# TAX UPDATE

**For period: April 2021 to June 2021**

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# 1. INTRODUCTION

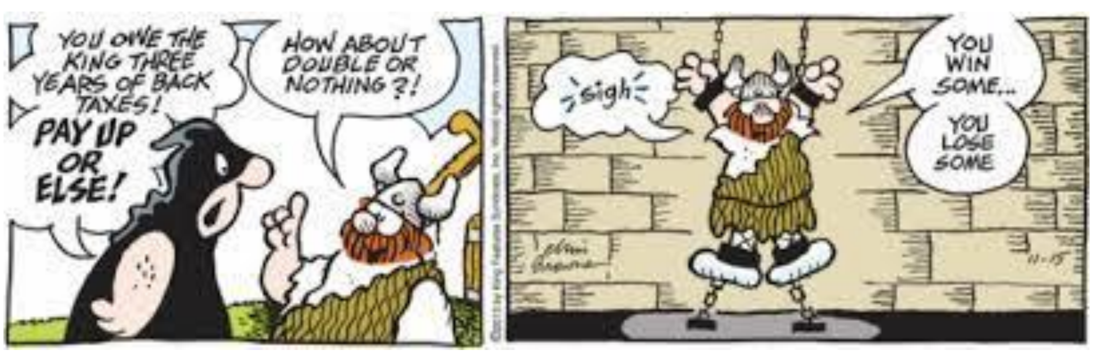
The purpose of this update is to summarise developments that occurred during the <u>second</u> quarter of 2021, specifically in relation to Income Tax and VAT. Johan Kotze, a Tax Executive at Shepstone & Wylie Attorneys, has compiled this summary.

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. REGULATIONS

## *2.1. List of transactions or matters in respect of which SARS may decline to make a decision in terms of section 72(1) of the VAT Act – No. 300*

No. 300 of 1 April 2021

**List of transactions or matters in respect of which SARS may decline to make a decision**

The transactions or matters in respect of which SARS may decline to make a decision under section 72(1) are as follows:

(a) The transactions or matters referred to in:

(i) section 80(1) and the additional considerations referred to in section 80(2) and section 80(3) of the Tax Administration Act read with Public Notice No. 748 published in Government Gazette No. 40088 of 21 June 2016; and

(ii) any regulation issued under section 74.

(b) A request to deem:

(i) a project to be a 'foreign-donor funded project' as defined in section 1(1);

(ii) a payment made to or on behalf of a vendor in terms of a national housing programme contemplated in the Housing Act, 1997 (Act No. 107 of 1997) read with sections 8(23) and 11(2)(s);

(iii) a particular payment to be a 'donation' or 'grant' as defined in section 1(1);

(iv) an activity to be a 'welfare organisation' as defined in section 1(1) read with Government Notice No. 112 published in the Government

Gazette No. 27235 of 11 February 2005;

(v) a supply to be made or not made;

(vi) a person to be the 'recipient' of a supply;

(vii) the issue of a token, voucher or stamp (other than a postage stamp defined in section 1 of the Postal Services Act, 1998 (Act No. 124 of 1998) to fall within section 10(18), (19) or (20) respectively, otherwise than provided for in these sections;

(viii) an exemption to apply on the importation of goods, as contemplated in section 13(3) read with Schedule 1 or the zero-rate to apply on the supply of goods contemplated in section 11(1)(g), 11(1)(j) and 11(1)(w) read with Schedule 2; and

(ix) any branch or main business of an enterprise, permanently situated at premises outside the Republic, to be carried on by a person separate from the vendor, as contemplated under proviso (ii) of the definition to 'enterprise' in section 1(1).

(c) A request to allow:

(i) a person to account on the invoice or payments basis, otherwise than provided for in section 15;

(ii) the submission of returns and payment of tax envisaged under section 28 by a person other than the vendor, or a person other than the person contemplated in sections 54(4) and (2B);

(iii) the issuing and receipt of tax invoices envisaged in section 20, in the name of any person other than the vendor, or any other person than the agent contemplated in section 54;

(iv) an input tax deduction under section 16(2), read with section 16(3) by any person other than the vendor, or by a person other than the person contemplated in sections 54(2A)(b) and (6);

(v) an enterprise carried on under paragraph b(v) of the definition of enterprise and any other enterprise activity, using a single VAT registration number;

(vi) an 'intermediary' to register and account for the supply of 'electronic services' where the foreign supplier of 'electronic' services is liable to register for VAT as contemplated in section 23(1A);

(vii) the non-payment of VAT charged under the circumstances prescribed in terms of section 31(1)(e).

# 3. DRAFT REGULATIONS

## *3.1. List of qualifying physical impairment or disability expenditure*

Expenditure prescribed by SARS and which is necessarily incurred and paid for by the taxpayer in consequence of a physical impairment or disability is a qualifying medical expense under section 6B of the Income Tax Act, subject to specified limitations.

The terms “necessarily incurred” and “in consequence of” are not defined in the Act.

Therefore, they retain their ordinary dictionary meaning. These terms mean that a prescribed expense does not automatically qualify as a qualifying physical impairment or disability expense by mere reason of its listing.

The expense must also be necessary for the alleviation of the restrictions on a person’s ability to perform daily functions. For example, if a wheelchair user without visual impairment buys a hand-held talking Global Positioning System (GPS), the cost of the hand-held talking GPS will not qualify under section 6B of the Act even though the expense is prescribed in the list.

This is so because the hand-held talking GPS is not directly connected to the wheelchair user’s disability and hence is neither necessarily incurred nor incurred in consequence of the person’s disability. In the case of a person who is, for example, visually impaired, the cost of the hand-held talking GPS may qualify.

## *3.2. Electronic form of record keeping in terms of section 30(1)(b) of the TA Act*

**SCHEDULE**

**1. General**

**[1.1.]** Unless the context indicates otherwise, **[A]**any word or expression contained in this notice to which a meaning has been assigned in a tax Act as defined in section 1 of the Tax Administration Act, 2011 ("the Act") has the meaning so assigned, **[unless the context indicates otherwise.**

**1.2. In this notice,]**and the following terms**[, if in single quotation marks,]** have the following meanings—

**'[an ]acceptable electronic form'** has the meaning contained in rule 3.2;

**'[the ]Electronic Communications and Transactions Act'** means the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002);

**'electronic records'** means records that are kept or stored in electronic form on a computer or on another electronic storage device and are either originally created in an electronic form or are converted from any non-electronic form into an electronic form; and

**'records'** mean the records, books of account or documents that a person is required to keep or retain in terms of section 29 of the Act.

**2. Authority to keep records in electronic form**

A person who is required to keep records in terms of section 29 of the Act may keep those records, or part of those records, in an electronic form as provided in the rules set out in this notice.

3. Acceptable electronic form

3.1. In addition to the other requirements contained in these rules, the electronic records must be kept in an acceptable electronic form.

3.2. An acceptable electronic form is a form in which—

(a) the integrity of the electronic record satisfies the standard contained in section 14 of the Electronic Communications and Transactions Act;

(b) the person required to keep records **[are]**is able to, within a reasonable period when required by SARS**[—**

**(i)** **]** provide SARS with an electronic copy of the records in a format that **[SARS]** is **[able to]** readily accessible, readable and correctly **[analyse]**analysable, including—**[**;

**(ii) send [the] records to SARS in an electronic form that is readily accessible by SARS; or**

**(iii) provide SARS with a paper copy of the records]**

(i) database records in delimited, Microsoft Excel or similar format; and

(ii) records that substantiate database records, such as supplier invoices, purchase orders, bank statements, in portable document or similar format; and

(c) the records kept in an electronic form may be accessed by SARS for the purpose of performing a function referred to in section 3 of the Act.

**4. Location of records**

4.1. Records retained in an electronic form must be kept and maintained at a place physically located in South Africa.

4.2. Despite rule 4.1, a **[A senior SARS official may authorise a ]**person **[to]**may keep records in an electronic form at a location outside South

Africa if **[the official is satisfied that]**<u>they, in the attached form provided to SARS at ElectronicRecords@sars.gov.za, declare that</u>—

(a) the electronic system used by the person will be accessible <u>to SARS—</u>

<u>(i)</u> from the person's physical address in South Africa; <u>or</u>

<u>(ii) in the case of a person who is not a resident of the Republic and is liable to register under section 23(1A) of the Value-Added Tax Act, from the natural person responsible for the value-added tax affairs of the person,</u>

for the duration of the period that the person is obliged to keep and retain records;

(b) the locality where the records are proposed to be kept will not affect access to the electronic records;

(c) there is an international tax agreement for reciprocal assistance in the administration of taxes in place between South Africa and the country in which the person proposes to keep the electronic records;

(d) the form in which the records are maintained satisfies all the requirements of these rules apart from the issue of physical locality of the storage; and

(e) the person will be able to provide an acceptable electronic form of the records to SARS on request within a reasonable period.

**5. System documentation explanation**

5.1. A person who uses computer software or an electronic platform that is commonly recognised in South Africa, to keep records in an electronic form, need not keep the documentation described in this rule.

5.2. If a person keeps records in an electronic form and uses computer software or an electronic platform that is altered or adapted for that person's environment, is created or designed for the person or is not commonly recognised in South Africa, then the person must keep the documentation described in this rule.

5.3. A person referred to in rule 5.2 must—

(a) keep any computer and software manuals that are relevant to accessing and understanding the person's method of electronic record keeping; and

(b) if the documents referred to in rule 5.3(a) do not adequately describe the person's system of electronic record keeping, then the person must prepare and keep a written document that accurately describes the person's system of electronic record keeping.

5.4. The written document referred to in rule 5.3(b) must contain a description of the following—

(a) how transactions are created, processed and stored;

(b) how and what reports are generated;

(c) how often electronic records are stored;

(d) the form**[at]** used to store and archive the records, that includes a description of the media, software and hardware used;

(e) the physical locality where records are stored or archived;

(f) a data dictionary that explains how records are indexed when created, processed, stored or backed-up; and

(g) the procedures and protocols in place to prevent the unauthorised deletion, alteration and destruction of records and reports.

5.5. If **[the]**<u>an</u> electronic record consists of any non-electronic record that is converted to an electronic form, or of any electronic record that is converted to another electronic form, a separate record must be kept of the following—

(a) a chronological record and explanation of all changes or upgrades to the software and hardware used, including explanations of how the new system can recreate an acceptable electronic form;

(b) where applicable, explanations of migrations of data that may have taken place across either software or hardware;

(c) a detailed record of the controls which maintain the integrity of an old system together with a record of the records processed to an electronic or another electronic form**[at]** as applicable; and

(d) an explanation of archival and back-up facilities for any electronic systems that are no longer used by the person.

5.6. If a person carries out internet-based transactions, the written document or record referred to in rule 5.3 and 5.5 must also contain a description of the—

(a) log files created to identify individual transactions; and

(b) security measures used to maintain the identity, integrity and authenticity of transactions.

**6. Storage, back-up and conversion**

A person who keeps records in an electronic form must ensure that measures are in place for the adequate storage of the electronic records for the duration of the period referred to in section 29 of the Act, which include—

6.1. the appropriate storage of the media on which the electronic records are recorded;

6.2. the storage of all electronic signatures, log-in codes, keys, passwords or certificates required to access the electronic records; and

6.3. procedures to obtain full access to any electronic records that are encrypted.

**7. Inspection of electronic system by SARS**

7.1. A person who keeps or retains electronic records must have the electronic records available for inspection by SARS in terms of section 31 of the Act—

(a) at all reasonable times; and

(b) at premises physically located in South Africa, or accessible from such premises or natural person under rule 4.2(a), as the case may be**[ if authority in terms of rule 4.2 has been granted]**.

7.2. In the course of an inspection carried out in terms of section 31 of the Act, the electronic system used by the person who keeps records in an electronic form**[at]**, must be capable of demonstrating positively that the provisions of these rules are complied with, including, but not limited to, validating that—

(a) the electronic records meet the standard of integrity referred to in rule 3.2(a); and

(b) an acceptable electronic form can be displayed or produced.

7.3. Any electronic signatures, log-in codes, keys, passwords or certificates required to access the electronic records must be available at all reasonable times to enable an inspection in terms of section 31 of the Act to be carried out.

7.4. The written document and records required to be maintained in terms of rule 5 must be available at all reasonable times to enable an inspection in terms of section 31 of the Act to be carried out.

**8. Making electronic records available for audit or investigation**

Electronic records must be able to be made available for the purpose of an audit or investigation in terms of section 48 of the Act, which includes having the following available on the date and at the time that the audit or investigation is scheduled to start—

8.1. any electronic signatures, log-in codes, keys, passwords or certificates required to access the electronic records for the purpose of audit or investigation; and

8.2. the written document and records required to be maintained in terms of rule 5.

**9. Duration of keeping or retaining electronic records**

A person who keeps records in an electronic form must be able to comply with the provisions of these rules throughout the period that the person is required to keep records in terms of section 29 of the Act.

# 4. TAX CASES

## *4.1. Cart Blanche Marketing CC v C:SARS (83 SATC 89)*

SARS on 4 August 2014, and acting in terms of the provisions of section 40 of the TA Act, had selected the applicants for an audit ('the decision') to allegedly verify their compliance with the Income Tax Act and the Value-Added Tax Act.

The Applicants sought the review and setting aside of the decision on the basis that it was unlawful by virtue of the following reasons: it was taken for an ulterior purpose; it was taken for a reason not authorised by the empowering legislation (ie the TA Act); it was irrational; it was taken in bad faith.

SARS' opposition was founded on two bases: a decision in terms of section 40 of the TA Act did not constitute reviewable administrative action, but even if a selection in terms of section 40 was reviewable, the decision in issue was lawful and should not be set aside.

The first two Applicants are close corporations, involved in the provision of commercial transport services to their clients. The First Applicant had been in business for 23 years, and the Second Applicant for 12 years. During this period neither the First nor the Second Applicant had ever had any income tax or VAT difficulties with SARS. The Third Applicant was the sole member of the First Applicant, and a 40% member of the Second Applicant. Two other natural persons owned the remaining 60% of the Second Applicant.

The First and Second Applicants were said to be affiliated to a group of companies that were controlled by the Third Applicant, Ms Airey, and a certain Mr Muller. The other companies included Clear Enterprises (Pty) Ltd, West Trucking (Botswana) (Pty) Ltd and Goss Motors (Pty) Ltd (‘the Airey/Muller companies’).

The Airey/Muller companies had since 2004 been involved in a plethora of litigation against, in the main, SARS and this litigation concerned the said companies’ alleged non-compliance with the provisions of the Customs and Excise Act (‘the Customs Act’ and ‘customs litigation’). The companies involved had imported second-hand trucks and trailers into South Africa without allegedly making due entry as required by the Customs Act, and although some of the cases had been finalised, eleven cases were still pending before this court.

The decision forming the subject of the current litigation was taken jointly by Ms De Swardt and Ms Biyela who, at the time, were members of SARS' Tax and Customs Enforcement Unit (‘the TCEU Unit’).

In essence the function of the TCEU was to investigate reports of non-compliance with, or breach of, the Tax and Customs Acts and, if necessary, to initiate the relevant processes to, e.g., assess the tax. The TCEU Unit was not involved in the customs litigation and it only became aware of the Applicants and their conduct when it received the ‘2010 memorandum’ referred to and dealt with hereunder.

In 2010, and apparently based on the activities that formed the subject of the customs litigation, SARS' customs division provided the TCEU Unit with a ‘suspicious activity’ memorandum in respect of Ms Airey, Mr Muller and the Airey/Muller companies (‘the 2010 memorandum’).

Because of a lack of resources the TCEU Unit stated that it could not immediately initiate a full investigation on receipt of the 2010 memorandum and it was thus decided to do the investigation in two phases: first a customs investigation and thereafter income tax and VAT.

On 4 August 2014 the Applicants were formally notified that they had been selected for an audit in terms of section 40 of the TA Act and in these letters the Applicants were called upon to make available certain records in order to enable the audit team to do the audit and the three notices stated that the decision to conduct the audit was based on a risk assessment.

As the Applicants had refused to provide SARS with any documentation to prove their compliance, the audits were proceeded with and regard was had to the documentation in SARS' possession only.

In letters dated 18 February 2015 SARS informed the Applicants of the findings in respect of the First and Second Applicants, the bases thereof and that, based thereon, he intended to issue additional assessments to them for payment of the income tax allegedly underpaid by them.

Pursuant to those letters the present application was instituted on 14 April 2015.

The Applicants claimed that their tax affairs had always been in order and in support thereof they relied on the fact that they had never before been subjected to any audit and that tax clearance certificates had in the past been issued to them by SARS.

The Applicants contended that right from the outset, SARS had pinned its colours to the mast, and had committed itself to a ‘risk assessment basis’ being the relevant consideration upon which it had decided to subject the Applicants to audit. The lawfulness of the decision therefore depended, among other reasons, so the argument went, on SARS having in fact established the existence of an income tax risk pertaining to the three taxpayers.

The Applicants insisted that their income tax affairs were in order and, from the outset, they contended that they suspected that the decision to subject them to an audit was unlawful and an abuse of power and accordingly refused to provide the information sought.

SARS was asked for the unredacted and unabridged copies of the risk assessments. SARS initially refused access to the risk assessments but subsequently, while still not providing the written risk assessment, SARS' attorneys stated that the ‘risk identified stemmed from the customs investigation into your clients’ activities and the litigation in that regard over a period of just less than ten years.’

The Applicants, in response, communicated a range of suggestions to SARS aimed at, so they contended, avoiding the need for litigation. One of these proposals was that the risk assessment be made available to the Applicants, on the basis of which they could take an informed decision whether or not to challenge the legality of the decision.

The Applicants responded by asserting that their tax affairs were in order, that they remained unconvinced that SARS had legitimate grounds to conduct the audits, restated their wish to avoid litigation, and that should the risk assessments contain valid grounds, they would immediately endeavour to comply, to the best of their abilities, with the request for information.

In response SARS insisted that there was no legal obligation on it to explain the basis upon which a taxpayer was selected for the audit.

In response, SARS finalised its audit findings on 18 February 2015 without access or reference to the information sought from the Applicants and SARS was advised on 24 March 2015 that the Applicants would initiate legal proceedings to review the decision to conduct the audit. SARS was expressly advised that the main ground upon which the review application would be based was that the decision to conduct the income tax audit was unlawful due to it being based on ulterior motive.

The notice of motion and supporting affidavits were intended to be formally served by no later than 14 April 2015 and SARS was requested to refrain, for the time being, from proceeding with the audit or any other further steps that flowed from the decision to commence the audits.

SARS proceeded to issue additional income tax assessments on 13 April 2015, one day before the date that the Applicants undertook to launch the review.

The assessments issued created an immediate indebtedness in excess of R238 million for the First Applicant, and R62 million for the Second Applicant, excluding interest and penalties.

Only after the commencement of the review proceedings did the ‘risk assessments’ come to light during the production of the record.

SARS relied on three separate areas of risk, upon which it had reached the conclusion in August 2014 that the three Applicants each posed an income tax risk that warranted their selection for income tax audits. The first area of risk was composed of the Applicants' alleged customs non-compliance ('customs non-compliance'). The second area of risk was composed of the alleged discrepancy in turnover between the (first and second) Applicant's VAT returns when compared to their income tax returns ('turnover discrepancies'). The third area of risk was composed of the alleged discrepancy in income declared by the Applicants in their income tax returns when compared to the content of their bank accounts ('bank account revelations').

The Applicants' case was founded primarily on the provisions of PAJA and, to the extent necessary, on the principle of legality. During oral argument, counsel for the Applicants abandoned reliance on the argument that the decision constituted administrative action as contemplated by PAJA and no longer relied on the provisions of PAJA for this review. The matter proceeded on the basis that it was brought as a legality review only.

Judge Opperman held the following:

(i) That the first question which fell for determination was what powers did the empowering provision, *i.e.* section 40 of the TA Act, give SARS and this was a question of interpretation. One of the powers of SARS was the right to select a taxpayer for an audit '…on the basis of any consideration relevant for the proper administration of a tax Act, including on a random or a risk assessment basis.'

(ii) That the wording, context and purpose of section 40 suggested that provided that the intended audit was to be undertaken for the proper administration of a tax Act, there was no limitation to the considerations on which a decision to select a taxpayer was to be founded.

(iii) That the Applicants contended that right from the outset, SARS had pinned its colours to the mast, and had committed itself to a 'risk assessment basis' being the relevant consideration upon which it had decided to subject the Applicants to audit, and the lawfulness of the decision therefore depended on SARS having in fact established the existence of an income tax risk pertaining to the Applicants.

(iv) That, on the face of it, it seemed as though every enquiry directed by SARS was relevant for the administration of a Tax Act, *i.e.* the Income Tax Act. Objectively adjudged it seemed that no value could be served and no purpose to SARS could be achieved, save to prove or disprove the correctness of the Applicants' VAT and income tax returns but, more importantly, falling squarely within the definition of an 'administration of a tax Act' as defined in section 3(2) of the TA Act.

(iv) That the decision taken in terms of section 40 of the TA Act and the subsequent making of the assessments against the first two Applicants, were separate decisions. The taking of the decision to select a taxpayer for audit did not necessarily lead to the making of an assessment. Similarly, the making of an assessment did not require the prior selection to subject the taxpayer to an audit. The overwhelming majority of assessments were made by SARS without any prior audit.

(v) That by selecting a person for an audit an investigative process is set in motion, nothing more. The initiation of an investigation did not constitute a decision which was capable of review or, simply put, it was not yet ripe for review as it was incomplete.

(vi) That before the process envisaged in section 42 of the TA Act had played out, the Applicants had intimated that they would approach the court to review the decision. Section 42 had embraced a procedurally fair process and these processes were available to the Applicants but were not utilised.

(vii) That, in the court's view, the essential flaw of the Applicants was also one of timing. The First and Second Applicants, in respect of whom additional assessments had been raised, could raise the lawfulness of the decision in the Tax Appeal Court once they had raised objections. It was clear that such court had the jurisdiction to entertain legality issues.

(ix) That all the Applicants had an opportunity to participate in the section 42 procedure of the TA Act but they elected not to do so. Section 42 performed the function of section 3(2) of PAJA, *ie* it afforded a taxpayer, in the position of the Applicants in receipt of the audit notifications, reasonable opportunities to make representations, and once that procedure was exhausted, the decision would potentially have reached the required degree of ripeness capable of forming the subject of a review.

(x) That the Tax Court created in Chapter 9 of the TA Act, had jurisdiction to entertain legality issues such as those raised by the Applicants in this review. As a speciality court it is also best equipped to adjudicate the issues forming the subject of the present application.

(xi) That the ripeness argument dovetailed with the subsidiarity principle and the subsidiarity principle is an important principle in our constitutional order. In our constitutional jurisprudence subsidiarity has come to mean that a litigant may not rely directly on a constitutional provision to assert his or her rights if there is legislation that gives effect to that right, and that a litigant cannot seek a general *declarator* of constitutional principle divorced from the existing legislative or common-law framework. The appropriate course is to identify the relevant law that governs the issue and then to interpret (in the case of legislation) or develop (in the case of common or customary law) it in line with the Constitution. If that was not possible, the law must be declared invalid to the extent of its inconsistency.

