technical system, and includes access to global information networks but does not include the content of the telecommunication.

Short title

3. These Regulations are called the Electronic Services Regulations.

9. TAX CASES

9.1. Telkom SA SOC Ltd v C:SARS

A wholly-owned subsidiary of the Appellant, Telkom SA SOC Ltd (Telkom), had made a disastrous investment when it acquired 75% of the issued share capital in Multi-Links Telecommunications Ltd (Multi-Links), a company registered and tax-resident in Nigeria, during May 2007 and, to make matters worse, Telkom then acquired the remaining 25% shareholding in Multi-Links during a subsequent year of assessment that ended in March 2009.

Telkom, in addition, made a number of shareholder loans to Multi-Links, as it required substantial capital from Telkom to become commercially viable, all of which were denominated in US dollars.

Telkom, by October 2010, had advanced a total amount of $877 022 900.86 to Multi-Links, of which $346 000 000 was converted into preference share equity, while the remainder of the loans in the amount of $531 022 900.86 were outstanding on the loan account.

From 2009 the prospects of Multi-Links repaying these loans appeared to be remote and it was apparent that there was little prospect of Telkom resuscitating the business of Multi-Links.

Telkom, however, continued to advance loans to Multi-Links until October 2011 when Telkom and Telkom International disposed of their equity interests in Multi-Links to HIP Oils Topco Ltd (HIP), an unrelated third party and as part of the sale Telkom also sold its rights in respect of its loan to Multi-Links, to HIP for $100 and this had occurred in Telkom's 2012 tax year of assessment.

Telkom, in its audited financial statements for the 2013 financial year, had reflected the realisations of these loans in the following terms: 'In determining the taxable income for the Annual Financial Statements ended 31 March 2012, Telkom included a foreign exchange gain to the value of R247 million on the realisation of the loan.'

However, in its income tax return for the 2012 year of assessment delivered to

SARS Telkom, instead of reflecting the realisation of the loan as a foreign exchange gain, had claimed a deduction in the amount of R3 961 295 256 as a foreign exchange loss, in terms of s 24I of the Income Tax Act.

The effect of this was that what would have been reflected as a taxable income of R3.12 billion, with a resultant tax liability of R875 million, was now reflected as a tax loss of R106 billion, with the result that Telkom was due for a refund of the provisional tax paid for that year, in the amount of R822 million.

SARS therefore issued an additional assessment for the 2012 tax year, disallowing the deduction of R3 961 295 256 and assessing Telkom for tax in the amount of R425 188 643, as a foreign exchange gain in terms of section 24I of the Act and this issue was referred to as the foreign exchange issue.

SARS contended that section 24I was clear and unequivocal. The rate of exchange that must be applied when an exchange item is realised is the ruling rate of exchange on the date that the realisation occurs. It had applied this amount to the capital amount of the loan and determined that a gain was required to be included in Telkom's income.

Telkom had also claimed a deduction of R178 788 421 in respect of cash incentive bonuses paid to Velociti (Pty) Ltd (Velociti) pertaining to the connection of initial subscriber contracts for a specific tariff plan, which Velociti made on behalf of Telkom Mobile.

SARS, however, only allowed a deduction of R42 256 879 and added back R136 531 542, in terms of section 23H(1)(*b*)(ii) of the Act and this issue will be referred to as the cash incentive bonus issue.

SARS, in addition, had imposed an understatement penalty in respect of the 2012 year of assessment in an amount of R91 232 665.64, on the grounds that Telkom's conduct constituted a substantial understatement of its tax liability and in the view of SARS the case warranted a 10% penalty in terms of section 223 of the Tax Administration Act.

Telkom appealed to the Cape Town Tax Court (*per* Davis J) where its appeal on the foreign exchange issue was dismissed, but its appeal on the cash incentive

bonus issue as well as the understatement penalties issue, was upheld.

Telkom, with the leave of the Tax Court, appealed to the Supreme Court of Appeal against the Tax Court's dismissal of its appeal on the foreign exchange issue and SARS cross-appealed against the Tax Court's decision to uphold Telkom's appeal on the cash incentive bonus issue, but did not cross-appeal the decision by the Tax Court on the understatement penalties issue, was accordingly not an issue in the appeal.

Judge Swain held the following:

<u>As to the foreign exchange issue</u>

(i) That the resolution of the dispute as to the deduction of R3 961 295 256 by Telkom must be found in the interpretation of the provisions of section 24I of the Act, which deals with 'gains or losses on foreign exchange transactions.' However, before dealing with the detailed submissions of Telkom and SARS, as to the correct interpretation to be placed upon this section, the submission by Telkom that its interpretation that resulted in a foreign exchange loss of R3 961 295 256 reflected the commercial reality of the transaction, whereas the interpretation advanced by SARS, that resulted in a foreign exchange gain of R267 421 739, did not, had to be considered.

(ii) That Telkom submitted that the interpretation advanced by SARS produced a result that was removed from the commercial reality and was not sensible or businesslike and it also undermined the purpose of section 24I of the Act and was unjust, inequitable or unreasonable. The enquiry is not whether this result is produced after the application of the section to the particular facts of this case, but rather whether this result is produced after the application of the fundamental interpretive technique to the section. Prof L M du Plessis answers in the affirmative, the question as to whether the common-law presumption that statute law is not unjust, inequitable or unreasonable, still has a function in the constitutional era.

(iii) That the court could accordingly see no reason why the common-law

presumption, which may facilitate resort to constitutional values in statutory interpretation, may not be used as a useful aid in purposive statutory interpretation.

(iv) That as correctly submitted by counsel for SARS, it was axiomatic that a statute must apply to all subjects equally and that its interpretation cannot vary from one factual *matrix* to the next. It is impermissible to apply a particular meaning to legislation, depending upon the factual situation, in which it is sought to be applied. The statement in *Natal Joint Municipal Pension Fund* v *Endumeni Municipality* 2012 (4) SA 593 (SCA) at para 18 that '….a sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results…' meant that in the process of attributing meaning to the words used in legislation (having regard to the words used, the context and the purpose of the legislation) one possible meaning will be preferred over another possible meaning, because the one meaning yields a commercially insensible result, for all subjects and in the appropriate context (for example commercial legislation).

(iv) That counsel for Telkom submitted that the *contra fiscum* rule should be applied at the outset, as part of the interpretive technique to be utilised in establishing the meaning of words, contained in a fiscal statute. The court, however, agreed with the submission by counsel for SARS, that the rule should only be invoked, after an interpretational analysis results in an irresoluble ambiguity as to the meaning of the particular provision in the fiscal statute.

(v) That, as regards the issue of whether any general distinction should be drawn between the interpretation of fiscal statutes and other statutes, the following *dictum* in *SIR* v *Kirsch* 40 SATC 95 sets out the correct approach: 'There is no particular mystique about 'tax law.' Ordinary legal concepts and terms are involved and the ordinary principles of interpretation of statutes fall to be applied.'

(vi) That the court then turned to consider the competing submissions by the parties as to the interpretation of the provisions of section 24I of the Act,

which dealt with 'gains or losses on foreign exchange transactions.' The resolution of the dispute as to the deduction of the R3 961 295 256 by Telkom was to be found in this section, because the loan to Multi-Links in US dollars, constituted an 'exchange item' as defined in section 24I(1) of the Act, as it was an amount in foreign currency owing and payable to Telkom.

(vii) That SARS submitted that the exchange difference in respect of the loan had to be determined by multiplying the loan, by the difference between the ruling exchange rate on the date on which the loan was realised and the ruling exchange rate on the transaction date, being the date when the loan was advanced and the ruling exchange rate of the loan on the transaction date, being the spot rate, was agreed between the parties.

(viii) That it was the determination of the ruling exchange rate, on the realisation date of the loan, that lay at the heart of the dispute between the parties. Central to the argument of Telkom was that the proviso to the definition of 'ruling exchange rate' applied on the facts of this case, with the result that the 'disposal rate' was to be used in *lieu* of the 'spot rate' because the 'disposal rate' was another 'rate', which was used to determine the consideration, payable for the loan. Telkom submitted that the $ 100 received by it as consideration for the disposal of the Multi-Links loan, was obviously not determined by applying the spot rate, defined as an exchange rate quoted by an authorised dealer at a specific time. The spot rate, as defined, on the relevant date, was 7,9600. According to Telkom, if that rate had been applied, the consideration would have been R3 959 520 551 and not R799, being the loan equivalent of $ 100.

(ix) That Telkom had submitted that in the context of the proviso to the definition of 'ruling exchange rate', where another 'rate' was applied to determine the consideration payable, the 'disposal rate' as defined, was to be used in *lieu* of the 'spot rate' as defined. The word 'rate' in the proviso was therefore directly linked with the definition of 'disposal rate' and, consequently, so the argument went, the immediate context of the word

'rate' was accordingly the definition of 'disposal rate.' The context of the word 'rate' therefore indicated that the word did not refer to an exchange rate between currencies, but to an agreement as to value or worth.

(x) That the Tax Court rejected the argument of Telkom and concluded that it had impermissibly invoked the provision involving exchange rate gains and losses, in order to deduct a commercial loss, which was completely unconnected to foreign exchange currency differences and that section 24I of the Act was not a self-standing deduction provision.

(xi) That SARS supported the findings of the Tax Court and submitted that for the proviso to the 'ruling exchange rate' to apply, Telkom had to demonstrate that the consideration received by it in respect of the disposal of the loan, was determined by applying a rate other than the spot rate, on the realisation date. However, the consideration for the loan of $ 100 was agreed by reference only to the perceived value of the loan, expressed in absolute terms in US dollars. Because the reference in the proviso to a 'rate other than [the] spot rate', was a reference to a currency exchange rate, the argument of Telkom was to be rejected.

(xii) That the argument of Telkom fell to be rejected for the following reasons: When the proviso to the definition of a 'ruling exchange rate' is interpreted in the context of the section as a whole, the use of the word 'rate' means an exchange rate that reflects the value of a particular currency in question and a currency exchange rate and not a discount rate is contemplated by the proviso. The Tax Court correctly concluded that the purpose of section 24I(10) of the Act was to solve the problem of amounts to be included in, or deducted for tax purposes, where these amounts were denominated in a currency other than the rand. The section dealt with losses or gains caused by foreign exchange fluctuations and was not applicable to a 'business' loss of the kind incurred by Telkom. The central argument of Telkom that the $ 100 received by it as a consideration for the disposal of the Multi-Links loan, was determined by applying a 'rate' and that this 'rate' fell within the definition of the 'disposal rate' failed to satisfy the requirement in the

proviso that the consideration must be 'determined' by 'applying' the rate. The consideration must be the result of a process of calculation which utilises the 'rate' as a factor to produce that result.

(xiii) That, accordingly, the submission by Telkom that its interpretation of section 24I of the Act reflected the commercial reality of the transaction, whereas the interpretation advanced by SARS did not and was not sensible or businesslike, fell to be rejected. The meaning of the relevant portions of the section, interpreted in context, are clear. Telkom lost sight of the fact that the section is not intended to deal with the tax consequences of commercial losses and its operation was limited to gains and losses arising out of currency fluctuations. The fact that Telkom realised a foreign exchange gain on disposal of the loan was a product solely of the fluctuation of exchange rates.

(xiv) That SARS had correctly submitted that what was insensible or unbusinesslike was the contention by Telkom that parties could generate a revenue tax deduction, based solely on the deterioration of the quality of foreign currency-denominated debt by applying section 24I of the Act, that dealt exclusively with gains and losses as a result of exchange rate differences.

