TAX UPDATE

For period: April 2022 to June 2022

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1. INTRODUCTION

The purpose of this update is to summarise developments that occurred during the second 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!

Alexander Hamilton, one of the most prominent of the founding fathers of the USA, concerning the supremacy of the US constitution and other matters, said the following:

'There is yet a further and a weightier reason for the permanency of the judicial offices, which is deducible from the nature of the qualifications they require.

It has been frequently remarked, with great propriety, that a voluminous code of laws is one of the inconveniences necessarily connected with the advantages of a free government.

To avoid an arbitrary discretion in the courts, it is indispensable that they should be bound down by strict rules and precedents, which serve to define and point out their duty in every particular case that comes before them; and it will readily be conceived from the variety of controversies which grow out of the folly and

wickedness of mankind, that the records of those precedents must unavoidably swell to a very considerable bulk, and must demand long and laborious study to acquire a competent knowledge of them.

Hence it is, that there can be but few men in the society who will have sufficient skill in the laws to qualify them for the stations of judges. And making the proper deductions for the ordinary depravity of human nature, the number must be still smaller of those who unite the requisite integrity with the requisite knowledge.'

2. DOMESTIC REVERSE CHARGE RELATING TO VALUABLE METAL,

2.1. Media Statement

13 June 2022

PUBLICATION OF GAZETTED REGULATIONS ON DOMESTIC REVERSE CHARGE RELATING TO VALUABLE METAL, ISSUED IN TERMS OF SECTION 74(2) OF THE VALUE-ADDED TAX ACT, 1991 (ACT NO 89 OF 1991)

The National Treasury publishes the gazetted Regulations on Domestic Reverse Charge Relating to Valuable Metal, issued in terms of section 74(2) of the Value Added Tax Act, 1991 (Act No. 89 of 1991) ('Regulations').

The Regulations are an anti-abuse measure aimed at foreclosing schemes and malpractices to claim undue VAT refunds from SARS by vendors operating in the value chain relating to highrisk goods containing gold, for example, gold, gold bars, gold granules, gold doré' or jewellery ('valuable metal'). The Regulations make provision for registered vendors acquiring valuable metal, to pay VAT on the supply of 'valuable metal' over to SARS before these registered vendors can claim the VAT input tax refund. This additional compliance process makes it difficult for registered vendors to claim input tax for VAT that was not actually declared and paid to SARS by the supplier registered vendor in respect of the supply of 'valuable metal'.

The gazetting of Regulations follows a publication of the draft Regulations for public comment on 6 October 2021. Taxpayers and stakeholders were given 30 days to submit their written comments, and the closing date for comments was 6 November 2021. National Treasury received 12 written submissions from a wide range of stakeholders including industry associations, tax practitioners, companies etc. Substantive comments were received in relation to the definition of 'valuable metal', which is the key definition specifying the type of 'valuable metal' falling

within the ambit of the Regulations. Other comments were received in relation to the responsibilities of the supplier and recipient of 'valuable metal', transitional measures and the effective date. Following receipt of public comments, several workshops were held with the taxpayers and stakeholders to discuss the written comments. The first workshop was held on 14 December 2021, the second workshop was held on 14 March 2022 and the third workshop was held on 13 April 2022.

After the workshops, further changes were made to the definition of 'valuable metal', responsibilities of the supplier and recipient of 'valuable metal', transitional measures and the effective date of the Regulations.

The Regulations will come into operation on 1 July 2022. In terms of the transitional measures, registered vendors will be allowed a period of one month from 1 July 2022 to 1 August 2022 to ensure that they comply with the requirements of Regulations. This implies that registered vendors must account for and pay VAT in respect of transactions falling within the ambit of Regulations in the tax period covering August 2022.

The Regulations and the accompanying Explanatory Memorandum, can be found on the National Treasury (www.treasury.gov.za) and SARS (www.sars.gov.za) websites.