(xii) That the principle of subsidiarity required that a party rely on the lower norm which regulated or should regulate the subject matter in issue and where legislation has been enacted to give effect to a right, a litigant should rely on that legislation in order to give effect to the right or alternatively challenge the legislation as being inconsistent with the Constitution.

(xiii) That, in this application, the lower norm was the section 42 procedure of the TA Act or the sections 116 or 117 processes of the TA Act. These sections of the TA Act give effect to the constitutional rights that the Applicants wished to protect with this application.

(xiv) That the Applicants did not challenge the validity of Chapter 9 of the TA Act appeal process or any shortcomings therein that affected their constitutional rights and/or their ability to enforce them. They deliberately chose not to utilise 'the lower norm' and directly approach this court. In doing so they had breached the subsidiarity principle. Absent a challenge to the constitutional validity of the Chapter 9 appeal process on the basis that it 'falls short of constitutional standards', this court cannot entertain the application; to do so would impliedly impugn the validity of the Chapter 9 appeal process, without there having been a properly mounted constitutional attack.

(xv) That, in regard to whether the decision was reviewable, it was accepted that the instances where a court will interfere with such decision will be extremely rare. On the other hand, the words 'relevant for the proper administration of a tax Act and for the purposes of the administration of a tax Act' cannot be ignored. Utilising the provisions of the Act for ulterior purposes will always be unlawful and will be a serious breach of the mutual trust that should exist between a taxpayer and SARS.

(xvi) That, in the court's view, the timing of this application on the facts of this case, was wrong, for all the reasons referred to herein. In addition, the court could not find on the evidence placed before it (and with the constraints imposed upon it in applying the *Plascon Evans* principle) that the decision was taken for a purpose other than for purposes of the administration of a tax Act as contemplated in section 3(2) of the TA Act. The court could certainly not find, as contended in the founding affidavit, that the decision was taken to exert pressure on the Applicants to pressurise Mr Muller.

(xvii) That the court had already concluded that the decision in issue was not capable of forming the subject of a legality review within the factual *matrix* of this case. The court then dealt with the lawfulness of the decision on the basis that it was wrong in that conclusion. If not wrong, these findings will only be *obiter* and not binding should these issues be raised in the Tax Court as they are based on the limited evidence before the court and had been assessed on the basis of the *Plascon Evans* approach.

(xviii) That SARS had initially claimed that three areas prompted it to take the decision. The bank account revelations were abandoned by SARS after the filing of the replying affidavit. SARS now admits that this area of risk was non-existent at the time of the taking of the decision. Ms De Swardt for SARS in a fourth affidavit explained that she mistakenly thought that SARS had received the bank statements prior to the decision having been taken. She says that her inclusion of this as a consideration was due to a *bona fide* oversight. The Applicants did not formally oppose the delivery of the fourth affidavit but argued that the unfolding events raised certain questions concerning Ms De Swardt's credibility which have a bearing on the entirety of SARS' case. As suggested previously, these were issues which could, in the fullness of time, be raised with Ms De Swardt at a hearing in the Tax Court.

(xix) That, in regard to the turnover discrepancies, this area of risk upon which SARS sought to justify its decision, related to a set of alleged discrepancies in turnover when comparing the first two Applicants' VAT returns with their income tax returns. Although VAT and income tax are fundamentally different tax types, both a taxpayer's VAT returns and its income tax returns, contain a declaration of a taxpayer's turnover. If a taxpayer were to declare, in the same period, more turnover for VAT than for income tax, a legitimate question arises from a compliance point of view. A business can only legitimately calculate one figure as its turnover, for both income tax and VAT purposes.

(xx) That, from SARS' point of view, it was therefore a legitimate risk detection methodology to compare a taxpayer's VAT returns and income tax returns, for a given period, to confirm if the same turnover had been declared.

(xxi) That in the court's view there were discrepancies and these justified a decision to undertake an audit and the decision to audit was thus a rational one based on the turnover discrepancies.

(xxii) That, applying *Plascon Evans*, as the court was compelled to do, the court accepted a statement by an experienced SARS official who drew on that experience to found a conclusion that a risk of non-compliance under the Tax Act often arises from non-compliance with the Customs Act.

(xxiii) That the Applicants contended that at best, the customs dispute could have served as a trigger to conduct an income tax risk assessment, with a view to determining whether the three Applicants did pose an income tax risk but in the court's view the Applicants had set the bar too high and the court agreed with the late CR Jansen AJ when he said that 'It should be noted that the threshold for SARS to pass before it can utilise section 40 must be extremely low.'

(xxiv) That in the court's view and having regard to both the turnover discrepancies and the customs non-compliance there was nevertheless sufficient information to initiate an audit as contemplated in section 40 of the TA Act based on a risk assessment basis.

The application was dismissed with costs.

## *4.2. Barnard Labuschagne Inc v C:SARS (83 SATC 115)*

Barnard Labuschagne Inc (BLI) had, on 20 February 2018, brought an application in the High Court for the rescission of a judgment that had been obtained by the SARS in terms of the recovery of tax provisions under Chapter 11 of the TA Act.

SARS had filed with the Registrar of the High Court a certified statement in terms of section 172 of TA Act setting out the amount of tax due and payable by BLI for an outstanding liquid debt in respect of VAT, PAYE, UIF and SDL due and payable to SARS.

BLI was a small law practice which had been in existence for a period of some 25 years and over the years it had encountered some difficulties with SARS, in respect of the payments that it made and were not properly allocated to the relevant accounts. As the dispute was said to have occurred over the years, it was apparent that BLI had left it unresolved and this led to the arrear amounts being disputed.

BLI asserted that in 2013 SARS had filed a similar certificate to the one which BLI currently sought to rescind, and which was the subject matter of this application and it had been strenuously opposed by BLI on the basis that payments made were not allocated correctly. SARS had raised interest and penalties on the amounts that were paid on time and, upon being advised, SARS then considered the unallocated amounts, and the amount which SARS alleged to be owed by BLI significantly dropped and this resulted in penalties being remitted and the judgment that was granted against BLI was withdrawn.

In the period between December 2013 and March 2014 a further effort was made by SARS to provide its employee on a full-time basis to try and sort out the unallocated funds and this exercise resulted in a considerable reduced debt. However, by September 2015, BLI's tax debt had shot up again. When this issue was brought to the attention of BLI, her response was *inter alia* that she needed to generate more fees in order to make ends meet, so indicating that she had no time to waste at SARS offices in order to resolve the matter and BLI proceeded to pay off the tax debt as and when it could.

In the course of 2017 SARS again threatened to apply for a judgment based on the incorrect arrears and it was BLI's contention that despite the fact that this was pointed out, SARS continued to apply for the judgment on 15 December 2017 after it had issued a letter of final demand in 2017 as BLI had been uncooperative with it.

When the letter of demand was not responded to, SARS issued a notice of third-party appointment to ABSA Bank to recoup the outstanding tax debt. Having received a negative response from the bank SARS issued a letter to BLI advising it that it intended to approach the court to obtain a civil judgment against BLI for failing to pay its tax debt and after no response had been received from BLI, SARS continued to obtain a judgment against BLI on 15 December 2017.

Although BLI expressed appreciation of the fact that the *onus* to do a proper accounting lay with itself, it contended that it was impossible for it to do so as SARS did not provide BLI with sufficient information with regards to the correct allocations.

SARS disputed this contention on the basis that it had extended its hand to BLI by allocating an employee to it who was tasked to deal with BLI's queries but, notwithstanding, BLI elected not to respond to SARS' correspondence nor utilise its employee.

BLI thereafter brought an application in the High Court to have the judgment rescinded and the issue for determination by the court was whether a civil judgment granted in terms of sections 172 and 174 of TA Act could be rescinded, and, in the alternative, whether sections 172 and 174 were unconstitutional.

SARS contended, *inter alia*, that BLI had several dispute resolution mechanisms at its disposal before approaching the court with this application in great haste.

BLI stated that its grounds for the rescission of the judgment were not based on an objection against an assessment or decision of SARS as referred to in section 104 of the TA Act, as SARS had not raised assessments or made decisions referred to in section 104 of the TA Act to which BLI would ordinarily object or appeal.

BLI contended that it was therefore entitled to bring these proceedings before the High Court in terms of section 105 of the TA Act as it appeared that section 105 could be read in isolation or as a standalone section without reference to section 104.

BLI further contended that the High Court had jurisdiction to rescind an incorrect judgment and it had jurisdiction to rescind judgments granted in terms of section 172 read with section 174 of the TA Act.

BLI contended that, in the alternative, the provisions of sections 172 and 174 should be declared constitutionally invalid to the extent that they ousted the court's jurisdiction to hear such applications for rescission.

SARS contended that the constitutional challenge to sections 172 and 174 was unfounded in that a judgment secured by it by filing a certified statement with the Registrar of the court in terms of section 172 read with section 174 lacked the rights determining character of a judicially issued judgment in that if the certified statement was an ordinary court judgment, then it would not be open to be unilaterally withdrawn by SARS as contemplated by section 176(1) and (3) of the TA Act. Hence there was no infringement of any constitutional right or principle in this matter.

SARS submitted that what was important in this regard are considerations underpinning the 'pay now, argue later' principle which include the public interest in obtaining full and speedy settlement of a tax debt and the need to limit the ability of recalcitrant taxpayers to use the objection and appeal procedures strategically to defer payment of their taxes.

SARS further contended that there were numerous mechanisms available to BLI in order to safeguard its rights and there was no prejudice or unfairness to BLI who has failed to timeously pay its tax liabilities and further repeatedly failed to comply with the procedures set out in the TA Act.

Moreover, it served the public interest to have a mechanism to collect tax debts relatively swiftly and to bring finality to disputes relatively quickly.

The Minister of Finance (MoF) had been joined to the court proceedings as a result of the constitutional challenge brought by BLI.

MoF agreed with SARS that the judgment that was sought to be rescinded did not exist and that the relief sought by BLI in this application was not a judgment or order which this court had made.

MoF submitted that BLI's interpretation was untenable as it overlooked the clear language of the TA Act. Section 174 explicitly required the certificates to be treated as though they were civil judgments which were lawfully given. It was contended that if this court were to treat the certificates as capable of rescission as *per* BLI's application, the order so granted would be unlawful. Moreover, only a civil judgment that has a final effect could be rescinded but in terms of sections 172 and

174 these certificates may subsequently be altered or entirely erased. The power of SARS to amend a certified statement is totally different to the powers of a court having handed down an ordinary and final judgment which may be subject to rescission proceedings.

MoF also submitted that the granting of a rescission order would offend on two statutes, i.e. the dispute resolution procedures as set out under Chapter 9 of TA Act and the requirement under section 7(2) of the Promotion of Administrative Justice Act which requires the exhaustion of internal remedies, in this instance disputes which the machinery under Chapter 9 of the TA Act was meant to resolve.

Judge Mantame held the following:

<u>As to the rescission of a civil judgment by the High Court granted in terms of sections 172 and 174 of TA Act</u>

(i) That SARS was statutorily mandated to collect revenues due, ensure optimal compliance with tax and customs legislation, and provide a customs and excise service that will facilitate legitimate trade as well as protect the economy and society in realising its mandate, amongst others, SARS had to ensure that the taxpayer complied with the applicable legislation, i.e. the TA Act.

(ii) That SARS was responsible for the administration of the TA Act to ensure the effective and efficient collection of tax. It should not have escaped BLI that it was bound by this legislation in the fulfilment of its tax obligations. It should therefore abide by this legislation. In fact, this was not denied by BLI. Somehow, BLI elected to remove its dispute from the jurisdiction of SARS to be adjudicated by the High Court.

(iii) That the legislature was alive to the fact that the administration of tax is a specialised field and for the effective and efficient tax collection, a legislation tailor-made for this process was warranted. Essentially the TA Act was promulgated for the cultivation of tax compliance other than to oust the jurisdiction of the courts as alleged. Even then, if read properly, the TA Act creates clearly defined dispute resolution mechanisms (Chapter 9) from objection against assessment or decision; appeal against assessment or decision; tax board; tax court and appeal against the decision of the tax court to the Supreme Court of Appeal. Nowhere does it state that a party can choose where the dispute has to be adjudicated.

(iv) That BLI contended that over the years it had encountered some difficulties with SARS with regard to the payments that it had made. They were not allocated to the relevant accounts. This assertion is highly disturbing as it suggests that BLI was the author of its own misfortunes. It left the tax debt unresolved for more than ten years without ensuring that it was resolved to the satisfaction of all parties involved. The fact that payments were allocated to the wrong accounts could only bear consideration to the fact that several accounts were sent to BLI for payment over a period of time and same were left unpaid and this resulted in payments that were made to the wrong accounts.

(iv) That there must be a civil judgment of the court in existence for the rescission of a civil judgment to take place. Sections 172 and 174 of the TA Act constituted a lawful enforcement mechanism and for the achievement of its purpose, one had to understand their correct legal meaning and the appropriate starting point was the language used.

(v) That section 172(2) was clear that 'SARS may file the statement irrespective of whether or not the amount of tax was subject to an objection or appeal under Chapter 9, unless the obligation to pay the amount has been suspended under section 164.' This subsection confirms that despite the application for a civil judgment, the dispute resolution will still be in motion and the upshot was that there was no finality to this judgment and it could not be accorded the status of a judgment.

(vi) That, further, the language used in section 174 was explicit as it stated that 'a certified statement filed under section 172 must be treated as a civil judgment lawfully given in the relevant court in favour of SARS…' It did not state that a certified statement filed under section 172 constituted a civil judgment or was a civil judgment. The interpretation put forward by BLI that it was a judgment was at odds with the interpretation ascribed to this section.

(vii) That, in fact, if regard is to be had to how the 2013 dispute was resolved between the parties, BLI knew that SARS could withdraw the judgment and it followed that it was not final in nature.

(ix) That the fact that the certified statements could be amended and/or withdrawn after they had been treated as a civil judgment unilaterally by SARS bore credence to the fact that the judgment obtained from the Registrar had no final effect and therefore was not capable of rescission.

(x) That BLI should have been acutely aware that its liability had not yet been judicially determined and a determination of the taxpayer's rights would have occurred when the Tax Court on appeal or when a superior court handed down a judgment upholding or setting aside the dispute in question and, simply put, there was no judgment to be rescinded by this court.

(xi) That BLI was well aware that these statements were not final in nature, they did not carry the force of a civilly obtained judgment by a court of law and therefore were not capable of rescission. The judgment obtained through the Registrar of the court was treated as a civilly obtained judgment for recovery purposes. Further, no 'good cause' and/or 'sufficient cause' had been shown by BLI for the rescission to be granted and, accordingly, the application for rescission under common law had no merit.

(xii) That BLI somehow submitted that its ground for the rescission of judgment was not based on assessment or decision of SARS as referred to in section 104 of the TA Act, as SARS had not raised assessments or made decisions as referred to in section 104 of the TA Act. BLI sought to create a situation whereby a dispute such as its dispute was not provided for anywhere in the TA Act, hence it approached the High Court. In the court's view, the fact that SARS allocated payments incorrectly and subsequently made a decision to recover a debt based on an incorrect amount, was a legitimate reason for BLI to have raised an objection. BLI's contention was opportunistic and mischievous as BLI bent over backwards to confer on itself its own jurisdiction to hear its dispute and thereby disregarded the dispute resolution mechanism as set out in the TA Act.

*As to the constitutional challenge*

(xiii) That, as argued by MoF, the question of whether the impugned provisions were constitutionally invalid did not arise, as the TA Act did not purport to oust this court's constitutional jurisdiction. In fact, the converse would be applicable in that the enforcement of the impugned provisions would give effect to tax compliance and taxpayers would maintain and uphold the rule of law.

(xiv) That it would appear that before a court could determine whether it had jurisdiction to adjudicate a constitutional challenge, first, it had to ascertain if the application raised any important constitutional issues which attracted the constitutional jurisdiction of the court as a constitutional challenge is not for the mere asking, simply because BLI was not successful in the main application.

(xv) That it was incumbent upon an applicant to demonstrate the existence of a *bona fide* constitutional question and an issue does not become a constitutional matter merely because an applicant calls it one.

(xvi) That the legislature had promulgated a specialised type of legislation, i.e. the TA Act whose main purpose is to collect tax effectively and efficiently. The fact that BLI misconstrued and/or misinterpreted the language used in these provisions and/or chose its own jurisdiction (the High Court) and thereby disregarded the jurisdiction as stipulated in the TA Act did not render the provisions unconstitutional.

(xvii) That in the event that BLI had failed to lay out a basis for the constitutional challenge in its application, it followed that an issue does not become a constitutional issue simply because BLI calls it one. Sections 172 and 174 do not offend sections 34, 164 and 169 of the Constitution or any other constitutional provision for that matter.

(xviii) That it therefore followed that if BLI failed to demonstrate the existence of a *bona fide* constitutional question, the general principles that the impugned provisions should comply with as stipulated in *Cool Ideas*, *supra*, do not come to the fore.

(xix) That, accordingly, the impugned provisions were not unconstitutional and the constitutional challenge therefore fails.

Application for the rescission of judgment was dismissed.

The impugned provisions were not unconstitutional.

## *4.3. ITC 1938 – Tax Administration*

In August 2000 the South African Custodial Services (Louis Trichardt) (Pty) Ltd (SACS) and the Minister of Correctional Services had concluded what was referred to as a 'concession contract' in terms of which SACS was contracted to design and construct and operate a correctional facility in Louis Trichardt. The contract was for a period of 25 years, at the end of which period the facility would be handed over to the State.

The initial contract price for the entire project amounted to R303 million but the total contracted amount which was eventually incurred in respect of the construction including equipment costs and financial costs in respect of loan finance professional fees amounted to R460 million and in February 2002 the facility became operational.

A dispute arose between SACS and SARS resulting from the completion of the facility and SARS had disallowed SACS' objection to its assessment raised for the 2002 year of assessment.

After SARS had disallowed SACS' objection it lodged an appeal to the Pretoria Tax Court which proved to be successful. That court held that expenditure in an amount of approximately R511 million, which SACS had contended had been incurred in relation to the construction of the facility, was deductible as it was expenditure which had been incurred in respect of materials and equipment, which constituted trading stock in terms of section 22(2A) of the Income Tax Act.

SARS thereafter successfully noted an appeal to the Supreme Court of Appeal (see *C: SARS v South African Custodial Services (Louis Trichardt) (Pty) Ltd* 74 SATC 61) which found that the work of constructing the facility had been subcontracted to a construction company which was the entity that undertook to provide the goods, material and labour necessary to perform the work concerned as an independent contractor. Accordingly, it was not SACS which provided the items in issue used in the construction of the facility nor did it ever own them. SACS was therefore not permitted to claim a deduction for the costs of these items as they had not constituted part of its trading stock and revised tax computations were produced in respect of the 2002 to 2004 years of assessment.

The war between the parties was only warming up and a dispute then arose in relation to assessments which were levied by SARS on 2 and 3 November 2015 for the 2005 to 2010 and the 2011 to 2012 tax years of assessment respectively.

SACS had requested reasons for these assessments to which SARS had replied on 15 December 2015 and an application for further and better reasons was then dismissed on 3 June 2016 by the Tax Court in Cape Town.

In May 2016 SARS requested certain information pertaining to the 2013 and 2014 years of assessment, which information was duly supplied by SACS a month later. On 5 July 2016 SACS' attorney informed SARS that objections to the 2013 and 2014 assessments would be filed on or before the deadline for doing so, which he calculated as being on 20 July 2016. SACS' attorney contended that, as the dispute relating to the 2005 to 2012 years of assessment was applicable to the subsequent years of assessment, an agreement should be reached for the years of assessment from 2013 until the last return filed prior to a 'final decision' being reached in respect of the disputed years between 2005 to 2012 and that agreement would provide that in the light of the need for a decision as defined, prescription should not begin to run from the normal three year period.

On 23 August 2016 SACS' attorney proceeded to lodge identically worded letters of objection in respect of each of the 2013 and 2014 assessments, the express purpose of which was to align these years of assessment with the 2005 to 2012 years and that was to make the objections which had been filed in relation to the earlier years equally applicable to the later years of assessment.

According to SACS' calculations, the net effect of upholding these objections would be to reduce its taxable income by some R69.8 million in respect of the add backs and a further amount of R53 783 in respect of the proposed building allowance adjustments for the 2013 to 2014 years of assessment.

Finally, some agreement was reached and on 19 October 2016 the parties entered into a so called 'prescription agreement', the purpose of which was to extend various time periods which were applicable to the further years of assessment being the 2013 and 2014 years and any subsequent years of assessment thereafter in respect of which a tax return had been filed, prior to a decision being arrived at in relation to the disputed assessments, i.e. assessments in respect of the 2005 to 2012 years of assessment.

The agreement defined 'a final decision' to mean a final decision as contemplated in section 100 of the Tax Administration Act 28 of 2011.

Further dispute broke out and on 31 January 2017 SACS lodged an appeal against the disallowance of its earlier objections, i.e. those which it had filed in respect of the 2005 to 2012 years of assessment. At a meeting on 10 April 2017 it was agreed that SARS would file an opposing statement, i.e. a Rule 31 statement, by 13 June 2017 but it failed to comply with various deadlines and on 17 July 2017 SACS gave notice that, unless SARS filed its Rule 31 statement within 15 days, it would make application for a final order by way of default in terms of Rule 56, whereby the original assessments issued in respect of the disputed years of assessment would be revised and reduced in accordance with SACS' notice of appeal.

SARS finally filed its Rule 31 statement on 9 September 2017 without, in any way, applying for condonation for the late filing thereof. What it did not do was file an answering affidavit by 12 September 2017 and this prompted SACS on 13 September 2017 to request the registrar of the Tax Court to allocate a date for the hearing of the application by default in the Tax Court.

The Tax Court held (*per* Cloete J) that SARS had made itself guilty of an egregious breach of the Tax Rules and thus exercised its discretion in favour of SACS and, accordingly, judgment was granted against SARS by default in terms sought by SACS and the order had effectively become final in respect of the disputed assessments, i.e. between 2005 and 2012.

However, the order of Cloete J was not the end of the story as SACS had requested similar revised assessments to be made in respect of its 2013 and 2014 years of assessment and this matter then also came before the Tax Court (*per* Nuku J) where it was unsuccessful and the court dismissed the application on the grounds that, inasmuch as SACS' objections for the 2013 to 2014 years of assessment had been delivered out of time, they were invalid and therefore no application could be entertained which sought to uphold them.

This decision of the Tax Court was then appealed to the Full Bench of the High Court in January 2020 who gave an order in terms of which SARS was obliged to allow or disallow SACS' objection within 60 days of the court order which order was dated 31 January 2020. Computing the time period with reference to business days, SARS was obliged to make a decision and communicate that decision to SACS by no later than 29 April 2020 but only on 7 July 2020 did SARS disallow the objection, more than two months out of time.

It was on the strength of the aforementioned order of the High Court that SACS now approached the Tax Court and sought to invoke Rule 56 of the Tax Court Rules in support of its application for default judgment.

SACS contended that SARS had responded more than two months late in complying with the High Court's order to which it had agreed and that this dilatory response justified the application of Rule 56 of the Tax Court Rules read with section 129(2)(*b*) of the TA Act.

