TAX UPDATE

For period: October 2022 to December 2022

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1. FOREWORD

The purpose of this update is to summarise developments that occurred during the fourth quarter of 2022, 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!

What does the pessimistic tax account thing?

It's accrual world!

It is hard to deal with because it keeps mutating … not the virus … tax law!

2. FROM THE BOOK: TAXES HAVE CONSEQUENCES, AN INCOME TAX HISTORY OF THE UNITED STATES[1]

The book deals with the history of income tax in the United States, since its inception in 1913. The United States has had an income tax with progressive rates that increase with income. The book is about how the American economy adapted to this reality.

It tells the story of the experience at every turn. When top rates have been high, top earners have heaved vast capital resources into tax shelters, depriving the economy not only of tax revenues, but investment and the wellspring of employment and a general prosperity.

When rates have been low, enormous shifts into real world investment have materialized as if out of nowhere, as the rich have picked up the nation's tax bill and growth, and the standard of living has bloomed. The consequences of rate of income tax on the wealty have been profound.

Some extracts:

> *'Probably the broadest and most serious charge is that the law has close to its heart something very much like a lie: that is, it provides for taxing income at steeply progressive rates, and then goes on to supply an array of escape hatches so convenient that hardly anyone, no matter how rich, need pay the top rates or anything like them.'*[2]

Under the heading '*The culture of tax avoidance*':

> '*Federal judge Learned Hand wrote in 1934:*
>
> > *Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's*

1 By Arthur B. Laffer, Brian Domitrovic and Jeanne C Sinquefield, of 2022
2 John Brooks on American tax law in Business Adventures (1969)

taxes[3].

And in 1947:

Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for noboy owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.[4]'

On page 98:

'The crux of the matter is that if top tax rates are raised on the pretax reported incomes of top income reporters, those people will report less income and pay less taxes. There are many ways for the top one-percenters to reduce pretax reported income. These include evading, sheltering, avoiding, shifting income to lower tax categories, working less, moving to lower tax environments, bartering, and the like. Regardless of how they do it, high-income earners have found ways to lower their pretax reported incomes when top tax rates have been high.'

On page 99:

'*President John F. Kennedy espoused the benefits of lowering tax rates in January 1963, in his Economic Report of the President:*

Tax reduction thus sets off a process that can bring gains for everyone, gains won by marshalling resources that would otherwise stand idle – workers without jobs and farm and factory capacity without markets. Yet many taxpayers seemed prepared to deny the nation the fruits of tax reduction because they question the financial soundness of reducing taxes when the federal budget is already in deficit. Let me make clear why, in today's economy, fiscal prudence and responsibility call for tax reduction even if it temporarily

3 Helvering v Gregory, 69 F.2d 809 (2d Cir.1934), 810
4 Commissioner of Internal Revenue v.Newman, 159 F.2d 848 (2d Cir. 1947) 850

enlarges the federal deficit – why reducing taxes is the best way open to us to increase revenues.[5]'

3. NOTICES / REGULATIONS

3.1. Table of interest

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

DATE FROM	DATE TO	RATE
1 November 2020	28 February 2022	7,00%
1 March 2022	30 April 2022	7,25%
1 May 2022	30 June 2022	7,50%
1 July 2022	31 August 2022	7,75%
1 September 2022	31 October 2022	8,25%
1 November 2022	31 December 2022	9,00%
1 January 2023	Until change in the Public Finance Management Act rate	9,75%

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

5 Washington: GPO, 1963

DATE FROM	DATE TO	RATE
1 September 2020	31 October 2020	3,25%
1 November 2020	28 February 2022	3,00%
1 March 2022	30 April 2022	3,25%
1 May 2022	30 June 2022	3,50%
1 July 2022	31 August 2022	3,75%
1 September 2022	31 October 2022	4,25%
1 November 2022	31 December 2022	5,00%
1 January 2023	Until change in the Public Finance Management Act rate	5,75%

As from 1 April 2003 the 'prescribed rate' is linked to the rate determined in terms of section 80(1)(b) of the Public Finance Management Act, but for income tax purposes the rate only becomes effective as from the first day of the second month following the date on which the PFMA rate comes into operation

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

DATE FROM	DATE TO	RATE
1 August 2020	30 November 2021	4,50%
1 December 2021	31 January 2022	4,75%
1 February 2022	31 March 2022	5,00%
1 April 2022	31 May 2022	5,25%
1 June 2022	31 July 2022	5,75%
1 August 2022	30 September 2022	6,50%
1 October 2022	30 November 2022	7,25%
1 December 2022	Until change in Repo rate	8,00%

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

4. DRAFT NOTICES / REGULATIONS

4.1. Draft notice in terms of section 18A(2)(a)(vii) of the Income Tax Act listing further information that must be included on a receipt issued in terms of section 18A(2)(a) of the Act.

Explanatory Note:

1. The draft notice prescribes the additional information to be included in the section 18A receipts issued by approved section 18A institutions to donors.
2. This information is in addition to the existing basic information listed in the section and page 19 of the Basic Guide to Section 18A Approval.

3. Approved section 18A institutions are, in terms of the current legislative requirements, already required to keep records of all section 18A receipts issued and make them available to SARS for tax administration purposes.

4. The additional information required is in line with evolving best practice of third-party data requirements that will enable SARS to develop a more efficient process to make deductions available to qualifying donor taxpayers and to help prevent section 18A claims abuse.

5. The additional information requirements will be applicable to all approved section 18A institutions with effect from 1 March 2023, requiring such institutions to issue receipts with the additional information and keep all the required information available for SARS.

6. SARS is also embarking on a further process that will ultimately prescribe the manner in which this information needs to be submitted to SARS. This will be dealt with in a different process and through a separate notice.

Schedule

1. General

In this notice, any term or expression to which a meaning has been assigned in a 'tax Act' as defined in section 1 of the Tax Administration Act, 2011, has the meaning so assigned, unless the context indicates otherwise.

2. Further information required in terms of section 18A(2)(a)(vii) of the Income Tax Act The following further information must be included on a receipt issued in terms of section 18A(2)(a) of the Income Tax Act:

- Donor nature of person (natural person, company, trust, etc.);
- Donor Identification type and country of issue (in case of a natural person);
- Identification or registration number of the donor;
- Tax reference number of the donor (if available);

- Contact number of the donor;
- Electronic mail address of the donor;
- A unique receipt number; and
- Trading name of the donor (if different from the registered name)

5. DEDUCTION IN RESPECT OF SCIENTIFIC OR TECHNOLOGICAL RESEARCH AND DEVELOPMENT – PROPOSED CHANGES TO SECTION 11D OF THE INCOME TAX ACT

5.1. Proposed changes to section 11D

[ ] Words in bold type in square brackets indicate omissions from existing enactments.

____ Words underlined with a solid line indicate insertions in existing enactments.

(1) Section 11D of the Income Tax Act, 1962, is hereby amended—[6]

(a) by the substitution in subsection (1) for the words preceding paragraph (a) of the following words:

> '(1) For the purposes of this section **'scientific or technological research and development'** means systematic investigative or systematic experimental activities **[of which the result is uncertain]** with an aim of resolving scientific or technological uncertainty and the resolution is not readily deducible by a person skilled in the relevant scientific or technological field for the purpose of — '

6 **[ ]** Words in bold type in square brackets indicate omissions from existing enactments. ____ Words underlined with a solid line indicate insertions in existing enactments.

(b) by the substitution for paragraph (a) of the following paragraph:

"(a) discovering **[non-obvious]** new scientific or technological knowledge;'

(c) by the substitution for paragraph (b) of the of the following paragraph:

'(b) creating or developing new or significantly improved products, processes or services; or' [**—**

(i) an invention as defined in section 2 of the Patents Act;

(ii) a functional design —

(aa) as defined in section 1 of the Designs Act, capable of qualifying for registration under section 14 of that Act; and

(bb) that is innovative in respect of the functional characteristics or intended uses of that functional design;

(iii) a computer program as defined in section 1 of the Copyright Act which is of an innovative nature; or

(iv) knowledge essential to the use of such invention, functional design or computer program other than creating or developing operating manuals or instruction manuals or documents of a similar nature intended to be utilised in respect of that invention, functional design or computer program subsequent to the research and development being implemented; or]

(d) by the deletion of paragraph (c):

(e) by the substitution for paragraph (c) for the following paragraph:

'**[(d)]** (c) creating or developing a multisource product, as defined in the World Health Organisation Technical Report Series, No 937, 2006 Annex 7 Multisource (generic) pharmaceutical products: guidelines on registration

requirements to establish interchangeability issued by the World Health Organisation, conforming to Regulation 344 of 23 April 2015 and any **[such]** requirements as must be prescribed by regulations made by the Minister after consultation with the Minister **[for]** of Higher Education, Science and **[Technology]** Innovation; or'

(f) by the substitution for paragraph (d) of the following paragraph:

'**[(e)]** (d) conducting a clinical trial as defined in Appendix F of the Guidelines for good practice in the conduct of clinical trials with human participants in South Africa issued by the Department of Health (2006), conforming to Regulation 346 of 23 April 2015 and any **[such]** requirements as must be prescribed by regulations made by the Minister after consultation with the Minister **[for]** of Higher Education, Science and **[Technology]** Innovation.

(g) by the substitution in the proviso to the definition of 'research and development' for the words preceding paragraph (a) of the following words:

'Provided that for the purposes of this definition, 'scientific or technological research and development' does not include activities for the purpose of —
'

(h) by the substitution for paragraph (b) of the proviso to the definition of 'scientific or technological research and development' of the following paragraph:

'(b) development of management or administrative business processes **[unless those internal business processes are mainly intended for sale or for granting the use or right of use or permission to use thereof to persons who are not connected persons in relation to the person carrying on that research and development]**;';

(i) by the substitution for paragraph (g) of the proviso to the definition of 'scientific or technological research and development' of the following paragraph:

'(g) the creation or enhancement of trademarks or goodwill; **[or]** '.

(j) by the substitution for paragraph (h) of the proviso to the definition of 'scientific or technological research and development' of the following paragraph:

> '(h) any expenditure contemplated in section 11(gB) or (gC); **or** '.

(k) by the addition after paragraph (h) of the proviso to the definition of 'scientific or technological research and development' of the following paragraph:

> '(i) research undertaken solely in preparation for the registration of products as required by the Department of Agriculture, Land Reform and Rural Development.'.

(j) by the substitution in subsection (2)(a) for the words preceding subparagraph (i) of the following words:

> '(2)(a) For the purposes of determining the taxable income of a taxpayer that is a company in respect of any year of assessment there shall be allowed as a deduction from the income of that taxpayer an amount equal to 150 per cent of so much of any expenditure actually incurred by that taxpayer directly and solely in respect of the carrying on of scientific or technological research and development in the Republic if — '

(k) by the substitution in subsection (2)(a) for subparagraph (iv) of the following subparagraph:

> '(iv) that expenditure is incurred within 6 months prior to or on or after the date of receipt of the application by the Department of Science and **[Technology]** Innovation for approval of that scientific or technological research and development in terms of subsection (9).'.

(l) by the substitution in subsection (4) for the words preceding subparagraph (a) of the following words:

> '(4) Where any amount of expenditure is incurred by a taxpayer to fund expenditure of another person carrying on scientific or technological research and development on behalf of that taxpayer, the taxpayer may deduct an amount contemplated in subsection (2) — '

(m) by the substitution in subsection (4) for paragraph (a) of the following paragraph:

'(a) if that scientific or technological research and development is approved by the Minister of Higher Education, Science and **[Technology]** Innovation in terms of subsection (9);';

(n) by the substitution in subsection (4) for paragraph (d) of the following paragraph:

'(d) if that expenditure is incurred within 6 months prior to or on or after the date of receipt of the application by the Department of Science and **[Technology]** Innovation for approval of that scientific or technological research and development in terms of subsection (9).'.

(o) by the substitution for subsection (5) of the following subsection:

'(5) Where a company funds expenditure incurred by another company contemplated in subsection (4)(c)(ii), any deduction under that subsection by the company that funds the expenditure must be limited to an amount of 150 per cent of the actual expenditure incurred directly and solely in respect of that scientific or technological research and development carried on by the other company that is being funded.'.

(p) by the substitution for subsection (6) of the following subsection:

'(6) For the purposes of subsections (2) and (4) —

(a) a person carries on scientific or technological research and development if that person may determine or alter the methodology of the research;

(b) notwithstanding paragraph (a), certain categories of scientific or technological research and development designated by the Minister in Regulation 343 of 23 April 2015 or by notice in the Gazette are deemed to constitute the carrying on of scientific or technological research and development.'.

(q) by the substitution for subsection (7) of the following subsection:

'(7) Where any amount is received by or accrues to a taxpayer from —

(a) department of the Government of the Republic in the national, provincial or local sphere;

(b) a public entity that is listed in Schedule 2 or 3 to the Public Finance Management Act; or

(c) a municipal entity as defined in section 1 of the Local Government Municipal Systems Act, 2000 (Act No. 32 of 2000).

to fund expenditure in respect of any scientific or technological research and development, an amount equal to the amount that is funded must not be taken into account for purposes of the deduction under subsection (2) or (4).'.

(r) by the substitution for subsection (9) of the following subsection:

'(9) The Minister of Higher Education, Science and **[Technology]** Innovation or a person appointed by the Minister of Higher Education, Science and **[Technology]** Innovation must approve any scientific or technological research and development being carried on or funded for the purposes of subsections (2) and (4) having regard to —

(a) whether the taxpayer has proved to the committee that the research and development in respect of which the approval is sought complies with the criteria contemplated in the definition of 'scientific or technological research and development' in subsection (1), and

(c) such other criteria as the Minister of Finance in consultation with the Minister of Higher Education, Science and **[Technology]** Innovation may prescribe by regulation.'.

(s) by the substitution for subsection (10) of the following subsection:

'(10) If scientific or technological research and development is approved under subsection (9) and —

(a) any material fact changes which would have had the effect that approval under subsection (9) would not have been granted had that fact been known to the Minister of Higher Education, Science and **[Technology]** Innovation at the time of granting approval;

(b) the taxpayer carrying on that scientific or technological research and development fails to submit a report to the committee as required by subsection (13); or

(c) the taxpayer carrying on that scientific or technological research and development is guilty of fraud, or misrepresentation or nondisclosure of material facts which would have had the effect that approval under subsection (9) would not have been granted,

the Minister of Higher Education, Science and **[Technology]** Innovation may, after taking into account the recommendation of the committee, withdraw the approval granted in respect of that scientific or technological research and development with effect from the date specified by that Minister.'.

(t) by the substitution for subsection (11) of the following subsection:

'(11)(a) A committee must be appointed for the purposes of approving scientific or technological research and development under subsection (9) consisting of —

(i) three persons employed by the Department of Science and **[Technology]** Innovation appointed by the Minister of Higher Education, Science and **[Technology]** Innovation;

(ii) one person employed by the National Treasury, appointed by the Minister of Finance; and

(iii) three persons from the South African Revenue Service, appointed by the Minister of Finance.

(b) The Minister of Higher Education, Science and **[Technology]** Innovation or the Minister of Finance may appoint alternative

persons to the committee if a person appointed in terms of paragraph (a) is not available to perform any function as a member of the committee.

(c) If any person is appointed as an alternative in terms of paragraph **[(a)]** (b), that person may perform the function of any other person from the Department of Science and **[Technology]** Innovation, or the South African Revenue Service in respect of which institution that person is appointed as alternative.

(u) by the substitution for subsection (12) of the following subsection:

'(12)(a) The committee appointed in terms of subsection (11) must perform its function impartially and without fear, favour or prejudice.

(b) The committee may —

(i) appoint its own chairperson and determine the procedures for its meetings;

(ii) evaluate any application and make recommendations to the Minister of Higher Education, Science and **[Technology]** Innovation for purposes of the approval of scientific or technological research and development approved under subsection (9);

(iii) investigate or cause to be investigated scientific or technological research and development approved under subsection (9);

(iv) monitor all scientific or technological research and development approved under subsection (9) –

(aa) to determine whether the objectives of this section are being achieved; and

(bb) to advise the Minister of Finance and Minister of Higher Education, Science and **[Technology]**

Innovation on any future proposed amendment or adjustment of this section;

(v) for a specific purpose and on the conditions and for the period as it may determine, obtain the assistance of any person to advise the committee relating to any function assigned to that committee in terms of this section; and

(vi) require any taxpayer applying for approval of scientific or technological research and development in terms of subsection (9), to furnish any information or documents necessary for the Minister of Higher Education, Science and **[Technology]** Innovation and the committee to perform their functions in terms of this section.'.

(v) by the substitution for subsection (13) of the following subsection:

'(13) A taxpayer carrying on scientific or technological research and development approved under subsection (9) must report to the committee annually with respect to —

(a) the purposes of that scientific or technological research and development; and

(b) the extent to which that scientific or technological research and development requires specialised skills,

within 12 months after the close of each year of assessment, starting with the year following the year in which approval is granted under subsection (9) in the form and in the manner that the Minister of Higher Education, Science and **[Technology]** Innovation may prescribe.'.

(w) by the substitution for subsection (14) of the following subsection:

'(14) Notwithstanding Chapter 6 of the Tax Administration Act, the Commissioner may disclose to the Minister of Higher Education, Science and **[Technology]** Innovation information in relation to scientific or technological research and development —

(a) as may be required by that Minister for the purposes of submitting a report to Parliament in terms of subsection (17); **[and]**

(b) if that information is material in respect of the granting of approval under subsection (9) or a withdrawal of that approval in terms of subsection (10); [**.**] <u>and</u>

<u>(c) as may be required to fulfil the duties as contemplated in subsection 11D(12)(iv).</u>'

(x) by the substitution for subsection (16) of the following subsection:

'(16) The Minister of <u>Higher Education</u>, Science and **[Technology]** <u>Innovation</u> or the person appointed by the Minister of <u>Higher Education</u>, Science and **[Technology]** <u>Innovation</u> contemplated in subsection (9) must —

(a) provide written reasons for any decision to grant or deny any application for approval of any <u>scientific or technological</u> research and development under subsection (9), or for any withdrawal of approval contemplated in subsection (10);

(b) inform the Commissioner of the approval of any scientific or technological research and development under subsection (9), setting out such particulars as are required by the Commissioner to determine the amount of the deduction in terms of subsection (2) or (4); and

(c) inform the Commissioner of any withdrawal of approval in terms of subsection (10) and of the date on which that withdrawal takes effect.'.

(y) by the substitution for subsection (17) of the following subsection:

'(17) The Minister of <u>Higher Education</u>, Science and **[Technology]** <u>Innovation</u> must annually submit a report to Parliament advising Parliament of the direct benefits of the <u>scientific or technological</u> research and development in terms of economic growth, employment and other broader

government objectives and the aggregate expenditure in respect of such activities without disclosing the identity of any person.'.

(z) by the substitution for subsection (18) of the following subsection:

'(18) Every employee of the Department of Science and **[Technology]** Innovation, every member of the committee appointed in terms of subsection (11) and any person whose assistance has been obtained by that committee —

(a) must preserve and aid in preserving secrecy with regard to all matters that may come to their knowledge in the performance of their functions in terms of this section; and

(b) may not communicate any such matter to any person whatsoever other than to the taxpayer concerned or its legal representative, nor allow any such person to have access to any records in the possession or custody of the Department of Science and **[Technology]** Innovation or committee except in terms of the law or an order of court'.'

(aa) by the substitution for subsection (19) of the following subsection:

'(19) The Commissioner may, notwithstanding the provisions of section 99 and 100 of the Tax Administration Act, raise an additional assessment for any year of assessment with respect to a deduction in respect of scientific or technological research and development which has been allowed, where approval has been withdrawn in terms of subsection (10).'.

(bb) by the substitution for subsection (20) of the following subsection:

'(20)(a) A taxpayer may, notwithstanding Chapter 8 of the Tax Administration Act, apply to the Commissioner to allow all deductions provided for under this section in respect of scientific or technological research and development —

(i) expenditure in respect of that scientific or technological research and development was incurred on or after the date

of receipt of an application by the Department of Science and **[Technology]** Innovation for the approval of that scientific or technological research and development;

(ii) that application was not allowable in respect of a year of assessment solely by reason of the absence of approval of that scientific or technological research and development under subsection (9); and

(iii) that scientific or technological research and development is approved in terms of subsection (9) after that year of assessment.

(b) The Commissioner may, notwithstanding the provisions of section 99 and 100 of the Tax Administration Act, make a reduced assessment for a year of assessment where expenditure incurred during that year in respect of scientific or technological research and development would have been allowable as a deduction in terms of this section had the approval in terms of subsection (9) been granted during that year of assessment'.

(cc) by the addition after subsection (20) of the following subsection:

'(21) Any person who contravenes the provisions of subsection (18) is guilty of an offence and liable on conviction to a fine or to imprisonment for a period not exceeding two years.'.

(2) Subsection (1) comes into operation on 1 October 2012 and applies in respect of research and development on or after 1 October 2012, but on or before [1 October 2022] 31 December 2033.'

5.2. *Draft Explanatory Memorandum - Proposed refinements to section 11d of the Income Tax Act*

REVIEWING AND REFINING THE RESEARCH AND DEVELOPMENT TAX INCENTIVE

[Applicable provisions: Section 11D of the Income Tax Act]

I. Background

Research and technological development is a key factor for improved productivity, leading to new or improved products, processes or services. This enhanced productivity in turn leads to increased economic growth and international competitiveness. While South Africa offers a variety of direct subsidies aimed at the development phase of the innovation process, the R&D tax incentive is aimed at the earlier phases of research that are not catered for by other existing measures. Providing a tax benefit for the earlier phases of research and development ensures that local R&D is globally competitive.

The current R&D tax incentive came into operation on 2 November 2006 and has undergone various design changes to better tailor it to meet its objectives. The most significant of these changes was the introduction of a pre-approval process in 2012. The pre-approval process is administered by the Department of Science and Innovation (DSI), supported by an adjudication committee that evaluates applications and makes recommendations to the Minister of Higher Education, Science and Innovation. The R&D tax incentive allows for operating expenses incurred directly and solely for the purpose of conducting R&D to be deductible at 150 per cent if the R&D is approved by the Minister of Higher Education, Science and Innovation. This is the case even if those expenses could be characterised as being capital in nature, such as pilot plants.

II. Reasons for change

On 15 December 2021, Government published a discussion document titled Reviewing the Design, Implementation and Impact of South Africa's Research and Development Tax Incentive. This review sought to determine whether to extend the R&D tax incentive beyond its sunset date and, if so, in what form. Following the review, government has determined that the R&D tax incentive should continue, but sees it necessary to refine the definition of R&D.

A. Definition of R&D

Section 11D(1) of the ITA sets out a definition for 'research and development' that determines eligibility for the R&D tax incentive. Currently, the wording 'scientific or technological' is only found in the title of the section and in one of the paragraphs of the definition, even though the intention has always been that the incentive should only apply to activities with an aim of solving a scientific or technological uncertainty.