(xv) That, in addition, Telkom impermissibly sought to interpret section 24I by reference to the factual setting, in which it was applied. The fundamental principle was that its provisions must apply equally to all, regardless of the circumstances in which the section is applied. The interpretation placed upon the section accords with its purpose and is neither unjust, inequitable nor unreasonable and as there is no ambiguity in the interpretation of the section, the *contra fiscum* rule is not applicable.

(xvi) That, accordingly, the Tax Court had correctly dismissed the appeal of Telkom against the additional assessment issued by SARS on the basis that Telkom had 'invoked the provision involving exchange rate gains and losses in order to deduct a commercial loss which was completely unconnected to foreign exchange currency differences.'

<u>As to the Cash Incentive Bonus Issue</u>

(xvii) That the period to which the expenditure 'relates' must be the period during which the benefit is enjoyed. Telkom did not incur the incentive bonus expenditure solely to establish a new connection with a customer. The benefit lay in having a customer who pays subscription fees over the fixed term of the contract. Telkom did not enjoy any benefit immediately upon the conclusion of a new contract. It had nothing to show for it until such time as the connection turned into fee income and that was when Telkom began to enjoy the true benefits of the cash incentive payments.

(xviii) That the Tax Court erred in disregarding the true benefit obtained by Telkom, in the form of the monthly subscriber payments over an anticipated 24 month period. Although the conclusion of the contract benefited Telkom, the enjoyment of that benefit was spread out over the period of the contract, so that the period to which the expenditure related could not be limited to the first year. The Tax Court also erred in treating as relevant to the application of section 23H, the fact that Velociti had rendered all the services which it was obligated to do in terms of the agreement with Telkom, because this had no bearing upon the central question, being when and how Telkom would enjoy the benefit of the contract.

(xix) That the question was whether Telkom had enjoyed the benefit of the cash incentive bonus, over the contract period. The fact that another type of payment was made as well, did not render the prior question, irrelevant. In addition, it was not apparent that Velociti had to do anything more to earn its ongoing commission and it was artificial to say that the ongoing commission was any more closely linked to the subscription fees, than the incentive payments.

(xx) That the Tax Court had therefore erred in concluding that there was no basis to add back and disallow R136 531 542 of the cash incentive bonus expenditure by the application of section 23H of the Act in the 2012 year of assessment.

Appeal in respect of the foreign exchange dispute was dismissed with costs.

SARS' cross-appeal in respect of the cash incentive bonus dispute was upheld.

9.2. Siphayi v C:SARS

First Applicant was the sole member of the Second Applicant, being a Close Corporation.

Second Applicant was a taxpayer which was indebted to SARS in the amount of R14 million.

Applicants brought an urgent application for various forms of relief to the High Court, but it was primarily aimed at a declaration that the deduction of funds by SARS from the bank account of the First Applicant in respect of a tax debt owed by the Second Applicant was unlawful and invalid.

Applicants had also sought an order directing that SARS be ordered and directed to re-send notices of intention to hold the First Applicant liable for the tax debts of the Second Applicant.

First Applicant submitted that in terms of section 184 of the Tax Administration Act (the Act) SARS had the same powers to recover tax from a person held personally liable under sections 155 or 157 as it had against the taxpayer itself but the section obliged SARS to first give notice to the person intended to be held personally liable and this it had not done in the case of the Applicants as the First Applicant had not received such notice.

The urgency alleged by the First Applicant was based on the fact that if the tax liability of the Second Applicant was deducted from the bank account of the First Applicant, then he would be severely affected in his ability to conduct his business and to service his creditors.

The evidence revealed that the liability of the Second Applicant to SARS exceeded R26 million.

SARS contended that the appropriate notices in terms of section 184 of the Act

were sent to the First Applicant *via* email on 7 June 2019 and 6 August 2019, and they were also posted to a physical address by registered post, but the tracking notes reflected that they were returned because the registered letters were not collected at the post office.

SARS, in consequence, had appointed Nedbank as a third party in terms of section 179 of the Tax Administration Act to withhold and immediately pay over to SARS all available funds, not exceeding R14 million, in the First Applicant's bank account and First Applicant had alleged that the monies were deducted from his personal bank account held at Nedbank on 17 September 2019.

First Applicant stated that he did not receive the email notices of 7 June and 6 August 2019 and had he received them he would have acted and made representations as requested in the notices.

Judge Van der Linde held the following:

(i) That it remained a mystery as to what happened to the emails that were sent to the email addresses referred to in the answering affidavit.

(ii) That since only an interim order had been sought at this stage, the court had to assume that the Applicants' version of events was correct unless SARS' version had cast serious doubt on the Applicants' version, which it did not in the view of the court.

(iii) That, accordingly, the SARS was interdicted from deducting monies from the First Applicant's bank account in terms of section 184 of the Tax Administration Act.

(iv) That SARS were directed to resend the notices of intention to hold the First Applicant liable for the tax debts of the Second Applicant at the email addresses to be supplied.

9.3. *ITC 1829 – Admin penalty*

The taxpayer was a registered company that provided products and services related to scaffolding and formwork to contractors in the construction industry.

The taxpayer, as employer, had filed and submitted its EMP201 Monthly Declaration for 2017/12 PAYE Return on Monday 18 December 2017 declaring an amount of R10 648 340.93 payable to SARS and had initiated an eFiling payment of R10 648 340.93 on SARS eFiling on the same day and the payment was going to be presented by SARS to B Bank on 3 January 2018.

The PAYE amount was due and payable to SARS in terms of this return within 7 days after the end of December 2017.

The taxpayer's accountant had relied on cash-flow forecasts in ensuring that there was sufficient credit available for payment on or before the end of the week of 7 January 2018. However, the taxpayer was unable to authorise the release of request for payment on 3 January 2018 as there were not sufficient funds available to make the payment.

The taxpayer explained that on Friday 5 January 2018, the day on which it had intended to release the payment of the declared amount to SARS, it ran into an unexpected shortage of credit of R5 924 in the relevant bank account and the payment to SARS could not be released.

The unforeseen credit shortage only became apparent on 5 January 2018 after 19h00 and the taxpayer was only able to credit the bank account with the amount which would enable the release of the payment on Monday 8 January 2018 after payment was authorised by taxpayer's holding company.

SARS request for payment of R10 648 340.93 was therefore only authorised by the taxpayer on 8 January 2018.

SARS, however, on 6 January 2018, had imposed a penalty assessment of R1 064 607.69 on the taxpayer in terms of, *inter alia*, par. 6(1) of the Fourth Schedule to the Income Tax Act. SARS had imposed a penalty of 10% and interest in terms of section 89*bis*(2) for the late payment of the employees' tax read

together with section 213 of the Tax Administration Act.

The taxpayer had requested a remittance of the penalty in terms of section 217(3) of the Tax Administration Act but the request was rejected by SARS and it then objected against the imposition of interest and penalty in a Notice of Objection and SARS disallowed the taxpayer's objection which led to the taxpayer's present appeal.

The main issue to be decided by the Tax Court was whether there were reasonable grounds which existed for the non-compliance for the late payment of the employees' tax to SARS by the taxpayer.

Section 217(3) of the Tax Administration Act provided that SARS may remit the penalty or a portion thereof if SARS was satisfied that (*a*) the penalty had been imposed in respect of a first incidence of non-compliance or involved an amount of less than R2000; (*b*) reasonable grounds for the non-compliance existed and (*c*) the non-compliance in issue had been remedied.

The taxpayer submitted at the hearing of this matter that, upon a correct interpretation of the law, the period within which the declared amount had to be paid only expired on 8 January 2018 and accordingly the penalty should not have been imposed at all and for that reason it should be remitted completely.

The taxpayer contended that in applying sections 1 and 4 of the Interpretation Act 33 of 1957 to the wording of par. 2(1) of the Fourth Schedule to the ITA when one calculates the seven-day period within which payment of the declared amount were to be made, one would clearly exclude the last day of December, starting the calculation of the seven days on 1 January 2018 at the earliest.

The taxpayer contended that it was compliant with the provisions of the Fourth Schedule to the ITA and the Tax Administration Act and that the penalty should not have been imposed at all.

The taxpayer further contended that if the court found that, in law, the declared payment was made out of time, then the circumstances in this case that led to the slightly late payment of the declared amount established objectively reasonable grounds for its non-compliance with par. 2(1) of the Fourth Schedule to the ITA.

The taxpayer submitted that to impose the maximum penalty available to SARS was a disproportionate response to the seriousness and the duration of the taxpayer's non-compliance with the Fourth Schedule.

SARS, however, contended that a proper interpretation of section 244(1) of the Tax Administration Act directed that the deadline for payment was due on the last business day before the Saturday or Sunday, which was Friday 5 January 2018 and that the payment made by the taxpayer on 8 January 2018 was made late and the penalty of 10% was correctly imposed in terms of par. 6(1) of the Fourth Schedule.

SARS contended that, due to the fact that the declared amount was not paid by 6 January 2018, the taxpayer was deemed to have used or applied the declared amount for purposes other than the payment to SARS, until the contrary is proved by the taxpayer by virtue of the deeming provisions contained in a statutory offence. The burden of proof was thus on the taxpayer to demonstrate that the amounts deducted or withheld had not been used or applied for the purposes other than the payment of such amount to SARS.

SARS was of the view that the taxpayer's explanation did not amount to reasonable grounds for non-compliance, but rather demonstrated that the taxpayer took 'reasonable steps' to remedy the non-compliance and it followed that no reasonable grounds could exist for the taxpayer's non-compliance and therefore SARS, in terms of section 217(3)(b) of the Tax Administration Act, was accordingly not satisfied that reasonable grounds existed for the non-compliance and the penalty remained payable.

Judge Goliath held the following:

(i) That the framework of the Fourth Schedule is directed at requiring the employer to pay over to SARS within the week the exact amount of PAYE deducted or withheld from the employee's salary or wage. The employees' tax is withheld from the remuneration and paid over to SARS on a monthly basis. The purpose of PAYE is to ensure that an employee's income tax liability calculated on remuneration is settled at the same time that the

remuneration is earned. The advantage of this system is that the liability for the year of assessment is settled over the course of that whole year. The employer who pays becomes liable to pay the amount and deduct the amount of PAYE from the remuneration every month.

(ii) That it is evident that the Interpretation Act 33 of 1957 excluded Sundays and public holidays, whereas section 244(1) of the Tax Administration Act includes Saturdays, Sundays and public holidays in calculating the dues. It must be borne in mind that the funds had already accrued to SARS upon payment of an employees' salary, and the seven day period is merely an indulgence to facilitate payment by the employer. It can therefore reasonably be concluded that the intention of the legislature with regard to deadlines, envisaged that a deadline should be calculated in days, inclusive of Saturdays, Sundays and public holidays. The Tax Administration Act envisages that a deadline may expire on a Saturday, Sunday or public holiday and directs that the last business day before the Saturday, Sunday or public holiday becomes the deadline, by calculating backwards. It must be borne in mind that the employees' tax had accrued to SARS at the end of the previous month, and calculating the dues backwards would not prejudice the employer in any manner.

(iii) That the intention of the legislature was clearly not to extend the period beyond seven days, but to calculate backwards in the event that a deadline falls on a Sunday or public holiday. The court was satisfied that a proper interpretation of section 244(1) of the Tax Administration Act directs that the deadline for the payment that was due should have been made on the last business day before the Saturday or Sunday, which was Friday 5 January 2018. This approach is consistent with the intention, purpose and scope of the legislation.

(iv) That an employer who misses a deadline in respect of their obligations to pay PAYE are subject to a percentage based penalty. Paragraph 6 of the Fourth Schedule provides that if an employer fails to pay employees' tax, they would be liable for a penalty in accordance with Chapter 15 of the Tax

Administration Act which provides that SARS must impose a penalty equal to 10% of such amount.