SARS, in seeking to resist this application, raised the question of the administrative nature of an assessment and contended that, until set aside, the disallowance of 7 July 2020 was valid and the court understood SARS to mean that the *Oudekraal/Kirland* doctrine was thus applicable. (See *Oudekraal Estates (Pty) Ltd* v *City of Cape Town* 2004 (6) SA 222 (SCA)

The issue before the Tax Court was whether SACS was entitled to default judgment against SARS in terms of Rule 56 of the Tax Court Rules.

Judge Dennis Davis held the following:

(i) That, in regard to the applicability of the *Oudekraal/Kirland* doctrine, in essence the doctrine laid out in *Oudekraal Estates (Pty) Ltd* v *City of Cape Town* (2004) (6) SA 222 (SCA) and confirmed in *MEC for Health Eastern Cape v Kirland Investments (Pty) Ltd* 2014 (3) SA 481 (CC) and later in *Merafong City Local Municipality* v *Anglo Gold Ashanti Ltd* 2017 (2) SA 211 (CC) set out a series of important administrative law principles, notwithstanding some blurring of the terrain by way of a series of minority judgments in *Kirland* and *Merafong*. At core the principle set out in *Oudekraal* and confirmed in the latter judgments recognises that administrative action, even though invalid, can give rise to consequences that must be held to be lawful. The government, for example, cannot ignore its own binding decisions on the basis that they are invalid. The validity thereof has to be tested in appropriate legal proceedings before the court.

(ii) That a decision erroneously taken may continue to hold lawful consequences until set aside properly by a court which considers an application to this effect. That would mean that allegedly unlawful action can only be challenged in properly constituted proceedings before a court and until that happens, in order to adhere to the principle of the rule of law, the decision must stand. The rule of law and the unilateral disregard for a decision simply are incompatible.

(iii) That in the present case it may well be argued that the effect of the application before this court which, although brought on the basis of a default judgment which is opposed by SARS which was given notice and which then filed a comprehensive answering affidavit, constituted the kind of proceedings envisaged. In other words, these were proceedings which could result in a setting aside of an invalid administrative act on the part of SARS which would include a decision to disallow the objection as contained in the letter of 7 July 2020.

(iv) That as SACS had submitted correctly, the invalidity or as he put it the 'purported' disallowance of the objection was in violation of the court order of 31 January 2020 and in the present dispute the source of the invalidity was the late decision of SARS coupled to what SACS considered a hugely inadequate basis for condoning the late decision of SARS.

(iv) That in this case the legal basis by which to set aside that decision and effectively to declare it to be invalid was to be found in Rule 56 which, by virtue of its own wording, provided the Tax Court with a discretion: Rule 56(2) provides that 'the Tax Court may, on hearing the application…'

(v) That in this case there were a series of reasons to decline to exercise a discretion in favour of SACS. In the first place, although SARS' grounds for condonation were not particularly weighty, it was correct that, for at least a month between 27 March 2020 and 29 April 2020, *Covid 19* caused a lockdown and with it a whole range of unpredicted consequences which affected the administration of SARS as it did the operation of the entire South African economy. In addition, although Cloete J in her judgment adopted the view that the merits of SARS' case in respect of the years 2005 to 2012 were hardly powerful, there was no argument which was presented to this court as to the merits of the respective cases of SACS and SARS which pertained to the present dispute.

(vi) That, in short, it was difficult, without more, to assess the merits of SACS' case contained in the letter of objection without proper argument and legal justification presented on the papers. The fact that there was no appeal against the order of Cloete J hardly takes the evaluation of the merits of the tax case any further.

(vii) That, moreover, the refusal to grant default judgment did not constitute the end of the road for SACS. Far from it as it was entitled to take its case to the Tax Court where it could be properly ventilated and, if there was merit in its arguments, not only will it succeed in having the assessments overturned but it may well be able to obtain a costs order in its favour in terms of section 130(1) of the TAA.

(ix) That there was an overarching principle that should guide a court in deciding these questions. The matter involved a significant amount of public money. To determine a case which involves such a significant sum without allowing a proper hearing before the Tax Court which will then determine the merits to tilt the balance excessively in favour of the Appellant.

(x) That, manifestly, this was a case which justified a punitive costs order. The approach of SARS, as the court had documented, had consistently been dilatory and utterly disrespectful of the rights of SACS. Indeed, even SARS' Heads were delivered 20 minutes before the hearing was to commence. The entire conduct of the litigation against SACS left much to be desired. The least that could therefore be done was to ensure that SACS was not out of pocket for any of the costs that were incurred in the bringing of this application for default judgment.

Application was dismissed.

SARS to pay SACS' costs incurred in this application on the scale of attorney and client costs.

### *4.4. ITC 1939 – VAT refunds*

The taxpayer was a registered micro refinery with the Diamond and Precious Metal Regulator of South Africa and a registered VAT vendor.

The taxpayer had appealed against the VAT assessments that SARS had issued pertaining to two tax periods.

The core issue relating to the first tax period, namely whether supplies were made to the taxpayer by two specific suppliers, X Gold and Z Gold, had been dealt with in a separate judgment. (see *ITC 1937* 83 SATC 60).

The issues relating to the second period, and the subject of this judgment, concerned the decision by SARS to raise additional assessments after it had made payment to the taxpayer in terms of a court order to 'write back' interest paid to the taxpayer in terms of the court order and the interpretation of section 45 of the VAT Act.

The taxpayer had rendered VAT returns for the second period, i.e. the individual months running from December 2015 to March 2016. These returns reflected that SARS was indebted to the taxpayer in an amount of R71 229 183.86 by means of refunds.

In terms of section 45(1) of the VAT Act SARS must, within 21 business days after the date on which the vendor's return in respect of a tax period is received, refund the vendor.

SARS did not make payment of the refunds within the prescribed 21 business days and in accordance with section 45(1) was liable to pay interest.

In May 2016 SARS' Compliance Audit Division (the CAD) selected the taxpayer for an audit as part of its compliance process in respect of the first and second VAT periods.

An audit of limited scope was conducted by the CAD and finalised in June 2016.

The audit confirmed that the taxpayer was in a refund position for the second period and from the ongoing investigation by the CAD, SARS stated that it had however identified further risks which necessitated that the matter be allocated to the VAT Investigative Audit section for a full scope audit and the matter was allocated to an official to conduct the full scope audit into the VAT refund claims of the taxpayer for, *inter alia*, the second period.

Whilst the full scope audit was still in progress the taxpayer instituted legal proceedings against SARS in the Johannesburg High Court where it applied for an order compelling SARS to pay the refund relating to the second period as well as interest on the outstanding capital refund amount which amounted to R3 570 115.33.

SARS did not oppose the application and the court granted judgment compelling SARS to pay to the taxpayer both the capital amount of the refunds for the relevant VAT periods as well as the interest thereon and SARS then paid the amounts of capital and interest to the taxpayer.

However, SARS had continued with the audit relating to the second period and on 7 March 2017 it issued assessments relating to the second period and in respect of the second period the audit process revealed that the taxpayer had failed to declare deemed output tax on the use of a motor vehicle by its member.

As a result, SARS raised an additional assessment on the deemed output tax, in respect of the fringe benefit as contemplated in terms of section 18(3) read with section 10(3) of the VAT Act.

The taxpayer objected to the fringe benefit assessments and thereafter SARS disallowed the objection.

In respect of the three tax periods falling within the second period, SARS clarified that it had 'recalled' the interest that it had paid in terms of the High Court judgment and its justification for the 'recall' of the interest were the provisions of section 45(1)(*i*) of the VAT Act.

The taxpayer submitted that SARS' 'recalling of the interest' was a clear attempt to 'claw-back' the interest that it had paid and it therefore objected and appealed SARS' decision to recall the interest on the basis that the *quantum* of the output tax relating to fringe benefits (in an amount of R601,09) was 'trifling and clearly immaterial' and did not constitute 'material incompleteness or defectiveness' as provided for in section 45(1)(*i*) of the VAT Act and, consequently, the provisions of section 45(1)(*i*) of the VAT Act did not find application.

SARS submitted that it was entitled to raise additional assessments in respect of the second period and in so doing it was performing its statutory duties and had an obligation in terms of section 92 of the TA Act to raise additional assessments.

SARS further submitted that the taxpayer's failure to declare deemed output tax on the fringe benefits had rendered the VAT returns for the second period incomplete and/or defective as provided for in section 45(1)(*i*) of the VAT Act and the 'adjustment' was therefore justified.

Moreover, SARS had raised the assessments in the correct periods and this had resulted in the reversal of interest.

Judge Windell held the following:

(i) That the first question was whether SARS was entitled to raise additional assessments for the second period after a court order had been issued ordering SARS to make payment of the refund with interest.

(ii) That when the taxpayer instituted the High Court application to compel SARS to pay the refund, the audit against the taxpayer had not been finalised. The court order did not suspend the audit process. The ultimate finding of the investigative unit was that the taxpayer did not declare deemed output tax on a fringe benefit on the use of a motor vehicle by its member. The taxpayer accepted the finding on the fringe benefit and, as a result of the audit findings, and in terms of section 92 of the TA Act, SARS was entitled to raise additional assessments in relation to the output tax not raised.

(iii) That the second question before the court was whether the taxpayer's failure to declare the output tax on the fringe benefit rendered the returns that the taxpayer had provided for the second period 'incomplete or defective in any material respect' as provided for in section 45(1)(*i*) of the VAT Act and whether SARS' decision to 'write back' the interest by effecting an 'adjustment' was justified. To put it differently: were the jurisdictional factors, i.e. that the taxpayer's returns were 'incomplete or defective in any material aspect' present in order to enable SARS to invoke the provisions of section 45(1)(*i*) of the VAT Act?

(iv) That it was common cause that the aggregate of the fringe benefit amounted to only R601,09 and the capital amount of VAT that SARS was ordered to pay by the High Court amounted to R71 229 184. The ratio of fringe benefit output VAT to the total amount of the refund was 1: 180 000 or 0.0006%.

(iv) That SARS' contention was the following: the taxpayer's failure to declare the fringe benefit amounted to non-compliance with the provisions of section 18(3) of the VAT Act and constituted an 'error'. The 'error' was material to SARS and non-compliance with the relevant provisions of the tax Acts could simply not be condoned. The Commissioner was tasked with collecting all the taxes due to the *fiscus*, regardless of how 'immaterial' they may seem to be. If the 'error' was so immaterial, this could have easily prompted the taxpayer to declare the output tax before it was caught by SARS.

(v) That section 45 of the VAT Act obliges SARS to refund any amount refundable in terms of section 44(1) and it was not contended by SARS that the refund of the 'capital' amount in issue before the High Court was not refundable. SARS was thus obliged, on first principles, to make payment thereof within 21 days after the date on which the taxpayer's returns were received. It failed to make payment and was liable to pay interest, except if the returns were incomplete or defective in any material respect.

(vi) That section 45 of the VAT Act was a pragmatic provision not concerned with principle but with materiality. It recognised the fact that vendors may render returns that are incomplete or defective. If it were a matter of principle then any defective or incomplete return would carry the consequence of SARS not having to pay interest. But the Legislature, in its wisdom, determined that expedience trumps principle insofar as the payment of interest by SARS was concerned.

(vii) That the aggregate of the fringe benefit amounted to R601,09 and the ratio of fringe benefit output VAT to the total amount of the refund was 0,0006%. This fraction did not satisfy the materiality test that the Legislature included in section 45(1)(*i*) of the VAT Act. In the premises the attempt to rely on the fringe benefit errors was a transparent attempt for SARS to *ex post facto* wriggle out of its obligations *vis-à-vis* the taxpayer.

(ix) That the court was satisfied that SARS should be mulcted with costs insofar as the fringe benefit issue was concerned.

(x) That, in the result, the relevant VAT returns that the taxpayer had rendered were not incomplete or defective in any material respect as contemplated in section 45 of the VAT Act. The appeal in respect of the relevant VAT periods was upheld and the additional assessments for the said VAT periods were altered by re-instating the interest paid by SARS in accordance with the High Court order.

## 4.5. C:SARS v Executor Estate LM Ndlovu (83 SATC 165)

Respondent was the executor of the estate of the late taxpayer who had been the appellant in the court *a quo*.

The late taxpayer had been employed as a director of the Nedbank Group and he had been registered as a taxpayer and was liable to pay income tax.

The late taxpayer had resigned from the Nedbank Group in October 2009 and during his employment at Nedbank as an executive director he had been granted options to acquire shares in his employer and which options had been exercised by him during his employment and he sold the vested shares in the market in three tranches. As a result of the disposal of the vested shares he realised a gain of R7 121 744.43 and the exercise and sale process was handled by the Nedcor Employment Shares Trust (the Scheme Administrator) who paid the aforesaid amount to the late taxpayer without deducting any taxes and this was reflected in the three IT3(*a*) returns for the payment for work and services from which no employees' tax had been deducted for the reason that it was non-taxable earnings.

The late taxpayer enquired from the Scheme Administrator as to whether the options so exercised by him in 2007 were taxable and he was informed in a letter that 'the earnings arising from the options exercised were non-taxable' and, due to this information, he did not declare the gain of R7 121 744.43 in his 2007 tax return, not even as a non-taxable gain.

Following an audit by SARS an additional assessment was raised and the aforesaid gain was included in the late taxpayer's taxable income.

SARS, acting in terms of the then section 76(1)(*b*) of the Income Tax Act imposed additional tax and interest in terms of section 89*quat*(2) of that Act.

The late taxpayer raised an objection to the additional tax and submitted that the amount of R7 121 744.43 should not be taxed as a capital gain in terms of the Eighth Schedule to the Income Tax Act and nor could it be taxed as income in terms of sections 8A and 8C of the Income Tax Act. He was also of the view that the additional tax imposed should be waived in terms of section 76(2)(*a*) of the Act and that the interest imposed should be remitted in terms of section 89*quat*(2) of the Act.

The late taxpayer had objected to the imposition of additional tax of 100% in terms of section 76(1)(*b*) of the Act and his ground of objection was that he had relied on the Scheme Administrator to deduct the appropriate taxes.

However, the late taxpayer did not object to the imposition of interest in terms of section 89*quat*(2) in his objection to the additional assessment raised by SARS.

SARS had disallowed the objection and the taxpayer had requested that the matter be referred for Alternative Dispute Resolution (ADR) but the parties could not resolve the issues through ADR and this resulted in the late taxpayer noting an appeal against the disallowance of his objection on 11 March 2012. His grounds of appeal were the same as his grounds of objection and it was important to note that he had not objected nor appealed against the imposition of interest in terms of section 89*quat*(2) of the Act and his ground of objection was solely against the payment of additional tax on the ground that it had not been his intention to evade the payment of tax.

The late taxpayer, however, had raised the issue of section 89*quat* interest for the first time during the ADR meeting where nothing had been resolved.

Meanwhile, SARS had found further extenuating circumstances and had reduced the 100% additional tax to 10%.

When the matter came before the Tax Court, by which time the taxpayer had passed away, the appeal was pursued by the executor of the deceased's estate.

The Tax Court, being the court *a quo*, had to determine:

- Whether the taxpayer may include a new ground of appeal for the first time in the Tax Court, which had not been contained in the objection;
- Whether the reduced additional tax of 10% should be further remitted to 0%.

The court *a quo* found that the issue of the section 89*quat* interest had been challenged for the first time on appeal and did not form part of the original objection, but nevertheless held that there was no prejudice to SARS and therefore a new ground of appeal may be introduced even where it had not formed part of the original objection.

The court found that the letter dated 10 February 2012 created a legitimate expectation that SARS would issue a further assessment and that the taxpayer would have objected to such assessment and it was accordingly held that SARS would suffer no prejudice if a new ground of appeal pertaining to the interest was introduced.

The court *a quo* also found in regard to the additional tax imposed by SARS in terms of section 76 that the 10% additional tax should be remitted in whole as the taxpayer did not have the intention to evade paying tax.

SARS appealed the aforementioned decision of the Tax Court to a full bench of the High Court in terms of section 133(1) of the TA Act.

Judge Pretorius held the following:

<u>As to whether additional tax should be reduced further in terms of section 76(1) of Act</u>

(i) That there can be no doubt that remission of tax can only take place if it has been proven that the taxpayer had no intention to evade tax. The only requirements in terms of the provisions of the Act was that a taxpayer had omitted from his return an amount of income which should have been included and there was no indication in this provision that it had to be done intentionally and not declaring income will suffice.

(ii) That in this instance SARS did not come to the conclusion that the taxpayer had the intention to evade the tax. SARS found extenuating circumstances and first remitted the additional tax from the prescribed 200% to 100% and then reduced it further to 10%. The taxpayer relied on the fact that his employer had to deduct the appropriate tax and he did not intend evading the payment of tax. SARS had already taken this into account as an extenuating circumstance when further remitting it from 100% to 10%. The provision is very clear that had the taxpayer had the intention to evade the payment of tax, no remission would have been granted.

(iii) That SARS had submitted that a higher degree of care could and should be expected from a person such as the taxpayer. As director of one of the major banks in South Africa he should have known that gains on share options are taxable. Furthermore, the taxpayer did not voluntarily declare the gains on the share options. It was only when SARS conducted an audit on the taxpayer's tax affairs that it was found that the taxpayer had not declared this amount and had not submitted the relevant tax certificate, which had been provided to him by his employer.

(iv) That although the taxpayer, according to him, relied on his employer to deduct the required taxes, it was still his duty to ascertain whether it had been done. In terms of clause 20 of the trust deed of the Nedcor Group Employee Incentive Scheme, any tax liability shall be the sole responsibility of the participant and shall be for the participant's account. It was clear that the Administrator and the employer of the taxpayer took it for granted that the taxpayer would have declared this amount.

(iv) That it was significant that the taxpayer had refrained from declaring the gain in question as a non-taxable receipt in his 2007 tax return. Moreover, no further reasons were submitted for a further remittance to 0%, alternatively to 1%. It was expected of a taxpayer, in this taxpayer's situation, to set out valid reasons for a further remittance where SARS had already found extenuating circumstances by first remitting the amount from the prescribed 200% to 100% and then to 10%.

(v) That the court, having considered all the facts and circumstances, found that there should be no further remittance from 10% to 0%, or alternatively 1% and therefore the appeal against the judgment of the court a quo succeeded in this regard and the taxpayer had to pay 10% additional tax in terms of section 76(1)(b) of the Income Tax Act.

<u>As to whether a new ground of objection could be raised during the Tax Court appeal</u>

(vi) That section 89quat(2) of the Income Tax Act provided that interest was to be levied on the underpayment of provisional tax and the court a quo had found that the taxpayer could raise the issue of the imposition of section 89quat(2) interest for the first time on appeal. In determining the correctness of the court a quo's decision the High Court considered the Rules of the Tax Court promulgated in terms of section 103 of the Tax Administration Act and, in particular, Rules 7 and 10 which provided, inter alia, that a taxpayer who lodges an objection to an assessment must specify the grounds of objection in detail and a taxpayer's notice of appeal must specify on which grounds of objection the taxpayer was appealing and the Rule also states that a taxpayer may not appeal on any ground that constitutes a new objection against a part or amount of the disputed assessment that was not objected to in terms of the objection under Rule 7.

(vii) That the court noted the Supreme Court of Appeal decision in Matla Coal Ltd v CIR where it was held that a court should not be unduly rigid in its approach when deciding whether to allow a new ground of objection only at the appeal stage and that the circumstances of each case should be taken into consideration when the court considered the facts of the case.

(ix) That the court also stated that it was in the public interest that a taxpayer cannot be allowed to continue changing the grounds of his objection and appeal and it was clear from the case of C: SARS v Brummeria Renaissance (Pty) Ltd that it was in the public interest that disputes should be resolved and the same principles should apply where it would be unfair to the appellant, SARS, if a respondent was allowed to change the basis of its appeal at a late stage when appealing to the Tax Court.

(x) That the basis for the court a quo's finding that the issue of section 89quat interest could be addressed on appeal, although it was not previously objected to, was the letter of 10 February 2012 and, according to the judgment, the letter caused a legitimate expectation with the taxpayer that a further assessment would be raised. However, unfortunately, no such evidence was presented to the court a quo on which such finding could be made and no reason had been advanced as to why the taxpayer filed his appeal on 11 March 2012 and did not mention the section 89quat interest at the time.

(xi) That, accordingly, this court found that the court a quo could not have made the decision that the taxpayer was entitled to raise this issue only at the appeal stage, thereby causing prejudice to SARS and therefore the court a quo had erred in finding that the section 89quat interest must be waived.

Appeal against the whole of the judgment of the Tax Court was upheld.

## *4.6. Purveyors South Africa Mine Services (Pty) Ltd v C:SARS (83 SATC 176)*

Purveyors had imported an aircraft into South Africa during 2015 which it then used to transport goods and personnel to other countries in Africa.

Purveyors became liable for the payment of import VAT to SARS in respect of the importation of the aircraft in 2015 but had failed to pay import VAT to SARS.

Purveyors, during the latter part of 2016, had manifested reservations about its failure to have paid import VAT and accordingly had engaged with certain representatives of SARS in order to obtain a view on its liability for such tax and, in doing so, it had conveyed to SARS a broad overview of the facts but no more.

Following these engagements Purveyors was advised by SARS on 1 February 2017 that the aircraft should have been declared in South Africa and VAT thereon paid but, more importantly, it was advised by SARS that penalties were applicable as a result of the failure to have paid the VAT and SARS also requested to see documentation in terms of section 101 of the Customs and Excise Act.

SARS wrote to Purveyors on 29 March 2017 in which SARS explained the reasons why VAT and penalties were payable and SARS further indicated that Purveyors needed to appoint a clearing agent to assist it with an import permit in order to regularise its continued default. SARS subsequently indicated that there existed no waiver of potential penalties and, further, that if the tax to the Receiver was late, then Purveyors would be liable for penalties and interest.

SARS, on 16 May 2017, informed Purveyors that SARS had allowed Purveyors sufficient time to regularise its tax affairs and Purveyors responded that it was still awaiting a response from its Head Office.

Purveyors, approximately a year later, subsequently applied to SARS for voluntary disclosure relief in terms of section 226 of the TA Act.

SARS declined to grant relief on the basis that Purveyors had not met the requirements of section 227 of the TA Act.

Purveyors, as a result thereof, applied to the High Court to have SARS' decision set aside.

The two relevant sections of the Tax Administration Act were sections 226 and 227 of the TA Act which provides a permanent voluntary disclosure programme (‘VDP’) for taxpayers for any ‘default’ in their submission of information or in the adoption of a ‘tax position’ which results in an understatement. The rules are contained in Part B of Chapter 16 of the Act (sections 225-233) and provide for relief from the penalties which would otherwise be imposed on such conduct and they also remove the danger of prosecution.

Purveyors contended that the crux of its case was that as at the date of submission of its VDP application, it had not been given notice by SARS of the commencement of an audit or criminal investigation into its affairs, which had not been concluded as contemplated by the provisions of section 226(2) of the TA Act, and that the effect thereof was that this application was indeed ‘voluntary’ as contemplated in section 227*(a*) of the TA Act, despite the said prior knowledge on the part of SARS.