The definition contains a purpose test that requires not only an understanding of the concept of R&D, but also an understanding of various intellectual property statutes and the associated intellectual property characteristics, such as novelty and non-obviousness. In addition to this, several of the purposes focus on the end result of the R&D, which is difficult for taxpayers to explain or prove upfront and equally difficult for the adjudication committee to evaluate. This stands in contrast to the approach taken by many other countries in the design of their R&D tax incentives.

In addition, the 'innovative' requirement linked to the creation of a functional design; the development of a computer program; or making significant improvements, has led to unintended consequences and complexity for taxpayers, as well as officials and technical experts assessing R&D tax incentive applications.

While the ‘innovative’ requirement was intended to raise the bar in terms of the R&D activities that should qualify for the incentive, government recognises that innovation can happen without R&D, and that it does not necessarily encompass R&D.

To enhance the practical simplicity of applying for and adjudicating the incentive, it is considered that it would be more appropriate to move away from an ‘end-result’ or IP statute approach. This is primarily because – while taxpayers may have a certain end-goal in mind, the reality of R&D is that it involves uncertainty and risk, and it is not practical to expect taxpayers to have detailed knowledge of how their envisaged R&D will unfold at the time of applying for the incentive.

Many other countries instead rely on the principles outlined in the OECD Frascati Manual (i.e. that activities should be novel, uncertain, systematic and transferable and/or reproducible) to design their legislation to test whether an activity should be considered R&D or not. Based on adjudicating experience, it is considered that this approach is preferable.

In addition to the principles outline above, the 2002 Frascati Manual explicitly refers to a person skilled in the art (someone familiar with the basic stock of common knowledge). This criterion is implied in the most recent Frascati Manual. To ensure this is explicit in the legislation and to ensure that R&D activities are non-obvious or inventive to qualify for the R&D tax incentive, the revised definition should include the test of whether a professional in the field with appropriate knowledge and skills, and having access to publicly available information, would resolve that scientific or technological uncertainty without undertaking any R&D activities (i.e. systematic investigative or systematic experimental activities).

It is envisaged that a revised definition will be simpler to understand and adjudicate, ensuring an easier application process. The

proposed changes to simplify the legislation combined with moving to an online process and enhancing support for smaller businesses should enhance the uptake of the incentive.

In line with government's stance from the outset, the revised definition is shifted more towards a scientific or technological uncertainty and the systematic investigative or systematic experimental activities that are to be performed, with an added emphasis on novelty of products, processes or services, instead of the intellectual property outcomes e.g. invention or design that may occur after the R&D.

a. Internal Business Process (IBP) exclusion

Certain activities are specifically excluded from the definition of R&D. The excluded activities extend to the development of internal business processes not mainly intended for sale or licensing that could be relevant to a range of sectors, such as manufacturing and software development. Over the years the interpretation and implementation of this exclusion has led to unintended consequences.

Various interpretation notes have sought to provide clarity that routine learning associated with the management or enhancement of internal business processes will not be eligible for the incentive. However, based on the adjudication of multiple applications and on feedback received, it is apparent that activities that fall under this exclusion have features and benefits that should allow the activities to be eligible.

A number of examples were included in the discussion document to highlight how the current interpretation of the internal business process exclusion potentially disqualifies what would otherwise be deemed eligible activities that

encompass the benefits intended by the incentive. If an activity is systematic investigative or systematic experimental with an aim of resolving a scientific or technological uncertainty and it meets the proposed (revised) definition of R&D for the purposes of this incentive, it should be considered R&D – regardless of whether it is intended for sale or the use thereof is granted to connected parties.

One of the primary objectives of the incentive is to encourage spending on R&D to recognise that it has the potential to generate positive spillover effects in the economy – including by, for example, transferring knowledge, diffusing ideas and enhancing growth and employment prospects. These effects are possible even if the R&D is for internal use.

However, an exclusion will remain for business processes that are for management and administrative purposes to make clear that this is not considered R&D for the purposes of this incentive.

B. Software and computer programmes

In the context of software development, only those software development activities that are systematic investigative or systematic experimental of which the result is uncertain may be eligible. These types of systematic investigative/experimental development activities that exist under the R&D umbrella can at times be confused with high-level product development and pre-production development. This is due to both types of development having stages, such as experimental development, that can only form part of R&D if it is systematic and the result has (a scientific or technological) uncertainty. Thus, product development per se is not

by definition the same as experimental development, and therefore not R&D.

When evaluating whether software development activities are eligible, the question to be considered is often whether a professional in the field (i.e. a software developer) with appropriate knowledge and skills, and having access to publicly available information, would conclude that software development can successfully be done. If the answer is yes and no systematic investigative or systematic experimental activities with scientific or technological uncertain results are required, it is unlikely that developing this computer program would be deemed R&D. Use of existing software for a new application or purpose does not, by itself, relate to a technological or scientific uncertainty, and is therefore generally excluded. Also excluded is the creation of a computer program using known methods of existing software tools.

C. Agrochemical products

Section 11D excludes routine testing, analysis, collection of information or quality control in the normal course of business; as well as financing, administration, compliance and similar costs from R&D expenditures. Additionally, regulations published in relation to clinical trials as they pertain to the R&D tax incentive excludes 'research activities undertaken in preparation for the registration of a clinical trial'.

The Department of Agriculture, Land Reform and Rural Development (DALRRD) sets out prerequisite registration requirements for products before they can be sold in the South African market. With such prerequisites, it cannot be said that an applicant is able to determine or alter the research methodology. Conducting activities to comply with such requirements is not deemed to fall within the scope of R&D in terms of section 11D. That being said, in the event that the testing required for registration

indicates that a new formulation or reformulation is required for a product, such uncertainty identified by the testing and required for formulation/reformulation could form the basis for R&D.

D. Additional administrative issues

a. Introduction of a six-month grace period for receipt of pre-approval applications

In terms of section 11D, only expenditure incurred on or after the date of receipt of the application by the Department of Science and Innovation qualifies for the 150 per cent deduction. This has led to some taxpayers unfamiliar with the incentive (as well as smaller taxpayers) missing out on an opportunity to benefit from the incentive, or rushing to submit applications with insufficient information for the committee to adjudicate those applications.

Allowing applicants a grace period to gather more information regarding the intended R&D activities will allow smaller applicants, new applicants or applicants undertaking R&D in a new field to be in a better position to provide detailed information on the R&D project that has been undertaken.

b. Disclosure of information by the Commissioner of SARS

Currently, section 11D(12)(b)(iv) allows the committee to monitor all R&D approved to determine whether the objectives of the incentive are being met, and to advise the Minister of Finance and the Minister of Higher Education, Science and Innovation. Section 11D(14) states that the Commissioner may disclose information to the Minister of Science and Technology as is required for parliamentary reporting or if that information is material in respect of granting approval for the incentive. This does not appear

wide enough to enable the committee and DSI employees to obtain information (data) from SARS to carry out a monitoring and evaluation function.

c. Sanctions for breach of secrecy

Every person involved in the administration of the R&D tax incentive is bound by confidentiality to preserve secrecy of the information that they may come across while performing their duties (section 11D(18)). However, section 11D does not include a sanction for contravening these sections of the Act.

III. Proposal

Based on the above, Government proposes the following:

A. Adjustments to the R&D definition

It is proposed that changes be made to the current definition of R&D as follows:

i. The definition of R&D should be amended to clarify that the intention has always been that the incentive should only apply to activities with an aim of solving a scientific or technological uncertainty. By referring to activities that are aimed at solving a scientific or technological uncertainty in the words of subsection (1) preceding paragraph (a), this intent is made clear. Amongst other things, this requirement will clarify the type of computer software activities that will be deemed to form part of R&D. Further, the words 'scientific or technological' should be included before the words 'research and development' throughout the section.

ii. The definition should also be amended to clarify that activities will not qualify for the incentive if knowledge to resolve a scientific or technological uncertainty is deducible

by a competent professional in the relevant scientific or technological field, having regard to information that is publicly available to such professional. In other words, a test for obviousness (or lack of inventiveness) should be brought into the definition.

iii. The ‘non-obvious’ requirement for scientific or technological knowledge in section 11D(1)(a) should be replaced with ‘new’ in line with the proposal that a test for nonobviousness be included in the definition (to ensure that research and development does not include an activity if knowledge to resolve the scientific or technological uncertainty is deducible by a person skilled in the relevant scientific or technological field, having regard to information that is publicly available to such professional).

iv. The intellectual property purpose test in the first part of the definition should be deleted to move away from a focus on the end-result at the time of applying to recognise the uncertainty inherent in R&D. The approach will shift to testing for R&D by considering some of the principles in the OECD Frascati Manual. In line with this, it is proposed that s11D(1)(b) and (c) be replaced with a purpose test aligned with the OECD Frascati principles that an R&D activity must be carried on for the purpose of creating or developing new knowledge, or new or improved products, processes or services. The OECD Frascati manual provides an internationally accepted definition on R&D activities based on five core criteria being met; i.e. the activity must be novel, creative, uncertain, systematic and transferable and/or reproducible. In summary, R&D eligibility should be assessed in the context of the type of activities proposed to be performed; the uncertainty being addressed and the new

knowledge being sought; or products, processes or services being created.

B. Exclusions from the definition of R&D

a. Certain internal business processes

It is proposed that the part of the exclusion for internal business processes relating to the for-sale requirement and granting of right/use to a non-connected party be deleted, so that the activities are measured against the requirements set out in the definition of R&D, rather than whether they are intended for sale / licensing or not. An exclusion will remain for management and administrative business process to ensure clarity that these types of activities are not eligible for this incentive.

b. Agrochemical products

It is proposed to specifically exclude research activities undertaken solely in preparation for the registration of products as required by the Department of Agriculture, Land Reform and Rural Development (DALRRD) from the incentive.

C. Additional administrative issues

a. Introduction of a six-month grace period for receipt of pre-approval applications

It is proposed that applicants be allowed a six-month grace period to submit preapproval applications.

For example, if a company has started spending on exploratory R&D activities on 16 June 2022, they will have up until 16 December 2022 to submit their application if they would like to be eligible to claim the expenditure on qualifying R&D activities.

b. Disclosure of information by the Commissioner of SARS

It is proposed that the circumstances under which the Commissioner of SARS discloses information to the Minister of Higher Education, Science and Innovation be extended to include anonymized information (data) from tax returns that may require fulfilling of duties insofar as they relate to monitoring R&D approved under the incentive and the consideration of proposed amendments and adjustments to the R&D tax incentive, beyond reporting to Parliament. As such, it is proposed that amendments be made in section 11D(14) by introducing a new subsection (c) dealing with the requirement.

c. Sanctions for breach of secrecy

With respect to any breaches of secrecy, it is proposed that a sanction in line with those provided under section 12I(23) be included in section 11D. As such, it is proposed that any person who contravenes the secrecy provisions is guilty of an offence and be liable on conviction to a fine or imprisonment for a period not exceeding two years.

D. Sunset clause

It is proposed that the revised R&D tax incentive be extended for a period of 10 years and apply in respect of amounts incurred on or after 1 January 2024 and up to and including 31 December 2033.

E. Other technical amendments

Additional technical amendments include:

i. Updating the names of the Department and the Minister in line with the new names throughout the section.

ii. Updating the applicable regulations throughout.

IV. Effective date

The proposed amendments will come into effect on 1 January 2024 and will apply in respect of amounts incurred on or after that date

6. TAX CASES

6.1. Barnard Labuschagne Incorporated v C:SARS (84 SATC 351)[7]

Applicant, being Barnard Labuschagne Incorporated (BLI), was an incorporated firm of attorneys.

SARS had filed with the Registrar of the High Court a certified statement in terms of section 172(1) of the Tax Administration Act (TA Act) recording that BLI owed SARS R804 747.

In terms of section 174 of the TA Act, a certified statement so filed '*must be treated as a civil judgment lawfully given in the relevant court in favour of SARS for a liquid debt for the amount specified in the statement*.' For convenience, the Constitutional Court called this a '*tax judgment*.'

The certified statement arose from BLI's self-assessments for value-added tax, employees' tax, unemployment insurance fund contributions and skills development levies. BLI's attack on the tax judgment was not that its self-assessments were wrong, but its complaint was that the certified statement was wrong because BLI had made payments which SARS had failed to appropriate to the relevant assessed taxes.

BLI had unsuccessfully brought an application in the High Court (see Barnard Labuschagne Inc v SARS and Another 84 SATC 115) to rescind the tax judgment.

SARS' main ground of opposition was that a tax judgment was not susceptible of rescission as it contended that the civil judgment secured by the filing of a certified

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statement lacks the rights-determining character of a judicially issued judgment and it pointed to SARS' right to withdraw a certified statement and to institute proceedings afresh for the same tax.

BLI, in response, contended that if a tax judgment was not susceptible of rescission, sections 172 and 174 of the TA Act were constitutionally invalid and in view of this contention the Minister of Finance was joined as a Second Respondent.

The High Court held that a certified statement in terms of section 172(1) of the TA Act filed by SARS with the Registrar of the High Court of South Africa, Western Cape Division, which recorded that BLI owed SARS an amount of R804 747 was not susceptible of rescission and dismissed the alternative challenge.

BLI was ordered to pay the costs of the application and the High Court refused an application for leave to appeal with costs, as did the Supreme Court of Appeal.

BLI now sought leave from the Constitutional Court and the parties were asked to file written submissions, which they did, on the following issues to be discussed:

- Is a certified statement filed with a court in terms of section 172 read with section 174 of the TA Act susceptible of rescission? The parties were referred to various authorities which had to be addressed in the submissions.
- If the court were to hold that a certified statement is, in principle, susceptible of rescission, was BLI's attack on the certified statement a grievance within the scope of Chapter 9 of the TA Act? If this is said to be so by virtue of section 104(2)(c) of the TA Act, the submissions must identify the section in any relevant tax Act providing for objection or appeal in respect of such a grievance.
- Did the High Court dismiss the rescission application on any grounds other than its finding that a certified statement is not in law susceptible of rescission? If so, what were the other grounds and where in the judgment were the High Court's findings in that regard to be found?

Judge Rodgers held the following:

<u>As to jurisdiction</u>

(i) That BLI's application, on the question of rescindability, raises an arguable point of law of general public importance. This is because several recent High Court judgments, of which the High Court's judgment in the present matter is the third, appear to have failed to apply binding precedent, a core component of the rule of law, which is a founding value of our Constitution. This is an issue which this court must redress. We thus have jurisdiction.

<u>As to the Tax Administration Act</u>

(ii) That section 172(1) of the TA Act provided that if a person has an 'outstanding tax debt' SARS may, after giving the person at least 10 business days' notice, 'file with the clerk or registrar of a competent court a certified statement setting out the amount of tax payable and certified by SARS as correct.' Section 172(2) provided that such a statement may be filed even though the tax debt is subject to an objection or appeal under Chapter 9 of the TA Act.

(iii) That three other features of the TA Act should be mentioned: (a) Section 164(1) embodied the 'pay now, argue later' rule. Unless a senior SARS official otherwise directs, the obligation to pay tax is not suspended by an objection or appeal in terms of Chapter 9 (b). Section 170 provides that the production of a document issued by SARS, purporting to be a copy of or an extract from an assessment, is 'conclusive evidence' of two things: 'the making of the assessment'; and, except in proceedings on appeal against the assessment, 'that all the particulars of the assessment are correct' (c) Sections 175 and 176 empower SARS to amend or withdraw a certified statement filed with the court. If SARS withdraws a certified statement, it is empowered by section 176(2) to file a new certified statement in terms of section 172, recording tax which was included in the withdrawn statement.

(iv) That the relevant provisions of the TA Act had antecedents in the Income Tax Act (IT Act) and the Value-Added Tax Act (VAT Act), and in order to

understand the authorities, reference must be made to these provisions. Section 91(1)(b) of the IT Act entitled SARS to file a certified statement with the court setting out the 'amount of tax or interest' due or payable by the taxpayer, and it was stipulated that 'such statement shall thereupon have all the effects of, and any proceedings may be taken thereon as if it were, a civil judgment lawfully given in that court in favour of SARS for a liquid debt of the amount specified in the statement.' Section 88 contained the 'pay now, argue later' rule. Section 92 provided that it was not competent for any person, in connection with a certified statement filed in terms of section 91, to question 'the correctness of any assessment on which such statement is based', notwithstanding that objection and appeal may have been lodged against the assessment. Section 94 contained a 'conclusive evidence' provision practically identical to section 170 of the TA Act. Section 91(1)(bA) was inserted into the Act and empowered SARS to withdraw a filed statement in which event 'such statement shall thereupon cease to have any effect.'

(iv) That section 40(2)(a), 40(2)(b), 40(5) and 42 of the VAT Act were in the same terms as sections 91(1)(b), 91(1)(bA), 92 and 94 of the IT Act. The 'pay now, argue later' rule was contained in section 36 of the VAT Act and these provisions of the IT Act and the VAT Act were repealed when the TA Act came into force. Despite modest changes in formulation, the essential features of the repealed provisions were replicated in the TA Act.

As to the rescindability of tax judgments

(v) That the court, in reviewing the authorities from 1965 to 2011, inter alia referred to and analysed the cases of Kruger v CIR 28 SATC 7 (Kruger 1) and Kruger v SBI 34 SATC 119 (Kruger 11). In Kruger 1 the Full Court held that a tax judgment was indeed susceptible of rescission in terms of section 36(a) of the Magistrates' Courts Act 32 of 1944 which empowered a Magistrate's Court to 'rescind or vary any judgment granted by it in the absence of the person against whom that judgment was granted. The appeal failed, however, because the taxpayer had not brought his

rescission application timeously. A subsequent round of litigation between the same taxpayer and the revenue authorities reached the Appellate Division in 1972 – Kruger 11 where the court was of the view that tax judgments were capable of rescission.

(vi) That in Kruger 11 Jansen JA said that the taxpayer's counsel had rightly not argued that Kruger 1 was wrong in holding that a tax judgment was rescindable. As to the limits imposed by section 94, Jansen JA stated that the 'conclusive evidence' only related to the making and correctness of the assessment. 'Assessment' was a defined term. Various matters going to the merits of a tax judgment could still be contested, for example the computation of the tax, the question of the date from which interest ran, and the lawfulness of the levying of tax. Notwithstanding section 94, therefore, there was a wide field of defences available to a taxpayer in rescission proceedings.

(vii) That in Traco Marketing (Pty) Ltd v Minister of Finance 60 SATC 526 it was held, with reference to the Kruger judgments, that a tax judgment taken in terms of section 40(2)(a) of the VAT Act was rescindable. In Barnard v KBI, an unreported judgment of the Cape Provincial Division (19 May 2000), a Full Court confirmed that a Magistrate had jurisdiction to entertain a rescission application in relation to a tax judgment taken in terms of section 40(2)(a) of the VAT Act. The rescission application was remitted to the Magistrate's Court to be dealt with on its merits.

(ix) That late in 2000 came the Constitutional Court's decision in Metcash Trading Ltd v C:SARS 63 SATC 13 where the court had to decide whether to confirm orders of the High Court declaring sections 36(1), 40(2)(a) and 40(5) of the VAT Act invalid. Kriegler J delivered the court's unanimous judgment that the said sections were constitutionally compliant. Kriegler J stated that the decisions in Kruger 1 and 11 provided 'clear judicial authority' at odds with BLI's argument. In these cases the courts found (a) that a tax judgment was in principle susceptible of rescission; and (b) that

despite the ‘conclusive evidence’ section of the IT Act, there was a wide field of defences available in rescission proceedings.

(x) That in Mokoena v C:SARS 72 SATC 279 (also reported as ‘Sepataka’) the court rightly regarded Kruger 11 and Metcash as authority for the proposition that rescission of a tax judgment was competent. The court’s finding that the taxpayer had a bona fide defence was enough to dispose of the case.

(xi) That the High Court (the court a quo) was referred to the authorities discussed above yet did not deal with them. Instead, so BLI complains, the High Court followed more recent provincial decisions which were adverse to BLI’s contentions on rescindability. The respondents in this court support these cases and the High Court’s reasoning in the present matter.

(xii) That the more recent cases supported by the respondents in this case included Capstone 556 (Pty) Ltd v C:SARS 74 SATC 20 where the court was not dealing with rescindability but with the question whether SARS could lawfully take a tax judgment when there was a pending objection and appeal. That court did not question the proposition that a tax judgment was in principle rescindable. Capstone did not provide authority for the view that a tax judgment was not susceptible of rescission.

(xiii) In Modibane v SARS 74 SATC 398 the court quoted Capstone, supra, as if it were authority for the proposition that a tax judgment is not rescindable and did not refer to the Kruger cases or Traco Marketing. Although the court cited Metcash, it only mentioned the paragraphs dealing with the ‘pay now, argue later’ rule and did not heed paras [65] and [66] which approved the Kruger cases and accepted that tax judgments are in principle rescindable. As this court noted, Capstone did not provide authority for the view that a tax judgment was not susceptible of rescission. Modibane has, for these reasons, been criticised academically as having been wrongly decided.

(xiv) That the last judgment cited by the High Court was SARS v Van Wyk, an unreported judgment of the Free State High Court (5 June 2015), where there is a terse statement that the Magistrate's Court was not entitled to entertain the rescission application 'as it was not a civil judgment in the ordinary sense' and that the certified statement 'could not be regarded as having the character of a judicially delivered judgment'. The judgment contained no reference to the Kruger decisions and, again, although Metcash, supra, was cited, the passages relevant to rescindability were not mentioned.

(xv) That the courts in Modibane and Van Wyk were bound by the decisions in Kruger 11 and Metcash. Since Kruger 11 was not mentioned at all, and since the relevant passages in Metcash were overlooked, there was no attempt to distinguish them or to suggest that the pronouncements on rescindability were non-binding observations made in passing (obiter dicta). While it might be argued that the discussion of rescission in Kruger 11 was obiter, the same cannot be said of Metcash. The fact that tax judgments are susceptible of rescission, and that certain defences remain available to a taxpayer in rescission proceedings, was an integral part of this court's reasoning in finding that the cumulative effect of the statutory provisions was not constitutionally repugnant.

(xvi) That the High Court in the present case was bound not only by Kruger 11 and Metcash, but also by the Full Court judgments in Kruger 1 and Barnard. The High Court was much impressed by the fact that SARS had the power to amend or withdraw a certified statement. This showed, in the High Court's view, that a tax judgment is not a 'final' judgment and was unlike an ordinary civil judgment. As this court has shown, however, the power to withdraw a certified statement was a feature of the IT Act since 1966, and was from the outset part of the VAT Act. That this feature did not change anything was apparent from Traco Marketing, Barnard and Metcash. It is true that the TA Act entitles SARS to amend a certified statement and not only to withdraw it, but this additional power cannot be regarded as

materially changing the legal character of a tax judgment. The power of withdrawal is itself at odds with a supposed requirement of finality. Furthermore, the power of withdrawal conferred by the IT Act and VAT Act was coupled with an express entitlement to file a new certified statement, which was a practical means of amending the tax judgment.

(xvii) That since all the relevant authorities were drawn to the High Court's attention, it is unacceptable that it did not discuss them and either follow them or explain why it thought they were distinguishable. In the light of the authorities to which the High Court was referred, it is difficult to fathom the court's statement, when refusing leave to appeal, that there were no conflicting judgments on rescindability.