2.2. Regulations

Schedule

1. Definitions

In these Regulations, unless otherwise indicated, any word or expression to which a meaning has been assigned in the Value-Added Tax Act, 1991 (Act. No. 89 of 1991) bears the meaning so assigned, and—

'domestic reverse charge' means the VAT charged at the standard rate on a taxable supply of goods, must be accounted for and is payable, on the supplier's behalf, by the recipient of the supply and is not payable by the supplier, if the—

(a) supply is of valuable metal;

(b) supplier is a registered vendor; and

(c) recipient is a registered vendor;

'residue' means any debris, discard, tailings, slimes, screening, slurry, waste rock, foundry sand, beneficiation plant waste or ash;

'the Act' means the Value-Added Tax Act, 1991 (Act No. 89 of 1991);

'valuable metal' means, any goods containing gold in the form of jewellery, bars, blank coins, ingots, buttons, wire, plate, granules, in a solution, residue or similar forms, including any ancillary goods or services but does not include supplies—

(a) of goods produced from raw materials by any 'holder' as defined in section 1 of the Mineral and Petroleum Resources Development Act 28 of 2002, or by any person contracted to such 'holder' to carry on mining operations in respect of the mine where the 'holder' carries on mining operations; or

(b) contemplated in section 11 (1) (f), (k) or (m) of the Act;

'VAT' means value-added tax.

2. Responsibilities of the supplier of valuable metal, being a registered vendor

Where a registered vendor makes a supply of valuable metal to another vendor in the Republic, the vendor making the supply shall—

(a) take reasonable steps to ensure that the recipient of the supply of valuable metal is a registered vendor;

(b) in addition to the requirements contemplated in section 20 of the Act, issue a tax invoice subject to the further requirements stated in Regulation 4, unless the recipient, being a registered vendor, has been granted approval to issue tax invoices under section 20 (2) of the Act;

(c) only account for the value of the supply of valuable metal on the tax invoice, debit or credit note contemplated in subparagraphs (b) and (e), in

accordance with Regulation 6 (a) and not the VAT charged on the supply of the valuable metal;

(d) not be entitled to input tax on irrecoverable debts under section 22 of the Act on the VAT charged on the supply of valuable metal;

(e) in addition to the requirements under section 21 of the Act, issue debit and credit notes subject to the further requirements stated in Regulation 5, unless the recipient, being a registered vendor, has been granted approval under section 21 (4) of the Act to issue debit and credit notes; and

(f) in addition to the normal VAT record-keeping requirements, obtain, retain and maintain, as part of the VAT record-keeping requirements, a list of all supplies of valuable metal that are subject to the domestic reverse charge contemplated in these Regulations and the documentary evidence contemplated in subparagraph (a) and Regulation 3 (a).

3. Responsibilities of the recipient of valuable metal, being a registered vendor

Where a registered vendor makes a supply of valuable metal to another vendor in the Republic, the vendor to whom the supply of valuable metal is made must—

(a) furnish proof to the supplier that the person is a registered vendor;

(b) not pay the VAT charged on the supply of valuable metal to the supplier making the supply of valuable metal, being a registered vendor;

(c) account for and pay the VAT charged on the supply of valuable metal in accordance with Regulation 6 (b) (i) in the tax period in which the tax invoice is held by the registered vendor to whom the supply of valuable metal is made;

(d) not deduct the input tax contemplated in sections 16, 17 and 21 of the Act if the VAT contemplated in subparagraph (c) has not been accounted for and paid to SARS;

(e) notify the registered vendor making the supply of valuable metal in writing, by means of a statement, within 21 days of the end of the calendar month

during which the tax has been accounted and paid for as contemplated in subparagraph (c), which statement shall contain the following particulars:

(i) the tax invoice number;

(ii) the value of the domestic reverse charge supplies of valuable metal;

(iii) full and proper description of the valuable metal as well as the percentage of the gold content contained within the valuable metal;

(iv) confirmation that the VAT charged by the registered vendor making the supply of valuable metal was accounted for and paid to SARS by reflecting the applicable tax period and payment reference number issued by SARS: Provided that, where the statement is not provided in accordance with this subparagraph and a deduction of input tax was made on the supply, VAT is payable on the amount equivalent to the input tax deduction made, in the tax period corresponding to the date on which the said 21-day period lapses;

(f) issue a tax invoice subject to the further requirements stated in Regulation 4, where the recipient, being a registered vendor, has been granted approval to issue tax invoices under section 20 (2) of the Act;

(g) In addition to the requirements under section 21 of the Act, issue debit and credit notes subject to the further requirements stated in Regulation 5, where the recipient, being a registered vendor, has been granted approval under section 21 (4) of the Act to issue debit and credit notes; and

(h) in addition to the normal VAT record-keeping requirements, retain a copy of the document contemplated in subparagraph (a) and the statement contemplated in subparagraph (e) as part of the VAT record-keeping requirements.