Purveyors further contended that, regard being had to the relevant statutory provisions, including section 227 of the TA Act, it was not compulsory for such application to disclose information or facts of which SARS was unaware and hence prior knowledge on the part of SARS was not a disqualifying factor.

SARS contended that section 227 of the TA Act envisaged a disclosure of information or facts of which SARS had been unaware of and, in addition, as there had been an indication by SARS officials that the VAT was due and penalties would be imposed, the disclosure was not voluntary. In other words, the relevant application did not constitute a ‘disclosure’, nor was it made voluntarily.

Judge Fabricius held the following:

(i) That the concepts of ‘default’, ‘voluntary’ and ‘disclosure’ make up the three essential components of section 227 of the Act.

(ii) That section 225 defines ‘default’ to mean the submission of inaccurate or incomplete information to SARS but in the present instance the concept of ‘default’ is not contentious as it is common cause that Purveyors had failed to pay import VAT in 2015 when it should have done so and hence its application for the voluntary disclosure relief. The inquiry herein must therefore be concentrated on the concepts of 'voluntary' and 'disclosure.'

(iii) That in determining the correct interpretation of sections 226 and 227 of the Act, the court deemed it important to place the relevant sections into the proper context. The VDP came into effect on 1 October 2012 and its purpose was to enhance voluntary compliance in the interests of good management of the tax system and the best use of SARS' resources. It sought to encourage taxpayers to come forward on a voluntary basis to regularise their tax affairs with SARS and thus avoid imposition of understatement penalties and, in certain circumstances, criminal prosecutions. The VDP is further aimed at promoting ethical and moral conduct by incentivising errant taxpayers to make amends in respect of any defaults by them by informing SARS of the default and of which SARS is ignorant. By doing so, a taxpayer may obtain the voluntary disclosure relief contemplated in section 229.

(iv) That in regard to the question whether the VDP application had been 'voluntary', the term is not defined but its ordinary meaning is 'an act in accordance with the exercise of free will.' If there is an element of compulsion underpinning a particular act, it is no longer done voluntarily. In the context of Part B of Chapter 16 of the Tax Administration Act, a disclosure is not made voluntarily where an application has been made after the taxpayer had been warned that it would be liable for penalties and interest owing from its mentioned default. It was submitted that the application was brought in fear of being penalised and with a view to avert the consequences referred to.

(iv) That it was contended on behalf of SARS that there had been no disclosure of information of which SARS had been unaware. When Purveyors made the VDP application it was obviously aware that SARS knew of its default. It in fact disclosed nothing new and the application was therefore not a valid one. There can be no disclosure to a person if the other already has knowledge thereof; certainly not in the present statutory context.

(v) That Purveyors' interpretation of sections 226 and 227 of the Act was too narrow and did not accord with the purpose of the said sections or what they sought to achieve. Purveyors had contended that if notice of an audit had been given then a subsequent VDP application could not be voluntary and, conversely, if no notice of an audit had been given, then the only possible result was that it was voluntary. However, that argument was premised on an interpretation of section 227 which was inconsistent with its context and purpose. Section 227 is broad in its ambit and is not subject to section 226(2). The legislature deliberately did not confine involuntary applications to the giving of an audit notice in terms of section 226(2) of the Act and the reason was obvious, i.e. there may be other circumstances under which an application is made which would not be classified as voluntary and the present is such an instance.

(vi) That, moreover, the purpose of the VDP provisions was to incentivise errant taxpayers to come clean and that purpose would be defeated if the only circumstance under which a VDP application were to be held as involuntary was the receipt of a notice of an audit in terms of section 226(2) of the Act.

Application dismissed with costs.

## *4.7. Consol Glass (Pty) Ltd v C:SARS (83 SATC 186)*

Consol Glass (Pty) Ltd ('Consol') manufactured and sold glass containers and it was a vendor registered as such under the VAT Act.

Consol, in 2012 restructured its debt and, in doing so, it procured services, some from local vendors and others from suppliers resident outside of South Africa. Services of this latter kind were defined in the VAT Act as imported services.

SARS had, in July 2015, raised additional assessments in respect of Consol's VAT liability for five tax periods in 2012. The additional assessments disallowed input tax deductions that Consol had claimed in relation to the services provided by local vendors and SARS imposed output VAT on the imported services procured by Consol.

Consol lodged an objection to the additional assessments which was disallowed and it appealed the additional assessments to the Gauteng Tax Court (*per* Louw J) which dismissed the appeal, save in respect of the 10% penalty imposed by SARS.

There was no cross appeal by SARS in respect of the 10% penalty and hence the appeal before the Supreme Court of Appeal concerned the disallowance by SARS of the input tax deductions and the imposition by SARS of output value-added tax in respect of the imported services procured by Consol.

During April 2007, Consol, then a shell company, had acquired the businesses of Consol Limited and two of its subsidiaries. These businesses were acquired as going concerns and, upon making these acquisitions, Consol commenced trading, continuing the glass making businesses previously conducted by the three companies.

The aforementioned acquisitions formed part of a leveraged buy-out which was the acquisition by one company of another (or its assets and liabilities) using a significant amount of debt to fund the cost of acquisition.

Consol was able to make the aforesaid acquisitions by securing debt funding and the debt funding took the form of Eurobonds issued by Consol. The debt was denominated in Euros and hence Consol's obligations to pay interest and redeem the bonds were in Euros. In order to cover the risk of Rand volatility against the Euro (since Consol's revenue was Rand based, but its debt obligations were in Euros), Consol entered into collateral hedging agreements to cover its Euro exposure.

One salient feature of the transaction in 2007, relevant for present purposes, was that the operating businesses of the listed company Consol Limited, and its two subsidiaries, were, upon the execution of the reorganisation, acquired by Consol, funded by the debt that Consol had secured by issuing Eurobonds. Functionally these businesses were otherwise unchanged and continued precisely the same business operations that they had engaged in prior to the transaction in 2007.

The evidence revealed that in the period 2007-2012 the cost of servicing Consol's Euro debt and securing hedging cover for its Euro exposure became ever more expensive because the Rand depreciated against the Euro and was subject to much volatility. As a result, in 2012, Consol sought competitive funding in the South African market, denominated in Rand, to replace its Eurobond debt and unwind the hedging positions. A consortium of South African banks agreed to lend some R5 billion to Consol and this took place in terms of an agreement, styled the Common Terms Agreement, concluded on 7 July 2012 between Consol and a number of lenders. In terms of the Flow of Funds Agreement concluded at the same time as part of these arrangements, the debt funding secured by Consol was to be used to redeem the Eurobonds and unwind the hedging instruments and these arrangements are referred to as the refinancing transactions.

Consol, in order to retire the Eurobond debt, unwind the hedge positions and secure domestic loans, had procured various services and these services fell into two categories. First, Consol procured the services of local service providers. The South African banks that participated in the lending consortium charged arranging and structuring fees. Consol retained the services of two firms of South African attorneys and these firms gave advice and drafted agreements to put in place the refinancing transactions. Second, foreign service providers were retained to advise upon the early redemption of the Eurobonds and the unwinding of Consol's hedging positions.

These service providers, local and foreign, raised fees that were paid by Consol and its liability for VAT, arising from the fees incurred by it, gave rise to this appeal.

Two issues required determination in this appeal to the Supreme Court of Appeal:

- Whether Consol was entitled to deduct as input tax the VAT paid by it on the services supplied to it by local service providers;

- Whether Consol was obliged to declare and pay VAT on the fees for services supplied to it by the service providers who carried on their business outside of South Africa.

SARS submitted that the services, local and foreign, were not acquired by Consol to make taxable supplies, but rather to make an exempt supply in the form of a financial service.

SARS contended that, in securing the loans from the consortium of banks under the refinancing transactions, Consol had issued a debt security and, if that were so, it was contended that Consol did not acquire the local services for the purpose of use in the course of making taxable supplies and nor did it utilize the foreign services for the purpose of making taxable supplies. Hence Consol was not entitled to the deduction of input tax that it had claimed in respect of the local services acquired by it and, so too, Consol was obliged to declare and pay VAT on the fees paid by Consol to non-resident suppliers for their services.

Although SARS' exempt supply submission failed the court still had to deal with the principal issues as to whether the local services acquired by Consol were acquired for the purpose of use in the course of making taxable supplies and whether the imported services were utilized by Consol for the purpose of making taxable supplies.

Judge Unterhalter held the following:

<u>As to the issues</u>

(i) That whether Consol was entitled to deduct as input tax the VAT paid on the services supplied to it by local service providers depended upon whether these services were acquired by Consol for the purpose of consumption, use or supply in the course of making taxable supplies and that enquiry raised two issues. First, for what purpose did Consol acquire the services? Second, did Consol do so in the course of making taxable supplies. The relationship between the purpose for which the services were acquired and the use to which these services were put lay at the heart of the matter.

(ii) That whether Consol was obliged to pay VAT on the services supplied to it by the service providers who carried on their business outside of South Africa, a similar enquiry was required. Section 7(1)(c) of the VAT Act levied VAT on the supply of any imported services by any person and this provision entailed that no VAT could be levied on the supply of services to Consol by suppliers who carried on business outside of South Africa if those services were utilized or consumed in South Africa by the Applicant for the purpose of making taxable supplies and, here too, the issue was this: did the Applicant make use of the services of foreign suppliers for the purpose of making taxable supplies?

<u>As to whether the services in issue were acquired to make an exempt supply</u>

(iii) That SARS had submitted that the services, local and foreign, were not acquired by Consol to make taxable supplies, but rather to make an exempt supply in the form of a financial service. A 'debt security' in terms of section 2(2)(iii) of the VAT Act meant 'an obligation or liability to pay money that is, or is to be, owing by any person.' In terms of section 2(1)(c) of the VAT Act 'The issue, allotment, drawing, acceptance, endorsement or transfer of ownership of a debt security' is deemed to be a financial service. Consol had procured the services to enable it to conclude the new loan facility. Section 12 lists the goods and services that were exempt from VAT imposed under section 7(1)(a). One category of exempt supply was the supply of any financial service. One variant of a financial service defined in section 2(1)(c) was the issue of a debt security. SARS contended that, in securing the loans from the consortium of banks under the refinancing transactions, Consol had issued a debt security.

(iv) That SARS had contended that if that was the position, Consol did not acquire the local services for the purpose of use in the course of making taxable supplies and it did not utilize the foreign services for the purpose of making taxable supplies as the issue of debt was not the making of a taxable supply and it would then follow that if the Applicant had made use of the local and foreign services supplied to issue a debt security, it did not utilize these services for the purpose of making, nor in the course of making, a taxable supply.

(iv) That SARS' exempt supply submission had failed to comprehend the position of Consol as a vendor within the scheme of the VAT Act. It was essential in any VAT enquiry to identify at the outset the enterprise that the vendor was conducting. Section 23(1) required that every person who carried on an enterprise, and was not registered for VAT, was required to be registered. A vendor is defined in section 1 to be any person who is or is required to be registered under the VAT Act. An enterprise, in the case of a vendor, is defined in section 1 to mean any enterprise or activity which is carried on continuously or regularly by any person in the Republic.

(v) Consol had registered as a vendor under the VAT Act and it did so because it carried on an enterprise. The enterprise carried on by Consol was the manufacture and sale of glass containers. The imposition of VAT in terms of section 7(1) was levied on the supply by any vendor of goods or services supplied by that vendor. In the case of Consol, VAT was levied on its sales of glass containers and that was the enterprise carried on by it and at no stage did it carry on a financial services enterprise.

(vi) That Consol, like every other enterprise, required a variety of inputs in order to carry out the enterprise upon which it was engaged. As the facts of this case make plain, Consol raised loans to acquire the businesses that then constituted the enterprise conducted by it. Consol concluded the refinancing transactions, which included taking out loans with a consortium of local banks, when it had previously raised funds by issuing Eurobonds.

(vii) That neither the original issuance of the Eurobonds, nor the loans secured from the local consortium, had transformed Consol from a vendor engaged upon the enterprise of selling glass containers into a vendor engaged also upon the enterprise of supplying financial services by issuing debt. Consol had elected to borrow money to acquire the businesses and it did so to carry on the enterprise of selling glass containers. When Consol entered into the refinancing transaction and borrowed moneys from the lending consortium, it remained the same enterprise being a seller of glass containers. It did not become, in addition, a supplier of financial services. Put simply, when an enterprise borrows money, it is supplied a financial service, it does not become the supplier of a financial service. To hold otherwise is to confuse a borrower with a lender. The lender supplies the financial service, the borrower receives that service. Consol is simply not a vendor of financial services. It registered as a vendor in respect of the enterprise upon which it engaged, that is, as a manufacturer and seller of glass containers and so it remained.

(viii) That, accordingly, the exempt supply submission must fail. Consol was not a supplier of financial services but it was a manufacturer and supplier of glass containers. Those were not goods exempt from VAT imposed under section 7(1)(a) of the VAT Act. VAT was levied on the supply by Consol of its glass containers and it followed that the exempt supply submission could not avoid the principal issues as to whether the local services acquired by Consol were acquired for the purpose of use in the course of making taxable supplies and whether the imported services were utilized by Consol for the purpose of making taxable supplies.

<u>As to the purpose of making taxable supplies</u>

(ix) That in considering the nature and closeness of the connection that must exist between the use of services acquired by Consol and the making of taxable supplies by Consol, that is to say, the supply of glass containers, the relevant part of the definition of input tax has these components. The services must be acquired wholly or partly for the purpose of consumption, use or supply. Acquisition for some other purpose will not do. Acquiring to consume, use or supply will not suffice if the purpose of the acquisition is not in the course of making taxable supplies. In this case, this means in the course of manufacturing and selling glass containers.

(x) That SARS submitted that 'in the course of' connotes 'during' or 'in the process of' manufacturing and selling glass containers, rather than steps preparatory to such process. It was of limited assistance to make use of synonyms in order to understand the specificity of the statutory formulation: in the course of making taxable supplies.

(xi) That two observations assist the interpretative exercise. First, the diversity of goods and services that may constitute taxable supply in a modern economy and the complexity of the lines of supply that may be used in the making of such goods and services should not be underestimated. An interpretation that is too restrictive of what is required to make taxable supplies runs the risk of underestimating this diversity and complexity. Second, since the purpose of acquisition was for consumption, use or supply, it was helpful to consider how these attributes of the goods or services acquired have utility in the making of the taxable supplies. It is this functional relationship that signifies. One way of analysing this relationship was to consider the following: for a given quantity of output, what inputs of goods or services are consumed, used or supplied to make or produce that output.

(xii) That similar considerations were of application in the interpretation and application of the definition of imported services in section 1 of the VAT Act. The definition specifies a relationship between the supply of imported services to a recipient and the extent to which such services are utilized or consumed, otherwise than for the purpose of making taxable supplies. In both definitions there is a differentiation between the purpose of making taxable supplies and other purposes. Under both definitions, the determination as to whether the supply was for the purpose of making taxable supplies provides an answer as to whether the requirements of the definition are met.

(xiii) That Consol procured and made use of the local and imported services for the purpose of executing the refinancing transactions. Consol's grounds of appeal as to the application of the law to the facts relied upon the contention that the Eurobonds were utilized to acquire the assets in order to make taxable supplies, that is to say, to manufacture and sell glass containers and the refinancing transactions substituted local debt for foreign debt with the same object.

(xiv) That it was therefore to the original transaction in 2007, in terms of which Consol acquired its glass manufacturing businesses, that the court had to look to in order to determine the purpose for which the local and imported services were procured in 2012. The premise of Consol's contention was that the purpose of securing funding to acquire the businesses to make taxable supplies in 2007 did not, in substance, change and remained in place in 2012. The substitution of local debt for foreign debt permitted Consol to continue the very same businesses it had acquired in 2007 and those businesses were fully functional and engaged upon the very enterprise that Consol now conducted.

(xv) That Consol's appeal rested upon the initial premise that the Eurobonds were utilized by it in 2007 to acquire the assets so as to make taxable supplies. Was this premise correct?

(xvi) That the stated purpose of the Eurobond debt was to effect the reorganisation of the Consol group of companies and nothing of the reorganisation was directed to any change in the making of taxable supplies, that is, in the manufacture of glass. That being so, there was no functional link between the issue of the Eurobonds and the making of taxable supplies and Consol's initial premise did not hold.

(xvii) That it followed, according to the logic of Consol's argument, that if the Eurobond debt was not issued in 2007 with the purpose of making taxable supplies, then neither was the raising of local debt in 2012. The purpose remained the same: to maintain the funding for the reorganisation of the Consol group of companies. Once that was so, the procurement of local and imported services in 2012 was not used by Consol in the course of making taxable supplies. The purpose of using these services was to replace Eurobond debt with local debt and thereby continue to finance the reorganisation that had taken place in 2007.

(xviii) That the use of the Eurobonds for capital expenditure was hedged about with qualifications and provision for the Bellville facility was so modest and subject to such conditionality that it simply could not be said to amount to the purpose for which the Eurobonds were issued and there was no basis to contend that the Eurobond was issued with the purpose of funding capital expansion, and in this sense, for the making of taxable supplies. Moreover, the reorganization was not undertaken to expand the Bellville facility and the expansion was entirely incidental to the reorganisation.

(xix) That one further matter arose in the course of argument before the court and that was that the refinancing of Consol's debt reduced its costs and the issue that arose was whether the refinancing, by reason of these cost savings, may be found to have a functional link to the manufacture by Consol of glass containers, and hence, to the making of taxable supplies.

(xx) That the difficulty in considering this issue was whether it formed part of the case before the tax court. Rule 32(1) of the tax court rules requires an Consol to deliver a statement of its grounds of appeal. The statement must set out the material facts and legal grounds upon which Consol relies for the appeal and the statement is a pleading, defining the issues so that SARS knows the case to be adjudicated.

(xxi) That a fair reading of the statement of grounds indicated that Consol's case was based upon the contention that the Eurobonds and the replacement funding were utilized to acquire assets so as to manufacture glass containers but it required some ingenuity to appreciate that Consol could also have been contending that the refinancing was undertaken to make Consol more competitive. The ground of appeal, based on Consol's competitive positioning, raised entirely distinctive issues.

(xxii) That the parties did not understand the case to be concerned with Consol's competitive positioning and the relationship of this to the refinancing transaction. This was not the basis upon which the trial was run, nor was it the basis upon which counsel argued their cases, either in the tax court or before this court. There can be little doubt that the refinancing was intended to place Consol in a position to continue to fund the original reorganisation at a lesser cost, and it did so. What the savings achieved by Consol permitted it to then do was a matter of effect rather than purpose, beyond the remit of the pleaded case.

(xxiii) That, in these circumstances, no injustice was done to Consol to hold it to the case that it sought to make out. Furthermore, the paucity of evidence that bore upon a case predicated upon competitive positioning, and the many questions that arose from it that could not be answered on the evidence before the court, provided a strong indication that the court should not entertain such a case and it declined to do so.

Appeal was dismissed.

## *4.8. ITC 1940 – Tax Avoidance, General Anti-Avoidance Rules*

The taxpayers in this matter launched two identical interlocutory applications in the Tax Court seeking:

(i) the striking-out of certain allegations from the SARS' Rule 31 statement of the grounds of assessment, and

(ii) an order declaring that two legal issues arising on the pleadings be determined separately.

The proceedings in this matter commenced by way of two consolidated appeals in terms of section 107 of the Tax Administration Act and pursuant thereto the two interlocutory applications were launched.

SARS, in respect of both cases, had brought an application in terms of section 118(3) of the Tax Administration Act read with Tax Court Rule 42(1) for an order declaring that both the taxpayerse had a duty to begin to lead evidence at the appeal hearing.

The factual background underpinning both interlocutory applications lodged by the taxpayers was largely common cause.

In order to fully comprehend the two interlocutory applications to strike out, it was necessary to explain from the outset that the assessments to which the appeals related were assessments made by SARS in the purported exercise of special powers under the general anti-avoidance rules ('the GAAR') contained in sections 80A-L of Part 11A of Chapter 111 of the Income Tax Act and the applications to strike out flow from the special nature of SARS' powers under the GAAR and, in this case, the taxpayers averred that in its Rule 31 statement SARS had sought to broaden its case by including significant averments that did not form part of the assessment in terms of s 80J(3)(*c*) of the Act.

The factual background in both applications is complex but similar and hereunder only a brief synopsis of the facts pertinent to both applications is given:

> On 26 October 2015 SARS dispatched to the taxpayers (Mr X and Mr Y) a notice of audit letter informing them that an audit would be conducted into their tax affairs in respect of certain years of assessment and, shortly thereafter, SARS issued a letter incorporating both its audit findings and a section 80J notice, indicating its intention to invoke the GAAR in raising the additional assessments.
>
> In the section 80J notice SARS alleges that Mr X and Mr Y were, pursuant to preliminary audit findings, involved in certain arrangements which, despite them being reportable, were not disclosed and these were envisaged in section 80A of the Act (Impermissible tax avoidance arrangements).
>
> In terms of section 80B SARS may determine the consequences of an impermissible tax avoidance arrangement and the transactions alleged to constitute impermissible avoidance arrangements in this case involved agreements concluded between various South African companies, including A Investments (Pty) Ltd as well as various companies in the Isle of Man.
>
> More specifically, these arrangements are said to consist of the following:

- The transactions between A Investments, its subsidiaries and the Isle of Man companies, giving rise to certain A subsidiaries holding promissory notes issued by A;
- The declaration of certain A Investments promissory notes to X;
- The 'settlement' of the promissory notes held by X via A Investments becoming obliged to pay those parties the net income from specific transactions involving specific A Investments subsidiaries; and
- In each case following a sale by A Investments, the payment by A Investments of amounts to X.

SARS further alleged that each arrangement involving the steps listed above was a separate arrangement for the purposes of the GAAR, consisting of a set of preconceived transactions which, together, constitute a 'scheme.'

Mr X responded to the section 80J notice, on 22 January 2016 and explained that, after consultations with his lawyers, he was unable to submit reasons in terms of section 80J(2) as to why SARS should not invoke the GAAR against SARS because SARS had failed to provide proper reasons for its election to invoke the GAAR against SARS. More specifically, according to Mr X, the section 80J notice was too vague, generalised, and in some places, contradictory.

SARS responded to Mr X and denied the vagueness alleged by SARS in the section 80J notice as SARS was of the view that they had provided sufficient reasons for their decision to invoke the GAAR.

Subsequent to the correspondence between the parties, SARS, on 22 August 2016, issued a finalisation of audit letter, raising additional assessments against Mr X. The reasons advanced by SARS for the invocation of the GAAR were similar to those provided in the section 80J notice and attached to the finalisation of audit letter was an annexure providing details of the arrangements in relation to which the GAAR was applied to raise the additional assessments against Mr X.

SARS, on 30 August 2016, raised the additional assessments set out in the finalisation of audit letter which resulted in a tax liability of R25 933 404.10. Mr X objected to the additional assessments on the grounds that SARS had failed to properly identify the arrangements in respect of which SARS sought to invoke the GAAR on 14 March 2017.

Thereafter SARS disallowed Mr X's objection and both he and Mr Y then appealed against the assessments in issue to the Cape Town Tax Court.