(iv) That the parties were in agreement that the penalty imposed by SARS is a non-compliance penalty contemplated in section 213 of the Tax Administration Act and the late payment of the declared amount was a first incidence of non-compliance by the taxpayer as contemplated in sections 208 and 217(3)(*a*) of the Act and the taxpayer remedied any non-compliance on 8 January 2018 at 10h13 am as contemplated in section 217(3)(*c*) of the Act.

(v) That the taxpayer made full payment on 8 January 2018 which was two days after the due date and SARS charged the taxpayer with the prescribed penalty and interest for the late payment. The taxpayer offered an explanation as to why it had found it difficult to make payment on time, i.e. it had experienced cash-flow problems which was attributed to waiting for debtors to make payments and relying on the cash-flow forecast prepared by the cash book administrator.

(vi) That the appropriate test concerning whether an insufficiency of funds amounted to a reasonable excuse is to examine if the underlying cause of the insufficiency is reasonably foreseeable or reasonably avoidable. If it was reasonably foreseeable or avoidable, it will not amount to a reasonable excuse. As a general rule, bad debts do not amount to a reasonable excuse, since they are an inherent risk for most types of business.

(vii) That the rationale for par. 16(2C) of the Fourth Schedule to the ITA was that the amount of employees' tax due by the employer to SARS constitute trustee funds, para. 2 and 16(2C) of the Fourth Schedule to the ITA. It required the director of the company to control or be regularly involved in managing the company's financial affairs and exercise her/his fiduciary duties as required by the Companies Act. In the court's view the payment of the employees' tax should have been given preference to other payments of business debts.

(ix) That the lack of funds for payment of the declared amount could have been reasonably avoided, given the exercise of reasonable foresight, due diligence and proper regard for the fact that tax was due on 5 January 2018. The taxpayer was also unable to prove that reasonable steps, other than reliance on the cash-flow forecast, were taken before the payment deadline to discharge the PAYE liability.

(x) That, accordingly, the Appellant had failed to establish reasonable grounds for the late payment of employees' tax.

Appeal dismissed with costs.

9.4. ITC 1929 – Request for reasons, assessment after three year prescription

SARS had made an original assessment in respect of the taxpayer's 2012 year of assessment on 31 January 2013 and that assessment stated that no amount was payable under the assessment and the taxpayer's return was not subject to audit or verification.

SARS, on 6 March 2018, more than five years after the original assessment, had issued an additional assessment in respect of the taxpayer's 2012 year of assessment.

Section 99(1)(*a*) of the Tax Administration Act provided at the relevant time that an assessment may not be made in terms of that Chapter three years after the date of assessment of an original assessment by SARS, but in terms of section 99(2)(*a*) of the Act it is provided that the above did not apply to the extent that in the case of an assessment by SARS, the fact that the full amount of tax chargeable was not assessed was due to fraud, misrepresentation or non-disclosure of material facts.

It was common ground that the assessments in these cases were assessments by SARS and it followed that the additional assessment made by SARS on 6 March 2018 would be incompetent unless SARS fell within the provisions of section 99(2)(*a*).

The taxpayer sought an order in the Tax Court that SARS provide reasons to enable it to formulate its objection to the additional assessment for the 2012 year of assessment issued by SARS on 6 March 2018.

The taxpayer contended that if SARS' contention should be sustained as to the non-disclosure of material facts, the taxpayer was entitled under Rule 6 of the Tax Court Rules to require SARS to provide the reasons for the 2012 additional assessment so that the taxpayer could formulate an objection to that assessment.

The taxpayer, in particular, contended that SARS must provide reasons as to why the non-disclosure caused SARS not to assess correctly the amount of tax chargeable in its original assessment, nor in the three year period thereafter that SARS was permitted to do so.

The taxpayer submitted that what SARS had put up by way of reasons did not meet its obligation to provide reasons and hence the application before the Tax Court.

SARS contended that it had given the taxpayer reasons in compliance with Rule 6 and the taxpayer was in a position to formulate its objection.

The issue before the court was whether SARS had provided the reasons required of it so as to enable the taxpayer to formulate an objection as to whether SARS could issue the additional assessment.

Judge Unterlhalter held the following:

(i) That it was common ground between the parties that the scope of the duty to give reasons has been authoritatively laid down by the Supreme Court of Appeal in *C:SARS* v *Sprigg Investments* 73 SATC 114 and, accordingly, it was common ground that what was required of SARS were the actual reasons for the additional assessment so as to enable the taxpayer to formulate its objection.

(ii) That it was also common ground that the reasons that were required of SARS for the purposes of Rule 6 include reasons as to why the additional assessment is competent in terms of section 99(2)(*a*) and that the Tax

Court enjoys jurisdiction to adjudicate an objection predicated upon the absence of competence on the part of SARS to issue an additional assessment, that is to say, that the jurisdictional facts required by section 99(2)(*a*) are absent. No final view was expressed on these issues, and the matter proceeded on the basis of the parties' agreement on these two aspects.

(iii) That section 99(1)(*a*) does not permit SARS to make an assessment three years after the date of its original assessment and this disability does not apply in the case of an assessment by SARS where the provisions of section 99(2)(*a*) are satisfied. Put simply, SARS, when making an assessment three years after its original assessment, may only do so if the provisions of section 99(2)(*a*) are satisfied.

(iv) That section 99(2)(*a*) postulates the fact that the full amount of tax chargeable was not assessed and this shall be called the ultimate fact. If the ultimate fact is proven, then SARS may only make an additional assessment three years after its original assessment if the ultimate fact was due to fraud, misrepresentation or non-disclosure of material facts. The court referred to this conduct as the misconduct. In sum, the ultimate fact must be due to the misconduct.

(iv) That the statutory provision that preceded section 99(2)(*a*) had been interpreted in *SIR* v *Trow* 63 SATC 189 on the basis that the concept 'due to' meant 'was causally related.' On this construction, the failure to assess the full amount of tax chargeable must be shown to be causally related to the misconduct, that is, in this case, to the material non-disclosure.

(v) That, put in simple terms, what caused SARS in its original assessment and during the period of three years thereafter not to assess the full amount of tax chargeable? If this came about because of the material non-disclosure, then the additional assessment is competent. If the ultimate fact came about for other reasons, such as neglect by SARS or some conduct of the taxpayer not amounting to misconduct, then the additional assessment is not competent and cannot be made.

(vi) That for SARS to give reasons within the scope of Rule 6 as to why it is competent for it to have made an additional assessment, the following must be discernible:

- That the full amount of tax chargeable was not assessed. This necessarily requires SARS to compare the tax payable under its original assessment and what SARS states is now due by way of its additional assessment.
- That there has been misconduct, in this case material non-disclosure by the taxpayer.
- That the misconduct caused SARS to fail in its original assessment and in the three years thereafter to assess the full amount of tax chargeable. The reasons must go back to consider the original assessment and why it is in the light of the assessment made after the three-year period that there was a failure to assess the full extent of the tax payable by the taxpayer.

(vii) That the taxpayer complained that the reasons put up by SARS do not deal with whether the material non-disclosure caused SARS to fail in its original assessment, and three years thereafter, to assess the full amount of tax for which the taxpayer was liable. <u>This the taxpayer states SARS must do because causation is a necessary component of the section 99(2)(*a*) enquiry that the taxpayer wishes to raise in its objection.</u>

(ix) That SARS contended that the passages referred to by the court in its finalisation of audit letter traversed all of these matters so as to satisfy the requirements of Rule 6 and the only issue was whether the causal question was traversed as to whether the material non-disclosure that SARS contended for caused SARS not to assess the full amount of the taxpayer's tax liability in the original assessment or in the three years thereafter.

(x) That the paragraphs relied upon by SARS in the finalisation of audit letter imply that the treatment of capital gains in the taxpayer's 2012 return caused SARS to make an incorrect assessment that did not reflect the full

amount of the taxpayer's tax liability. However, the passages did not expressly traverse causation and in the court's view that was insufficient because in order to make an objection, the taxpayer should not be left with uncertainty as to what SARS has given as its reasons substantiating causation. What is to be implied from reasons expressed may be ambiguous and subject to later dispute. Hence SARS should have made express in its correspondence stating its reasons what it has clarified and rendered express in the passages of its answering affidavit in these proceedings to which the court had referred.

(xi) That, happily, SARS had now explained its position on causation in paragraphs 32 and 33 of its answering affidavit. The parties before the court now accepted that these paragraphs in the answering affidavit, taken together with paragraphs 1.1.1 and 2.3 of the finalisation of audit letter, constituted the reasons that SARS relied upon in respect of its competence to make the additional assessment, and that these reasons sufficed to satisfy the requirements of Rule 6.

(xii) That the court granted an order based on the agreement that the parties reached on the reasons that SARS had now provided and the order now given would simply be declaratory in nature as to what the parties now accepted to be the required reasons under Rule 6.

(xiii) That, as to the question of costs, it appeared to the court that the taxpayer had to come to court to secure clarity as to the reasons that SARS was giving as to the causal component of the requirements that might satisfy section 99(2)(*a*) and, that being so, the taxpayer was entitled to its costs.

9.5. ITC 1930 – Retrospective VAT ruling

The taxpayer had provided *inter alia* money transfer services within Africa, mobile phone credit and bureau de change services.

The taxpayer, in the conduct of its enterprise, it made both taxable and exempt

supplies for value-added tax purposes.

The taxpayer, on 20 February 2017, had applied to SARS for a binding private VAT ruling in terms of section 17(1) read with section 41B of the VAT Act allowing it to apply, with effect from 1 February 2014, the Transaction Count Based ('TCB') method in terms of which input tax incurred on supplies for mixed purposes is apportioned in the same ratio as the number of taxable transactions.

The taxpayer had in practice not applied the standard turnover-based method of apportionment (the 'STB method') contained in Binding General Ruling 16 ('BGR 16') but had used an unapproved 'varied turnover based' calculation method.

BGR 16 expressly recorded as a condition that: 'The vendor may only use this method if it is fair and reasonable. Where the method is not fair and reasonable or appropriate, the vendor must apply to SARS to use an alternative method.'

When the taxpayer applied on 20 February 2017 for a binding private ruling to be issued by SARS, as envisaged in Chapter 7 of the Tax Administration Act, BGR 16 was in force, having first been issued on 25 March 2015 with effect from 1 April 2015.

SARS issued a private binding ruling on 8 November 2017 approving the application of the TCB method of apportionment in respect of the taxpayer's mixed-purpose input tax deductions from 1 March 2016.

The application to use the same method in respect of deductions from 1 February 2014 to 29 February 2016, as had been requested by the taxpayer, was not authorised and thereafter the taxpayer lodged an objection against SARS' refusal to approve the TCB method for that period, but SARS refused to allow the application of the TCB method by the taxpayer from 1 February 2014 to 1 March 2016.

The taxpayer then appealed against the refusal by SARS to grant it approval to apply the Transaction Count Based (TCB) method of apportionment for its mixed-purpose input tax deductions, for the period from 1 February 2014 to 29 February 2016 inclusive.

Judge Savage held the following:

(i) That in issue in this appeal was whether the SARS was precluded by law, and more particularly by proviso (iii) to section 17(1) of the VAT Act, from approving the use by the taxpayer of the TCB method in respect of the period from 1 February 2014 to 29 February 2016 and there was no dispute that the TCB method was a suitable or appropriate apportionment method for the taxpayer's enterprise since SARS had approved the use of such method by the taxpayer with effect from 1 March 2016.