4. Additional requirements for tax invoices

The requirements for tax invoices contemplated in section 20 of the Act are applicable for the purposes of these Regulations, with the following additional requirements:

(a) a clear reference on the tax invoice that the supply of valuable metal Is subject to the domestic reverse charge as contemplated in these Regulations;

(b) the VAT charged on the supply of valuable metal under these Regulations should not be included in the amount shown as VAT due by the registered vendor recipient of the supply to the registered vendor making the supply of valuable metal; and

(c) a statement that the amount of VAT charged must be accounted for and paid (on behalf of the supplier) by the recipient, being a registered vendor.

5. Additional requirements for credit and debit notes

In addition to the requirements for credit and debit notes contemplated in section 21 of the Act, a debit or credit note must contain the following additional requirements:

(a) a clear reference on the debit or credit note that the supply of valuable metal is subject to the domestic reverse charge as contemplated in these Regulations; and

(b) a statement that the—

(i) increase, in the case of a debit note, to the VAT amount that was previously accounted for and paid by the recipient, being a registered vendor, must be accounted for and paid by such recipient to SARS; or

(ii) decrease, in the case of a credit note, from the VAT amount that was previously accounted for and paid by the recipient, being a registered vendor, must be accounted for and deducted by such recipient in its VAT return.

6. Additional reporting requirements in VAT returns

In addition to the requirements for returns and payment of tax contemplated in section 28 of the Act, the following additional requirements apply:

(a) Supplier, being a registered vendor

(i) the value of the supply of valuable metal must be reported in Field 3 of its VAT return; and

(ii) the value of the increase or the decrease as a result of the issue of a credit or debit note must be reported in Field 3 of its VAT return.

(b) Recipient, being a registered vendor

(i) the VAT that is subject to the domestic reverse charge must be reported in Field 12 of its VAT return;

(ii) where the recipient, being a registered vendor, is entitled to a deduction of input tax, subject to the provisions of sections 16, 17, 20 and 21 of the Act, such input tax must be reported in Field 18 of its VAT return; and

(iii) where the recipient, being a registered vendor, is required to increase the amount of VAT contemplated in Regulation 5 (b) (i), such increase must be reported in Field 12 and to decrease the amount of VAT contemplated in Regulation 5 (b) (ii), such decrease must be reported in Field 18 of its VAT return.

7. Liability for VAT

(a) Failure to apply the domestic reverse charge on supplies of valuable metal will result in the supplier and recipient, being registered vendors, being held jointly and severally liable for any VAT loss suffered by the fiscus in this regard: Provided that this provision will not be applicable to the supplier of valuable metal where the supplier, being a registered vendor satisfies the Commissioner that it has taken reasonable steps to comply with its obligation under these Regulations, including verifying the recipient vendor's VAT registration status and issuing, obtaining and maintaining the required records and statements of compliance from the recipient vendor.

(b) The recipient, being a registered vendor, shall be held liable for any enforcement action by SARS in respect of any obligation to account for and

pay VAT in terms of these Regulations as if that VAT were VAT on a supply of valuable metal made by that person.

8. Transitional measures

(a) Where a registered vendor has made a supply of valuable metal and the time of supply contemplated in section 9 of the Act has occurred on a date prior to the commencement date of these Regulations, such registered vendor being the supplier must account for the VAT in its VAT return and must pay the VAT to SARS.

(b) Where a registered vendor has made a supply of valuable metal and the time of supply contemplated in section 9 of the Act has occurred on or after the commencement date of these Regulations, the supplier and recipient, being registered vendors must comply with the domestic reverse charge contemplated in these Regulations.

(c) A registered vendor will be allowed a period of one month from 1 July 2022 to ensure that it complies with the requirements of these Regulations.

9. Re-validation of VAT registration status under Chapter 3 of the Tax Administration Act

(a) A registered vendor or representative vendor contemplated in section 46 of the Act is required to update its VAT registration status, within 21 business days from the earlier of implementation of the domestic reverse charge or the date that a supply of valuable metal is made which is subject to the domestic reverse charge, to indicate that such vendor makes supplies of valuable metal that are subject to the domestic reverse charge.