SARS filed its Rule 31 statement of grounds of assessment and opposing the appeal in terms of the Tax Court Rules on 31 January 2018 and Mr X averred that in the Rule 31 statement SARS sought to broaden its case by including significant averments that did not form part of the assessment in issue in terms of section 80J(3)(*c*). Furthermore, the inclusion of these averments in the Rule 31 grounds of assessment was, according to Mr X, an attempt to remedy certain shortcomings which were already identified by Mr X in his objection.

The nub of Mr X's case in his application to strike out certain portions of SARS' Rule 31 statement was that SARS had impermissibly sought to address the defects referred to earlier by pleading in its Rule 31 statement a basis for exercising its powers under the GAAR that differed from the basis set out in its section 80J letter and finalisation of audit letter. Put differently, whereas SARS decided to exercise its, powers under the GAAR on the basis that each arrangement as a whole resulted in a tax benefit, in its Rule 31 statement SARS now alleged not only that:

(i) the arrangement as a whole resulted in a tax benefit, but also that

(ii) one or more of the constituent parts of the arrangement separately resulted in a tax benefit.

Finally, Mr X alleged that under the GAAR the powers of SARS do not enable SARS to broaden its case from that on which the assessment was raised as formulated in the section 80J notice, and in the finalisation of audit letter. In other words, the broadening of SARS' case as suggested by Mr X amounted to a novation of the whole of the factual basis of the disputed assessment for the purposes of Rule 31(3) of the Tax Court Rules promulgated under section 103 of the Tax Administration Act.

SARS, in addition, brought an application in the Tax Court in terms of Rule 51(2) of the Tax Court Rules promulgated under section 103 of the Tax Administration Act, against each of the taxpayers in which SARS sought an order declaring that the taxpayers in each appeal bear the *onus* to begin adducing evidence at the hearing of the appeals against the disputed general anti-avoidance rules (GAAR).

The background to this application, according to SARS, could be traced back to the pre-trial conference wherein SARS expressed the view that the taxpayer bore the duty to begin during the determination of the appeal.

The taxpayers opposed the contention that they bore the duty to begin to adduce evidence at the hearing of the tax appeals on the ground that the assessments that were the subject of the appeals in the Tax Court were made by SARS under the provisions of the GAAR and that the correct position, based on statutory provisions and the authorities, was that SARS bore the *onus* of the duty to begin.

Judge Ndita held the following:

<u>As to the application to strike-out</u>

(i) That it was well to recall that the striking out application was rooted in the fact that the disputed assessments were made in the exercise of special powers conferred on SARS under the GAAR rules contained in Part 11A of Chapter 111 of the Income Tax Act. At the heart of each of the striking out applications is the contention by the taxpayers to the effect that it is impermissible for SARS to seek to broaden, amplify or change the basis for determination of a taxpayer's tax liability and in order to properly consider the powers of SARS under the GAAR it is necessary to first restate the old GAAR provisions as contained in section 103(1) of Act.

(ii) That, as regards the old GAAR, the basic jurisdictional requirement for the exercise of the power of SARS was that SARS had to be 'satisfied' of various requirements. Under the new GAAR the relevant provisions are contained in sections 80A-L of the Income Tax Act, but the requirement that

SARS must be satisfied has been specifically excluded by the legislature. It was clear from the provisions of both GAARs that certain procedural requirements must be met in order to trigger SARS' power under the GAAR in order to determine a taxpayer's liability and section 80B(1) of the Act sets out SARS' powers to determine the tax consequences under the GAAR.

(iii) That as could be recognised from the provisions of both GAARs, before SARS can exercise its powers under the GAAR, there must first be an 'impermissible avoidance arrangement' and, in turn, for an impermissible avoidance arrangement to be said to exist there are four specific requirements that must be fulfilled and the substantive trigger for the exercise of, or parts thereof, arises where SARS forms an opinion that there is an impermissible avoidance arrangement.

(iv) That it made better sense to first consider the interpretation that must be accorded to the new GAAR and it was clear from the provisions of the new GAAR that the lawmaker intended a departure from the provisions of the old GAAR, and to this end, specifically excluded as a jurisdictional requirement that SARS must be 'satisfied.' The corollary was that it was impermissible to read the jurisdictional requirements of the old GAAR into the new GAAR and, as such, the cases ITC 1862 and ITC 1876, relied upon by the taxpayers, were not applicable in the present circumstances.

(iv) That an interpretation of the new GAAR sections through the prism of its predecessor may well have the effect of negating the very purpose of the new sections and the underlying mischief that they were intended to address in the first place which was that 'the GAAR has proven to be an inconsistent and, at times, ineffective deterrent to the increasingly sophisticated forms of impermissible tax avoidance that certain advisors and financial institutions are putting forward and some taxpayers are implementing.'

(v) That, in conclusion, to import the requirements of the old GAAR into the new GAAR undermines the intention of the legislature and renders the new GAAR completely ineffective. Upon a proper consideration of all the facts in this matter, there is no basis for adopting an interpretation that will extend the legislature's clear intention.

(vi) That, against the backdrop of this finding, the question that arises is whether SARS is, under the new GAAR, permitted to, after determining the taxpayer's liability, to seek to broaden, amplify or change the basis of the determination without issuing a fresh assessment. SARS contended that the new GAAR does not contain the jurisdictional requirement of the now-repealed section 103 to the effect that 'once SARS has, in the exercise of its powers under the GAAR 'determined' the taxpayer's liability, SARS cannot thereafter seek to broaden, amplify or change its basis for determination.'

(vii) That in the present matter a much closer scrutiny must be paid to the provisions of section 80J(4) of the Act as the section authorises SARS to revise or modify its reasons for applying Part 11A in the event that 'additional information comes to its knowledge' at any time after issuing a notice in terms of section 80J(1) to the taxpayer. The provision does not make reference to 'how' and 'when' SARS may revise or modify its reasons, but the reference to 'any stage' clearly denotes that such course of action is not precluded at the Rule 31 statement stage.

(ix) That SARS must give the taxpayer notice of such revised or modified reasons before SARS exercises its powers under the GAAR to 'determine' the taxpayer's liability on the basis of such revised or modified reasons. This is in line with the principles of procedural fairness and, in the court's judgment, SARS may, in terms of section 80J(4), revise or modify its reasons for invoking the GAAR in the event that additional information comes to it, at any time after issuing a notice in terms of section 80J(1), after giving a notice to the taxpayer. This makes logical sense when regard is had to the fact that SARS would have additional information entitling SARS to modify its reasons, and the basis for revision or modification must surely be provided to the taxpayer who would be affected by such a decision.

(x) That said, there too is the jurisdictional fact which must first be satisfied, namely that additional information must have come to the knowledge of SARS. There is no indication in these papers as to what knowledge would have come to SARS which prompted the revision and the modification. This is understandable given that SARS' stance is that the Rule 31 statement introduces no new facts and is no different from the section 80J notice and finalisation of audit letter.

(xi) That the use of the words ‘revise’ and ‘modify’ indicated that the substance of the assessment should not be materially changed such that a new basis for the assessment is introduced and this interpretation is in line with the approach adopted in Africa Cash and Carry (Pty) Ltd v C: SARS 82 SATC 73.

(xii) That, in the light of this interpretation, it must follow that the question that must be answered is whether SARS' Rule 31 statement completely changes the basis of the tax assessment such as to introduce facts giving rise to a new basis of the taxpayer’s liability and to arrive at an answer to this question it was necessary to restate and evaluate the factual matrix.

(xiii) That, given the analysis of the interplay between sections 103(2) and 80J(4) of the Act, what must be determined is whether SARS' Rule 31 statement completely changes the basis of the assessment such as to introduce facts giving rise to a new basis of the taxpayer’s liability. Put differently, it was whether SARS' Rule 31 statement amounted to a novation of the factual and legal basis on which SARS purported to exercise its power under the GAAR and, in a nutshell, what this court must decide is whether SARS introduced ‘new elements’ to its Rule 31 statement.

(xiv) That there had been no novation of SARS' case in the Rule 31 as the relevant allegations were made in the section 80J statement as already alluded to in the judgment and the contention that SARS had novated or altered materially the basis of its case in the Rule 31 statement was unmeritorious. Stated differently, the taxpayers had failed to demonstrate that SARS had introduced 'new elements' into the Rule 31 statement and for this reason the application to strike out the words or phrases in the paragraphs referred to in the notice of motion had to fail.

As to the duty to begin adducing evidence

(xv) That it was plain that the determination of the duty to begin must begin with the interpretation of Rule 44(1) of the Tax Court Rules in the context of the GAAR assessments. Rule 44(1) provided, inter alia, that 'at the hearing of the appeal, the proceedings are commenced by the appellant unless…'

(xvi) That although the court had held that the two decisions, ITC 1862 and ITC 1876 may not be relied upon by the taxpayers in the interpretation of the new GAAR, which had specifically omitted the need for SARS to be 'satisfied', insofar as the procedural aspect of the onus was concerned, one should not throw the baby out with the bath water. This was so because the four substantive requirements that must be present before SARS can invoke its powers under the GAAR remained the same.

(xvii) That in considering whether the onus of proof that each party bears in relation to the dispute was relevant to the question of the duty to begin, Rule 39 of the Uniform Rules of Court contains provisions which demonstrate that the duty to begin follows from the onus of proof. To this end, Uniform Rule 39(5) and (9) provide that where the onus of proof is on the plaintiff, or the defendant respectively, 'that party may briefly outline the facts intended to be proved….and may then proceed to the proof thereof.'

(xviii) That SARS' argument was primarily that because the Tax Court is a creature of statute, and the provisions of Rule 44(1) unequivocally burden the taxpayers, as respondents, with a duty to begin the leading of evidence in a tax appeal, on this point alone, SARS was entitled to the relief SARS sought. The taxpayers, on the other hand, contend for several reasons that it could not have been the intention of the legislature to straitjacket the question of the duty to begin and, with this in mind, the court proceeded to consider the interpretation that must be accorded to Rule 44(1).

(xix) That in considering the interpretation of Rule 44(1) it must be placed on record that it is not in dispute that the primary onus of proof is on SARS and the court had outlined the recognised relationship between the onus of proof and the duty to begin. Likewise, the court had also set out the four requirements that must be met before SARS invokes the GAAR when alleging the existence of an impermissible arrangement as contemplated in sections 80A and 80B. What could be discerned from those provisions is that if SARS relies on the existence of an avoidance arrangement, it then bears the onus of proving same and it then becomes illogical to require the taxpayer to adduce first evidence concerning its purpose in carrying out an alleged avoidance arrangement. There could not logically be evidence from the taxpayer as to the purpose behind 'an avoidance arrangement' unless and until there has been evidence from SARS to establish the existence of that 'avoidance arrangement' on which SARS relied.

(xx) That in the matter at hand, the very circumstances of the existence of an 'avoidance arrangement' are placed in dispute and it therefore is perfectly logical for SARS to commence the leading of evidence, and in turn, illogical for the taxpayer to have to do so. It followed as a matter of fact that since the primary onus was on SARS, it should also bear the duty to begin. However, the question that arose was whether SARS' strict reliance on Rule 44(1) was correct.

(xxi) That it must be stated from the outset that Rule 44(1) made no reference or contained no provision relating to the GAAR and the two exceptions it created to the taxpayer's duty to begin shared a crucial feature in common with the GAAR assessments in that the onus of proof was, all three instances, on SARS. The exceptions correlated with instances where SARS bore the onus of proof in terms of section 102(2) of the Tax Administration Act.

(xxii) That it followed that the intention behind the express exceptions created in Rule 44(1)(a) was clear recognition and entrenchment of the logic that where SARS bore the onus of proof, the taxpayer should not have the duty to begin and this was particularly so because it was evident from the wording of Rule 44(1)(a) that in promulgating the Tax Court Rules, the Minister intended to link the duty to begin to the onus of proof and this view was fortified by the judgment in ITC 1636 where the onus of proof in respect of the old GAAR was found to be on SARS, notwithstanding the general onus provisions on the taxpayer.

(xxiii) That although in ITC 1636, supra, the analysis applied to the old GAAR, the reasoning still is relevant to the question of onus in the new GAAR as the provisions were substantially the same. For the reasons espoused above, SARS bore the primary onus and also bore the duty to begin.

(xxiv) That even if the court may be wrong on this aspect, Rule 42(1) provides that if the Tax Court Rules do not provide for a procedure in the Tax Court, then the most appropriate rule under the Uniform Rules of Court, and to the extent consistent with the Act, may be utilised by a party or the Tax Court. Seeing that there was no specific provision relating to the duty to begin in relation to the new GAAR, the most appropriate rule is Uniform Court Rule 39 as under Rule 39(5) and (9) the duty to begin is on the party who bears the onus of proof and, in casu, that party was SARS as it must prove the existence of the 'impermissible arrangements' on which it relied.

(xxv) That the duty to begin provisions of Rule 44(1)(a) are not to be construed so narrowly as to apply to only the mentioned exceptions when the overriding effect of those very exceptions was to recognise the burden of proof and this approach was in keeping with the primary onus that SARS acknowledged that it had in this matter, as well as the burden of proof under Uniform Rule 39 and therefore SARS had the duty to begin.

The applications to strike out were both dismissed with costs.

SARS' applications on the duty to begin in respect of both taxpayers was dismissed with costs.

### 4.9. Pricewaterhousecoopers Inc v Minider of Finance (83 SATC 253)

The two Applicants were related entities and the Second Applicant (the PWC Partnership) provided ongoing professional services (all being taxable supplies for VAT purposes) to PWC Inc, being the First Applicant, and for which it furnished tax invoices based on estimates of the services rendered at the end of each month.

The First Respondent was the Minister of Finance and the Second Respondent was SARS.

At the end of each financial year the PWC Partnership conducted a 'true-up' exercise by reference to the services actually supplied in order to determine whether it had over-or under-invoiced PWC Inc through its monthly invoices.

The PWC Partnership duly conducted that exercise for the financial years 2009–2013 and in each of those five years found that it had in fact over-invoiced PWC Inc for its services.

The result of the true-up exercise, i.e. the reduction of the amount charged to PWC Inc, was duly processed for income tax and accounting purposes and the financial statements and income tax returns for both entities for each of the five years in question reflected the correct amounts for the services in question.

The Applicants, however, stated that owing to an 'administrative or system oversight', the true-up results were not processed with regard to the declaration and payment of VAT. Because PWC Partnership had overcharged PWC Inc in each year, it had also overcharged VAT on its services. PWC Partnership ought, therefore, to have issued VAT credit notes to PWC Inc at the end of each financial year, thereby reducing its taxable supplies for the year, and reclaimed the overpaid VAT from SARS. Because it did not process the true-up exercise for VAT purposes, it did not do so.

As a result of this failure, PWC Inc did not pay the VAT that it ought to have paid at the required time and PWC Partnership paid more VAT than it should have paid and by the same margin as the underpayment of PWC Inc.

SARS imposed penalties and interest on the late VAT payments as the VAT Act obliged it to do. Arising out of this a Voluntary Disclosure Agreement (VDA) was concluded between PWC Inc and SARS on 7 November 2014.

SARS, in accordance with the VDA, then issued assessments for the relevant tax periods totalling R97 988 700.18 and levied late payment penalties of R9 798 870 and levied interest in the total amount of R27 390 270.

Following a request by PWC Inc for the remittal of the penalties imposed as well as interest charged, SARS remitted the full late payment penalty as well as the interest for 2009, being R7 381 683.71, but did not remit the interest for the period 2010 to 2013.

SARS' reasoning was that section 39(7) of the VAT Act, on which SARS had relied in remitting the interest for 2009, had been amended in 2010 and the effect thereof was to remove the possibility of remitting interest when there was no loss to the fiscus.

PWC Inc lodged an objection against the decision of SARS, which objection was rejected on 23 August 2018 and this resulted in the launch of this application to the High Court on 11 April 2019 which was a constitutional challenge to the provisions of section 39(7) of the VAT Act which provided for the circumstances under which SARS was empowered and authorised to effect a remittal of interest levied and paid in terms of the Act.

The relief sought in the Applicants' Notice of Motion included a declaration that section 39(7) of the VAT Act was unconstitutional and invalid to the extent that it failed to provide for the remittal of interest on late VAT payments where, having regard to the output tax and input tax relating to the supply in respect of which interest was payable, the failure to make payment within the prescribed period did not result in any financial loss to *the fiscus* or the State.

The Applicants challenged the constitutionality of section 39(7) on two main grounds and contended that the section was:

(*a*) irrational and arbitrary in that it permitted the charging of interest without any right of remittance in the absence of loss to the *fiscus,* and (*b)* section 39(7) permitted the arbitrary deprivation of property and was in conflict with section 25(1) of the Constitution.

The Applicants contended that the interest that was levied on late VAT payments constituted money which in turn was property and that the imposition of penalty interest therefore constituted a deprivation of property. To that extent they argued that section 39(7), which prohibits a remittal where there is no loss to the *fiscus*, constitutes an arbitrary deprivation of property in conflict with the guarantee enshrined in section 25(1) of the Constitution.

It was apparent that section 39(7) as it stood in the period prior to 1 April 2010 and the position after its amendment with effect from 1 April 2010 represented a significant shift in focus in regard to the basis upon which a remittal of interest may be granted. In the pre-April 2010 period it was focussed exclusively on the question of benefit and loss to the *fiscus* and a remittal was permissible where the State did not suffer a financial loss or where the taxpayer did not benefit financially. In the post-April 2010 period the focus shifted to the cause of the delay and a remittal may now only be granted where the cause of the delay in making a late payment was beyond the control of the taxpayer.

Judge Kollapen held the following:

<u>As to the constitutionality of section 39(1) of the Act</u>

(i) That section 39(1) of the Act, which regulates the levying of interest, was cast in peremptory terms with the result that SARS is obliged to levy interest where payment of the tax due is made late.

(ii) That section 39(1) dealt exclusively with the circumstances under which interest may be charged and lateness was the trigger for the levying of interest. Whatever reason the taxpayer may offer in mitigation of the late payment is not relevant at this stage of the enquiry as its relevance arises in the section 39(7) determination of remittal and so the two relevant parts of the section that deal with the raising of interest and then its remittal stand separately apart from each other both in structure as well as in the policy and legal basis on which they rest and hence a joint overview of their unconstitutionality was problematic and conceptually impossible.

(iii) That, therefore, even if one had regard to the section in its entirety, there was no attack on section 39(1) and given the considerable difference in what section 39(1) and section 39(7) seek to do, it could hardly be permissible to allow the Applicants to argue the unconstitutionality of section 39(1) when the papers do not traverse such a challenge.

*As to whether section 39(7) of the Act was irrational and arbitrary*

(iv) That the obligation on the part of SARS to raise interest on the late payment of VAT in terms of section 39(1) of the Act was not the subject of any attack in these proceedings but the rationale for levying interest had arisen quite sharply in the context of the attack on section 39(7) of the Act.

(iv) That the Applicants contended that the purpose of interest was to compensate for loss and not to deter and our courts have generally accepted that one of the purposes of interest was to compensate the creditor for the lost opportunity of productively using the money if it had been paid timeously.

(v) That in *Metcash Trading Limited* v *C: SARS and Another* 63 SATC 13 the court referred to the formidable powers of SARS which included the power to levy interest as aimed at ensuring proper compliance on the part of vendors to keep proper records and make timeous payments – a clear recognition that interest was one of the means of establishing a compliant tax system and beyond serving a compensatory function was also part of the package available to SARS to deter errant tax conduct and to incentivise taxpayers to act in accordance with what the law expects of them.

(vi) That what was clear was that the pre-April 2010 position and post-April 2010 position represented a policy and legislation shift in moving away from remittal of interest based on a consideration of loss to the *fiscus* to a system that focussed on the conduct of the taxpayer and in particular whether the failure to pay tax timeously was due to circumstances beyond the control of the taxpayer and it is against this backdrop that one proceeds to consider the argument that this shift in section 39(7) is irrational and arbitrary.

(vii) That ultimately the question that arises in the context of this challenge was whether the means chosen through the vehicle of section 39(7) to regulate the remittal of interest was connected to the ends of achieving an efficient VAT system that requires the prompt settlement of tax debts in the overall context of VAT as the court had alluded to in *Metcash*, *supra*.

(ix) That the question therefore was not whether the pre-2010 system was a better system or a fairer one but rather in this part of the enquiry whether the scheme could be said to be rational in the sense of whether the measure introduced by the impugned section 39(7) was properly related to the public good that it sought to realise.

(x) That the Applicants have argued that it was irrational for the *fiscus* to retain interest that it has levied under circumstances where there is no loss to the *fiscus*. Apart from the practical difficulties associated with implementing the no loss model, this argument is largely located on the view that the only legitimate basis to levy and retain interest is if there was a loss to the *fiscus*. The argument ignores the other legitimate reason to impose interest – namely as an incentive and as a deterrent to ensure that taxpayers comply with their obligations.

(xi) That on that rationale the question of loss to the *fiscus* cannot be dispositive of the issue as *Metcash*, *supra*, has affirmed that reasons other than loss to the *fiscus* justify the levying of interest. On that basis the same justification of incentivising taxpayers is equally applicable to the circumstances under which a remittal of interest is provided for.

(xii) That in addition the regime of loss is located in an understanding that the defaulting taxpayer is entitled to a remittal because another taxpayer has paid more VAT than what was required. This represented a system that was akin to cross subsidisation between different and possibly unrelated taxpayers and stands in stark contrast to the rationale of incentivising taxpayer conduct. That such a system was in place before April 2010 is not of any great significance. SARS has explained the reasons why that system was problematic and why it elected to introduce a new system which the current section 39(7) embodied.

(xiii) That whether the new system was fair or proportional was not part of this leg of the enquiry, except to point out that in the view of SARS, which cannot be gainsaid, the new system was intended to introduce a fairer regime for the remittal of interest.

(xiv) That under the circumstances and for the reasons given, the test of rationality which had been accepted to be a relatively low threshold had been met and it could not be contended that a system that triggers a right to remittal of interest based exclusively on the conduct of the taxpayer was irrational. Simply put, if the failure to pay VAT timeously was within the control of the taxpayer, the right to seek a remittal is excluded. There can be nothing irrational or arbitrary about such a system – it accords with the objectives of the *fiscus* to advance an efficient and compliant system of tax collection.

(xv) That, accordingly, the rationality challenge to section 39(7) of the Act must fail.

*<u>As to the arbitrary deprivation of property challenge</u>*

(xvi) That this part of the challenge to the constitutionality of section 39(7) of the Act was grounded in the provisions of section 25(1) of the Constitution which provided that 'no one may be deprived of property except in terms of law of general application, and no law may permit the arbitrary deprivation of property.' It could hardly be contended that the interest in question was not property for the purpose of section 25(1) of the Constitution.

(xvii) That the first question that arose was whether taxation and interest thereon constituted a deprivation of property and connected to that, whether the failure to remit such interest levied constituted a deprivation. The Applicants had argued that both taxation as well as interest related to that taxation would constitute a deprivation of property.

(xviii) That very few rights can be regarded as absolute or constitutionally insulated from interference or limitation. The essence of a rights framework is the recognition that rights are indivisible, inter-connected and inter-related and the limitation or interference with one right is necessary to advance another right.