(ii) That, in regard to SARS' contention that the court lacked jurisdiction to determine the appeal, on a purposive and contextual reading of section 32(1)(*a*)(iv) of the VAT Act a refusal to approve a method for determination of the ratio contemplated in section 17(1) of the Act must necessarily include the refusal to apply any method approved retrospectively. To find differently would be to strain at the language of the provision and lead to an unbusinesslike and unwieldy result, which the court was not persuaded was intended by the legislature, to limit the right of appeal and require a review where the issue of retrospectivity is in issue.

(iii) That the provision expressly provides for the right to appeal a refusal to approve a method. The effect of a refusal to allow the retrospective application of a method is to refuse the application of the method in respect of such period. Had it been intended by the legislature that this Court, as a specialist court established to determine tax disputes of this nature, was not to have jurisdiction to determine a matter such as this, this would have been expected to have been expressly stated in the statute, which it is not.

(iv) That it followed for these reasons that from a plain reading of the provision, and having regard to its purpose and context, the matter fell squarely within the ambit of this Court's jurisdiction.

(iv) That proviso (iii) to section 17(1) of the Act provided at the relevant time that 'where a method for determining the ratio referred to in this subsection has been approved by SARS, that method may only be changed with effect

from a future tax period, or from such other date as SARS may consider equitable and such other date must fall….in the case of a vendor who is a taxpayer as defined in section 1 of the Income Tax Act, within the year of assessment as defined in the Act…during which the application for the aforementioned method was made by the vendor.'

(v) That it was clear from the provision that a ratio must be applied to determine the amount of input tax that may be claimed as a deduction and, since such ratio does not appear from the VAT Act, before SARS issued a general ruling in the form of BGR 16, section 17 had no meaningful content. Since the issue of BGR 16 as a general ruling, it applies to all vendors to whom section 17 is applicable in producing the formula for the STB method of apportionment.

(vi) That BGR 16 expressly rendered the approval of the STB method subject to the condition that 'the vendor may only use this method if it is fair and reasonable. Where the method is not fair and reasonable or appropriate the vendor must apply to SARS to use an alternative method'.

(vii) That the conditions attached to BGR 16 provide for the use of the STB method 'if it is fair and reasonable.' Where a vendor considers its use not to be fair or reasonable, the obligation is placed on the vendor, which 'must apply' to SARS to use an alternative method. Where the vendor does not form the view that the use of the STB set out in BGR 16 is not fair and reasonable, there is no obligation on it to apply to use an alternative method, and it followed as a matter of logic that the default position that applies is the STB method as set out in BGR 16.

(ix) That a vendor that has not sought an alternative ruling is not entitled to elect not to be bound by BGR 16 on the basis that it is not fair or reasonable and it cannot be that a vendor who is enjoined to apply to use an alternative method, but fails or refuses to do so, should be placed in the same position as a vendor who applies timeously.

(x) That where application is made to use an alternative method to that set out

in BGR 16, the statute allows flexibility to ensure that the correct and appropriate input tax deductions for the particular enterprise are permitted but it provides a time limit on the retrospective application of the alternative method in terms of section 17(1) and proviso (iii).

(xi) That while the taxpayer took issue with the restriction on retrospectivity contending that it served to frustrate the purpose of the statute and BGR 16, having regard to the context and purpose of the provision there is no reason why the legislature should not restrict the period of retrospective application of a private binding ruling having regard to the context and purpose of the provision and affording the provision a sensible and business-like interpretation.

(xii) That a sensible interpretation of section 17(1) and proviso (iii) was not one that would allow the taxpayer to have its private binding ruling applied retrospective to 1 February 2014 in spite of the express statutory language on retrospectivity to the contrary. An interpretation that would serve to condone the taxpayer's tardiness in seeking a private ruling in respect of previous tax years, while nevertheless allowing it the retrospective application of such ruling, strains the language, context and purpose of the provision.

(xiii) That the fact that SARS may have accepted in 2017, by issuing the private ruling, that the STB method did not render a fair and reasonable outcome for the taxpayer did not allow a conclusion that, in spite of section 17(1) and proviso (iii), SARS recognised that the application of BGR 16 was not fair and reasonable in respect of all previous tax periods. The STB method set out in BGR 16 was the only ratio applicable to the taxpayer until its private binding ruling had been issued in 2017 and proviso (iii) to section 17(1) expressly precluded SARS from issuing a ruling that had effect from a date earlier than 1 March 2016.

Appeal dismissed.

9.6. SIP Project Managers (Pty) Ltd v C:SARS

SIP was a well-established construction company that had been in business for 36 years and was a registered taxpayer with an e-filing profile.

SARS had issued SIP with a tax assessment in June 2019 in terms whereof SARS owed SIP a refund of approximately R1.6 million.

SARS then chose to verify the assessment and requested certain additional documents from SIP which were never furnished and, as a result, SARS issued an additional assessment in terms whereof the previous assessment was reversed and SIP was assessed to owe SARS an amount of R1 233 231.

The additional assessment was uploaded on SIP's e-filing profile but, due to no fault on the side of SARS, it did not come to SIP's attention.

The additional assessment complied with the requirements set out in the Tax Administration Act and the validity of the assessment was not in dispute for purposes of this application.

The date for payment of the aforementioned amount by SIP as required by section 96(*f*) of the Act was reflected on the assessment as 30 September 2019.

The evidence revealed that SIP first became aware of the additional assessment on 6 February 2020 and on that day SIP was informed by Standard Bank that it had received notification to pay an amount of R1 262 007 over to SARS from SIP's bank account.

Furthermore, there was no letter of demand to be found on the e-filing profile of SIP, pursuant to the non-payment of the assessed amount.

SIP then immediately lodged an objection against the additional assessment and applied for condonation of the late-filing of the objection and applied for suspension of payment of the amount assessed until finalisation of the objection but the necessary funds had already been removed from SIP's bank account and were paid over to SARS.

SIP then contacted SARS who advised him that three letters of demand had been

sent before the third-party appointment letter had been issued, namely on 7 November 2019, 11 November 2019 and 22 January 2020.

SIP was adamant that none of the aforementioned letters had been sent to it or had been loaded onto SIP's e-file profile and none of the three letters referred to by SARS had appeared on the e-filing profile Annexure DA 7.

SIP then approached its legal advisors and a letter of demand for repayment of the amount paid over by Standard Bank to SARS in terms of the third-party notice was sent on 10 February 2020.

SARS did not respond to the letter of demand and SIP then launched an urgent application in which it sought declaratory relief, namely that SARS' notice to appoint a third party in terms of the provisions of section 179 of the Tax Administration Act be set aside and declared null and void and that SARS be ordered to repay to SIP the amount of R1 261 007, which was paid over by the third party bank to SARS in terms of the notice together with interest.

SIP contended that no letter of demand had been delivered to it prior to the issue of the third-party notice to the bank as required by section 179 of the Act.

SIP contended further that if the court should find that such a letter or letters were delivered, then the letters were either premature as the tax debt was not yet payable at the time or the 10-business day period prior to the issue of the third-party notice had not yet expired by the time that the notice was in fact delivered.

SARS contended that a valid letter of demand as required by the Act had been delivered to SIP and he relied on the letter of demand dated 7 November 2019 as a final letter of demand that was delivered to SIP.

The issue before the court was whether the letter of demand had been delivered *via* the electronic e-filing profile of SIP.

Judge Lingenfelder held the following:

(i) That the court only dealt with the issue as to whether the letter of demand sent by SARS on 7 November 2019 to SIP had been delivered to it in terms of the provisions of the Tax Administration Act.

(ii) That for electronic communication to be complete and regarded as delivered, the complete transaction must have been entered into the information system of SARS and correctly submitted by SARS to the electronic page of the registered user as is set out in Rule 3(2)(*b*)(ii) of the Rules for Electronic Communications issued in terms of the Act. The annexures SARS 4 and 5 do not counteract SIP's contention that the letters were not on SIP's electronic page. These annexures are merely copies of SARS service manager and at best show that the letters were created on the dates reflected.

(iii) That it was not enough to prove the existence of a final letter of demand, the letter should be delivered to the taxpayer. The Rules for Electronic Communication prescribed in terms of the Act, state that an electronic filing transaction includes a communication in relation to payment made by SARS and other electronic communication that is capable of generation and delivery in a SARS electronic filing service.

(iv) That in terms of Rule 3(3) if an acknowledgment of receipt for the electronic communication is not received, the communication should be regarded as not delivered, except for an electronic filing transaction. It therefore follows that if SARS did deliver the letter of demand *via* SIP's e-filing profile, it will be deemed to have been delivered.

(iv) That SARS accordingly only needs to show that the demand was delivered via the electronic e-filing profile of the taxpayer, once it was challenged by SIP that these documents do not appear on the e-filing page of the taxpayer.

(v) That it should have been relatively simple for SARS to furnish proof that the letter does appear on the e-filing system, but this was not done and SIP's version that the letters were not sent on the dates reflected therein remained accordingly unchallenged and there could be no *bona fide* dispute of fact on this point.

(vi) That, accordingly, no letter of demand was delivered to SIP herein.

(vii) That it was common cause that the date for payment reflected on the additional assessment was 30 November 2019 and the letter of demand of 7 November 2019 (which was the only letter that SARS still relied on) was before the due date for payment in terms of the assessment and accordingly also before SARS could demand payment of the assessed amount, which was not yet payable.

(ix) That it was clear that section 179 dealt with a scenario where there is an outstanding debt by the taxpayer, which in this instance, was not the position as at 7 November 2019 – the taxpayer would only have an outstanding debt after the due date for payment, namely 30 November 2019. SARS conceded that on this date there was not yet an outstanding tax debt owed by SIP. In accordance with the *contra fiscum* rule, the words 'outstanding debt' must be construed against SARS and the letter of demand dated 7 November 2019 was accordingly premature and therefore not lawful.

(x) That subsection (5) to section 179 of the Act was introduced by an amendment to the Act in 2015 and, prior to this amendment, there was no obligation on SARS to deliver a demand for an outstanding debt before issuing a third-party notice. The context of this amendment was that SARS may only use the method in section 179 to obtain payment through a third party if it complies with the provisions of the requirements of the section and the wording of section 179(5) was unambiguous and clear – the notice to a third party 'may only be issued after delivery of a final demand for payment which must be delivered at least 10 business days before the issue of the notice…' and this is a peremptory requirement before the step can be taken to issue a third-party notice for recovery of an outstanding tax debt.

(xi) That the notice issued to the third party in terms of section 179(1) of the Act did not comply with the peremptory qualification as set out in section 179(5) in that the notice was issued in the absence of a letter of demand delivered to SIP as required. The notice issued is therefore unlawful and declared null

and void.

(xii) That a finding that a legislative provision is peremptory is not the end of the matter and the court must further enquire whether it was fatal that it had not been complied with. The Appellate Division as it then was laid down the test as 'in deciding whether there has been compliance with the object sought to be achieved by the injunction and the question of whether this object has been achieved, are of importance.'

(xiii) Once it is established that a legislative provision is peremptory and the question arises whether exact compliance therewith is required, the answer is sought in the purpose of the statutory requirement which is to be found ascertained from its language read in the context of the statute as a whole.

(xiv) That the introduction of section 179(5) was clearly done to limit the powers of SARS in recovery of outstanding tax debts by means of the issue of a third-party notice without first advising the taxpayer thereof and SARS cannot be excused from not following the prescriptions of the Act and then state that it would serve no purpose to order a repayment of funds obtained in terms of an unlawful process as that would render the inclusion of section 179(5) in the Act obsolete.

(xiv) That the third-party notice was declared to be null and void and SARS was ordered to repay the amount of R1 262 007 to SIP, together with interest as from the date of payment of the amount to SARS by Standard Bank.

Application upheld.

9.7. ITC 1931 – Employees' tax, Independent Contractors

The taxpayer company had been selected for an audit to be conducted into its tax affairs by SARS and it was informed that the scope of the audit would be 'to verify whether its employees' tax obligations were in accordance with the Fourth Schedule to the Income Tax Act.