(xviii) That the reasoning in Metcash on rescindability was not 'merely….an observation', it was an integral part of this court's reasoning. And Metcash in turn endorsed the two judgments in Kruger. Observance of the rules of precedent is not a display of politeness to courts of higher authority; it is a component of the rule of law, which is a founding value of the Constitution.

(xix) That, moreover, the issue now under discussion is not one of constitutional validity, but whether a tax judgment is rescindable. In Metcash, which concerned the VAT Act, this court accepted the correctness of the Kruger judgments on this issue, and the Kruger judgments were decided with reference to the IT Act. This court will not depart from an earlier binding statement of the court unless satisfied that the earlier statement was 'clearly wrong.' In applying this rule of precedent to itself as the country's apex court, the court must tread with caution: it 'must not easily and without coherent and compelling reason deviate from its own previous decisions, or be seen to have done so.'

(xx) That, of course, where the grounds on which a tax judgment is impeached in rescission proceedings are grounds which are being pursued, or can be pursued, by way of objection and appeal under Chapter 9, an applicant for rescission will be unable to establish a bona fide defence, because the court hearing the rescission application will not be entitled to go behind the

certified statement. This was recognised in Kruger 11 and Metcash, but it was nevertheless held that tax judgments were susceptible of rescission and that there were a number of grounds on which the taxpayer might still legitimately base an application for rescission.

(xxi) That rescission is only of practical significance where a tax judgment is impeached on grounds which cannot be pursued by objection and appeal, because it is only in such cases that an applicant for rescission can potentially establish a bona fide defence.

(xxii) That the position thus remains that a tax judgment in terms of the TA Act is susceptible of rescission, in terms of section 36(1)(a) of the Magistrates' Courts Act or, in the High Court, in terms of the common law jurisdiction to rescind judgments taken in the absence of the other party.

(xxiii) That the court's affirmation of Kruger 11 and Metcash must not be misunderstood. The judgments in these cases make clear that the 'conclusive evidence' provisions in the tax legislation considerably narrow the scope of bona fide defences which the taxpayer can raise. Apart from the 'conclusive evidence' provision in section 170 of the TA Act, another limitation on bona fide defences arises from section 105 of the TA Act, which forms part of the dispute resolution procedures of Chapter 9. These procedures are initiated by an 'objection'. In terms of sections 104(1) and (2), a taxpayer may only object to an 'assessment' or 'decision' of the kind specified in section 104(2). If the taxpayer's grievance concerns an 'assessment' or 'decision', section 105 stipulates that the taxpayer may only dispute such assessment or decision 'in proceedings under this Chapter, unless a High Court otherwise directs.' For present purposes, the point to note is that section 105 will generally have the effect that, in rescission proceedings, the taxpayer will struggle to demonstrate a bona fide defence if its grievance relates to an assessment or decision governed by Chapter 9.

(xxiv) That the dispute in this case was not covered by the 'conclusive evidence' provisions of section 170 nor was it excluded by section 105. As to section

170, BLI was not challenging the correctness of the self-assessments; the question was whether they had been paid. As to section 105, the High Court said that Chapter 9 was available to BLI, but did not explain how. BLI was not complaining about an 'assessment'. Nor was it complaining about a 'decision' as defined in section 104(2) of the TA Act. There was no provision in any relevant tax legislation stating that a dispute about whether an assessment had been paid was subject to objection or appeal. SARS has not pointed to any statutory provision which renders payment disputes subject to objection in terms of Chapter 9 of the TA Act. If the payment dispute is not a matter required to be dealt with by way of objection in terms of Chapter 9, it is one of those 'defences' which the courts in Kruger 11 and Metcash had in mind as being available to a taxpayer in rescission proceedings.

(xxv) That it followed that the High Court should have found that the tax judgment was susceptible of rescission and should have considered whether BLI had made out a case for rescission at common law. This court recently repeated the well-known requirements: first, BLI must give a reasonable and satisfactory explanation for its default; and second, it must show that on the merits it has a bona fide defence which prima facie carries some prospect of success. Because the procedure for taking a tax judgment does not call for a procedural response from the taxpayer, the focus inevitably fell on the second of these requirements.

(xxvi) That the proper course is to remit the matter to the High Court to decide the merits of the rescission application. In view of some adverse remarks made by the High Court about BLI, including criticism based on the High Court's erroneous view on rescindability, prudence dictated that the merits should be heard by a different Judge.

Appeal upheld.

6.2. *C:SARS v Esibonga Investments (Pty) Ltd (84 SATC 405)*

Applicant, being the SARS, had been granted a provisional preservation order against the First Respondent, Esibonga Investment (Pty) Ltd, on 1 October 2021.

The order related to the preservation of Erf 1635, Fourways Extension 15, City of Johannesburg, which had been registered in the names of Gary and Lesley Watson, the Eighth and Ninth Respondents in the case.

The order as granted by the High Court authorised the Registrar of Deeds to register a *caveat* notice on the property to ensure that it was not transferred without notice to SARS and the appointed *curator bonis* who was authorised to take control of the property.

Esibonga had been started as a business in 2018 and had failed to submit its tax returns for the period 2018–2020.

SARS had conducted an in-depth information gathering process in respect of the Esibonga and had ascertained that it did not keep any trial balances or general ledgers and did not draft any financial statements.

SARS had audited Esibonga for the period 2019–2020 and had ascertained that it had a tax debt of R987 972 392,40 and then obtained a compulsory winding-up order against the company.

Esibonga's statements revealed that it had purchased *inter alia* immovable properties in excess of R11 million, all of which were owned by Zimbabwean nationals and were not registered in the name of the Esibonga.

One of these properties had been registered into the names of a husband and wife, referred to as the Eighth and Ninth Respondents under the name of 'the Watsons' in the judgment and it was on this basis that the purchase of the property had required a thorough investigation by the liquidators and SARS had sought and obtained the order to prevent the property from being disposed of as it could have frustrated the collection of the full amount of tax that was due and payable.

SARS had harboured the fear of risk that Esibonga may dissipate the assets, and which would then hinder the collection of the tax due and that led to SARS having obtained a provisional preservation order.

Eighth and Ninth Respondents (the Watsons) had then anticipated the return day of the provisional preservation order granted in favour of SARS on the ground that there was no evidence of dissipation to warrant the granting or maintaining of the order. In their view SARS had failed to show that in the absence of a preservation order, there was a material risk that the asset available for the satisfaction of tax would no longer be available and it had also failed to show the existence of a material risk that they, the Watson family, would dissipate the property in order to frustrate the collection of tax by SARS.

According to the Watsons, the property had been used as their primary residence and family home in South Africa and had been purchased for that reason. Moreover, they were citizens of Zimbabwe and the husband was also a citizen of South Africa and they did not seek to and had no intention of disposing of or transferring the property in question. They alleged that they had paid the funds required to acquire the property to a Zimbabwean foreign exchange agent in Harare but they did not identify the agent nor did they provide any support to their bald allegations regarding payment.

They also alleged that they had had no dealings or involvement of any kind with the Esibonga and had learnt for the first time of the company's name upon receipt of the papers in the application for the provisional preservation order.

The application before the court was the Eighth and Ninth Respondents' anticipation of the return date of the provisional preservation order.

Judge Thulare held the following:

(i) That the Eighth and Ninth Respondents (the Watsons) did not set out any iota of evidence that the operation of the preservation order caused or will cause them undue hardship and such hardship outweighed the risk that the property may be destroyed, lost, damaged, concealed or transferred. This is not an anticipation in which the variation of the order is sought as

envisaged in section 163(9) of the Tax Administration Act and the facts set out by the Watsons did not support an anticipation for the rescission on the grounds of undue hardship.

(ii) That SARS demonstrated, through following the money trail, that the Esibonga had paid R2.1 million for the purchase of the property in question and that the property had not been registered in the name of the Esibonga, but that of the Watsons. The court understood that the order envisaged, sought and granted in terms of section 163(1) of the Act to be a form of an anti-dissipation interdict.

(iii) That the purpose of the order of the kind in section 163(1) is to ensure that the property concerned is not disposed of or concealed in anticipation of such proceedings. In the court's view s 163(1) extended the protection of property against being disposed of or concealed to include persons in the position of the Watsons. In this matter the debtor was the Esibonga, and the property was already registered in the names of the Watsons. The facts suggested that the Esibonga was dissipating its funds when it purchased the property and registered it in the name of the Watsons.

(iv) That section 163(1) of the Act makes provision for an order to be made for the preservation of assets of the taxpayer or other person. This includes a person in the position of the Watsons, to whom the trail of money paid from the account of a taxpayer, led SARS to their door. It was incumbent upon the Watsons to consider whether it could be said that they took reasonable steps to investigate whether, in the circumstances, the payment of the purchase price for their home by the Esibonga was required and the payment was reasonably made. This was necessary because the Watsons should be measured with the yardstick of a reasonable person.

(iv) That where a preservation order is made against a person in the position of the Watsons, the order, in my view, has the significance that such person is called upon to take reasonable steps to ascertain whether the payment was legally due, payable and paid from the taxpayer. In the court's view, to secure a discharge of the preservation order, they [the Watsons] should

have made the necessary enquiries into the trail of payment from the moment they had made it, wherever it was, until it reached the transferring attorneys. This was more so because the preservation order provided that they disclose all particulars of all transfers of the property to enable a determination whether the transfer can and should be set aside.

(v) That it was for the Watsons to establish, in the anticipation, that the court must be satisfied that a reasonable person in the position of the Watsons could not know that the Esibonga paid or if they knew, that the payment was not in furtherance of dissipation of the taxpayer's assets. Where SARS had shown that it was probable that the Esibonga had entered the transaction whilst it appreciated that it would prejudice SARS, the inescapable conclusion was that the transaction was unreasonable for the Esibonga to have entered into, and that what the Esibonga had intended through the payment was to prejudice SARS.

(vi) That in the court's view the arm of the law as envisaged in section 163(1) of the Act, was intended to extend in order to reach property in the hands of other persons like the Watsons, where the trail of the money, followed from a taxpayer by SARS, led SARS to.

(vii) That to avoid a successful and complete dissipation by the taxpayer, the Esibonga, which dissipation would frustrate the collection of taxes, it was necessary to preserve the property. It must be borne in mind that the property, now in the hands of the Watsons, the other person and not the taxpayer, are strategically out of the scope of assets preserved by virtue of the liquidation of the Esibonga.

(viii) That, accordingly, in the absence of a preservation order, the Watsons are at liberty to transfer or dispose of the property without the knowledge of SARS and in that freedom, they have no obligation to wait for the finalisation of the liquidation process.

Application dismissed.

The provisional order granted against the Eighth and Ninth Respondents was confirmed.

6.3. *Bechan v SARS Custom Investigations Unit (84 SATC 413)*

SARS on 28 March 2022 had obtained a warrant issued in terms of sections 59 and 60 of the Tax Administration Act in terms of which they were authorised to seize information and documentation, including information saved or stored on electronic devices at the premises of a particular taxpayer.

SARS, on the following day, arrived at the premises of the taxpayer in order to execute the warrant. The particular premises were in an office park shared with a number of other companies. Access to the office park was controlled and SARS were not immediately granted access and were delayed in entering the premises.

During the period of delay SARS observed various people carrying items from the office premises to motor vehicles parked in the parking area.

When the SARS officials eventually obtained access to the premises, besides finding the directors of the taxpayer, they also found the Mr Bechan on the premises. He was there purportedly to do business with a different entity but in respect of whom one of the directors of the taxpayer was also a director.

SARS, in executing the warrant, also had cause to look into the vehicles parked in the parking lot and observed in a number of these what appeared to be documents relating to the taxpayer and which fell within the ambit of the warrant that they were executing.

SARS stated that they had asked Mr Bechan to open his motor vehicle and that he had informed them that he was unable to do so as he did not have the keys.

The execution of the warrant did not proceed as smoothly or without incident as SARS had anticipated and the result was that the execution of the warrant was protracted and both the South African Police Service and the Hawks had to be called in to assist SARS.

Thereafter SARS elected to procure the services of a locksmith who had then proceeded to open not only Mr Bechan's vehicle but other vehicles also whose owners had refused to open them.

Once Mr Bechan's vehicle was opened items were removed from the vehicle and taken into custody and inventoried by SARS.

Mr Bechan denied that he had ever refused to open his vehicle or that he had said that he did not have his keys and asserted that he had immediately, when asked by SARS, handed both his cell phone and his vehicle's keys to SARS.

Mr Bechan, against this background, had brought an urgent application in the High Court for a '*mandament van spolie*' in order to obtain the return of 2 laptops and 2 cellular telephones claimed by him from SARS.

Although Mr Bechan had asserted that he was the owner of the property in question and had required it in order to make his living and to conduct the business of the Second Applicant, he was either unable or unwilling to furnish the proof of ownership as requested by SARS and chose rather to proceed by way of the aforementioned urgent application.

Judge Millar held the following:

As to the mandament van spolie application

(i) That the essence of the mandament van spolie was the restoration before all else of unlawfully deprived possession of the possessor. The spoliation order is meant to prevent the taking of possession otherwise than in accordance with the law. Its underlying philosophy is that no one should resort to self-help to obtain or regain possession.

(ii) That the basis upon which the Applicant had advanced the application was that the 2 laptops and 2 cellular telephones had been in his undisturbed possession and that SARS had unlawfully, in entering into his vehicle and removing the items, dispossessed him of them.

(iii) That, having regard to the version of SARS, it was inherently more probable that the Applicant did not relinquish possession of the motor vehicle and its contents voluntarily by handing over his keys to SARS.

(iv) That, on the probabilities, the Applicant, notwithstanding his version, which the court did not accept, did not voluntarily relinquish possession of the

keys or the vehicle or its contents for that matter and there could be no doubt that the Applicant had been deprived of possession by SARS.

(iv) That, therefore, was SARS' deprivation of the Applicant's possession of the 4 items in his vehicle lawful or not? It is well established that the mandament van spolie will only succeed in circumstances where the dispossession was unlawful. If the dispossession of the property was lawful, then the mandament van spolie will not be granted.

As to the search of premises not identified in a warrant

(v) That it was contended by SARS that although neither the Applicant nor his vehicle were specifically identified in the warrant, the provisions of section 62(1) of the Tax Administration Act were applicable.

(vi) That section 62(1) provides, inter alia, that if a senior SARS official has reasonable grounds to believe that the relevant material referred to in section 60(1)(b) and included in a warrant is at premises not identified in the warrant and may be removed or destroyed, a SARS official may enter and search the premises and exercise the powers granted in the Act as if the premises had been identified in the warrant.

(vii) That, with this section being applicable, SARS was entitled, in the execution of the warrant to ascertain whether the Applicant had in his possession or under his control any of the taxpayer material specified in the warrant. Their decision to search him and his vehicle was, in the circumstances of their earlier observations of material being carried to motor vehicles while their entry to the premises was delayed, not unreasonable.

(viii) That, as submitted by SARS, in consequence the Applicant was obliged to follow the procedure set out in section 66 of the Tax Administration Act for the return of his property.

As to the return of seized relevant material

(ix) That section 66(1) provided, inter alia, that a person may request SARS to return some or all of the seized material and if SARS refused the request, the person may apply to a High Court for the return of the seized material or

payment of compensation for physical damage caused during the conduct of the search and seizure.

(x) That the warrant provided for the seizure of material relevant to the taxpayer at the specified premises. The warrant in its terms provided for the search anywhere on the premises identified in the warrant – and this would include vehicles parked on the premises. To interpret the warrant as restrictively as in the manner argued on behalf of the Applicant would serve to undermine its efficacy. However, even if it could be argued that the warrant was not wide enough to cover the Applicant's vehicle, the provisions of section 62 of the Act would in any event in the court's view, have entitled SARS to open the vehicle and take possession of the taxpayer information in it.

Application dismissed.

6.4. *Attieh v C:SARS (84 SATC 420)*

Globalcom Investments Limited (Globalcom) was a foreign company and its business was managed by Attieh.

Globalcom held 47.3% of the shareholding in Smartphone SP (Pty) Limited t/a Smartcall (Smartcall) and Attieh was also a shareholder in Smartcall.

During September 2003 an offer was received from Vodacom Group (Pty) Limited (Vodacom) to acquire, from the shareholders of Smartcall, such number of shares in Smartcall as would constitute a 51% shareholding, together with corresponding claims, at a purchase consideration of R295 800 000.

Globalcom resolved to totally disinvest in Smartcall and its entire shareholding was accordingly sold to Vodacom for a purchase price of R257 800 000.

During June 2006 Globalcom notified Attieh of its intention to institute an action for damages against him. He was advised that Globalcom had discovered that he had not disclosed material information to it when he represented Globalcom in the sale of shares transaction with Vodacom. The information that he withheld, according to

Globalcom, would materially have affected the decision to dispose of its entire shareholding to Smartcall.

Negotiations between Globalcom and Attieh ensued and Globalcom demanded that it be reinstated as a shareholder of Smartcall for it to be put in the position it would have been if it had only disposed of 51% of its shareholding at the time when it had sold its shareholding to Vodacom.

The reinstatement of Globalcom as a shareholder in Smartcall would have entailed a transfer of shares to Globalcom for the then 27.005% shareholding of Attieh and the 2.995% shareholding of Mr Leon Richards in Smartcall. They too would then be put in the position that they would have been if they had also sold 51% of their respective shareholdings to Vodacom during September 2003.

On 28 August 2007 Attieh and Mr Richards sold their entire respective shareholdings in Smartcall to Vodacom. The shares were sold for a total purchase consideration of R935 000 000.

On 3 September 2007 Vodacom paid the purchase price of R935 000 000 into Attieh's bank account.

On 8 October 2007 Globalcom instituted an action for damages against Attieh based on his alleged non-disclosure, as Globalcom's agent, of relevant facts.

On 15 October 2007 Globalcom and Attieh settled the action for damages in terms of a written agreement of settlement whereby Attieh agreed to pay Globalcom an amount of R694 888 271 in full and final settlement of its claim.

Attieh, for purposes of calculating the taxable capital gain realised by the sale of his shares in Smartcall to Vodacom, had deducted the amount of R625 437 601 which he had paid to Globalcom in terms of the settlement agreement, from the amount of R841 655 833 which Vodacom had paid to him, to arrive at the amount of R216 218 233 which, according to Attieh, represented 'the proceeds from the disposal of an asset' as contemplated in par. 35(1) of the Eighth Schedule to the Income Tax Act.

Attieh further contended that the deduction of R625 437 601 was, in any event, one that may be made in terms of par. 35(3)(*c*) of the Eighth Schedule.

SARS had conducted an income tax audit on Attieh in respect of the 2007 and 2008 tax years of assessment.

SARS, following the audit, had raised an assessment on Attieh to subject the full purchase price received from Vodacom to capital gains tax. It increased the net proceeds of R216 218 233 declared by Attieh for the sale of his shares in Smartcall by R625 437 601 to R841 655 834, for purposes of calculating the capital gains tax.

SARS maintained that the full purchase price of R841 655 833 was deposited in Attieh's bank account and was therefore the 'proceeds from the disposal of an asset' as defined in par. 35(1) of the Eighth Schedule.

SARS maintained that Attieh had understated the proceeds of the disposal of the shares and, accordingly, also levied an understatement penalty percentage of 75% amounting to R46 907 820 in terms of section 222, read with section 223 of the Tax Administration Act.

The Tax Court, after consideration, directed that an understatement penalty percentage of 10% be levied on the basis that Attieh's behaviour fell under item (i) of the table in section 223 and that his case was a standard one.

SARS had also levied interest on Attieh's underpayment of tax in terms of section 89*quat* of the Income Tax Act without waiver, in terms of section 89*quat*(3), of any portion of the interest based on Attieh's contention.

The court *a quo* (see *ITC 1880* (2014) 78 SATC 103 *per* Wepener J) had found that the amount of R841 655 833 was the amount which was 'received' by Attieh for the disposal of his shares in Smartcall to Vodacom and, consequently, constituted 'the proceeds from the disposal of an asset' by Attieh as contemplated in par. 35(1) of the Eighth Schedule to the Act.

Judge Meyer held the following:

<u>As to the capital gains tax issue</u>

(i) That 'received' and 'accrue' are familiar words, often encountered in taxation legislation, particularly in the context of the definition of 'gross income' in section 1 of the Income Tax Act. The definition includes 'the total amount, in cash or otherwise, received by or accrued to or in favour of' a taxpayer.

(ii) That the context in which the words 'received by' and 'accrued to' were used in par. 35(1) of the Eighth Schedule, in the court's view, similarly required that the word 'received' be given the meaning 'has been or actually received' in such circumstances that the recipient becomes entitled to it and the word 'accrued' the meaning 'entitled to' in contrast to the meaning 'actually received.' The 'proceeds from the disposal of an asset by a person' are, in terms of par. 35(1), equal to the amount received by, or accrued to 'that person in respect of that disposal.' The receipt or accrual relates to the disposal.

(iii) That the court agreed with the court *a quo* that Attieh was unconditionally entitled to the whole amount of R841 655 833 as consideration for the sale of his shares in Smartcall to Vodacom and that that amount was actually received by him. The 'disposal' was the sale of his shares, and the amount of R841 655 833 'accrued to' him and was 'received by' him as the consideration for that disposal. No one else but Attieh received or was, in terms of the sale of shares agreement, entitled to any part of the purchase consideration of R841 655 833.

(iv) That the court then considered the alternative argument of Attieh, which was that if the whole amount had accrued to him or was received by him, within the meaning of par. 35(1) of the Eighth Schedule, the amount fell to be reduced by the amount of R625 437 601 paid by him to Globalcom, such payment being 'any other event', as contemplated in par. 35(3)(*c*) of the Eighth Schedule. In the court's view there was no merit in this argument either.

(iv) That the Tax Court found that the 'deduction' provided for in par. 35(3)(*c*), on a proper interpretation of that provision, found no application to the payment of R625 437 601, which Attieh made to Globalcom in terms of the settlement agreement. The court was, with respect and for the reasons given in the judgment, in agreement with the Tax Court that the words 'any other event' in par. 35(3)(*c*) were *ejusdem generis* with the immediately preceding words in that paragraph. The 'event' on which Attieh relied – its payment to Globalcom in terms of the settlement agreement – did not fall within the ambit of the deductions contemplated in par. 35(3)(*c*).

(v) That the 'proceeds' (the amount received by or accrued to the person who disposed of an asset, in respect of that disposal) must be reduced by any reduction in the amount to which the person who disposed of the asset became entitled, in respect of that disposal, as a result of or due to the occurrence of the specific events listed in subpar. (3)(*c*). These specific events all affect the rights or entitlements and concomitant obligations of the counter parties to the disposal – the person who disposed of the asset and the person to whom it was disposed. The reduction applied to the extent that the entitlement of the person to the amount that was owed or due to him for the disposal was reduced or extinguished. The concomitant obligation, of the person to whom the asset was disposed, to pay, was similarly reduced or extinguished.

