TAX UPDATE

For period: July 2021 to September 2021

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1. INTRODUCTION

The purpose of this update is to summarise developments that occurred during the second 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. MEDIA STATEMENT - PUBLICATION OF THE 2021 DRAFT TAX BILLS FOR PUBLIC COMMENT

National Treasury and SARS published on 28 July 2021, for public comment:

- the 2021 draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (2021 draft Rates Bill),
- the 2021 draft Taxation Laws Amendment Bill (2021 draft TLAB), and
- the 2021 draft Tax Administration Laws Amendment Bill (2021 draft TALAB).

These draft tax bills contain tax proposals made in the 2021 Budget on 24 February 2021. The 2021 tax bills will be introduced in Parliament later this year.

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

National Treasury and SARS solicit written comments on tax proposals contained in the 2021 draft tax bills. After receipt of the written comments, National Treasury and SARS normally engage with stakeholders through public workshops to discuss the written comments on the draft tax bills. However, due to the national lockdown regulations as a result of the COVID-19 pandemic, further information will be provided on the manner and platform of public engagement for purposes of discussing the written comments. The Standing Committee on Finance and the Select Committee on Finance in Parliament are expected to make a similar call for public comment, and convene public hearings on these draft tax bills before their formal introduction in Parliament. Thereafter, a response document on the comments received will be presented at the parliamentary committee hearings, after which the bills will then be revised, taking into account public comments and recommendations made during committee hearings, before they are tabled

formally in Parliament for its consideration.

The 2021 draft Rates Bill, which was first published on Budget Day (24 February 2021), contains tax announcements made in Chapter 4 and Annexure C of the 2021 Budget Review that deal with changes to the rates and monetary thresholds and increases of the excise duties. The 2021 draft TLAB and the 2021 draft TALAB provide the necessary legislative amendments required to implement the more complex tax announcements made in Chapter 4 and Annexure C of the 2021 Budget Review that will require greater consultation with the public.

Key tax proposals contained in the 2021 draft Rates Bill include the following:

- Changes in rates and monetary thresholds to the personal income tax tables
- Increases of the excise duties on alcohol and tobacco

Key tax proposals contained in the 2021 draft TLAB include the following:

- Strengthening the rules dealing with limitation of interest deductions in respect of debt owed to persons not subject to tax
- Restricting the set-off of the balance of assessed losses in determining taxable income
- Refining the timeframes of compliance requirements of the industrial policy projects tax incentive
- Curbing the abuse of the Employment Tax Incentive
- Applying tax on retirement fund interest when an individual ceases to be a tax resident
- Strengthening anti-avoidance rules in respect of loans between trusts
- Refinements to the corporate reorganisation rules
- Clarifying the scope and definition of carbon sequestration

Key tax proposals contained in the 2021 draft TALAB include the following:

- Administrative non-compliance penalties based on estimates for non-

submission of six-monthly employees' tax returns

- Removal of double-penalty for the same incidence of non-compliance relating to employees' tax
- Expanding the purposes for which air cargo may be removed to degrouping depots
- Amendments related to changes in the accreditation system
- Increasing the caps for refunds and underpayments of duties

The 2021 draft tax bills and the accompanying draft explanatory memoranda containing a comprehensive description of the proposed tax amendments contained in the 2021 draft TLAB and the draft TALAB, can be found on the National Treasury (www.treasury.gov.za) and SARS (www.sars.gov.za) websites. More general information underlying the changes in rates, thresholds or any other tax amendments can be found in the 2021 Budget Review, available on the above treasury website.

3. MEDIA STATEMENT – 2021 EMERGENCY TAX RELIEF LEAFLET

30 July 2021 – SARS published a leaflet to clarify the measures as announced by the Minister of Finance on 28 July 2021. The measures are:

- The introduction of a tax subsidy of up to R750 per month for the next four months for private sector employers who have employees earning below R6 500. This subsidy will be provided under the current Employment Tax Incentive.
- Tax compliant businesses with a gross income of up to R100 million will be allowed to delay 35% of their Pay –As- You Earn (PAYE) liabilities over the next three months, without penalties or interest.

- Tax compliant businesses in the alcohol sector can apply to the SARS for deferrals of up to three months for excise duty payments.

In order to qualify for the emergency tax measures, you must be tax compliant, which means that you:

- Are registered for all required taxes
- Have no outstanding returns for any taxes you are registered for
- Have no outstanding debt for any taxes you are registered for, excluding:
  - Instalment payment arrangements
  - Compromise of tax debt
  - Payment of tax suspended pending objection or appeal.

4. MEDIA STATEMENT – PUBLICATION OF THE SECOND BATCH OF THE 2021 DRAFT TLAB & TALAB – DEALIGN WITH EMERGENCY TAX MEASURES IN RESPONSE TO THE CONTINUING COVID-19 PANDEMIC AND RECENT UNREST IN THE COUNTY

12 August 2021 - Following the announcement by the Minister of Finance on 28 July 2021 on the emergency tax measures as part of the fiscal package outlined by President Cyril Ramaphosa on 25 July 2021, which was in response to the continuing Covid-19 pandemic and recent unrest in the country that resulted in the destruction of businesses, the National Treasury and the SARS published, for public comment, the second batch of the 2021 Draft Taxation Laws Amendment Bill and 2021 Draft Tax Administration Laws Amendment Bill (TALAB).

The second batch of draft tax bills contains emergency tax measures taking effect on 1 August 2021 and seek to make amendments in the Disaster Management Tax Relief Act, 2020 and Disaster Management Tax Relief Administration Act, 2020.

These measures are over and above the tax proposals made in the 2021 Budget on 24 February 2021, which were included in the initial batch of the 2021 draft tax bills, published for public comment on 28 July 2021. These two sets of amendments will be combined to form the 2021 Taxation Laws Amendment Bill and 2021 Tax Administration Laws Amendment Bill that will be tabled in Parliament during the 2021 Medium-Term Budget Policy Statement. The measures are:

- The introduction of a tax subsidy of up to R750 per month for 4 months for those private sector employees earning below R6 500; this subsidy will be provided under the current Employment Tax Incentive.
- SARS will accelerate the payment of Employment Tax Incentive reimbursements from twice a year to monthly to get cash into the hands of compliant employers as soon as possible.
- T ax compliant businesses with a turnover of less than R100 million will be allowed to delay 35% of their Pay As You Earn liabilities over 3 months without penalties or interest.

Tax compliant businesses in the alcohol sector can apply to SARS to obtain deferrals of up to three months for excise duty payments, after setting out the circumstances justifying a deferral. This measure does not require a legislative amendment as the customs and excise rules that SARS administers were amended in 2020 to provide for deferrals of excise in cases of temporary financial constraint.

The second batch of the 2021 draft tax bills and the draft explanatory notes can be found on the National Treasury (www.treasury.gov.za) and SARS (www.sars.gov.za) websites.

5. EXPLANATORY MEMORANDUM ON THE TAXATION LAWS AMENDMENT BILL, 2021

5.1. Income Tax: Individuals, savings and employment – Reviewing the nature of long service awards for fringe benefit purposes

[Applicable provisions: Paragraphs (c) and (i) of the definition of 'gross income' and paragraph 5(2)(b) and new paragraphs 6(4)(d) and 10(2)(e) of the Seventh Schedule to the Income Tax Act, 1962 (Act No. 58 of 1962) ('the Act')]

<u>Background</u>

Paragraph (i) of the definition of gross income together with paragraph 5 of the Seventh Schedule to the Act make provision for a taxable benefit to arise when an employee acquires an asset from an employer, either for no consideration or for consideration which is less than the value of the asset (generally referred to as a fringe benefit). A fringe benefit is generally referred to as any noncash benefit ranted to employees, this however specifically excludes cash payments made to employees.

On the other hand, the Act further makes provision for a taxable benefit not to arise in the hands of the employee, in the event that the fringe benefit is deemed to have no value. Consequently, paragraph 5(2)(b) of the Seventh Schedule to the Act makes provision for the granting of a long service award (which can currently be provided as an asset or non-cash benefit) to an employee as a no value fringe benefit, provided that the value of such long service award does not exceed R5 000.

<u>Reasons for change</u>

Government recognises that the current prevailing practice is for employers to grant their employees a wider range of awards (which take a variety of forms) in recognition for long service, and these long service awards can in terms of the Act

be considered as non-cash benefits. These include for example the granting of gift vouchers, cash, services or the right of use of an asset owned by the employer for private purposes.

Proposal

In order to cater for current prevailing practices, it is proposed that the current provisions as relates to long service awards are not only limited to non-cash assets, but rather extended to apply to other reasonable awards granted for long service. In order to qualify as a no value fringe benefit, all the current requirements in the Act should be met, for example, the number of years required to be onsidered a long service period together with the requirement that the value of the long service award should not exceed R5 000 would still apply.

Effective date

The amendments will come into operation on 1 March 2022 and apply in respect of years of assessment commencing on or after that date.

5.2. Income Tax: Individuals, savings and employment – Curbing abuse in the employment tax incentive

[Applicable provisions: Definition of 'employee' in section 1 of the Employment Tax Incentive Act, 2013 (Act No. 26 of 2013) ('the ETI Act'), and definition of 'qualifying employee' in terms of section 6 of the ETI Act]

Background

The Employment Tax Incentive (ETI) programme was introduced in January 2014 to promote employment, particularly of young workers. The main aim of the programme is to reduce the cost of hiring young people between the ages of 18 and 29 (also referred to as qualifying employees) through a cost sharing mechanism with Government, by allowing the employer to reduce the amount of Pay-As-You-Earn (PAYE) they pay to the SARS, while leaving the wage received by the qualifying employees unaffected. Consequently, section 1 of the ETI Act

defines an employee as a natural person who works for another person and receives or is entitled to receive remuneration from that other person. In turn, section 6 of the ETI Act stipulates the conditions that need to be met for the employee to be classified as a qualifying employee for ETI purposes.

Reasons for change

It has come to Government's attention that some taxpayers have devised certain schemes where they claim the ETI in respect of individuals who do not work for them, therefore failing to meet the definition of 'employee' as outlined in section 1(1) of the ETI Act. The nature of these schemes is to market and utilise the ETI as a means of facilitating the entry of qualifying, unskilled, inexperienced, previously disadvantaged South Africans in the modern economy.

Eligible participants are recruited by a recruitment agency and employed by a participating employer for a fixed term period of 12 to 24 months. Participating employers engage with the recruitment agency to recruit eligible participants. Contracts signed by the eligible participants indicate the receipt of remuneration while 'employed' by the participating employer. Once 'employed', participants are trained by a training institution (over the 12 to 24 month period) and, in some cases, enrolled in Sector Education and Training Authority (SETA) accredited courses. The training institution is contracted by the participating employer at a cost equal to the remuneration stated in the eligible participant's contract. The remuneration stipulated in the contract is paid to the training institution as opposed to being paid to the eligible participant.

In some cases, the eligible participants are exposed to work-based exercises and activities by an independent company. The independent company is able to utilise the eligible participants for a fixed monthly fee, which similar to the remuneration, is not paid to the eligible participant. Once the training programme is completed, the eligible participant may work for the participating employer for the remainder of the 12 to 24 month period. In accordance with said scheme, the participating employer is then able to claim the ETI for the 12 to 24 month period that the eligible participant is supposedly 'employed' by the employer.

Proposal

The proposed clarification to the legislation is more of a confirmation of the policy position regarding the meaning of 'employee' in section 1 of the ETI Act as well as the requirements needed to be met to be considered a 'qualifying employee' as stipulated in section 6 of the ETI Act. In order to address the above-mentioned contraventions, it is proposed that changes be made in the ETI Act to clarify that substance over legal form will be considered when assessing an employer’s ability to claim the ETI. As such, ‘work’ must actually be performed in terms of an employment contract and the employee must be documented in the employer’s records as envisaged in the record keeping provisions contained in section 31 of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997).

Effective date

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

5.3. Income Tax: Individuals, savings and employment – Clarifying the timing of disposal rules in respect of an asset acquired from a deceased estate

[Applicable provisions: Section 1(1) new definition of 'liquidation and distribution account' and section 25(3) of the Act]

Background

When a person dies, the Estate Duty Act, 1955 (Act No. 45 of 1955) ('the Estate Duty Act') makes provision for the assets of that person, as at the date of death, to be part of a deceased estate, before the assets are distributed to the respective heir(s). Estate Duty is then levied on the net value of a deceased estate in excess of the individual estate duty rebate of R3.5 million. If the dutiable amount of an

estate does not exceed R30 million, Estate Duty is levied at a rate of 20% and at a rate of 25% on the dutiable amount of an estate exceeding R30 million.

The Estate Duty Act also makes provision for the Executors to step into the shoes of the deceased and administer the deceased estate, this includes the preparation and submission of the Liquidation and Distribution Account to the Master of the High Court Office, the submission of the relevant tax returns to SARS (including the payment of the estate duty to SARS). According to South African law, the relevant heir(s) of the estate have a personal right to claim delivery of the assets from the deceased estate after the finalisation of the Liquidation and Distribution Account.

Reasons for change

The South African law requires that the Liquidation and Distribution account lies open for inspection in the Master of the High Court's office for 21 business days. In the event that no objection is lodged against the Liquidation and Distribution account during this 21-day period, the Liquidation and Distribution Account can then be finalised. If any objections are lodged against the Liquidation and Distribution account, the law requires that the Liquidation and Distribution account remains open for inspection for another 21 business days (this 21-day period will be required until such time as no objections are raised).

At issue is a timing uncertainty around when the heirs are regarded as having acquired an asset from the estate of the deceased.

Proposal

In order to clarify the time of disposal of the heir's personal right to claim delivery of the deceased estate assets, it is proposed that changes be made in the legislation so that the disposal of assets by the estate occurs on the date when the Liquidation and Distribution account becomes final.

Effective date

The proposed amendment will come into operation on 1 March 2022 and apply in respect of Liquidation and Distribution accounts finalised on or after that date.

5.4. Income Tax: Individuals, savings and employment – Tax treatment of the cession of the right to receive an asset

[Applicable provision: New section 57B of the Act]

Background

Paragraph (c) of the definition of 'gross income' in section 1(1) of the Act makes provision for a taxpayer to include in gross income any amount received or accrued in respect of services rendered, to be rendered or in respect of employment or the holding of any office. In addition, the proviso to this paragraph also makes provision for any amount received or accrued for the benefit of any person in respect of services rendered or to be rendered by any other person to be deemed to have been received by or to have accrued to the other person. In turn, section 54 of the Act makes provision for donations tax to be levied on the value of any property disposed of, whether directly or indirectly, under any donation by any resident. Section 62 of the Act provides for the value of property disposed of under donations.

Reasons for change

It has come to Government's attention that some taxpayers have devised schemes aimed at undermining the donations tax provisions. These schemes entail a service provider (for example, an employee or independent contractor) ceding the right to receive or use an asset received from the person to whom the services are rendered or to be rendered. The right to receive or use the asset is generally ceded to a family trust before services are rendered.

In these instances, the service provider may be able to circumvent donations tax as the right to receive an asset would have been ceded to the trust before the services are rendered and a value can be attached to it. The argument is that the

service provider is simply disposing of a worthless spes and is therefore not liable for donations tax at the time the services have been rendered and the employer transfers the asset to the cessionary. Moreover, the service provider will not be entitled to the asset and cannot be regarded as having disposed of it.

It may also be argued that the service provider is not subject to the attribution rules in section 7 of the Act or paragraphs 68 to 73 of the Eighth Schedule to the Act because the asset was not donated by the service provider, and the right to the asset was worthless. This argument is addressed by deeming the asset to have been disposed of by the service provider to the other person by way of donation for purposes of section 7 of the Act and paragraphs 68 to 73 of the Eighth Schedule to the Act.

Proposal

In order to address these types of schemes, it is proposed that changes be made in the Act to clarify that instances where a right to receive an asset, which asset would otherwise have been acquired in respect of services rendered or to be rendered, is disposed of, that asset will be deemed to be disposed of under a donation as envisaged in Part V of Chapter II of the Act.

Effective date

The proposed amendment will come into operation on 1 March 2022 and apply in respect of years of assessment commencing on or after that date.

5.5. Income Tax: Individuals, savings and employment – Strengthening anti-avoidance rules in respect of loan transfers between trusts

[Applicable provision: Section 7C of the Act]

Background

The Act contains anti-avoidance measures aimed at curbing the tax-free transfer of wealth to trusts using low interest or interest-free loans, advances or credit that

were first introduced in 2016. The anti-avoidance measures were first introduced when it came to light that taxpayers would transfer growth assets to trusts and allow for the purchase price that the trust owes in respect of the assets to be left outstanding as a loan, advance or credit in favour of that taxpayer on which no interest or very low interest is charged. As an alternative, taxpayers would also advance a low interest or interest-free loan, advance or credit upfront to a trust in order for the trust to use the money to acquire assets.

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

As recent as 2020, Government made further changes to curb the use of further schemes that avoided the application of the anti-avoidance measures by way of natural persons subscribing for preference shares with no or a low rate of return in a company owned by a trust that is a connected person to those individuals. The use of preference share funding avoided the application of the anti-avoidance rules as the 2017 changes only applied in respect of loans made available to a company that is owned by a trust that is a connected person in relation to the natural person advancing that loan or credit.

Reasons for change

It has come to Government's attention that further schemes are being devised to increase the base cost of high value trust assets and in particular, shares in off-shore companies. These schemes result in loan arrangements between South

African trusts that are not subject the antiavoidance measures. The features of the schemes are as follows:

Step 1: Shares in a foreign company held by a family trust (which is established in South Africa) are bought back on loan account.

It has come to light that the share capital of the foreign company would be minimal but it would have significant amounts of undistributed reserves. Under some foreign legislation, e.g. the Cayman Islands Company law, the buy-back is not treated as a dividend or a distribution by the company. Therefore, there is no foreign dividend or foreign return of capital.

Step 2: Through journal entries and principles of set-off, the buy-back amount is used to capitalise new foreign companies held by a trust.

Under step 2, there are no cash flows nor any money inflow into South Africa. The scheme enables taxpayers to rebase the cost of foreign capital assets for the family through the capitalisation of new foreign companies.

Step 3: As a final step, the loan claim (reflecting the amount owed by the original foreign company is to the trust in respect of the share buy-back) is disposed of to another trust in which the relatives of the founder of the first trust are beneficiaries or the founder.

This disposal is effected in terms of an interest free loan account.

Proposal

It is proposed that further changes be made to the anti-avoidance measures for trusts in order to curb the use of these new avoidance schemes that result in interest free loan arrangements between trusts and thus avoid the application of the current anti-avoidance measures that only apply to loans advanced to trusts by the natural person or at the instance of the natural person, to companies owned by certain trusts. As such, changes are proposed to ensure that the anti-avoidance measures also apply in respect of any loan, advance or credit that a trust, directly

or indirectly provides to a trust in relation to which, its beneficiaries or the founder are connected persons in relation to the founder or beneficiaries of the trust that provided the loan, advance or credit.

Effective date

The proposed amendments will come into operation on the date of the publication of draft Taxation Laws Amendment Bill, 2021 for public comment and apply in respect of any amount owed by a trust in respect of a loan, advance or credit provided to that trust, before, on or after that date.

5.6. Income Tax: Individuals, savings and employment – Allowing members to use retirement interest to acquire annuities on retirement

[Applicable provisions: Paragraph (b)(ii) of the proviso to the definition of "retirement annuity fund", paragraph (ii)(dd) of the proviso to the definition of "pension fund", paragraph (e) of the definition of "pension preservation fund", paragraph (ii)(dd) of the proviso to the definition of "provident fund" and paragraph (e) of the definition of "provident preservation fund" in Section 1(1) of the Act]

Background

In accordance with the proviso to the definition of "retirement annuity fund", paragraph (ii)(dd) of the proviso to the definition of "pension fund", paragraph (e) of the definition of "pension preservation fund", paragraph (ii)(dd) of the proviso to the definition of "provident fund" and paragraph (e) of the definition of "provident preservation fund" in section 1(1) of the Act, any member retiring from a retirement fund is, upon retirement, allowed to receive a maximum of one third of the total value of the retirement interest as a lump-sum. The remainder of the retirement interest may be utilised to purchase or provide an annuity (including a living annuity).

The annuity can be provided by the retirement fund in one of three ways, namely, the annuity can be:

- paid directly by the retirement fund to the member,
- purchased from a South African registered insurer in the name of the fund, or
- purchased by the retirement fund from a South African registered insurer in the name of the life of the retiring member.

Reasons for change

If a member of a retirement fund opts to receive an annuity, the full value of the member's retirement interest following commutation is to be used to provide either of the above-mentioned annuities. Therefore, a member is prohibited from utilising the retirement interest to acquire various annuities. The above-mentioned prohibition limits flexibility in relation to the types of annuities a member can purchase with their retirement interest following commutation.

Proposal

In order to increase flexibility for a retiring member and maximise the retirement capital available to provide for annuities, Government proposes expanding the types of annuities a member can purchase upon retirement. For example, the full value of the member's retirement interest following commutation can therefore be utilised to purchase a combination of living and guaranteed annuities. In turn, the portion of the retirement interest utilised to purchase each type of annuity must exceed R165 000. The R165 000 threshold is required to curb the circumvention of prevailing legislation.

Effective date

The proposed amendment will come into operation on 1 March 2022 and apply in respect of annuities purchased on or after that date.

5.7. Income Tax: Individuals, savings and employment – Applying tax on retirement fund interest when an individual ceases to be a tax resident

[Applicable provisions: Section 9H and new section 9HC of the Act]

Background

Prior to 1 March 2021, the definitions of “pension preservation fund”, “provident preservation fund” and “retirement annuity fund” in section 1(1) of the Act made provision for a payment of lump sum benefits when a member of a pension preservation, provident preservation or retirement annuity fund withdraws from the retirement fund as a result of that member emigrating from South Africa, and such emigration is recognised by the South African Reserve Bank (SARB) for exchange control purposes.

In 2020, changes were made to the tax legislation to make provision for the efficient application of the tax provisions as a result of the removal of the concept of “emigration” for exchange control purposes due to the modernisation of the South African foreign exchange control system. As a result, changes were made to the definitions of “pension preservation fund”, “provident preservation fund” and “retirement annuity fund” in section 1(1) of the Act to remove the reference to the payment of lump sum benefits when a member emigrates from South Africa and such emigration is recognised by the SARB for exchange control purposes. Consequently, with effect from 1 March 2021, a member who ceases or ceased to be a South African tax resident (as defined in the Act) will only be able to withdraw his or her interest in a retirement fund before retirement date when that member has been non-tax resident for three consecutive years or longer.

When an individual ceases to be a South African tax resident, a member’s interests in retirement funds are, due to the provisions of certain treaties, not always subject to tax in terms of the Act. In contrast, for example, when an individual ceases to be a South African tax resident, but retains his or her investment in a South African retirement fund, and only withdraws from the retirement fund when he or she dies

or retires from employment, section 9(2)(i) of the Act deems such amounts to be from a South African source, thus remaining within the South African tax jurisdiction, despite the individual no longer being a South African tax resident.

Reasons for change

When an individual ceases to be a South African tax resident before he or she retires and becomes a tax resident of another country, that individual's interest in a retirement fund may be subject to tax in the other country. The application of a tax treaty between South Africa and the new tax resident country may in some instances result in South Africa forfeiting its taxing rights.

Withdrawals from retirement funds by individuals who remain tax resident in South Africa will be taxable when the member either retires, dies or makes a pre-retirement withdrawal. Based on the fact that contributions to retirement fund are deductible when calculating the members annual taxable income, Government wishes to ensure neutrality of tax treatment for all types of withdrawals (irrespective of the individual's tax residency status at withdrawal).

In instances where South African tax residency is ceased, Government further wishes to ensure that there is a mechanism in place that ensures that tax is calculated on the correct value as there will be a lag between the time when tax residency is ceased and withdrawals from the retirement fund are possible and tax is due (this in light of the 2020 amendments to the definitions of "pension preservation fund", "provident preservation fund" and "retirement annuity fund").

Proposal

To address this anomaly, it is proposed that changes be made in the tax legislation to ensure that when an individual ceases to be a South African tax resident, interests in retirement funds are subject to taxation in South Africa at the same tax rates applicable to either a withdrawal benefit or a retirement benefit.

In order to establish an appropriate tax base, Government proposes that, regardless of the individual's intentions at the time, the value of the interest in the fund be determined on the day before residency is ceased. The onus of ensuring a

valuation of from the fund on that date, as well as notifying SARS that they have ceased being a South African tax resident will rest with the individual.

As a result, Government proposes that the following two-pronged approach applies:

A. When an individual ceases to be a South African tax resident, and withdraws his or her interest in the retirement fund from a South African retirement fund prior to retirement or death

- The individual will be deemed to have withdrawn from the fund on the day before he or she ceases to be a South African tax resident as envisaged in the Act.
- The interest in the retirement fund will form part of the assets of the individual subject to tax applicable to withdrawal benefits, however, the tax payment (including associated interest) will be deferred until a withdrawal payment is receivable from the retirement fund.
- When the individual receives a payment from the retirement fund, the tax on the withdrawal benefit will be calculated based on the prevailing withdrawal tax tables.
- A tax credit will be provided for the deemed tax as calculated when the individual ceased to be a South African tax resident.

B. When an individual ceases to be a South African tax resident, but retains his or her investment in a South African retirement fund, and only withdraws his or her interest in the fund when he or she dies or retires from employment

- The individual will be deemed to have withdrawn from the fund on the day before he or she ceases to be a South African tax resident as envisaged in the Act.
- The interest in that retirement fund will form part of the assets of the individual subject to tax applicable to withdrawal benefits, however,

the tax payment (including associated interest) will be deferred until payments are receivable from the retirement fund.

- When the individual ultimately receives payments from the retirement fund, the tax on those payments will be calculated based on the prevailing retirement fund lump sum tax tables or in the form of an annuity.
- A tax credit will be provided for the deemed tax as calculated when the individual ceased to be a South African tax resident.

Effective date

The proposed amendments will come into operation on 1 March 2022 and apply in respect of years of assessment commencing on or after that date.

5.8. Income Tax: Individuals, savings and employment – Transfers between retirement funds by members who are 55 years or older

[Applicable provisions: Paragraph (e) of the definition of "gross income", paragraph (a) of the definitions of "pension preservation fund" and "provident preservation fund", paragraph (e) of the definitions of "pension preservation fund" and "provident preservation fund" in Section 1(1) of the Act, read with paragraphs 2(1)(c) and 6A of the Second Schedule to the Act]

Background

Paragraph (e) of the definition of "gross income" in section 1(1) of the Act includes retirement fund lump sum benefits as referred to in paragraph 2(1)(c) of the Second Schedule to the Act in an individual's taxable income. Paragraph 2(1)(c) of the Second Schedule regulates the amount to be included in gross income for any year of assessment, namely, any amount transferred for the benefit of a member of a retirement fund scheme on or after normal retirement age (as defined in the rules

of the fund), but before retirement date (as defined in section 1(1) of the Act), less any deductions allowed under paragraph 6A of the Second Schedule to the Act.

Paragraph 6A of the Second Schedule permits the following deductions when calculating the retirement lump sum benefit to be included in gross income:

- Transfers from a pension fund into a pension preservation fund or a retirement annuity fund or;
- Transfers from a provident fund into a pension preservation fund, a provident preservation fund or a retirement annuity fund.

Reasons for change

In the event that a member of a pension preservation or provident preservation fund (who has reached normal retirement age in terms of the fund rules but has not yet opted to retire from the respective fund) makes a transfer into a similar fund, such transfer would be taxable in the individual's hands. This is due to the fact that the current wording of paragraph 2(1)(c) of the Second Schedule includes these transfers in gross income, while paragraph 6A of the Second Schedule fails to provide a deduction for such transfers.

As a result, any individual transfers between preservation funds where the transfer is between similar funds and the member involved has reached normal retirement age in terms of the fund rules but has not yet opted to retire from the relevant fund will be subject to tax, this despite the fact that the policy intention is not to tax transfers from a less to a more restrictive fund, or between similar funds.

Proposal

Government proposes addressing this anomaly by allowing for tax-free transfers from a preservation fund into similar funds by members who have already reached normal retirement age.

Effective date

The proposed amendment will come into operation on 1 March 2022 and apply in respect of years of assessment commencing on or after that date.

5.9. Income Tax: Individuals, savings and employment – Clarifying the calculation of the fringe benefit in relation to employer contributions to a retirement fund

[Applicable provisions: Paragraphs 2(l) and 12D of the Seventh Schedule to the Act]

<u>Background</u>

With effect from 1 March 2016 and in terms of paragraph 2(l) of the Seventh Schedule to the Act, all employer contributions to a retirement fund on behalf of employees are considered taxable fringe benefits in the employees' hands. In turn, paragraph 12D(2) of the Seventh Schedule stipulates that if the employer contributes towards a fund that consists solely of a 'defined contribution component', as defined in paragraph 12D(1) of the Seventh Schedule, the value of the fringe benefit will be the cash equivalent of that part of the contribution that pertains to that employee. Further to the above, the employer is not required to provide the employee with a contribution certificate. In contrast, paragraph 12D(3) of the Seventh Schedule determines that the value of the taxable benefit in relation to employer contributions containing a 'defined benefit component' or an 'underpin component', as defined in paragraph 12D(1) of the Seventh Schedule, is to have the value calculated in accordance with the prescribed formula. In this instance, the employer is required to provide the employee with a contribution certificate.

That said, the paragraph (b) of the definition of 'defined contribution component' in paragraph 12D(1) of the Seventh Schedule to the Act would include a benefit or part of a benefit receivable from a pension fund, provident fund or retirement annuity fund that consists of a risk benefit provided by the fund directly or indirectly for the benefit of a member of the fund, if the risk benefit is provided solely by means of a policy of insurance.

<u>Reasons for change</u>

It has come to Government's attention that an anomaly arises in instances where a retirement fund provides both a retirement benefit in relation to the 'defined

contribution component' and a self-insured risk benefit. The current wording of the Act would result in the classification of the total contribution to the said fund as a defined benefit component, subject to valuation in terms of the formula contained in paragraph 12D(3) of the Seventh Schedule to the Act as well as the issuance of a contribution certificate. This due to the fact that self-insured risk benefits are not considered a defined contribution component.