The taxpayer company was informed that it should provide for inspection all of the

following: documents dealing with its remuneration policies, minutes of all meetings dealing with remuneration and/or incentives, employment contracts, cashbook and bank statements, the pension and/or provident fund rules, a list of independent contractors, personal service providers and/or labour brokers, exemption certificates, tax directives and rulings from SARS.

The taxpayer had responded by sending some of the documents requested by SARS and SARS, after perusing them, had requested the taxpayer to explain the business relationship between itself and one VWX Construction (VWX) as a customer and supplier.

The taxpayer responded by stating that the relationship between it and VWX was that the taxpayer had sub-contracted all construction type service and works to VWX who had the professional expertise and equipment to conduct these services and works.

Thereafter a meeting of the parties took place and the purpose of the meeting was for the SARS representative to understand the taxpayer's payroll system in order for it to be able to establish whether, amongst others, the necessary PAYE tax and SDL levies had been deducted from the taxpayer's employees and had been paid over to SARS.

The taxpayer had informed SARS that it had 600 employees, but it had not handed over to SARS copies of the payroll records of all its employees despite its undertaking to do so at the aforementioned meeting.

The taxpayer at the meeting had also completed a standard form document provided by SARS which contained a list of questions and in question 130 the following was posed: 'Do you make any payments to any of the following? Independent contractors (answer: yes), Labour Brokers (answer: no).

SARS, after the meeting, was presented with copies of two employment contracts: one for a Mr D and one for Mr C and on the basis of these contracts SARS accepted without more that both Mr C and Mr D were employees of the taxpayer.

SARS thereafter sent the taxpayer a letter outlining its audit findings, which referred to two entities, being VWX Construction and IOP.

In regard to both entities the audit letter found that 'Service rendered by the above [*ie* VWX and IOP] to the taxpayer were not to be an independent trade. According to the employment contracts and IRP5 issued it was found that Mr C who trades as IOP and Mr D who trades as VWX Construction are both employees of the taxpayer. The contract in place is between employer and employee. According to the employer-employee relationship it was observed that both parties perform their services mainly at the premises of the taxpayer and conditions of service as to what services will be rendered, hours of work and that work will be performed under client supervision is stipulated.'

SARS noted that further information gathered during its enquiry indicated that no formal agreement existed between VWX Construction and the taxpayer and there was also no formal agreement with IOP.

Moreover, according to SARS, the services rendered by VWX and IOP were part of the taxpayer's business plan and it also emerged that VWX Construction used a work force that belonged to the taxpayer for construction projects.

SARS, in light of the above, came to the conclusion that the exclusion clause in the definition of 'remuneration' in par. 1 of the Fourth Schedule to the Income Tax Act providing for amounts paid to a person for services rendered in the course of trade carried on by him independently could not be demonstrated on the facts of the case as the only relationship observed was the employer-employee relationship and therefore payments received from VWX Construction and IOP were to be included as part of 'remuneration' as defined in terms of par. 1 and would be subject to employees' tax and in terms of par. 2(1) an obligation was placed on the employer to deduct or withhold employees' tax from the remuneration paid to its employees.

The taxpayer, however, contended that IOP provided payroll services to the taxpayer while, at the same time Mr C, who was the sole member of IOP, was an employee of the taxpayer in the capacity of a General Manager. For this reason it was contended that the services provided by IOP to the taxpayer were not subject to PAYE as IOP was an independent contractor. Moreover, an identical contention was made with regard to VWX. It was said that Mr D was employed by the

taxpayer in the capacity of a Technical Advisor while at the same time as the sole proprietor of VWX and he was therefore not to be treated as an employee of the taxpayer when he acted for VWX as the taxpayer had a contractual relationship with VWX and VWX had an independent contract of employment with him.

The issue before the court was whether in terms of the common law both IOP and VWX were independent contractors with whom the taxpayer had contracted for certain services and whether payments made to them by the taxpayer constituted remuneration as defined in par. 1 of the Fourth Schedule to the Act and hence was required to deduct SDL or PAYE from such payments.

The definition of 'remuneration' in par. 1 of the Fourth Schedule excludes any amount paid or payable for services rendered or to be rendered by a person in the course of a trade carried on by him independently of the person by whom the amount is paid or payable and of the person to whom the services are rendered and, consequently, these amounts are not subject to employees' tax.

To assist the court in its consideration of the issue before it, the parties decided to lead *viva voce* evidence and the taxpayer called three witnesses, Mr C, Mr F and Mr D.

Judge Vally held the following:

(i) That the taxpayer's case was as confused as it was confusing. None of its witnesses knew what exactly its case was and none of them knew exactly what the relationship was between each of them and the taxpayer and between each of them and VWX, and between the taxpayer and VWX.

(ii) That the taxpayer's witnesses could not produce a document that coherently explained all or even one of these relationships and the documents they produced were so incoherent that they raised numerous questions and some of these questions were posed to them when they each testified, but none of them were able to enlighten the court as to what the true nature of the relationships were.

(iii) That the taxpayer's witnesses were evasive in their answers and the evidence of Mr C and Mr D were replete with contradictions and Mr D was

also argumentative. None of their evidence was really elucidatory and none of their witnesses were candid with the court.

(iv) That the taxpayer was not able to show that VWX was an independent fully operational construction entity and, in fact, it was not able to show that VWX was an operating construction entity at all. What appears from the evidence is that VWX existed mainly, if not wholly, in name. Put differently, Mr D was employed by the taxpayer only and not by VWX, nor was he a sole proprietor in any meaningful sense of the term.

(iv) That the above conclusion made it unnecessary to decide whether VWX qualified as an independent contractor as understood in the common law. However, for the sake of completeness it was necessary to point out that VWX did not meet the criteria set out in the common law to qualify for the title 'independent contractor.' The Appellant was not able to show that VWX had more than three employees and nor was it able to show that VWX operated at any premises other than that of the taxpayer.

(v) That, in the result, based on a conspectus of the evidence before the court, the taxpayer was not able to show that the factual findings of the audit as well as the reasons for rejecting the objection were faulty or marred by any misdirection and, accordingly, the appeal had to fail.

Appeal dismissed with costs.

10. DRAFT INTERPRETATION NOTES

10.1. Taxation of the receipt of deposits

This Note provides guidance on the words 'received by' in the definition of 'gross income' in section 1(1) and the treatment of the receipt of a deposit in the ordinary course of business. Accordingly, an examination of possible capital gains tax consequences attached to the receipt of a deposit does not form part of the scope of this Note. In addition, the Note does not deal with amounts deposited by clients with banks and similar deposit-taking financial institutions.

In the ordinary course of business, taxpayers may receive money in advance in the form of deposits related to or for goods or services to be delivered or rendered at a future date. Having regard to the definition of 'gross income', the facts of each transaction must be considered to determine whether a deposit should be included in gross income and, if so, in which year of assessment. In the context of deposits received in advance, one of the requirements which has in the past given rise to interpretational difficulties and resulted in the courts being called on to make a determination, is whether the physical receipt of a deposit means it has been received for purposes of the definition of gross income. An aspect which may be relevant when a deposit is included in gross income is the availability of a deduction for any expenditure actually incurred in the production of that income or an allowance for future expenditure which meets all the requirements under section 24C. This aspect is not considered further in this Note.

This Note deals only with general principles. The facts and circumstances of each case, including the conditions attached to the deposit and the intention of the taxpayer, must be considered. Deposits received by a taxpayer must be included in the taxpayer’s gross income if received by the taxpayer 'on his own behalf for his own benefit'. For a deposit to be excluded from gross income on the basis that it has not been received by the taxpayer, the amount must be held in trust and generally in a separate trust account controlled by trustees who are appointed to manage the account. The use of a separate trust account, however, does not override the true nature of the transaction and intention of the taxpayer. Thus, even if the taxpayer keeps the deposits in a separate trust account but there is no intention of refunding them, they must be included in gross income in the year of assessment in which they are received.

If applicable, the consequences of the CPA and any obligations it places on a taxpayer must be considered in determining whether a deposit must be included in a taxpayer’s gross income.

11. BINDING PRIVATE RULINGS

11.1. BPR 346 – Tax implications resulting from the elimination of intra-group loans

This ruling determines the income tax and dividends tax consequences of the redemption of intra-group loans by way of set-off against dividends payable.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 11 March 2020. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 19; and
- section 64F(1)(a).

Parties to the proposed transaction

The below-mentioned companies belong to the same group of companies as defined in section 41(1).

The applicant: A private company and a resident

Co-applicant A: A private company and a resident

Co-applicant B: A private company and a resident

Co-applicant C: A private company and a resident

Description of the proposed transaction

The applicant is an investment holding company. It owns all the equity shares in coapplicant A and co-applicant B.

Co-applicant B holds 100% of the share capital of co-applicant C.

The following loan accounts exist between the applicants:

- loan 1 receivable by co-applicant A from the applicant;
- loan 2 receivable by co-applicant A from co-applicant B;

- loan 3 receivable by co-applicant C from the applicant;
- loan 4 receivable by co-applicant C from co-applicant A; and
- loan 5 receivable by co-applicant B from the applicant.

The loans arose from ongoing advances by the group companies to one another to fund operations within the group. None of the funds were used to fund the acquisition of assets. The loans were used to fund the day-to-day operations of the group companies.

The group wishes to eliminate the intra-group loans as far as possible. The steps to implement the proposed transactions are as follows:

Step 1

- Co-applicant A will declare a dividend to the applicant equal to the balance of loan 1, which will be left outstanding on loan account.
- Co-applicant A and the applicant will agree to set off the dividend payable by co-applicant A against loan 1 payable by the applicant to co-applicant A, resulting in the full settlement of both loans.

Step 2

- Co-applicant C will declare a dividend to co-applicant B equal to the balance owing in respect of loan 3, which will be left outstanding on loan account. Co-applicant C will cede loan 3 to co-applicant B in settlement of the dividend.
- Co-applicant B will cede loan 3 and loan 5 to co-applicant A in part payment of loan 2.

Step 3

- Co-applicant C will declare a dividend to co-applicant B for an amount equal to the balance in respect of loan 4, which will be left outstanding on loan account. Co-applicant C will cede loan 4 to co-applicant B in settlement of the dividend.

- Loan 2 and loan 4 will be set-off against each other. The net balance will be an amount owing by co-applicant B to co-applicant A in respect of loan 2.

Step 4

- Co-applicant A will declare a dividend to the applicant for an amount equal to the sum of the balances of loan 2, 3 and 5, which will be left outstanding on loan account.
- Loan 3 and loan 5 will be set off against the dividend.
- Co-applicant A will cede loan 2 to the applicant in settlement of the dividend.

Conditions and assumptions

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

Ruling

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

- The dividend to be declared by co-applicant A, which equals the amount owed by virtue of loan 1 by the applicant, will be exempt from dividends tax under section 64F(1)(a).
- The dividends to be declared by co-applicant C in steps 2 and 3 will be exempt from dividends tax under section 64F(1)(a).
- The dividend to be declared by co-applicant A in step 4 will be exempt from dividends tax under section 64F(1)(a).
- The redemptions of loans 1, 3 and 5 by way of the set-off arrangements in step 1 and step 4 will, in each instance, constitute a 'concession or compromise' as defined in paragraph (a)(ii)(aa) of that term in section 19(1). However, the set-off arrangements will in none of those cases amount to a 'debt benefit' as defined in section 19(1).

11.2. BPR 347 – When the temporary setting aside of voluntary liquidation proceedings will no jeopardise roll-over relief

This ruling determines whether the setting aside of a voluntary liquidation, by order of court, would be a withdrawal or invalidation of any steps to liquidate, wind-up or deregister the applicant, within the meaning of section 47(6)(c)(ii).