(b) The person referred to in subparagraph (1) who wilfully or negligently fails to update its registration status is guilty of an offence and upon conviction is subject to a fine or imprisonment as contemplated in section 234 (2) (a) of the Tax Administration Act.

10. Short title and commencement

These regulations are called the Domestic Reverse Charge Regulations and come into operation on 1 July 2022.

2.3. Explanatory Memorandum to Regulations

ON THE DOMESTIC REVERSE CHARGE RELATING TO VALUABLE METAL, ISSUED IN TERMS OF SECTION 74(2) OF THE VALUE-ADDED TAX ACT, 1991 (ACT NO 89 OF 1991)

13 JUNE 2022

1. BACKGROUND

1.1 VAT system in general

Generally, the VAT system makes provision for persons that meet the requirements (referred to as vendors) to register for and to charge and collect VAT on the supply of goods or services. The mechanism of charging, collecting and paying the VAT to the Government is based on self-assessment, which allows the vendor to determine its liability or refund of VAT. It adopts a subtractive or credit input method that allows the vendors to deduct the VAT incurred on enterprise expenses (input tax) from the VAT collected on the supplies made by the vendor (output tax). The vendor may deduct the VAT paid during the preceding stages of the production and distribution chain (that is, the burden of the VAT is on the final consumer whilst maintaining neutrality in the business chain). The subtractive method also serves as a reliable method of accounting to ensure that the VAT is paid on every transaction.

In essence, the characteristics of the VAT system is that the final consumers pay the VAT, VAT is levied on every taxable supply, vendors collect the VAT at each stage, and the allowable input tax is deductible by vendors.

A tax invoice is critical to the VAT system. The purpose of a tax invoice is to reflect information on the VAT rate applicable, to enable a vendor to prove their right to deduct input tax, and most importantly, it also allows the tax authority to cross-check the transactions, i.e. that what is reflected by the seller is the same as what is in possession of the recipient. The tax authority is able to verify that the VAT charged by the supplying vendor and the input tax deduction by the recipient vendor match. However, if the tax periods of the vendors are different or, for example, the vendor deducting the input tax makes the deduction in a later tax period, the tax authority can only verify the information on whether the input tax deducted has been remitted to the tax authority, post facto.

1.2 Previous VAT fraud scheme in respect of second-hand goods constituting gold

Although the general VAT system subscribes to the canons of taxation and best practice of VAT principles, VAT on second-hand goods, particularly second-hand gold, was and still is a target of abusive and fraudulent activities. The post facto verification of VAT charged against VAT deducted has led to the South African Revenue Service (SARS) having challenges in curbing these malpractices.

It came to Government's attention that while a deduction of notional input tax on the acquisition of gold jewellery by VAT vendors from non-VAT vendors was allowed, in practice this provision significantly contributed to creating an enabling environment to obtain fraudulent input tax deductions. Jewellery is smelted along with gold coins and illegally acquired raw gold.

As a result, in 2014, changes were made to the definition of 'second hands goods' in the VAT Act to the effect that vendors were excluded from obtaining the notional input tax on second-hand goods containing gold, unless such goods were re-sold in the same or substantially the same state as they were bought in.

2. REASONS FOR CHANGE

Government has identified a new modus operandi used by vendors to extract undue VAT refunds from the fiscus. These vendors have moved away from making fictitious input tax deductions (resulting in VAT refunds) under the pretence that the goods are second-hand goods, containing gold. Instead, various fictitious businesses are registered for VAT purposes as vendors and required documentation is fabricated. These vendors acquire and supply Krugerrands, illegal gold, etc. These types of goods are introduced into the production and distribution chain to manufacture mainly gold in the form of jewellery, bars, blank coins, ingots, buttons, wire, plate, granules, in a solution, residue or similar forms, for export purposes. These vendors diligently submit VAT returns that, in most cases, reflect minimal amounts of VAT payable to SARS, but large amounts of VAT refunds are claimed when the gold in the form of jewellery, bars, blank coins, ingots, buttons, wire, plate, granules, in a solution, residue or similar forms are exported.