Proposal

In order to address this anomaly, it is proposed that changes be made in the legislation so that self-insured risk benefits are classified as a 'defined contribution component'. This would ensure that retirement funds that provide both defined contribution component retirement benefits and self-insured risk benefits can account for the fringe benefit based on the actual contribution. As a result, the value of the risk premiums under self-insured risk benefits will be determined based on the cost to the employer (i.e. the actual contribution made by the employer).

Effective date

The proposed amendment will come into operation on 1 March 2022 and apply in respect of years of assessment commencing on or after that date.

5.10. Income Tax: Business (General) – Strengthening the rules dealing with limitation of interest deductions in respect of debts owed to persons not subject to tax

[Applicable provisions: Sections 23M and 23N of the Act]

Background

In 2013, the rules dealing with the limitation of interest deductions in respect of debts owed to persons not subject to tax were introduced in section 23M of the Act. These rules were effective from 1 January 2015 and apply in respect of amounts of interest incurred on or after that date. The main aim of these rules is to limit

excessive interest deductions in respect of debts owed to persons not subject to tax in South Africa, if the debtor and the creditor are in a controlling relationship. In particular, these rules apply as follows:

A. Meaning of the term "interest" for purposes of these rules

Currently, for the purposes of these rules, the term "interest" means interest as defined in section 24J. This implies that these rules are only applicable to interest as defined in section 24J.

B. Deductible interest limitation: Formula calculation

When these rules were first introduced in 2013, the aggregate deduction for interest incurred in respect of a debt owed under the circumstances set out above was based on an annual limitation determined according to a formula as defined section 23M(3). In this regard, the aggregate deductions for these amounts was limited to the sum of:

- The total interest received or accrued to the debtor; and
- 40% of adjusted taxable income;
- Reduced by interest incurred in respect of debts owed (other than debts to creditors in a controlling relationship).

The term 'adjusted taxable income' was defined as taxable income of the debtor less interest received or accrued, net income included in terms of section 9D (controlled foreign company net income), and recoupments in respect of capital assets; with the addition of interest incurred and all capital allowances. In illustrative terms, 'adjusted taxable income' included the following:

Starting point	Taxable income
Less	Interest received or accrued CFC net income Recoupments
Plus	Interest incurred Capital allowances

At the time, the 40% deduction formula was based on the assumption of relatively low national interest rates. It was set to increase if the national repo rate exceeded 10% as follows:

(40%) x repo rate / 10

Interest expense in excess of the limitation was not deductible in the year of assessment, but was carried forward to the following year of assessment.

In 2014, before these rules came into effect, changes were made to the term 'adjusted taxable income' to exclude current year and previous years' assessed losses carried forward from the current year's adjusted taxable income. Currently, 'adjusted taxable income' calculated as follows:

Starting Point	Taxable Income
Less	Interest received/accrued CFC net income
	Recoupments
Plus	Interest incurred
	Capital allowances
	Assessed losses

Changes were also made to the 40% deduction formula in order to be more closely aligned to the cost of debt financing in the market. The limitation – expressed as a percentage of the tax equivalent of "earnings before interest, taxation, depreciation and amortisation" (EBITDA) – was changed to adjust up and downwards based on the prevailing repo rate. The formula was amended to link deductible interest expenditure to the average repo rate for the year, regardless of whether the repo rate exceeds 10%. The formula became flexible so that any change to the average repo rate for the year of assessment (together with a 400-basis point addition to the average repo rate) is reflected to allow for a balanced reflection of market conditions on the interest deduction limitation. To protect the fiscus and tax base in periods of high interest rates, a cap on the interest deduction limitation ratio of 60% was inserted.

These changes were made to recognise taxpayer's concerns. However, Government did point out at the time – in public consultations, on page 22 of the Explanatory Memorandum to the 2014 TLAB, and on page 13 of the 2014 Response Document to the 2014 TLAB – that available data indicated that 40% was too high. Given that this was based on financial accounting information from Statistics South Africa, and not micro-level tax data from SARS, it was decided to retain the 40% starting point with a flexible formula, but that this would be subject to review.

C. Back-to-back loans

Currently, section 23M(2) makes provision for these rules to apply to back-to-back loans. As indicated above, the ordinary scenario of application contained in section 23M(2)(a) makes provision for these rules to apply to loans to a debtor from a creditor that is in a controlling relationship with that debtor.

To address the use of back-to-back lending arrangements that would avoid the application of the interest limitation rules, section 23M(2)(b) makes provision for these rules to also apply to loans made to a debtor from a creditor that is not in a controlling relationship with that debtor if that creditor obtained the funding for the debt advanced to the debtor from a person that is in a controlling relationship with that debtor.

D. Refining the amount of interest deduction for REITS: Changes to the definition of Adjustable Taxable Income

Currently, section 23M provides no distinct treatment for REITs (defined in section 1(1) of the Act and which are subject to a specific tax regime under section 25BB of the Act).

E. Interaction between the level of withholding tax on interest in terms of tax treaties and application of section 23M rules

Currently, one of the requirements for section 23M to apply is that the amount of interest incurred is not subject to tax in the hands of the recipient. In instances where the corresponding interest income is subject

to tax in the hands of the recipient, the tax rate varies from 5% (if the withholding tax on interest has been reduced by a treaty) to the corporate tax rate. This means that some taxpayers are not subject to the limitation even though the interest income is taxed at very low rates.

Reasons for change

On 26 February 2020, Government published a discussion document titled "Reviewing the Tax Treatment of Excessive Debt Financing, Interest Deductions and Other Financial Payments" to conduct a review of the current rules dealing with the limitation of interest deductions in respect of debts owed to persons not subject to tax, in line with the OECD/G20 BEPS Action 4 recommendations on interest deductions. The review highlighted the following issues that are problematic in the current rules.

A. Meaning of the term "interest" for purposes of these rules

Relative to the OECD/G20 BEPS recommendations, the existing rules are narrow. The meaning of interest for the purposes of these rules is narrowly defined and does not consider avoidance scenarios where interest can be labelled as other types of payments to circumvent the application of these rules.

B. Deductible interest limitation: Formula calculation

As noted above, available data during 2014 showed that the 40% starting point may be too high and should be subject to review.

The OECD/G20 BEPS Action 4 Report recommends that countries use a fixed ratio of earnings to limit the deduction of excessive interest deductions and other financial payments. To recognise that countries having different interest rate and risk environments, the Report recommends a corridor approach where countries consider a range of factors to assess which percentage of earnings would be most appropriate for their economies.

South Africa's current rules are unique in that no other country uses a formula to determine the limitation as a percentage of earnings. All

developed and developing countries that have such rules apply a fixed ratio of earnings. In 2014, internal analysis indicated that a ratio of 30% would have been more appropriate than 40%. Available data indicated that the average net interest expense / EBITDA ratios were just above 15%, and this was at a time when prevailing interest rates were higher than what they are currently.

More recently, analysis using SARS micro-level data for all taxpayers shows that applying a fixed ratio of 30% would be fair in that the majority of taxpayers will be able to deduct all their interest and equivalent payments without restriction. In contrast to the proposal in the Discussion Document, the rules will continue to apply to interest payments between taxpayers where there is a controlling relationship (including back-to-back arrangements), rather than applying to total interest expense.

Furthermore, with the indefinite carry-forward being retained for now, no interest expense deductions will expire. While Government was considering imposing a restriction on the carry forward, it was decided that this would be too punitive in conjunction with the proposed restriction on the offset of assessed losses in determining taxable income. The stance on the ability to carry forward excess interest deductions will be reviewed after 5 years. From a policy perspective – if interest payments are considered to be excessive, allowing an indefinite carry forward is a contradiction to the policy aim. However, Government recognises that not all business's investment and profit patterns follow the same time horizons and that those with longer timeframes between investing and yielding taxable profits would be worse off if a time limit was imposed.

Introducing a fixed ratio limitation of 30% based on adjusted taxable income does not result in much change given that the existing formula yields in a 30% restriction.

C. Back to back loans

It has come to Government's attention that the current rules give rise to anomalous results in the case of some back-to-back lending arrangements. The back-to-back lending arrangements of concern involve loans that are channelled between two or more tax paying companies that are ultimately owned by another company that is not subject to tax in South Africa (e.g. a resident taxexempt entity). Under these back-to-back lending arrangements, which are often entered into by a chain of companies that are in controlling relationships with each other, the fiscus ends up bearing a much larger interest deduction as a result of the net effect of these back-to-back lending arrangements. The interest limitation rules are effectively side stepped under these arrangements as the rules apply where there is a controlling relationship and the interest incurred is not subject to tax in the hands of the person to which it accrues. In these arrangements, a company that is subject to tax receives the interest income from the debtor and pays a slightly smaller amount in interest expense to a company that is not subject to tax on the corresponding interest income.

D. Refining the amount of interest deduction for REITS: Changes to the definition of Adjustable Taxable Income

In general, a REIT or a controlled company is not taxed on the income it derives due to a deduction for qualifying distributions made by it. In certain instances, the deduction of a qualifying distribution may result in zero-taxable income for a REIT or controlled company.

Section 23M of the Act limits the deductibility of interest incurred in respect of loan funding advanced between any "debtor" that obtains funding, directly or indirectly, from a creditor that is in a "controlling relationship" with the debtor. At issue is that the deduction for qualifying distributions will distort their "tax EBITDA" and will result in them having a much lower "tax EBITDA" than other taxpayers.

E. Interaction between the level of withholding tax on interest in terms of tax treaties and application of section 23M rules

The current wording in section 23M can create a perverse incentive that encourages companies to route their interest payments via countries with the lowest interest withholding tax rate (as a result of the application of tax treaties) that exceeds zero (i.e. 5%). Doing so yields two benefits for a taxpayer: (i) the interest payment is not subject to 23M; and (ii) the WHT on interest at a rate of 5% is more favourable than the standard rate of 15%.

Proposal

Based on the above, Government proposes the following:

A. Meaning of the term 'interest' for purposes of these rules

It is proposed that for the purpose of these rules, the meaning of the term 'interest' should be expanded beyond the current definition of interest contained in section 24J, to include the following:

- Payments under interest rate swap agreements

  These agreements involve one party simply swapping one stream of interest expense (e.g. fixed rate payments) for another party's stream (e.g. variable rate payments). To curb circumvention of the application of these rules, Government proposes to include payments under interest rate agreements as defined in section 24K(1) of the Act in the definition of the term 'interest' for purposes of these rules. This is applicable for both payments incurred and received.

- Finance cost element included in finance lease payments

  The proposed amendment will limit the deduction of the finance cost element included in finance lease payments to persons where there is a controlling relationship. The current tax treatment for finance leases will continue to apply, except that the finance cost element will be grouped with other interest income and payments subject to

section 23M, and only in cases where there is a controlling relationship.

- Foreign exchange differences

  It is proposed that foreign exchange gains and losses taken into account in determining taxable income in terms of section 24I(3) and (10A) should be included in the definition of 'interest' for purposes of these rules.

B. Deductible interest limitation: Formula calculation

It is proposed that changes be made to the deduction formula as follows:

- The deduction of interest expenditure should be limited to 30% of 'adjusted taxable income' instead of the current calculated percentage of 'adjusted taxable income'. Therefore, part of the deduction formula in section 23M(3)(b), which adjusts up and downwards based on the average repo rate for the year will be deleted.
- In view of the fact that the part of the formula that refers to the average repo rate and repo rate is deleted, consequential amendments should be made in section 23M(1) to delete the definitions of 'average repo rate' and 'repo rate'.
- Consequently, the deduction formula provided for in section 23N(3) and (4) will be amended in line with the deduction formula in section 23M(3)(b) as set out above.
- Similarly, the definitions of 'average repo rate' and 'repo rate' in section 23N will be deleted.

C. Back-to-back loans

To curb the circumvention of the rules applicable to back-to-back loans, it is proposed that changes be made in the current provisions of section 23M(2) so that the interest limitation rules apply in instances where a debtor incurs

an amount of interest owed to a creditor that is in a controlling relationship with that debtor, if that creditor, directly or indirectly through another creditor that is in a controlling relationship with that creditor, obtained the funding for the debt advanced to the debtor from a person that is in a controlling relationship with that creditor and that other creditor and would not be taxed on interest accrued.

D. Refining the amount of interest deduction for REITS: Changes to the definition of Adjustable Taxable Income

It is proposed that a change be made in the definition of 'adjustable taxable income' in section 23M(1) to take into account a 'qualifying distribution' of a REIT. As such, calculating 'adjusted taxable income' requires the following:

Starting Point	Taxable Income
Less	Interest received/accrued
	CFC net income
	Recoupment
Plus	Interest incurred
	Capital allowances
	Assessed losses
	Deductible 'qualifying distribution' of a REIT or controlled company

E. Interaction between the level of withholding tax on interest in terms of tax treaties and application of section 23M rules

It is proposed that changes be made in the legislation so that there is a more consistent treatment for all resident debtors paying interest, and so that the restriction is not dependant on which country the payment is routed through.

In instances where a resident debtor makes an interest payment and either the payment attracts WHT on interest at a rate of zero or it is not included in

the recipient's income, the deduction for interest expense will be subject to section 23M as under the current rules.

For cases where a resident debtor makes an interest payment and the payment attracts WHT on interest at a rate higher than zero, a portion of the deduction for interest expense will be subject to section 23M.

For example, if a resident debtor pays R100 of interest to a non-resident creditor (and there is a controlling relationship), and the relevant treaty reduces the WHT rate to 5%. The debtor can fully deduct 5/28ths of the interest expense and the remaining interest amount will be subject to the section 23M limitation. In this example, the amount subject to section 23M would be (28- 5)/28 x 100, which equals R82.14.

From a review of a variety of countries, it appears that most apply interest limitation rules regardless of how the corresponding interest income is treated or whether withholding taxes apply. This appears to be the case for many countries, including the United States, Germany, India and African countries that choose to adopt the drafting guidelines published by the African Tax Administrative Forum. Should Government follow this approach, the only consideration for being subject to section 23M would be whether there is a controlling relationship or not.

The Act has precedent for introducing the proposed change. The extent to which taxpayers can deduct tainted royalties depends on the rate of WHT applied. The basis is slightly different as one portion is denied, rather than limited, but this is because Government funding was often used to fund the intellectual IP that was moved offshore. For these reasons, this is considered the most equitable approach for the revised rules.

Effective date

The proposed amendments will come into operation on 1 April 2022 and apply in respect of years of assessment commencing on or after that date.

5.11. Income Tax: Business (General) – Restricting the set-off of the balance of assessed losses in determining taxable income

[Applicable provision: Section 20(1) of the Act]

Background

In determining taxable income, section 20 of the Act enables taxpayers to set off their balance of assessed losses carried forward from the preceding tax year against their income. An unutilised assessed loss balance may be carried forward to future years of assessment to be set off against future income (provided that the taxpayer's trade continues without interruption). Accordingly, taxpayers will only be liable for income tax once they have earned a taxable profit and their assessed loss balance is depleted.

The purpose of providing for the deductibility of assessed losses for corporate taxpayers is to smooth the tax burden for companies whose primary business is cyclical in nature and not in line with a standard tax year, and for start-up companies that are not profitable in the early years of trading.

Even so, there has been a global trend to restrict the use of assessed losses carried forward. In 2015, out of a group of 34 OECD and non-OECD countries, 16 countries limit carry-forward periods to between 3 and 20 years, while 8 countries limit the amount of tax losses that can be offset in any given year. The latter are restricted to a percentage of either taxable income (ranging from 50 to 80%) or accumulated assessed losses (ranging from 25 to 50%) per year. The Slovak Republic, for instance, uses two restrictions – assessed losses can be carried forward for 5 years and the maximum set-off against taxable income is 50% of the tax base.

Restricting the use of assessed losses is not unique to OECD countries. In Brazil, revenue tax losses may be carried forward indefinitely, but may only reduce up to 30% of taxable income in one tax period. Russian companies can carry forward operating tax losses indefinitely and, until the start of 2021, these could only be

offset against up to 50% of the annual tax base. India and China both use time limits – India has a time limit of 8 years for setting off business losses, while losses in China can be carried forward for 5 years (10 years for new / high-tech / small and medium technology enterprises). With respect to neighbouring countries, Botswana and Mozambique both restrict the time period for carrying forward assessed losses to 5 years (with the exception of mining and prospecting in Botswana).

Reasons for change

Over the past few years, there has been an international trend to restrict the use of assessed losses and reduce the corporate income tax rate. To improve the country's competitiveness, reduce the appeal of base erosion and profit shifting, encourage investment and promote economic growth, the Minister of Finance announced (in the 2020 Budget Review) Government's intention to restructure the corporate income tax system over the medium term by broadening the base and reducing the corporate income tax rate in a revenue neutral manner.

Restricting the use of assessed losses against taxable income provides some of the fiscal space required to lower the rate and, as a result, forms part of a corporate income tax package to broaden the base and reduce the headline corporate tax rate in an overall revenue neutral manner.

There are four reasons for continuing with this proposal as announced in the 2020 Budget Review:

- As stated, it forms part of a corporate income tax package to broaden the base and reduce the headline corporate income tax (CIT) rate in an overall revenue neutral manner. Restricting the offset of accumulated assessed losses against taxable income provides some of the fiscal space required to lower the rate.
- While allowing full loss offsets against taxable income allows for less distortions towards less risky projects and enhances the stabilisation effects of corporate income taxation, a number of other countries do not achieve perfect symmetry in their CIT regimes and have used this type of measure

as a means to fund lowering CIT rates.

- CIT is the most volatile of the main tax revenue instruments and this measure will assist in smoothing CIT revenues. A minimum tax would also achieve this function, but would be more punitive in that it would apply to businesses that make a taxable loss in the current year. This proposed measure will only apply once businesses turn profitable.
- While partial loss offsets may have a negative impact on business' cash flow and investment, they can help in curtailing tax avoidance. Given the time value of money, there is less incentive to overstate losses.

The following three methods are used by various countries to restrict the use of assessed losses:

(i) limiting the carry-forward periods to a set number of years;

(ii) basing a restriction on a specified percentage of accumulated assessed losses that may be used to reduce taxable income; and

(iii) restricting the set off of accumulated assessed losses to a specified percentage of taxable income.

Some countries also combine a restriction based on a set number of years with a restriction based on either a percentage of accumulated losses or taxable income.

The time-bound limit has a large effect on both symmetry and stabilisation and has an uneven effect across businesses depending on their business models. Those with long lead times between upfront investment and the realisation of income and profits (e.g. mining) would be worse off than those with shorter periods in a loss position.

Restricting the amount of assessed losses to be offset does not discriminate against varying business models and would affect a larger share of businesses. With respect to choosing between basing the amount on a percentage of the accumulated assessed loss itself or on taxable income, research shows that defining the offsetting restriction in relation to accumulated losses can have a more negative impact on symmetry and stabilisation compared to using taxable income

as the reference point. This is because the latter allows the full balance of assessed losses to be exhausted assuming an indefinite carry forward.

Based on research and the desire to work towards an efficient corporate tax regime with a broad base and lower rate, placing a restriction on a high share of taxable income is seen as the most appropriate policy stance for South Africa to balance the effects for businesses and government. This is viewed as a reasonable approach that affects all businesses more equally, rather than restricting the number of years for carrying forward assessed losses, which would disproportionately hurt businesses with large initial investments or long lead times to profitability.

South Africa has no provision for carrying back losses (against prior year taxable income). This type of measure has been used in economic downturns and some countries have done so (many on a temporary basis) to alleviate the negative economic impact of the Covid-19 pandemic on previously profitable companies.

Research shows that, for depreciation schedules which are not too accelerated, carry-backs are an effective policy to help with symmetry and stabilisation. South Africa's depreciation schedules are predominantly accelerated – particularly in the primary and secondary sectors where large capital investments are common, such as mining, agriculture and manufacturing. In addition, there is not sufficient fiscal space to provide businesses with this option. Most of the countries that offered temporary loss carry-backs are developed countries with more room for expansionary fiscal measures.

Proposal

In line with the 2020 Budget announcement, government proposes to broaden the corporate income tax base by restricting the offset of the balance of assessed losses carried forward to 80% of taxable income.

The proposal extends to the balance of assessed losses at the time of implementation, i.e. it is not only the accumulation of losses starting from the date of implementation that will be subject to the new rules. This will contribute to providing the fiscal room for government to lower the corporate tax rate.

The effect of the proposed restriction is that only companies that would be in a positive taxable income position before setting off the balance of assessed losses would be affected.

The table below provides an overview of four potential combinations of taxable profit / loss positions combined with whether there is an assessed loss balance or not.

Group:	**Current Year:**	**Accumulated assessed loss**
A	Taxable profit (before setting off assessed loss balance)	No assessed loss balance
B	Taxable profit (before setting off assessed loss balance)	Assessed loss balance
C	Taxable loss (before setting off assessed loss balance)	No assessed loss balance
D	Taxable loss (before setting off assessed loss balance)	Assessed loss balance

Those in groups A, C and D will not be affected by the proposed restriction on assessed losses.

It is only companies in group B that will be potentially affected.

Within Group B, if the company's accumulated assessed loss balance exceeds 80% of its taxable income, the company will be required to pay corporate income tax on 20% of its current-year taxable income.

The examples below illustrate how three different companies in Group B would be affected – all of which have years of assessment starting on/after 1 April 2022 and would be in a positive taxable income position before offsetting any prior year

losses.

Example 1

Company B1 has a year of assessment starting on 1 April 2022. It has R500 of taxable income before offsetting accumulated losses of R1,000. The accumulated loss balance exceeds current year taxable profit – and, by implication, is more than 80% of taxable income. Company B1 will be required to pay corporate income tax on the portion of its current-year taxable income that exceeds 80% of taxable income (i.e. on 20% of taxable income). As a result, Company B1 will be required to pay CIT of R28 (CIT rate of 28% applied to taxable income of R100). The remaining balance of the assessed loss can be carried forward to the following year of assessment.

Example 2

Company B2 has a year of assessment starting on 1 July 2022. It has taxable income of R500 prior to setting off assessed losses of R475. The balance constitutes 95% of current-year taxable income – exceeding the proposed 80% restriction. As a result, Company B2's assessed loss balance which can be set off against its taxable income will be limited to R400 (80% of its taxable income), with the remaining balance of R75 carried forward to future years. Company B2 will pay CIT of R28 (CIT rate of 28% applied to taxable income of R100).

Example 3

Company B3 has a year of assessment starting on 1 October 2022. It also has taxable income of R500 before offsetting the assessed loss balance. However, its assessed loss balance is R200, which is less than 80% of taxable income. Company B3 will be able to use its total assessed loss balance of R200 to reduce its taxable income.

AL restriction	80%	80%	80%
Company	B1	B2	B3
Existing regime			
Taxable income	R500	R500	R500
Assessed loss balance b/f	R1 000	R475	R200
Taxable income	-	R25	R300
CIT @ 28%	-	R7	R84
AL balance c/f	R500		
Proposed regime			
Taxable income	R500	R500	R500
80% of taxable income	R400	R400	R400
Assessed loss balance b/	R1 000	R475	R200
% of taxable income	200%	95%	40%
Taxable income	R100	R100	R300
CIT @ 28%	R28	R28	R84
AL balance carried forward	R600	R75	-
Change in tax liability			
CIT pre-change (no restriction on assessed loss balance)	-	R7	R84
CIT post-change (restriction on assessed	R28	R28	R84

loss balance)			
Difference	R28	R21	-

Effective date

The proposed amendment will come into operation on 1 April 2022 and apply in respect of years of assessment commencing on or after that date.

5.12. Income Tax: Business (General) – Clarifying the definition of contributed tax capital

[Applicable provision: section 1(1) of the Act – 'contributed tax capital' definition and the insertion of a further proviso to the definition]

Background

The concept of contributed tax capital (CTC) was introduced in the Act in 2008. The CTC of any company is a notional and ring-fenced amount derived from contributions made to a company by holders of a class of shares as consideration for the issue of that class of shares by that company. It is reduced by any capital amount that is subsequently transferred back by the company to one or more shareholders of that class of shares (commonly known as a capital distribution) utilising the notional tax amount so received.

Reasons for change

The policy rationale of this provision and the wording of the current proviso to the definition of CTC the legislation specifically requires that no holder of shares within a particular class of shares may receive CTC in excess of an amount per share derived by dividing the total CTC by the number of shares in that class immediately before that distribution. However, it has come to Government's attention that some companies are exploiting the current provisions of the CTC by allocating CTC on the basis of an alleged 'share premium' contributed by a particular shareholder but not to all shareholders holding shares in the same class of shares.

Proposal

In order to curb this abuse, it is proposed that changes be made to the definition of CTC to clarify the principle that shareholders within the same class of shares should equally, in relation to their shareholding, share in the allocation of CTC as a result of distribution.

Effective date

The proposed amendments will be deemed to have come into effect on the date of publication of the 2021 Draft TLAB for public comment.

5.13. Income Tax: Business (General) – Limiting potential for double taxation under the hybrid debt anti-avoidance rules

[Applicable provision: Sections 8F, 8FA and 50A of the Act]

Background

The Act contains specific anti-avoidance rules in section 8F and section 8FA dealing with hybrid debt instruments and hybrid interest. The general aim of these anti-avoidance rules is to curb the artificial generation of interest deductions by an issuer if the debt instrument qualifies as a hybrid debt instrument because of its equity features, or if the yield is determined not to constitute bona fide interest and seeks to recharacterise interest labelled returns as dividends in specie paid in respect of a share. Consequently, the issuer may be liable for dividends tax at a rate of 20%.

Section 8F focuses on the equity-like features of a debt instrument and applies when the debt instrument exhibits certain equity features that taxpayer include in their financial arrangements in order to take advantage of the equity features and would otherwise benefit from the tax deductibility of interest from interest bearing debt arrangements. The section deals with the convertibility of the debt instrument into shares, the repayment of the debt or interest on the debt instrument conditioned upon the solvency of the issuer and the period until redemption of the

debt. Where the debt instrument qualifies as a hybrid debt instrument the yield is regarded as a dividend in specie paid in respect of a share.

On the other hand, section 8FA focuses on the nature of the yield (i.e. the interest labelled return) and requires that the yield must be determined with reference to a rate of interest, and that the rate of interest must not be dependent on the profits of the issuer for that yield to qualify as interest instead of an equity-like return (i.e. hybrid-interest). Where the yield is not determined in an acceptable manner, the yield is regarded as a dividend in specie paid in respect of a share.

Reason for change

Concerns have been raised regarding the effect of the above-mentioned hybrid debt and hybrid interest anti-avoidance rules in sections 8F and 8FA. The deeming provisions, which deem any return from tainted debt instruments or any tainted returns to be dividends in specie in respect of a share to be declared and paid by the issuer to the person to whom the amount accrued, do not specifically deem the return to be the accrual of dividends in specie for the holder or recipient of the return. As a result, the return may not qualify for an interest deduction, dividends tax may be payable by the issuer if no exemption applies and the holder may be taxed on the interest. In such an instance, the anti-avoidance rules would be going too far as the return would be regarded as interest and thus also be taxable for the holder of a tainted instrument or recipient of a tainted return, leading to economic double taxation.

The above-mentioned effect goes against the policy rationale for the introduction of these rules as well as further changes made to these rules in 2016 and 2017 ensuring that interest will be classified as a dividend in specie and dividends tax may be levied on the deemed dividend in specie.

Proposal

It is proposed that the policy position regarding the deeming provisions in sections 8F and 8FA be refined. In order to address concerns raised, it is proposed that changes be made in the tax legislation to explicitly extend the deeming provision to apply to the holder of a tainted instrument or recipient of tainted return. In addition,

consequential amendments are proposed to refine the tax treatment of the reclassified return for purposes of withholding tax on interest in terms of the Act.

Effective date

The proposed amendments will come into operation on 1 January 2022 and apply in respect of amounts incurred on or after that date.

5.14. Income Tax: Business (General) – Clarifying the meaning of 'interest' under the debt relief rules

[Applicable provision: Section 19(8)(f) and paragraph 12A(6)(g) of the Eighth Schedule to the Act]

Background

The Act contains debt relief rules in section 19 and paragraph 12A of the Eighth Schedule that trigger tax consequences in respect of a waiver, cancellation, reduction or discharge of a debt owed by a taxpayer. Section 19 of the Act deals with normal tax implications in respect of a debt that was previously used to fund tax deductible expenditure, for example, operating expenses. On the other hand, paragraph 12A of the Eighth Schedule to the Act deals with capital gains tax implications in respect of a debt in respect of which a debt benefit arises.

In 2018, changes were made to the debt relief rules. The changes introduced a new concept of a 'debt benefit' that seeks to tax the benefit to a debtor resulting from a concession or compromise of a debt entered into with a creditor. Consequently, the concept of a 'debt benefit' results in a regime that triggers a recoupment in terms of section 19 or capital gain in terms of paragraph 12A of the Eighth Schedule in instances where an arrangement that is included in the definition of 'concession or compromise' gives rise to an economic benefit that is not equally reflected in the market value of the reduced consideration received by the creditor or the amount of the reduced debt exceeds the expenditure incurred by the debtor in respect of a transaction. Under the debt relief rules a concession or compromise encompasses arrangements where there is:

- a debt cancellation or waiver;
- a debt that is extinguished either by way of a redemption of the debt claim by the debtor or a person that is a connected person in relation to the debtor or extinguished by merger as a result of the acquisition of the debt claim by the debtor; or
- a conversion of debt into shares where a debt owed by a company is settled directly or indirectly by being converted to or exchanged for shares in that company or by applying the proceeds from shares issued by that company.

In the case of a conversion of debt into shares, the debt relief rules trigger a debt benefit that is subject to tax if the face value of the reduced amount of the debt prior to the entering into of that arrangement exceeds:

- the market value of the shares acquired by reason or as a result of the implementation of that arrangement, in the instance that the creditor held no interest in the shares in the debtor prior to the arrangement; or
- the amount by which the market value of the interest in the shares held by that creditor in that debtor company after the implementation of that arrangement exceeds the market value of the interest in the shares held by that creditor in the debtor company prior to entering into of that arrangement, in the instance that the creditor held an interest in the shares in the debtor prior to the arrangement.

However, an exclusion has been provided so that the debt forgiveness rule does not apply to a debt benefit arising from debt to share conversions to the extent the debt converted does not consist of or represent an amount owing in respect of interest incurred during any year of assessment.