(vi) That the general words – 'or any other event' – were, therefore, restricted by the context. They could not possibly refer to an event that did not affect the rights and concomitant obligations of the parties to the disposal of an asset. There was nothing to show that a wider sense was intended. The deduction provided for in par. 35(3)(*b*) also related to an event (any amount of the proceeds that had been repaid or become repayable to the person to whom the asset was disposed of) that affected only the rights and concomitant obligations of the counter parties to the transaction.

(vii) That, in conclusion, the words 'or any other event' were, no doubt, wide, but, within their context in par. 35(3), to borrow the words of Innes CJ in *Director of Education, Transvaal* v *McCagie and Others* 1918 AD 616 at

623 'their interpretation must be affected by what precedes them' and hence Attieh's appeal to this Full Court had to fail.

As to the cross-appeal by SARS in regard to the understatement penalty imposed

(ix) That SARS had concluded that Attieh had made an incorrect statement in his tax return for the 2007–2008 tax period and that he, consequently, in terms of section 222 read with section 221 of the Tax Administration Act was obliged to pay an understatement penalty percentage of 75% in accordance with the table in section 223 of the Act on the basis that Attieh's case was a standard one.

(x) That the court was not persuaded that the Tax Court had erred in holding that, having received advice from a tax practitioner, there were reasonable grounds for Attieh to take the position which he did. Attieh had relied on expert advice on a matter of tax law in adopting the position which he took.

(xi) That, therefore, the Tax Court had considered the imposition of a proper understatement penalty percentage, both in terms of section 222 read with section 223 and in terms of section 270(6D) of the Act and had correctly concluded that a reduction of the understatement penalty percentage from 75% to 10% should follow.

(xii) That, in regard to interest in terms of section 89*quat* of the Income Tax Act, the Tax Court relied on the commentary by Dennis Davis *et al* on section 89*quat*(3) in *Juta's Income Tax* Vol 2 when it stated that 'On the other hand, the reliance by the taxpayer on expert advice, even if this is wrong, will in most cases constitute reasonable grounds for the action taken.'

(xiii) That this court was unable to fault the findings of the Tax Court which had held that the interest levied by SARS on the underpayment be remitted in whole on the basis that 'there is no reason not to find that Attieh's reliance on advice was reasonable' and that 'no facts were proved to show that Attieh was nevertheless unreasonable.'

Appeal dismissed with costs. Cross-Appeal dismissed with costs.

6.5. *ITC 1958 (84 SATC 432)*

The taxpayer, being XYZ (Pty) Ltd, provided outsourced staffing services and payroll administration for clients predominantly operating in the construction and civil engineering sectors in South Africa.

The taxpayer, in doing so, entered into a staffing services contract with its client and a separate contract of employment with each of its employees.

The taxpayer was obliged to pay employees in accordance with the provisions of the Labour Relations Act, the Basic Conditions of Employment Act and applicable sectoral wage determinations and bargaining council agreements with industry-wide collective agreements forming part of the contract of employment.

The taxpayer's charge out rate to clients, although not expressly stated, included a component for accrued leave and bonus liabilities. The bonus was paid out at the December year-end industry shut-down period, with that portion of the bonus obligation which had accrued from 1 December to the end of February, and which had not been paid out, treated for accounting purposes as a liability at the end of February. For tax purposes, the same amount was claimed as a deduction. Employees received pro rata payment of an annual bonus where their services were terminated through no fault of their own.

Leave days accrued to employees during the course of their employment and leave was required to be taken during the December industry shut-down period, save for exceptional circumstances in which it could be taken earlier. Employees were paid accrued leave if their employment terminated without leave having been taken. As with the bonus, the taxpayer calculated leave which had accrued for the period from 1 December to the end of February and treated this for accounting purposes as a liability at the end of February and, as with the bonus, for tax purposes, the same amount was claimed as a deduction.

Where no alternative employment is available at the end of a project, the taxpayer will dismiss an employee for operational reasons. Specific provision is made by the taxpayer for the payment of a cash amount *in lieu* of notice where the employee is unable to work in their notice period, such as where the project ends before a full

notice period can be given and worked in by an employee. The taxpayer calculates the total amount in notice pay that would have to be paid if all employee contracts were terminated at the end of February 2015 and based on historical trends in the business, a 25% 'risk factor' was applied recognising the possibility that 25% of employees may not be able to work in their notice period and would therefore need to be paid *in lieu* of notice and it was in respect of these employees that notice pay liability was determined and claimed as a deduction from income at the end of February.

The payment of severance pay applied on the termination of an employee's services on grounds of operational requirements, with the *quantum* of severance pay subject to the number of an employee's continuous completed years of service. The taxpayer assessed the total payment that would have to be made if all employees who had been employed for a year or more and remained on the books at the end of February were to be retrenched. An 80% 'risk factor' was applied, based on historical trends observed in the business, since only employees who resigned or were dismissed were not paid notice or severance pay and this amount then represented the total severance liability which was treated as an accrued liability and claimed as a deduction.

The taxpayer, in its 2015 income tax return, as it had done in previous years, had declared an amount of R3 124 574 as 'other current liabilities' which it claimed as being deductible from its taxable income in terms of section 11(*a*) of the Income Tax Act for notice pay, severance pay, accrued leave and accrued bonus liability, alternatively, in respect of the leave payment and bonus liability only, deductible in terms of section 24C of the Act.

SARS had, on 30 January 2018, raised an additional assessment against the taxpayer in respect of the 2015 year of assessment, in which it had disallowed income tax deductions in respect of amounts which the taxpayer contended that it had incurred in relation to employee accrued leave, accrued bonus pay, notice pay and severance pay liabilities.

SARS had disallowed the deductions on the basis that the leave and bonus payments were not deductible in terms of section 11(*a*) or section 7B of the Act

since there was no unconditional obligation to pay these amounts and leave and notice were deductible when paid to employees and PAYE was deducted and that leave pay and bonus expenses were only deductible in terms of section 7B of the Act at the time that the taxpayer made payment of such amounts as remuneration to its employees. Furthermore, it was determined that notice and severance pay did not constitute expenditure incurred in the production of income as contemplated in terms of section 11(*a*) of the Act.

SARS had also levied interest in terms of section 89*quat*(2) of the Act on the amount deducted by the taxpayer on the basis that it had underpaid its provisional tax and that this was not as a result of circumstances beyond its control.

The taxpayer, on 28 March 2018, had lodged an objection against the additional assessment which was disallowed on 27 June 2018 and on 6 August 2018 the taxpayer noted its appeal to the Tax Court.

Judge Savage held the following:

<u>As to leave pay and bonus</u>

(i) That in Edgars Stores Ltd v CIR 50 SATC 81 expenditure ‘actually incurred’ was held to represent expenditure in respect of which there was an unconditional liability to make payment, even if it was not paid. In CIR v Edgars Stores Ltd 48 SATC 89 it was found not to be fatal to the deduction that the quantum of the payment ‘is subject to some uncertainty.’ In Nasionale Pers Bpk v KBI 48 SATC 55 it was made clear that probable future expenditure was not deductible.

(ii) That there was no dispute that in respect of the period from December 2014 to the end of February 2015 an unconditional obligation arose in terms of which the taxpayer became liable to pay the leave and bonus pay which had accrued to its employees in respect of the three-month period worked. Payment of these amounts was not discretionary since the taxpayer was legally obliged, by virtue of the applicable sectoral determinations and bargaining council agreements which had through collective agreement been incorporated into the terms of the employment

contract, to pay both this portion of accrued annual bonus and leave pay to employees.

(iii) That in terms of section 7B of the Income Tax Act an employee who becomes entitled to an amount by way of 'variable remuneration', (i.e. bonus and leave pay) such remuneration is deemed to accrue to the employee and to constitute expenditure incurred by the employer on the date during the tax year on which the amount is paid to the employee by his/her employer. The taxpayer contended that the bonus paid to employees amounted to a contractual entitlement and was not the variable remuneration with which section 7B was concerned and hence it took the view that the bonus and leave pay liability which had accrued pertained to an absolute, non-variable amount, which constituted expenditure incurred in the production of income and this made the amounts in issue deductible under section 11(a) of the Act with no purpose served in deferring the deduction.

(iv) That in issue in the current matter is the interpretation of both a general and a specific provision within the context of the Income Tax Act. Section 11(a), as a general provision, permits the deduction of expenditure and losses actually incurred in the production of income in determining taxable income and this provision is to be interpreted in its context and not in isolation from other provisions of the Income Tax Act, including section 7B as a specific provision directed at the treatment of variable remuneration.

(v) That the purpose of section 7B of the Act was to match the timing between accrual and payment of various forms of variable remuneration such as commission, bonuses and overtime pay. The legislative intent apparent from the wording of the provision was manifestly clear and unambiguous, namely that inter alia bonus and accrued leave pay are deductible in the tax year of assessment in which these amounts were paid to employees.

(vi) That the fact that 'bonus' is not defined for purposes of section 7B does not support the contention that the term was limited only to the payment of a variable bonus or where payment of a bonus is discretionary and does not arise from an express contractual entitlement. Such an interpretation is not

borne out by the language and wording of the provision and, in addition, the proposition that leave pay liability may not fall within the definition of variable remuneration was not supported by language and wording of the provision, which expressly references leave pay.

(vii) That it followed that it would constitute an unduly strained interpretation of the provision (i.e. section 7B) to interpret it in such a manner as to omit leave pay and bonus pay from its ambit. What was clear was that section 7B expressly provided for the manner in which these liabilities were to be treated and there was therefore no reason to justify a finding that the bonus and leave pay liabilities claimed by the taxpayer should not be deferred for deduction in accordance with the express terms of such provision.

(viii) That there could be little doubt that section 7B was aimed at governing the treatment of accrued bonus and leave pay liabilities under what was termed 'variable remuneration.' It followed that since the amounts in question were not actually incurred in the sense of being paid to employees in the tax year in question, their deduction was disqualified by section 7B.

(ix) That even if the accrued bonus and leave pay amounts may be considered to be 'actually incurred' in the sense that there existed an unconditional liability to make payment of such expenditure as contemplated by section 11(a) as a general provision, the specific provision, being section 7B, expressly provided for the manner in which both amounts were to be treated and it followed that in terms of section 7B(2) the amounts accrued in respect of bonus and leave pay constituted expenditure which could only be incurred by the employer when such amounts were paid to the employee.

<u>As to the application of section 24C of the Income Tax Act</u>

(x) That in the event that accrued amounts in respect of the leave pay and bonus categories did not qualify for deduction under section 11(a) read with section 7B of the Income Tax Act, the taxpayer sought in the alternative that the deduction of the leave pay and bonus amounts be permitted in terms of section 24C of the Act.

(xi) That section 24C created an exception to the general rule in the Income Tax Act that expenditure is only deductible in the year of assessment in which the expenditure is actually incurred. The purpose of the provision was to address the anomaly that arose when income was received under a contract in one year and the expenditure is incurred to perform under that contract in a subsequent year of assessment.

(xii) That section 24C(2) had three requirements: there must be income received or accrued in terms of an income-producing contract; an obligation on the taxpayer under a contract that requires future expenditure, which will be financed by this income; and contractual sameness.

(xiii) That the facts of the current matter were distinguishable from both Big G Restaurants (Pty) Ltd v C:SARS 82 SATC 403 and Clicks Retailers (Pty) Ltd v C:SARS 84 SATC 71. The taxpayer had submitted that there was a clear relationship between the income-producing contract it had entered into with its clients and the obligation-imposing contract it had entered into with its employees, with employee bonus and leave costs included in the applicable price calculator and the income received by the taxpayer from its clients.

(xiv) That SARS had taken the view that the taxpayer's contract with its client did not create an obligation to incur future expenditure, making section 24C inapplicable. This was apparent from the fact that no specific provision created an obligation to incur future expenditure in relation to bonus and leave pay.

(xv) That whilst the taxpayer sought to place reliance on section 24C, the fact remained that the treatment of both bonus and leave pay liabilities were expressly included within the ambit of section 7B, in terms of which it was provided that such expenses are deductible in the year that they are paid. With such express provision as to the manner of treatment of accrued leave and bonus liabilities existing in section 7B, it cannot have been intended by the legislature that such liabilities were capable of constituting 'future expenditure' for purposes of section 24C when such an interpretation did

not accord with a patently distinct provision in the statute, namely section 7B, when considered in context.

(xvi) That, accordingly, it followed that accrued bonus and leave pay liabilities did not constitute future expenditure for purposes of section 24C, which provision did not apply to such amounts.

<u>As to notice and severance pay</u>

(xvii) That in relation to severance pay and notice pay, the taxpayer submitted that for purposes of section 11(a) of the Act, the liability incurred in respect of notice and severance pay constituted expenditure actually incurred in the production of income insofar as there existed a sufficient degree of certainty that an obligation to pay severance and notice pay had arisen, with payment being 'inevitable' on the termination of employment, subject to a reasonable risk factor based on past experience applied.

(xviii) That in issue was whether these amounts were 'actually incurred' in the sense that an unconditional liability to make payment existed, even if it had not been paid. SARS contended that section 11(a) barred the deduction of provisions for expenditure or losses that are uncertain or may arise in the future or that are no more than impending or expected and as long as a liability remains contingent it did not constitute expenditure actually incurred and that notice and severance pay were not actually incurred in the production of income as they were not absolute and unqualified.

(xix) That the fact that a risk factor was applied to the amounts claimed in respect of notice and severance pay indicated that these amounts constituted probable future expenditure, but that the amount of such payments remained uncertain in the sense that it could not factually be determined with sufficient certainty what would constitute a fair and reasonable determination of the amount to be paid in due course.

(xx) That, accordingly, it followed in such circumstances that reliance could not be placed on section 11(a) of the Act to permit the deduction of such amounts as expenditure from income received.

(xxi) That, in regard to the taxpayer's liability for interest as a result of the additional assessments raised and that it had underpaid provisional tax in terms of section 89quat(2)(b) of the Act, it followed from the facts before the court that in terms of section 89quat(3) circumstances beyond the control of the taxpayer appeared to have existed and therefore interest imposed in respect of the additional assessments raised against the taxpayer should be remitted to SARS for reconsideration.

Appeal against the additional assessments raised was dismissed and the assessments were confirmed.

6.6. Lueven Metals (Pty) Ltd v C:SARS (84 SATC 447)

Lueven Metals (Pty) Ltd (Lueven) was not a mine nor did it produce gold ore which was then extracted from the surrounding material and refined and manufactured into gold in the form of bars, blank coins, ingots, buttons, wire, plate or granules or in solution as provided for in section 11(1)(f) of the Value-Added Tax Act.

Lueven was a purchaser and trader in gold which had already previously been refined in whatever form and which had thereafter principally been manufactured into gold coins (not blanks) and jewellery pieces of various nature and purity and these facts were not in dispute.

Lueven then took the gold (also referred to by it as 'gold containing material' due to its lesser purity) which it had sourced or purchased from members of the public and 'processed' it by in-house melting, refining and casting into 'lesser purity' bars. Thereafter, these bars were taken to a refinery (in this case Rand Refinery) where the gold was (for a second or even third time) refined and manufactured into one of the listed eight forms whereafter it was sold and supplied to the listed entities.

In terms of section 11(1)(f) of the Value-Added Tax Act (the VAT Act) the supply of gold to the South African Reserve Bank, the South African Mint Company (Pty) Ltd or any registered bank under the Banks Act 94 of 1990 in certain unwrought forms as listed was zero-rated provided that such gold had not undergone any

manufacturing process other than the refining thereof or the manufacture or production thereof.

SARS was of the opinion that the gold so supplied by Lueven was precluded from zero-rating by the proviso in section 11(1)(f) of the VAT Act in that the gold supplied should not have undergone a refining or manufacturing process other than the refining or manufacturing process for purposes of supply to the listed entities and, as the gold so supplied by Lueven had undergone a prior refining and manufacturing process before the refining and manufacture for purposes of supply to the listed entities, it was therefore precluded from being zero-rated for VAT.

Lueven disputed SARS' contention and applied to the High Court for a declaratory order to be issued in terms whereof, inter alia, it be declared that the word 'gold' in section 11(1)(f) of the VAT Act referred to, and only applied to gold (in any of the unwrought forms permitted in the subsection) refined to the grade of purity required for acquisition by the South African Reserve Bank, the South African Mint Company (Pty) Ltd or by any bank registered under the Banks Act 94 of 1990.

The declaratory order applied for also requested that the proviso to section 11(1)(f) of the VAT Act did not refer to any process(es) to which gold may have been subjected to historically, prior to being refined to the grade of purity required for acquisition by the listed entities.

For the tax periods 03/2018 to 03/2020 Lueven supplied gold bars of a purity of 99.5% to ABSA in accordance with its requirements and which supplies were zero-rated.

Lueven contended that the 'gold' referred to in section 11(1)(f) ought to be interpreted as 'referring to the gold being supplied to the closed-list recipients' and not the gold initially sourced prior to the supply to Rand Refinery, i.e. the supplied product and not the source product.

Lueven also submitted that 'refining' was not to be interpreted in a limited extent, but should include the concept of 're-refining' and that section 11(1)(f) never intended nor required an investigation into the source of the gold or its historical processes.

SARS pointed out that section 11(1)(f) of the VAT Act should be interpreted in the context of the Act as a whole. The purpose of the VAT Act was to raise revenue for the benefit of the National Revenue Fund and section 7(1) provided that for this purpose, a tax, known as Value-Added Tax shall be levied and paid on the supply by any vendor of goods or services supplied by such vendor in the furtherance of its business and, currently, this is calculated at 15% of the value of the supply concerned.

Judge Davis held the following:

(i) That the principles of statutory interpretation have been encapsulated in Natal Joint Municipal Pension Fund v Endumeni Municipality 2012 (4) SA 593 (SCA) per Wallis JA. The fact that the interpretational process commences with the wording and ordinary grammatical meaning of the words used in the statute under examination has been confirmed in Cool Ideas 1186 CC v Hubbard and Another 2014 (4) SA 474 (CC) in the following fashion: 'A fundamental tenet of statutory interpretation is that the words in the statute must be given their ordinary meaning, unless to do so would result in an absurdity.'

(ii) That the words used in section 11(1)(f) of the VAT Act do not comprise of technical terms and spell out certain jurisdictional requirements for a sale of gold to qualify to be zero-rated. Upon a simple reading of the words used in the subsection these requirements appear to be: (1) the sale must be to a prescribed list of purchasers; (2) the gold must be in one of eight prescribed forms and (3) the gold must not have undergone a process other than that of the refining, manufacturing or production of the eight prescribed forms i.e. bars, ingots and the like.

(iii) That in the section under consideration the lastmentioned of the three requirements is introduced by the relative pronoun 'which'. Where, in section 11(1)(f), the 'antecedent' is the gold to be sold, the words following 'which' therefore not only refers to that gold but qualifies or restricts its refining, manufacturing or production processes. Lueven's interpretation, namely that gold (of this purity) only refers to the gold once sold to the

closed list of recipients, irrespective of where it came from, would render the words 'which has not undergone any manufacturing other than refining or the manufacture….into such bars…' superfluous.

(iv) That often formulations of statutory enactments lead to unforeseen consequences and the interpretive model heralded in by Natal Joint Municipal Pension Fund, supra, have cast the net much wider and more purposive than a mere attempt at deducing the 'intention of the legislature' as prescribed in earlier cases. Policy considerations shall be taken into account as part of the 'context' within which the section must be interpreted, but not as the intended goal of the legislature. In order to properly appreciate Lueven's contentions, regard should also be had to the 'context' or factual environment within which Lueven operated and sought to apply its interpretation of section 11(1)(f) of the Act.

(iv) That, in regard to the route taken by the gold which Lueven supplied to the listed entities, it was mined at some stage, then refined and thereafter it had undergone a manufacturing or production process whereby it became jewellery, coins or scrap gold as a result of these manufacturing processes. Lueven, as a gold trader, then acquired this gold and in-house refined, melted and manufactured it into lesser-purity gold bars. Thereafter these bars were delivered to Rand Refinery where it was yet again refined and then manufactured into one of the eight categories of gold mentioned in section 11(1)(f), in this case bars of pure gold, before it was sold to ABSA.

(v) That there was no doubt that the gold had undergone an initial 'refining' and subsequent 'manufacturing or production' process before being refined and manufactured by Rand Refinery for the second (or even third) time.

(vi) That there is also no definition of 'gold' contained in the VAT Act, save in respect of second-hand goods, (which is not applicable here) and the fact that the closed list of recipients may require gold at a certain purity (for minting or investment purposes) cannot define the word used in section 11(1)(f) of the Act.

(vii) That, to the court's mind, simply put, section 11(1)(f) simply conveys the message that when gold is sold to the South African Reserve Bank, the South African Mint Company (Pty) Ltd or the banks, in whatever purity they may require, that gold should not have previously undergone a refinement or manufacturing process prior to it being refined or manufactured into gold bars, ingots and the like. If the volume of gold supplied to the listed recipients emanated from gold which had previously been refined and undergone manufacturing processes, that supply would not qualify to be zero-rated.

(ix) That one of the principles aiding interpretation is that all the words used in a statutory provision must be given meaning and afforded their due weight and 'contextual interpretation requires that regard be had to the setting of the word or provision to be interpreted with particular reference to all the words, phrases or expressions around the word or words sought to be interpreted'. It is impermissible to simply excise words from a section or ignore words. To do so would offend against the current state of our law of interpretation as sanctioned by the Constitutional Court and secondly, to achieve the meaning contended for by Lueven, it was not only the 'double use' of the eight forms which was excised, but also the use of the second relative pronoun used, namely 'such'.

(x) That to interpret section 11(1)(f) to refer to a factual absurdity would render such an interpretation itself absurd. The opposite interpretation, i.e. that of SARS, namely to disqualify from zero-rating once-refined and manufactured gold (such as second-hand jewellery) when it is subsequently re-refined, did not lead to such an absurdity. It simply meant that those suppliers (such as mines) who had ore and mined gold refined and manufactured into the eight forms of unwrought gold, could have sales or supplies of such gold to the listed recipients zero-rated and that traders in previously refined gold could not, after re-refining such gold, have their supplies to the listed recipients zero-rated for VAT. The second interpretation, espoused by SARS, leads to a 'sensible meaning [which] is

to be preferred to one that leads to insensible or unbusinesslike results…' as put in the Natal Joint Municipal Pension Fund case, supra, at para [18], while Lueven's interpretation suffers from 'absurdity disabilities.'

(xi) That revenue law constitutes foreign domestic law and not international law. Furthermore, our courts have repeatedly cautioned against '…the dangers inherent in placing reliance on the meaning ascribed to a particular word in the context of another statute, especially that of a foreign country.' For these reasons neither the New Zealand Goods and Services Tax Act 141 of 1985 nor the inconclusive section dealing with the zero-rating of gold to a restricted list of recipients in the United Kingdom, being section 30 of the UK VAT Act 23 of 1994, were either convincing or definitive of the interpretational issue of section 11(1)(f) of the VAT Act.