In this ruling references to sections are to sections of the Income Tax Act applicable as at 18 March 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 47(6)(c)(ii) of the Act.

Parties to the proposed transaction

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

The co-applicant: A resident private company

Description of the proposed transaction

As part of a group restructuring, the entire business of the applicant, including all the shares in subsidiary companies (subco shares), were distributed to the coapplicant as a dividend in specie in anticipation of the applicant's liquidation (the distribution) early in 2017. The applicant and co-applicant applied the provisions of section 47 to the distribution.

After the voluntary liquidation process the applicant commenced with the registration of the special resolution passed by the co-applicant as sole member of the applicant, with the Companies and Intellectual Property Commission (CIPC), towards the end of 2019. Before the liquidator was appointed, the applicant became aware that some of the subco shares were not formally transferred to the coapplicant. The share registers of these subsidiaries have not been updated to reflect the change in ownership. The failure to transfer the subco shares and update the share registers of these subsidiaries was an oversight, which the

applicants now seek to correct.

The notice of the voluntary liquidation of the applicant was published in the Government Gazette, but CIPC had not yet deregistered the applicant.

The applicant does not have any assets or liabilities and the parties merely seek a mechanism to take the necessary steps to transfer the subco shares to the coapplicant and to correct the failure to update the share registers, without adversely affecting the tax group relief provisions that applied to the distribution.

The co-applicant has prepared a court application, supported by an affidavit that sets out the material facts demonstrating why continuation of the winding-up is undesirable. If the court so orders, the voluntary liquidation will be set aside. Once the subco shares have been successfully transferred to the co-applicant, a new special resolution will be passed and registered with CIPC, authorising the voluntary liquidation of the applicant. This intention is confirmed by the fact that the South African operations of the group have been carried on by the co-applicant since the date of the distribution, in early 2017. No operations or business activities have been conducted by the applicant following the distribution to the co-applicant.

Conditions and assumptions

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

Ruling

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

- The suspension or setting aside of the voluntary liquidation of the applicant, in the specific circumstances, will not constitute a withdrawal or invalidation of any steps to liquidate, wind up or deregister the applicant, as contemplated in section 47(6)(c)(ii), as it will facilitate the ultimate deregistration of the applicant. Thus, in so far as section 47 of the Act, section 8(25) of the VAT Act and section 8(1)(a)(v) of the STT Act applied to the distribution, section 47(6)(c)(ii) will not have any effect.

11.3. BPR 348 – Income tax consequences for a public benefit organization lending funds to qualifying entrepreneurs

This ruling determines the income tax consequences for a public benefit organisation resulting from the provision of loans to qualifying entrepreneurs to start or grow their businesses.

In this ruling references to sections and schedules are to sections of and schedules to the Income Tax Act applicable as at 26 March 2020. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 10(1)(cN)(ii)(aa), and
- section 10(1)(cN)(ii)(dd).

Parties to the proposed transaction

The applicant: A resident non-profit company

Description of the proposed transaction

The applicant is incorporated as a non-profit company under the Companies Act 71 of 2008 and approved as a public benefit organisation under section 30(3) read with section 18A. Its principal object is to carry on a public benefit activity as contemplated in section 30(1) focusing on the provision of education as contemplated in paragraph 4 of Part I and paragraph 3 of Part II of the Ninth Schedule.

The applicant is approved to carry on public benefit activities contemplated in paragraphs 4(a) and 4(o) of Part I and paragraphs 3(a) and 3(o) of Part II of the Ninth Schedule.

The Applicant's primary and subsidiary objects are directed at the promotion of entrepreneurship through education and training. Its programs are targeted at the youth. It teaches a two year academic curriculum.

One of the applicant's subsidiary objects is to collaborate with other educational organisations and organisations promoting entrepreneurship and leadership or governance or both.

To promote entrepreneurship amongst the youth, the applicant proposes to solicit funds from philanthropists with which to grant loans to young entrepreneurs who are starting or scaling their businesses. Its loan funding will be provided as complimentary funding of at least an equal amount when the qualifying young entrepreneurs attract funding from other philanthropists or investors. Once the applicant provides funding to the entrepreneurs, the applicant will monitor its investment in their businesses, collect data and disseminate information to existing philanthropists and other stakeholders in the wider philanthropy network to encourage greater participation from other philanthropists.

The applicant will target young entrepreneurs who do not have access to funding from conventional commercial lending institutions because, due to their age, the entrepreneurs will not have built a credible business track record, will not be able to provide security for the repayment of loans and will not have proof of a stable income.

Eligible entrepreneurs will be alumni of the applicant and alumni of an associated entrepreneurship program. Those who apply for funding must have a registered business, a bank account, a business plan, be the founders or have a validated leadership role in the business and be endorsed by the applicant's Portfolio Manager.

Persons who qualify for funding will receive a letter of guarantee that will enable them to seek matching funding from investors.

Conventional interest will not be charged on the loans. Instead, the beneficiaries will repay the loans by paying a small percentage of their monthly revenue (revenue share) to the applicant until 100% of the loan amount plus a very small margin is recovered over the loan term. No revenue share will be payable when the beneficiaries have not generated any revenue. Any income received from the repayment of the loans will either be ploughed back into the programme or

otherwise used to further the applicant's public benefit activities.

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 receipts and accruals of the entrepreneur loan programme of the applicant will not qualify to be exempt from normal tax under section 10(1)(cN)(ii)(aa), because the undertaking is not integral or directly related to the applicant's sole or principal object of providing education.
- The receipts and accruals of the entrepreneur loan programme will however qualify to be exempt from normal tax under section 10(1)(cN)(ii)(dd), subject to the basic exemption amount calculated under that provision. The basic exemption amount is applicable to the receipts and accruals of all business undertakings and trading activities of the applicant that qualify under that provision during any relevant year of assessment.

11.4. BPR 349 – Acquisition of equity shares in non-resident REIT

This ruling determines the income tax and dividends tax consequences of property income distributions to be made by a foreign REIT.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 14 February 2020. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definitions of 'foreign dividend' and 'foreign partnership';
- section 10B(2) and (4);
- section 64D – definition of 'beneficial owner';

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

Parties to the proposed transaction

The applicant: A resident REIT listed on the JSE

The co-applicants: Ten companies incorporated outside South Africa (SA) but which will be SA residents

Description of the proposed transaction

The co-applicants are wholly-owned subsidiaries of the applicant.

The co-applicants propose to acquire together the majority of the total equity shares in a REIT resident outside SA (the Foreign REIT).

The Foreign REIT will make distributions to its investors from time to time. The only distributions relevant to this ruling are the property income distributions.

For the proposed transaction to comply with the laws of the country of registration of the Foreign REIT, the transaction must comply with local regulatory requirements.

The foreign tax authority will permit the proposed investment if the applicant has no beneficial entitlement to the property income distributions made by the Foreign REIT and each co-applicant's entitlement to property income distributions is individually below a certain percentage. In that event certain of the regulatory constraints will not apply.

Also for regulatory reasons, the Foreign REIT will structure the proposed transaction so that the shareholding in the Foreign REIT is held by a person acting on behalf of a limited partnership which is a collective investment scheme in the country of registration of the Foreign REIT.

The Foreign REIT is obliged to distribute a large percentage of its profits from its property rental business within 12 months of an accounting year end.

The applicant therefore proposes to implement the proposed transaction as follows:

- A limited partnership will be established in the country in which the Foreign REIT is registered (the Limited Partnership). The co-applicants will be the limited partners of the Limited Partnership and their liability for debts and obligations of the Limited Partnership will be limited to their respective capital contributions. They will not take part in the management of the partnership's business. The general partner (the GP) of the Limited Partnership will be a non-resident company that is not part of the same group of companies as the applicant.
- The Limited Partnership will be structured as a foreign collective investment scheme.
- The GP will appoint the applicant to exercise all rights, powers and privileges attaching to the Foreign REIT's shares in the name and on behalf of the GP, including voting the Foreign REIT's shares and attending its general meetings.
- The Limited Partnership will therefore constitute a 'foreign partnership' as defined in section 1(1).

The post-transaction structure will be as follows:

- The applicant will hold 100% of the shares in all the co-applicants.
- The co-applicants will be the limited partners in the Limited Partnership and the GP will be a non-resident company.
- The GP will appoint the applicant to exercise all rights, powers and privileges attaching to the Foreign REIT's shares in the name and on behalf of the GP, including voting the Foreign REIT's shares and attending its general meetings.
- The Limited Partnership will hold the majority of the equity shares in the Foreign REIT. The Foreign REIT will make property income distributions to, amongst others, the Limited Partnership from time to time.

<u>Conditions and assumptions</u>

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

- The tax authority of the country in which the Foreign REIT is resident is satisfied that the applicant may split the holding of shares in the Foreign REIT between the co-applicants so as not to fall foul of its regulatory requirements.
- The Limited Partnership will constitute a collective investment scheme in accordance with the laws of the country in which it is established.
- The co-applicants have the right to use and enjoy the property income distributions made by the Foreign REIT unconstrained by any contractual or legal obligation to pass on the payment to another person and they assume the risk and control of the distributions received or accrued.
- The foreign dividend will not be paid out of any amounts as envisaged in section 10B(4)(a)(i) and (ii).

<u>Ruling</u>

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

- A property income distribution made by the Foreign REIT will constitute a 'foreign dividend' as defined in section 1(1).
- The foreign dividend so paid will be exempt from SA normal tax under section 10B(2)(a).

11.5. BPR 350 – Vesting of a capital gain in a trust beneficiary and deferral of its payment

This ruling determines the tax consequences of the vesting of a capital gain in a beneficiary, where the payment of the capital gain is deferred at the discretion of the trustees and the capital gain is invested on behalf of the beneficiary.

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 26 June 2020. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 7C; and
- paragraph 80(2).

Parties to the proposed transaction

The applicant: A resident trust

The beneficiary: A resident natural person

The trustees: The trustees of the applicant

Description of the proposed transaction

The trust deed was amended specifically to provide unilateral powers to the trustees, whereby the trustees have the right to credit a vested capital gain to the account of the beneficiary, to invest it on behalf of the beneficiary or to otherwise deal with it without actual payment of an amount or delivery of an asset to the beneficiary.

The trustees propose to dispose of an investment held by the trust. This disposal will result in a capital gain which will be awarded to the beneficiary. The trustees will unilaterally invoke their powers to defer the enjoyment of this amount to a date to be determined in the sole discretion of the trustees.

The beneficiary will play no role in the decision to be made by the trustees to defer the enjoyment of the vested amount. The beneficiary will not make any loan or credit to the trust and will not conclude any agreement with the trustees in this regard.

The trustees will invest the vested amount on behalf of the beneficiary for his benefit. The income arising from such investment will accrue to the beneficiary and not to the trust.

The trustees will keep accurate records of the vested amount, to which enjoyment has been withheld, so as to track and identify the amount so vested and the income that it yields. Any assets acquired on behalf of the beneficiary with the vested amount will be accounted for and recorded by the trustees in the financial records of the trust.

The beneficiary has the right to alienate the award, and to offer it as security.

The last date for the payment of the award, if it is not paid out earlier, is the date of death of the beneficiary.

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:

- Paragraph 80(2) will apply and the capital gain must be disregarded for the purpose of calculating the aggregate capital gain or loss of the trust and must be taken into account for the purpose of calculating the aggregate capital gain or loss of the beneficiary.
- Section 7C will not apply to the proposed transaction.
- Any subsequent income earned on the vested amount, or such income as will be apportioned to the vested amount, to which enjoyment has been withheld, will accrue to the beneficiary and must be included in the gross income of the beneficiary.