<u>Reason for change</u>

Concerns have been raised regarding the meaning of the word 'interest' in the debt relief rules that provide for the inclusion of the amount of debt in the form of interest incurred that is converted into shares or settled by applying the proceeds of shares

in the application of debt relief rules. At issue is the fact that there is no definition of the word 'interest' contained in the debt relief rules.

Proposal

In order to provide clarity as to the meaning of the word 'interest' for purposes of applying the debt relief rules, it is proposed that for purposes of the debt relief rules, the meaning of the word 'interest' be clarified to mean interest as defined in section 24J of the Act.

Effective date

The proposed amendments will come into operation on 1 January 2022 and apply in respect of years of assessment commencing on or after that date.

5.15. Income Tax: Business (General) – Refining the interaction between anti-value shifting rules and corporate reorganization rules

[Applicable provision: Section 40CA of the Act]

Background

A. Anti-value shifting rules

The Act contains rules in section 24BA and section 40CA aimed at curbing the use of structures that shift value between taxpayers free of tax, referred to as "anti-value shifting rules". Section 24BA applies to transactions involving asset for share exchanges and triggers a capital gain (in respect of which capital gains tax is payable) or deems a distribution of an asset in specie (in respect of which dividends tax will be payable) where these exchanges are not effected on a value-for-value basis. In its application, section 24BA provides that where a company acquires an asset in exchange for the issue of its shares and the market value of the asset immediately before that disposal exceeds the market value of the shares immediately after that issue, the amount in excess is deemed to be a

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

In turn, section 40CA prescribes a base cost for assets acquired by companies in exchange for the issue of their shares to the seller of those assets as the sum of the market value of the shares it issued and the amount of the capital gain triggered by the application of the provisions of section 24BA to ensure that there is no double taxation on the future disposal of the assets.

B. Roll over base cost rule under corporate reorganisation rules

On the other hand, the Act contains corporate reorganisation rules in Part III of Chapter II that allow for the tax neutral transfer of assets between companies that are part of the same group of companies. These corporate reorganisation rules also prescribe that qualifying asset-for-share transactions are subject to anti-value shifting rules and such transfers are subject to the roll-over base cost rules within the corporate reorganisation rules. In essence, these rules provide that asset transferred in terms of the corporate reorganisation rules are subject to the roll-over base cost rules that deem the acquirer and seller to be one and the same person for purposes of the base cost determination. These corporate reorganisation rules also prescribe those transactions that qualify for tax deferral under the corporate reorganisation rules are subject to the anti-value shifting rules that aim to ensure that all assets transferred in exchange for shares are affected on a value-for-value basis.

<u>Reasons for change</u>

The interaction between the anti-value shifting rules in sections 24BA and 40CA and the corporate reorganisation rules in Part III of Chapter II of the Act gives rise to anomalous results as the capital gain triggered under the anti-value shifting rules is only added to the base cost of an asset acquired in exchange for the issue of shares by a company in terms of section 40CA, which is outside of the corporate reorganisation rules in Part III of Chapter II of the Act. The capital gain triggered under the anti-value shifting rules in section 24BA is, however, not taken into account when the anti-value shifting rules are triggered in respect of transactions that are subject to the corporate reorganisation rules in Part III of Chapter II, as the corporate reorganisation rules only provide for rolled over base cost. As a result, a company will, on the future disposal of an asset acquired under the reorganisation rules in Part III of Chapter II, be subject to double taxation as the company is not granted an uplift of base cost in respect of the capital gain previously triggered in terms of the anti-value shifting rules in terms of section 40CA.

<u>Proposal</u>

In order to address these concerns, it is proposed that changes be made in the tax legislation to provide for additional base cost equal to any deemed capital gain resulting from the application of the anti-value shifting rules in section 24BA for corporate reorganization rules in Part III of Chapter II, namely, asset-for-share transactions rules in section 42, substitutive share-for-share transactions rule in section 43 and amalgamation transactions rules in section 44. However, such additional base cost is not required until a taxpayer subsequently disposes of an asset by way of a transaction that is not tax deferred in terms of the corporate reorganisation rules. In this regard, it is proposed that a company will be deemed to have incurred expenditure equal to the triggered deemed capital gain immediately before a subsequent disposal of an asset previously acquired in terms of the abovementioned reorganisation provisions in a transaction that falls outside of Part III of the Act (i.e. the corporate reorganisation rules set out in Part III of Chapter II, sections 41 to 47).

Effective date

The proposed amendments will come into operation on 1 January 2022 and apply in respect of any disposal of an asset on or after that date.

5.16. Income Tax: Business (General) – Clarifying the rules that trigger additional consideration in asset-for-share transactions when a debt is assumed by a company

[Applicable provision: Section 42(8) of the Act]

Background

The corporate reorganisation rules in Part III of Chapter II of the Act contain asset-for-share transaction rules in section 42 that allow for the tax neutral transfer of assets when a person (transferor) disposes of an asset to a company in exchange for the issue of shares by that company to that transferor or when a transferor disposes of an asset that was acquired using debt and as part of that disposal, that debt is assumed as a consideration by a company acquiring that asset. In essence, these rules entail that an asset that is disposed of in terms of an asset-forshare transaction results in no immediate taxable income (including a capital gain) for the transferor as the disposal is deemed to have been effected for a consideration equal to the base cost or cost of that asset. However, when that asset is subsequently disposed of in terms of a transaction that falls outside the corporate reorganisation, then there will be tax consequences.

That said, the asset-for-share transaction rules dealing with the tax neutral transfer of assets when a transferor disposes of an asset that was acquired using debt and, as part of that disposal, that debt is assumed as consideration by a company acquiring that asset are subject to an antiavoidance measure in section 42(8), that is aimed at preventing a permanent loss to the fiscus, instead of a tax deferral. This is to ensure that these rules do not allow taxpayers to benefit from a permanent loss to the fiscus resulting from the transferor ending up with shares that reflect the net asset value (i.e. market value of the asset less the debt assumed) transferred.

As a result, section 42(8) provides that a proportional part of any qualifying debt that was assumed by a company as part of an asset-for-share transaction will constitute an amount received by or accrued to the transferor in respect of the disposal of any of the shares in the company acquired in terms of the asset-for-share transaction, when such shares are subsequently disposed of by the transferor. Consequently, a transferor must account for any debt assumed under an asset-forshare transaction as additional proceeds upon the disposal of the shares.

Reason for change

It has come to Government's attention that the above-mentioned anti-avoidance rules that trigger additional consideration upon disposal are undermined when the shares are subsequently transferred in terms of a corporate reorganisation transaction as other applicable corporate reorganisation rules will enforce the rolled-over base cost of the previous asset-for-share transaction.

Proposal

In order to prevent the above-mentioned anti-avoidance rules contained in section 42(8) from being undermined, it is proposed that changes be made to the legislation and the anti-avoidance rules should be amended so that, going forward, the additional consideration accrues to the transferor in relation to any assumed debt immediately before any subsequent disposal of the shares acquired in terms of an asset-for-share transaction. Consequently, a transferor will irrespective of whether such a subsequent disposal of the shares is in terms of tax deferred transaction or not, be subject to tax on the additional consideration that is triggered immediate before that subsequent disposal of the shares. This immediate tax consequence is favoured and is viewed in the same light as the immediate tax consequence that taxpayers are subject to when they shift value by entering into asset-for-share transactions using the reorganisation rules that are subject to anti-value shifting rules that trigger an immediate capital gain or in specie dividend.

Effective date

The proposed amendments will come into operation on 1 January 2022 and apply in respect of the disposal of a share on or after that date.

5.17. Income Tax: Business (General) – Clarifying the early disposal anti-avoidance rules in intra-group transactions

[Applicable provision: Section 45(5) of the Act]

Background

The corporate reorganisation rules in Part III of Chapter II of the Act contain intra-group transaction rules in section 45 that allow for tax deferral in respect of a disposal of an asset or a business as a going concern between companies that form part of the same group of companies at the end of the day of that disposal transaction. These intra-group transaction rules contain anti-avoidance measures that make provision for the early disposal rules to apply when an acquirer of an asset in terms of an intra-group transaction disposes of that asset within 18 months of such an acquisition. These early disposal anti-avoidance disposal rules reverse the deferral benefit that applied in terms of the intra-group transaction by ring-fencing so much of any capital gain, capital loss or income arising from the early disposal of an asset, as does not exceed the capital gain, capital loss or income that would have arisen on the date of intra-group transaction to ensure that such a gain, loss or income is not set-off against other gains, losses or income.

These early disposal anti-avoidance rules were introduced to curb the risk that group companies may enter into tax deferred transactions in terms of the intra-group transaction rules with the aim of minimising any adverse tax consequences of an asset disposal outside the group of companies, through offsetting any resultant tax consequences within the group. For example, a company may dispose of its asset (in respect of which a capital gain was anticipated on the date of an intragroup transaction) to a fellow group company with an assessed loss in order for that fellow group company to offset any capital gain on the disposal of

that asset outside the group companies to a third party. Applying the early disposal anti-avoidance rules in the given example, the rules entail that the company that is disposing of an asset within 18 months of acquiring it in terms of a tax deferred intra-group transaction, must ring-fence the resultant tax consequences of such a disposal (i.e. the capital gain in the example provided) and not offset it against its losses, thus enforcing that tax must be paid on such capital gain.

Reason for change

It has come to Government's attention that in some instances, a capital gain may have been anticipated from the disposal of an asset at the date of the intra-group transaction, yet, at the date of the early disposal of an asset (disposal of an asset within 18 months after the acquisition in terms of the intra group transaction), a capital loss arises in respect of that asset. The difference in the nature of the resultant consequences in respect of the disposal of an asset on the date of the intra-group transaction and the date of the early disposal creates ambiguity in the application of the early disposal anti-avoidance rules.

Proposal

In order to address this ambiguity, it is proposed that clarification be made in the early disposal anti-avoidance rules regarding the resultant tax consequences of an early asset disposal. It is proposed that changes be made in the legislation to ensure that any capital gain, capital loss or income arising in the hands of a transferee company from any early disposal of an asset that was previously acquired in terms of an intra-group transaction should be ring-fenced without regard to any capital gain, capital loss or income that would have arisen on the date of the intra-group transaction.

Effective date

The proposed amendments will come into operation on 1 January 2022 and apply in respect of the disposal of any asset on or after that date.

5.18. Income Tax: Business (General) – Extending the reversal of the nil base cost rules to apply on the sixth anniversary of an intra-group transaction

[Applicable provision: Section 45(3B) of the Act]

Background

The corporate reorganisation rules in Part III of Chapter II of the Act make provision in section 45, dealing with intra-group transactions, that allows for a tax deferral in instances where one company transfers an asset or a business as a going concern to the other company and both companies form part of the same group of companies at the end of the day of that transaction. However, these intra-group transaction rules also contain various anti-avoidance measures aimed at limiting or discouraging abuse by taxpayers. Of particular concern is the de-grouping antiavoidance rule and the zero base cost anti-avoidance rule.

The de-grouping anti-avoidance rule reverses any tax deferred from the original intra-group transaction in the hands of the transferee, which in effect reverses the tax benefit of that original intra-group transaction, in instances when a transferor company ceases to form part of any group of companies as the transferee company within six years of the original intra-group transaction.

On the other hand, the zero base cost anti-avoidance rule applies to transfers of assets in exchange for debt or a non-equity share issued by a fellow group company of an acquirer or company disposing of an asset in terms of an intra-group transaction. In terms of this zero base cost anti-avoidance rule, the holder of the debt or non-equity shares is deemed to have acquired the debt or non-equity shares for an amount of expenditure equal to nil.

In 2020, changes were made in section 45 of the Act to remove the potential double taxation arising in instances where an intra-group transaction is subject to the zero base cost antiavoidance rule resulting in a zero base cost for the holder of a debt or non-equity share that facilitated or funded an intra-group transaction and

then subsequently a de-grouping or deemed de-grouping occurs and the de-grouping rules also reverse the tax deferral benefits.

Reason for change

Concerns have been raised that because the de-grouping anti-avoidance rule ceases to apply on the sixth anniversary of an intra-group transaction, the zero base cost anti avoidance rule should similarly be reversed on the sixth anniversary of an intra-group transaction. Further, it is counterintuitive that parties that operate within the spirit of the intra-group tax deferral rules and remain within the original group, should not be granted base cost in respect of debt and non-equity shares used to facilitate such an intra-group transaction.

Proposal

In order to address these concerns, it is proposed that changes be made in the intra-group transaction rules to extend the reversal of the zero base cost anti-avoidance rules and ensure that base cost is restored for holders of debt and non-equity shares used to facilitate the transfer of assets in terms of an intra-group transaction, on the sixth anniversary of that intra-group transaction.

Effective date

The proposed amendments will come into operation on 1 January 2022 and apply in respect of years of assessment commencing on or after that date.

5.19. Income Tax: Business (General) – Clarifying the interaction between early disposal anti-avoidance rules and the nil base cost anti-avoidance rules

[Applicable provision: Section 45(3B) of the Act]

Background

The intra-group transaction rules in section 45 of the Act allow for tax deferral in respect of transactions under which one company transfers an asset or a business as a going concern to the other company if both companies form part of the same

group of companies at the end of the day of that transaction. These intra-group transaction rules also contain anti-avoidance measures aimed at discouraging abuse by taxpayers. The first anti-avoidance measure, namely, the degrouping anti-avoidance rule, is triggered when a transferor company ceases to form part of any group of companies as the transferee company within six years of the original intra-group transaction. The de-grouping anti-avoidance rule reverses any tax deferred from the original intragroup transaction in the hands of the transferee, which in effect reverses the tax benefit of that original intra-group transaction.

The second anti-avoidance measure, namely, the early asset disposal anti-avoidance rule applies when a company within the same group of companies enter into tax deferred intra-group transaction with the aim of transferring assets to another company within the same group of companies that will be able to absorb any tax consequences that may result from a future disposal out of the group of companies. The early asset disposal anti-avoidance rule reverses any tax deferred in respect of any asset subsequently disposed of within 18 months of an intra-group transaction and ring-fence the arising gain, loss or taxable income.

The third anti-avoidance measure, namely, the zero base cost anti-avoidance rule applies to a holder of any debt or and non-equity share issued by a fellow group company of an acquirer or company disposing of assets in terms of an intra-group transaction if that debt or non-equity share was used to facilitate or fund that intra-group transaction. The zero base cost anti-avoidance rule deems the holder of such debt or non-equity share to have acquired the debt or non-equity share for an amount of expenditure equal to zero. This anti-avoidance rule is aimed at limiting the use of debt or non-equity shares by taxpayers to transfer market value consideration for assets transferred under an intra-group transaction which could further be abused by transferring the debt or non-equity shares outside of the group by the transferor.

Reason for change

In 2020, changes were made in section 45 of the Act to remove the potential double taxation arising in instances where an intra-group transaction is subject to the zero base cost antiavoidance rule resulting in a zero base cost for the holder of

a debt or non-equity share that facilitated or funded an intra-group transaction and then subsequently a de-grouping or deemed de-grouping occurs and the de-grouping rules also reverse the tax deferral benefits. Because the early asset disposal anti-avoidance rule reverses the tax deferral benefit in respect of the disposal of an asset which was acquired in terms of the intra-group transaction within 18 months of such an acquisition, it is therefore appropriate that the zero base cost anti-avoidance rule should be reversed when the early disposal anti-avoidance rule is triggered.

Proposal

In order to address these concerns, it is proposed that changes be made in the intra-group rules to give effect to the reversal of the application of the zero base cost anti-avoidance rule in instances when the early asset disposal anti-avoidance rule applies. It should be noted that the reinstatement of the base cost for any debt or non-equity share will only be provided for to the extent to which the debt and/or non-equity share facilitated or funded an asset disposed of early and in respect of which the provisions of the Act applied to reverse and ring-fence the deferred capital gain, capital loss, taxable income or assessed loss.

Effective date

The proposed amendments will come into operation on 1 January 2022 and apply in respect of years of assessment commencing on or after that date.

5.20. Income Tax: Business (General) – Refining the provisions applicable to unbundling transactions

[Applicable provisions: Sections 46 and 46A of the Act]

Background

The corporate reorganisation rules in Part III of Chapter II of the Act contain unbundling provisions in section 46 that allow for a tax neutral transfer of shares in instances where shares of a resident company (unbundled company) that are held

by another resident company (unbundling company) are distributed to the shareholders of that unbundling company in accordance with the effective interest of those shareholders. As a result, in a qualifying unbundling transaction, distribution of shares is disregarded for purposes of determining the taxable income, assessed loss or net income of an unbundling company. The distribution of shares is also disregarded for Dividends Tax purposes and there is no consideration taken into account when determining reduction of contributed tax capital. These unbundling rules contain the following anti-avoidance measures aimed at limiting or discouraging abuse by taxpayers from distributing shares on a tax neutral basis if the shareholders do not fall within the South African tax net.

A. Anti-avoidance measure:

Exclusion of distributions to disqualified persons Prior to 2020, this anti-avoidance measure made provision for the roll-over relief not to apply if immediately after the distribution of shares in terms of an unbundling transaction, 20% or more of the shares in the unbundled company are held by disqualified persons either alone or together with any connected persons (who is a disqualified person) in relation to that disqualified person. The term 'disqualified persons' is defined in this regard to include a person that is regarded as a non-resident in terms of the South African tax legislation or exempt persons in terms of South African tax legislation (for example, the government of South Africa in the national, provincial or local sphere contemplated in section 10(1)(a), a public benefit organisation as defined in section 30, a recreational club as defined in section 30A, a mining rehabilitation company or trust contemplated in section 37A, a pension fund, a provident fund, a retirement annuity fund, a benefit fund contemplated in section 10(1)(d)(i) or (ii) or a person contemplated in section 10(1)(cA) or (t)).

It came to Government's attention that this anti-avoidance measure was anomalous as it was not aligned with the initial policy intent of corporate reorganisation rules and created an exemption instead of a deferral by allowing an exemption on significant shareholding as opposed to a

deminimis exemption. This anti-avoidance measure created a loophole in that the 20% exclusionary rule did not apply as intended to deny roll-over relief where tax exempt or nonresident shareholders are not connected persons in relation to each other, thus effectively resulting in a tax exemption instead of a tax deferral as future disposals of shares by tax exempt or non-resident shareholders would not be subject to tax in South Africa.

As a result, in 2020, changes were made to this anti-avoidance measure to make provision for the roll-over relief not to apply in respect of any equity share that is distributed by an unbundling company to any shareholder that is a disqualified person and holds at least 5% of the equity shares in the unbundling company immediately before an unbundling transaction.

B. Anti-avoidance measure: Limitation of expenditure in respect of shares held in an unbundling transaction

Prior to 2008, some taxpayers were abusing the roll-over relief in the unbundling transactions rules by creating for example, structures where a person that is not subject to South African tax and in particular, capital gains tax, such as a non-resident or resident tax exempt person that indirectly holds shares in high value operating companies through a South African Holding company, recapitalising the South African group to achieve an increase in the base cost of the shares held in entities within the group in order to decrease a future tax burden. This would be achieved as follows:

Example

Step 1: A non-resident or resident exempt person that already holds an interest in a South African group would form a Resident NewCo by subscribing for shares in Resident NewCo for an amount reflecting the market value of the South African group that is much higher than the cumulative base cost of the shares in the South African holding company.

Step 2: Resident NewCo would use the capital to acquire the shares in the South African holding company from the non-resident or resident exempt person.

Step 3: Thereafter the South African holding company would distribute the shares it holds in the operating companies to Resident NewCo in terms of a tax deferred unbundling transaction. As a result, of applying the provisions of section 46(3) to the Resident NewCo, the base cost of the shares in the SA HoldingCo is split between the shares held in the SA HoldingCo and the operating companies without tax being paid and providing future lowered tax (for example capital gains tax) on future disposal of the shares in the operating companies.

In 2008, changes were made in the unbundling transaction rules by introducing an anti-avoidance measure in section 46A that makes provision for limitation of the base cost of shares received in terms of an unbundling transaction if the shares in the unbundling company are preceded by the disposal of shares between connected persons that are not fully taxable. As a result, upon application of this anti-avoidance measure, the base cost of the shares received in an unbundling transaction is limited. This limitation applies where a shareholder in an unbundling company acquires an unbundled company's shares within two years after the unbundling company shares were held by a connected person and the connected person was not fully subject to normal tax on disposal of the shares. Under such circumstances, the acquisition cost incurred by the first connected person for the unbundling shares in the two-year period is substituted by the base cost of the unbundling shares for the connected person with adjustment allowed for specified deductions, ordinary revenue and capital gains of any connected person holding the unbundling shares during the two-year period.

Reason for change

A. Anti-avoidance measure: Exclusion of distributions to disqualified persons

Following the 2020 legislative changes, there is no tax deferral for an unbundling transaction in respect of any equity share that is distributed by an unbundling company to any shareholder that is a disqualified person and holds at least 5% of the equity shares in the unbundling company immediately before that unbundling transaction. The 2020 changes resulted in the pro rata application of this anti-avoidance measure and results in a more equitable outcome in respect of unbundling transactions as only shares distributed to persons that are not disqualified persons will benefit from the roll-over relief and the rest will be subject to normal tax and dividends tax rules applicable on distribution.

That said, the pro rata application of these rules implies that in the case of a distribution, any taxes paid are indirectly borne by all shareholders proportionate to their equity shareholdings in the unbundling company. As a result, any shareholders that are not regarded as disqualified persons will be subject to tax on future disposals of their respective shares in the unbundled company without any recourse in the manner of an uplift of base cost in respect of the tax indirectly borne.

B. Anti-avoidance measure: Limitation of expenditure in respect of shares held in an unbundling transaction

It came to Government's attention that this anti-avoidance measure may be applied broadly as the current wording in the legislation may be applied to limit expenditure incurred by a taxpayer in respect of any share held in an unbundling company irrespective of how such share in the unbundling company was acquired by the taxpayer. This is of particular concern in instances that shares are not part of an unbundling transaction, a taxpayer may have acquired shares in an unbundled company from a third party that was subject to tax on the disposal of such shares. The limitation should apply only to shares acquired as part of an unbundling transaction and not limit the base cost of shares that were not acquired as part of a tainted unbundling transaction.

Proposal

A. Anti-avoidance measure: Exclusion of distributions to disqualified persons

It is proposed that changes be made in this anti-avoidance measure so that shareholders in an unbundling company that qualifies for tax deferral for an unbundling transaction should receive additional base cost that is reflective of the tax paid by the unbundling company in respect of their shares in the unbundled company, in accordance with their respective shareholding. This will, in practical terms, only benefit non-disqualified persons on future disposal of the unbundled shares as disqualified persons would in any case not be subject to tax.

B. Anti-avoidance measure: Limitation of expenditure in respect of shares held in an unbundling transaction

It is proposed that changes be made in this anti-avoidance measure to ensure that this measure only applies to shares that are acquired by way of an unbundling and not to those shares that are acquired through either subscription or acquisition for a full consideration.

Effective date

The proposed amendments will come into operation on 1 January 2022 and apply in respect of the allocation of expenditure to unbundled shares acquired on or after that date.

5.21. Income Tax: Business (General) – Clarifying rehypothecation of collateral within collateral arrangement provisions

[Applicable provision: Definition of 'collateral arrangement' in section 1(1) of the Securities Transfer Tax Act, 2007 (Act No. 25 of 2007) ("STT Act")]

Background

In 2015, 2016 and 2017 changes were made in the Act and the STT Act to allow for an outright transfer of listed shares or local and foreign government bonds in

collateral lending arrangements. As a result, if a listed share, local or foreign government bond is transferred as collateral for an amount owed by the transferor to the transferee, there are no income tax (including capital gains tax) and securities transfer tax implications provided that identical shares or bonds are returned to the transferor by the transferee within a limited period of 24 months from the date of transfer of the collateral.

Reason for change

At issue is the rehypothecation of collateral, where the bank, broker dealer or collateral taker (transferee) intends to use collateral received through a tax-neutral collateral arrangement for trading or as security for its own borrowing. The use of collateral for purposes other than subsequent collateral arrangements is against the policy rationale for the introduction of these provisions and could result in the avoidance of securities transfer tax or capital gains tax.

Proposal

It is proposed that changes be made to the legislation to clarify the policy intention that the shares or bonds transferred as collateral in terms of a collateral arrangement may subsequently only be used for collateral and not be used for trading or in other financial transactions.

As a consequential amendment it is also proposed that the same policy clarification be extended to government’s ability to identify and sanction the improper use of the collateral received by the transferee during the 24-month time frame of collateral arrangements.

Effective date

The proposed amendments will come into operation on the date of publication of the 2021 draft Taxation Laws Amendment Bill for public comment and apply in respect of any collateral arrangements entered into on or after that date.

5.22. Income Tax: Business (Financial institutions and products) – Refining a deduction formula for taxable long term insurer policyholder funds

[Applicable provision: Section 29A(11) of the Act]

Background

In 2012, changes were made to section 29A of the Act by revising the deduction formula for selling, administration and indirect expenses for long-term insurers. In general, this formula is based on taxable income divided by net economic income. For purposes of the denominator, the concept of "net economic income" is intended to reflect total taxable income without a reduction of nonincludible dividends, foreign dividends and capital gains.

Reasons for change

At issue is that unrealised gains to be accounted for in the denominator does not refer to any level of aggregation of unrealised gains and losses and is inconsistent with dividends, foreign dividends and realised capital gains which refer to an aggregation of amounts.

Proposal

In order to address this anomaly, it is proposed that changes be made in the deduction formula so that unrealised gains and losses should also be aggregated for all assets allocated to the relevant policyholder fund.

Effective date

The proposed amendments will come into operation on the date of promulgation of the 2021 Taxation Laws Amendment Bill.

5.23. Income Tax: Business (Financial institutions and products) – Clarifying the transfer of liabilities in respect of insurance business between short-term insurers

[Applicable provision: Section 28 of the Act]

Background

In general, for regulatory purpose, under section 50 of the Insurance Act, 2017 (Act No. 18 of 2017) an insurer (other than a branch of a foreign reinsurer, Lloyd's underwriter or Lloyd's) may not, without the approval of the Prudential Authority, transfer all or any part of its assets and liabilities relating to its insurance business to another insurer. The general purpose of requiring approval is to ensure that the Prudential Authority can assess whether or not the proposed transfer could impair the financial soundness of the insurer, the insurer's controlling company or the acquirer, or impact negatively on the interests of policyholders.

However, section 28 of the Act which deals with the taxation of short-term insurers does not specifically address all the tax consequences that arise from the sale of all or a part of insurance business, which involve the transfer of all rights such as premiums receivable and obligations such as claims to be settled under an insurance contract, in which case the general provisions of the Act apply.

As a general matter, the transaction requires the buyer to assume all outstanding liabilities with the obligation to settle any future claims as recorded in the seller's accounting records at date of transfer and have the right to all future premium's receivable under the insurance contract. In addition, the seller also transfers the rights in respect of the insurance contracts to the buyer. Lastly, for the buyer's assumption of the outstanding liabilities the seller reduces the consideration for the transaction or pays the buyer an amount equal to the value of the outstanding liabilities.

Reasons for change

As stated above, section 28 of the Act does not specifically address all the tax consequences that arise from the sale of all or a part of insurance business and

the general provisions of the Act apply. However, the interpretation of the general provisions of the Act read with section 28 of the Act may result in inconsistent tax treatment of the insurers that are parties to the transfer of business.

Proposal

In order to address these concerns, it is proposed that the following changes be made in section 28 of the Act to clarify the tax treatment of transfer of liabilities as part of the transfer of short-term insurance business or short-term policies.

A. Seller's tax treatment

The outstanding claims and premiums that were recognised as liabilities for purposes of IFRS relating to claims and premiums in terms of section 28(3) of the Act may include the liabilities that are to be transferred to the buyer and were claimed as a tax deduction in the seller's tax computation in line with the provisions of section 28(3) of the Act in the previous year of assessment (prior to the year of transfer to the buyer).Thereafter, section 28(4) of the Act requires that the total of all amounts deducted from the income of a short-term insurer in respect of a year of assessment in terms of section 28(3) shall be included in the income of the short-term insurer in the following year of assessment (the year of transfer to the buyer). Given that an amount will be paid by the seller to the buyer or the consideration for the transfer of the insurance business will be reduced for the buyer to assume these liabilities, it is proposed that this amount be allowed as a deduction for the seller in terms of section 11(a).

B. Buyer's tax treatment

It is proposed that the liabilities relating to claims and premiums that have been assumed by the buyer constitute "gross income" in the hands of the buyer

Effective date

The proposed amendments will come into operation on 1 January 2022 and apply in respect of years of assessment ending on or after that date.

5.24. Income Tax: Business (Incentives) – Extension of the urban development zone tax incentive sunset date

[Applicable provision: Section 13quat of the Act]

Background

In 2003, the Urban Development Zone (UDZ) tax incentive was introduced in the Act to increase investment in 16 designated inner cities. The UDZ tax incentive was designed to encourage property investment in central business districts and to address dereliction and dilapidation, and to promote investment in urban renewal. The incentive is in the form of an accelerated depreciation allowance applicable on the value of new buildings and improvements to existing buildings in the qualifying municipalities demarcated as UDZs. When the UDZ tax incentive was introduced, it contained a sunset date of 31 March 2014. In 2013, the sunset date for the UDZ incentive was extended from 31 March 2014 to 31 March 2020.

Since its inception, there have been a number of legislative amendments to the UDZ tax incentive. In 2008, the incentive was amended to include low-cost housing and changes in the accelerated depreciation regime in view of changes in other property depreciation clauses in the Act. In 2015, changes were made to the tax incentive to allow municipalities with a population of one million to demarcate an additional UDZ area. Furthermore, where the municipality's population is below one million, the Minister of Finance may approve the demarcation of an additional UDZ area having regard to the provisions set out under subsections 13quat(6) and (7) of the Act.

Reasons for change

All tax incentives contain a sunset date which allows for a review of its effectiveness before the incentive comes to an end. The UDZ tax incentive was expected to come to an end on 31 March 2020 and before this date, a review had to be concluded to determine the future of the incentive. In the 2020 Budget Review, the Minister of Finance announced that the urban development zone incentive would be extended for one year, to 31 March 2021, while a review of the

incentive was completed. However, due to the challenges posed by the Covid-19 global pandemic, a comprehensive review of the effectiveness of the UDZ tax incentive could not be concluded. In the 2021 Budget Review, the Minister of Finance announced that the incentive would be extended by a further two years beyond its current sunset date of 31 March 2021, as the review process continues.