(xii) That, to sum up, the court found that, upon a simple reading of section 11(1)(f), the ordinary grammatical meaning of the words used did not give rise to a 'glaring absurdity' nor did it give rise to 'inconsistency, hardship or an anomaly' from the consideration of the VAT Act as a whole which would justify a departure from the words used. The interpretation advanced by Lueven, on the other hand, entailed the excision of some words used in the subsection and led to either an absurd or 'insensible' result, neither of which was assisted by any of the general principles applicable to the interpretation of statutes.

(xiii) That, in conclusion, in any interpretative exercise, the supremacy of the Constitution and the rights contained therein, must be acknowledged, but no constitutional principle is offended by the interpretations under debate in this matter.

(xiv) That, therefore, the supply of gold which was derived from gold which had previously been refined and subsequently undergone any manufacturing process before being refined or manufactured in the prescribed eight unwrought forms for purposes of supply to the listed recipients, was therefore excluded from zero-rating.

(xv) That, accordingly, the interpretation of section 11(1)(f) of the VAT Act advanced by Lueven was incorrect and it was therefore not entitled to the declaratory orders sought.

Application dismissed with costs, including the costs of senior and junior counsel.

6.7. Zimbabwe Platinum Mines (Pvt) Ltd v Zimbabwe Revenue Authority (84 SATC 461)

Zimbabwe Platinum Mines (Pvt) Ltd (ZPM) undertook mining and processing operations in terms of a special mining lease (SML) supported by a mining agreement.

Zimbabwe Revenue Authority (ZRA), is a regulatory body responsible for collecting revenue in terms of the Revenue Authority Act [Chapter 23:11].

ZPM had submitted its Income Tax Return for the 2003 tax year on 18 June 2004 and the return was accompanied by the Income Tax Computation based on United States Dollar (US$) financial statements. It submitted its income tax returns for the years 2004, 2005 and 2006 on 12 April 2007 and these returns were accompanied by the Income Tax Computations and the US$ based financial statements.

The assessments for the 2004, 2005 and 2006 tax years were issued to ZPM by ZRA on 27 September 2007 and the date of issue of the assessment for 2003 was before 27 September 2007.

ZPM, on 29 October 2007, objected to the assessments for the tax years 2004, 2005 and 2006 on the basis that they were denominated in Zimbabwe currency and it also objected to the rate of tax that was used to tax it.

ZPM, on 29 January 2008, in the absence of any decision by ZRA, gave its notice of appeal against the Zimbabwe dollar denominated assessments for 2004, 2005 and 2006.

ZRA, on 30 January 2008, had allowed ZPM's objection in respect of the 2004, 2005 and 2006 assessments and, as a result, ZPM withdrew its appeal.

ZPM, on 6 August 2009, had requested the US$ denominated assessments as had been promised by ZRA and in 2012 ZRA commenced investigation into the tax affairs of ZPM.

After correspondence and ensuing discussions between the parties it was agreed that the assessments up to the year 2006 had prescribed and that ZPM would withdraw its objection on that issue.

This was subsequently confirmed in a letter by ZPM in which it formally withdrew its objection in relation to the assessments issued in the prescribed period and ZPM's liability was thus restricted to the period 2007 to 2012 only.

After further negotiations ZRA, by letter dated 24 December 2014, cancelled the additional assessments for the years 2003 to 2006 in recognition of the prescription period and issued further amended assessments for those four years. However, on 17 July 2015 ZRA dealt with ZPM's objections and disallowed the objection in respect of prescription and it found that there had been misrepresentation and wilful non-disclosure by ZPM.

Following upon the above determination ZPM lodged an appeal to the court *a quo*, being the Special Court of Income Tax Appeals, against ZRA's determinations relating to:

- prescription,
- additional profits tax (APT) and
- penalty on additional profits tax.

The court *a quo* found that the assessments that had been undertaken in terms of the Zimbabwean currency were in contravention of the law and were accordingly a nullity.

Accordingly, ZRA was entitled to issue fresh assessments denominated in US$ at any time without regard to the provisions of section 47 of the Income Tax Act [Chapter 23:06]. It found that this was because the assessments did not derive their validity from the objection that was raised but from the provisions of the law.

The court *a quo* further found that the provisions of section 62(6) of the Income Tax Act [Chapter 23:06] did not apply to the facts of this matter as that provision presupposed an objection noted against a valid assessment. ZRA, as a creature of statute, could not amend a nullity as that would be against its enabling statute. This was not a matter where a valid assessment was wrong in terms of minor details but a case where an assessment was issued contrary to the peremptory provisions of the law and was therefore null and void ab initio.

In the result the court *a quo* dismissed the appeal in its entirety and the 30% penalties on additional profits tax (APT) that were imposed by ZRA on 8 May 2015 were confirmed.

ZPM, aggrieved by the decision of the court *a quo*, filed its appeal to the Supreme Court on the following grounds of appeal:

- The court *a quo* had erred in law by holding that the incorrect tax assessments for the 2003 to 2006 years of assessment carried out by ZRA on ZPM's income tax liabilities for those years were 'invalid' and a legal 'nullity';
- The court *a quo* had erred in law by holding that section 62(6) of the Income Tax Act [Chapter 23:06] was not engaged in circumstances where a taxpayer's objection was against an incorrect tax assessment by ZRA;
- The court *a quo* had erred in law by holding that ZRA could adjust an 'original' Additional Profits Tax Assessment pursuant to section 47 of the Income Tax Act or any other provision of the Income Tax Act;
- The court *a quo* had erred in law by holding that ZRA was permitted to impose a penalty of additional tax on an Additional Profit liability;
- The court *a quo* had erred in law when, having correctly found that it was conducting a rehearing, it restricted its enquiry to considering whether ZRA had 'misdirected' itself when imposing a penalty on ZRA;
- The court *a quo* had erred in law in upholding the penalty of 30% on the Additional Profit Tax given the mitigating factors.

ZPM, on appeal to the Supreme Court, submitted that the court *a quo* had erred in finding that the failure of ZRA to comply with the peremptory provisions of par.

11(2)(b) of the 22nd schedule of the Income Tax Act automatically rendered the assessments for the years 2004 to 2006 a nullity.

ZPM maintained that an assessment that did not so comply was incorrect, but was not invalid, and it also submitted that ZRA could not adjust additional profits tax under section 47 of the Income Tax Act as the section was only applicable to income tax and it further submitted that no penalty could be levied on additional profits tax.

ZRA, on appeal to the Supreme Court, submitted that the court *a quo* did not err in finding that the assessments in issue were a nullity as the statutory provision was peremptory.

ZRA further submitted that where there was default in the payment of tax, a penalty was imposed regardless of it being in respect of additional profits tax.

The issues for determination before the Supreme Court were:

- Whether or not the court *a quo* had erred in holding that the tax assessments issued by ZRA were invalid;
- Whether or not ZRA could not adjust the additional profits tax under section 47 of the Income Tax Act.

Judge Mavangira held the following:

(i) That ZPM's primary bone of contention before this court was that the court *a quo* had erred in holding that the tax assessments issued by ZRA were invalid in that ZRA had computed the income tax in Zimbabwean dollars which was contrary to the provisions of par. 11 of the 22nd Schedule to the Income Tax Act [Chapter 23:06].

(ii) That ZPM had elected, at the inception of its operations, to maintain its books of account in US$, in terms of par. 11(1) of the 22nd Schedule. In terms of the law, such an election was final and it was common cause that ZPM kept its books of account in US$.

(iii) That par. 11(2)(b) commanded the Commissioner to determine the taxable income or assessed loss pertaining to ZPM in US$ currency. Contrary to this clear provision of the law, ZPM was issued with an assessment

sounding in Zimbabwe dollars and such assessment was clearly not issued in terms of the law and it followed therefore that no legal validity could attach to it because no legal validity attaches to any act done contrary to the provisions of a statute. As was correctly observed by counsel for ZRA, 'the law does not allow ZRA to issue tax assessments to a taxpayer in the mould of ZPM in any currency other than that elected by ZPM for purposes of keeping books of account.'

(iv) That counsel also highlighted, correctly in the court's view, the importance of appreciating the difference and distinction between, on the one hand, an invalid assessment, which is a nullity at law and cannot therefore be corrected or create any obligation to pay and, on the other, an incorrect assessment which is afflicted by, inter alia, a mathematical error or miscalculation and which can be corrected.

(iv) That the wording of the provisions in par. 11 of the 22nd Schedule of the Act was clear and unambiguous. It did not require the court to read anything into the Act in order to derive the intention of the legislature. ZRA could not have validly issued assessments in Zimbabwe dollars where the wording of the statute was peremptory and required that the assessments be computed in US$.

(v) That ZRA was a creature of statute and therefore could not act contrary to the four corners of its enabling Act. Once it was established that ZRA had erroneously issued tax assessments in the wrong currency, it therefore followed that ZRA had to issue assessments that were in compliance with the law.

(vi) That ZPM could not thus seriously argue that the failure by ZRA to comply with the provisions of par. 11 of the 22nd Schedule of the Act did not automatically render the assessments invalid as no validity attached to the purported assessments. The law imposed a duty on ZRA, in terms of the Act, to issue tax assessments to a taxpayer in the currency elected by the taxpayer.

(vii) That the court *a quo* had correctly found that the assessments for the tax years 2003 to 2006 were invalid.

(ix) That it followed from the above that ZPM's second ground of appeal could not stand either. ZPM's contention was that the court *a quo* had erred in law in holding that section 62(6) of the Income Tax Act was not engaged in circumstances where a taxpayer's objection was against an incorrect tax assessment by ZRA. The reasoning of the court *a quo* was that the section was not applicable to the facts of the matter because the provision presupposed an objection against a valid assessment and the assessments *in casu* were not merely incorrect but were nullities.

(x) That the court *a quo*'s reasoning was sound as it was borne out by a close look at section 62(6). *In casu*, the supposed determination did not reduce, increase or alter tax in favour of or against ZPM. Furthermore, there was nothing final and conclusive about ZRA accepting that it had not made an assessment in terms of the law. The letter 'allowing' the objection did not contain any figures and as such could not be said to be final and exclusive in terms of section 62(6) of the Act.

(xi) That ZPM argued that the court *a quo* had erred in holding that ZRA could adjust additional profits tax assessments pursuant to section 47 of the Act or any other provisions of the Act. It maintained the view that once the taxpayer had made a wrong return for purposes of income tax in terms of the 22nd Schedule, that consequently affected additional profits tax, hence there could not be any penalty imposed on additional profits tax.

(xii) That, in dealing with this ground of appeal, it was important, if not imperative, to take into account the definition of 'tax' in the Income Tax Act. Section 2 of the Act defined 'tax' as 'any tax or levy leviable under the Act.' It was not in dispute that additional profits tax was leviable under the Act in terms of section 33 of the Act.

(xiii) That, furthermore, where an 'original' assessment is issued on the basis of incorrect information supplied by the taxpayer and this was uncovered, ZRA

was at large to adjust it to ensure that it reflected the actual tax due and owing to the fiscus.

(xiv) That, from the given definition of tax in the Act and the provisions of section 33, it was evident that additional profits tax was a tax and therefore it was taxable under the Act. Once it had been established that additional profits tax was tax in terms of the Act, it therefore followed that the tax must be paid and, in addition, section 46(1) of the Act required a taxpayer to make payment in respect of additional tax. Section 46(1) thus enjoined ZPM to pay such tax in addition to the tax chargeable in respect of its taxable income. The furnishing of wrong information in respect of income tax, which consequently affected additional profits tax, was the basis of the applicability of section 46 to the later tax.

(xv) That ZPM had furnished incorrect information to ZRA by misrepresenting its capital redemption allowances that had been claimed. Having misrepresented such, the provisions of sections 46(1) and 47 of the Act were correctly invoked to compute the actual tax payable. It was clear from section 47 that the Commissioner had a right to re-open audits after the lapse of the six-year period where the Commissioner was satisfied that the taxpayer’s returns did not disclose the correct amount or amounts for income tax purposes. However, in terms of section 47(1)(c)(ii) the Commissioner could only do that after he or she was satisfied that there was, on the part of the taxpayer, evidence of fraud, misrepresentation or wilful non-disclosure of facts.

(xvi) That *in casu* the Commissioner found that there had been wilful non-disclosure by ZPM through the manner in which the capital redemption allowances had been claimed and therefore he was entitled to re-open the assessments for the years 2001 to 2006 as well as for the period of 2014.

(xvii) That in the circumstances the court *a quo* could not be faulted for finding against ZPM in that if any return in relation to additional profits tax was made in terms of par. 5 of the 23rd Schedule, which did not disclose

information which affected the quantum of the additional profits tax, a penalty, that is, additional tax, was chargeable.

(xviii) That, in addition, another significant factor that was also taken into consideration by the court *a quo* was the fact that ZRA had, in its discretion, reduced the penalty from 100% to 30% and the court *a quo* found no misdirection on ZRA's part in exercising its discretion.

Appeal dismissed with costs.

7. INTERPRETATION NOTES

7.1. Public benefit organisations: Provision of residential care for retired persons – No. 124

This Note provides guidance on the interpretation and application of PBA 3(c) relating to the provision of residential care for retired persons.

Institutional care of older persons was in the past prioritised by government and nongovernmental organisations resulting in the establishment of old age homes and care centres. Government policy, however, shifted the emphasis to:

- encourage older people to live active, healthy and independent lives within the community to retain their independence for as long as possible;
- encourage family and home care of older persons; and
- restrict institutional care to the frail elderly who require 24-hour care and who do not have the financial resources to meet their own needs.

The care for older persons has therefore become the responsibility of every citizen. Retired persons who can afford to do so therefore may choose to live in housing schemes built to meet their particular needs, to maintain relative independence and to secure a comfortable quality of life. These housing schemes typically comprise housing units that range from freestanding houses with private gardens to multi-storey apartments, or flats, or a combination of these. The housing schemes are

also normally walled or fenced off to form a separate village or complex and may offer communal facilities such as gyms, tennis courts, swimming pools, bowling greens, community centres as well as laundry services.

Section 10(1)(cF), which was repealed on 15 July 2001, provided an exemption from income tax for organisations providing residential accommodation under a sale or a lease or otherwise to aged or retired persons in a building, housing complex or village. An organisation had to provide at least one meal per day as well as nursing services in addition to residential accommodation in order to qualify for exemption under section 10(1)(cF). Organisations exempted under the repealed section 10(1)(cF) were thus mainly organisations selling accommodation by operating Life-Right Schemes contemplated in the Housing Schemes for Retired Persons Act 65 of 1988.

Section 10(1)(cN) and section 30 were introduced into the Act to deal with exempt organisations. The concept of a 'PBO' carrying on a 'PBA' was introduced. Specific PBAs were included in the Ninth Schedule to be carried on by a qualifying PBO. One such PBA is the provision of residential care for retired persons as contemplated in PBA 3(c). Section 10(1)(cF) was repealed simultaneously with the introduction of these sections.

Organisations previously exempted under section 10(1)(cF) were required to re-apply to SARS for approval as a PBO carrying on PBA 3(c) on or before a prescribed date. An organisation that did not submit a re-application to SARS before the prescribed date lost its exempt status and became a normal taxpayer.

Approval of the previously exempt organisations by SARS as a PBO was not automatic. Many organisations exempted under the repealed section 10(1)(cF), especially those operating only Life-Right Schemes, did not qualify as carrying on PBA 3(c).

This Note considers the requirements of only PBA 3(c) and not those of the repealed section 10(1)(cF).

In order to be approved as a PBO an organisation carrying on PBA 3(c) must, on application, and after obtaining such approval on submission of its annual income tax return, satisfy SARS that:

- its sole or principal object is the provision of residential care for retired persons;
- more than 90% of the retired persons including retired persons who are poor and needy to whom residential care is provided are over the age of 60;
- nursing services are provided by that organisation;
- nursing services are provided to retired persons who are poor and needy albeit it does not have to be at less than full cost;
- residential care for retired persons who are poor and needy is actively provided by that organisation;
- the organisation does not recover the full cost of providing residential care for retired persons who are poor and needy; and
- the receipts and accruals derived by the organisation providing residential care meet the requirements of section 10(1)(cN)(ii).

An organisation bears the onus of proving that it complies with the requirements relative to the approval as a PBO carrying on PBA 3(c) as discussed in this Note63 and must retain the necessary evidence to support the view taken (see 8). 64 The burden may be discharged by way of supporting evidence submitted by the organisation, provided such evidence is reasonable

Whether an organisation complies with the requirements of PBA 3(c) will be a factual enquiry and since the facts and circumstances, pertaining to each organisation may differ, each case will be considered on its own merits.

7.2. Association: Funding Requirement – No. 125

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. This Note considers only the 'funding' requirement and does not consider any of the other requirements required for approval under section 30B(2) for purposes of the exemption from income tax under section 10(1)(d)(iii) or (iv).

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 the Commissioner 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 granted approval under section 30B(2), an entity must satisfy the Commissioner that it falls within the definition of 'entity' in section 30B(1) and

meets all the prescribed requirements, which include, that substantially the whole of its funding is derived from its annual or other long-term members or from an appropriation by the government, are met.

An entity bears the onus of proving that it complies with the requirements relative to the approval as highlighted 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.

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

7.3. Extra-ordinary dividends treated as income or proceeds on the disposal of certain shares – No. 126

This Note provides guidance on the interpretation and application of section 22B and paragraph 43A relating to the income tax treatment of extraordinary dividends on certain disposals and deemed disposals of shares by a company to prevent so-called 'dividend stripping'.

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

- The Taxation Laws Amendment Act 20 of 2021 which was promulgated on 19 January 2022 (as per Government Gazette 45787).
- The Tax Administration Laws Amendment Act 21 of 2021 which was promulgated on 19 January 2022 (as per Government Gazette 45786).
- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 19 of 2021 which was promulgated on 19 January 2022 (as per Government Gazette 45788).

The current section 22B and paragraph 43A came into operation on 19 July 2017 and apply to any disposal of shares on or after that date, other than a disposal

under an agreement all the terms of which were finally agreed to before that date by all the parties to the agreement. These provisions are anti-avoidance provisions aimed at 'dividend-stripping' when a shareholder reduces the value of a shareholding through extracting exempt dividends so that, upon the subsequent disposal, the taxable disposal proceeds are lower than would have been the case if all the reserves had still been retained in the company.

The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2018 explains the reasons for the necessity of provisions dealing with dividend stripping as follows:

> 'The anti-avoidance rules dealing with dividend stripping were first introduced in the Act in 2009. These rules were inserted to curb the use of dividend stripping structures by taxpayers as a result of the tax exemption in respect of dividends paid by a resident company to another resident company. Dividend stripping normally occurs when a resident shareholder company that is a prospective seller of shares in a target company avoids income tax (including capital gains tax) arising on the sale of shares by ensuring that the target company declares a large dividend to that resident shareholder company prior to the sale of shares in that target company to a prospective purchaser. This presale dividend, which is exempt from normal tax and dividends tax, decreases the value of shares in the target company. As a result, the seller can sell the shares at a lower amount, thereby avoiding a larger normal tax (including capital gains tax) charge in respect of the sale of shares.'

Although the wording of section 22B and paragraph 43A is almost identical, section 22B applies to the disposal of shares held by a company as trading stock, while paragraph 43A applies to the disposal of shares held by a company as capital assets. Broadly, to overcome the normal tax advantage of having declared extraordinary dividends, section 22B and paragraph 43A add an additional amount to income or proceeds (as appropriate) on disposal of the applicable shares. Both provisions apply to the disposal of shares by companies only, which may be

residents or non-residents, provided all the requirements of section 22B or paragraph 43A are met.

Section 22B and paragraph 43A are anti-avoidance provisions aimed at 'dividendstripping' when a shareholder reduces the value of a shareholding through extracting exempt dividends so that, upon the subsequent disposal, the taxable disposal proceeds are lower than would have been the case if all the reserves had still been retained in the company. These two provisions apply only to companies.

Section 22B(2) and paragraph 43A(2) respectively provide for the amount of an exempt dividend, to the extent that it is an extraordinary dividend, received by or accrued to a company in respect of the disposal or deemed disposal of shares under section 22B(4) or paragraph 43A(4) to be:

- included in the company's income if the company held the shares as trading stock immediately before the disposal or deemed disposal under section 22B(4);
- taken into account as part of proceeds on the disposal of the shares if the company held the shares as capital assets immediately before the disposal; or
- taken into account as a capital gain if the company held the shares as capital assets immediately before the deemed disposal under paragraph 43A(4).

The amount of the extraordinary dividend must be included in income or taken into account as proceeds on disposal of the shares:

- in the year of assessment in which those shares are disposed of or deemed to be disposed of; or
- if the dividend is received or accrues after that year of assessment, in the year of assessment in which the dividend is received or accrues.

Section 22B(2) or paragraph 43A(2) will apply if the following requirements are met:

- A company disposes of shares in another company under a transaction that does not constitute a deferral transaction.
- The company disposing of shares in another company must hold a qualifying interest in that company at any time during the period of 18 months before the disposal of the shares.

Section 22B(3) and paragraph 43A(3) deal with the consequences when a company disposes of shares within 18 months after having acquired those shares under a deferral transaction, other than an unbundling transaction.

Section 22B(4) and paragraph 43A(4) deem a disposal of shares to occur for purposes of section 22B(2) and paragraph 43A(2) when a company's effective interest in a target company's equity shares is reduced through the issue of 'new shares' by the target company to another person. Under these circumstances the company holding equity shares in the target company before the issue of the 'new shares' must, for purposes of section 22B and paragraph 43A only, be treated as having disposed, immediately after the 'new shares' were issued, of a percentage of those equity shares.

8. DRAFT INTERPRETATION NOTES

8.1. Definition of 'Associated Enterprise'

This Note provides guidance on the interpretation and application of the definition of 'associated enterprise' in section 31(1).

Section 66(1) of the Taxation Laws Amendment Act 20 of 2021 amended the effective date such that the inclusion of an 'associated enterprise' in section 31 comes into operation on 1 January 2023 and applies in respect of years of assessment commencing on or after that date.

The Act contains rules in section 31 which are aimed at preventing a reduction in the South African tax base as a result of the mispricing or incorrect characterisation of specified transactions, operations, schemes, agreements or understandings.

Broadly, this is achieved by applying the arm's length principle to affected transactions, as defined in section 31(1), and requiring the persons specified in section 31(2) to calculate their taxable income or tax payable as if transactions, operations, schemes, agreements or understandings had been entered into on terms and conditions that would have existed had the persons been independent persons dealing at arm's length. In summary, affected transactions are transactions, operations, schemes, agreements or understandings directly or indirectly entered into or effected between or for the benefit of specified parties that are connected persons in relation to one another and that contain any terms or conditions that differ from those that would have existed had the parties been independent persons dealing at arm's length.

The definition of 'affected transaction' currently only includes transactions, operations, schemes, agreements or understandings directly or indirectly entered between the specified parties that are connected persons in relation to one another. As such, the application of the transfer pricing rules contained in section 31 have the unintended consequence of not always capturing transactions between 'associated enterprises' which may not fall within the 'connected persons' definition. To correct this unintended consequence and to bring the legislation in line with international standards, the term 'associated enterprise' as contemplated in Article 9(1) has been inserted into section 31(1) and into the definition of an affected transaction with effect from years of assessment commencing on or after 1 January 2023. This will result in 'affected transactions' applying to both associated enterprises and connected persons in respect of years of assessment commencing on or after this date.