(xix) That in the context of deprivation as contemplated in section 25(1) of the Constitution, our courts have been clear that not all interference with property rights constitutes a deprivation of property. The Constitutional Court has held that at the very least substantial interference or limitation that goes beyond the normal restrictions on property use or enjoyment found in an open and democratic society would amount to deprivation. What would constitute 'substantial interference' would of course depend on the particular facts and circumstances but at the very least must be the kind of interference that must extend beyond what the courts described as 'the normal restrictions on property use or enjoyment found in an open and democratic society.'

(xx) That taxes are very much part of the normal restrictions on property use and they are indispensable in an open and democratic society to enable the State to discharge its obligations towards its citizens. In *Metcash*, *supra*, the court had emphasized the need for those payments to be made timeously and diligently to ensure a steady and accurately predictable stream of revenue for the *fiscus*. To suggest that taxation is somehow beyond what may be regarded as the normal restrictions on the use of property was to misconceive the very essence of a democratic system of government and the mutual obligations that rest on State and citizen in such a system.

(xxi) That, therefore, the argument that taxes constitute a deprivation is ill conceived. The Applicants however contend that interest levied by the *fiscus* is not a tax but a penalty and if taxes do not constitute a deprivation of property then interest must constitute such a deprivation but again this argument is flawed. The attempt to distinguish between the obligation to pay tax and the obligation to pay interest upon the failure to pay tax is not appropriate. There can be no interest obligation in the absence of a tax obligation and the rationale for having an interest obligation as part of the broader tax model has been explained. It too is very much a part of the normal systems of our *fiscus* and probably most other systems in the world and it cannot be considered an interference in property rights that extends beyond the normal restrictions on property use in an open and democratic society and can therefore not constitute a deprivation of property.

(xxii) That mindful that the issue before this court is squarely the constitutionality of section 39(7) of the Act, it must be concluded that the creation of an obligation to pay tax coupled with an obligation to pay interest when the primary tax obligation was not fulfilled does not constitute a deprivation of property in terms of section 25(1) of the Constitution.

(xxiii) That if the payment of interest does not constitute a deprivation of property, it is even more onerous to suggest that a provision such as section 39(7) that allows for a remittal of interest under defined circumstances, would result in a deprivation of property when a taxpayer is unable to bring its claim within those defined circumstances and this is precisely the case here.

(xxiv) That the framework that allowed for a remittal of interest could also be characterized as part of the normal restrictions on the use of property, creating as it does a system that circumscribes the circumstances under which an errant taxpayer may trigger a claim for remittal. Beyond having found that the scheme was rational, it does not constitute a substantial interference that goes beyond restrictions on property use that may be described as normal.

(xxv) That, accordingly, the provisions of section 39(7) of the Act do not lead to a deprivation of property as contemplated in section 25(1) of the Constitution.

(xxvi) That having concluded that no case had been advanced that the impugned section may lead to a deprivation of property, there was no need to consider the question of arbitrariness as required in terms of section 25(1) of the Constitution.

(xxvii) That, however, assuming that the court's conclusion on deprivation was incorrect and that it could be said that section 39(7) led to a deprivation of property, the court considered briefly the requirement that such deprivation shall not be arbitrary. A deprivation of property will be arbitrary if it takes place 'without sufficient reason.' Sections 39(1) and 39(7) create a framework that provides that a vendor who fails to pay VAT timeously is liable to have interest levied on the amount concerned and then further provided that such interest may only be remitted where the late payment was due to circumstances beyond the control of the vendor.

(xxviii) That the scheme *in casu* was sufficiently reasoned and the rationale that an errant taxpayer who made a late payment under circumstances that were within his or her control could not have interest remitted was far from being an arbitrary provision and hence the challenge located in section 25(1) of the Constitution also had to fail.

Application was dismissed.

No order made as to costs.

## *4.10. Mobile Telephone Networks (Pty) Ltd v C:SARS (83 SATC 270)*

MTN was in the business of a mobile network operator and service provider and provided mobile telephony, data and related services and facilities to the South African customer.

This case revolved around the provision and supply of pre-paid services where MTN provided pre-paid vouchers in Rand denominations which provided the voucher holder to access different types of services and products of MTN up to the value of the voucher.

There were two classifications of vouchers:

(a) those vouchers purchased which entitled the holder to specific products or services known as a single-purpose voucher, and

(b) vouchers purchased for multi-purpose where the voucher is a pre-paid voucher in Rand denominations valid for a specific period and where the holder may use this voucher for any of MTN's services or products once activated to the value of the voucher and it was this multi-purpose voucher which was the corner-stone of this case.

In this case MTN's multi-purpose voucher had been dubbed the 'airtime' voucher and the products and services purchased were redeemed against the available pre-paid funds of the subscriber at the prevailing price when purchased. MTN stated that 'the pre-paid amount is effectively currency from which the subscriber pays for the services selected from time to time.'

The 'airtime' voucher is deemed to operate as follows: as soon as the subscriber purchases and activates this multi-purpose voucher the subscriber's relevant SIM card is credited to the value of the voucher. MTN describes this storage of money from which the subscriber can activate funds as a 'main wallet' which can be used for products and services on MTN's network. The subscriber determines when and for what he or she will utilize the pre-paid value in the main wallet and once a particular service is accessed by the subscriber, the applicable cost of that service based on the prevailing tariff is then deducted from the subscriber's main wallet.

The question that arose in this case was whether these vouchers were to be treated for VAT purposes in terms of:

(a) section 10(18) or

(b) section10(19)

of the VAT Act.

MTN submitted that the vouchers in issue should be treated under section 10(18) as the supply of multi-purpose vouchers fell under this section, whilst SARS contended that the applicable legislation for the multi-purpose vouchers was section 10(19).

MTN had sought a VAT ruling from SARS to regard the pre-paid multi-purpose voucher as falling within the realm of section 10(18) of the VAT Act, but SARS had refused to grant the ruling sought by MTN and had, in fact, made a ruling that the airtime vouchers of MTN fell within the realm of section 10(19) and not section 10(18) of the VAT Act.

MTN then approached the High Court where it sought an order declaring that the supply by MTN of pre-paid tokens or vouchers for a consideration denominated in Rand, entitling the holder to receive available services and products on the MTN mobile network, as selected by the holder, to the extent of the monetary value stated on or attributed to the tokens or vouchers ('multi-purpose vouchers') constituted a supply as envisaged in section 10(18) of the VAT Act and declaring, accordingly, that the supply of such token or voucher be disregarded for the purpose of the VAT Act except to the extent (if any) that the consideration for the multi-purpose vouchers exceeded the monetary value stated thereon.

MTN also sought an order declaring to be incorrect the ruling issued by SARS on 4 April 2019, to the effect that the pre-paid vouchers fell within the ambit of section 10(19) of the VAT Act and that the VAT must accordingly be accounted for by MTN when the voucher is sold to the subscriber.

MTN contended that the corner-stone of its case was that when a subscriber purchased the multi-purpose voucher it did not recognize the revenue at that time and it was only when the voucher is used for a particular service or product, as requested by the subscriber, and the main wallet is debited that the revenue was recognized. In other words, the voucher did not entitle the holder to specific goods or services but, instead, it was a means to pay for unspecified services in the future.

SARS contended firstly that the relief sought by MTN was not competent in the context of the VAT Act as MTN had sought a 'generic declaratory order' that was not time specific and did not have a termination date as well in respect of its supply of airtime vouchers.

SARS then contended that in the light of the evidence presented by MTN the voucher fell within the ambit of section 10(19) of the VAT Act as the nature of the voucher in question was that 'the recipient of the voucher is entitled on the surrender thereof to receive goods or services that by usage or arrangement entitled the holder to specified goods or services.'

SARS further stressed that MTN, all along, had treated the multi-purpose vouchers in terms of section 10(19) of the VAT Act until it sought the ruling from SARS referred to above.

SARS was of the view that MTN merely sought the delay of the VAT consideration at the point of sale of the voucher and sought in effect to disregard the supply of the voucher and rather sought to subject to VAT the 'supplies made using the voucher.'

Judge Hughes held the following:

*<u>As to the competency of the declaratory relief sought</u>*

(i) That the relief sought by MTN was declaratory in nature on the ground that a real dispute with regard to the interpretation of the relevant VAT legislation existed and that there was no dispute of fact as the issue was merely one of interpretation and application of the law, that being the VAT Act and MTN was requesting the court to exercise its discretion in the granting of the declaratory order.

(ii) That MTN, in advancing its case for the declaratory order in this matter, relied on the *dicta* in *C:SARS v Langholm Farms (Pty) Ltd* 82 SATC 135 where the Supreme Court of Appeal stated that there was nothing objectionable in the Respondent in that case seeking clarity on an issue of statutory interpretation that would clearly influence the outcome of a SARS audit and that was exactly the situation for which declaratory orders were made and seeking one in the context of a taxing statute was endorsed by the Constitutional Court in *Metcash Trading Limited v C: SARS and Another* 63 SATC 13.

(iii) That SARS had accepted that an applicant as a taxpayer may seek a declaratory order from the court in the appropriate circumstances but it contended that the circumstances presented in this case were not appropriate.

(iv) That the fact that SARS had expressed an interpretation in its ruling coupled with the fact that MTN had disagreed with this interpretation, MTN was not precluded from bringing this application to resolve the difference of opinion. Since SARS had made an interpretation of the ambit within which the 'airtime' vouchers fell, in terms of the VAT Act, this entitled MTN who disagreed to seek clarity with regards to SARS' interpretation.

(iv) That, further, MTN was entitled to seek the court's assistance in light of SARS' legal stand point on this matter. Nothing would change SARS' interpretation of this specific section of the statute and no amount of further facts or information would alter SARS' legal view. It is trite that such court assistance may be sought in terms of tax statutes and, in the circumstances, MTN's declaratory application was properly before the court.

*As to the application of sections 10(18) and 10(19)*

(v) That the rules of interpretation of statutes have been expressed succinctly, that being that a statute must be interpreted in line with ordinary rules of grammar and syntax taking cognisance of the context and purpose thereof.

(vi) That MTN issued two categories of vouchers, the one granting the holder thereof to acquire specified services or products and the other voucher was a multi-purpose voucher, which once activated for its monetary value the holder was entitled to use it for any service or product on MTN's network. It was the multi-purpose voucher which was the bone of contention in this case.

(vii) That the multi-purpose voucher was termed by MTN as an 'airtime' voucher and once the 'airtime' voucher is used for a service or product, the holder is charged at the prevailing rate and such amount is deducted from the value of the 'airtime' voucher.

(ix) That MTN's contention that on issuing the multi-purpose voucher to the voucher holder it did not equate to revenue and only when the voucher was activated and in fact used that was when it was considered as revenue could not be correct as in terms of section 9(1) of the VAT Act MTN was entitled to account for VAT charged on the sale of a voucher in the period in which the voucher was sold. As the supply of 'airtime' in the form of a voucher attracted revenue for MTN, in terms of section 7(1)(*a*) of the VAT Act tax was levied 'on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him.'

(x) That the voucher supplied was specifically an 'airtime' voucher and it cannot be said that an 'airtime' voucher was akin to a gift voucher and this was so as the 'airtime' voucher could be used to make calls, receive calls, send messages, use the internet and for data and as such did not take away from the fact that the supply of 'airtime' fell within the category of specific goods or services.

(xi) That the 'airtime' voucher as a specific good or service could be used for multi-purposes but this did not change the nature of the voucher from being specifically an 'airtime' voucher and thus SARS was correct when he ruled that the 'airtime' voucher fell within the ambit of section 10(19) of the VAT Act.

(xii) That 'airtime' vouchers had been used by MTN over many years and in that time it had always accepted the interpretation accorded to such vouchers by SARS and in so doing this had to be factored in when dealing with statutory interpretation and examining the words, their context and the determination of their meaning and purpose.

(xiii) That, consequently, considering the factual background, the purpose of the relevant sections of the statute in question, its context and wording, the court was satisfied that the interpretation ascribed by SARS to the airtime voucher bringing it within the ambit of section 10(19) of the VAT Act was correct for the reasons that it had given.

Application for a declaratory order was dismissed with costs.

# 5. INTERPRETATION NOTES

## *5.1. Allowances, advances and reimbursements – No. 14 (Issue 5)*

This Note provides clarity on the tax treatment of allowances, advances and reimbursements granted to employees and office holders, and gives guidance on the record-keeping requirements relating to motor vehicles.

Since 1 March 2002, the system of employment income taxation was simplified by consolidating the provisions relating to allowances, advances and reimbursements in section 8(1), and enacting section 23(m) to limit the deductions available to employees and office holders.

Recently, amendments have been made to the tax treatment, for income tax and employees' tax purposes, of reimbursements under the travel allowance system, as well as the rules relating to general reimbursements. In addition, clarity is provided on what the requirements are for a valid logbook, as well as what is required to permit a travel deduction when using alternative transport methods such as taxis. These are explained in the changes to this Note.

Section 8(1)(a):

- deals with all allowances and advances paid by a 'principal' to a 'recipient' (for example, travel, subsistence, public office, cell phone and housing allowances);
- provides that all such allowances and advances must be included in the

recipient's taxable income to the extent that they were not expended as specified in section 8(1); and

- provides that, if reimbursements meet the qualifying requirements, they are not included in taxable income.

Section 8(1) only permits a deduction for expenditure incurred in relation to travelling on business, expenditure incurred for accommodation, meals and incidental costs while an office holder or employee is obliged to spend at least one night away from his or her usual place of residence as a result of business or official purposes and expenditure incurred by reason of the duties attendant upon public office.

The method of calculating the amount of the allowable deduction is specified in section 8(1).

This Note discussed the methods of calculating the allowable deduction which, in the case of the travel allowance, includes actual business kilometres and an actual rate per kilometre or a deemed rate per kilometre as determined by the Minister of Finance in the Government Gazette.

The allowable deduction for subsistence expenses may, depending on the circumstances, be based on a deemed rate per the Government Gazette or on actual expenditure.

Employers are generally required to calculate and withhold employees' tax on a monthly basis on all advances and allowances. With effect from 1 March 2011 employers must include 80% of the travel allowance in remuneration. However, should an employer be satisfied that at least 80% of the use of the motor vehicle for a year of assessment will be for business purposes, only 20% of the travel allowance or advance is included as remuneration and is subject to employees' tax.

The portion of travel reimbursements that exceed the prescribed rate per kilometre determined by the Minister by notice in the Government Gazette must be included in remuneration.

Reimbursements below the prescribed rate are not subject to the deduction or withholding of employees' tax.

Subsistence allowances are generally not subject to employees' tax.

The amount of the subsistence allowance must be included in remuneration in the month following the month in which the allowance was paid to an employee if the employee receives a subsistence allowance but does not spend the anticipated time away from home.

## *5.2. Withholding tax on interest – No. 115*

This Note deals with the interpretation and application of sections 50A to 50H relating to withholding tax on interest.

South African residents sometimes engage in cross-border transactions either for a trade or a non-trade purpose. Some of these transactions are entered into for the purpose of raising foreign debt capital. The debt capital often incurs an interest charge with the result that repayments comprise both a return of the borrowed capital and the interest incurred. The interest charge incurred may result in a deduction for the resident taxpayer (if legislative requirements are met) while the corresponding interest income may be exempt from tax for the recipient by virtue of section 10(1)(h). This situation results in the erosion of the domestic tax base. In order to address this loss of income to the fiscus, a withholding tax on interest paid to or for the benefit of a foreign person was introduced with effect from 1 March 2015.

The withholding tax on interest provisions were previously contained in sections 37I to 37O. These sections were deleted before they became effective and replaced with sections 50A to 50H. Before the introduction of withholding tax on interest, the South African tax system provided (and still provides) for a blanket income tax exemption for interest payable to non-residents under section 10(1)(h), subject to two exceptions relating to physical presence in South Africa. The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010 explains the rationale for introducing withholding tax on interest as follows:

> '[T]he current blanket interest exemption does not achieve a fair balance between the attraction of foreign debt capital and the need to protect the tax base against potential erosion. The exemption is also not in line with global practice.
>
> Most developed and emerging economies currently exempt cross-border interest relating to mobile portfolio debt (and possibly incidental trade finance). Other forms of cross-border debt remain fully taxable (and subject to a flat rate form of withholding). More generous forms of exemption typically exist only through tax treaties where both countries believe that the cross border interest will remain subject to a relatively high level of global tax. Hence the current blanket exemption employed via domestic South African tax legislation appears to be overly generous from a competitive point of view.'

A prerequisite for the imposition of withholding tax on interest is that the interest must be from a South African source. The withholding tax on interest is a final tax currently levied at a rate of 15%, which may be reduced by the application of a tax treaty. In addition to a legislative amendment to the rate of withholding tax on interest, the Minister may announce a new rate of withholding tax on interest in the national annual budget which will be effective from the date mentioned as the effective date in the Minister's announcement. The new rate will apply for a period of 12 months from the effective date as announced by the Minister pending the passing of legislation by Parliament giving effect to that announcement within that period.

Interest payments fulfilling the requirements of section 50D will be exempt from withholding tax on interest.

It is not a requirement that the interest must be incurred for a trade purpose or that it must be deductible by the payer before it may be subject to withholding tax on interest.

In summary:

- Withholding tax on interest became effective on 1 March 2015 and applies to interest paid to or for the benefit of a foreign person from a South African source on or after that date. However, because section 50B(2) deems interest to have been paid on the earlier of the date on which the interest is paid or becomes due and payable, it means that Part IVB of the Act will apply only if the interest is both paid and due and payable on or after 1 March 2015.
- A foreign person is defined in section 50A(1) and means any person that is not a resident.
- Interest is deemed to be paid to a foreign person on the earlier of the date on which the interest is paid or becomes due and payable.
- Withholding tax on interest is levied at the rate of 15% on the gross amount of the interest paid to the foreign person.
- Under section 9(2)(b) interest is from a South African source if:
    - it is payable by a person that is a resident except when it is attributable to a permanent establishment which is situated outside South Africa; or
    - it is received or accrues in respect of the use or application in South Africa by any person of any funds or credit obtained under any form of interest-bearing arrangement.
- It is not a requirement that the interest incurred be deductible by the payer before it may be subject to withholding tax on interest, that is, withholding tax on interest is not subject to a trade requirement.
- While the foreign person is liable for payment of withholding tax on interest, the person who has the obligation to pay the interest also has an obligation under section 50E(1) to withhold withholding tax on interest from that payment.
- The person withholding any withholding tax on interest must submit a return and pay the tax over to SARS by the last day of the month following the

month during which the interest was paid.

- The foreign person also has an obligation to submit a return and pay the tax over to SARS by the last day of the month following the month during which the interest was paid, unless the tax has been paid by another person.
- Under section 50D an interest payment to a foreign person may be exempt from withholding tax on interest. The exemption may be subject to certain specific requirements. A payment of interest may also be exempt under an applicable tax treaty. Section 50E(2) imposes certain additional requirements for some of the exemptions which must be met before the payer may refrain from withholding the withholding tax on interest.
- Section 50E(3) provides for withholding tax on interest to be levied at a reduced rate should there be an applicable tax treaty which provides for a reduced rate. The reduced rate at which withholding tax on interest may be levied applies only after the foreign person has submitted the prescribed declaration and undertaking to the payer.
- Withholding tax on interest is refundable under specified circumstances under section 50G, including when interest that is due and payable subsequently becomes irrecoverable.
- Any amount of tax withheld under section 50E(1) denominated in a foreign currency must, for purposes of determining the amount to be paid to the Commissioner, be translated to rand at the spot rate on the date on which the amount was so withheld.

## *5.3. Withholding tax on royalties – No. 116*

This Note provides guidance on the interpretation and application of sections 49A to 49H which relate to withholding tax on royalties.

An analysis and discussion of the impact of various tax treaties on withholding tax on royalties is beyond the scope of this Note. Should an arrangement between parties be subject to a tax treaty, the specific provisions of that treaty should be considered and applied.

Broadly speaking, withholding tax on royalties applies to royalties from a source within South Africa paid by any person (whether a resident or not) to a foreign person for the use of intellectual property belonging to that person or for the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render any assistance or service in connection with the application or utilisation of such knowledge or information. Withholding tax on royalties can potentially be reduced or eliminated by a tax treaty.

Withholding tax on royalties was previously contained in section 35, which provided for a withholding rate of 12%. Owing to the need for uniformity between the different types of withholding taxes, the withholding regimes were amended. Section 35 was accordingly repealed and replaced with sections 49A to 49H with effect from 1 July 2013. The withholding rate was increased to 15% with effect from 1 January 2015.

In summary:

- Sections 49A to 49H deal with withholding tax on royalties.
- In essence a royalty is an amount received or accrued for the use of intellectual property as defined in section 23I or for the imparting of scientific, technical, industrial or commercial knowledge or information as well as the rendering of assistance or service in connection with the application or use of such knowledge or information.
- Withholding tax on royalties applies to royalties paid to or for the benefit of a foreign person from a South African-source. A foreign person means any person that is not a resident.
- Although the foreign person to whom a South African-source royalty is paid is liable for the payment of withholding tax on the royalties, the person paying the royalty is obliged to withhold the tax.

- Royalties are deemed for withholding tax purposes to be paid to a foreign person on the earlier of the date on which the royalty is paid or becomes due and payable.
- Withholding tax on royalties is levied at the rate of 15% on the gross amount of the royalty paid to the foreign person.
- The person withholding any withholding tax on royalties must submit a return and pay the tax over to SARS by the last day of the month following the month during which the royalty was paid.
- The foreign person also has an obligation to pay the tax over to SARS by the last day of the month following the month during which the royalty was paid, unless the tax has been paid by another person, for example, the person paying the royalty.
- Under section 49D a royalty payment to a foreign person may be exempt from withholding tax on royalties. The availability of some of the exemptions is subject to specific requirements being met.
- Section 49E(3) provides for withholding tax on royalties to be levied at a reduced rate in line with a tax treaty if there is an applicable treaty in place between South Africa and the country in which the foreign person is resident. The reduced rate applies only after the foreign person has submitted the prescribed declaration and undertaking to the payer.
- Withholding tax on royalties is refundable under specified circumstances under section 40G.
- Any amount of tax withheld under section 49E(1) denominated in a foreign currency must, for purposes of determining the amount to be paid to the Commissioner, be translated to rand at the spot rate on the date on which the amount was so withheld.

## 5.4. *Taxation of the receipt of deposits – No. 117*

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.

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 be held in a separate bank account. The use of a separate bank 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 bank 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.

## *5.5. The taxation of foreign dividends – No. 93 (Issue 3)*

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

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

- The Taxation Laws Amendment Act 23 of 2020 which was promulgated on 20 January 2021 (as per Government Gazette 44082).
- The Tax Administration Laws Amendment Act 24 of 2020 which was promulgated on 20 January 2021 (as per Government Gazette 44082).
- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 22 of 2020 which was promulgated on 20 January 2021.