Proposal

In line with the Minister's announcement in the 2021 Budget Review, it is proposed that changes be made in section 13quat of the Act to extend the UDZ tax incentive by another two years, to 31 March 2023. The extension of the incentive's sunset date will provide time for an extensive review of its effectiveness in achieving its objectives to be conducted.

Effective date

The proposed amendment will be deemed to have come into effect on 1 April 2021 and applies in respect of any building, part thereof or improvement that is brought into use on or after that date.

5.25. Income Tax: Business (Incentives) – Extension of the learnership tax incentive sunset date

[Applicable provision: Section 12H of the Act]

Background

The learnership tax incentive, which was introduced in the Act on 1 October 2001, is a programme that supports skills intensity through the tax system. To encourage skills development and job creation, the learnership tax incentive provides employers with an additional tax deduction over and above the normal remuneration that can be deducted. The additional deduction is intended to encourage vocational training through formal learnership contracts, and provide accredited workplace training by employers. To claim the allowance, the employer, learner and an accredited training provider must enter into a formal learnership

contract. Similar to all other tax incentives, when the learnership tax incentive was introduced, it had a sunset date of 1 October 2011.

In 2011, a review was conducted to assess the effectiveness of the learnership tax incentive in achieving its objectives, before the sunset date. After the review, the learnership tax incentive was extended by another five years to 1 October 2016. In 2016, a comprehensive review was again conducted to assess the effectiveness of the learnership tax incentive in achieving its objectives. The outcome of the review indicated that there was sufficient evidence to support the continuation of the learnership tax incentive beyond its previous sunset date of 1 October 2016. However, the review also revealed that claims were not evenly spread across sectors. Sectors with high uptake were those where SETAs where perceived to administer training programmes more effectively. The review then recommended:

(i) the extension of the incentive sunset date to 1 April 2022,

(ii) improving the targeting of the incentive by encouraging employers to train learners in those skill categories where demand is highest, and

(iii) to improve future incentive policy analysis, completion of the SARS IT180 form was made compulsory for taxpayers to claim the learnership tax incentive.

Reasons for change

The learnership tax incentive has a current sunset date of 1 April 2022. The effectiveness of the incentive in achieving its objectives will need to be assessed before this date to determine whether it continues. In the 2021 Budget Review, the Minister of Finance announced that the incentive would be extended by a further two years beyond its current sunset date while a review is completed.

Proposal

In line with the Minister's 2021 Budget announcement, it is proposed that changes be made in section 12H of the Act to extend the learnership tax incentive by another two years, to 1 April 2024.

Effective date

The proposed amendment will come into effect on 1 April 2022, and applies in respect of learnership agreements entered into on after that date.

5.26. Income Tax: Business (Incentives) – Refining the timeframes of compliance requirements of industrial policy projects tax incentives

[Applicable provision: Section 12I of the Act]

Background

In 2009, the Industrial Policy Projects tax incentive was introduced in section 12I (the section 12I tax incentive) to support investment in manufacturing assets that would improve the productivity of the manufacturing sector. The section 12I tax incentive is available for new industrial policy projects as well as the expansion or upgrading of existing projects. The section 12I tax incentive makes provision for an additional investment allowance for an industrial policy project as determined according to the type of investment (greenfield or brownfield) and its approval status (qualifying or preferred).

The section 12I tax incentive offers support for both capital investment and training, with qualification for the incentive based on points scoring criteria reviewed by an adjudication committee constituted in terms of section 12I(16) of the Act. The adjudication committee assesses projects for approval, and if approved, monitors these projects in terms of their compliance. Section 12I(19)(a) of the Act makes provision for the adjudication committee to make recommendations to the Minister of Trade, Industry and Competition to extend the time periods within which approved projects must comply with the provisions of the section, by one year.

The section 12I tax incentive initially had a sunset date of 31 December 2015. In 2015, the sunset date was extended by two years to 31 December 2017. In 2017, the date was again extended by two years 3 months to 31 March 2020. This

implies that approvals for new section 12I tax incentive applications officially ceased on 31 March 2020 when its latest sunset date was reached, and the tax incentive was not renewed. This notwithstanding, projects approved before 31 March 2020 still enjoy the benefits and are bound by the provisions of section 12I of the Act.

Reasons for change

As indicated above, in 2017, the sunset date was again extended to 31 March 2020, and no further extension was granted in this regard. However, the sunset date of 31 March 2020 fell during the Covid-19 pandemic. As a result, many beneficiaries of the section 12I tax incentive experienced the following challenges during the 2020 Covid-19 national lockdown:

- Compliance with the period of four years plus the additional one year allowed to bring qualifying assets into use in terms of subsections 12I(2) and 12I(19)(a).
- Delay in further acquisition of qualifying assets.
- Knock-on effect on providing skills development (training – such as practical hands-on training, which cannot be properly substituted with online classes. Some training required foreign or distant expert support, most of whom could not travel. Local training providers also have stringent measures in place in terms of the lockdown regulations.
- Compliance with the energy efficiency requirement was also a challenge as lower production led to lower potential energy efficiency.
- Compliance with the further requirement of more than 50% of the manufacturing assets to be acquired and brought into use within 4 – 5 years in terms of 12I(7)(c).

This disruption is expected to last throughout 2020 and the whole of 2021. Should these compliance requirements not be met, it would lead to a withdrawal of approval for projects in terms of section 12I of the Act. This would place additional strain on the manufacturing sector in an environment where projects face severe

challenges in reaching completion, and many businesses struggle to remain operational.

Proposal

In order to ensure that approved projects have a better chance of complying with section 12I provisions and are not adversely affected by Covid-19 and consequent restrictions on economic activity resulting in non-compliance, the following amendments are proposed in section 12I of the Act:

A. Extension of the time period that the adjudication committee can recommend to the Minister of Trade, Industry and Competition within which approved projects must comply with the provisions of section 12I of the Act

- Currently, section 12I(19)(a) of the Act makes provision for the adjudication committee to make recommendations to the Minister of Trade and Industry to extend the time periods within which approved projects must comply with the provisions of the section, by one year.
- It is proposed that changes be made to section 12(19)(a) of the Act to allow for up to an additional two years to bring assets into use for approved section 12I projects negatively affected by Covid-19 and consequent disruptions and restrictions to economic activity.
- The proposed additional two years to bring assets into use is in addition to the oneyear extension the Minister of Trade, Industry and Competition is currently allowed to provide, upon the recommendation of adjudication committee.
- The proposed extension will not provide blanket relief to all approved section 12I projects, but will be upon application by affected projects to the section 12I adjudication committee.
- After assessing these projects on a case-by-case basis, the adjudication committee should recommend to the Minister of Trade, Industry and Competition whether affected projected projects should

be allowed:

- An additional year or two years to bring (more than 50% of) assets into use due to Covid-19 related disruptions.

B. Extension of 'compliance period' within which approved projects must fully comply with the provisions of section 12I of the Act

- The 'compliance period' in section 12I determines the period at the end of which approved projects must fully comply with all provisions of the section. It also defines the period over which projects are required to produce annual progress reports to be assessed by the adjudication committee. In turn, section 12I(1) of the Act defines the 'compliance period' as the period:
  - commencing at the beginning of the year of assessment following the year of assessment in which assets are first brought into use; and
  - ending at the end of the year of assessment three years after the year of assessment in which assets are first brought into use;
- It is proposed that if projects apply for and are approved to extend the four-year period within which to bring the qualifying assets into use, this would mean that the 'compliance period' is also increased by the extended period (by the end of which qualifying projects must adhere to all provisions of section 12I of the Act). This provides additional time within which to ensure compliance with the provisions of section 12I of the Act.
- This would not be a blanket relief and the extended 'compliance period' would not apply to all approved section 12 projects but will, upon application by affected projects, apply to projects approved for the extended compliance period to bring assets into use in terms of the recommendation of the adjudication committee in section

12I(19)(a).

- As a result, it is proposed that changes be made to the definition of 'compliance period' to allow for an extended period of not more than two additional years, upon application to the adjudication committee. This would cater for projects that have brought assets into use in line with section 12I, but due to Covid-19 related disruptions, may not be able to comply with all 12I requirements by the end of the compliance. For example, skills development, energy efficiency, and other point scoring criteria as set out in the section 12I regulations.
- The proposed amendments are intended to bring relief to approved projects that have not yet brought more than 50% of assets into use by the time Covid-19 related disruptions to economic activity started at the end of March 2020.

Effective date

The proposed amendments will be deemed to have come into effect on 1 January 2020.

5.27. Income Tax: International – Clarifying the controlled foreign company anti-diversionary rules

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

Background

The Act contains anti-avoidance provisions in section 9D aimed at taxing South African residents on the net income of a controlled foreign company (CFC). As a result, an amount equal to the net income of the CFC is included in the income of a South African resident according to the resident's proportion of participation rights in that CFC.

In order to strike a balance between protecting the South African tax base and the need for South African multinational entities to be competitive, the South African

CFC rules contains various exemptions of certain types of business income, for example, foreign business establishment exemption in section 9D(9)(b) of the Act. This exemption makes provision for CFC income to be exempt if that income is attributable to a foreign business establishment as defined in section 9D of the Act.

In order to limit tax avoidance, the foreign business establishment exemption does not apply if the CFC foreign business establishment income is regarded as diversionary foreign business income in terms of the CFC anti-diversionary rules. Diversionary foreign business income arises when a CFC engages in transactions such as outbound sale of goods, inbound sale of goods and services with a related South Africa resident in a manner that will most likely lead to transfer pricing tax avoidance.

Reasons for change

In 2011, changes were made to the CFC rules. The anti-diversionary rules in respect of the CFC outbound sale of goods were completely abolished and the rationale for removing these rules was that the transfer pricing rules could be applied as an alternative. In addition, the diversionary rules in respect of the CFC inbound sale of goods were narrowed.

In 2016, Government reinstated the anti-diversionary rules in respect of the CFC outbound sale of goods due to their effectiveness in preventing base erosion and profit shifting (BEPS). The 2016 anti-diversionary rules for CFC outbound sale of goods now provide for an exemption if similar goods are purchased by the CFC, from unconnected persons in relation to that CFC, mainly within the country in which the CFC is resident. Notably, these rules do not contain legal reference to physical delivery of the goods.

It has come to Government's attention that certain taxpayers are circumventing these antidiversionary rules by merely entering into a contract of purchase in the country of the CFC that implies that the purchase of goods took place in the country of residence of the CFC when the goods are never physically present or delivered in that country.

Proposal

In order to curb this abuse, it is proposed that changes be made in the anti-diversionary rules dealing with the CFC outbound sale of goods to provide clarity that when a CFC purchases those goods, these goods should be physically present or delivered within the country of residence of that CFC.

Effective date

The proposed amendments will come into operation on 1 January 2022 and apply in respect of years of assessment commencing on or after that date.

5.28. Income Tax: International – Clarification fo the interaction between the provisions dealing with a CFC ceasing to be a CFC and the participation exemption

[Applicable provision: Section 9H(5) of the Act]

Background

In 2020, changes were made in the Act to address tax avoidance opportunities that may have emerged as a result of the withdrawal of the approval requirement from the Financial Surveillance Department of South African Reserve Bank for loop structures. One of the amendments made was in relation to the participation exemption in paragraph 64B of the Eighth Schedule for gains on the disposal of shares in a non-resident company to a non-resident. Paragraph 64B was amended so that the participation exemption does not apply to the disposal of shares in a CFC to the extent the value of the assets of the CFC are derived from South African assets.

Reasons for change

At issue is that the amendment to the participation exemption mentioned above creates uncertainty in the application of section 9H(5) of the Act when a foreign company ceases to be CFC as a direct or indirect result of the disposal of equity shares in that CFC.

Proposal

It is proposed that section 9H(5) of the Act be amended so that when a portion of the resulting gain or loss resulting from a CFC ceasing to be a CFC is not disregarded in terms of paragraph 64B of the Eighth Schedule, the application of section 9H(5) of the Act is not precluded.

Effective date

The proposed amendment is deemed to have come into operation on 1 January 2021 and applies to disposals on or after that date.

5.29. Income Tax: International – Clarifying the rules dealing with withholding tax exemption declaration

[Applicable provisions: Sections 49E(2)(b), 64G(2)(a) and 64H(2)(a) of the Act]

Background

The Act contains provisions in Part IV A, Part IV B and Part VIII for withholding tax on royalties, interest and dividends respectively.

In general, withholding tax on royalties applies to royalties from a source within South Africa paid by any person whether that person is a resident or not to a foreign person. However, this withholding tax on royalties can potentially be reduced or eliminated by a tax treaty.

Similarly, a prerequisite for the imposition of withholding tax on interest is that the interest must be from a South African source. Again, the withholding tax on interest may be reduced by the application of a tax treaty.

With respect to dividends tax, a company that is a resident that declares and pays a dividend is liable for dividends tax on that dividend to the extent that the dividend consists of a distribution of an asset in specie. Given that the dividends tax is a tax on shareholders when dividends are paid to them, and, under normal circumstances, is withheld from their dividend payment by a withholding agent either the company paying the dividend or, where a regulated intermediary is

involved, by the latter. The dividends tax imposed may also qualify for any of the exemptions or a reduced rate by the application of a tax treaty.

Currently, one of the requirements under section 49E(2)(b) the Act provides the release from obligation to withhold royalties, if the foreign person to or for the benefit of which the payment of the royalty is to be made has submitted, before the royalty is paid, the following to the person making payment:

- a declaration in such form as prescribed by SARS that the person is exempt from withholding tax on the royalty payment if that foreign person was physically present in South Africa for a period exceeding 183 days in aggregate during the twelve-month period preceding the date on which the royalty is paid or if the property in respect of which that royalty is paid is effectively connected with a permanent establishment of that foreign person in South Africa and that foreign person is registered as a taxpayer under Chapter 3 of the Tax Administration Act, 2011 (Act No. 28 of 2011) ("TAA"); and
- a written undertaking in such form as prescribed by SARS to forthwith inform the person making the payment in writing should the circumstances affecting the above-mentioned exemption change or should the royalty no longer be for the benefit of that foreign person.

With respect to withholding tax on interest, one of the requirements under section 50E(2)(b) the Act provides the release from obligation to withhold interest, if the foreign person to or for the benefit of which that payment of interest is to be made has, before the interest is paid, submitted to the person making the payment:

- a declaration in such form as prescribed by SARS that the person is exempt from withholding tax on interest payment if that foreign person was physically present in South Africa for a period exceeding 183 days in aggregate during the twelvemonth period preceding the date on which the interest is paid or the debt claim in respect of which that interest is paid is effectively connected with a permanent establishment of that foreign person in South Africa and that foreign person is registered as a taxpayer under

Chapter 3 of the TAA or an agreement of the avoidance of double taxation, exempt from the withholding tax on interest in respect of that payment; and

- a written undertaking in such form as prescribed by SARS to forthwith inform the person making the payment in writing should the circumstances affecting the above-mentioned exemption change or should the payment of the interest no longer be for the benefit of that foreign person.

Reasons for change

In relation to withholding tax on interest, the income tax provides that a person must not withhold at the prescribed rate an amount of interest if the foreign person receiving interest has submitted a declaration that the amount is exempt from the withholding tax on interest as a result of an applicable double tax treaty agreement. However, a similar declaration does not exist for withholding tax on royalties and withholding of dividends tax which is contrary to the intent to align the withholding tax regime. Notably, the Act provides for a reduced withholding tax rate as a result of the application of a double tax treaty agreement in all three withholding tax regimes.

Proposal

To address this anomaly, it is proposed that the tax legislation be amended to provide for the release from obligation to withhold if the foreign person to or for the benefit of which that payment is to be made has, before the payment is paid, submitted to the person making the payment that an agreement of the avoidance of double taxation exist for royalties or dividends.

Effective date

The proposed amendments will come into operation on 1 January 2022 and apply in respect of the payment of royalties or dividends to foreign persons on or after that date.

5.30. VAT – Zero-rating of superfine maize meal

[Applicable Provisions: Schedule 2 Part B, read together with section 11(1)(j) of the Value-Added Tax Act, 1991 (Act No. 89 of 1991) ("the VAT Act")]

Background

In South Africa, the grading of maize products is regulated in the Agricultural Products Standards Act, 1990 (Act No.119 of 1990) ("Agricultural Products Standards Act"). Before 2016, the Agricultural Products Standards Act allowed for 18 grades of maize products, including the below mentioned to be sold in South Africa. In turn, Item 2 of Part B of Schedule 2 of the VAT Act provides for a list of zero-rated items, which includes the following grades of maize meal: super maize meal; special maize meal; sifted maize meal or unsifted maize meal.

Reasons for change

In 2016, another grade of maize meal, namely, super fine maize meal was added to the list regulated by the Agricultural Products Standards Act, to make it 19 graded maize products. In terms of specifications provided in the regulation in terms of Agricultural Products Standards Act, both super maize meal and super fine maize meal must have a maximum fat content by mass of less than two% and maximum fibre content by mass of 0.8%. The only difference being that for super maize meal at least 90% of the fineness or granulation by mass shall pass through a 1.4 mm sieve, and less than 90% shall pass a 0.3 mm sieve, whereas with super fine maize meal at least 80% of the fineness or granulation by mass shall pass through a 0.3 mm sieve.

At issue is that in 2016, when changes were made to the list regulated by the Agricultural Products Standards Act to add super fine maize meal as another grade of maize meal to be regulated in this regard, no consequential amendments were made in Item 2 of Part B of Schedule 2 to the VAT Act to allow for zero rating of super fine maize meal.

Proposal

In order to align the VAT Schedule to the Agricultural Products Standards Act and Regulations relating to the Grading, Packing and Marking of Maize Products intended for sale in South Africa, as gazetted in Government Gazette No. 39613, dated 22 January 2016, and to allow for zero rating of super fine maize meal, it is proposed that Item 2 of Part B of Schedule 2 to the VAT Act should be updated to include super fine maize meal. IV. Effective date The proposed amendments will come into operation on 1 April 2022

5.31. VAT – VAT treatment of temporary letting of immovable property

[Applicable provisions: New section 18D, new section 10(29) and section 9(6) of the VAT Act]

Background

The VAT Act makes provision for the supply of residential fixed property by a VAT vendor (being a property developer) to be subject to VAT at the standard rate of 15%. The property developer has to charge VAT on the sale of the residential fixed property. Depending on market conditions, residential fixed property developers are at times unable to dispose of newly built residential fixed properties for extended periods of time. In order to maintain expenses incurred in developing such fixed property, such as bank loan repayments, property developers often enter into short term temporary leases for such fixed property until a buyer can be found.

While the VAT Act recognizes the sale of residential fixed property by a property developer as a taxable supply, the leasing of residential fixed property is an exempt supply which would generally result in the VAT incurred being denied. The VAT Act requires a change in use adjustment were property developers temporary lease residential fixed property.

Property developers are entitled to deduct input tax on the VAT costs incurred to build residential fixed property (dwellings) for sale. However, where the property developer is unable to sell the residential fixed property and enters into a lease, until a buyer is found, the property developer is required to make an output tax adjustment based on the open market value of the residential fixed property when the residential fixed property is leased for the first time. In 2010, an announcement was made in Chapter 4 of the 2010 Budget Review (Heading entitled: "VAT and residential property developers" on page 79 of the Budget Review) to investigate and determine an equitable value and rate of claw-back for property developers as the current treatment is disproportionate to the temporary rental income. As a result, changes were made in the VAT Act by inserting new section 18B, for a short period, from 10 January 2012 to 1 January 2018. This section ceased to apply on 1 January 2018

Reasons for change

Concerns have been raised with regard to the inequitable value attributed to this change in use adjustment. Further, it has come to Government's attention that there seems to be confusion amongst taxpayers relating to whether the change in use adjustment results in the subsequent supply of the residential fixed property being permanently or temporarily removed from the VAT net. As such, some taxpayers interpret the legislation to imply that output tax is still payable when the residential fixed property is subsequently sold while others interpret it otherwise.

Proposal

In order to address these concerns, it is proposed that changes be made in the VAT Act by inserting a new section that will deal with the deemed change in use adjustment when the residential fixed property is leased for the first time, including whether that deemed change in use adjustment results in the residential fixed property exiting the VAT net or not and the subsequent deemed supply where the residential fixed property is sold. This approach is considered equitable and will serve as an anti-avoidance measure. It will not prejudice property developers whose intention, with regard to the residential fixed property, was always that the

residential fixed property is trading stock, intended for the making of taxable supplies in the course of such property developer's enterprise activities.

Effective date

The proposed amendments will come into operation on 1 April 2022

5.32. VAT – Reviewing the section 72 arrangement with regard to telecommunication services

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

Background

In 2019 changes were made to section 72 of the VAT Act, which deals with the SARS Commissioner's discretion to make arrangements or decisions regarding the application of the VAT Act to specific situations where the manner in which a vendor or class of vendors conducts their business leads to difficulties, anomalies or incongruities. These changes had an impact on the arrangements or decisions made before 21 July 2019. To address these concerns, in the 2020 Budget Review, government agreed to review the impact and the role of these arrangements and decisions to ascertain whether they should be discontinued or extended in accordance with the new provisions of section 72.

One of the arrangements and decisions made in terms of section 72 of the VAT Act, which was impacted by these changes is the VAT treatment of telecommunication services. South Africa is a signatory to the International Telecommunications Regulations that were concluded at the World Administrative Telegraph and Telephone Conference, Melbourne 1988 (the Melbourne ITR). South Africa is also a signatory to the International Telecommunication Regulations that were concluded at the World Conference on International Telecommunication held in Dubai (Dubai ITR) which was effective from January 2015.

Reasons for change

In 2020, changes were made in the VAT Act to introduce a new zero-rating provision in order to ensure that the provisions of the Dubai ITR are upheld, in line with the section 72 rulings that were previously given to taxpayers. However, in the Response Document to the 2020 TLAB, it was noted in page 61 that any further proposed amendments regarding the implementation of the Dubai ITR could be considered in the subsequent legislative cycle. Based on the above, in 2021, it is proposed that further amendments be made in the provisions dealing telecommunications services in order to align these provisions with the Dubai ITR, but subject to certain limitations.

Proposal

It is proposed that further amendments be made to section 11(2)(y) to extend the zero-rate to all supplies between telecommunications service providers registered in South Africa and international telecommunications service providers to the extent that such services are not provided to any branch, main business or customer of the international telecommunications service provider, situated in South Africa at the time the services are rendered. In order to comply with the Dubai ITR, it is proposed that the only exception to this will be international roaming services. Since the existing rulings given by SARS to telecommunications service providers in this regard will end on 31 December 2021, it is proposed that this amendment be effective from 1 January 2022.

Effective date

The proposed amendments will come into operation on 1 January 2022.

6. EXPLANATORY MEMORANDUM ON TAX ADMINISTRATION ACT

6.1. Income Tax – Donation receipts, third-party reporting

Amendment of section 18A

The information required by law in the receipts issued for tax-deductible donations is limited and entities issuing the receipts are not required to provide third-party data on the donations to SARS on a systematic basis.

SARS has detected that receipts are being issued by entities that are not approved to do so. To ensure that only valid donations are claimed and to enhance SARS' ability to pre-populate individuals' returns, it is proposed that the information required in the receipts be extended to allow such information as SARS may prescribe by public notice from time to time.

Third-party reporting will be extended in future to cover the receipts issued.

6.2. Income Tax – Withholding tax on royalties, foreign person to submit return

Amendment of section 49F

Section 50F of the Income Tax Act provides that a foreign person will is only be required to submit a return in respect of withholdings tax on interest, if the foreign person makes the payment of the tax. If another person makes the payment, no submission of return obligation for the foreign person exists.

It is proposed that a similar requirement should be included for purposes of withholding tax on royalties.

6.3. Income Tax – Farmers, reopening assessment for previous year of assessment

Amendment of paragraph 13 of First Schedule

Farmers are allowed to deduct the cost of livestock purchased, within a fixed period, to replace livestock sold in a previous year of assessment on account of drought, fire or other specified reasons, by reopening the assessment for the previous year of assessment.

Having regard to the time-periods allowed in paragraph 13 for a taxpayer to exercise this option, the original assessments may have prescribed.

The proposed addition enables SARS to issue a reduced assessment where such deductions were claimed in terms of the time-periods set out in paragraph 13 of the First Schedule, but such time-periods fall outside the prescription periods listed in section 99 of the Tax Administration Act. The record retention periods contained in section 29 and 97 of the Tax Administration Act will also be adjusted in line with the time-periods set out in paragraph 13 of the First Schedule

6.4. Income Tax – Six-monthly employees' tax return penalties

Amendment of paragraph 14 of Fourth Schedule

SARS may impose a penalty for the non-submission of the six-monthly employees' tax returns by employers. The penalty is calculated as a percentage of the employees' tax for the period covered by the return. Where the employees' tax for the period is not known to SARS, due to the non-submission of monthly or six-monthly returns, the penalty can only be imposed retrospectively.

This undermines the purpose and deterrent effect of the non-compliance penalty.

The proposed amendment enables SARS to raise the penalty on an alternative basis in such cases, through an estimate of the employees' tax with an adjustment once the actual employees' tax is known.

6.5. Income Tax – Provisional tax payment for a year of assessment less than 6 months

Amendment of paragraph 21 of Fourth Schedule

Provisional taxpayers are required to make provisional tax payments within six months after the commencement of a year of assessment and then again by the end of the year of assessment.

Currently, no provision is made for instances where a taxpayer has a short year of assessment, whether by reason of death, ceasing to be a tax resident, a company being incorporated during a year or a change of a company's financial year.

It is proposed that a first provisional tax payment and return not be required when the duration of a year of assessment does not exceed six months

6.6. Income Tax – Employees' tax, fringe benefits double penalty remove

Amendment of paragraph 17 of Seventh Schedule

Under paragraph 13 of the Fourth Schedule to the Income Tax Act, employers have an obligation to issue Employees' Tax Certificates (IRP5/IT3(a) certificates) to their employees. The Employees' Tax Certificate must reflect the total remuneration including the amount of any fringe benefit and allowance, and the sum of employees' tax (PAYE) deducted during that period.

If the employer under deducts PAYE and under pays SARS as a result of understating taxable fringe benefits SARS must impose a penalty of 10% on the underpayment.

The employer has an obligation to determine the cash equivalent of the value of the taxable benefit granted to its employees.

Paragraph 17 of the Seventh Schedule to the Income Tax Act provides that the nature of the taxable benefit and the cash equivalent of the value thereof must be reflected on the Employees' Tax Certificate or a separate certificate.

If an employer fails to comply with this requirement, SARS may impose a penalty equal to 10% of the amount by which the cash equivalent is understated.

Two separate penalties may thus be imposed for the same understatement. The proposed amendment removes this double penalty.

6.7. Tax Administration Act – 40 day extension beyond prescription

Amendment of section 95

SARS may make an original, additional, reduced or jeopardy assessment based in whole or in part on an estimate, if the taxpayer does not submit a response to a request for relevant material after delivery of more than one request for such material.

The taxpayer may, within 40 business days from the assessment, request SARS to issue a reduced or additional assessment by submitting the relevant material. A senior SARS official may extend the 40 business day period for a period not exceeding the relevant prescription periods under section 99 of the Act.

It may happen that SARS issues an additional estimated assessment close to the end of the relevant prescription period.

The 40 business day period may thus end after the prescription date or very close to it, which means that the taxpayer is unable to request a reduced or additional assessment.

The proposed amendment addresses this situation and provides SARS with a discretion to extend the 40 business day period for up to 40 business days beyond the prescription date in these unusual circumstances.

7. EXPLANATORY NOTES ON THE EMERGENCY TAX MEASURES IN RESPONSE TO THE CONTINUING COVID -19 PANDEMIC AND RECENT UNREST IN THE COUNTRY

7.1. Extension of the expanded employment tax incentive age eligibility criteria and amount claimable

Background

In 2020, Parliament passed the Disaster Management Tax Relief Act, 2020 and the Disaster Management Tax Relief Administration Act, 2020, containing exceptional tax measures which formed part of the fiscal package aimed at assisting taxpayers who experienced cash flow constraints as a result of the COVID-19 pandemic and required national lockdown.

One of the exceptional tax measures included in the above-mentioned Acts was an expansion to the Employment Tax Incentive (ETI). This expansion was provided to assist employers to retain employees, thus reducing the risk of lowincome earners losing their employment as a result of the lockdown.

The expanded ETI was structured as follows:

- A R750 increase to the maximum monthly amount of ETI allowable.
- Allowing the above mentioned monthly ETI claim to apply to employees not classified as “qualifying employees” in terms of the current provisions of the ETI Act for a limited period, irrespective of their date of employment (employees employed before 1 October 2013 for whom the ETI has never been claimable also qualified for the relief).
- Since the requirement for social distancing was likely to result in employees working significantly reduced hours, which would impact the monthly remuneration paid, the proposal allowed for the calculation of the ETI claim based on actual remuneration paid in that month where the employee

worked less than 160 hours a month (the remuneration paid to the employee did not need to be grossed-up).

- Accelerating the ETI reimbursements from twice a year to monthly as a means of getting cash into the hands of tax compliant employers as soon as possible.
- As the contractual agreement entered into at the beginning of the employees employment with the employer was not altered, the extent of the ETI claimable in instances where the employee was employed for less than 160 hours a month would still be impacted by the hours employed and paid for in that month (the incentive claimable would bear the same ratio that the number of hours the employee was remunerated bears to 160 hours – the incentive needed to be grossed-down).
- The inclusion of an anti-avoidance measure aimed at limiting potential abuse where an employer claimed the incentive despite having significantly reduced the employee’s wages. This anti-avoidance measure applied to wages below R2 000.
- The expansion applied for four months and was deemed to have come into operation on 1 April 2020 and ended on 31 July 2020.

Reasons for change

Despite the recent relaxation of the national lockdown, various businesses and employees are still negatively impacted by the COVID-19 pandemic. These negative impacts are further exacerbated by the impacts of the recent unrest in the country that destroyed businesses and infrastructure. The Government, therefore, wishes to provide additional assistance to those who continue to be adversely affected by COVID-19, as well as assisting in the process of reconstructing businesses. Moreover, this support measure is aimed at supporting employment in the most vulnerable sections of the labour market.