Broadly, section 31 deals with the tax payable by persons in respect of international transactions, operations, schemes, agreements or understandings and requires such transactions, operation, scheme, agreement or understanding to be based on the arm's length principle. Prior to the amendment of this section which included a definition of 'associated enterprise' and included that term in the definition of 'affected transaction', section 31 and the definition of 'affected transaction' only covered connected persons.

The exclusion of associated enterprises from section 31 effectively created a potential anomaly and unfair reduction in the tax base. As such, the 'associated enterprise' definition was inserted in section 31 in order to correct this potential irregularity.

8.2. Exemption of income relating to South African ships used in international shipping

This Note provides guidance on the interpretation and application of section 12Q of the Income Tax Act, which provides for an exemption from normal tax, capital gains tax, dividends tax and withholding tax on interest for an international shipping company meeting the requirements of the section.

As part of the National Transport Policy, government aims to promote the development of an efficient and productive South African maritime industry capable of competing internationally and to encourage ships to carry the South African flag. To give effect to this strategic objective, section 12Q was inserted with effect from 1 April 2014 and applies to years of assessment commencing on or after that date, providing certain tax relief for qualifying international shipping companies. The issue of double taxation and the application of various double tax treaties are not dealt with in this Note since double taxation relief measures vary from treaty-to-treaty.

Section 12Q provides for an exemption from normal tax, capital gains tax, dividends tax and withholding tax on interest for international shipping companies if the requirements of the section are met. In determining whether an international shipping company qualifies for these exemptions, the definitions of the terms 'South African ship', 'international shipping', 'international shipping company' and 'international shipping income' should be considered and applied to the relevant tax under section 12Q.

9. BINDING PRIVATE RULINGS

9.1. BPR 379 – Qualifying purpose

This ruling determines the tax consequences of a dividend declared by the issuer of a preference share which was issued for a qualifying purpose after the shares in an operating company financed by the preference share funding are disposed of by the shareholder in the operating company.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 13 June 2022. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 8E; and
- section 8EA.

Parties to the proposed transaction

The applicant: A resident company, and wholly owned subsidiary of Company H

The co-applicant: A resident company

Company H: A resident company

Company T: A listed resident company

Description of the proposed transaction

Company H contemplated an investment in Company T, an operating company, and requested its subsidiary, the applicant, to provide financial assistance. The applicant raised the funding by issuing cumulative redeemable preference shares to the co-applicant and provided a loan to Company H. The preference shares are 'hybrid equity instruments' as defined in paragraph (c)(i), of that definition, in section 8E(1). The preference share terms contain an 'enforcement right', as defined in section 8EA(1) and would have qualified as hybrid equity instruments as defined in paragraph (c)(i) of the definition of that term in section 8EA(1). The ordinary shares in Company T have since been disposed of by Company H

because of on-going losses sustained in the market on the value of the shares.

It is proposed that a preference share dividend be declared by the applicant subsequent to the disposal of the ordinary shares held in Company T.

Conditions and assumptions

This binding private ruling is subject to the following condition and assumption:

- Company T is an 'operating company', as defined in section 8EA(1), at the time the dividend is declared by the applicant.

Ruling

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

- Any dividends paid by the applicant to the co-applicant on the preference shares, after the sale by Company H of the equity shares in Company T, will not be recharacterized as income under the provisions of either section 8E or 8EA of the Act in the hands of the co-applicant.

9.2. BPR 380 – Transfer of shares in resident company to non-resident holding company

This ruling determines the tax consequences of the transfer of ordinary and preference shares by a South African resident company (the applicant) to a non-resident, indirect subsidiary (Foreign Company) of the applicant.

In this ruling, references to sections and paragraphs are to sections of the relevant act and paragraphs of the Eighth Schedule to the Income Tax Act applicable on 29 July 2022.

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

This is a ruling on the interpretation and application of:

- the Act:

- section 9D;
- section 64E;
- paragraph 38;
- paragraph 39; and
- paragraph 76B of the Eighth Schedule to the Act.

- the STT Act:
  - section 1 – definition of 'transfer' and 'security';
  - section 2(1);
  - section 6(2); and
  - section 7(2).

Parties to the proposed transaction

The applicant: A listed resident company

Foreign Company: A company incorporated in and a resident of a foreign country, that is an indirectly held subsidiary of the applicant

SA Holdco: A resident private holding company

SA Opco: A resident private operating company

Description of the proposed transaction

The applicant holds 90% of the ordinary shares in SA Holdco, which indirectly holds the ordinary shares of SA Opco. SA Opco issued two classes of redeemable, non-participating, no par value preference shares to the applicant. Together, the ordinary shares in SA Holdco and the preference shares in SA Opco are referred to as the sale shares. The sale shares will be transferred to the Foreign Company for a price determined with reference to a market valuation done in January 2022.

The financial position of the operating company is weak and as a result, the sale shares will be transferred for a significant discount, which will result in a capital loss for the applicant.

Conditions and assumptions

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

- The applicant holds the sale shares on capital account.
- The Foreign Company does not conduct any business in South Africa through a permanent establishment in South Africa.
- The effective rate of tax (taxes on income payable to all spheres of government) applicable in the country of residence of the Foreign Company is at least 18.225%.
- At all material times, the Foreign Company is the beneficial owner of the dividends in respect of the sale shares and complies with the evidentiary requirements under section 64G(3) to qualify for the reduced rate under the DTA referred to below.

Ruling

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

- Subject to the application of paragraphs 38 and 39, the applicant will be required to include any gains or losses realised on the transfer of the sale shares in the calculation of its net gains or losses for the relevant fiscal year.
- Under paragraph (d) of the first proviso to section 9D(2A), the exemption under section 10(1)(k) of future dividend income received by the Foreign Company in respect of the sale shares from SA Holdco and SA Opco will be limited and the dividend income must be attributed to the applicant in accordance with section 9D(2), subject to the application of the comparable tax exemption in the second proviso to section 9D(2A).
- On the basis that the Foreign Company will own at least 10% of the capital of SA Holdco and SA Opco, the reduced dividends tax rate of 5% will apply in respect of dividends received by the Foreign Company in respect of the

sale shares (Article II of the Protocol to the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion between South Africa and the United Kingdom).

- Under section 2 read with section 6(1) of the STT Act, STT will be payable upon the transfer of the sale shares on the taxable amount.
- SA Holdco, as the issuer of the ordinary shares, is liable for the STT on the transfer of these shares to the Foreign Company under section 6(2) of the STT Act but may recover that amount from the Foreign Company under section 7(2).
- SA Opco, as the issuer of the preference shares, is liable for the STT on the transfer of these preference shares to the Foreign Company under section 6(2) of the STT Act but may recover that amount from the Foreign Company under section 7(2).

9.3. BPR 381 – Beneficial ownership in respect of back-to-back share transfers

This ruling determines the securities transfer tax consequences of the transfer of listed shares from a client to the applicant and by the applicant to an authorized user or vice versa.

In this ruling references to sections are to sections of the STT Act applicable as at 25 August 2022. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the STT Act.

This is a ruling on the interpretation and application of:

- section 1 – definition of 'transfer' and 'unrestricted and security restricted stock account';
- section 2(1); and
- section 8(1)(q).

Parties to the proposed transaction

The applicant: a resident company carrying on the business of a bank

Co-applicant a resident company and fellow subsidiary of the applicant, and an authorised user as defined in section 1 of the Financial Markets Act, 19 of 2002

Description of the proposed transaction

The applicant has an over-the-counter derivative product licence and intends to offer its clients the ability to enter into single stock equity forwards and single stock equity options (the derivative) in respect of shares which are listed on an exchange in South Africa. The derivatives will be entered into using the standard International Swaps and Derivatives Association (ISDA) documentation.

The transactions and steps envisaged are described below:

- The client will enter into the derivative with the applicant to forward purchase or sell shares or enter into an option transaction.
- The applicant will hedge the derivative with the co-applicant (commonly known as execution of the 'delta'). Since the applicant is not a member of the JSE, the delta is executed by the co-applicant.
- The co-applicant will either buy or sell shares on an exchange to hedge the derivative.
- Upon settlement of the derivative, and if the client elects physical settlement, co-applicant will be responsible for the physical delivery of the shares. The co-applicant is then required to process a 'Report Only Trade' on the JSE approved and conformed trading system. The JSE trade types used is OX (Exercise of Option), OD (Option Delta) or GU (Give Up). These trade types were designed by the regulator to fulfil exactly this obligation.
- Even though the applicant is obligated to deliver the shares to or purchase the shares from the client in terms of the agreement between them, the coapplicant will execute the transfers since the applicant does not have the regulatory licence to do so.

- Legal ownership of the shares is transferred from the co-applicant to the applicant and from the applicant to the client (or vice-versa), but economically the applicant assumes no risk. The terms of the agreements between the applicant and the client, and between the applicant and the coapplicant are similar. The forward price or strike price at which the applicant acquires the shares from the co-applicant or from the client will equal the price at which the applicant on-sells the shares to the client or to the coapplicant. It is not the intention that the applicant becomes the beneficial owner of the shares.

Conditions and assumptions

This binding private ruling is subject to the additional condition and assumption that the listed shares purchased by the co-applicant must be allocated to the coapplicant's 'unrestricted and security restricted stock account' at the JSE in accordance with the JSE Equities Rules and indicated as such as per the required account type codes and account identification codes.

Ruling

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

- The purchase of shares by the applicant from the co-applicant and the subsequent transfer of the shares to the client by the applicant (in terms of the derivative) constitute a single 'transfer' as defined in section 1 of the STT Act, as the applicant will not be the beneficial owner of the shares. Consequently, STT is only leviable once on the transaction when the shares are transferred to the client.

- The purchase of shares by the applicant from the client and the subsequent transfer of the shares to the co-applicant by the applicant (in terms of the derivative) constitutes a single 'transfer' as defined in section 1 of the STT Act, as the applicant will not be the beneficial owner of the shares. Consequently, STT is only leviable once on the transaction when the shares are transferred to the co-applicant. The co-applicant will account for the STT under section 2(1) if the exemption in section 8(1)(q) of the STT

Act does not apply.

9.4. *BPR 382 – Rebate in respect of foreign taxes*

This ruling determines the tax consequences of a capital gain arising from the disposal of shares in a resident company, which shares derive their value principally from immovable property situated in a foreign jurisdiction.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 15 June 2022. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 6quat and paragraphs 2 and 35 of the Eighth Schedule to the Act; and
- the treaty between South Africa and Country X for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income.

Parties to the proposed transaction

The applicant: A resident company

Company B: A resident company

The purchasers: A resident company and a non-resident company

Description of the proposed transaction

The applicant owns 50% of the shares in Company B and proposes to sell a portion of the shares it holds to the purchasers. Company B holds, inter alia, immovable property in Country X.

In terms of Country X's domestic law any capital gain derived from the direct or indirect transfer of shares by a non-resident in a company with assets located in Country X, is regarded as income sourced in Country X, and consequently subject to tax in Country X.

In addition, as provided for in the treaty between South Africa and Country X, because the shares in Company B principally derive their value from immovable property situated in Country X, the capital gain on the disposal of the shares may be taxed in Country X. Immovable property for treaty purposes is determined with reference to the domestic laws in which the property is situated.

The domestic tax laws of Country X prescribe that capital gains will be taxed by applying a specific inclusion rate based on source principles. The inclusion rate is calculated by determining the total value of Company B's assets located in Country X, in relation to its total asset value. The inclusion rate which Country X will apply in respect of the sale of the shares has been calculated at 60%.

The applicant will dispose of the shares for a purchase price equal to a determined amount plus, if applicable, a deferred amount which will be determined at a date in the future.

The fixed amount is determinable according to a formula, whereas the deferred amount consists of additional proceeds which may accrue in a future tax year, depending on whether or not certain specified conditions for payment of the deferred amount are met. It is uncertain whether any part of the deferred amount will ever accrue to the applicant.

Conditions and assumptions

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

- Asset A located in Country X is immovable property in terms of the law of Country X.
- Company B's assets, including Asset A, 'principally' consist of immovable property as contemplated in the treaty at the date of the disposal.
- The market values attributed to Company B's assets at the date of the disposal reflect that more than 50% of the market value is attributable to immovable property situated in Country X.
- Country X has a legitimate right to tax the capital gain on the sale of the shares under its domestic law.

Ruling

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

- The applicant will qualify for a rebate under the provisions of section 6quat(1) in respect of the disposal of shares.
- The rebate, to be determined under the provisions of section 6quat, will be subject to the provisions of subsection (1A) and (1B), but will not be limited by reason of the fact that Country X applies an inclusion rate which is lower than the South African inclusion rate.
- The foreign taxes will not qualify for a rebate to the extent that any capital losses for the year of assessment, or an assessed capital loss for the previous year of assessment, is set off against the foreign capital gain under consideration.
- The proceeds, for purposes of paragraph 35, will be the purchase price finally determined and agreed on, which amount excludes any amount not received by or accrued to the applicant in respect of that disposal during that year of assessment.
- Any deferred amounts, which are not received and do not accrue in respect of the disposal during the year of disposal, but that are received or accrue in a subsequent year of assessment, will be a capital gain in that subsequent year.
- If Country X includes in its tax calculation any element of proceeds that has not accrued to or been received by the applicant, no foreign tax attributable to the inclusion of those proceeds will qualify for a tax rebate under section 6quat(1), read with section 6quat(1A).

9.5. BPR 383 – Transfer of profits for group tax purposes between controlled foreign companies

This ruling determines the tax consequences of the transfer of profits and assumption of losses amongst controlled foreign companies under the German fiscal unity regime.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 3 October 2022. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 9D(2A); and
- section 9D(9).

Parties to the proposed transaction

The applicant: A resident company

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

Company B: A controlled foreign company (CFC) and a resident of Germany that is a wholly owned subsidiary of the applicant

The subsidiaries: Resident companies of Germany

Description of the proposed transaction

The applicant holds all the shares of Company A and all the issued ordinary shares of Company B. Company B is the parent company of the subsidiaries. The applicant will increase its interest in all the subsidiaries in excess of 70 per cent, by acquiring shares held by minority shareholders.

Company B and the subsidiaries each have a foreign business establishment, as defined in section 9D(1), located in Germany. The receipts and accruals of each of these companies are either attributable to a foreign business establishment and those amounts are not taken into account for purposes of determining their net income in terms of section 9D(9)(b), or are attributable to interest or rentals paid to

the company by one of the other companies that form part of the same group of companies and not attributable to the net income in terms of section 9D(9)(fA)(i). As a result, the applicant does not impute any foreign amounts as contemplated in section 9D(2).

The proposed transaction entails that Company B, as the parent company of the subsidiaries, will elect to establish ‘fiscal unity’ for income tax and trade tax purposes in Germany.

As a requirement for the establishment of a ‘fiscal unity’, Company B and each of the subsidiaries will conclude a Profit and Loss Pooling Agreement (PLPA) for a period of at least five years.

The relevant provisions of the PLPA will be as follows:

- The controlled company (a subsidiary) will agree to transfer its profit to Company B (the controlling company), except for certain transfers to the reserves as the controlling company may agree to. The amounts to be transferred in this manner are herein referred to as ‘allocated income’. The controlling company has a claim for the transfer of profits against the controlled company which arises on the last day of the financial year of the controlled company.
- The controlling company will assume any operating losses suffered by the controlled company. The obligation of the controlling company to assume such a loss is referred to herein as an ‘assumed loss’. The controlled company’s claim against the controlling company also arises on the last day of the controlled company’s financial year.

Conditions and assumptions

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

- All the subsidiaries and Company B are (or will be) CFCs as defined in section 9D(1) in relation to the applicant; and
- Company B and the subsidiaries will form part of the same ‘group of

companies' as defined in section 1(1).

Ruling

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

- The allocated income that accrues to Company B must not be attributed to the net income of Company B in terms of section 9D(9)(b);
- The allocated income that the subsidiaries are liable to pay to Company B should not be deducted in determining the net income of the subsidiaries as contemplated in section 9D(2A);
- An assumed loss that Company B becomes liable to pay to a subsidiary should not be deducted in determining the net income of Company B as contemplated in section 9D(2A); and
- An assumed loss that accrues to a subsidiary must not be attributed to the net income of the subsidiary in terms of section 9D(9)(b).

9.6. *BPR 384 – Cession to special trust of the beneficiary's loan account*

This ruling determines the donations and capital gains tax consequences resulting from the cession to a special trust by the beneficiary of his loan account against it.

In this ruling references to sections and paragraphs are to sections of the Income Tax Act and paragraphs of the Eighth Schedule to the Act applicable as at 29 August 2022. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 54;
- section 55(1) – definition of 'donation';
- paragraph 38; and

- paragraph 39.

Parties to the proposed transaction

The applicant: A resident person with a disability

The co-applicant: A resident special trust

Description of the proposed transaction

The applicant suffered a traumatic brain injury, as a result of which he is unable to work, talk or maintain himself independently but is still able to make decisions. His wife takes care of his physical needs and manages his financial affairs under power of attorney. The co-applicant is, by virtue of an amendment to its trust deed, a special trust for the sole benefit and maintenance of the applicant for the duration of his lifetime, due to his mental and physical disabilities.

The secondary beneficiaries of the trust are his spouse and children who may only benefit as discretionary beneficiaries from the trust after the death of the applicant. The co-applicant formerly served as a family trust for the benefit of the applicant, his spouse and children.

The applicant has a loan account against the co-applicant due to funds made available to the co-applicant. The applicant proposes to cede this loan account to the co-applicant with the objective of reducing the co-applicant's liabilities and ensuring more funds are available to take care of the applicant's maintenance needs during his lifetime should something happen to his wife. He is currently maintained out of personal funds.

Conditions and assumptions

This binding private ruling is made subject to the additional condition and assumption that the cession by the applicant of his loan account does not result in an amount being transferred to the co-applicant which, for purposes of maintaining the applicant, is excessive.

Ruling

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

- The cession by the applicant of his loan account to the co-applicant will not constitute a donation in terms of section 54.
- The proceeds in respect of the cession of the loan account by the applicant will be equal to the face value of the loan account under paragraph 38. Consequently, no capital gain or loss will be realised by the applicant from the cession of the loan account and paragraph 39 is not applicable.

9.7. BPR 385 – Use of preference share proceeds to fund employee share ownership plan

This ruling determines the tax implications pertaining to the use of funds derived from the issue of preference shares to fund an employee share ownership plan (ESOP).

In this ruling references to sections and paragraphs are to sections of the Income Tax Act and paragraphs of the Eighth Schedule to the Act applicable as at 16 September 2022. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definition of 'gross income';
- section 8E; • section 8EA;
- section 10(1)(k)(i);
- section 24J(1) – definition of 'instrument';
- section 54;
- section 58;
- section 64F(1)(a);
- section 64G(2);
- paragraph 19;

- paragraph 20(1)(a);
- paragraph 38;
- paragraph 39;
- paragraph 43A; and
- paragraph 80(2).

Parties to the proposed transaction

The applicant: A listed resident company

Co-applicant 1: A resident company that is a wholly-owned subsidiary of the applicant

Co-applicant 2: A resident company that is wholly-owned by co-applicant 3

Co-applicant 3: A resident trust established by the applicant

The participants: Employees of the applicant and of its group companies

Third party: A resident bank

Description of the proposed transaction

The applicant will establish the ESOP for the participants to create a long-term broad-based employee ownership in the applicant. Co-applicant 3 will acquire shares in the applicant on the open market as well as from co-applicant 1 that holds treasury shares in the applicant. Following the acquisitions, co-applicant 3 will hold approximately 3% of the applicant's issued share capital.

The steps for implementing the ESOP are as follows:

Phase I: Implementation of the ESOP

Step 1: Subscriptions for preference shares

- The third party will subscribe for senior front ranking cumulative A class preference shares (A Prefs) in co-applicant 2 and the applicant will subscribe for subordinated B class preference shares (B Prefs) in co-applicant 2.

- The A Prefs contain, amongst others, the following terms:
  - a redemption date on the fifth anniversary of the subscription date; and
  - a dividend rate linked to the prime lending rate, with dividends payable on a semi-annual basis.
- The security arrangements for the due compliance with the A Pref obligations by the issuer are as follows:
  - Co-applicant 2 will open an interest-bearing bank account to receive distributions from co-applicant 3 (the reserve account).
  - Co-applicant 2 will open a second interest-bearing account into which the applicant, or its nominee, may pay amounts to subscribe, if necessary, for further back-ranked preference shares for purposes of providing an equity cure in relation to the security cover ratio (the equity cure account).
  - Co-applicant 3 will open an interest-bearing bank account to receive distributions from the applicant (the collection account).
  - Co-applicant 2 will cede in securitatem debiti to the third party its rights to:
    - the reserve account;
    - the rights to all other bank accounts; and
    - its interest in co-applicant 3.
  - Co-applicant 3 will provide a guarantee in respect of the obligations of co-applicant 2 under the A Prefs, which will be secured by a cession in securitatem debiti and pledge to the third party of:

  - the shares held in the applicant;
  - the shares held in co-applicant 2;
  - any other investments it may hold, from time to time, in co-applicant 2;
  - the collection account; and
  - the rights to all other bank accounts.

- The security arrangements will be linked to a security cover ratio (SCR), which will be calculated using the following formula:
  - A = (B+C) / (D-E), where
  - A = SCR measured daily;
  - B = the value of the applicant's shares;
  - C = funds in the collection account plus funds in the other accounts held by the trustees of co-applicant 3;
  - D = the redemption amount and other outstanding amounts in respect of the A Prefs; and
  - E = funds in the reserve account and the equity cure account.
- The applicant will subscribe for B Prefs in co-applicant 2. The B Prefs will yield a dividend rate of 120% of the prime lending rate and will be redeemable on the seventh anniversary of the subscription date. The dividends are payable on a semi-annual basis, but will be capitalised until the A Prefs have been redeemed in full.
- The terms of the B Prefs provide, amongst others, that the applicant, or its nominee, may subscribe for further back-ranked preference shares (the C and D Prefs), on the same terms as the B Prefs.

- The B Prefs are secured by a reversionary cession by co-applicant 2 to the applicant, or its nominee, of:
  - the collection account;
  - the reserve account;
  - the rights to all other bank accounts; and
  - its interest in co-applicant 3.
- The B Prefs are also subject to a guarantee by co-applicant 3 to the applicant, or its nominee, in respect of the obligations of co-applicant 2 under the B Prefs. This guarantee will be secured by a reversionary security cession and pledge of:
  - the shares held in the applicant;
  - the shares held in co-applicant 2;
  - any other investments it may hold, from time to time, in co-applicant 2;
  - the collection account; and
  - the rights to any other bank accounts.
- Any C Prefs and D Prefs issued will be subject to the same security arrangements as the B Prefs, but only to the extent that the funds derived from the issue of the C Prefs and D Prefs are applied for a 'qualifying purpose' as defined in section 8EA(1).