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

Broadly speaking, a foreign dividend is included in a person's gross income but may qualify for a full or partial exemption from normal tax under section 10B. With effect from March or April 2012 the exemptions available for foreign dividends meeting the relevant criteria under section 10(1)(k)(ii)(aa) to (dd) were moved to section 10B(2) and underwent some amendment. In addition, the basic exemption available to natural persons of R3 700 under section 10(1)(i)(xv)(aa) for foreign dividends and foreign interest not otherwise exempt, was deleted and a partial exemption was introduced under section 10B(3). The partial exemption under section 10B(3) is intended to ensure that the maximum effective rate of normal tax on taxable foreign dividends does not exceed the dividends tax rate applicable to local dividends. With effect from years of assessment commencing on or after 1 March 2017, the maximum effective rate of normal tax on taxable foreign dividends increased from 15% to 20%.

This Note discusses the current gross income inclusion, exemptions and other provisions applicable to foreign dividends.

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

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

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

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

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

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

For the purposes of determining the net income of a CFC, a CFC is deemed to be a resident for purposes of the definition of "gross income" in section 1(1). Foreign dividends received by or accrued to a CFC are therefore included in its gross income. Section 10B also applies to foreign dividends received by or accrued to a CFC for purposes of determining its net income for inclusion in a resident's income. Special rules apply to a CFC in calculating its net income and in determining the cost price or base cost of the right in a CFC when foreign dividends are distributed by the CFC or by another CFC in which the first-mentioned CFC has an interest.

The anti-avoidance provisions of sections 8E, 8EA, 22B, 64EB and paragraphs 19 and 43A are relevant when entering into share or dividend transactions.

# 6. DRAFT INTERPRETATION NOTES

## *6.1. Deductions of home office expenses incurred by persons in employment or persons holding an office – No. 28 (Issue 3)*

This Note provides clarity on the deductibility of home office expenses incurred by persons in employment or persons holding an office.

This Note incorporates the changes made to section 23(m) by section 56(1) of Taxation Laws Amendment Act 31 of 2013, and section 35(1) of Taxation Laws Amendment Act 17 of 2017.

It has become common in recent times for employers to require or permit employees to work from home. The reasons for this include supporting flexibility, increasing productivity, health reasons, or as a cost-saving measure for employers to minimize working space and related costs. Such arrangements could be temporary in nature, or may have a degree of permanency. Persons in employment or persons holding an office may therefore wish to claim a deduction for certain expenses incurred in relation to a home office.

Expenses in maintaining a home office have been a controversial issue since the judgment handed down in KBI v Van der Walt.

The legislation relating to home office expenditure that a taxpayer may claim, section 23(b), has therefore been periodically amended since 1990. The most recent amendment to have an effect on the deduction of home office expenditure was the amendment to section 23(m) which, subject to specific exceptions, prohibits the deduction of certain expenditure, losses and allowances that relate to employment or the holding of an office.

The effect of section 23(b) and 23(m) on the deductibility of home office expenditure for employees and holders of an office is the main focus of this Note.

In the event that section 23(m) applies, and the requirements of section 23(b) are met, the deductible home office expenses are limited to rental, repairs and expenses incurred in relation to a dwelling house or domestic premises under section 11(a) and (d), and wear-and-tear allowances under section 11(e) for items such as office equipment used by the taxpayer for the purpose of his or her trade (employment).

# 7. BINDING PRIVATE RULINGS

## *7.1. BPR 362 – Transfer of assets between share incentive trusts*

This ruling determines the income tax consequences of the transfer of shares and cash from existing share incentive trusts to new share incentive trusts.

In this ruling references to sections and paragraphs are to sections of the Income Tax Act and paragraphs of the Eighth Schedule to the Act as at 20 April 2021. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- the definition of "gross income" in section 1(1);
- the definition of "donation" in section 55(1);
- the definition of "disposal" in paragraph 1;
- paragraph 13(1)(a)(iiB); and
- paragraph 38.

Parties to the proposed transaction

The applicant: A resident discretionary trust

Co-applicants 1 and 2: Resident discretionary trusts (The applicant, co-applicant 1 and co-applicant 2 will be collectively referred to as the old trusts)

Co-applicants 3 and 4: Resident discretionary trusts (Co-applicant 3 and co-applicant 4 will be collectively referred to as the new trusts)

Description of the proposed transaction

Before June 2018 the old trusts administered the employee share incentive scheme for participating employer companies in the ABC Limited group. The new trusts administered the new share incentive scheme and made all employee share awards from September 2018 onwards.

Both the old trusts and the new trusts hold ABC Limited shares as:

- allocated shares – those shares allocated to employees from 1 March 2016 onwards, but held by the trusts on their behalf; and
- unallocated shares – those shares held in the names of the trusts, not yet allotted to employees.

The old trusts also hold cash from dividends received in respect of unallocated shares and interest earned.

ABC Limited has embarked on a project to simplify the group as a whole in terms of administration and reporting. The old trusts will transfer all the shares as well as any remaining cash to the new trusts which will assume the obligations of the old trusts.

The new trusts will:

- receive the unallocated shares in pursuance of the objects of the trusts to be allocated to future eligible employees; and
- undertake the obligations stipulated in their constitutive deeds to vest the allocated shares in employees when required. 5

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:

In respect of the allocated shares and unallocated shares:

- The transfer of the shares by the old trusts to the new trusts will result in disposals for purposes of the Eighth Schedule for the old trusts.
- Paragraph 38 will apply to the disposals by the old trusts to the new trusts and the
    - proceeds for the old trusts; and
    - base costs for the new trusts

  will be the market values of the shares on their respective dates of disposal.
- The transfers of the shares by the new trusts to participating employees, upon the vesting of those shares for purposes of section 8C, will result in disposals under paragraph 13(1)(a)(iiB) by the new trusts.

In respect of the transfer of the cash reserves by the old trusts to the new trusts:

- The amounts received by the new trusts will be of a capital nature and will therefore not constitute "gross income" as defined in section 1(1).

In respect of the transfer of the cash reserves and shares by the old trusts to the new trusts:

- The disposals will not constitute donations as defined in section 55(1).

## *7.2. BPR 363 – Value of a supply of services*

This ruling determines the income tax and value-added tax consequences of the provision of certain services to employees.

In this ruling references to sections are to sections of the Income Tax Act and the VAT Act applicable as at 1 April 2021. 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 1(1) – paragraph (i) of the definition of "gross income";
- Paragraph 1 of the Fourth Schedule to the Act – definition of "remuneration";
- Paragraphs 2(e) and 10(1)(b) of the Seventh Schedule to the Act.

- the VAT Act:
  - Section 7;
  - Section 9(7);
  - Section 10(13); and
  - Section 18(3).

Parties to the proposed transaction

The applicant: A resident company

Employees: The qualifying employees of the applicant

Description of the proposed transaction

The applicant is an asset manager.

The "employees" of the applicant will be employed by and/or hold office as executive directors of the applicant.

The employees may from time to time make investments in investment funds managed by the applicant. The applicant will not charge the employees any asset management service fees for the administration of these investments.

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 value of the supply of the asset management services as contemplated in section 10(13) read with section 9(7) of the VAT Act will be the cash equivalent as determined in paragraph 10(1)(b) of the Seventh Schedule to the Act.

- The cash equivalent of the asset management services as contemplated in paragraph 10(1)(b) of the Seventh Schedule is the marginal cost of rendering those asset management services to the employees.

## *7.3. BPR 364 – Extraordinary dividend followed by the dilution of shareholders' interest*

This ruling determines the capital gains tax consequences of a proposed special dividend, followed by a dilution of shareholders' interest.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 13 April 2021. 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 paragraphs 43A and 64B of the Eighth Schedule to the Act.

<u>Parties to the proposed transaction</u>

The applicant: A resident company

Company A: A non-resident company

<u>Description of the proposed transaction</u>

The applicant currently holds more than 90% of the ordinary shares in Company A. Company A is not incorporated or effectively managed in South Africa. The applicant has held this shareholding in Company A, on capital account, for more than 18 months prior to the date of this application and the date of the proposed transaction.

Company A is considering listing 100% of its equity shares on a foreign securities exchange (FSE), which will include an Initial Public Offering (IPO) of 20% of Company A.

It is proposed that Company A will declare a special dividend, payable in cash, to its existing shareholders prior to the IPO (pre-IPO special dividend). It is assumed that the special dividend will exceed 15% of the higher of the market value of the Company A shares. The pre-IPO special dividend will be funded either through debt financing, existing cash reserves or a combination thereof.

Company A will increase its authorised share capital in preparation for the IPO, where after Company A will issue shares to new non-resident investors, that are not connected persons, in terms of the IPO on the FSE.

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 dilution of the applicant's shareholding in Company A, as a result of the issue of shares on the FSE, will not constitute a "disposal" as contemplated in paragraph 64B of the Eighth Schedule.
- The capital gain or loss, as determined by paragraph 43A(2), may not be disregarded under the provisions of paragraph 64B of the Eighth Schedule.

## *7.4. BPR 365 – Interpretation and application of the de-grouping provision in section 45(4)(b)*

This ruling determines whether there is a de-grouping charge under section 45(4)(b) when a group of companies previously engaged in an intra-group transaction is transferred to form part of another group of companies which group is ultimately held by the same controlling group company. This ruling also considers the securities transfer tax consequences of the transfer of the shares.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 31 May 2021. 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 1(1) – definitions of “group of companies” and “controlling group company”;
  - section 41(1) – definition of “group of companies”; and
  - section 45(4)(b).
- STT Act
  - section 8(1)(a)(vi)(C).

Parties to the proposed transaction

The applicant: A resident company

Company A: A resident company that holds all of the shares in the applicant and 81% of the shares in company B

Company B: A resident company

Company C A resident company that holds 100% of the shares in company A

Company D A resident company that holds 100% of the shares in company C

Company E A resident listed company that holds 100% of the shares in company D

Company F A resident company that is wholly-owned by company E

Description of the proposed transaction

In 2018, when company A was held 75% by company C, and company A held 100% of the shares in the applicant and company B, the applicant acquired the assets and business of a division of company B from company B in terms of an intra-group transaction as contemplated in section 45 of the Act. The applicant discharged the purchase price by assuming liabilities related to the division and settled the balance by way of a cash payment.

Subsequent to the intra-group transaction mentioned above:

- a third party acquired 19% of the shares in company B; and
- company C acquired the remaining 25% shares in company A. Company A is therefore currently a wholly-owned subsidiary of company C.

It is proposed that the shares in company A be transferred to company F. The proposed transaction will be implemented as follows:

- Company F will purchase the shares in company A from company C.
- Company C and company F will agree, as contemplated in section 45(6)(g), that section 45 will not apply to the transaction.

No ruling was requested and thus no opinion is expressed on any of the prior transactions and values at which the transactions were implemented.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions other than the one mentioned in 6.b) below.

Ruling

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

- The disposal by company C of the shares in company A to company F will not give rise to a de-grouping charge under section 45(4)(b) of the Act as the Applicant will remain part of the same group of companies as company E, the controlling company in relation to company B.
- The transfer by company C of the shares in company A to company F will be exempt from securities transfer tax in terms of section 8(1)(a)(vi)(C) of the STT Act, subject to the public officer of company C making the required sworn affidavit or solemn declaration.

## *7.5. BPR 366 – Distribution in specie of shares*

This ruling determines the tax consequences of a distribution in specie of shares by a resident company to its shareholders.

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 31 May 2021. 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 "dividend" and "return of capital"; and
- paragraph 75.

Parties to the proposed transaction

The applicant: A listed resident company

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

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

Company C: A company that is not resident and the majority of its shares are held by Company A

Description of the proposed transaction

The applicant and its subsidiaries are holding companies with portfolios of interests in various companies. Their objective is to hold the investments on capital account.

The applicant and its subsidiaries have commenced a corporate restructuring. The proposed transaction is the last step in the restructuring. Before the restructuring commenced, the applicant and its subsidiary structure was as follows:

- The applicant held all the ordinary shares in Company A.
- Company A held all the ordinary shares in Company B.
- Company B held all the shares in Company C. Company C has a primary listing of its ordinary shares on both the JSE and on a foreign exchange.

Company C is a controlled foreign company in relation to Company B.

It is proposed that the shares in Company C be distributed to the shareholders of the applicant. The eventual distribution of the shares of Company C entails various transaction steps, some of which have already been implemented. The proposed transaction relevant for this ruling is the final transaction step.

Transaction steps one to three have been implemented as follows:

- Step one: Share consolidation
  - The issued ordinary shares in Company C were consolidated to eliminate fractional shares.
- Step two: Unbundling of Company C shares
  - Company B unbundled all its shares in Company C to Company A in accordance with paragraph (b) of the definition of "unbundling transaction" in section 46(1).
- Step three: Asset-for-Share Purchase
  - Company C acquired investment assets from Company B in exchange for the issue of its own shares to Company B.

Transaction step four will be implemented as follows:

- Step four: Equity Repurchase
  - Company A will repurchase a certain number of its own ordinary shares from the applicant at a certain consideration amount. The repurchase consideration will be settled by Company A transferring a certain number of shares in Company C to the Applicant and will reduce the contributed tax capital of Company A's ordinary shares. The base cost of shares that the applicant holds in Company A will also be reduced.
  - The applicant will acquire an aggregate base cost in the Company C shares equal to the value of those shares. These values at which this transaction step will be done will be determined by the

applicant.

The final step in the restructuring is the proposed transaction which will be implemented as follows:

- Step five: Distribution of Company C shares
  - The applicant will distribute in specie all the shares it holds in Company C to its shareholders. The distribution will reduce the applicant's contributed tax capital.

Conditions and assumptions

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

- The directors of the applicant will pass a resolution directing that the distribution of the Company C shares will constitute a return of capital and not a dividend.
- The shareholders of the applicant hold their shares on capital account.

Ruling

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

- The distribution in specie by the applicant of the Company C shares to its shareholders will constitute a "return of capital" as defined in section 1(1).
- The distribution in specie by the applicant of the Company C shares to its shareholders will fall within the ambit of paragraph 75. Consequently, the applicant will be treated as having disposed of the Company C shares for an amount equal to market value on the date of distribution as contemplated in paragraph 74.

# 8. BINDING GENERAL RULINGS

## *8.1. Application for a decision under section 72 – No. 56 (VAT)*

For purposes of this ruling:

- 'Public Notice 299' means the Public Notice setting out the application and cost recovery fees for binding private rulings and binding class rulings under section 81(1) of the TA Act, published on 1 April 2021 in Government Gazette 44383;
- 'Public Notice 300' means the Public Notice in terms of section 72(3) prescribing a list of transactions or matters in respect of which SARS may decline to make a decision under section 72(1), published on 1 April 2021 in Government Gazette 44383;

<u>Purpose</u>

This BGR prescribes the requirements and conditions relating to an application for a decision under section 72, pursuant to section 72(2) read with section 90 of the TA Act.

<u>Background</u>

Since the inception of VAT in South Africa, the VAT Act contained provisions in section 72 that 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, subject to certain requirements being met.

Challenges regarding the application of the mandatory wording of the other provisions of the VAT Act versus the discretionary wording of the provisions of section 72 arose. In order to address these, changes were made in section 72 to align the provisions of this section with the construct and policy intent of the other provisions of the VAT Act.

The changes in section 72 introduced by Act 34 of 2019 with effect from 21 July 2019, limit the extent of SARS' discretion in making a decision under this section, by clarifying that a decision under section 72 cannot:

- have the effect of reducing or increasing the liability for VAT; or
- be contrary to the construct and policy intent of the VAT Act as a whole, or any specific provision in the VAT Act.

In addition, SARS must be satisfied that similar difficulties, anomalies or incongruities have arisen or may arise for any other vendor or class of vendors (other than the applicant) of the same kind or who make similar supplies of goods or services.

Whilst the application for a decision under section 72 will be facilitated through the Advance Tax Rulings system, the decision will be under section 72. In this regard, certain provisions1 of the TA Act relating to advance rulings were introduced in the amended section 72 to align with the process of application and issuing of decisions under section 72.

These include, amongst others:

- a fee of R2 500 that is payable on applications for a decision under section 72 in accordance with section 81 of the TA Act read with Public Notice 299;
- the issuing, in accordance with section 90 of the TA Act, of procedures and guidelines in the form of BGRs for the implementation and operation of the process to obtain a decision under section 72.

In addition, under section 72(3) read with Public Notice 300, SARS may decline to make a decision in respect of the list of transactions set out in the said Public Notice. This BGR sets out certain requirements and conditions relating to an application for a decision under section 72.

<u>Ruling</u>

This ruling constitutes a BGR issued under section 89 of the TA Act insofar as it relates to the items listed hereunder:

- An application for a decision under section 72 must be made via eFiling.
- An application for a decision under section 72 may be made by one person who is a party to a transaction or by two or more parties to a transaction as

co-applicants. If there is more than one applicant, each applicant must join in designating one applicant as the lead applicant to represent the others, provided that the applicants are vendors.

- A person may make an application for a decision under section 72 on behalf of a class of vendors.
- An application for a decision under section 72 must contain the following minimum information:
  - The applicant's name, VAT registration number (if applicable), 2 postal address, email address and telephone number.
  - The name, postal address, email address and telephone number of the applicant's representative, if any.
  - The relevant statutory provision(s) or legal issue(s) applicable in the circumstances.
  - A full and accurate description of the transaction (including financial implications) for which the decision is sought.
  - A complete description of any other transaction entered into by the applicant or class member before the application was filed or that may be undertaken after filing the application, if that other transaction may have a bearing on the tax consequences of the transaction, or may be considered to be part of a series of transactions involving the transaction in respect of which the decision is sought.
  - Specify the relevant provisions in the VAT Act that result in the difficulties, anomalies or incongruities.
  - A concise description of the difficulties, anomalies or incongruities that have arisen or that may arise when applying the aforementioned provisions of the VAT Act.
  - The applicant's interpretation of the relevant statutory provisions or legal issues, as well as an analysis of any relevant authorities that

the applicant considered or is aware of, and whether those authorities support or are contrary to the specific section 72 decision the applicant is seeking.

- The reasons why the applicant believes the specific section 72 decision should be granted.
- A complete description of the impact the transaction might have upon the tax liability of the applicant or class member or if relevant, any connected person in relation to the applicant or class member.
- An explanation to support the view that the decision (if granted) will not reduce or increase the liability for tax levied under the VAT Act.
- An indication of how the difficulties, anomalies or incongruities that have arisen or that may arise, will apply equally to other vendors or a class of vendors that may face the same or similar business circumstances.
- An explanation to show that the decision (if granted) will not be contrary to the construct and policy intent of the VAT Act as a whole or any specific provision in the VAT Act.
- A statement that none of the grounds for the rejection of the application under section 72(3) of the VAT Act read with Public Notice 300 apply to the application.
- In the case of a class of vendors:
  - a description of the class of vendors; and
  - the impact the transaction might have upon the tax liability of the class of vendors or, if relevant, any connected person in relation to the applicant or class of vendors.
- A statement confirming that the applicant(s) has or have complied with any registration requirements under a tax Act with regard to any tax for which the applicant(s) is or are liable, unless the application concerns a section 72 decision to determine that a person is not

required to register under the VAT Act.

- A statement confirming that all tax returns required to be rendered by the applicant under a tax Act have been rendered and tax has been paid or arrangements acceptable to SARS have been made for the submission of any outstanding returns or for the payment of any outstanding tax. In the case of a class of vendors making application, the class of vendors' representative should provide the aforementioned statement on behalf of the class of vendors.
- Consent to the publication of the section 72 decision (positive and negative).
- A description of the information that the applicant believes should be deleted from the final section 72 decision before publication in order to protect the confidentiality of the vendor or class of vendors.

- SARS may require additional information from an applicant at any time.
- An application must be accompanied by an application fee set out in Public Notice 299 read with section 81 of the TA Act.
- SARS must provide the applicant with a reasonable opportunity to make representations if, based upon receipt of the application and any additional information, it appears that the decision under section 72 will differ materially from the proposed decision sought by the applicant.
- An applicant may withdraw an application for a decision under section 72 at any time.
- A co-applicant to an application for a decision under section 72 may withdraw from an application any time.
- A withdrawal does not affect the liability to pay the fees under section 81 read with Public Notice 299. The fee is generally non-refundable.

# 9. DRAFT BINDING GENERAL RULINGS

## *9.1. Purchase of different types of annuities at retirement*

For the purposes of this ruling –

- "retirement fund" refers collectively to a "pension fund", "pension preservation fund", "provident fund", "provident preservation fund" or "retirement annuity fund" as defined in section 1(1);
- "the Pension Funds Act" means the Pension Funds Act 24 of 1956
- "section" means a section of the Act, unless the context indicates otherwise;
- "the Act" means the Income Tax Act 58 of 1962;
- any other word or expression bears the meaning ascribed to it in the Act.

Purpose

This BGR confirms that, for income tax purposes, any annuity purchased or provided by any retirement fund must be compulsory, non-commutable, payable for and based on the lifetime of the retiring member.

This means that the annuity may not be transferred, assigned, reduced, hypothecated or attached by creditors as contemplated by the provisions to sections 37A and 37B of the Pension Funds Act.

Background

General Note 12, issued on 20 July 1995, confirmed that even though some approved pension, provident and retirement annuity funds were, in terms of the rules of those funds, terminating that retirement fund's liability to pay an annuity, the retirement fund could not terminate its liability to pay an annuity. General Note 18 replaced General Note 12 with effect from 1 September 2008.

General Notes 18 and 18A were issued following discussions held with various representatives of the retirement fund industry. By virtue of an agreement, retirement funds were permitted to terminate their continued liability in respect of a retiring member once an annuity was purchased, subject to certain terms and conditions as laid out in General Notes 18 and 18A. Both General Notes 18 and 18A were withdrawn on 26 February 2021.

This BGR is now issued to provide clarity after the withdrawal of General Notes 18 and 18A.

Discussion

The proviso to the definitions of retirement fund permits the Commissioner to prescribe additional limitations and conditions for the approval of rules of retirement funds. This discretion may be exercised whenever the Commissioner deems it necessary. General Notes 18 and 18A were issued in terms of this discretion of the Commissioner.

Any annuity so purchased in the name of the retiring member, in the name of the retirement fund or paid directly by such a retirement fund, must be compulsory, noncommutable, payable for and based on the lifetime of the retiring member. The annuity may not be transferred, assigned, reduced, hypothecated or attached by creditors as contemplated by the provisions to sections 37A and 37B of the Pension Funds Act.

This is in line with Regulation 39 of the Pension Funds Act that requires trustees to have an annuity strategy for members.

It is, however, not something specifically governed by the Income Tax Act, but rather by the provisions in the Pension Funds Act, as stated above.

The definitions of each type of retirement fund state that up to one-third of the member's total retirement interest may be commuted for a single payment and the remainder must be paid in the form of an annuity (including a living annuity). These provisions to the Act do not prescribe whether the annuity must be provided by the retirement fund or purchased from an insurer nor does it prescribe the nature or characteristics of such an annuity.

Sections 37A and 37B of the Pension Funds Act state that no benefit, including an annuity purchased by the retirement fund from an insurer for a member may be transferred, assigned, reduced, hypothecated or attached by creditors. It should, however, be noted that there is no distinction between member-owned annuities and fund-owned annuities purchased when the member retires from the retirement fund.