Proposal

As a result, it is proposed that the expansion of the ETI be reinstated for another limited four-month period, following the design implemented in 2020:

- A R750 increase to the maximum monthly amount of ETI allowable. Therefore, the maximum allowable values will be increased in the following manner:
    - Employees are eligible under the current ETI Act from R1 000 to R1 750 in the first qualifying twelve months and from R500 to R1 250 in the second twelve qualifying months.
    - Allowing a monthly ETI claim in the amount of R750 during these four months for employees from the ages of 18 to 29 who are no longer eligible for the ETI as the employer has claimed ETI in respect of those employees for 24 months, or they were in the employer's employ before 1 October 2013.
    - Allowing a monthly ETI claim in the amount of R750 during these four months for employees from the ages 30 to 65 who are not eligible for the ETI due to their age.
- Formulae will apply to calculate the value of the incentive relative to remuneration received, to introduce the incentive at a positive rate for wages between R0 and R2 000 per month, at a constant value for wages between R2 000 and R4 500 per month, and a declining rate for wages between R4 500 and R6 500.
- Since the requirement for social distancing may result in employees working significantly reduced hours, coupled with businesses that are being reconstructed being unable to trade as normal at the moment, both of which would impact the monthly remuneration actually paid, the proposal allows for the calculation of the ETI claim based on actual remuneration paid in that month where the employee worked less than 160 hours a month (the remuneration paid to the employee would not need to be grossed-up).

- As the contractual agreement entered into at the beginning of the employees employment with the employer will not be altered, the extent of the ETI claimable in instances where the employee was employed for less than 160 hours a month would still be impacted by the hours employed and paid for in that month (the incentive claimable will bear the same ratio that the number of hours the employee was remunerated bears to 160 hours – the incentive would need to be grossed-down).
- The inclusion of an anti-avoidance measure aimed at limiting potential abuse where an employer claims the incentive despite having significantly reduced the employee's wages. This anti-avoidance measure will apply to wages below R2 000.
- Accelerating the ETI reimbursements from twice a year to monthly as a means of getting cash into the hands of tax compliant employers as soon as possible.
- To qualify for this relief, the employer must be tax compliant and registered with the South African Revenue Service (SARS) as an employer by 25 June 2021.

Effective date

The proposed measures will apply for four months and will come into operation on 1 August 2021 and end on 30 November 2021.

7.2. Extension of the deferral of the payment of employees' tax liabilities for tax compliant small to medium sized businesses

Background

In 2020, Parliament passed the Disaster Management Tax Relief Act, 2020 and the Disaster Management Tax Relief Administration Act, 2020, containing exceptional tax measures which formed part of the fiscal package aimed at assisting taxpayers

who experienced cash flow constraints as a result of the COVID-19 pandemic and required national lockdown.

One of the exceptional tax measures included in the above-mentioned Acts was the deferral by employers of the payment of employees' tax liabilities (PAYE) to SARS for a limited five-month period. This PAYE deferral was structured as follows:

- Deferral of payment of 35% of the PAYE liability, without SARS imposing administrative penalties and interest for the late payment thereof.
- The deferred PAYE liability had to be paid to SARS in equal instalments over the six-months commencing on 1 September 2020, (i.e. the first payment had to be made on 7 October 2020).
- The application of the proposal to small or medium sized businesses conducted by a company, partnership, individual or trust with a gross income not exceeding R100 million for the year of assessment ending on or after 1 April 2020 but before 1 April 2021.
- The inclusion of a limitation stating that gross income should not include more than 20% of income derived from interest, dividends, foreign dividends, royalties, rental from letting fixed property, annuities and any remuneration received from an employer,
- Rental income derived from the letting of fixed property excludes rental income derived by a person whose primary trading activity is the letting of fixed property and substantially the whole of the gross income is rental from the fixed property.
- The requirement is that the employer is tax compliant in terms of the Tax Administration Act when making a reduced payment.
- The relief measure applied for a limited period of five months beginning 1 April 2020 and ending 31 August 2020.

Reasons for change

Despite the relaxation of the national lockdown, various businesses and employees are still negatively impacted by the COVID-19 pandemic. These negative impacts are further exacerbated by the impacts of the recent unrest in the country that destroyed businesses and infrastructure. The Government, therefore, wishes to provide additional assistance to those who continue to be adversely affected by COVID-19 as well as assisting in the process of reconstructing businesses.

Proposal

As a result, it is proposed that the PAYE deferral relief measure be reinstated for another limited three-month period as follows:

- Deferral of payment of 35% of the PAYE liability, without SARS imposing administrative penalties and interest for the late payment thereof.
- The deferred PAYE liability for the three-month period of August to October 2021 must be paid to SARS in equal instalments over a four-month period commencing on 1 November 2021, (i.e. the first payment must be made on 7 December 2021).
- The proposal will be available to small or medium sized businesses conducted by a company, partnership, individual or trust with a gross income not exceeding R100 million for the year of assessment ending on or after 1 April 2021 but before 1 April 2022.
- The inclusion of a limitation that gross income should not include more than 20% of income derived from interest, dividends, foreign dividends, royalties, rental from letting fixed property, annuities and any remuneration received from an employer,
- Rental income derived from the letting of fixed property excludes rental income derived by a person whose primary trading activity is the letting of fixed property and substantially the whole of the gross income is rental from fixed property.

- The requirement that the employer is tax compliant in terms of the Tax Administration Act when making a reduced payment.
- To qualify for this relief measure, the employer will need to have been registered with SARS as an employer by 25 June 2021.

Effective date

The proposed measures will come into operation on 1 August 2021 and end on 31 October 2021

8. TAX CASES

8.1. Public Protector v Commissioner for South African Revenue Service and other (83 SATC 313)

Applicant, being the Public Protector, brought an application for leave to appeal directly to the Constitutional Court against a judgment of the High Court of South Africa, Gauteng Division, Pretoria, in *C: SARS* v *Public Protector and Others* 82 SATC 279.

The background facts were that in 2017 a journalist had published a book in which he had alleged that former President Jacob Zuma, being the Second Respondent, had been on the payroll of, and had received a salary from, an entity called Royal Security CC, the Fourth Respondent, for at least four months after becoming President in 2009.

The former President had allegedly failed to pay income tax on this salary and Mr Mmusi Maimane, the Third Respondent and then leader of the opposition in the National Assembly, laid a complaint with the Public Protector, requesting her office to investigate the alleged payments.

In 2018, in the course of the investigation, the Public Protector issued a subpoena for the First Respondent, SARS, to appear before her and bring the former President's taxpayer information.

SARS objected to the disclosure of the taxpayer information on the basis that disclosure was prohibited by the secrecy and confidentiality regime under the Tax Administration Act.

The Public Protector took the view that the aforementioned regime was no bar to her subpoena powers.

During discussions at a meeting, SARS suggested that the High Court be approached for a *declarator* on the divergent views. However, the parties agreed to jointly seek senior counsel's opinion which would be paid for by SARS. Senior Counsel subsequently gave an opinion (the first opinion) to the effect that there was no conflict between the Public Protector's subpoena powers and the Tax Administration Act, and that the Public Protector's subpoena powers did not include the power to compel the disclosure of confidential taxpayer information in the possession of SARS.

The Public Protector felt that this opinion did not engage sufficiently with the Constitution and she was, therefore, not happy with it and she informed SARS that she would seek a second opinion.

The second opinion stated that the Public Protector's subpoena powers were constitutional powers that could not be trammeled by the secrecy and confidentiality regime of the Tax Administration Act and, therefore, the Public Protector was entitled to subpoena taxpayer information.

The Public Protector, on the basis of that opinion, issued a second subpoena, still requiring production of former President Zuma's taxpayer information. This she did without sharing with SARS the fact that she now had a second opinion whose conclusion differed from that of the first.

Thereafter, SARS approached the High Court for a *declarator* that SARS officials are permitted under the proviso of 'just cause' in section 11(3) of the Public Protector Act read with section 69(1) of the Tax Administration Act to withhold taxpayer information, and that the Public Protector's subpoena powers do not extend to taxpayer information. He further sought an order that the Public Protector

pay 15% of the costs of the application *de bonis propriis*, *ie* in her personal capacity.

The Public Protector opposed the application contending that her subpoena power was implied in the power to investigate contained in section 182(1) of the Constitution. She also contended that the subpoena power under the Public Protector Act was an additional power envisaged in section 182(2) of the Constitution and, as such, it was a power that was 'umbilically linked to the Constitution.'

As a conditional counter-application, the Public Protector asked the High Court to order SARS in terms of section 69(2)(*c*) of the Tax Administration Act to disclose former President Zuma's taxpayer information.

The High Court, being the court *a quo*, held that there was 'just cause' as contemplated in section 11(3) of the Public Protector Act for a SARS official to withhold from the Public Protector taxpayer information as defined in section 67(1)(*a*) of the Tax Administration Act 28 of 2011 and the court declared that a SARS official was permitted and was required under the provision of 'just cause' as contemplated in section 11(3) of the Public Protector Act read with section 61(1) of the Tax Administration Act to withhold such taxpayer information.

The court *a quo* appeared to accept that this interpretation commended itself as it was consonant with a taxpayer's constitutional right to privacy.

The court *a quo* declared that the Public Protector's subpoena powers did not extend to such taxpayer information and the court ordered the Public Protector to pay *de bonis propriis* 15% of the taxed costs of the opposing party, being SARS.

Section 7(4) of the Public Protector Act gave the Public Protector the power to 'direct any person to submit an affidavit or affirmed declaration or to appear before him or her to give evidence or to produce any document in his or her possession or under his or her control which has a bearing on a matter being investigated.'

Section 11(3) of the Public Protector Act made it an offence for any person 'without just cause' to 'refuse or fail to comply with a direction or request under section 7(4) or to refuse to answer any question put to him or her under that section.'

The court *a quo* dismissed the Public Protector's counter application and it found that the Public Protector had acted improperly, grossly negligently, in bad faith, and with a flagrant disregard for constitutional norms and that was the basis of the order that she pay 15% of SARS' costs *de bonis propriis.*

The Public Protector then sought leave to appeal the High Court's decision directly to the Constitutional Court against the High Court judgment on the questions of her subpoena power and costs, and the dismissal of her conditional counter-application and this application was opposed by SARS.

The Public Protector contended that there were exceptional circumstances warranting a direct appeal, including the urgent need to finalise an ongoing investigation, strong prospects of success and the fact that the court was best placed to deal with the growing tendency to grant personal costs orders against the Public Protector.

The Public Protector further contended that the Public Protector's power to subpoena was part of the power to investigate, under section 182(1) of the Constitution, and thus could not be limited by the Tax Administration Act and it also had an additional power granted under section 182(2) of the Constitution. Furthermore, section 181(3) of the Constitution obliged organs of state, including SARS, to support the Public Protector in fulfilling her obligations.

The Public Protector also argued that section 69(1) of the Tax Administration Act did not impose an absolute prohibition, and should be interpreted not to apply to the Public Protector.

SARS opposed the application and contended that the Public Protector's attempt to bypass the constitutional hierarchy of courts of appeal was not in the interests of justice.

SARS aligned himself in all other material respects with the reasoning of the High Court.

Judge Madlanga held the following:

<u>As to jurisdiction and leave to appeal-conditional counter-application</u>

(i) That it was trite that an application that simply demands the reconsideration of the application of an uncontroversial legal question did not engage this court's jurisdiction.

(ii) That the application raised neither a constitutional issue nor an arguable point of law of general public importance which ought to be considered by this court.

(iii) That, accordingly, leave to appeal the decision of the High Court regarding the counter-application was refused for lack of jurisdiction.

<u>As to the power to subpoena taxpayer information</u>

(iv) That the Public Protector's contention that her subpoena power trumped the prohibition of disclosure provided for in section 69(1) of the Tax Administration Act was based on sections 182(1) and (2) of the Constitution and that argument entailed the interpretation of section 182 of the Constitution.

(iv) That the aforementioned interpretative exercise also involved the power of subpoena under the Public Protector Act and its relationship with section 182 of the Constitution and the Public Protector Act was itself legislation envisaged in section 182 of the Constitution and, axiomatically, all of this did engage the court's constitutional jurisdiction.

(v) That, also, the interpretation advocated by the Public Protector implicated the right to privacy of taxpayers and that, too, raised a constitutional issue.

(vi) That, however, that a matter raises constitutional issues, was not enough; leave to appeal is granted only if it is in the interests of justice to do so and in an application for leave to appeal directly to the Constitutional Court, the interests of justice enquiry required proof of exceptional circumstances and proof of exceptional circumstances had to be demonstrably established.

(vii) That although the nature of exceptional circumstances will depend on the facts of each case, they often include urgency, prospects of success on appeal, the public interest and the saving in time and costs. The reasons advanced by an applicant must be persuasive enough to compel this court to deviate from the normal procedure and appellate hierarchy.

(ix) That the Public Protector's argument for a direct appeal rested, firstly, on urgency which was grounded in the need to finalise the investigation with expedition. If acting expeditiously was any consideration, the Public Protector would not have gone on a power-testing expedition which could potentially – and actually turned out to be-protracted. She could have done the simple thing of obtaining the taxpayer's written consent in terms of section 69(6)(*b*) of the Tax Administration Act.

(x) That an approach to the High Court is a legal vehicle that exists, whereas testing whether courts will agree that the mooted power does exist is unknown, uncertain terrain. So, the urgency argument was contrived and – as it was the most important point for the direct appeal – that detracted significantly from the Public Protector's entitlement to a direct appeal.

(xi) That the Public Protector further contended that she had strong prospects of success but did she? The upshot of her three arguments was that the constitutional provisions relied upon by her entitled her as of right to taxpayer information upon the issue of a subpoena. The effect was that section 69(1) of the Tax Administration Act was as good as non-existent.

(xii) That section 69(1) of the Tax Administration Act provided that SARS officials 'must preserve the secrecy of taxpayer information and may not disclose taxpayer information to a person who is not a SARS official.' Thereafter, the Act creates narrow exceptions to this prohibition. The disclosure of taxpayer information in compliance with a subpoena issued by the Public Protector was not one of the exceptions. SARS officials are thus enjoined to withhold taxpayer information even in the face of such subpoena. Any other interpretation is at odds with the clear wording of

section 69(1). The interpretation advocated by the Public Protector was not viable.

(xiii) That the effect of the Public Protector's argument was that – in the face of the constitutional power she is asserting – section 69(1) is constitutionally invalid. According to her, she is entitled as of right to taxpayer information upon the issue of a subpoena. Her case is fundamentally flawed. Section 69(1) can only not have its force – which is to deny the Public Protector access to taxpayer information – if it is invalid.

(xiv) That even though the Public Protector did not expressly argue that section 69(1) was constitutionally invalid, the effect is the same. Thus, the authority the court had just referred to stands in her way. She cannot wish section 69(1) away. She should have brought a direct formal challenge to the constitutionality of the section for including her office within its sweep, or to the Tax Administration Act for failing to include the office in the exceptions it creates.

(xv) That, as a result, absent a direct frontal challenge to the validity of section 69(1), there are no reasonable prospects of success.

(xvi) That, in the circumstances, other reasons for seeking leave to appeal directly to this court, like a saving in costs and time, the absence of disputes of fact, the inevitability of the matter reaching this court and the fact that this court was well-placed to consider the application, pale into insignificance and hence leave to appeal directly to this court fell to be refused.

As to costs

(xvii) That the court had to decide whether the High Court had exercised its discretion judicially in ordering the Public Protector to pay 15% of SARS' costs *de bonis propriis*. Unwarranted costs orders against the Public Protector in her personal capacity in work-related litigation may have a chilling and deleterious effect on the exercise of her powers.

(xviii) That personal costs orders against public officials, even if on the party and party scale, are by nature punitive; punitive because ordinarily public officials get mulcted in costs in their official capacity. So, the very idea of costs attaching to them personally is out of the ordinary and punitive in that sense. Such punitive costs orders are justified if the conduct of public officials 'showed a gross disregard for their professional responsibilities, and where they acted inappropriately and in an egregious manner.' What constitutes inappropriate or egregious conduct depended on the circumstances of each case and was something to be determined by the court on an objective basis and thus there was no closed list as it was for each court in the exercise of its discretion to decide what met this standard.

(xix) That amongst the issues that led to the order of costs *de bonis propriis* being made against the Public Protector was that in issuing the subpoena against SARS she had acted *in fraudem legis* and her view that she was entitled to issue the subpoena regardless of the prohibition in section 69(1) of the Tax Administration Act was misguided. However, it appeared to have been a genuinely held view. Based on that genuinely held view, there was no cogent basis for suggesting that the subpoena was issued for any purpose other than the investigation that the Public Protector was conducting. The High Court's conclusion that it was issued *in fraudem legis* was without factual foundation and constituted a misdirection on the facts.

(xx) That an incontrovertible (or even common cause) fact was that the Public Protector did advise SARS beforehand that she would seek a second opinion; she was not cagey about it. She was not required to involve SARS in seeking that second opinion and she was entitled to obtain it if she was not satisfied with the first opinion. In those circumstances, failure to share the second opinion hardly justified a conclusion of *mala fides*. Had she been acting *mala fide* in this regard, she would not even have shared with SARS the fact that she was going to seek a second opinion.

(xxi) That, according to the High Court, a 'proclivity' to operate outside of the law, and a 'deep rooted recalcitrance to accept advice from senior and junior counsel' were proof of unreasonable, arbitrary and *mala fide* conduct. What we have on the facts of this case was only the one instance of not being happy with the first opinion and, as a result, seeking a second opinion. How that became a proclivity escaped the court. Also mind-boggling was the holding that the Public Protector acted outside the law in seeking a second opinion, when she was perfectly entitled to seek it. The reality was that the Public Protector had two conflicting opinions and she preferred one: the correct legal position could have been what was stated in the one or the other, or in neither. The conclusion that – by picking the one opinion – she acted unreasonably, arbitrarily and in bad faith thus beggared belief and was gratuitous.

(xxii) That in stating that a 'high standard of perfection' was expected from the Public Protector, the High Court had applied an unduly high and legally non-existent standard and to hold that the slightest deviation from that standard must result in a personal costs order in the event that the deviation led to litigation had never been our law. It is not any deviation from the set norm that results in personal costs orders. To attract such an order, the deviation must be reprehensible or egregious or it must constitute a gross disregard of professional responsibilities and that was a far cry from ordering costs *de bonis propriis* as a result of a dip even by a slight margin from perfection.

(xxiii) That if the conduct of a public official has fallen short of the required standard and given rise to litigation, it may attract a costs order against her or him in her or his official capacity. It is only where there is reprehensibility in whatever form that the punitive step of ordering costs *de bonis propriis* may then be taken and so the High Court's standard of 'a high degree of perfection' was yet again a misdirection.

(xxiv) That, therefore, there was simply no basis for the High Court's award of costs *de bonis propriis* against the Public Protector and that award must be set aside.

8.2. Massmart Holdings Ltd v C:SARS (83 SATC 333)

During 2000 it was resolved that the Massmart Holdings Ltd (Massmart) would adopt and implement a share incentive scheme for its key management personnel, which scheme would be conducted through a discretionary Trust and the purpose of the Trust was to incentivise and retain employees of Massmart and the other companies in the group.

The beneficiaries of the Trust were to be specified in the Deed of Trust as the individual employees who participated in the employee share incentive scheme and Massmart, but the latter only in relation to the profits earned on the resale of the shares.

Massmart, pursuant thereto, established The Massmart Holdings Limited Employee Share Trust ('the Trust') whose trust deed listed the duties of the trustees, *inter alia*, to grant options to offerees, when instructed to do so by Massmart, not only in respect of new shares to be allot section 236 of the same Act criminalises a contravention ted by the company but also in respect of shares which are acquired by the Trust from whatsoever source.

The Trust was obliged to grant specific quantities of share options to specific employees at specified strike prices when instructed to do so by the directors of Massmart.

From time to time the Trust would acquire shares in Massmart, which were paid for by Massmart, which ensured that at any given point in time the Trust owned enough shares in the group of companies to enable it to implement the share incentive scheme and in the books of account of the Trust the shares were reflected as assets owned by the Trust and the purchase price for these shares, financed by Massmart, was reflected as a loan by Massmart to the Trust.

Massmart, once it had identified those employees whom it wished to incentivise by their participation in the scheme, would then instruct the trust to allocate shares owned by the Trust to those employees identified and to offer options to purchase those shares in terms of the Deed of Trust.

The benefit to the employees was that they made a profit in the purchase and sale of the shares pursuant to the provisions of the option agreements.

In furtherance of the objective to incentivise the employees in accordance with the scheme as set out in the Deed of Trust, Massmart and the trustees had agreed that any losses suffered by the Trust in the implementation of the scheme would be borne by Massmart.

It was always understood by all concerned that the Trust would make losses as a result of the granting of share options to selected employees, which losses would be made good by Massmart.

Employees of Massmart who accepted the options granted to them only exercised their options and paid the strike price if the prevailing market value of the shares was higher than the strike price. This was so because it would have made no sense to exercise an option and pay a strike price that was more than the market value of the shares, when the shares could be obtained for their market value by buying them on the Johannesburg Stock Exchange. This meant that in reality the Trust typically made losses, being the difference between the market value of the shares (acquired and therefore owned by the Trust) and the price (being the 'strike price') at which the employees bought the shares when they exercised their options.

In this process of the Trust acquiring the shares in Massmart and then on-selling them to the individual employees, there was more often than not, a 'commercial loss' in that the shares would be sold at a price less than what the employees purchased them and the corollary was a profit in the hands of the employee who acquired shares at a price less than the value on the open market and this fact was confirmed by the income tax levied on the profit made by the employees when they, in turn, resold the shares soon after acquiring them.

Massmart was able to track these losses and same was recorded in the books of account of both Massmart and the Trust on an annual basis and these were losses represented by the amounts claimed as capital losses by Massmart for the 2007 to 2013 years of assessment and the question was whether these losses were capital losses 'in the hands of Massmart.'

The issue in these appeals related to the consequences in regard to Capital Gains Tax (CGT) in the context of the employee share incentive scheme with the Trust as the vehicle used in the implementation of the scheme.

The question before the court was whether the capital losses reflected in the books of account of the Trust were in fact capital losses as defined in the Eighth Schedule to the Income Tax Act and, if so, whether those losses could and should be attributed to Massmart for purposes of CGT.

Massmart contended that during the 2007 to 2013 years of assessment it had suffered substantial capital losses as envisaged in the Eighth Schedule to the Act and SARS was requested to take these losses into account in the assessment of Massmart's liability for tax in respect of those years.

SARS disallowed the capital losses in issue in the amount of R954.1 million during the relevant years of assessment.

Massmart then appealed to the Gauteng Tax Court (*per* Adams J) where its appeal was dismissed and the assessments raised by SARS were confirmed.

Massmart had initially claimed the loss as its capital loss on the basis that it was a vested beneficiary of the Trust. However, by the time that Massmart had come to file its Rule 32 statement with the Tax Court, it no longer persisted in the contention that it was a vested beneficiary of the Trust and it explained that its Rule 32 statement contained new grounds of appeal that embodied an approach that differed from the approach previously relied on by it.

SARS had unsuccessfully attempted to challenge Massmart's right to rely on new grounds of appeal, see *ITC 1912* 80 SATC 417 and *ITC 1926*82 SATC 161.

Massmart explained that during the years of assessment in question the Trust Deed required the Trust, on its instruction, to grant call options to certain employees to acquire shares at the strike price and it required Massmart to bear the losses made by the Trust as a result of the Trust granting the options when such options were eventually exercised by the offerees and Massmart did *de facto* bear such losses. In order to be able to deliver the shares to the offerees, the Trust generally had to purchase shares in the market and the acquisition and disposal of shares typically resulted in a loss for the Trust, which loss was borne by Massmart, both *de facto*, as provided for in the Deed, and as detailed in notes to the annual financial statements of the Trust.

As a result Massmart actually incurred expenditure equal to the share sale losses incurred by the Trust resulting from Massmart's instruction to the trust, in terms of the Trust Deed, *inter alia* to issue the options to the offerees. This expenditure was directly related to Massmart's action in instructing the Trust to grant the options to the offerees and to satisfy those options on the exercise thereof by the offerees.

Moreover, in this matter Massmart acquired a right against the Trust to require the Trust to grant the options to the offerees and, on the exercise of such options, to acquire shares to the extent necessary, at the expense of Massmart, and to deliver them to the offerees at the strike price specified in the option contracts.

The pattern of events set out above was carried out repeatedly during Massmart's 2007 to 2012 years of assessment, as a result of which it actually incurred *de facto* commercial losses during those years of assessment.

The new case sought to be advanced by Massmart in its Rule 32 statement was as follows:

- For CGT purposes, whenever Massmart instructed the Trust to grant the options and to deliver shares to the offerees pursuant to the exercise of such options by the offerees, Massmart acquired the right ('the Right') to require the Trust to perform the obligations arising from the instructions issued by it and accepted by the Trust;

- The Rights thus acquired by Massmart constituted an 'asset', as defined in par. 1 of the Eighth Schedule to the Act in the hands of Massmart;
- The base cost of these Rights, namely rights to require the Trust *inter alia* to acquire and offer shares to the offerees, was the expenditure actually incurred by Massmart, as contemplated in par. 20(1)(*a*) of the Eighth Schedule, which expenditure was equal to the losses made by the Trust on the delivery of the relevant shares;
- When these assets were extinguished as a result of the performance of its obligations by the Trust, this resulted in a 'disposal' of the assets as contemplated in par. 11(1), which expressly referred to the 'extinction of an asset'. Massmart's rights against the Trust simply ceased to exist, and thus its assets were extinguished, resulting in the 'extinction of an asset', *ie* a 'disposal' of the assets as contemplated in par. 11(1);
- There were no 'proceeds' as defined in par. 1 of the Eighth Schedule, from the disposal of these assets as nothing was received by or accrued to Massmart 'in respect of that disposal', as contemplated in par. 35(1) of the Eighth Schedule;
- As a result, for CGT purposes, Massmart suffered a 'capital loss', being 'the amount by which the base cost of that asset exceeds the proceeds received or accrued in respect of that disposal', as contemplated in par. 4(*a*) of the Eighth Schedule, each time such an asset was extinguished during the year of assessment in question. This was borne out by the commercial reality that Massmart factually incurred expenditure equal to the losses incurred by the Trust without any proceeds being received by or accruing to the Applicant in respect of the relevant 'disposals', as defined, resulting in *de facto* commercial losses to Massmart.

Massmart's case, in a nutshell, was that when it issued instructions to the trustees of the Trust to offer specific share options to specific employees at specified prices ('the strike prices') Massmart acquired a *jus in personam ad faciendum*, *ie* a right to claim performance, against the trustees, requiring them to offer the share

options as aforesaid. The right was an 'asset' for CGT purposes. When this right was extinguished or discharged by performance by the trustees, the extinction or discharge thereof constituted a disposal in terms of par. 11(1) of the Eighth Schedule.

The Tax Court held that the losses in the books of account of Massmart arising from the employee share incentive scheme did not entitle Massmart to have its tax liability for the 2007 to 2013 years reduced on the basis that these losses constituted capital losses. They did not relate to any assets disposed of at a loss by Massmart, neither did they relate to a right in or to property owned by Massmart or anyone else.

The Tax Court accepted that a right, whether personal or real, is an asset if regard is had to our common law principles but was of the view that a personal right was not an asset as defined in the Eighth Schedule to the Act as it is based on contract and is not in any way attached to or related to property. Hence the provisions relating to the definition of a right in par. 1 of the Eighth Schedule were not of application to the right alleged by Massmart. This was a personal right unrelated to any proprietary rights vesting in Massmart and in the court's view it had not been established by Massmart that it had suffered a capital loss.

Judge Ponnan held the following:

(i) That the issue that arose for determination before the Tax Court was whether, during its 2007 to 2013 years of assessment, Massmart had suffered capital losses for capital gains tax (CGT) purposes, by virtue of its dealings with, and in relation to, the Trust.

(ii) That the CGT provisions are contained in the Eighth Schedule to the Income Tax Act 58 of 1962 and s 26A of that Act serves as a link between the main body of the Act and the Eighth Schedule. The Eighth Schedule determines the taxable capital gain or assessed capital loss and s 26A provides that the taxable capital gain must be included in the taxable income of a taxpayer for the year of assessment.

(iii) That in terms of par. 4(*a*) of the Eighth Schedule to the Act a person's capital loss for a year of assessment in respect of the disposal of an asset during that year was equal to the amount by which the base cost of that asset exceeded the proceeds received or accrued in respect of that disposal.

(iv) That an 'asset', according to par. 1 of the Eighth Schedule, included (*a*) property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency, but including any coin made mainly from gold or platinum and (*b*) a right or interest of whatever nature to or in such property.

(iv) That Massmart had called three witnesses and, far from supporting Massmart's case, the evidence of the three witnesses rather appears to have bolstered SARS' contention that the notion that the so-called right constituted an asset, was illusory and an *ex post facto* reconstruction to establish a basis by Massmart for a claim for capital losses.

(v) That Massmart's witness, one of the first trustees of the Trust, confirmed that the Trust granted options to the employees as part of their duties as trustees, on the instruction of Massmart's directors. He was asked to identify the asset disposed of which gave rise to the capital loss. He could not.

(vi) That, but even were it to be accepted that the right contended for was an asset as defined, there may well be a further insuperable difficulty in the way of Massmart. It was unclear when precisely, as contemplated by par. 4 of the Eighth Schedule of the Act, a 'disposal' of the asset occurred.

(vii) That, at best for Massmart, it would seem that the disposal would have occurred when the trustees had agreed to grant the options as instructed from time to time. But, as one of Massmart's witnesses testified, employees had to first accept the grant of the option and if accepted, exercise the option. Two of Massmart's witnesses confirmed that the mere granting or

acceptance of the option would not result in any financial obligation for either the Trust or Massmart.

(ix) That there therefore was no unconditional obligation to pay, nor had any expenditure actually been incurred at that point in time. And, at the time that the options were granted, it was uncertain if any loss would indeed arise.

(x) That, what was more, Massmart's witness accepted that the funds that it had advanced to the Trust were recorded as loans. He testified, however, that there was never any intention that the loans would be repaid. But he could not explain why the loans were recorded as unpaid loans in the financial statements of the Trust and the balances were carried forward to each succeeding year.

(xi) That the unpaid loans plainly constituted an asset in the hands of Massmart and there could thus be no loss to speak of. Instead, what Massmart purported to do was to account for the Trust's losses in its books. This despite the fact that at the outset they had received legal advice from their attorney that they could not, by arrangement between them and the Trust, change the incidence of capital gains or losses.