Step 2 – Acquisition of Limited Vested Beneficiary (LVB) interest

- Co-applicant 2 will utilise the preference share subscriptions proceeds to make a cash contribution to co-applicant 3 and in exchange for the cash contribution, co-applicant 2 will obtain an LVB interest in co-applicant 3.

- In terms of the LVB interest, co-applicant 3 will have a vested right to receive 80% of all income and 100% of the cash contributions and 100% of the income attributable to unallocated units from co-applicant 3, until such time as a pre-determined gross distribution in an amount equal to the aggregate of the A Pref obligations, B Pref obligations, additional back-ranked preference share obligations and any other amount payable by co-applicant 2 to any member of the applicant's group had been received by co-applicant 2 (the distribution hurdle). Thereafter, co-applicant 2 will cease to be a beneficiary of co-applicant 3.
- The distribution hurdle will provide sufficient cash liquidity for co-applicant 2 to service and ultimately redeem both the A Prefs and the B Prefs, in accordance with their terms.

Step 3 – Acquisition of ordinary shares in the applicant

- Co-applicant 3 will utilise a portion of the cash contribution to acquire shares of the applicant (comprising 1.2% of the applicant's issued share capital) on the open market. 5
- Co-applicant 3 will utilise the remainder of the cash contribution to acquire treasury shares (comprising 1.8% of the applicant's issued share capital) from co-applicant 1 at a discount to the prevailing market value.

Step 4 – Addition of participants as beneficiaries

- The trustees of co-applicant 3 will allocate units (being a notional concept) to confer on the holder of each such unit the vested bundle of personal rights and obligations stipulated in the trust deed (the units) in favour of each participant.
- For a period of 10 years after the date on which the units are

first allocated to the relevant participant, or the date on which the preference shares are finally redeemed, whichever is the later (Restriction Period), the units will be subject to the following restrictions:

  - the units may not be encumbered, redeemed, disposed of or transferred to any other person (including a fellow participant); and
  - the units shall not confer on the participant in question, any right to any award from capital and no participant shall have any right to demand that the trustees make any award to that participant from capital other than upon the termination of co-applicant 3.

- Until such time as co-applicant 2 ceases to be a beneficiary of co-applicant 3, the participants will have vested rights to receive up to 20% of all income distributions from co-applicant 3. Once co-applicant 2 ceases to be a beneficiary of co-applicant 3, the participants will have vested rights to receive all income from co-applicant 3.
- The units will be subject to a 7-year vesting period, with the applicable vesting profile set out in each participant's allocation letter.
- 80% of the units will be allocated upfront, with 20% of units reserved for subsequent new participants (the reserve allocation).
- The reserve allocation is intended to be allocated within a period of five years from the ESOP implementation date. Units which remain or become unallocated units after the fifth anniversary of the ESOP implementation date shall be available for allocation to existing participants, provided that

all units shall be allocated by the fourteenth anniversary of the ESOP implementation date.

- All vested units held by participants who cease to be employed will be retained by them unless the employment of the relevant participant is lawfully terminated for cause as a consequence of misconduct, as a result of committing a dismissible offence or conviction of a criminal offence, in which case all vested and unvested units allocated to that participant will be surrendered to co-applicant 3 for no consideration and be available for allocation to other participants.
- A participant who ceases to be employed for reasons other than mentioned in (u) above shall, notwithstanding such termination of the employment, be entitled to all vested units allocated, and shall automatically forfeit for no compensation all unvested units.
- Participants will be restricted from dealing in their vested units for the restricted period. At the end of the restricted period, all vested units held by participants will be redeemable for ordinary shares in the applicant, as described under Phase III.

Phase II: Operation of the ESOP

- The applicant will, from time to time in accordance with its dividend policy, declare dividends in respect of its ordinary shares.
- The participants will have a vested right to receive 20% of the dividends received in respect of the applicant's ordinary shares held by co-applicant 3, after which co-applicant 2 will, in terms of its LVB interest, be entitled to the remaining dividends (80% of such dividends plus the dividends

attributable to the unallocated units – in both instances, net of any expenses incurred by co-applicant 3).

- The A Prefs and B Prefs terms provide for trigger events which, if they occur or continue to occur, will affect distributions to the participants as payment of the dividends on the A Prefs and B Prefs will be prioritised. The specified events include:
  - failure by co-applicant 2 to meet its solvency and liquidity requirements;
  - non-payment of dividends on mandatory dividend payment dates;
  - non-payment of accrued dividends in excess of certain specified limits;
  - failure by co-applicant 2 to satisfy specified financial covenants while also failing to bring the SCR to 2.5 within three business days as provided for under the financial covenants; and
  - failure by co-applicant 2 to redeem the A Prefs and the B Prefs by the relevant specified redemption dates.

Phase III: Redemption of the A Prefs and the B Prefs

Step 1 – Repurchase and/or disposal on the open market of a portion of the applicant's ordinary shares

- On the fifth anniversary of the A Prefs subscription date, assuming that the A Prefs are not refinanced, co-applicant 3 will dispose of so many ordinary shares in the applicant (on the open market and/or to the applicant) as is equal in value to the applicable remaining portion of the distribution hurdle (attributable to the A Prefs) not yet distributed to co-applicant

2 to provide sufficient cash liquidity for co-applicant 2 to ultimately redeem the A Prefs.

- On the seventh anniversary of the B Prefs subscription date, assuming that the B Prefs are not refinanced, co-applicant 3 will similarly dispose of so many ordinary shares in the applicant (on the open market and/or to the applicant) as is equal in value to the applicable remaining portion of the distribution hurdle (attributable to the B Prefs) not yet distributed to co-applicant 2 to provide sufficient cash liquidity for co-applicant 2 to ultimately redeem the B Prefs.
- Any C Prefs and D Prefs, to the extent that they have been issued, will be redeemed on a similar basis to the B Prefs and co-applicant 3 will similarly dispose of so many ordinary shares in the applicant (on the open market and/or to the applicant) as is equal in value to the remaining portion of the distribution hurdle (attributable to the additional back-ranked preference shares) not yet distributed to co-applicant 2 to provide sufficient cash liquidity to co-applicant 2 to ultimately redeem the C Prefs and the D Prefs.
- On the fifth anniversary of the A Prefs subscription date, assuming that the A Prefs have not been refinanced, co-applicant 3 will dispose of so many of the ordinary shares in the applicant (on the open market and/or to the applicant) as is equal in value to the remaining portion of the distribution hurdle not yet distributed to co-applicant 2 (the settlement amount).

Step 2 – Distributions to co-applicant 2

- Co-applicant 2, by virtue of its LVB interest, will have a vested right to receive the settlement amount.

Step 3 – Redemption of the A Prefs and the B Prefs

- Co-applicant 2 will redeem the A Prefs and the B Prefs in accordance with their terms.
- The LVB interest is automatically extinguished by co-applicant 3 upon redemption of the A Prefs and the B Prefs (the distribution hurdle will be overcome at this point) and co-applicant 2 will be liquidated.

Phase IV: Redemption of the units and distribution of ordinary shares in the applicant to the participants

- At the end of each participant's relevant restriction period, the units will be redeemed in return for the distribution of the number of ordinary shares in the applicant, attributable to the participant. A portion of such shares will be sold by an independent stockbroker to settle the resulting Pay-As-YouEarn liability.

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:

Phase I: Implementation of the ESOP

Step 1: Subscription for the A Prefs and B Prefs

- The preference shares will not constitute:
  - 'hybrid equity instruments' as defined in section 8E(1); nor
  - 'third-party backed shares' as defined in section 8EA(1).
- Neither section 22B nor paragraph 43A will apply to the

preference share dividends distributed to the third party and the applicant in respect of the A Prefs and B Prefs, respectively.

Step 2: Cash contribution to co-applicant 3

- The cash contribution by co-applicant 2 to co-applicant 3 will constitute expenditure incurred in acquiring the LVB interest resulting in a base cost for the LVB interest equal to the cash contribution under paragraph 20(1)(a).
- The LVB interest will not constitute an 'instrument' as defined in section 24J(1) in the hands of co-applicant 2.
- No donations tax will be payable by co-applicant 2 in respect of the cash contribution to co-applicant 3 for purposes of section 54 and section 58.
- The receipt of the cash contribution by co-applicant 3 will not constitute 'gross income' as defined in section 1(1).
- The receipt of the cash contribution by co-applicant 3 will not be subject to capital gains tax.

Step 3: Acquisition of ordinary shares in the applicant

- Co-applicant 1 will realise either a capital gain or a capital loss upon the disposal of its treasury shares held in the applicant to co-applicant 3, depending on whether the proceeds received are greater than or less than its base cost for such ordinary shares.
- In the event of a capital loss in the hands of co-applicant 1, the provisions of paragraph 39 will not apply.
- Neither paragraph 38 nor section 54 and section 58 will apply to the acquisition of the applicant's ordinary shares from co-applicant 1 at a discount.

Phase II: Operation of the ESOP

- Dividends received by co-applicant 2 from co-applicant 3 in respect of its LVB interest will be exempt from dividends tax in terms of section 64F(1)(a) read with section 64G(2), provided that co-applicant 2 has by the date of payment submitted a declaration and a written undertaking to the applicant in the form prescribed by SARS in accordance with section 64G(2)(a)(ii).
- The dividends paid by the applicant will be exempt from income tax in the hands of co-applicant 2 under section 10(1)(k)(i).

Phase III: Redemption of the A Prefs and the B Prefs

Step 1: Repurchase and/or disposal on the open market of a portion of the applicant's ordinary shares

- Any resultant capital gain on the disposal of the applicant's shares on the open market will be subject to capital gains tax at the applicable rate in the hands of co-applicant 2.
- The settlement amount will, to the extent that it is a dividend, be exempt from normal tax under section 10(1)(k)(i) in the hands of co-applicant 2.
- The settlement amount will, to the extent that it is a dividend, be exempt from dividends tax under section 64F(1)(a) read with section 64G(2), provided that co-applicant 2 has by the date of payment submitted a declaration and a written undertaking to the applicant in the form prescribed by SARS in accordance with section 64G(2)(a)(ii).
- Paragraph 43A will not apply to the repurchase of the applicants ordinary shares held by co-applicant 3.

Step 3: Redemption of the A Prefs and the B Prefs

- Any redemption consideration payable in respect of the A

Prefs and the B Prefs will not trigger the application of sections 8E, 8EA and paragraph 43A.

- To the extent that the redemption consideration constitutes a 'dividend', that dividend must be included in the holder's 'gross income' in accordance with paragraph (k) of the definition of 'gross income' in section 1(1), but will be exempt from normal tax under section 10(1)(k)(i).
- No dividends tax should be withheld on any dividend distributions to the holders of the A Prefs and the B Prefs given the exemption applicable to resident companies, as provided for in section 64F(1)(a), provided that the relevant holder submits the necessary declaration and written undertaking to co-applicant 2 prior to the share redemption.
- Any capital losses triggered on the redemption of the A Prefs and the B Prefs, to the extent that the redemption amount constitutes a dividend that is exempt from normal tax under section 10(1)(k)(i) and dividends tax under section 64G(2), must be disregarded under paragraph 19.

Phase IV: Redemption of the units and distribution of ordinary shares in the applicant to the participants

- In respect of the vesting of the shares by co-applicant 3 in the participants, paragraph 38 will not apply under the current circumstances as such disposals will be regarded as being at arm's length. Any capital losses determined will not be subject to paragraph 39.

9.8. BPR 386 – Share disposal between two employee share incentive trusts

This ruling determines the income tax treatment of share disposals between two Employee Share Incentive Trusts with different beneficiaries.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 21 October 2022. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) definition of 'connected person';
- section 54;
- section 58(1); and
- paragraph 38.

Parties to the proposed transaction

The applicant: An employee share incentive trust set up by Company A for the benefit of the employees of the Company A group of companies

Company A: A company incorporated in and a resident of South Africa and listed on the JSE. It is also a parent company of a group of companies

New trust: A newly formed employee share incentive trust with the employees of the Company A group of companies as the beneficiaries

Description of the proposed transaction

The applicant is an employee share incentive trust that was established by Company A for the benefit of the employees of the Company A group of companies. The applicant currently holds a number of shares in Company A (the Shares). Company A is the ultimate beneficiary of the applicant, that is, upon dissolution of the applicant, Company A stands to receive the residual proceeds (i.e., after settling any liabilities of the applicant) of all the Shares sold. The current employee share scheme in place does not fulfil the envisaged objectives of

Company A and its subsidiaries. Accordingly, Company A intends to establish a new trust that will be more aligned with its objectives.

It is anticipated that the applicant will sell the Shares to the new trust for a consideration equal to the cost at which the applicant acquired the Shares. These Shares will be sold in multiple tranches as and when the new trust requires the Shares in order to make awards to eligible employees. The applicant uses the specific identification method to determine the base cost of batches of Shares purchased and will sell each batch of Shares to the new trust for an amount equal to the base cost thereof.

A new employee share scheme is proposed, as detailed below.

A person who is eligible to participate under the share incentive scheme administered by the new trust will fall within one of three categories. Excluded is any employee who:

- has, at any time, whether before or after the establishment of the new trust, participated in, or benefitted from, any share incentive trust or any other share incentive scheme of whatsoever nature of any of the Company A group of companies;
- is a trustee, a member of the board of Company A or a member of the remuneration committee of Company A, as the case may be, on the date that such person is identified by the remuneration committee as an offeree;
- is, directly or indirectly, a shareholder of any Company A group of companies, other than Company A;
- is the spouse of a shareholder of any Company A group of companies, other than Company A;
- is a fixed-term employee, independent contractor, consultant, service contractor, temporary contract holder (including any person employed by a labour broker/temporary employment service and rendering services to any Company A group company); or
- is a spouse or other relative of a person who has participated in, or

benefitted from, the scheme embodied in the second amended and restated deed of trust in respect of the applicant.

Once an eligible employee has been identified by the remuneration committee, on the advice of the relevant subsidiary of the Company A group (i.e. the relevant group company who employs such eligible employee), the trustees of the new trust will, pursuant to the written directive received from the remuneration committee, make an offer to such eligible employee, to acquire and be allocated units (based on the pre-determined formula set out in the proposed trust deed of the new trust) for no consideration. An eligible employee will become a 'participant' once the participation offer is accepted. These units will be linked to an equal number of Shares held by the new trust.

The units shall be awarded subject to certain restrictions. The participant will be a vested income and capital beneficiary of the new trust. Company A or a connected person in relation to Company A will not in any circumstances be a beneficiary of the new trust. On termination of the new trust, any unallocated Shares will be sold by the new trust and the proceeds (after the deduction of all expenses) will be distributed to the participants, or if there are no participants at that time, a public benefit organisation contemplated in section 30(3) of the Act.

Conditions and assumptions

This binding private ruling is subject to the additional condition and assumption that none of the participants of the new trust alone or together with any connected person holds, directly or indirectly, 20% or more of the shares in Company A.

Ruling

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

- Paragraph 38 of the Eighth Schedule will not apply to the sale of Shares by the applicant to the new trust and as a result the disposal of the shares held by the applicant for a consideration equal to base cost will not result in capital gains.
- The sale of Shares by the applicant to the new trust for a consideration

equal to base cost is not deemed a donation under section 58(1).

10. BINDING CLASS RULINGS

10.1. Deductibility of mining rehabilitation insurance premiums – No. 82

This ruling determines the deductibility of insurance premiums incurred by a holder of a mining right for an environmental management programme guarantee issued to the Department of Mineral Resources (DMRE).

In this ruling references to sections are to sections of the Income Tax Act applicable as at 29 September 2022. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 8(4)(a);
- section 11(a);
- section 23(g);
- section 23(c);
- section 23H; and
- section 23L.

<u>Class</u>

The class members to whom this ruling will apply are the mining companies referred to below.

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

The applicant: A resident public company carrying on business as a short-term insurer

Class Members: Companies, operating in South Africa and carrying on the business of mining, to be insured by the applicant by way of a guarantee to secure compliance with their statutory environmental maintenance obligations under the National Environmental Management Act 107 of 1998 (NEMA)

Description of the proposed transaction

NEMA, together with the Regulations pertaining to the Financial Provision for Prospecting, Exploration, Mining or Production Operations promulgated under NEMA in Government Gazette No. 3942520 dated 20 November 2015 (Regulations), require the class members to make financial provision to guarantee the availability of sufficient funds to undertake rehabilitation and remediation of the adverse impacts of mining operations carried on by it.

The applicant has developed a short-term insurance product that will assist the class members to meet the requirements under NEMA, read together with the Regulations.

The proposed transaction entails the applicant issuing a financial guarantee to the DMRE in respect of the required financial provision for the rehabilitation by each class member. The guarantee will be issued following the conclusion of the insurance policy and payment of the premium by a class member.

The duration of the policy will generally be a period of three years (fixed cover period) and it calls for a premium from the insured at the beginning of each cover year. Each fixed cover period is used in the calculation of the annual premium payable for the cover. The cover limit is the total amount for which the applicant shall be liable in terms of the policy and shall be the quantum of the underlying guarantee for which the applicant shall indemnify the class member.

The premiums are calculated for a class member considering several factors, including the credit risk of the class member, the class member's historical rehabilitation record and the nature of the mining conducted, for example, open cast mining, open pit mining, etc. In addition, fees are payable to the applicant by the class member annually in advance, calculated as a percentage of the

underlying guarantee issued excluding Value Added Tax, or such rate agreed in any endorsement, for the duration of the fixed cover or any extended cover period.

Some class members will treat a portion of the premiums under the policy, generally the management fee component, as an expense for purposes of International Financial Reporting Standards (IFRS). The other class members will treat the entire premium as an expense for purposes of IFRS.

In the event that the class member fails or remains in default to execute its obligations, the DMRE may call for payment in terms of the guarantee. In the event the applicant is called upon to pay any amount in terms of the guarantee, the class member will be obliged to pay an additional premium to the applicant, equal to the excess of the amount payable in terms of the underlying guarantee, after taking into account the amount of the premiums actually paid by the class member to the applicant.

The guarantee provides that the DMRE may call for payment in terms of the guarantee in the following instances:

- When the class member fails or remains in default to execute the environmental management programme;
- When the class member ceases to conduct mining or prospecting operations;
- When the class member's estate is liquidated;
- When the class member surrenders its estate in terms of the Insolvency Act 24 of 1936; or
- When the applicant notifies the DMRE that it wishes to withdraw from the guarantee.

Conditions and assumptions

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

Ruling

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

- The portion of a premium incurred by a class member which is not taken into account as an expense for the purpose of financial reporting in terms of IFRS will not be deductible under section 11(a) by virtue of section 23L(2)).
- Section 23L(3) will apply where any policy benefits are received by or accrue to a class member who has been denied a deduction in terms of section 23L(2) of any premiums paid under such policy.
- Section 23L(2) will not apply to the premium, or portion thereof, incurred by a class member which is taken into account as an expense for the purpose of financial reporting pursuant to IFRS. The premium, or portion thereof, will accordingly be deductible under section 11(a) read with section 23(g).
- If the annual premium is incurred within the first six months of the class member's year of assessment, section 23H will not apply to the deductible portion.
- Section 23H will apply to the deductible portion of the premium to the extent that the benefit of the premium extends beyond six months of the class member's year-end if the annual premium is incurred in the last six months of its year of assessment.
- Where any policy benefits are received by or accrue to a class member, any premium or portion thereof which was previously allowed as a deduction and which was returned by way of such benefit, must be recouped under section 8(4)(a). For the avoidance of doubt, a policy benefit as defined in section 23L(1) includes a performance bonus.
- Section 23(c) does not apply to the deductible portion of a premium.

10.2. Simultaneous unbundling of shares held in more than one listed company – No. 83

This ruling determines the tax implications arising from the simultaneous unbundling of shares held by the applicant in more than one listed company.

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 1 August 2022. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 46; and
- paragraph 75 read with paragraph 31(1)(a)(i).

Class

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

Parties to the proposed transaction

The applicant: A listed resident company, holding listed shares as well as unlisted shares

The co-applicants: Listed resident companies, in which the applicant holds shares which are being unbundled under the proposed transaction

The shareholders: Shareholders of the applicant at the record date of the unbundling transaction, which includes a 'disqualified person' as defined in section 46(7)(b)

Description of the proposed transaction

The share price of the applicant has traded at a significant discount to the value of its underlying investments over recent years. The applicant proposes to unlock value for its shareholders by the simultaneous unbundling of all the shares held in the co-applicants.

Subsequent to the unbundling transaction the applicant will, by way of a specific repurchase of shares, repurchase (and cancel) its issued ordinary shares held by the general public for cash using cash reserves and borrowings. The applicant's current management and its founders will remain as shareholders. The applicant will not issue any new shares and no contributed tax capital (CTC) will be used to repurchase the shares.

The applicant will delist from the JSE and retain the unlisted shares as well as shares in the listed company that was excluded from the unbundling transaction.

Conditions and assumptions

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

Ruling

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

- Pursuant to the proposed simultaneous unbundling transactions, for purposes of determining the expenditure and market values of the shares of the applicant and the co-applicants in terms of section 46(3)(a), the proportionate amount of the expenditure and market value to be allocated to the unbundled shares must be determined in accordance with the ratio that the market value of all the unbundled shares in a specific co-applicant, as at the end of the day after that distribution, bears to the sum of the market value as at the end of that day, of the unbundling shares and the unbundled shares in all the other co-applicants plus the market value, as at the end of that day, of the unbundled shares in the specific co-applicant.
- Pursuant to the proposed simultaneous unbundling transactions, the CTC of the applicant immediately after the distribution, is deemed under section 46(3A)(a), to be an amount which bears to the CTC of the applicant immediately before the distribution, the same ratio as the aggregate market value immediately after the distribution of the applicant's shares bears to the aggregate market value of the shares immediately before the distribution.

- Pursuant to the simultaneous unbundling transactions, the CTC of each unbundled company is determined as A + B; wherein:
  - A is determined as a two-fold process by first determining the CTC of the applicant immediately before the distribution. Secondly, such amount is allocated to the relevant co-applicant based on the ratio that the aggregate market value of the unbundled shares in the relevant co-applicant before the distribution bears to the aggregate market value of the shares in the applicant immediately before the distribution; and
  - B is the amount which bears to the CTC of the relevant co-applicant immediately before the distribution the same ratio as the shares held in the relevant co-applicant immediately before the distribution by persons other than the applicant bear to the total of the shares held in that co-applicant immediately before the distribution.
- The meaning of 'market value, immediately before the distribution' in section 46(3A) is the closing price as at the last date to trade (LDT) and 'market value, immediately after the distribution' in the same section is the closing price as at LDT+1.
- Each shareholder receiving shares under an unbundling transaction to which the provisions of section 46 apply, must determine the portion of tax paid by the unbundling company in respect of the distribution of its shares in a specific unbundled company in the simultaneous unbundling transactions to a 'disqualified person' as contemplated in section 46(7) that is relevant to it, in accordance with item (iii) of the definition of 'expenditure' in section 46(3)(b), namely the ratio that the number of equity shares held by that shareholder in the unbundling company bears to the number of all the issued equity shares in that unbundling company immediately before that unbundling transaction.
- The portion of the tax calculated in ruling (e) must be allocated to the unbundled shares in the specific co-applicant in accordance with section

46(3)(a)(v), namely the ratio that the market value of the unbundled shares in the specific co-applicant, as at the end of the day after that distribution, bears to the sum of the market value as at the end of that day, of the unbundling shares and the unbundled shares in the specific co-applicant. The allocated amount will form part of the expenditure in relation to the shares in the specific co-applicant.