11.6. BPR 351 – Waiver of an intra group loan to and subsequent liquidation distribution by a subsidiary

This ruling determines the income tax, dividends tax and securities transfer tax consequences of the waiver of an intra group loan by a holding company to its

subsidiary followed by the distribution in specie of the subsidiary's only asset to its holding company.

In this ruling references to sections and paragraphs are to sections of the relevant Act and paragraphs of the Eighth Schedule to the Income Tax Act applicable as at 31 July 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:

- the Act:
  - section 10(1)(k);
  - section 47;
  - section 64FA(1)(b);
  - paragraph 12A(6)(e);
  - paragraph 43A(2);
- the STT Act –
  - section 1 – definition of "transfer"; and
  - section 8(1)(a)(v).

Parties to the proposed transaction

The applicant: A wholly-owned subsidiary of the co-applicant and a resident

The co-applicant: An investment company and a resident

Description of the proposed transaction

The co-applicant is an investment holding company. The co-applicant previously advanced an unsecured, non-interest-bearing loan to the applicant to enable it to acquire ordinary no par value shares of the co-applicant from a shareholder of the co-applicant. The shares in the co-applicant comprise the applicant's only asset.

The shareholders of the co-applicant seek to restructure their investments and it

will entail the sale of specific investments of the co-applicant to the shareholders wishing to increase their shareholdings in those investments. As part of the proposal, the 10% shareholding in the co-applicant will however first be eliminated to remove the inevitable circular distribution consequences of the proposed liquidation distribution.

In order to eliminate the shareholding of the applicant in the co-applicant, the following is proposed:

- The co-applicant will waive the loan previously advanced to the applicant.
- The applicant will distribute all its assets, namely the shares in the coapplicant, as a dividend in specie to the co-applicant availing the parties of the relief provided by section 47.

Conditions and assumptions

This binding private ruling is subject to the additional condition and assumption that the liquidating company (the applicant) must, within 36 months after the date of the liquidation distribution or within such longer period as the Commissioner may allow, take steps to liquidate, wind-up or deregister. It may not at any stage withdraw any such step or do anything to invalidate such step with the result that it is not woundup, liquidated or deregistered.

Ruling

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

- Paragraph 12A(6)(e) will apply to the waiver of the loan by the co-applicant.
- The distribution of the shares by the applicant to the co-applicant will constitute a "liquidation distribution" as defined in paragraph (a) of the definition of that expression in section 47(1).
- The applicant will be deemed to have disposed of the shares at their base costs and no capital gain will therefore arise for the applicant.
- Section 47(5)(a) will apply to the proposed transaction and the co-applicant must disregard the disposal for purposes of determining its taxable income,

assessed loss, aggregate capital gain or aggregate capital loss.

- The liquidation distribution will constitute a dividend, but it will be exempt under section 10(1)(k)(i).
- Section 64FA(1)(b) will apply to the dividend and the applicant will not be required to pay any dividends tax.
- Paragraph 43A(2) will not apply to the distribution of the dividend in specie.
- The transfer of the shares from the applicant to the co-applicant will be exempt from STT under section 8(1)(a)(v) of the STT Act.
- The cancellation of the shares by the co-applicant will not constitute a "transfer" as defined in section 1 of the STT Act and no STT will be payable.

11.7. BPR 352 – Taxation of employees participating in an option programme

This ruling determines the tax consequences relating to the exercise of share options acquired by an employee under an incentive scheme.

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 28 July 2020. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definition of "gross income";
- section 8C; and
- paragraph 58.

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

The applicant: A resident individual

The co-applicant: A resident individual

Company A: A company incorporated in a foreign country and listed on the New York Stock Exchange, a limited partner of and the general partner of partnership B

Partnership B: A limited partnership incorporated under the laws of the same foreign country as company A

Description of the proposed transaction

The applicant and co-applicant are employed by a company that is part of an African e-commerce group. The applicant and co-applicant rendered their services in South Africa.

Company A introduced an incentive scheme for eligible employees within its group that included the applicant and the co-applicant. In terms of the incentive scheme, the eligible employees would be offered, for no consideration, a series of call options by the general partner of partnership B. The call options would, once exercisable, entitle participants to acquire shares in company A. The call options may also be cash settled at the discretion of the grantor.

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:

- Section 8C will apply to the call options, but not the call option shares.
- The value of the call option shares will, on a purposive interpretation of paragraph (c) of the definition of "gross income" in section 1(1) and section 8C, not constitute gross income in the hands of the applicant and co-applicant.
- Any capital gain or loss on the exercise of the call options will be disregarded under paragraph 58, unless realised as the result of the cash settlement of the option.

11.8. BPR 353 – Linear adjustment of gross sales of unrefined mineral resource

This ruling determines that a linear adjustment may be made to adjust gross sales of an unrefined mineral resource in the event that the mineral is supplied in a condition higher than the maximum condition specified in Schedule 2 to the Act, read with section 6(2).

In this ruling references to sections are to sections of the Mineral and Petroleum Resources Royalty Act applicable as at 14 August 2020. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

12. BINDING CLASS RULINGS

12.1. BCR 72 – Deductibility of employment related expenditure, incurred as part of a B-BBEE ownership transaction and the PAYE treatment of interest-free loan to share trust

This ruling determines the deductibility of contributions by employer companies (class members) to fund an employees' trust to enable the trust to participate as a part shareholder of a newly established black-owned and controlled property entity (B-BBEE company). The ruling also confirms that the advance of an interest-free loan by the listed holding company (listco) of the applicant and class members to a managers' trust destined to hold a percentage of the B-BBEE company, would not constitute a taxable benefit, with the effect that no PAYE withholding obligation would arise in respect thereof.

In this ruling references to sections and paragraphs are to sections of the Income Tax Act and paragraphs of the Fourth and Seventh Schedules to the Act, applicable as at 24 April 2020. Unless the context indicates otherwise any word or

expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 11(a), read with section 23(g);
- section 23H(1)(ii);
- paragraph 1 of the Fourth Schedule – definition of 'remuneration';
- paragraph 2 of the Fourth Schedule; and
- paragraph 2(f) read with paragraphs 4 and 16(1)(b) of the Seventh Schedule.

Class

The class members to whom this ruling will apply are the Employer companies

Parties to the proposed transaction

Applicant: A private company and a resident

Employer companies: The group companies that employ the participating employees and managers and who are, together with the applicant, wholly-owned subsidiaries of listco, forming a group of companies

Listco: A holding company of the applicant and class members and listed on the JSE

Description of the proposed transaction

The group is in the process of implementing a B-BBEE transaction in terms of which immovable property, previously owned by the group, is transferred to the B-BBEE company. The shareholders of this entity include the employees' trust and the managers' trust, as well as members of the broader public who are black. The B-BBEE points earned by the group will contribute to the B-BBEE status of the applicant and each group company, including the employer companies. It is important to note that the B-BBEE status of the group prior to the transaction is already at the maximum level, due to previous equity-based B-BBEE transactions. However, this status is at risk, mainly due to uncertainty relating to the mandated

investment by black shareholders who may sell the equity at any time. Therefore, the group seeks a more sustainable solution to ensure that the group remains blackowned.

The objects of both the employees' trust and managers' trust comprise the creation of an employee incentive scheme, as well as the implementation of the B-BBEE transaction. These objects are set out in the various founding documents and may be summarised as the incentivising of employees of group companies by affording them the opportunity to become beneficiaries of trusts that participate in the equity of the B-BBEE entity, thereby contributing to the sustained unencumbered B-BBEE ownership profile of the group.

Neither the managers' trust nor the employees' trust will be 'connected persons' as defined by section 1(1) in relation to the applicant, any employer company, or listco.

Listco does not have any employees – all the South African based employees within the group are employed by the employer companies. It is intended that the employees' trust be funded directly by contributions from the employer companies, whilst listco will make an interest-free loan available to the managers' trust and invoice each employer company for its proportional share (the recovery amount). Each recovery amount is calculated with reference to the number of participatory units to be offered to the employees of each employer company, proportional to total units available to employees of the group. Units are allocated to employees in proportion to the national economically active population targets published by the Department of Labour.

Although the recovery amount for each employer company is calculated using employment-related criteria, each employer company also benefits from the more robust BEE credentials achieved in consequence of the B-BBEE transaction in which the trust plays an essential part. For each employer company, the recovery amount serves a dual purpose. On the one hand, the implementation of the B-BBEE transaction is facilitated and, on the other hand, the employees are incentivised. These two purposes are achieved equally. Therefore, 50% of the recovery amount relates to the staff incentive and 50% relates to the B-BBEE

status, of each employer company.

The participating employees and managers will be taxed on the value of the shares in the B-BBEE company under section 8C, upon vesting, as governed by the scheme rules. Listco will not claim a deduction in relation to the expenditure it incurs and will also not include the recovery amounts in its gross income. The tax consequences for the employees, managers and listco fall outside the scope of this binding class ruling.

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:

- Fifty percent (50%) of each employer company's recovery amount is not deductible, because it relates to the implementation of the B-BBEE transaction and is capital in nature. However, fifty percent (50%) of each employer company's recovery amount relates to incentivising employees and will be deductible in terms of section 11(a), read with section 23(g).

  Section 23H(1) will apply to this portion, with the effect that that amount must be deducted proportionally over the period for which staff is incentivised.

- The advance by listco of an interest-free loan to the managers' trust does not result in a taxable benefit contemplated under paragraph 2 of the Seventh Schedule and in consequence there is no PAYE withholding obligation in the hands of the employer companies in relation to the beneficiaries of the managers' trust.

12.2. BCR 73 – Dividends: When the 'qualifying purpose' definition must be satisfied

This ruling determines when the definition of 'qualifying purpose' must be satisfied for purposes of section 8EA(3) if third-party backed shares pay dividends.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 26 March 2020. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 8EA(1) – definition of 'qualifying purpose';
- section 8EA(2); and
- section 8EA(3).

Class

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

Parties to the proposed transaction

The applicant: A company incorporated in and a resident of South Africa

Preference shareholders: The investors who will acquire preference shares in the applicant

Company A: A resident company

Company B: A resident of Country X

Company C: A resident of Country Y

Description of the proposed transaction

The applicant is wholly-owned by company A.

Company A intends to invest in company C, which will carry on business in country Y. Company A will invest via company B. The applicant will acquire 42.5% of the shares in company B, and the remaining shareholding in company B will be held by non-residents. Company B will acquire 100% of the shares in company C.

A consortium of financiers will advance a bridge loan to the applicant. The applicant will use the funds advanced to it to subscribe for ordinary shares in company B. Company B will use the proceeds from the ordinary share subscription from the applicant (and the other non-residents) to subscribe for shares in company C.

The bridge loan advanced to the applicant will be refinanced by the preference shareholders who will subscribe for preference shares in the applicant. The preference shares will be secured by, amongst others, a guarantee issued by company A to the preference shareholders.

At the time that the preference shares are issued, company C will not be an 'operating company' as defined in paragraph (a) of that definition in section 8EA(1) as it will not be a company that carries on business continuously and which, in the course or furtherance of that business, provides goods or services for consideration. Accordingly, company B will not be a controlling group company as contemplated in paragraph (b) of the definition of 'operating company' and will therefore also not be an operating company for purposes of section 8EA. It is anticipated that company C will become an operating company at a later stage and company B will then become a controlling group company in relation to an operating company at that stage.

The preference shareholders will be paid dividends by the applicant. It is anticipated that those preference share dividends, in the case of at least some of the preference shareholders, will be paid in a year of assessment during which company C becomes an operating company, but before it actually does so.