(xii) That it followed that the appeal had to fail and it was accordingly dismissed with costs, including those of two counsel.

8.3. ITC 1941 (83 SATC 387) – Capital Gains Tax

The taxpayer, being a discretionary *inter vivos* trust, was a vested beneficiary of various vesting trusts and made awards to its beneficiaries by virtue of the disposal of capital assets by the vesting trusts.

The taxpayer was a 'resident' of South Africa, as defined in section 1 of the Income Tax Act as were all of its beneficiaries at all times material to this appeal.

The taxpayer, during the 2014 to 2016 years of assessment, became entitled to various capital gains by virtue of the fact that it was a vested beneficiary of various

vesting trusts, each of which was a 'resident' as defined in section 1, which vested trusts had disposed of certain capital assets.

During each of the 2014, 2015 and 2016 years of assessment, the trustees of the taxpayer in turn awarded the amounts which had thus vested in it (as aforesaid), and to which it had thus simultaneously become entitled as beneficiary of the various resident vesting trusts, to its own resident beneficiaries. Each of these awards was made in the same year of assessment as that in which the vesting in the taxpayer and the taxpayer's entitlement thereto arose.

The taxpayer maintained that there was no amount of tax to pay as no capital gain had been received by or had accrued to it because it had merely acted as a 'conduit pipe,' and that both the receipts and the accruals of the amounts in question took place only in the hands of the taxpayer's beneficiaries to whom the awards and the distributions were made by it.

Each of the awards made by the taxpayer to its beneficiaries arose by virtue of the disposal of capital assets giving rise thereto by the resident vesting trusts of which the taxpayer was a vested beneficiary.

The manner in which the capital gains in question were taken into account by the taxpayer was by awarding such amounts to its own beneficiaries in the same year of assessment, leaving the taxpayer with no gain or loss of its own.

The capital gains that vested in the taxpayer by the vesting trusts were, in turn, distributed by the taxpayer to its resident beneficiaries in the same years of assessment as those in which the vesting in the taxpayer occurred.

During the teleconference hearing of the appeal the parties were also agreed that:

(a) The taxpayer's beneficiaries had in fact paid Capital Gains Tax (CGT) on the capital gains referred to in the agreed facts as set out above and, importantly,

(b) There were no relevant disputes of fact between the parties but that

(c) The Court could have regard to the documents uploaded to Caselines.

It was the Court's view alone that there were no relevant disputes of fact and that the disposal of this appeal needed only the application of the law to the agreed facts.

The taxpayer had submitted tax returns for the tax years 2014, 2015 and 2016 and in its returns for the relevant years had stated that no capital gain was made nor capital loss incurred in those years and disclosed that it had received any amounts that it had considered not taxable.

SARS had raised assessments and then additional assessments for each of those years and in the additional assessments had assessed the taxpayer for capital gains tax, understatement penalties and interest.

The taxpayer objected to the additional assessments and, but for one aspect, the objections were dismissed by SARS and the taxpayer thereafter noted an appeal to the Tax Court against the disallowance by SARS of its objections.

Judge Wright held the following:

(i) That at the heart of the dispute between the parties was the correct treatment of capital gains and the consequent taxability or otherwise of these gains in the hands of the taxpayer.

(ii) That the fact, agreed during the hearing, that the taxpayer's beneficiaries had paid Capital Gains Tax on the capital gains that they had received, should not play any appreciable part in this appeal.

(iii) That on 20 January 2021 an amendment to section 25B(1) of the Income Tax Act had been promulgated and there was no warrant for reading the newly worded section 25B(1) retrospectively and this was not suggested by SARS.

(iv) That in the court's view the Legislature, when enacting the January 2021 amendment, had sought to cure what in its eyes was the mischief of being unable to trap capital gains where SARS now sought to place them. The Legislature, in the 2021 amendment, seemed impliedly to recognize that,

absent the recent amendment, the capital gains flow rather than become trapped.

(v) That the words 'any amount' which open section 25B(1) included capital gains as the words themselves were as wide as they could be when considered literally. The word 'any' has been held to be 'a word of wide and unqualified generality. It may be restricted by the subject-matter or the context, but *prima facie* it is unlimited'.

(vi) That, at least for the purposes of this case, if not generally, section 26A of the Income Tax Act operates to leave the determination of the taxability of capital gains to be made with reference to the Eighth Schedule to the Act, read not in a vacuum but with reference to other applicable law.

(vii) That the relevant legislation in this appeal had accordingly to be read in the light of the Constitutional Court's pronouncements on the principles of statutory interpretation as set out in *Road Traffic Management Corporation* v *Waymark Infotech (Pty) Ltd* 2019 (5) SA 29 (CC) at para. [29] to [31], [33] and [37], as quoted in this judgment.

(viii) That what passed from the vesting trusts to the taxpayer and then to the taxpayer's beneficiaries were capital gains 'determined in respect of the disposal of an asset' and which constituted 'capital gain but not an asset' within the meaning of these words in the main body of par. 80(2) rather than 'an asset' as these words were used in the main body of par. 80(1) of the Eighth Schedule and this finding flowed from the agreed facts.

(ix) That, on these facts, the vesting trusts disposed of certain capital assets and in consequence thereof made capital gains. What the trustees of the vesting trusts awarded to the taxpayer were the realised proceeds of these capital gains and these proceeds were accurately described by the parties as 'amounts' in the agreed facts. What was awarded from the vesting trusts to the taxpayer and then on to the taxpayer's beneficiaries were amounts, being the proceeds of and representing capital gains.

(ix) That, in short, the capital gains in question fell within the purview of section 25B(1), section 25B(2) and par. 80(2) but not within par. 80(1) at least as these subsections and subparagraphs read for the years under consideration.

(x) SARS had argued that income as defined in section 7(1) of the Income Tax Act included capital gains and that it followed that the capital gains so included needed to be disclosed in returns and attracted taxability accordingly. However, this argument left out of account the wide ambit of the words 'any amount' in section 25B of the Act and which words must necessarily include income as defined in section 7(1) as well as capital gains.

(xi) That in *SIR* v *Rosen* 32 SATC 249 Trollip JA held that 'consequently *Armstrong's* case [*Armstrong* v *CIR* 10 SATC 1] in my view authoritatively established the *conduit* principle for general application in our system of taxation in appropriate circumstances.'

(xii) That the words 'authoritatively established the *conduit* principle for general application in our system of taxation in appropriate circumstances' encouraged the court to hold that what is applicable to dividends is equally applicable to the capital gains at issue in the present appeal and to hold otherwise would be to adopt an overly narrow approach to the words of Trollip JA.

(xiii) That the aforementioned findings made it unnecessary for the court to deal with other matters raised in the objection and on appeal by the taxpayer and it followed that the additional assessments and consequent understatement penalties and interest had to fall.

(xiv) That as far as costs were in consideration the court took the view that both sides had taken reasonably arguable positions and the taxpayer did not sought costs for itself and accordingly there was no order as to costs.

Appeal was upheld.

8.4. *ITC 1942 (83 SATC 396) – VAT*

The taxpayer was a property developer and a registered value-added tax (VAT) vendor.

The taxpayer, during the two tax periods in question, had claimed a deduction of input tax pertaining to five immovable properties which it had purchased from sellers who were not registered VAT vendors.

As the sellers were non-vendors the taxpayer had been required to pay transfer duty on the five properties and the immovable property purchased from a non-vendor is regarded as second-hand goods in terms of the Value-Added Tax Act and the taxpayer was allowed a notional input tax credit in relation to the purchase of second hand goods which was equal to the tax fraction, (being the tax fraction applicable at the time the supply was deemed to have taken place) of the lesser of the consideration in money given by the vendor for the immovable property or its open market value.

The taxpayer had calculated its notional input tax based on the consideration of money paid for the immovable properties and had included the transfer duty paid in its calculation of the consideration paid.

SARS had disallowed the inclusion of the transfer duty amounts paid in the calculation of the consideration to which the tax fraction was applied and thereby had reduced the taxpayer's notional input tax amount.

The taxpayer then noted an appeal to the Tax Court against the two VAT 217 Notices of Assessment that had been issued by SARS.

The court had to determine whether the taxpayer had correctly calculated its notional input tax when it included the transfer duty paid by it in its calculation of the consideration paid.

Judge Sievers held the following:

(i) That VAT was a tax on added value which was imposed at each step along the chain of distribution of goods and which was calculated on the value of each such step. The deduction of the input tax on purchases from the

output tax on supplies had the effect that the vendor did not bear any VAT, with the total VAT burden to be borne by the final consumer.

(ii) That the principles applicable to the interpretation of statutory provisions were set out in *Natal Joint Municipal Pension Fund* v *Endumeni Municipality* 2012 (4) SA 593 (SCA) at paras [17] to [26]. Consideration must be given to the language used, the context in which it appeared and the purpose of the provision. It was an objective process with a sensible meaning to be preferred to one with insensible or unbusinesslike results or one which would undermine the provision's apparent purpose.

(iii) That the taxpayer had calculated its input tax on the 'consideration' in money given by the vendor as provided for in the definition of 'input tax' in section 1 of the Act by including the transfer duty paid and the crisp question before the court was whether the words 'any consideration in money given by the vendor' in section 1 included the payment of transfer duty.

(iv) That the word 'any' was to be given a wide meaning unless the context required differently and it was, *prima facie*, unlimited. The definition of 'consideration' in section 1 of the Act also referred to 'any payment made or to be made (including tax) whether in money or otherwise….in respect of, or in response to, or for the inducement of, the supply of any goods or services…' and the phrase 'in respect of' imported the notion of connection or relationship between the supply and the payment.

(iv) That the broad definition of 'consideration' in section 1 of the Value-Added Tax Act which included any payment made in respect of the properties was unambiguous and the clear language used included transfer duty paid. The words in parenthesis in the definition were not relevant to this enquiry with the word 'tax' referred to therein being defined as tax chargeable in terms of the Value-Added Tax Act.

(v) That the aforementioned conclusion was based upon the clear language used and the conclusion reached was sensible and not unbusinesslike and

it did no violence to the context of the provision. The court stated further that the fact that the legislature did not intend to impose both VAT and transfer duty on the same supply of fixed property was evidenced by the complete exemption from transfer duty provided for in section 9(15) of the Transfer Duty Act in respect of the acquisition of property under a transaction which, for purposes of the Value-Added Tax Act, was a taxable supply of goods to the person acquiring such property.

(vi) That although SARS led evidence that his practice was that the purchase price paid in respect of the sale of the immovable property was the only consideration that was utilised in the calculation of the notional input tax credit, the court was of the view that his practice was irrelevant to the present enquiry on the basis that a unilateral practice on one part of the executive arm of government should not play a role in the objective and independent interpretation of legislation by the courts which was to be done in accordance with constitutionally compliant precepts. (*Marshall NO and Others* v *C: SARS* 80 SATC 400)

(vii) That, accordingly, transfer duty was to be included in the calculation of the taxpayer's notional input tax based on the consideration of money paid for the immovable properties in issue.

Appeal upheld.

8.5. ABSA Bank Ltd v C:SARS (83 SATC 401)

ABSA and its wholly owned subsidiary, Absa Towers (Pty) Ltd), had bought, on four occasions, tranches of preference shares in a South African company, PSIC3, and this purchase entitled the ABSA to dividends when declared.

PSIC3 thereupon bought preference shares in another South African company, PSIC4 and, axiomatically, when it declared a dividend PSIC3 would receive revenue and in turn be able itself to declare a dividend to its shareholders.

PSIC4 had invested in an offshore trust, DI Trust, and this investment was a capital outlay. The DI Trust then lent money to MSSA, a South African company, by means of subscribing for floating rate notes and this company was a subsidiary of the Macquarie group of companies domiciled in Australia.

The DI Trust made investments by way of the purchase of Brazilian government bonds and it then derived interest income thereon. In turn, PSIC4 received interest income on its capital investment in DI Trust. Axiomatically PSIC4 was able, in turn, to declare a dividend payable to PSIC3 and, in turn, PSIC3 declared a dividend payable to ABSA and, further, the dividends received by ABSA from PSIC3 were tax-free.

SARS, on considering the aforementioned series of transactions, was of the view that a tax avoidance arrangement had been constructed by means of the Brazilian investment by DI Trust and that ABSA were parties to an impermissible tax avoidance arrangement in terms of section 80A of the Income Tax Act.

SARS, on unravelling this series of transactions, came to the view that ABSA were a party, as defined in section 80L of the Act, to an arrangement comprising all these transactions and that ABSA had received an impermissible tax benefit in the form of a tax-free dividend.

SARS was of the view that the proper result of these transactions ought to have been that interest had been received by ABSA which would have attracted tax.

SARS, as a result of its belief that ABSA had participated in an impermissible tax avoidance arrangement, had issued notices in terms of section 80J of the Income Tax Act in respect of each Applicant which had addressed a specific alleged 'arrangement' and provided the reasons on which its belief was based.

SARS had also issued letters of assessment to each of ABSA in respect of a tax liability imposed in terms of section 80B of the Act on ABSA in respect of the alleged arrangement.

The two section 80J notices were identical as were the two letters of assessment and the basis for the assessments was identical to the section 80J notices.

ABSA contended that they had bought the preference shares in PSIC3 on the understanding that PSIC3 and MSSA had a back-to-back relationship and that the funds would flow directly to MSSA to repay debt to its parent being the Macquarie Group and they were also unaware of the intermediation of PSIC4 and the DI Trust, and of the DI Trust's Brazilian transaction.

ABSA thus contended that they could not, in a state of ignorance, have participated in an impermissible tax avoidance arrangement and nor did they have a tax avoidance motive in mind and they did not procure a tax benefit to which they were not entitled and hence the provisions comprising sections 80A-80L of the Act which dealt with impermissible tax avoidance arrangements did not apply to them.

SARS had thereafter refused to withdraw his section 80J notices and letters of assessment and this resulted in ABSA bringing a review application to the High Court to review two decisions of SARS, i.e. his refusal to comply with a request by ABSA to withdraw his section 80J notices and his refusal to withdraw his letters of assessment to each of them in respect of a tax liability imposed in terms of section 80B of the Act in respect of the alleged arrangement.

The two review applications were inextricably linked as had the first decision to issue the section 80J notices been withdrawn, then no letters of assessment could have followed and the rationale for the assessments was also the rationale in the section 80J notices.

The issues to be determined by the court were:

- Was SARS' refusal to withdraw the section 80J notices reviewable, at all, and if so, on what jurisprudential basis?
- Were ABSA a 'party' to an impermissible 'arrangement' as contemplated by GAAR?
- Did ABSA procure a 'tax benefit' as contemplated by GAAR?

SARS contended, in regard to the reviewability of its decisions by the High Court, that it was anathema to the dispute resolution scheme crafted by the tax legislation to opt out of the internal remedies provided for therein and evade a progression through a process of objections, appeals and eventually, a trial in the special tax

court, by approaching, directly, a court of law at the inception of a dispute about tax liability. Moreover, the section 80J notice was manifestly an integral step in a multi-step process and the integrity of that process was being violated by a parallel process.

SARS further contended that section 9 of the Tax Administration Act, properly interpreted, was not a valid nor legitimate hook upon which to hang a review of a decision in an anti-tax-avoidance dispute.

ABSA contended, on the other hand, that, firstly, the scope of the dispute was a pure point of law which was an attribute which lent itself to broader considerations than those that dominated the stance taken by SARS and, secondly, allied to the first point, the guarantee in section 34 of the Constitution of access by a person to a court to resolve a dispute had not been compromised by the provision of a system of internal remedies leading to the special tax court and this was demonstrated by the abundant precedent for the courts' dealing with tax disputes on points of law.

Judge Sutherland held the following:

As to the reviewability of SARS' decisions by the High Court

(i) That insofar as a court has a discretion to deal with a tax dispute or insist that internal remedies be exhausted, it was argued by ABSA that a court would regard a pure point-of-law-dispute as an appropriate rationale to hear and dispose of the controversy, in preference to condemning the parties to a protracted slog through all the internal steps towards the special tax court and then, if necessary, to a court of law to which the parties could have approached directly at the outset and, in the court's view, this general proposition as advanced on behalf of ABSA was correct.

(ii) That section 9 of the Tax Administration Act had been invoked by ABSA to demand the withdrawal of the notices in issue and despite SARS' view that section 9 did not apply to the section 80J notices and section 80B assessments the court was of the view that the exclusion provided for in section 9 referred to assessments already given effect to and not to

assessments not yet given effect to and the right question to ask was not whether the tax regime offered two routes but whether the court's jurisdiction was plainly excluded. In the face of clear precedents, the court has dealt with tax disputes on points of law and have not compelled aggrieved taxpayers to exhaust internal remedies.

(iii) That as regards the implication of the officials' discretion taking the matter out of the hands of a court, the argument is advanced that when the dispute is about a point of law there is no room to debate a range of options in making a decision: only a correct view of the law is rational and lawful, hence there was no room for deference – the decision is right or wrong and accordingly the two decisions in issue were not excluded from the ambit of section 9 of the Tax Administration Act.

(iv) That section 105 of the Tax Administration Act provided that 'a taxpayer may only dispute an assessment or 'decision' as described in section 104 in proceedings under this Chapter, unless a High Court otherwise directs.' The right of objection in section 104 refers to objection to an assessment and 'any other decision that may be objected to or appealed against under a tax Act.' Although it was contended that the provisions of section 105 indicated a confined arena in which to conduct any disputations over a tax liability, then, plainly, if a court may '…otherwise direct…' that would result in an environment for dispute resolution in which there was more than one process.

(iv) That a court plainly had a discretion to approve a deviation from what might fairly be called the default route. In as much as section 105 is couched in terms which imply permission needs to be procured to do so, there is no sound reason why such approval cannot be sought simultaneously in the proceedings seeking a review, where an appropriate case is made out. It was common cause that such appropriate circumstances should be labelled 'exceptional circumstances'. The court would require a justification to depart from the usual procedure and, this, by definition would be 'exceptional.' However, the quality of exceptionality need not be exotic or rare or bizarre;

rather it needs simply be, properly construed, circumstances which sensibly justify an alternative route. When a dispute is entirely a dispute about a point of law, that attribute, in my view, would satisfy exceptionality.

(v) That, accordingly, sections 104 and 105 of the Tax Administration Act did not impinge adversely on the course of action launched by ABSA.

(vi) That the next issue to be determined in relation to the reviewability of SARS' refusal to withdraw the section 80J notice was an examination of the decision in question in order to determine to what species it belonged. Was it 'administrative action' or was it merely an exercise of public power and reviewable under the principle of legality? The decision to issue the section 80J notice was of course not final because the notice *per se* placed no immediate adverse burden on ABSA and thus had no 'external or legal effect' and was therefore plainly not administrative action as contemplated by the Promotion of Administrative Justice Act (PAJA).

(vii) That, however, it was common cause that the effect of a letter of assessment did constitute administrative action and the decision to refuse to withdraw, an option open to the decision-maker, stood in a different light and, arguably, the refusal to withdraw the notice could be construed as administrative action as well but ABSA however invoked the principle of legality to review the decision.

(ix) That it was unnecessary to decide whether ABSA might have relied on PAJA because it could fairly be said that the attributes of the decision to refuse lay in the borderlands of which review-regime should prevail, i.e. PAJA or Legality. The refusal undoubtedly had an effect even if it could plausibly be argued that it was not final in effect. More important, in the court's view, was that the decision to refuse was plainly a decision by an organ of state exercising a statutory power and its notional non-final attribute was not a bar, precisely because it nevertheless had an impact. Similar non-final decisions have been held to be susceptible to review.

(x) That in the result it was appropriate to proceed by way of a legality review in preference to PAJA.

(xi) That, as to the question whether the dispute *in casu* turned wholly on a pure point of law, the court stated that no rebuttal of the facts described herein appeared in the section 80J notice, nor subsequently in the answering affidavits and no clear allegation of mendacity appeared anywhere. Moreover, SARS had put his eggs in one basket by issuing the letters of assessment on the factual premise in the section 80J notice. The significance of the letters of assessment to this specific analysis was limited to the effect it had on understanding and interpreting the stance adopted by SARS in the section 80J notice. Put bluntly: If you seek to assess and collect tax on the basis that it is due despite ABSA being ignorant, then it was not open to claim that you deserve a chance to go behind the premise of the assessment levied, so you can afterwards attempt to prove that ABSA did have knowledge. In the court's view, it would be untenable, having regard to SARS' conduct, appraised holistically, to endorse a reading of the section 80J notice that would allow it to wriggle out of the premise that it chose to rely on to levy an assessment.

(xii) That, accordingly, there was no room for a plausible dispute of fact. ABSA were served section 80J notices and were subsequently served with letters of assessment on the facts reported by ABSA about its role in the series of transactions and hence a semantic gyration cannot turn a Naartjie into an orange.

(xiii) That, accordingly, the decisions by SARS refusing to withdraw the section 80J notices were appropriately decisions reviewable under the principle of legality.

(xiv) That a taxpayer was not obliged to pursue a remedy in respect of a dispute over a tax liability in terms of the procedures set out in tax legislation only and may apply directly to a court of law for relief in exceptional circumstances and ABSA, insofar as judicial authorisation was required, were authorised to do so. Moreover, exceptional circumstances included a dispute that turned wholly on a point of law.

(xv) That the letters of assessment were issued on the factual premise of the section 80J notices and their fate was indistinguishable from that of the section 80J notices.

As to the substantive grounds of review

(xvi) That ABSA contended that two substantive errors of law were made by SARS in his section 80J notices setting out his rationale for issuing them: First, it was an error to suppose that ABSA could be a 'party' as defined in section 80L of the Income Tax Act and, second, the transaction to which ABSA were a party did not result in it escaping from any tax liability.

(xvii) That the fundamental issue was whether ABSA' conduct demonstrated that it was a party to an 'impermissible arrangement'. The section required a taxpayer to 'participate or take part' and such conduct required volition. A taxpayer has to be, not merely present, but participating in the arrangement. The fact that it might be the unwitting recipient of a benefit from a share of the revenue derived from an impermissible arrangement cannot constitute 'taking part' in such an arrangement. SARS elides the notion of sharing with participation in para 66 of the section 80J notice and this was incorrect.

(xviii) That the 'arrangement' contended for must encompass all the transactions described. An arrangement which is alleged to comprise several distinct transactions must therefore be a scheme. It was plain that the scheme required a unity to tie the several transactions into a deliberate chain. A mere series of subsequential events did not constitute a chain. Without a factual basis to allege that ABSA were anything more than an investor in preference shares, no scheme was established that reached ABSA, even if it extended to some or all of the other entities.

(xix) That, moreover, there was no basis to construe the factual basis as supporting an inference that ABSA' investment was, in the least, motivated by an intention to obtain relief from an anticipated tax liability, a necessary attribute of an arrangement. The expectation of receiving dividend income

which was free of tax was so banal a transaction that it could not support a suspicion of pursuing an ulterior motive and thus could not serve to broaden the compass of the participants in a scheme.

(xx) That, in regard to the receipt of a tax benefit as required by section 80A of the Act, whether a tax liability was evaded was determined by the 'but for' test applied to a future anticipated tax liability. SARS' rationale was articulated in the passages cited in the judgment but in the court's view there was no plausible link demonstrated between ABSA and the supposedly nefarious transactions. On the but for test the question must be posed: but for the purchase of preference shares in PSIC 3, how might an anticipated tax liability be evaded? No foundation is set out that demonstrates such a result and, thus, the conclusion is irrational.

(xxi) That the premise of the section 80J notice was that ABSA were liable to be taxed in respect of an impermissible arrangement despite their ignorance of the arrangement.

(xxii) That premise was incorrect in law because the factual premise did not establish that ABSA were a party to such arrangement nor that they had an intention to escape an anticipated tax liability nor that they had received relief from a tax liability as result of acquiring preference shares in PSIC 3.

(xxiii) That, accordingly, SARS' decision to refuse to withdraw the section 80J notices and the issue of the letters of assessment were reviewed and set aside and it was appropriate that an order be made withdrawing the section 80J notices issued by SARS.

8.6. Rappa Resources (Pty) Ltd v C:SARS (83 SATC 418) – VAT

Rappa purchased and sold gold bearing bars which were an alloy of between 55 and 99.9% gold and the remainder silver and all of their sales were exports.

Rappa paid VAT on their purchases but their exports were zero-rated for VAT purposes and they claimed VAT refunds for the VAT paid to their suppliers.

Rappa's business model was such that they relied on the VAT refunds for survival as if there were no VAT refunds then they would operate at a deficit.

SARS had notified Rappa that they were being audited and had stopped the payment of their VAT refunds while the audit was taking place.

The basis of the audit, according to SARS, was that it had reason to believe that Rappa were either directly or indirectly involved in unlawful activities which used their business model as a front for disposing of either illegally mined gold or smelted down Krugerrands, which were zero-rated for VAT.

SARS had withheld VAT refunds since February 2020 and the total amount of refunds withheld from February to June 2020 was approximately R1.6 billion.

Rappa submitted that they would not be able to function without the refunds which constituted the basis for urgency in this matter and their bank had also terminated their overdraft facility on which they had been reliant.

Rappa further contended that they were entitled to the refunds as they had submitted VAT returns which showed that the refunds were due and suggested that SARS' decision to withhold the refunds was without lawful or factual basis and that was why it sought to review that decision.

Rappa then approached the High Court on an urgent basis for an interim order that SARS make payment of the VAT refunds which it had withheld, pending a review of his decision to withhold payment of those VAT refunds.

Rappa also sought an order that SARS complete the audit instituted in March 2020 within 15 days of the grant of the order and directing SARS not to withhold any further refunds in respect of periods not part of the March audit.

Section 190(1) of the Tax Administration Act provided at the relevant time that SARS must pay a refund if a person was entitled to a refund but section 190(2) provided that SARS need not authorise a refund as referred to in subsection (1) until such time that a verification, inspection, audit or criminal investigation of the refund in accordance with Chapter 5 had been finalised.

Section 190(3) provided that SARS must authorise the payment of a refund before the finalisation of the verification, inspection, audit or criminal investigation if security in a form acceptable to a senior SARS official is provided by the taxpayer.

SARS had opposed all the relief sought by Rappa, including that the matter was urgent and had requested that its answering affidavit be kept confidential and that the matter be heard in camera.

SARS further contended that no decision had been made to withhold the refunds in question and hence there was no decision that may be reviewed. It submitted that the withholding of refunds when an audit was instituted was automatic and was not a decision as the decision is only made after the audit.

Judge Yacoob held the following:

As to the confidentiality issue

(i) That the reason given by SARS for wishing to keep the proceedings and the affidavits confidential was that the answering affidavit, and therefore the replying affidavit in the relevant parts, identified certain taxpayers, provided certain information, set out the details of a suspected scheme, and included evidence from a confidential inquiry. Nevertheless, having made an interim order that the papers in the matter may not be published, and that the argument would not be open to the public, it remained for the court to decide whether the specified papers should remain embargoed from publication.

(ii) That SARS did not make a formal application for the order it sought and it also did not file a separate affidavit containing the allegedly confidential material. The manner in which the issue of confidentiality was dealt with was therefore somewhat perplexing and SARS did not actually point to any prejudice that may result to its investigations were the information to become public.

(iii) That, accordingly, SARS' application to preserve the confidentiality of these proceedings and the answering and replying affidavits was dismissed with costs.

As to condonation

(iv) That, considering the urgent nature of these proceedings, and that SARS clearly had sufficient time to respond to the application, it was clearly in the interests of justice that Rappa's failure to comply with section 11(4) of the Tax Administration Act be condoned and Rappa had also demonstrated compliance with section 11(5) of the Act.

As to payment of the refunds

(v) That section 190 of the Tax Administration Act requires SARS to pay a refund if a person was entitled to it, but need not pay a refund if that person was under audit, until the audit had been finalised. SARS must pay the refund even if the person was under audit, if that person provided acceptable security.

(vi) That SARS' submission that no decision had been made to withhold the refunds and therefore there was no decision that may be reviewed and that the decision was only made after the audit was patently inconsistent with both the Tax Administration Act and with SARS' practice. Accepting that a decision had been made to withhold the refunds for the present, the question was then whether Rappa had demonstrated a right to the refunds pending the audit, or pending the decision on part B of the application.

(vii) That it was clear that although Rappa had cast the relief as interim relief, the relief was actually final in nature. Rappa did not have security for the amounts claimed on their own version, and if they did have security, they would have been able to obtain the necessary refunds from SARS in accordance with the section. If the refunds had been paid, they would not have been preserved for SARS to reclaim if the audit and inquiry had

disclosed that Rappa were somehow involved in the unlawful scheme that SARS had described.

(viii) That Rappa therefore had to show a clear right to the refunds.

(ix) That while the prejudice to Rappa in the withholding of the refunds (and future refunds while the audit was proceeding) was astronomical, the prejudice to the fiscus if the audit or inquiry disclosed that Rappa were in fact colluding with others in the supply chain was also astronomical. The Tax Administration Act seemed to seek to balance the interests of the taxpayer and the fiscus by allowing SARS to retain the refunds pending the outcome of the audit. If this is not done the taxpayer who claims refunds based on the self-assessment system that is used would always have an advantage and SARS would be able to do nothing until it had clear evidence that there was something untoward at play.

(ix) That if SARS had made an incorrect decision to withhold the refunds, Rappa may then be successful in reviewing that decision. SARS contended that the decision was not reviewable on the basis of the judgment in Cart Blanche Marketing CC and Others v C: SARS 83 SATC 89. However, the court was of the view that the decision to withhold refunds was patently different to a decision to audit as was the case in Cart Blanche Marketing because it had a direct, external legal effect, ie the taxpayer's liquidity was immediately affected.

(x) That, applying the principles of statutory interpretation set out in Cool Ideas 1186 CC v Hubbard and Another 2014 (4) SA 474 (CC), that a statute must be interpreted purposively, in context, and as much as possible in a manner consistent with the constitution, the court could not agree that the scheme of the Tax Administration Act led to the necessary conclusion as contended for by the Rappa that section 190(2) did not interfere with the taxpayer's entitlement as set out in section 190(1) of the Act.

(xi) That section 190(2) of the Act then functioned as a mechanism to rebalance the scales somewhat in favour of the fiscus, to protect money that may have been claimed wrongly or mistakenly as a refund. It would be ludicrous if SARS was still obliged to pay out refunds with no security when there was doubt as to the correctness of returns or any other reason to doubt the taxpayer's entitlement to the refund.