Ruling

It is accepted that, as per the agreement and the practice generally prevailing at this point, the following practice still prevails and is in line with an exercise of the Commissioner's discretionary power. The rules of retirement funds may therefore provide for:

- the retirement fund paying the annuity directly;
- purchasing the annuity in the name of the retirement fund; and
- purchasing the annuity in the name of a retiring member.

It is further confirmed that no annuity provided on retirement may be transferred, assigned, reduced, hypothecated or attached by creditors and must be compulsory, non-commutable, payable for and based on the lifetime of the retiring member.

## *9.2. Disqualification as a qualifying company under section 12R(4)(b)*

For the purposes of this ruling:

- "Government Gazette" means Government Gazette 39930 issued on 15 April 2016;
- "qualifying company" means a "qualifying company" as defined in section 12R(1);
- "SEZ" means a "special economic zone" as defined in the Special Economic Zones Act 16 of 2014 that is approved for the purposes of

section 12R by the Minister of Finance under section 12R(3);

- "SIC Code" means version 7 of the Standard Industrial Classification Code as issued by the Statistics South Africa;
- "section" means a section of the Act, unless the context indicates otherwise;
- "the Act" means the Income Tax Act 58 of 1962;
- any other word or expression bears the meaning ascribed to it in the Act.

Purpose

This BGR provides guidance on the interpretation and application of the excluded activities under section 12R(4)(b) conducted by a qualifying company located within an SEZ. It does not address any aspect of the accelerated building allowance available under section 12S. This ruling sets out SARS' view.

Background

The South African government introduced the SEZ's regime as a means of promoting foreign direct investment, growth and especially job creation in the South African manufacturing and industrial sector, and to encourage the exportation of value-added commodities by specific industries situated within a designated SEZ. An income tax incentive in the form of a reduced corporate income tax rate is available to qualifying companies located within an SEZ. Although a company may be classified a "qualifying company" as defined in section 12R(1) it may be disqualified from participating in the income tax incentive if it conducts an activity listed in either section 12R(4)(a) or an activity listed in the SIC Code as gazetted by the Minister of Finance under section 12R(4)(b). In this regard the Minister of Finance issued a Government Gazette listing the activities from the SIC Code that constitute a disqualifying activity by a qualifying company. The problem arises in that some of the activities listed in the Government Gazette may constitute ancilliary activities to the main business of the qualifying company. Due to the fact that the qualifying company may conduct any of these activities, it could be disqualified from participating in the income tax incentive.

This BGR provides clarity on the interpretation and application of the excluded activities under section 12R(4)(b).

Discussion

Section 12R(4)(a) and (b) reads as follows:

(4) Notwithstanding a qualifying company being located in a special economic zone —

(a) a company is not a qualifying company if that company conducts any of the following activities classified under "section C: Manufacturing" in the SIC Code:

(i) (vi) …..

(b) a company that conducts any activity classified in the SIC Code, which the Minister of Finance may designate by notice in the Gazette is not a qualifying company; or

The disqualified activities under section 12R(4)(a) relate to certain specific manufacturing activities that are not targeted as part of the income tax incentive. Section 12R(4)(b) allows for the Minister to proclaim through the issuing of a gazette certain further non-manufacturing activities to constitute a disqualifying activity. The list of non-manufacturing activities in the gazette relate mainly to ancilliary activities that support the main trade of a qualifying company.

Both, section 12R(4)(a) and (b) refers to "a company that conducts any activity" and "is not a qualifying company". In applying the same strict interpretation under both paragraphs as is required following the judgement in Western Platinum Ltd v C:SARS, such an approach would result in a qualifying company being disqualified to participate in the income tax incentive due to conducting a disqualified activity under section 12R(4)(b) which may only be an ancillary activity to the main trade of the qualifying company

Such an interpretation creates an absurdity as some of the activities listed in the Government Gazette are required to be undertaken as part of most business processes. The proper approach to the interpretation of statues was decided in the case of Natal Joint Municipal Pension Fund v Endumeni Municipality3 where the judgment confirmed that it is incorrect to simply apply a purposive interpretation if the ordinary meaning does not give rise to an absurd or ambiguous result. In the case of an absurd or ambiguous result a sensible and businesslike interpretation taking into account the purpose of the legislation should be adopted.

The courts also noted that it is important when giving words and expressions their ordinary meaning, to consider the context in which such words or expressions is contained. Since the purpose of the SEZ regime is to promote investment in certain under-capitalised manufacturing and industrial sectors and thereby create jobs, a businesslike interpretation must be adopted. This interpretation would mean that if an activity listed in the said Government Gazette is ancillary to the manufacturing or industrial process undertaken by the qualifying company, then the qualifying company would not be disqualified from the income tax incentive under section 12R(4)(b). However, if any activity under section 12R(4)(b) is a separate income-earning activity that is conducted on a continuous basis, then that activity would result in the disqualification of that company as a qualifying company.

Example 1: An excluded ancillary activity conducted by a qualifying company

Facts:

Company M, a qualifying company, carries on the trade of manufacturing electronic appliances in a designated SEZ. Company M packages the final manufactured product for its safe and secure transport. Customers are invoiced for the final product and not separately for the cost of packaging.

Result:

The activity of packaging is listed as an excluded activity in Government Gazette 39930. The packaging activity is a necessary activity in support of the manufacturing trade of Company M and is not conducted as a separate incomeearning activity. Since the packaging activity is ancilliary to the income-earning activity, Company M will not be disqualified from participating in the income tax incentive by virtue of the application of section 12R(4)(b)

Example 2: Excluded activity conducted by a qualifying company as a separate income-earning activity

Facts:

Company D, a qualifying company, carries on the trade of manufacturing motor vehicles in a designated SEZ. Company D owns and operates a fleet of customized vehicles to transport the vehicles it manufactures to the harbour which is several hundred kilometres away, for export. On the return trip Company D, on behalf of other motor vehicle manufacturers situated in the SEZ, transports vehicles imported by such other companies for a fee.

Result:

The activity of land transport is listed as an excluded activity in Government Gazette 39930. The activity by Company D of transporting the vehicles it manufactures to the harbour will be considered a necessary activity in support of its manufacturing activity and will not be disqualified from participating in the income tax incentive under section 12R. However, the activity of transporting vehicles imported by other vehicle manufacturers is not a necessary activity in support of its manufacturing activity and will be considered as one of the dual-trades of Company D. Company D will be disqualified as a quailifying company under section 12R, as it conducts an excluded activity as envisaged under section 12R(4)(b), and is therefore not entitled to the income tax incentive for that year of assessment.

<u>Ruling</u>

A qualifying company will be disqualified from the income tax incentive under section 12R if it conducts any activity listed in the Government Gazette. However, where that activity is an integral part of the manufactured product to protect or transport the final product, it is accepted that it is not disqualified, provided the secondary product is not sold separately.

# 10. BINDING CLASS RULINGS

## *10.1. Capital gains tax consequences of in specie distribution by company to its shareholders – No. 77*

This ruling determines the capital gains tax consequences of an in specie distribution by a company to its shareholders.

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 27 May 2021. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- paragraph 75; and
- paragraph 76B.

<u>Class</u>

The class members to whom this ruling will apply are the shareholders of the applicant referred to herein.

<u>Parties to the proposed transaction</u>

The applicant: A listed company incorporated in and a resident of South Africa

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

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

Company C: A company that is not resident and the majority of its shares are held by Company A

Shareholders: The shareholders of the applicant

<u>Description of the proposed transaction</u>

The applicant and its subsidiaries are holding companies with portfolios of interests in various companies. Their objective is to hold the investments on capital account.

The applicant and its subsidiaries have commenced a corporate restructuring. The proposed transaction is the last step in the restructuring. Before the restructuring commenced, the Applicant and its subsidiary structure was as follows:

- The applicant held all the ordinary shares in Company A.
- Company A held all the ordinary shares in Company B.
- Company B held all the shares in Company C. Company C has a primary listing of its ordinary shares on both the JSE and on a foreign exchange. Company C was a controlled foreign company in relation to Company B.

It is proposed that the shares in Company C be distributed to the shareholders of the applicant. The eventual distribution of the shares of Company C entails various transaction steps, some of which have already been implemented. The proposed transaction relevant for this ruling is the final transaction step.

Transaction steps one to three have been implemented as follows:

- Step one: Share consolidation
  - The issued ordinary shares in Company C were consolidated to eliminate fractional shares.
- Step two: Unbundling of Company C shares
  - Company B unbundled all its shares in Company C to Company A in accordance with paragraph (b) of the definition of "unbundling transaction" in section 46(1).
- Step three: Asset-for-Share Purchase
  - Company C acquired investment assets from Company B in exchange for the issue of its own shares to Company B.

Transaction step four will be implemented as follows:

- Step four: Equity Repurchase
  - Company A will repurchase a certain number of its own ordinary shares from the applicant at a certain consideration amount. The

repurchase consideration will be settled by Company A transferring a certain number of shares in Company C to the Applicant and will reduce the contributed tax capital of Company A's ordinary shares. The base cost of shares that the applicant holds in Company A will also be reduced.

  - The applicant will acquire an aggregate base cost in the Company C shares equal to the value of those shares. These values at which this transaction step will be done will be determined by the applicant.

The final transaction step which is the proposed transaction will be implemented as follows:

- Step five: Distribution of Company C shares
  - The applicant will distribute in specie all the shares it holds in Company C to the Shareholders. The distribution will reduce the applicant's contributed tax capital.

Conditions and assumptions

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

- The directors of the applicant will pass a resolution directing that the distribution of the Company C shares will constitute a return of capital and not a dividend.
- The Shareholders hold their shares on capital account.

Ruling

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

- The distribution in specie by the applicant of the Company C shares to the Shareholders will fall within the ambit of paragraph 75. Consequently, the Shareholders will be treated as having acquired the Company C shares for expenditure equal to their market values on the date of distribution as contemplated in paragraph 74, which expenditure will be treated as expenditure actually incurred by each Shareholder for purposes of paragraph 20(1)(a).

- The Shareholders must in terms of paragraph 76B(2) reduce the expenditure in respect of their shares held in the applicant by the amount of the market value of the Company C shares determined on the date that the Company C shares are received or accrued to the Shareholders.
- Where the market values of the Company C shares as contemplated in paragraph 76B(2) exceed the expenditure in respect of a Shareholder's shares in the applicant, the excess amount must, in terms of paragraph 76B(3), be treated as a capital gain in determining the Shareholders aggregate capital gain or aggregate capital loss for the year of assessment in which the Company C shares are received by or accrue to the Shareholder.

General Note

No ruling was requested and none is issued in respect of transaction steps prior to the final transaction step.

The transaction steps have not been considered with regard to the application of any general or specific anti-avoidance provisions or doctrines.

# 11. GUIDES

## *11.1. Transfer Duty Guide (Issue 5)*

This document contains a discussion of the application of the Transfer Duty Act, in respect of transactions involving immovable property such as land, buildings and other real rights in connection with immovable property situated in South Africa.

The Transfer Duty Act was promulgated in Gazette Extraordinary 4193 on 28 July 1949.

It came into effect on 1 January 1950 and applies to all acquisitions of property on or after that date. Any acquisitions before 1 January 1950 remain liable to duty under the relevant laws operative at the date of the transaction.

Transfer duty is a tax levied by the national sphere of government and is paid into the National Revenue Fund.

The main purpose of this guide is therefore to assist the reader to:

- determine if 'property' has been acquired, or if a transaction or event is otherwise subject to transfer duty in principle, or if an exemption from duty applies;
- determine if a transaction is subject to VAT or transfer duty;
- identify the factors which SARS must (or may) take into account when determining the 'fair value' of property as well as which amounts must be included or excluded from the consideration which is subject to duty;
- calculate the amount of duty (including any interest thereon) for different types of property transactions and determine the period within which transfer duty is payable;
- understand the administrative requirements relating to the submission of transactions to SARS for processing on eFiling; and
- generally understand the application of the Transfer Duty Act with regard to property transactions.

The approach of this guide in dealing with the topics is set out below:

Chapter 1 – Provides a brief historical perspective and some background information relating to transfer duty. It also describes the scope of topics that will be covered in the guide and the approach adopted.

Chapter 2 – This chapter explores some of the main definitions and concepts which underpin the application of the Transfer Duty Act in the context of the law of property, the law of contract and various other legislative acts which govern property transactions in South Africa. The most fundamental definition is that of 'property' which has a particular meaning in the legal context as well as a specific defined meaning in section 1(1). The definition also has a link with the definition of the term 'fixed property' as defined in section 1(1) of the VAT Act which is explained in some detail in the guide.

Chapter 3 – Describes the transactions and events which make up the tax base of transfer duty, being acquisitions of 'property' either by way of a transaction or in any other manner, as well as renunciations of interests in 'property' which has the effect of enhancing the value of property. As most of the important definitions and concepts would have already been explained in Chapter 2, this chapter provides a summary of the meaning of those terms and puts them into context within the meaning of the term 'acquisition'. Also dealt with in this chapter is the cancellation of transactions and transactions which are concluded through representatives or agents who act on behalf of, or for the benefit of others.

Chapter 4 – Briefly sets out aspects which relate to the date of liability for transfer duty and the period in which the duty must be paid. This chapter focuses on the practical aspects relating to the definition of the terms 'date of acquisition' and 'acquisition' which are explained in Chapters 2 and 3.

Chapter 5 – Deals with determining who is liable to pay transfer duty in any particular situation. The general rule is that the transferee is liable, but the Transfer Duty Act also contains provisions which make other persons liable for the duty in certain types of transactions.

Chapter 6 – Focuses on the determination of the dutiable value of the property acquired or the value by which property is enhanced by the renunciation of an interest therein. The applicable valuation rules as set out in the definition of the term 'fair value' are discussed in the context of the different transactions and events. The chapter includes a discussion of different valuation factors that SARS may consider (or which must be considered) when an inadequate consideration is paid or where the declared value is less than the fair value of the property acquired or renounced. This chapter also sets out what is to be included and excluded from the consideration paid (or payable) which will be subject to duty.

Chapter 7 – Sets out the rules for calculating transfer duty and the rates of duty that have applied over the years. Included are a number of different examples of how to calculate duty for past and current transactions as well as the application of the formula in section 2(5) for calculating the duty on an acquisition of an undivided share in property. The examples also demonstrate how to establish whether transfer duty or VAT is payable on a transaction.

Chapter 8 – Deals with exemptions from duty. One of the most important of these is section 9(15) which provides for an exemption from transfer duty when a property transaction constitutes a taxable supply of 'fixed property' as defined in section 1(1) of the VAT Act. This exemption, amongst others, are explained in more detail, mainly as a result of other legislation or legal principles which apply in certain transactions, or as a result of the complexity of the wording of the exemption itself.

Chapter 9 – Deals with matters associated with the payment and recovery of duty. It covers the period for payment, the issuing of receipts and penalties or interest payable on late payments.

Chapter 10 – Deals with compliance matters concerning the administration of the Transfer Duty Act generally in the context of the TA Act. It includes a discussion on how these aspects impact on the interpretation of definitions, the submission of returns and payments, recovery of unpaid duty, objections, appeals and dispute resolution.

## *11.2. VAT Section 72 Decisions Process – Reference Guide*

A number of changes have been made to section 72 by Act 34 of 2019.

The reason for these changes have been explained in the Explanatory Memorandum to the Taxation Laws Amendment Bill, 2019 as follows:

> 'When VAT was introduced in South Africa in 1991, the VAT Act contained provisions in section 72 that 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. The arrangement or decision by SARS as provided under section 72 of the Act must have the effect of assisting the vendor to overcome the difficulty, anomaly or incongruity without having the effect of substantially reducing or increasing the taxpayer's ultimate liability for VAT. …

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

In view of the fact that the provisions of the VAT Act are in itself mandatory, in order to address the above-mentioned anomaly, it is proposed that changes be made in section 72 of the VAT Act to align the provisions of this section with the spirit of the other provisions of the VAT Act. It is further proposed that transitional measures be introduced to deal with the consequences of the proposed amendments on existing rulings. As a result, any arrangement or decision made in terms of section 72 of the VAT Act which constituted a binding general ruling and ceases to be effective on or after 21 July 2019 or does not specify an effective period, shall cease to be effective on 31 December 2021.'

The aforementioned changes in section 72 limit the extent of SARS' discretion in making a decision under this section, by clarifying that a decision under section 72 cannot:

- have the effect of reducing or increasing the liability for VAT; or

- be contrary to the construct and policy intent of the VAT Act as a whole, or any specific provision in the VAT Act.

In addition, SARS must be satisfied that similar difficulties, anomalies or incongruities have arisen or may arise for any other vendor of class of vendors (other than the applicant) of the same kind or who make similar supplies of goods or services.

Whilst the application for a decision under section 72 will be facilitated through the ATR system, the decision will be under section 72. In this regard, certain provisions of the TA Act relating to advance tax rulings were introduced in the amended section 72 to align with the process of application and issuing of decisions under section 72.

These include, amongst others

- a fee of R2 500 that is payable in respect of applications for a decision under section 72 in accordance with section 81 of the TA Act read with Public Notice 299; and
- the issuing, in accordance with section 90 of the TA Act, of procedures and guidelines in the form of binding general rulings (BGRs) for the implementation and operation of the process to obtain a decision under section 72. In this regard, see BGR 56 that sets out certain requirements and conditions relating to an application for a decision under section 72.

In addition, under section 72(3) read with Public Notice 300, SARS may decline to make a decision in respect of the list of transactions set out in the said Public Notice.

Transitional rules were also introduced to deal with vendors that have an existing arrangement or decision issued under section 72 before 21 July 2019, which expires on or after that date. In certain cases, these decisions or arrangements can be reconfirmed.

The process for issuing a section 72 decision involves a number of steps, beginning with the electronic submission of a section 72 decision application via eFiling and ending with the issuing of a section 72 decision signed by a designated senior SARS official. This part deals with the acceptable form and content of a section 72 decision application, as well as the submission of the application via eFiling.

## *11.3. Tax Directive: Emigration, cease to be resident and expiry of visas*

The purpose of this guide is to provide basic information relating to the tax directive applications for emigration withdrawals and withdrawals due to the expiry of a visa.

This guide is applicable to retirement fund lump sum withdrawal benefits payable from retirement annuity funds before the member's retirement. From 1 March 2019 this guide is also applicable to retirement fund lump sum withdrawal benefits payable from preservation funds before the member's retirement date.

The target audience is:

- Retirement annuity fund administrators;
- Retirement annuity fund trustees;
- Insurers,
- Preservation fund administrators, and
- Preservation fund trustees.

Before 1 March 2008, retirement annuity fund members who had emigrated from South Africa and were no longer tax resident in SA, had to wait until they reached their retirement age in order to access their benefits.

The definition of 'retirement annuity fund' in section 1(1) of the Income Tax Act was amended with effect from 1 March 2008, to allow a member who discontinues his/her contributions before his/her retirement date to be entitled to the payment of a lump sum benefit where that member emigrated from South Africa.

Only members whose emigration was recognised by the South African Reserve

Bank (SARB) for purposes of exchange control could withdraw the discontinued contributions as a lump sum.

With effect from 1 March 2016 the definition of ‘retirement annuity fund’ was amended to allow non-residents who were employed in South Africa on a contractual basis, for a certain period of time, and who contributed to a ‘retirement annuity fund’, to withdraw their lump sum benefit from a retirement annuity fund at the expiry of the various listed visas.

The withdrawal of the discontinued contributions is regarded as a lump sum benefit as contemplated in paragraph 2(1)(b)(ii) of the Second Schedule to the Act and remains taxable as a withdrawal benefit.

The definitions of ‘pension preservation fund’ and ‘provident preservation fund’ were amended with effect from 1 March 2019 to allow members who have already made use of the once-off withdrawal prior to retirement, to withdraw the full benefit before the member elected to retire. Members of a preservation fund, who have emigrated from South Africa (and that emigration is recognised by SARB for purposes of exchange control) or on expiry of a work or visitor’s visa, can withdraw their benefit in a preservation fund.

The reason ‘Cessation of South African Residence’ should be used from 1 March 2021, however if the taxpayer who was in the process of emigrating and has submitted the MP336(b) to the Authorised dealer (bank) on or before 1 March 2021 the reason ‘emigration withdrawal’ can be used. The reason ‘emigration withdrawal’ may only be used for those in the process of formally emigrating and may only be used for emigrations accepted by SARB on or before 28 February 2022.

The definitions of ‘pension preservation fund’, ‘provident preservation fund’ and ‘retirement annuity fund’ were amended with effect from 1 March 2021 to allow members who have ceased to be resident for an uninterrupted period of three years or longer to withdraw the full benefit before the member elects to retire from that fund, even if the member ceased to be resident before 1 March 2021.

From 1 March 2021 a member of a ‘pension preservation fund’ and a ‘provident preservation fund' who has ceased to be a resident for an uninterrupted period of three years or longer and who has previously accessed the once off withdrawal in that preservation fund may also withdraw the full benefit before the member elects to retire from that fund.

From 1 March 2021, a member of a 'retirement annuity fund' who has ceased to be a resident for an uninterrupted period of three years or longer on or after 1 March 2021 and who has stopped contributing to a retirement annuity fund can before the member elects to retire from that fund, withdraw the full benefit.

Employees' tax reflected on the tax directive is determined on the taxable portion of the lump sum payable after the allowable deductions, in terms of the Second Schedule to the Act, have been taken into account.

The provisions of paragraphs 2(1) and 9(3) of the Fourth Schedule to the Act require that, before a lump sum benefit can be paid out, a fund administrator, trustees or insurers apply for a tax directive from SARS.

## *11.4. Comprehensive Guide to Dividends Tax (Issue 4 – 11 June 2021)*

The purpose of this guide is to assist users in gaining a more in-depth understanding of dividends tax. While this guide reflects SARS' interpretation of the law, taxpayers who take a different view are free to avail themselves of the normal avenues for resolving such differences.

The foundation for this guide can be found in the various Explanatory Memoranda which supported the dividends tax legislation. The explanations contained in these Explanatory Memoranda have been expanded with additional explanations and examples.

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

- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 22 of 2020 which was promulgated on 20 January 2021 (as per GG 44082).

- The Taxation Laws Amendment Act 23 of 2020 which was promulgated on 20 January 2021 (as per GG 44083).
- The Tax Administration Laws Amendment Act 24 of 2020 which was promulgated on 20 January 2021 (as per GG 44080).

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### 11.5. Guide on the determination of medical tax credits (Issue 12)

This guide provides general guidelines regarding the medical scheme fees tax credit and additional medical expenses tax credit for income tax purposes. It does not delve into the precise technical and legal detail that is often associated with tax, and should, therefore, not be used as a legal reference.

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:

- A medical scheme fees tax credit (MTC) that applies in respect of qualifying contributions to a medical scheme.
- 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:

- Taxpayers aged 65 years and older.
- Taxpayer, his or her spouse or his or her child is a person with a disability.
- 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.

The two types of credits are dealt with separately in this guide, namely:

- Part A – the MTC, dealing with contributions to a medical scheme; and
- Part B – the AMTC (which replaced the deduction of the medical allowance) dealing with other qualifying medical expenses, including out-of-pocket expenses

## 12. INDEMNITY

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