Conditions and assumptions

This binding class ruling is subject to the additional condition and assumption that the preference shares to be issued by the applicant will constitute third-party backed shares for purposes of section 8EA.

Ruling

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

- Any dividend received by or accruing to a preference shareholder in its year of assessment will not be deemed to be income if at the time that the dividend is received by or accrues to the preference shareholder, company C is an operating company and company B a controlling group company in relation to company C.
- Any dividend received by or accruing to a preference shareholder in its year of assessment:
  - before company C becomes an operating company and company B becomes a controlling group company in relation to company C, will be deemed to be income by section 8EA(2); and
  - when company C has ceased to be an operating company and company B is consequently no longer a controlling group company in relation to company C, will be deemed to be income by section 8EA(2).

12.3. BCR 74 – Treaty relief: Authorised contractual scheme

This ruling determines that UK investors in an authorised contractual scheme are entitled to claim treaty relief on income from SA equity and debt instruments.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 13 May 2020. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definitions of 'company', 'foreign company' and 'foreign partnership';
- section 50A – definition of 'foreign person';

- section 50C;
- section 50E;
- section 64D – definition of 'beneficial owner';
- section 64EA;
- section 64G;
- section 64H;
- section 108; and
- articles 10 and 11 of the Treaty read together with article 2 of the Protocol.

Class

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

Parties to the proposed transaction

The Authorised Contractual Scheme (ACS): A UK registered authorized contractual scheme

The applicant: A non-resident company

The depositary: A non-resident company

Investors: The investors who will acquire units in the ACS

Description of the proposed transaction

The ACS is a UK registered authorised contractual scheme established as a coownership scheme. The applicant is the authorised manager of the ACS.

Each class member is a resident of the UK.

The applicant advised that under UK law:

- The ACS is not a separate legal entity but a contractual arrangement established by way of a deed initially entered into between the applicant and the depositary.
- The ACS is structured as an umbrella scheme with different sub-funds,

which are separate pools of assets and liabilities, which have, amongst others, distinct investment objectives and do not constitute separate entities.

- An investor participates in the ACS by acquiring a unit or units in a sub-fund of the ACS.
- The property in each sub-fund is beneficially owned by the investors in the sub-fund as tenants in common: The investors are the beneficial owners of any income derived from the property held in a sub-fund, whether or not that income is distributed to the investors.
- The ACS is not a taxable entity in the UK and is not within the charge to direct taxes: It is fiscally transparent: Each investor is responsible for its own tax arising on its own share of income arising in the ACS at its own rate of tax. Each investor is also taxable at its own rate of tax on its capital gains on the sale of its units in the ACS and not on gains realised in respect of the underlying assets held in a sub-fund as capital gains and losses do not flow through to the investor.
- The ACS manager acts in its own name when entering into contracts in the course and furtherance of its management activities, but does so for and on behalf of the investors.

It is proposed that:

- The investors will invest in one of the sub-funds of the ACS (the sub-fund) by purchasing units in the sub-fund.
- The applicant, acting in its capacity as the manager of the ACS, will, through the sub-fund, acquire SA equities and debt instruments that will yield dividend and interest income.
- The investors will obtain co-ownership rights in the SA equities and debt instruments and any dividend and interest income arising from the investments.

<u>Conditions and assumptions</u>

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

- The ACS is not a taxable entity in the UK and is not within the charge to tax. Each investor is the taxable party on its proportionate share of income arising from the ACS.
- The UK treats an investor's share of any income of the ACS to be attributed directly to the investor on an arising basis regardless of whether or not any income is actually paid to the investor.
- The UK treats the character and source of the income in the hands of an investor as the same as if the investor had become entitled to income directly from the SA equities and debt instruments.

<u>Ruling</u>

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

- The ACS is not a 'foreign partnership' as defined in section 1(1) and is therefore not treated locally as fiscally transparent. The ACS is a 'company' as defined in paragraph (e)(ii) of that definition in section 1(1) and a 'foreign company' as defined in that definition in section 1(1).
- As the ACS is a company as defined in paragraph (e)(ii) of that definition in section 1(1), it is the:
    - 'beneficial owner' of dividends that will be paid as contemplated by that definition in section 64D read with section 64EA; and
    - 'foreign person' to or for the benefit of which interest will be paid as contemplated in that definition in section 50A read with section 50C.
- Due to the application of the Treaty read together with the Protocol and section 108, each class member is a beneficial owner of its proportionate share of dividends or interest or both that will be received by or accrue to the ACS, and will be entitled to claim relief in accordance with article 10 or

article 11 or both of the Treaty, read together with article 2 of the Protocol and sections 64G(3), 64H(3) and 50E(3), whichever is applicable, provided that the class member complies with sections 64G(3), 64H(3) or 50E(3), as the case may be.

13. BINDING GENERAL RULINGS

13.1. Sale of dwellings by fixed property developers following a change in use adjustment under section 18(1) or 18B(3) – No 55 (VAT)

For purposes of this ruling:

- “BGR 48” means Binding General Ruling (VAT) 48 “The Temporary Letting of Dwellings by Developers and the expiry of section 18B”;

Purpose

This BGR clarifies the VAT consequences of the sale of fixed property consisting of dwellings, by a developer, pursuant to such dwellings being deemed to have been supplied by the developer under section 18(1) or 18B(3).

Background

Under section 18(1), a vendor that changes the use or application of goods or services from a wholly or partly taxable purpose to a wholly non-taxable purpose, is deemed to have made a taxable supply in the course or furtherance of the vendor’s enterprise.

As a consequence, developers that applied their fixed property for letting as a result of adverse economic factors, became liable to make an output tax adjustment under section 18(1).

Section 18B came into operation on 10 January 2012 in order to provide temporary relief to developers that:

- constructed, extended or improved dwellings for the purpose of sale; and

- subsequently applied such dwellings for exempt supplies under section 12(c)(i), namely, supplying accommodation in a dwelling under an agreement for the letting and hiring thereof, on a temporary basis.

The temporary relief was initially intended to expire on 1 January 2015. However, the relief period was extended until 31 December 2017.

BGR 48 clarified the circumstances in which section 18B applies, the period in which a developer is required to make a change in use adjustment, as well as the effect of the cessation of section 18B on dwellings let temporarily for the first time on or after 1 January 2018. Developers were alerted to the following VAT implications in BGR 48:

- A developer, that developed dwellings for sale but subsequently applied one or more of such dwellings for temporarily letting during the relief period, must account for the output tax adjustment based on the open market value of each dwelling concerned in the tax period during which the 36-month period ends. The 36-month period is calculated from the date that any agreement for the temporary letting of the dwelling concerned was entered into for the first time from 10 January 2012 until 31 December 2017.
- Where the 36-month period expires after 31 December 2017 and the property was not permanently applied for non-taxable purposes, the developer must account for the output tax in the tax period falling on the date when the 36- month period expires. For example, a developer that applied a dwelling for temporarily letting for the first time on 31 December 2017, must account for the output tax adjustment in the tax period within which the 31st of December 2020 falls.
- Should any of the dwellings be applied permanently for non-taxable purposes during the relief period, the developer is required to account for the output tax adjustment in the tax period in which the specific dwelling is applied permanently for non-taxable purposes.
- As section 18B expired on 31 December 2017, any dwelling that is temporarily let for the first time from 1 January 2018 will not qualify for the

relief under section 18B. Developers that let dwellings for the first time, in terms of an agreement entered into on or after 1 January 2018, are required to account for the output tax adjustment under section 18(1).

On the basis that section 18B ceased on 1 January 2018, developers that let dwellings that were held for sale, in terms of an agreement entered into for the first time, on or after 1 January 2018, are required to account for the output tax adjustment under section 18(1).

Developers that have not accounted for the aforementioned output tax adjustments in the relevant tax periods, are liable to be assessed for the VAT, penalties and interest levied under the VAT Act and the Tax Administration Act 28 of 2011, respectively.

In order to ensure compliance, developers are encouraged to remedy their tax affairs by means of voluntary disclosure, where they have failed to make the required VAT adjustment in past tax periods.

Ruling

The subsequent sale of a dwelling in respect of which the developer was required to have declared the deemed supply under section 18(1) or 18B(3), is not subject to VAT. The purchaser will be liable for transfer duty on the acquisition of such dwelling.

14. GUIDES

14.1. Guide on the Determination of Medical Tax Credits (Issue 11)

This guide provides general guidelines regarding the medical scheme fees tax credit and additional medical expenses tax credit for income tax purposes.

Expenditure of a personal nature is generally not taken into account in determining a taxpayer's income tax liability, under South Africa's tax system. One of the notable exceptions relates to medical expenditure. South Africa is aligned with the practice in many other countries of granting tax relief for medical expenditure.

There are a number of reasons that tax systems provide such relief. One of the reasons is that serious injury or illness can present taxpayers with disproportionately high medical bills in relation to income, which can be difficult to meet. The resulting hardship affects a number of economic areas for taxpayers, including the ability to settle obligations to the fiscus, such as a tax bill.

Historically, South Africa utilised a deduction system to facilitate tax relief for medical expenditure. Allowances, subject to certain limits, were permitted to be deducted from income for contributions to medical schemes, as well as for out-of-pocket medical expenditure.

In 2012, tax relief for medical expenditure began a phased-in conversion from a deduction system to a tax credit system. The reason for the change was to eliminate vertical inequity relating to medical contributions: those at higher marginal tax rates received a larger reduction of tax payable than those on lower marginal rates, in respect of the same amount of medical expenditure. The purpose of the change was to spread tax relief more equally across income groups, thus bringing about horizontal equity – those who pay equal values for medical expenditure receive absolute equal tax relief.

A tax credit system differs from a deduction system in that, instead of permitting a deduction of the medical allowance against a taxpayer's income, the relief is granted as a reduction in tax payable. It therefore operates as a tax rebate.

The new dispensation consists of a two-tier credit system:

1. A **medical scheme fees tax credit (MTC)** that applies in respect of qualifying contributions to a medical scheme.
2. An **additional medical expenses tax credit (AMTC)** that applies in respect of other qualifying medical expenses.

The application of the AMTC system falls into three categories:

(a) Taxpayers aged 65 years and older.

(b) Taxpayer, his or her spouse or his or her child is a person with a disability.

(c) All other taxpayers.

In order to qualify for the AMTC in the '65 years and older' category, the taxpayer must be 65 years or older on the last day of the relevant year of assessment or, had he or she lived, would have been 65 years or older on the last day of the relevant year of assessment.

14.2. Guide to the Taxation of Special Trusts (Issue 3)

This guide has been prepared to assist those involved with special trusts to gain an understanding of the provisions of the Act relating to such special trusts, with particular reference to the income tax and CGT provisions. A brief summary of other taxes relating to special trusts has also been included. This guide focusses mainly on the tax implications for a special trust and not on the tax implications for its beneficiaries.

This guide reflects the income tax and tax administration legislation (as amended) at the time of publishing and includes the following amending acts which were promulgated on 15 January 2020:

- The Taxation Laws Amendment Act 34 of 2019 (as per Government Gazette 42951).
- The Tax Administration Laws Amendment Act 33 of 2019 (as per Government Gazette 42952).
- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 32 of 2019 (as per Government Gazette 42950).

Unlike conventional trusts which are taxed at a flat rate of tax, a special trust is taxed on the same sliding scale applicable to natural persons. The Act makes provision for two types of special trust in section 1(1) which will be referred to as type-A and type-B trusts. In essence a type-A trust is created for a person or persons having a disability, while a type-B trust is created on the death of the testator and can subsist only while it has a minor as a beneficiary.

The distinction between a type-A trust and a type-B trust is important because a type-A trust qualifies for specific relief from CGT which is not granted to a type-B

trust.

15. 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.