(xii) That the above was made clear by the provision in section 190(3) of the Act requiring payment of refunds on the provision of acceptable security. The purpose here was to preserve the funds until it was clear who was entitled to it and Rappa had not, at this stage, demonstrated a clear right to the relief sought.

(xiii) That Rappa were not able to offer security to SARS for the full amount of the refunds and SARS had refused to accept security for anything less. At the hearing SARS contended that it could not make part payment of a refund and that Rappa had to offer security for the whole amount of the refund and the whole refund would be paid, or none at all.

(xiv) That in the court's view SARS' position was an unreasonable one to take and was not at all supported by the plain language or obvious purpose of the statute and, accordingly, Rappa were entitled to a refund of as much as they were able to provide acceptable security for.

(xvi)That, accordingly, Rappa had not demonstrated a clear right to the relief sought but SARS' refusal to accept security for anything less than the full amount of the refunds was found to be unreasonable and Rappa were immediately entitled to a refund for as much as they had been able to provide as acceptable security. Further, SARS could not continue to withhold refunds where those refunds were not under audit.

<u>As to the completion of the audit in issue</u>

(xvii) That taking the scheme of the Tax Administration Act as a whole, where SARS has withheld a refund, particularly where the refund is as integral to

the business model of the taxpayer as in this matter, it cannot be allowed to take an indefinite time to complete an audit. This would mean that the Tax Administration Act is inherently unfair towards the taxpayer and the audit has to be completed in a reasonable time, taking into account the circumstances.

(xviii) That Rappa' order proposing that SARS complete its audit within fifteen days of the order was far too short but SARS' contention that it would require six months to complete the audit was also rejected by the court and it then took into account that SARS had had the necessary information since at least 11 August and hence gave SARS a further four months until 11 December at the latest to finalise its audit and make payment of the refunds unless the audit indicated that the payment was not due.

(xix) That, accordingly, SARS was directed to pay Rappa immediately a portion of the refunds that had been withheld for which amount Rappa were able to provide acceptable security.

8.7. ITC 1943 (83 SATC 429) – Transfer pricing

The taxpayer was a company incorporated in terms of the company laws of South Africa and was in the business of manufacturing, importing and selling chemical products.

The taxpayer had a catalyst division that manufactured and sold catalytic converters called catalysts which were used in the abatement of harmful exhaust emissions from motor vehicles.

The taxpayer, in order to produce the catalysts, required *inter alia* certain metals known as Precious Group of Metals (PGMs) and it purchased the PGMs from a Swiss entity ('the Swiss entity') which was a connected party to it as defined in section 1 of the Income Tax Act.

The taxpayer, once the manufacturing process was complete, sold the catalysts to customers in South Africa known as the original equipment manufacturers (OEMs).

SARS, carried out a transfer pricing audit into the taxpayer's 2011 year of assessment which resulted in SARS raising an additional assessment on 11 January 2016 in order to effect an adjustment that it had made to the taxpayer's taxable income in terms of section 31(2) of the Income Tax Act.

SARS, in its Letter of Audit Findings dated 22 October 2015, stated that it had formed a view that the transactions involving the purchase of the PGMs between the taxpayer and the Swiss entity did not meet the arm's length standard as required by section 31(2) of the Act.

SARS formed the aforementioned view following a detailed analysis of the total cost base incurred by the taxpayer in acquiring the PGMs and other raw materials including the manufacturing and distribution costs of the catalysts. SARS also took into account the role played by the taxpayer in purchasing and manufacturing the catalysts, the assets and the risks involved and which risks the taxpayer had accounted for in its financial statement.

SARS, using the Transactional Net Margin Method (TNMM) with a Full Cost Mark-Up (FCMU) conducted a benchmarking study using external companies that it considered comparable to the taxpayer's business circumstances.

Following that comparability study, SARS noted that the FCMU of 1%, declared by the taxpayer in its 2011 financials, fell between the minimum and lower quartile of the range of comparable companies and on this basis it concluded that the FCMU achieved by the taxpayer was not at arm's length and because of this an adjustment was warranted.

SARS, as recommended in the *OECD Transfer Pricing Guidelines* (TPGs) and adopted by it in its *Practice Note 7* (PN 7), invited the taxpayer's comments in relation to the proposed upward adjustment of its 2011 FCMU.

Although the taxpayer had provided comments to persuade SARS against the proposed adjustment, SARS was not persuaded.

It was common cause that, contrary to the recommended practice (i.e. the *OECD Guidelines* and *PN 7*), that taxpayers test their transfer prices for the arm's length

requirements, the taxpayer had not tested the transactions involving the purchase of the PGMs from the Swiss entity.

SARS, on the strength of the recommendations set out in PN 7, which flowed directly from the TPGs, had adjusted the taxpayer's FCMU to the median arm's length range achieved by the comparable companies and this resulted in an increase in the taxpayer's income for the 2011 year of assessment by an amount of R114 157 077.

SARS contended that an adjustment of the FCMU of the transaction was an adjustment for the consideration of the PGM transactions and hence the taxpayer was appealing the additional assessment already referred to the Tax Court.

However, the present proceedings before the Tax Court constituted an application by the taxpayer for separation of a legal issue in terms of Rule 33(4) of the Uniform Rules of Court as provided for in terms of Rule 42(1) of the Rules relevant to the Tax Court as promulgated in terms of section 103 of the Tax Administration Act and the aforesaid application was opposed by SARS.

However, in the background of this application was a pending income tax appeal by the taxpayer before the Tax Court which is referred to as the main proceedings.

The pending income tax appeal was against the additional assessment raised by SARS which gave effect to its adjustment of the taxpayer's taxable income as described and the adjustment, according to SARS, was based on section 31(2) of the Income Tax Act as it then read in 2011.

Rule 33(4) of the Uniform Rules of Court provided that if, in any pending action, it appeared to the court that there was a question of law or fact which may conveniently be decided either before any evidence is led or separately from any other question, the court may make an order directing the disposal of such question in such manner as it may deem fit and may order that all further proceedings be stayed until such question has been disposed of, and the court shall on the application of any party make such order unless it appears that the questions cannot conveniently be decided separately.

The court thus had to consider whether there was a cogent legal point to be tested and in the event that the court were to find that there was cogency in the issue, whether the determination of the issue sought to be separated would advance the objects of Rule 33(4) and give direction to the rest of the case and obviate the need to lead evidence.

The taxpayer contended that section 31(2) of the Act as it read in 2011 only permitted SARS to adjust the consideration in respect of the transactions between it and the Swiss entity to reflect an arm's length price for the purchase and supply of PGMs. It contended that even if it had been found that it had not paid an arm's length price for the PGMs, which it denied, SARS was only entitled to adjust the price/consideration paid for the PGMs as between itself and the Swiss entity and not the consideration between itself and third parties.

The taxpayer further contended in this regard that SARS' adjustment of its profits pursuant to its application of the TNMM and the FCMU was not a legitimate exercise of transfer pricing power authorised by section 31(2) of the Act.

The taxpayer had suggested that SARS had overreached the powers provided for in section 31(2) of the Act when it had adjusted the consideration of a different transaction between the taxpayer and third parties and not that of the PGMs.

The taxpayer accordingly contended that SARS' additional assessment was legally impermissible and the issue that it sought to be separated was whether the conduct of SARS fell within the powers set out in section 31(2) of the Act.

The taxpayer further submitted that the issue raised was compact, discrete and could easily be incised and could be decided 'without reference to the underlying merits or to whether the sale of the PGMs was or was not at arm's length' and the issue sought to be separated was dispositive of the issues in the appeal as if it was found that SARS had acted outside its powers, the assessment could not stand and there would thus be no need to lead evidence into the remaining issues raised in the pleadings.

SARS contended, on the other hand, that the answer to the question raised by the taxpayer, i.e. whether it had acted within the powers set out in section 31(2) of the

Act, involved a factual analysis which commenced with a determination as to whether the transaction between the taxpayer and the Swiss entity was at arm's length or not. In other words, the question of adjustment in terms of section 31(2) did not even arise before one established as a fact whether the transactions between the taxpayer and the Swiss entity were at arm's length or not. Thus, the issue sought to be separated was neither discrete nor compact and nor could it be easily incised and far from being discrete, the issue was inextricably bound with the main issue in the appeal, and that was whether the transactions between the taxpayer and the Swiss entity were at arm's length. Moreover, the enquiry into the arm's length nature of a transaction was an overriding principle in transfer pricing matters and may not be receded to the back as the taxpayer had sought to do.

It was common cause that in 2011 section 31 of the Act was amended in its entirety by the Taxation Laws Amendment Bill 2011 and was replaced in April 2012.

Judge Bam held the following:

(i) That the point raised by the taxpayer which it sought to separate from the issues raised in the appeal, concerned the powers of SARS as sanctioned by section 31(2) of the Income Tax Act. The taxpayer challenged that on a proper reading of section 31(2) SARS was only entitled to adjust the price/consideration paid for the PGMs as between itself and the Swiss entity. Consequently, the act of adjusting its profits, pursuant to the application of the TNMM and the FCMU, was not a legitimate exercise of transfer pricing power authorised by section 31(2) of the Act.

(ii) That the court referred to the taxpayer's letter of response to the audit finding dated 27 November 2015 wherein it advanced points, the majority of which were entirely premised on the authoritative statement of the arm's length principle. In the first instance the taxpayer dealt with how it had sought to meet the arm's length principle as found in par. 1 of Article 9 of the *OECD Model Tax Convention* which formed the basis of bilateral tax treaties involving OECD member countries and an increasing number of non-member countries.

(iii) That all methods of determining the arm's length nature of a transaction enquired into the profits made or ought to be made, submitted SARS. Once it was found that the transaction was not at arm's length, adjustments were then made to the profit margins of the respective transactions to determine the taxable income. SARS also submitted that the taxpayer, by its very own reference to the authoritative statement of the arm's length principle, had accepted that profits which would have accrued to it, but for the transaction which was not at arm's length, may be included in its profits and be taxed accordingly.

(iv) That, bearing in mind that the court was not called upon to decide the merits in the case, it nevertheless had regard to a fair number of transfer pricing cases and it referred to three of them. The point illustrated by the reference to the three cases demonstrated that regardless of what method had been used to determine the arm's length consideration, ultimately, adjustments were made to the profits of the taxpayer to ensure that tax was levied on the correct amount of taxable income.

(iv) That the taxpayer, notwithstanding having placed reliance on the authoritative statement in both the TPGs and PN 7 which sought to tax profits that ought to have accrued to a party, but for the fact that they were not dealing with each other at arm's length, what made it decide to attack the very conduct that it had acknowledged in advancing its case against SARS? The court noted that the taxpayer, all along, had pursued its case on the basis that the transactions involving the PGMs had no transfer pricing implications as they were 'flow through transactions'. Thus, it did not test the PGM transactions for the requirements of the arm's length principle.

(v) That, accordingly, the court agreed with SARS that there was no cogent point of law to be tested in what the taxpayer was raising and hence the point sought to be separated had no cogency. Besides arguing that SARS ought not to have adjusted its profits, the taxpayer had not made any practical suggestion on how the adjustment ought to have been done in

order to determine its taxable income, given that the PGM transactions took place in 2011 whereas the audit was conducted in 2014.

(vi) That the court then turned to the attack launched by the taxpayer against SARS' reliance on the OECD TPGs and PN 7 and enquired whether those attacks made the point sought to be separated any more cogent. In testing the arm's length nature of the transactions and effecting the adjustment, SARS had placed reliance on the TPGs and PN 7, but the taxpayer contended that section 31 made no reference to the TPGs nor PN 7. Moreover, it stated that South Africa was not even a member of the OECD nor did the TPGs have any legal status. Thus, it contended that the powers afforded to SARS by section 31(2) must be established only by reference to the statute itself.

(vii) That, with regard to SARS' reliance on PN 7, the taxpayer argued that the decision in *Marshall NO and Others* v *C: SARS* 80 SATC 400 was support for the proposition that a statute may not be determined with reference to how the administrative agency responsible for implementing it interprets it and, accordingly, PN 7 was not a permissible guide when interpreting section 31(2) of the Act.

(ix) That in advancing its case the taxpayer had placed reliance on both PN 7 and the TPGs and such reliance demonstrated that PN 7 evinced a practice that was internationally accepted and applied by both the taxpayer and SARS and it had to be assumed that it was a practice recognized by all concerned. The *Marshall* case, *supra*, in other words, supported SARS' reliance on PN 7 as did the court in *Natal Joint Municipal Pension Fund* v *Endumeni Municipality* 2012 (4) SA 593 (SCA) at par. [18]. The court also accepted SARS' submission that PN 7 and the TPGs constituted materials known to those responsible for the production of section 31(2) of the Act.

(x) That there was a further reason why the taxpayer should be precluded from raising its argument about SARS' reliance on PN 7 and the TPGs as the taxpayer had made its case placing reliance on both the PN 7 and the

TPGs and this was plain from its Rule 32 and Rule 33 statements and it was now not open to the taxpayer to divorce itself from the case it had made in its pleadings and the parties should be held to their cases as pleaded.

(xi) That there was yet another reason why the taxpayer should not succeed in its attack on SARS' reliance on the OECD TPGs, i.e. its proposition that the OECD TPGs have no legal status and South Africa is not even a member of the OECD. However, the TPGs are followed by many non-member countries and are becoming a global standard. Moreover, it was necessary for countries to align themselves with the OECD TPGs in order to overcome the challenges brought about by BEPS. A high-level survey of Transfer Pricing cases on the international front demonstrated that OECD TPGs were applied in many countries.

(xii) That it had to be acknowledged that BEPS had claimed the centre stage in many a country's agenda and as BEPS impacts development, South Africa must be the lighthouse for Africa as the BEPS sub-committee of the *Davis Tax Commission* noted. There was no gainsaying that TPGs are a world standard in Transfer Pricing matters.

(xiii) That, accordingly, neither the attack on SARS' reliance on the TPGs and PN 7 by the taxpayer made the point sought to be separated by it any more cogent and hence to order the separation would be a waste of resources. Moreover, on a *conspectus* of evidence before the court, ordering a separation would not achieve any practical benefit and there was not a cogent point worthy of testing.

(xiv) That the appropriateness of a method to test the arm's length nature of a transaction is determined by the circumstances of a case and it must be accepted that the taxpayer was aware that the establishment as a fact whether a consideration is or is not at arm's length preceded the question of adjustment, regardless of what method was employed.

(xv) That the establishment of the arm's length nature of a transaction was the first step in transfer pricing matters and it involved a factual inquiry which culminated in a decision being made as to which of the methods endorsed by PN 7 was to be employed.

(xvi) That the question of adjustment of the price did not even arise prior to determining the arm's length nature of a transaction. The inquiry into the arm's length nature of a transaction was an overriding principle in transfer pricing matters and could not be receded to the back.

Application for separation was dismissed with costs.

8.8. ITC 1944 (83 SATC 449) – Zimbabwe – Tax Administration

The taxpayer was a limited liability company registered and incorporated in Zimbabwe and carried on the business of mining.

The Zimbabwe Revenue Authority was an administrative authority tasked with the collection of taxes in Zimbabwe and had carried out tax investigations into the affairs of the taxpayer for the tax years 2009 to 2012.

The income tax collection system in Zimbabwe was embodied in the Income Tax Act and involved the submission of self-assessments of one's income tax which, however, was subject to audit by the Zimbabwe Revenue Authority.

The Zimbabwe Revenue Authority had issued amended assessments to the taxpayer in 2014 and the taxpayer had objected thereto through its tax advisors, but its objections were disallowed by the Zimbabwe Revenue Authority on 9 November 2015.

The taxpayer then appealed to the Special Court for Income Tax Appeals where the court entertained a point *in limine* raised by the Zimbabwe Revenue Authority for the first time after the hearing was complete which was based on what it termed 'a fatally defective appeal'.

The Zimbabwe Revenue Authority submitted in that regard that the citation of the Zimbabwe Revenue Authority in the appeal was fatally defective as the person cited as the Zimbabwe Revenue Authority was 'the Commissioner General, Zimbabwe Revenue Authority' and this was in contravention of section 3 of the Revenue Authority Act [*Chapter 23:11*], which provided for the establishment of the Zimbabwe Revenue Authority 'which shall be a body corporate capable of suing and being sued in its own name and, subject to this Act, of performing all acts that bodies corporate may by law perform.'

The taxpayer contended *inter alia* that the Zimbabwe Revenue Authority had never before during the five years that this matter had been pending objected to its citation of the Zimbabwe Revenue Authority as there was no objective prejudice to it and it was only after it was further confirmed through the evidence that its position was untenable on the merits that it had scrambled to gather some dust to throw about in the hope of detracting from the substance of the matter.

The taxpayer further contended that the Zimbabwe Revenue Authority had admitted its true identity in its papers and hence on the face of its own pleadings the reality was that the true the Zimbabwe Revenue Authority was the Zimbabwe Revenue Authority and this created an issue estoppel as regards the *locus standi* and identity of the Zimbabwe Revenue Authority.

Judge Mtshiya held the following:

(i) That, admittedly, this issue, which was a point of law capable of being raised in the manner it was, came in the form of an ambush to both the court and the taxpayer. This practice, if deliberate, should be frowned upon and the points raised in the authorities quoted by the taxpayer, particularly the issue of prejudice, were important.

(ii) That, however, in terms of applying the law as stated in *G (Pvt) (Ltd)* v *The Commissioner General Zimbabwe Revenue Authority* HH347/20, the court found itself in a situation where departure from the already stated position would not enjoy the support of the law, i.e. section 3 of the Revenue Authority Act [*Chapter 23:11*] provided that the Zimbabwe Revenue

Authority was a body corporate capable of suing and being sued in its own name and that stated position of the law did not allow the issue of estoppel.

(iii) That, apart from dwelling on the issue of possible prejudice, the taxpayer did not deny that a wrong party had been cited and it merely objected to the timing with respect to the raising of the point *in limine*. Unfortunately, the law permits the raising of the issue at any time before judgment.

(iv) That, in view of this position of the law, the court was disabled from rejecting the point *in limine* raised by the Zimbabwe Revenue Authority and the point *in limine* should be upheld as there had been an invalid citation of the Zimbabwe Revenue Authority contrary to the statute.

(iv) That, accordingly, the appeal should be struck from the Roll and that meant that there was no appeal before this court and accordingly the merits of the case, and indeed any other issue pertaining to the case, could not be addressed. Proceeding further would be improper because there was no proper appeal before the court.

8.9. ITC 1945 (83 SATC 454) – VAT

The taxpayer, being a registered bank, had conducted business with regard to both transactional banking (including savings accounts and credit card facilities) and unsecured lending.

The taxpayer had appealed against the additional VAT assessment raised by SARS against its November 2017 VAT return in which it had claimed an input tax deduction in terms of section 16(3)(*c*) of the VAT Act.

The input tax deduction claimed related to the taxpayer's unsecured lending business.

The standard form loan agreements with the taxpayer's customers contained a contractual provision that the taxpayer would, on their retrenchment or death, settle their outstanding loans up to a specified amount.

During the VAT period from November 2014 to November 2015, the taxpayer had made payments in this regard totalling R582 383 753, 66 and the tax fraction of this amount, being R71 520 811, 85 was claimed as an input tax deduction.

SARS, on 15 February 2018, had issued an additional assessment in terms of which it had disallowed the input tax deduction claimed by the taxpayer and had levied a 10% late payment penalty for the resultant understatement of the taxpayer's VAT liability.

SARS, in his statement of grounds of assessment and for opposing the appeal, contended that the loan cover payments did not qualify for an input tax deduction in terms of section 16(3)(*c*) of the VAT Act, because the supply of the loan cover did not constitute a 'taxable supply' in that the loan cover was provided for no 'consideration' and accordingly the supply of the loan cover had no 'value' and the loan cover constituted, alternatively was in respect of, an exempt supply.

The following facts were not in dispute:

1. The taxpayer paid out loan cover in the amount of R582 383 753,66 during the tax periods in question and the tax fraction of the total payments made was R71 520 811, 85.
2. The standard written loan agreement between the taxpayer and its clients included an undertaking in clause 13 that for loans of 6 months or more, if the customer dies or is retrenched, the amount owing to the taxpayer would be covered to a maximum of R264 000, save that if the customer was retrenched within 3 months from taking the loan, only half of the amount owing would be covered.
3. The agreement stated that the taxpayer did not charge any fees for the loan cover.
4. The agreement recorded the costs of credit as being the initiation fee charged upfront, the monthly services fee, included in the instalment, and interest. Both the initiation fee and monthly service fee included 14% VAT.

5. The loan cover which the taxpayer afforded its clients was a discreet contractual obligation and that there was no *nexus* between such clients and the insurer with whom the taxpayer concluded a contract of insurance to protect itself against the portion of the loss to which it was now exposed in respect of such clients.

The issue in dispute was whether the supply of the loan cover was a 'taxable supply' as required by proviso (i) to section 16(3)(*c*) of the VAT Act.

Section 16(3)(*c*) permitted the deduction of an amount equal to the tax fraction of any payment made by the vendor to indemnify another person in terms of any contract of insurance provided that the supply of that contract of insurance was a taxable supply.

A 'taxable supply' is defined in section 1 of the VAT Act as the supply of goods or services chargeable with tax under the provisions of section 7(1)(*a*), including tax chargeable at the rate of zero *per cent* under section 11.

Section 7(1)(*a*) provided for VAT to be levied and paid on the supply of goods or services by any vendor in the course or furtherance of any enterprise carried on by him.

An 'enterprise' was defined in section 1 as an activity carried on by any vendor continuously or regularly in the course or furtherance of which goods or services are supplied to another person for a consideration, whether or not for profit.

'Consideration' was defined as any payment made, whether in cash or otherwise, in respect of the supply of any goods or services by that person or any other person.

Judge Sievers held the following:

(i) That the definition of what constituted a taxable supply did not contain a requirement for there to be a consideration. It did, however, require that the supply of services was chargeable with tax under section 7(1)(*a*), including tax chargeable at zero *per cent* under section 11.

(ii) That section 7(1)(*a*) provided for VAT to be levied on the supply by any vendor of goods or services during the course or furtherance of any enterprise carried on by him. The definition of enterprise required that services be supplied to another person for a consideration, whether or not for profit.

(iii) That in the present matter the taxpayer provided a loan to its customers and in respect of such loan the customers paid an initiation fee, service fees and interest and the initiation and service fees included VAT.

(iv) That while the written loan contract expressly stated that the taxpayer did not charge any fees for the loan cover, it did set out the statutory service fees charged and these service fees were defined in section 1 of the National Credit Act 34 of 2005 (the NCA) as being a fee that may be charged periodically by a credit provider in connection with the routine administration cost of maintaining a credit agreement.

(v) That thus whilst the taxpayer made no separate and distinct charge for the loan cover, the cost of such cover to the taxpayer was at least in part recovered through service fees which provided for its operational costs and these fees constituted consideration for the cover period.

(vi) That the taxpayer's unsecured lending business was thus an enterprise as defined and as required by section 7(1)(*a*) of the VAT Act. VAT is levied on the initiation fee and service fees by the taxpayer and this was during the course or furtherance of its unsecured lending business.

(vii) That the fact that the supply of the loan cover was not charged for in a separate fee would not disqualify it from being a taxable supply. In this regard the SARS *Interpretation Note 70* dated 14 March 2013 provided in para 5.2.2 that 'the effect is that VAT incurred on marketing efforts, including certain promotional supplies made for no consideration, may be deducted if the expenses can be directly attributed to specific taxable supplies made for a consideration, or generally, for the purpose of promoting the vendor's other taxable product offerings.'

(viii) That a client would however only receive the loan cover against the obligation to pay fees and interest, and it was only against this

consideration that the client would obtain the benefit. The loan cover was accordingly not purely gratuitous, but linked to the provision of credit which enabled the taxpayer to generate its loan revenue from fees and interest. Accordingly, the loan cover was for a consideration and the supply of the loan cover was made in the course and furtherance of an 'enterprise' that involved the making of taxable supplies.

(ix) That it was clear that the provision of the loan cover was made during the process of, and in order to, advance the taxpayer's lending business. The taxpayer made taxable supplies for a consideration in the context of that lending business. That consideration took the form of fees which were a key component on the income side of the business model. As the loan cover gave the taxpayer a competitive and marketing advantage to generate fees, the loan cover was therefore supplied in the course and furtherance of making taxable supplies.

(ix) That the second basis of disallowance advanced by SARS was that the supply of the loan cover constituted, alternatively was in respect of, an exempt supply. Proviso (v) to the definition of 'enterprise' provided that any activity, to the extent to which it involved the making of exempt supplies, shall not be deemed to be the carrying on of an enterprise. The basis for SARS' argument was that the loan cover was advanced or was supplied in the course and furtherance of the making of an exclusively exempt supply. This was premised upon it being accepted that one can separate the provision of credit from the provision of services in relation to the initiation fee and the provision of monthly services in respect of the service fee, and that the supply of loan cover was exclusively made in the course and furtherance of the exempt provision of credit.

(x) That in applying the *ratio* in *C: SARS* v *Capstone 556 (Pty) Ltd* 78 SATC 231 in the present matter and adopting a commercial approach towards the analysis of the taxpayer's unsecured lending business, it was clear that one was dealing with the provision of credit to clients which could not artificially

be broken down into the provision of credit on the one hand and other distinct separate transactions in relation to the initiation fee and service fee.

(xi) That the clients contracted for and received no benefit over and above the loan itself, apart from the loan cover. Where no loan was advanced, no initiation fee was payable and no service fee was levied. Furthermore, as set out in section 1 of the National Credit Act (NCA), both 'initiation fee' and 'service fee' are defined (with Regulation 44(3)) by reference to the types of costs incurred by the vendor and not by reference to any particular service supplied to the customer.

(xii) That the loan cover promoted and was made in the course and furtherance of an enterprise that included the making of taxable supplies. These fees were a key component on the income side of the taxpayer's business model. It would be uncommercial and inconsistent with the taxpayer's evidence in this regard to accept that the loan cover exclusively advanced an exempt supply.

(xiii) That the clients contracted to get a loan and not for other separate distinct services. The taxable fees recovered costs to the taxpayer and not services to the client. The NCA included these with interest as being 'costs of credit.' All three were the consideration paid for credit.

(xiv) That as the supply of loan cover advanced the entire business of advancing credit and this included a taxable supply, the loan cover advanced a taxable supply for consideration.

(xv) That, accordingly, the requirements of section 16(3)(*c*) of the VAT Act were thus satisfied and the taxpayer qualified for the deduction provided for therein.

Appeal upheld.

9. INTERPRETATION NOTES

9.1. Additional investment and training allowances for industrial policy projects – No. 86 (Issue 3)

This Note provides guidance on the interpretation and application of section 12I which provides for the deduction of additional investment and training allowances from the income of a company carrying on an “industrial project” which qualifies as an “industrial policy project”.

Section 12C(1)(a), read with paragraph (c) of the proviso to section 12C(1), allows for the deduction of the cost to a taxpayer of machinery or plant used by a taxpayer directly in a process of manufacture or any other similar process at a rate of 40:20:20:20 over four years. Section 12H, in turn, allows the taxpayer an additional deduction per learner in respect of any registered learnership agreement entered into between the learner and an employer.

Section 12I, which provides for an additional investment allowance and an additional training allowance, was introduced with the aim of supporting the main objectives of the National Industrial Policy Framework to diversify South Africa’s industrial output, support a knowledge-based economy and nurture labour-intensive industries. These incentives are aimed solely at benefitting projects within the manufacturing sector.

Section 12I aims to encourage investment in industrial projects, predominantly large industrial projects, in order to improve productivity within the manufacturing sector and thus support South Africa’s industrial strategy. This objective is achieved by allowing an additional investment allowance on manufacturing assets and an additional training allowance for the training of employees engaged in providing services in relation to the qualifying industrial policy project.

9.2. Additional deduction for learnership agreements – No. 20 (Issue 8)

This Note provides clarity on the interpretation and application of section 12H which provides deductions for registered learnership agreements.

This Note deals with learnership agreements entered into from 1 October 2016. The relevant previous issue of Interpretation Note 20 should be consulted for learnership agreements entered into before that date.

Section 12H provides additional deductions to employers for qualifying learnership agreements. These additional deductions are intended as an incentive for employers to train employees in a regulated environment in order to encourage skills development and job creation. Training contracts qualifying for these deductions are learnership agreements and apprenticeships registered with a SETA. These additional deductions consist of an annual allowance and a completion allowance. Effective from 1 October 2016, the amount of the allowance will depend on the NQF level held by the learner before entering into the learnership agreement.

Section 12H provides an annual allowance and a completion allowance to employers that are a party to a qualifying learnership agreement with an employee.

Amendments to section 12H by the Taxation Laws Amendment Act 15 of 2016 effective to learnership agreements entered on or after 1 October 2016, distinguishes between learners holding NQF levels 1 to 6 and NQF levels 7 to 10 qualifications. The pre-existing qualifications of the learner entering the learnership agreement will determine the value of the claim.

All learnership agreements entered into before 1 October 2016 are thus still subject to the previous legislation even if the learnership agreement continues beyond 1 October 2016.

9.3. Circumstances in which certain amounts received or accrued from the disposal of shares are deemed to be of a capital natture – No. 43 (Issue 8)

This Note provides clarity on the interpretation and application of section 9C, which deems any amount received or accrued (other than a dividend or foreign dividend) or any expenditure incurred in respect of an equity share to be of a capital nature if that equity share had, at the time of the receipt or accrual of that amount or incurral of that expenditure been held for a continuous period of at least three years.

The first step in determining a person's income tax liability on the disposal of shares is to determine whether the amount received or accrued is of a capital or revenue nature. Any amount received or accrued of a capital nature is specifically excluded from a person's "gross income" as defined in section 1(1) unless specifically included.

The distinction between capital and revenue is fundamental to the tax system, but neither concept has proved capable of a satisfactory definition in the Act. The question whether shares are held as trading stock or as an investment will, to a large extent, depend on the intention of the taxpayer.

Despite guidelines laid down by case law, the determination of whether the amount received or accrued on the disposal of a share falls on capital or revenue account is often a contentious matter which can lead to costly and protracted legal disputes. For commentary on the capital versus revenue issue, see the Tax Guide for Share Owners and the Comprehensive Guide to Capital Gains Tax in Chapter 2.