- The balance of the tax remaining, that is, the portion of the tax calculated in ruling (e) not allocated to the unbundled shares in the specific co-applicant in ruling (f), may not be allocated to the shares in the unbundling company as such allocation is not provided for in section 46(3)(a)(i)(bb).
- The tax paid by the applicant in respect of the unbundling of its shares to a 'disqualified person' must be determined at LDT+1 with reference to the market value of the shares at LDT as provided for by paragraph 75(1) read with paragraph 31(1)(a).

11. BINDING GENERAL RULING

11.1. Securities transfer tax implications on the re-use of collateral (STT) – No. 61

For the purposes of this ruling:

- 'collateral' means a listed share transferred for the purposes of providing security in respect of an amount owed, which is used to repay the liability upon default;
- 'exception' means the exception listed in paragraph (ii) of the definition of a 'collateral arrangement' in section 1 that takes effect on 1 January 2023;
- 're-use' means the practice whereby the transferee uses the collateral for its own purposes – either for trading or to place as collateral for its own transaction;

- 'transferee' means a person receiving collateral from the transferor for an amount owed by the transferor to the transferee;
- 'transferor' means a person transferring collateral for purposes of providing security for an amount owed by the transferor to the transferee.

Purpose

This BGR clarifies the STT consequences when a person re-uses collateral received for another purpose. The STT consequences relate to transactions both when the requirements of a 'collateral arrangement' as defined in section 1(1) has been complied with and when not, specifically in relation to every transaction within a chain where the same collateral is re-used.

Background

The Taxation Laws Amendment Act 25 of 2015 introduced an exemption from STT for a transfer of listed shares under a collateral arrangement, with effect from 1 January 2016, by inserting the definition of a 'collateral arrangement' in section 1 and adding section 8(u) to the list of exemptions. According to the Explanatory Memorandum to the said Act, the purpose of this exemption is to align the tax treatment of an outright transfer of collateral with the dispensation already allowed for securities lending arrangements, thereby alleviating the negative effects of the previous tax regime on business practices and market liquidity. The Taxation Laws Amendment Act 15 of 2016, the Taxation Laws Amendment Act 17 of 2017 and the Taxation Laws Amendment Act 34 of 2019 refined the STT implications of a collateral arrangement by, amongst others, extending the period in which to return the listed shares to the transferor from 12 months to 24 months.

With effect from 1 January 2023, the TLAA 2021 clarified the STT implications of a scenario when a transferee re-uses collateral received through a qualifying collateral arrangement (meaning, the transferee received the collateral exempt from STT).

Discussion

STT, by its nature, is a transactional tax. This means that, in the absence of clear language to the contrary, the STT liability is determined in respect of each transaction, being the transfer of a security. Read in this context, a 'collateral arrangement' is defined in section 1 with reference to a transferor, a transferee, and the transfer of the listed shares between them (the first transfer). Although this definition allows for the re-use of the collateral by the transferee, the subsequent transfer by the transferee to another person is a separate transaction of which the STT implications should be considered on its own merits. This means that the subsequent transaction cannot impact the determination of the STT liability of the first transfer, unless this subsequent transfer falls within the exception.

To illustrate the above, consider the following example:

A transfers listed shares as collateral to B for an amount owed by A to B under a qualifying collateral arrangement.

B transfers the above listed shares received as collateral to C for an amount owed by B to C under a qualifying collateral arrangement.

C transfers the same listed shares as collateral to D for an amount owed by C to D under a qualifying collateral arrangement.

Two months after D received the listed shares as collateral it transfers the shares to E, for example, because:

- C defaulted;
- D sold the shares as part of its trading activities; or
- as part of a financial arrangement with E (such as a lending arrangement).

Each of the above collateral arrangements entered into is a separate transaction for STT purposes and must be evaluated on its own merits. Therefore, on each date of entering into the above collateral arrangement agreements, it must be evaluated whether each of the agreements entered into by the respective transferors and transferees contain stipulations that indicate the relevant parties' intention to comply with the requirements set out in paragraphs (a) to (e) of the

definition of a 'collateral arrangement' in section 1. At the point of transfer of the listed securities, each of the above transactions may use the exemption under section 8(u).

Upon D transferring the listed shares to E in the above example, the specific collateral arrangement being impacted is the transfer of the listed shares as collateral from C to D. As the exception is triggered, STT becomes payable in accordance with section 3 of the STTA Act (with reference to the original transfer date of the listed shares from C to D). As the requirements of a 'collateral arrangement' as defined in section 1 is still complied with for the transfers of the listed shares between A and B, and B and C respectively, these transactions are not impacted by the sale of the listed shares by D to E and will continue to be exempt under section 8(u) should all the requirements remain to be met.

Ruling

In determining whether a transfer of listed shares by a transferor to a transferee as collateral falls within the exemption from STT under section 8(u), each arrangement must be separately measured against the requirements of a 'collateral arrangement' as defined in section 1. Should a transaction not comply with all the relevant requirements, only that transaction will not be a collateral arrangement for the parties to the arrangement and be subject to STT. Any prior qualifying collateral arrangements entered into using the same listed shares, will not be impacted by the non-complying transaction.

12. DRAFT BINDING GENERAL RULING

12.1. Value-Added Tax treatment of rounding difference in cash transactions

For the purposes of this ruling:

- 'cash transaction' means a transaction tendered in coins or paper currency that fall in paragraph (a) of the definition of 'money' in section 1(1) of the VAT Act;
- 'rounding difference' means the practice of rounding the total amount due on the sale of goods or services, to the nearest circulated coin, when returning change for cash transactions.

<u>Purpose</u>

This BGR sets out the circumstances and conditions under which a supplier need not issue a credit note and the input tax consequences for the recipient vendor when a rounding difference occurs as a result of a cash transaction.

<u>Background</u>

Some suppliers, in addition to receiving payment for goods or services by way of debit and credit cards, still receive payment by way of cash. The discontinuance by the South African Reserve Bank of the minting and circulation of certain coins resulted in those suppliers adopting the practice of rounding the total amount due on the sale of goods or services to the nearest circulated coin, when returning change for cash transactions.

As a consequence of the above, the supplier has in effect charged a lesser consideration for goods or services than the advertised amount for cash transactions. The tax invoice issued in relation to a supply, and the amount shown as tax charged on the tax invoice differs from the actual tax charged for the supply. This can be illustrated by the following example:

A customer purchases item A for R39,99 and item B for R9,99. The total consideration due for the items is R49,98. The customer makes a cash payment of

R50. The supplier is unable to provide the customer with change of two cents since this denomination of coin is no longer minted. As a result, the supplier will round the price payable down to the nearest 10 cents and the new total amount due and paid by the customer is R49,90.

Discussion

On the basis that the consideration for the supply has been altered as contemplated in section 21(1)(c), the tax charged as shown on the tax invoice exceeds the tax that should have been charged. In practice, suppliers generally account for output tax on the consideration due, before the rounding difference (in the above example, on the amount of R49,98 instead of R49,90). It follows that the supplier is entitled to an adjustment contemplated in section 21(2) for the difference of eight cents and the recipient vendor must reduce the amount of its input tax as required under section 21(6).

In the event of a tax invoice consisting of multiple supplies (that is, standard-rated, zero-rated and non-taxable supplies), a recipient vendor must do a reasonable split in order to determine the correct input tax to be deducted. No adjustment of the input tax must be made by a recipient vendor that acquires only zero-rated and non-taxable goods and services.

Under section 21(3)(a), the supplier is required to issue a credit note as the tax shown on the tax invoice exceeds the actual tax charged. As a result, the supplier is, under section 16(3)(a)(v) read with section 21(2)(b), entitled to deduct the excess tax as input tax, or alternatively, to reduce the amount of output tax attributable to the tax period in which the adjustment is to be made, by the amount of the excess tax.

The Commissioner may, however, direct that a credit note is not required to be issued under section 21(5)(b), if the Commissioner is satisfied that:

- there are, or will be, sufficient records available to establish the particulars of a supply; and
- it is impractical to issue a full credit note.

Ruling

Supplier

The Commissioner directs that, under section 21(5)(b), the supplier is not required to issue a credit note as contemplated in section 21(3) in respect of the rounding difference mentioned in paragraph 2, subject to the following conditions:

- The tax invoice must clearly indicate that due to the rounding difference, input tax can only be deducted on the adjusted amount in the case of a cash transaction.
- The supplier may only make an adjustment [that is, by reducing output tax or making a deduction under section 16(3)] as contemplated in section 21(2), to the extent that it relates to standard rated supplies made.
- The supplier must retain the relevant records to substantiate the adjustment referred to above for the period contemplated in section 55 read with Part A of Chapter 4 of the TA Act.

Recipient vendor

The recipient vendor may use the tax invoice issued by the supplier as described above, for the purpose of deducting input tax, under section 16(3)(a)(v) read with section 16(2)(b)(ii) and the definition of 'input tax' in section 1(1).

Input tax can only be deducted on the adjusted amount for cash transactions.

The recipient vendor must do a reasonable split for the purpose of deducting input tax on acquisition of goods and services charged with different tax rates.

13. GUIDES

13.1. Frequently Asked Questions on BGR 40 and 41 – Non-Executive Directors, VAT and PAYE (Issue 2)

Binding General Ruling (BGR) 40 (issued on 10 February 2017) 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 NED 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 (PAYE) by the company concerned.

BGR 41 (also issued on 10 February 2017) 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.

Following the publication of the aforementioned BGRs, various questions have been received regarding the liability for an NED to register for VAT, as well as the relevant income tax implications. The questions and answers below are therefore intended to provide more clarity on certain practical and technical aspects relating to the BGRs.

	Question	Answer
1.	Do the BGRs apply to NEDs of public entities, private companies and state-owned companies?	**Yes.** The BGRs apply to any person appointed as an NED under the Companies Act 71 of 2008. It does not matter what type of company the NED

		serves – whether it be a public, private, state owned or non-profit company. SARS cannot rule on whether a particular entity falls within the definition of a 'company' for purposes of the Companies Act and whether a particular individual is an NED or not.
2.	I am a member of an audit committee. Do the BGRs apply to me?	**Yes.** The BGRs apply to the extent that the member is an NED, serving in any of the various committees of a company. This includes, for example, Board committees, Risk and Audit committees, Remuneration committees and Social and Ethics committees.
3.	Should all NEDs register for VAT?	**No.** Only those NEDs that earn NED fees and other income from taxable supplies that have, in total, exceeded the compulsory VAT registration threshold of R1 million in any consecutive period of 12 months (or will exceed that amount in terms of a written contractual arrangement). NEDs that earn fees below the compulsory VAT registration threshold can choose to register voluntarily if the minimum threshold of R50 000 has been exceeded and all the other requirements for voluntary registration have been met.
4.	What happens if I am not liable	You will not levy and account for VAT on

	to register as a vendor, and do not register voluntarily?	the supply of your NED services. Furthermore, you will not be able to deduct any VAT incurred on goods or services acquired in order to supply your NED services.
5.	Must I still register for VAT if my NED fees exceed the VAT registration threshold, but Pay-As-You-Earn (PAYE) is being deducted?	**Yes.** BGR 40 clarifies that the fees earned by an NED (sole proprietor) should not be subject to PAYE unless the NED voluntarily elects for PAYE to be deducted from those fees. However, fees earned by non-resident NEDs remain subject to the compulsory deduction of PAYE as stipulated in BGR 40. It should be noted that the registration for VAT and the deduction of PAYE has no bearing on each other
6.	Must a non-resident NED register for VAT?	This will depend on whether or not the NED is conducting enterprise activities in the Republic, or partly in the Republic.
7.	Can an NED choose to register and account for NED fees in a company?	**No,** an NED is appointed to serve a company as a natural person. As such, the NED will be providing those services in the capacity of a sole proprietor. A company cannot render services in that capacity.
8.	What if I am already registered for VAT, but I did not account for VAT on NED fees?	You must start levying and accounting for VAT on NED fees earned from 1 June 2017.
9.	When determining if I exceed	**No,** you must add together the value of **all**

	the compulsory VAT registration threshold, must I only take into account NED fees earned?	**taxable supplies** of goods or services made in the course or furtherance of **all your enterprises** that you conduct as a **sole proprietor**. For example, if, in addition to your NED fees for serving on the board of a company, you also supply forensic accounting services to other clients in the normal course of conducting an enterprise as a sole proprietor, then you need to add the total value of NED fees and the total value of service charges from the forensic accounting business together. The resultant total value of income from taxable supplies in a 12-month consecutive period must then be compared to the R1 million compulsory VAT registration threshold to see if you have to register.
10.	Must I add my salary earned as an employee together with my NED fees when determining my VAT registration liability?	**No.** Any salary (or any other type of remuneration) earned in the capacity as an employee is not taken into account when determining your VAT registration liability. The reason is that NED fees or other charges for goods or services supplied constitute consideration received for the taxable supply of goods or services, whereas remuneration earned for services supplied to your employer is not.
11.	My employer nominated me to serve as an NED (nominee	**Yes.** The NED fees must be included when calculating the value of your taxable

	NED) of a company in which he is a shareholder (in addition to my normal duties as an employee). The NED' fees for my services are paid directly to my employer and retained by him. Must I include these fees when determining my VAT registration liability?	supplies in determining whether you are liable to register for VAT or not. This rule applies even if those fees are paid to, and retained by, your employer. Only a natural person can be legally appointed as an NED of a company. Therefore, the fees retained by your employer are still regarded as consideration payable for services rendered by you as an NED in your individual capacity (that is, as a **sole proprietor**) and VAT must accordingly be accounted for thereon.
12.	I am a South African resident and an NED of a non-resident company. Part of my duties include regular travel abroad to physically attend board meetings in another country. Must I include the fees earned as the NED of that company in full when determining my VAT registration liability?	Yes. The NED fees received from the non-resident company must be included in full when calculating the value of your taxable supplies in determining whether you are liable to register for VAT or not. It may be that some or all the NED fees received in this regard qualify to be charged with VAT at the zero rate, however the NED services are considered to be rendered in the course or furtherance of an enterprise conducted by you in the Republic. The fact that you are required to travel abroad from time to time in rendering the services does not mean that you are not conducting an enterprise in the Republic to that extent.
13.	I serve as an independent member of the board of a public entity (not being a company).	There are a few things to consider in this regard. The first is that the VAT rules for any independent person supplying

	Am I regarded as an NED and subject to the same maximum VAT-inclusive rates of remuneration prescribed by the National Treasury which apply to NEDs?	services in that capacity on the board of an entity, whether it is a company or not, or whether it is a public entity or not, will apply to you. Therefore, whether your title is that of an NED or not, you will determine your liability to register for VAT and to charge VAT in the same manner. Secondly, if National Treasury has determined that independent members of boards of public entities are regarded as NEDs and bound by the same prescribed maximum VAT-inclusive rates of remuneration, then, yes, those rates will apply to you too.1 Thirdly, since the prescribed rates are listed as maximum rates that are already VAT-inclusive, it means that if you are a vendor charging fees at the maximum rate, the VAT that you declare on your VAT 201 return will be calculated by applying the tax fraction (currently 15/115) to the consideration charged. Lastly, note that SARS cannot prescribe to a vendor or any authority how to set or determine prices to be charged, except in certain cases relating to connected parties, and the general requirement that prices charged by vendors must include VAT.
14.	I have been appointed as an NED from 1 August 2017 and will earn NED fees exceeding	**No.** You are only required to register with effect from 1 August 2017, provided you were not already liable to register for VAT

	R1 million in the next 12 months from that date. Must I register on 1 June 2017?	because of any other taxable supplies that you made before that date. Only those NEDs that became liable to register before 1 June 2017, but have not done so, will be required to register and start accounting for VAT from 1 June 2017 on NED fees earned from this date, unless the NED chooses an earlier date of registration.
15.	What happens if I am liable to register with effect from 1 June 2017, but I only apply for registration after that date?	Your liability date remains 1 June 2017 and you must levy and account for VAT on any NED fees earned from that date. If as a result of the late registration you end up paying your VAT late, then penalties and interest for any tax periods covering the period from 1 June 2017 onwards will be payable. You can apply for the penalty to be waived if you have a good reason why payment was late. The waiving of interest will only be considered if you did not pay on time due to exceptional circumstances which were beyond your control. In either case, your application for remission of penalty and/or interest should be in writing.
16.	I am registered as a vendor and I previously accounted for VAT on NED fees before 1 June 2017. What must I do?	The issuing of the BGRs will not affect you. You must therefore continue to charge and account for VAT on your NED fees and any other charges for goods or services supplied in the course or

		furtherance of your enterprise.
17.	I am an executive director. Do the BGRs apply to me?	**No.** Executive directors are normally regarded as employees of the company which they serve. The BGRs only deal with individuals that are appointed as NEDs to serve on the board of a company as contemplated in the Companies Act. As such, NEDs are regarded as independent contractors (sole proprietors) that provide services to the company concerned in their personal capacity and are therefore treated differently to employees of the company.
18.	If PAYE has been deducted from my fees as an NED, does it have to continue until 1 June 2017?	**No.** The deduction of PAYE can be stopped with immediate effect.
19.	I am an NED and receive other benefits, for example, a company car in addition to the NED fees. How should it be treated for income tax purposes and VAT purposes?	The Seventh Schedule to the Income Tax Act 58 of 1962 must still be used to value such taxable benefits granted to the NED. Although the taxable benefit is valued under the Seventh Schedule, it will nevertheless not be included in 'remuneration' and no PAYE needs to be deducted or withheld. The value of the benefit will be included in the total fees earned by the NED and subject to normal tax on assessment. For VAT purposes, the value of the benefit forms part of the calculation of the consideration charged in

		respect of the NED services. The NED is therefore required to account for VAT based on the open market value of the benefit as well as any other component of consideration which is used to calculate the total of the NED fees.
20.	If I elect to voluntarily have PAYE deducted from my NED fees earned, under which income source codes should the following be disclosed: Fees, travel reimbursements, other reimbursements and a company car?	The fees, company car and other reimbursements should be disclosed under income source code 3620. Travel reimbursements should be disclosed under income source codes 3702 or 3703, whichever is applicable.
21.	In the event that an NED registers for VAT, does the NED still remain liable for income tax?	**Yes.** The fact that the payments to an NED are subject to VAT and not subject to PAYE, does not mean they are not subject to normal tax. The normal tax liability arising from the income earned must be settled via the provisional tax system during the year of assessment.
22.	I am an independent contractor. Do the BGRs apply to me?	**No,** the BGRs only apply to NEDs. However, whether or not a person is an independent contractor and whether such person has a liability to register for and charge VAT on their services must be determined by applying the normal VAT rules as contemplated in the definition of 'enterprise'. You will be liable to register and account for VAT if the income earned

		from your activities as an independent contractor exceed the VAT registration threshold of R1 million in any consecutive period of 12 months or will exceed that amount in a period of 12 months in terms of a contractual obligation in writing. SARS does not rule on whether or not a person is an independent contractor.
23.	How does an NED apply for VAT registration?	The following options are available for purposes of making the application: a) Via eFiling • If the applicant is an existing eFiler, he/she can register for VAT via the RAV01 form. In the event that the registration is applied for on eFiling, the VAT application (VAT101 form) should only be completed if an interview is required. • If the applicant is not an eFiler, he/she must first register as an 'eFiler' and can then register for VAT via the RAV01 form. b) At a SARS branch, via virtual, audio or walk in appointment made via the SARS website. The applicant can complete the VAT101 form and submit it in person at the nearest SARS Branch.
24.	What is the main industry classification code to be used on	The main industry classification code to use is 2572.

	the VAT registration application form?	
25.	Which supporting documentation must be submitted with the VAT registration application form?	The standard supporting documents that are required for a normal VAT registration application must be submitted, that is, proof of identity; proof of address; proof of banking details; representative/tax practitioner' details and financial information. The following documents will be accepted as proof of financial information: • Copy of the letter of appointment as an NED; • IRP 5 certificate with a source code 3620 or 3621 (where PAYE was deducted from the NED's fees); or • Copy of the minutes of the directors' meeting where the consideration for NED services has been approved; or • Copy of a service contract/agreement evidencing the consideration for NED services

13.2. VAT Quick Reference Guide – Non-Executive Guide (Issue 3)

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 'VAT Treatment of Non-Executive Directors'.

Binding General Ruling 40 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 NED 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.

Binding General Ruling 41 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 the Republic is therefore required to register if the total value of taxable supplies made has exceeded the compulsory registration threshold of R1 million or will exceed that amount in terms of a contractual obligation in writing in any consecutive period of 12 months.

Both BGRs 40 and 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 was subsequently issued on 4 May 2017 to clarify certain aspects relating to an NED's liability date for VAT registration. Binding General Rulings 40 and 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, BGR 40 as well as the VAT 404 – Guide for Vendors.

13.3. *Tax Guide for Share Owners (Issue 8)*

This guide provides general guidance on the taxation of share owners.

An increasing number of persons have become share owners. Many investors have turned to participation in the stock exchange either directly through share ownership or indirectly through collective investment schemes in an attempt to derive a return that beats inflation. The proliferation of broad-based employee share incentive arrangements has also contributed to share ownership among South Africans.

This guide summarises some of the key aspects holders of shares need to be aware of in computing their liability for income tax and CGT. It is primarily aimed at resident individuals who own shares in their own names. However, many of the principles covered apply equally to companies and trusts, and when appropriate the more obvious differences in the treatment of these entities have been highlighted.

Non-residents are subject to income tax in relation to their gross income on amounts from a source within South Africa. For example, a non-resident would potentially be subject to income tax on shares held as trading stock if such shares formed part of a branch in South Africa. In addition, equity shares in a land-rich company meeting the requirements set out in section 9J (see below) are deemed to be from a source within South Africa.

Paragraph 2(1)(b) provides that non-residents are subject to CGT on disposal of the following assets:

- Immovable property in South Africa or any interest or right of whatever nature to or in such property 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. Equity shares in a land-rich company meeting the requirements set out in paragraph 2(2) (see below) are deemed to comprise an interest in immovable property and are potentially subject to CGT.

- Any asset effectively connected with a permanent establishment in South Africa. A non-resident holding shares as capital assets forming part of a branch in South Africa would therefore potentially be subject to CGT on disposal of those shares.

Under section 9J(2) and paragraph 2(2) respectively, amounts derived from the disposal of equity shares held as trading stock are deemed to be from a source within South Africa, while for CGT purposes such shares are deemed to be an interest in immovable property if–

- 80% or more of the market value of those equity shares at the time of their disposal is attributable directly or indirectly to immovable property in South Africa; and
- the person (whether alone or together with any connected person in relation to that person), directly or indirectly, holds at least 20% of the equity shares in that company.

This guide will therefore have limited application to non-residents.

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.