While section 9C eliminates uncertainty over the capital nature of shares falling within its ambit, it does not apply to all types of shares, nor does it apply to disposals of shares within three years of acquisition or returns of capital or foreign returns of capital received or accrued within that period.

Section 9C provides taxpayers with certainty that if they hold equity shares for at least three years, the gains and losses on disposal will be of a capital nature regardless of the intention with which the shares were originally acquired. Similarly,

a return of capital or foreign return of capital will be regarded as being of a capital nature once the equity shares have been held for at least three years. Not all types of shares qualify under section 9C. For example, non-participating preference shares, shares in foreign companies (other than shares listed on a South African exchange) and participatory interests in portfolios of collective investment schemes in property fall outside section 9C.

The application of section 9C is mandatory and no election is required or even possible. The wider ambit of section 9C has necessitated the inclusion of a number of anti-avoidance measures. The capital or revenue nature of shares disposed of within three years of acquisition will continue to be determined according to principles laid down by case law.

9.4. Game Farming – No. 69 (Issue 3)

This Note provides guidance on the application of selected sections of the Act and paragraphs of the First Schedule to persons carrying on game-farming operations, with its primary focus being the provisions applicable to livestock. It is not intended to deal with farming in general. A brief discussion is also included on the legislative amendments affecting deceased persons and deceased estates and the transfer of assets between spouses.

Section 26(1) provides that the taxable income of any person carrying on pastoral, agricultural or other farming operations shall, in so far as the income is derived from such operations, be determined in accordance with the Act but subject to the First Schedule. The First Schedule details the computation of taxable income derived from pastoral, agricultural or other farming operations. The taxable income from farming operations is combined with the taxable income from other sources to arrive at the taxpayer's taxable income for the year of assessment.

The First Schedule applies regardless of whether a taxpayer derives an assessed loss or a taxable income from farming operations. The First Schedule may also apply even after farming operations have been discontinued. Section 26 and the First Schedule apply to game farming, since it comprises farming operations.

The same principles used to determine whether a person carries on farming operations apply to game farmers. The test for this purpose is based on the taxpayer's intention.

Income from the sale of game, game meat, carcasses and skins and fees related to hunting constitutes farming income. However, income from accommodation, catering and admission charges is not farming income. Income not constituting farming income will be relevant when applying the ring-fencing provisions of paragraph 8 to game livestock. Game viewing fees may not constitute farming income depending on the facts and circumstances.

The rules governing the deduction of expenditure, including capital development expenditure, are similar to those applying to normal farming operations.

A farmer is required to bring to account the value of game livestock in opening and closing stock. No standard values have been prescribed by regulation for game livestock, but SARS accepts that game livestock may be allocated a standard value of nil. Game livestock acquired by donation is included in opening stock in the year of acquisition at market value under paragraph 4.

The deduction under section 11(a) for the cost of livestock is ring-fenced under paragraph 8, while an assessed loss or balance of assessed loss from farming is subject to potential ring-fencing under section 20A.

A farmer ceasing to carry on game-farming operations must generally continue to deal with any game livestock under the First Schedule.

Special rules apply for income tax and CGT purposes upon the death or sequestration of a farmer and the transfer of trading stock, livestock or produce between spouses.

9.5. Produce held by nursery operators – No. 79 (Issue 3)

This Note provides guidance on the valuation of produce held and not disposed of by nursery operators at the beginning and at the end of each year of assessment. A brief discussion is also included on the legislative amendments affecting

deceased persons and deceased estates and the transfer of assets between spouses.

A nursery operator growing seeds, bulbs, young trees or plants for resale is likely to be a farmer carrying on farming operations. As will become apparent, whether farming operations are carried on is a question of fact.

Section 26(1) stipulates that the taxable income of any person carrying on pastoral, agricultural or other farming operations shall, in so far as the income is derived from such operations, be determined in accordance with the Act but subject to the First Schedule. The First Schedule deals with the computation of taxable income derived from pastoral, agricultural or other farming operations.

The taxable income from farming operations is combined with the taxable income from other sources to arrive at the taxpayer's total taxable income for the year of assessment.

The First Schedule applies regardless of whether a taxpayer derives an assessed loss or a taxable income from farming operations. The Schedule may further apply even after farming operations have been discontinued [section 26(2)].

Both section 26 and the First Schedule apply to farming operations conducted by a nursery operator. Some nursery operators, however, have failed to comply with paragraph 2. Paragraph 2 requires a nursery operator carrying on farming operations to include in that operator's return of income the value of all produce held and not disposed of at the beginning and at the end of each year of assessment.

Persons conducting the business of a nursery in the course of which plants or trees are grown for sale are regarded as carrying on farming operations. Persons in this category are taxed in accordance with section 26 subject to the First Schedule. The same tests used to determine whether a person carries on farming operations apply to these nursery operators.

The produce held at the beginning and at the end of the year of assessment of a nursery operator carrying on farming operations is specifically excluded from section 22 and must be dealt with under the First Schedule. The value of the

produce held and not disposed of must be brought to account at the beginning and end of the year of assessment. The value to be placed upon the produce on hand is its fair and reasonable value under paragraph 9. The plants or trees grown by a nursery, which are not ready for sale, will fall into the category of growing crops and must not be brought to account when the taxable income from farming operations is determined.

Any trading stock purchased from outside sources and offered for sale is not attributable to farming operations and must be dealt with under section 22.

Special rules apply for income tax and CGT purposes upon the death or sequestration of a nursery operator carrying on farming operations.

10. DRAFT INTERPRETATION NOTES

10.1. Reduced assessments: Meaning of 'readily apparent undisputed error'

This Note provides guidance on the interpretation and application of section 93(1)(d) with specific focus on the phrase "readily apparent undisputed error".

A taxpayer who is aggrieved by an assessment or decision of SARS against that taxpayer has the right to dispute that assessment or decision. If an original assessment has not been issued, SARS may request a taxpayer to submit an amended return to correct an undisputed error made in the prior return.

In the case where an assessment has already been issued, Chapter 9 provides the legal framework to be followed by both, SARS and the taxpayer to resolve any disputes. Section 93(1)(d) provides an alternative to the dispute resolution process under Chapter 9 allowing taxpayers a less formal mechanism to request corrections to their assessments if certain requirements are met, without having to follow the objection process under Chapter 9.

Due to the misuse of the alternative mechanism, section 93(1)(d) was amended to include the requirement that the error either in an assessment by SARS or in a

return by a taxpayer must be "readily apparent" and not just "apparent". The Memorandum on the objects of Tax Administration Laws Amendment Bill, 2015, explains the reason for the amendment as follows:

> "Section 93(1)(d) of the Tax Administration Act was inserted to allow taxpayers a less formal mechanism to request corrections to their returns and so reduced assessments, without having to follow the objection and appeal route to do so. However, taxpayers have attempted to use these requests for correction to raise substantive issues that would more properly be the subject of an objection under section 104, so as to bypass the timeframes and procedures for an objection. Furthermore, taxpayers and unregistered tax practitioners have also attempted to use the requests for correction to obtain fraudulent refunds for multiple years. For these reasons, the wording has been amended to provide that SARS must be satisfied that there is a ''readily apparent'' error to clarify the nature of the errors anticipated here." (Emphasis added)

The determination of what constitutes a "readily apparent undisputed error" to the satisfaction of SARS is of importance for the following reasons:

- It determines whether the taxpayer is entitled to request a correction for a reduced assessment under section 93(1)(d) or whether the taxpayer must follow the objection and appeal route under section 104.
- It ensures consistency in the interpretation and application of section 93(1)(d) by both, SARS and taxpayers.

Section 93(1)(d) can only be applied if all the requirements are satisfied. It entails a factual enquiry and will be based on the specific facts of each request. It is important to note that section 93(1)(d) does not replace the dispute resolution process under Chapter 9 but offers a less formal mechanism and is also cost effective in resolving disputes of errors that are readily apparent. It is applied only in limited circumstances where all the requirements are met.

10.2. Disposal of assets by deceased person, deceased estate and transfer of assets between spouses

This Note provides guidance on the application of the deemed disposal of assets by the deceased, a deceased estate and the transfer of assets between spouses.

Section 9HA provides for the tax treatment of the assets of a person upon death, including the value that such assets are disposed at to the deceased's surviving spouse, heirs and legatees. Section 9HA came into operation on 1 March 2016 and applies to a person who dies on or after this date.

Section 25 provides for the tax treatment of the deceased's assets in the deceased estate and also prescribes the values of assets acquired from a deceased estate that should be taken into account by spouses, heirs and legatees. Section 25 came into operation on 1 March 2016 and applies to a person who dies on or after this date. A comprehensive discussion on the taxation of deceased estates under section 25 is outside the scope of this Note. Section 25 is discussed in this Note to the extent that it applies to section 9HA.

Section 9HB provides for the tax treatment of assets transferred between spouses. Section 9HB came into operation on 17 January 2019 and ensures parity of treatment of all disposals of assets between spouses.

The insertion of sections 9HA, 9HB and the substitution of section 255 was effected with the intention to move some of the rules in paragraphs 40, 41 and 67 of the Eighth Schedule into the main body of the Act.

The implications of donations made by a deceased estate and between spouses are not covered in this Note. The provisions under Part V of the Act should be considered in this regard.

The deceased is deemed to have disposed of his or her assets at the market value on the date of death, subject to certain exclusions and exceptions. Specific scenarios qualify for roll-over relief of a capital gain or capital loss.

The special rules under section 9HB must be considered to determine the tax implications when a person disposes of an asset to his or her spouse. While

providing for a roll-over of a capital gain or capital loss when an asset is transferred between spouses during their lifetimes, it also ensures that a resident spouse to whom an asset is disposed of takes over all aspects of the history of the asset from that person's spouse

10.3. Associations – Funding requirement

This Note provides guidance on the interpretation and application of the "funding" requirement contemplated in section 30B(2)(b)(ix), requiring that substantially the whole of an entity's funding must be derived from its annual or other long-term members or from an appropriation by the government.

The entities referred to in section 30B fall outside the scope and income tax rules for public benefit organisations (PBOs) and recreational clubs.

The definition of "entity" in section 30B(1) provides for two distinct categories of entities, comprising –

• mutual loan associations, fidelity or indemnity funds, trade unions, chambers of commerce or industry and local publicity associations; and

• professional bodies.

The respective entities are diverse in nature but have in common that they usually do not have a profit motive nor do they provide any monetary gain or material advantage for their individual members. The entities are membership based and exist for the benefit of their members. Although these entities are established to conduct their activities with and for the benefit of their members, they are not prohibited from dealing with non-members within prescribed parameters.

The approval under section 30B(2) is limited to those entities that can demonstrate that substantially the whole of their funding is derived from their annual or other long-term members or from an appropriation by the government.

Entities approved by SARS under section 30B currently have the advantage of an absolute exemption on their receipts and accruals under section 10(1)(d)(iii) and

(iv).

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

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

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

11. BINDING PRIVATE RULINGS

11.1. BPR 367 – Employment tax incentive

This ruling determines that students in the proposed training programme are not 'employees' as contemplated in the ETI Act and that the applicant will not be entitled to claim an employment tax incentive in respect of any of them.

In this ruling references to sections are to sections of the ETI Act applicable as at 24 June 2021. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the ETI Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definitions of 'employee', 'qualifying employee' and 'monthly remuneration';
- section 2; and
- section 6

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

The applicant: A resident company

Company B: A resident non-profit company

Description of the proposed transaction

The applicant and company B will enter into an agreement with the stated purpose that students will be employed by the applicant for the purpose of obtaining a qualification. The students will participate in a training programme offered by company B.

Company B will train the students for a year, supply a tablet, data and cash per month as incentive to stay in the programme. Students will have to perform certain online tasks every week and meet for group discussions every second week.

The applicant will invoice company B for payroll related services which the applicant will render monthly in respect of each student it proposes to employ.

The applicant will sign agreements with the students for a period of 12 months and pay the students a monthly salary. The applicant is not obliged to employ the students after the 12 month training programme has been completed.

The students will consent to forfeit their monthly salaries in order to be trained by company B. The students will be on the applicant's payroll and protected by its group life policy.

The students are not required to do any work. The main duty of a student will be to attend training courses 'virtually' at the skills centres hosted by company B.

There is no expectation that a student will report to the applicant's offices on a daily basis. There may be times that the students would be expected to make themselves available to perform specific forms of work such as marketing, printing and distribution of pamphlets. The applicant will only call on them to perform these ad hoc activities to the extent that doing so does not interfere with their studies.

Company B will exercise supervision and control over the students by way of mentors assigned to each of them. The mentors will monitor and supervise the students to ensure they progress successfully through the training course.

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:

- No student will meet the definition of an 'employee' in section 1(1) of the ETI Act.
- The applicant will not be entitled to claim an incentive, as contemplated in the ETI Act, in respect of any of the students.

12. GUIDES

12.1. Crypto Assets & Tax

Per SARS' website:

What is it?

A crypto asset is a digital representation of value that is not issued by a central bank, but is traded, transferred and stored electronically by natural and legal persons for the purpose of payment, investment and other forms of utility, and applies cryptography techniques in the underlying technology.

According to the Explanatory Memorandum on the Taxation Laws Amendment Bill as issued on 20 January 2021 the word "cryptocurrency" was replaced with "crypto asset" in line with the proposed adoption of a uniform definition of crypto assets within the South African regulatory framework.

How did we get here?

The process to understand and document crypto assets in South Africa started in 2014:

- 2014: The initial public statement alerting the public to the risks of crypto assets was issued by National Treasury (NT) in a joint initiative with the South African Reserve Bank (SARB), the Financial Services Board (now the Financial Sector Conduct Authority (FSCA), the South African Revenue Service (SARS) and the Financial Intelligence Centre (FIC).
- 2016: The Intergovernmental Fintech Working Group (IFWG) was established, comprising members from NT, SARB, FSCA and FIC. The objective of the IFWG is to foster fintech innovation by supporting an enabling regulatory environment and reviewing both the risks and the benefits of emerging innovations.
- 2018:
  - SARS issued a media release to clarify its stance on the tax treatment of crypto-currencies.
  - SARS published a list of FAQs (reviewed in 2021).
- 2019:
  - The National Credit Regulator (NCR) and SARS joined the IFWG.
  - The IFWG released a consultation paper on crypto assets. The consultation paper highlighted the perceived benefits and risks of crypto asset-related activities, as well as policy proposals for a regulatory framework.
- 2020: The IFWG released a position paper on crypto assets. The purpose of the position paper is to provide specific recommendations for the development of a regulatory framework for crypto assets, including suggestions on the required regulatory changes to be implemented.
- 2021: The position paper released in 2020 is being used as input into the proposed Regulations and a policy on crypto assets. Note

that SARS is only one of many role-players in South Africa, and the South African Reserve Bank (SARB) is taking the lead in the formulation of these documents. Since the crypto industry is relatively new, SARB said it is in the process of developing its own set of rules that could allow its clients to transfer assets abroad. Until the regulation is fully established, it is illegal for crypto users to transfer funds abroad, according to SARB.

Do I need to pay tax on crypto assets?

Yes, normal income tax rules apply to crypto assets and affected taxpayers need to declare crypto assets' gains or losses as part of their taxable income.

The onus is on taxpayers to declare all crypto assets-related taxable income in the tax year in which it is received or accrued. Failure to do so could result in interest and penalties.

How will it work?

Following normal income tax rules, income received or accrued from crypto assets transactions can be taxed on revenue account under "gross income".

Alternatively such gains may be regarded as capital in nature, as spelt out in the Eighth Schedule to the Act for taxation under the Capital Gains Tax (CGT) paradigm. Determination of whether an accrual or receipt is revenue or capital in nature is tested under existing jurisprudence (of which there is no shortage).

Taxpayers are also entitled to claim expenses associated with crypto assets accruals or receipts, provided such expenditure is incurred in the production of the taxpayer's income and for purposes of trade.

Base cost adjustments can also be made if falling within the CGT paradigm. Gains or losses in relation to crypto assets can broadly be categorised with

reference to three types of scenarios, each of which potentially gives rise to distinct tax consequences:

- Crypto assets can be acquired through so called "mining". Mining is conducted by the verification of transactions in a computer-generated public ledger, achieved through the solving of complex computer algorithms.
- Investors can exchange local currency for a crypto asset (or vice versa) by using crypto assets exchanges, which are essentially markets for crypto assets, or through private transactions.
- Goods or services can be exchanged for crypto assets. This transaction is regarded as a barter transaction. Therefore the normal barter transaction rules apply.

12.2. PAYE reconciliation for employers

The penalty for late filing of a PAYE reconciliation was introduced for the first time this year. However, SARS is still in the process of enhancing the Dispute Resolution process so that this penalty can be disputed separately from a PAYE late payment penalty.

In the event that you receive another PAYE penalty for the same tax period, you will not yet be able to do a Request for Remission or lodge an Objection against the added penalty on eFiling when your prior Request for Remission or Dispute has already been finalised.

The enhancements to the Dispute Resolution process should be ready soon, but in the event that you wish to do a Request for Remission or Dispute in relation to such an added penalty, SARS will as an interim measure accept a written Request for Remission or ADR1/ADR2 forms in relation to the added PAYE penalty.

To make use of the interim process to submit a Request for Remission, Notice of Objection or Notice of Appeal, please follow these steps:

Step 1

Check on eFiling that the penalty amount for which you wish to request remission, object or appeal against is indeed blocked from being submitted. If eFiling blocks you then proceed to Step 2.

Step 2

Type or write a Request for Remission, and make sure that you include the reason for your request as well as the PAYE reconciliation period or transaction numbers of the penalties incurred or the EMP201 periods. Before you do all of this please visit the Request for Remission of Administrative Non-compliance penalty webpage to understand the legislative requirements.

If you already submitted a Request for Remission but you remain aggrieved by the outcome then use the ADR1 form in the case of an objection. If you already objected and the objection was dismissed, and you wish to appeal, then use the ADR2 form. The ADR1 and ADR2 forms can be downloaded here https://www.sars.gov.za/find-a-form/ .

Step 3

Submit your Request for Remission, ADR1 or ADR2 to contactus@sars.gov.za or pcc@sars.gov.za. You will receive a case number which must be used in any future correspondence with SARS relating to this matter.

Step 4

Once SARS has considered the request for remission, objection or appeal, SARS will notify you by way of a letter addressed to your preferred channel of communication.

12.3. VAT Quick Reference Guide for Non-Executive Directors (Issue 2)

This quick reference guide provides information and guidelines regarding the VAT treatment of non-executive directors (NEDs) and should be read in conjunction with Binding General Ruling (BGR) 40 “Remuneration Paid to Non-Executive Directors” and BGR 41 (Issue 2) “VAT Treatment of Non-Executive Directors”.

BGR 41 confirms that non-executive directors (NEDs) are not common law employees and that no control or supervision is exercised by the company concerned, over the manner in which an NED performs his or her duties or the NED’s hours of work.

Based on the above, the fees earned for services rendered as an NED (hereinafter referred to as director’s fees) do not constitute “remuneration” as contemplated in paragraph 1 of the Fourth Schedule to the Income Tax Act and should therefore not be subject to the mandatory deduction of employees’ tax by the company concerned.

BGR 40 confirms that for VAT purposes an NED is treated as an independent contractor as contemplated in proviso (iii)(bb) to the definition of “enterprise” in section 1(1) in respect of those NED activities. An NED who carries on an “enterprise”1 in South Africa is therefore required to register if the compulsory registration threshold of R1 million in total value of taxable supplies is exceeded, or will exceed that amount in terms of a contractual obligation in writing in any consecutive period of 12 months. Both BGR 40 and BGR 41 were issued on 10 February 2017.

BGR 41 clarified that NEDs are carrying on an “enterprise” in respect of services rendered as an NED. BGR 41 (Issue 2) was subsequently issued on 4 May 2017 to clarify certain aspects relating to an NED’s liability date for VAT registration. BGR 40 and BGR 41 both apply with effect from 1 June 2017. The information in this guide applies to an NED, being a sole proprietor. This guide is intended to assist NEDs by highlighting specific aspects particular to NEDs, and the VAT implications of those aspects. This guide must be read in conjunction with BGR 41 (Issue 2),

BGR 40 as well as the VAT 404.

12.4. Guide to the Urban Development Zone (UDZ) Allowance (Issue 8)

This guide is a general guide about the urban development zone (UDZ) allowance provided for in section 13quat of the Income Tax Act (the Act).

It is not meant to deal extensively with the precise technical and legal aspects associated with the allowance but is intended merely as a general guide for potential investors. Moreover, urban development zones should not be confused with "special economic zones" under sections 12R and 12S which became effective on 9 February 2016.

In line with many countries, South Africa has a number of urban areas that are impoverished and suffering from extensive urban decay. In order to address these concerns and maintain existing infrastructure, governments internationally have increasingly used tax measures to support efforts aimed at regenerating these urban areas.

In 2003, the Minister of Finance announced a tax incentive in the form of an accelerated depreciation allowance under section 13quat to promote investment in designated inner cities. Currently, 15 of these cities have one or more demarcated UDZs within its boundaries making up a total of 16 UDZs. The core objectives of the allowance are to address dereliction and dilapidation in South Africa's largest cities and to encourage urban renewal and development by promoting investment by the private sector in the construction or improvement of commercial and residential buildings, including low-cost housing units situated within demarcated UDZs. The allowance is also intended to encourage investment in highly populated areas, central business districts or inner city environments and areas with existing urban transport infrastructure for trains, buses or taxis.

The allowance, when deducted, reduces the taxable income of a taxpayer and is not limited to the taxable income of a taxpayer. It can therefore create an assessed

loss.

Municipalities may apply to the Minister through the National Treasury for extensions to existing designated zones and to apply for an additional demarcated UDZ in that municipal zone. In order for an additional demarcated UDZ to be approved, the municipality must have a population of 1 million persons or more and must comply with all the requirements for demarcation.

Only areas which have a specific and necessary need for an extra zone will be granted UDZ status and will be granted Ministerial approval. The Minister announced in the 2021 budget review that this allowance is available only until 31 March 2023

12.5. Guide on Determining the Market Value of Assets for Capital Gains Tax Purposes

This guide provides general guidance on determining the market value of assets for CGT purposes.

Capital gains tax was introduced in South Africa with effect from 1 October 2001 and applies to the disposal of an asset on or after that date. A South African resident is subject to CGT on the disposal of assets not only in South Africa, but anywhere in the world. A non-resident is subject to CGT on the disposal of:

- any immovable property situated in South Africa held by the person;
- any interest or right of whatever nature to or in immovable property situated in South Africa including rights to variable or fixed payments as consideration for the working of, or the right to work mineral deposits, sources and other natural resources; and
- any asset effectively connected with a permanent establishment through which that non-resident is carrying on a trade in South Africa.

A capital gain or capital loss on disposal or deemed disposal of an asset is determined during a year of assessment by subtracting its base cost from the

proceeds. All capital gains and capital losses made on the disposal or deemed disposal of assets are subject to CGT unless specifically excluded. Once the capital gain or capital loss for each asset that is disposed during a year of assessment is determined, all capital gains or capital losses are added together or aggregated.

Section 26A provides that the taxable capital gain must be included in taxable income. CGT is therefore not a separate tax but forms part of income tax. A capital loss cannot be used to reduce taxable income. Such loss can only be set off against future capital gains.

The CGT provisions are mostly contained in the Eighth Schedule, although some are in the main body of the Act, such as those dealing with change of residence, ceasing to be a controlled foreign company or becoming a headquarter company (section 9H), disposals by deceased persons (section 9HA), government grants (section 12P), international shipping (section 12Q) and the corporate restructuring rules (sections 41 to 47).

12.6. Guide on the taxation of franchisors and franchisees

This guide considers the income tax implications of specified income received and specified expenditure incurred by franchisors and franchisees.

The franchise industry in South Africa is a major contributor to the South African economy. There is a need for clarity concerning the tax implications that arise in relation to franchise arrangements, in particular, the income tax treatment of specified income received or accrued and specified expenditure incurred by franchisors and franchisees under franchise agreements. The aim of this guide is thus to assist in clarifying uncertainties that may arise on the application of the income tax laws to a franchise arrangement. This guide focuses mainly on transactions between franchisors and franchisees that are resident in South Africa.

This guide is intended to provide clarity regarding some of the general issues pertaining to franchisors and franchisees in South Africa. Note that each case has

to be considered on its own merits when determining the taxability of a franchisor and a franchisee. The terms and conditions of the franchise agreement, as well as the manner in which payments are construed, will be important in determining the tax implications of the different types of amounts received, or expenses incurred, by franchisors and franchisees.

12.7. Basic Guide to Income Tax Exemption for Public Benefit Organisation (Issue 3)

This guide has been prepared to assist organisations in understanding the basic requirements to obtain and retain approval as a public benefit organisation.

An organisation that has a non-profit motive, or is established or registered as an NPO under the NPO Act, or is incorporated as an NPC, does not automatically qualify for preferential tax treatment or approval as a PBO. An organisation will enjoy preferential tax treatment only after it has been granted approval as a PBO by SARS, and continues to comply with the relevant prescribed requirements and conditions set out in the Act.

An organisation approved by SARS as a PBO could be subject to partial taxation.

13. DRAFT GUIDES

13.1. Draft Tax Exemption Guide for Institutions, Boards or Bodies

This guide provides general guidance on the exemption from income tax of qualifying institutions, boards or bodies under section 10(1)(cA)(i). These institutions, boards or bodies enjoy preferential tax treatment after they have been granted approval by SARS and continue to comply with the relevant requirements and conditions as set out in the Act. Any institution, board or body approved by SARS under section 10(1)(cA)(i) carrying on PBAs in Part II in South Africa may

also qualify for approval under section 18A.

Section 10(1)(cA)(i) and (ii) respectively provide an absolute exemption from income tax of the receipts and accruals of any:

- institution, board or body established by or under any law engaged in specified prescribed activitie; and
- association, corporation or company all the shares of which are held by any such institution, board or body. The approval of this exemption will not be discussed in this guide.

The exemption under section 10(1)(cA)(i) will, however, apply only to the extent that such institution, board or body:

- has been approved by SARS subject to any conditions deemed necessary to ensure that the activities of that institution, board or body are wholly or mainly directed to the furtherance of its sole or principal object; and
- complies by law or under its constitution with the prescribed requirements.

Any institution, board or body approved by SARS under section 10(1)(cA)(i) carrying on PBAs in Part II in South Africa may potentially qualify for approval under section 18A subject to the requirements of that section being met (see 10). An institution, board or body bears the onus of proving3 that it complies with the requirements relative to the exemption and approval under section 18A and must retain the necessary supporting evidence.

13.2. Draft Tax Exemption Guide for Companies wholly owned by Institutions, Boards or Bodies

This guide provides general guidance on the exemption from income tax of qualifying wholly owned associations, corporations or companies of institutions, boards or bodies under section 10(1)(cA)(ii). These wholly owned associations, corporations or companies of institutions, boards or bodies enjoy preferential tax treatment only after SARS has granted them approval and if they continue to

comply with the relevant requirements and conditions as set out in the Act and discussed in the guide.

Section 10(1)(cA)(i) and (ii) respectively provide an absolute exemption from income tax of the receipts and accruals (see 11) of any:

- institution, board or body established by or under any law; and
- company all the shares of which are held by any institution, board or body provided the operations of such company are ancillary or complementary to the object of the institution, board or body.

An institution, board or body envisaged in section 10(1)(cA)(i) may for various reasons establish a company whose operations are ancillary or complementary to the object of the institution, board or body. If that institution, board or body holds all the shares in such company, the receipts and accruals of that company will also be exempt from income tax if the requirements of section 10(1)(cA)(ii) are met.

Section 10(1)(cA) does not contain provisions restricting or prohibiting business or trading activities. All the operations of the wholly owned company, however, must be ancillary or complementary to the object of the institution, board or body. If the company is merely a trading entity operating, say, a hotel, holiday resort, service station, cinema, or carries on business as a debt collector for the sole financial benefit of the institution, board, or body, it will not qualify for the exemption under section 10(1)(cA)(ii). Examples of qualifying operations may include the development and maintenance of the South African national road system, the provision of development finance to small, micro and medium enterprises to stimulate growth and development of the economy, mining, housing finance or investments.

This guide considers only section 10(1)(cA)(ii).

13.3. Draft Tax Exemption Guide for Small Business Funding Entities

This guide provides general guidance on the approval of small business funding entities under section 30C and taxation under section 10(1)(cQ).

A major challenge in the growth of small, medium and micro enterprises is access to funding due to their inherent risk and lack of collateral together with the fact that they often lack the necessary training and commercial skills to manage and develop the business.

Several funding entities are engaged in activities that support small, medium and micro enterprises, for example, the provision of developmental funding, business support and training. Relief was previously afforded to funders of small, medium and micro enterprises only if monies were invested through a venture capital company (VCC), or if approved by SARS as a PBO. Any activity provided to small, medium and micro enterprises that did not fall under the VCC regime or PBO legislation therefore did not qualify for relief under the Act.

To assist in the development of and to encourage support to SMMEs the following were introduced specifically for SBFEs:

• Definitions in section 1(1) of the terms “small business funding entity” and “small, medium or micro-sized enterprise”.

• Section 30C setting out the prescribed requirements an entity must comply with to qualify for and retain approval as an SBFE so as to enjoy partial taxation.

• Section 10(1)(cQ) providing for the exemption from income tax of certain receipts and accruals of SBFEs and the taxation of receipts and accruals falling outside the permissible business undertaking or trading activity categories provided in that section at a rate of tax of 28% of its taxable income.

An entity will enjoy preferential tax treatment under section 10(1)(cQ) only after it has been granted approval by SARS under section 30C(1) and continues to comply with the relevant prescribed requirements as set out in the Act.

An entity whose sole or principal object is the provision of funding for SMMEs potentially qualifies for approval as an SBFE. The entity must be approved by SARS as an SBFE under section 30C(1) if it complies with the prescribed requirements and conditions set out in that section.

SARS may withdraw the approval of an SBFE, which fails to comply with the prescribed requirements and may then be subject to tax and penalties.

An approved SBFE is subject to partial taxation on its receipts and accruals in accordance section 10(1)(cQ) and will also enjoy the benefit of being exempt from other taxes and duties.

An SBFE is required to comply with administrative provisions contained in the TA Act and other taxes and duties such as PAYE, UIF and SDL.

14. 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.