More specifically, these vendors utilise 'invoice-farms' to create a paper trail to authenticate and re-characterise the supply of Krugerrands, illegal gold, etc. and VAT at the standard rate is charged, i.e. a deliberate and purposeful misrepresentation of the nature, type and origin of the gold obtained from the Krugerrands, illegal gold, etc. Further, numerous other fraudulently registered vendors are interposed between the initiating vendor supplying the Krugerrands, illegal gold, etc. and the last vendor that acquires the gold in the form of jewellery, bars, blank coins, ingots, buttons, wire, plate, granules, in a solution, residue or similar forms (at the standard rate) and exports them at the zero rate, whilst deducting input tax and claiming a VAT refund. This VAT refund may then be effectively shared with the other interposed vendors in the production and distribution chain.

Due to the interposing of numerous vendors, i.e. the creation of multiple layers, between the initiating vendor and the vendor that ultimately undertakes the exports, it is very difficult for SARS to detect at which stage

the fraudulently re-characterised goods and fabricated documentation entered the production and distribution chain to supposedly manufacture goods containing gold, in the form of jewellery, bars, blank coins, ingots, buttons, wire, plate, granules, in a solution, residue or similar forms.

The overall scheme is therefore aimed at effectively capturing the VAT refund at the final stage of the production and distribution chain, where input tax is deducted on the acquisition of the goods containing gold, in the form of jewellery, bars, blank coins, ingots, buttons, wire, plate, granules, in a solution, residue or similar forms and output tax is declared at the zero-rate by the vendor that undertakes the export of these goods.

The estimated financial impact of the above-mentioned schemes is estimated at billions of rands a year.

3. PROPOSAL

3.1 Measures adopted by other jurisdictions to curb VAT fraud schemes

Other jurisdictions that experienced the above-mentioned similar types of fraudulent activities and schemes introduced the concept of a Domestic Reverse Charge Mechanism on goods and services that are prone to abuse and malpractice.

- Australia – Reverse Charge in the Valuable Metals Industry

  With effect from 1 April 2017, Australia introduced a mandatory reverse charge that applies to business-to-business transactions of valuable metals. This applies to sales between Goods and Services Tax (GST)-registered suppliers and GST-registered purchasers on all taxable supplies of gold, silver or platinum. A reverse charge transaction makes the purchaser responsible for remitting GST, rather than the supplier. It makes it easier and faster for businesses in the valuable metal industry to meet their GST and reporting obligations.

- United Kingdom – Domestic Reverse Charge Procedure

  In the United Kingdom (UK), the VAT domestic reverse charge procedure is an anti-fraud measure designed to counter criminal attacks on the UK VAT system by means of sophisticated fraud. The reverse charge only applies to supplies where:

  - those supplies are specified supplies of goods or services as set out in section 3 of the UK VAT Act.
  - the customer is registered or liable to be registered for UK VAT.
  - the customer is buying the goods or services for a business purpose.

3.2 Measure proposed by South Africa to curb VAT fraud schemes

In order to curb VAT fraud schemes in relation to gold and goods containing gold, it is proposed that similar to other countries, South Africa introduces a Domestic Reverse Charge ('DRC'). This DRC will be introduced through Regulations in terms of section 74(2) of the VAT Act. The policy objective of the DRC Regulations is that it is an antiabuse measure aimed at removing the opportunity for fraudulent vendors to recharacterise gold and goods containing gold, make minimal VAT payments to SARS and extract large amounts of VAT refunds from the fiscus.

- Vendors subject to DRC Regulations

  The DRC Regulations will apply to all registered vendors involved in the entire production and distribution chain that make supplies of defined valuable metal, namely, any goods containing gold in the form of jewellery, bars, blank coins, ingots, buttons, wire, plate, granules, in a solution, residue or similar forms, including any ancillary goods or services

- Goods subject to DRC Regulations

  The DRC Regulations will apply to the valuable metal as defined in the Regulations, being any goods containing gold in the form of jewellery, bars, blank coins, ingots, buttons, wire, plate, granules, in a solution, residue or similar forms, including any ancillary goods or services.

  Such goods may have traces of other metallic materials, but the ambit of the supply, for purposes of these Regulations, remains the supply of a gold bearing good or, including the supply of any 'ancillary goods or services' (for example packaging, polishing, storage etc). As such, where a supply consists of a goldbearing item in the forms above, together with ancillary goods or services, the full consideration in respect of both supplies will be subject to VAT at the standard rate and subject to the DRC Regulations.

- Goods excluded from the application of DRC Regulations

  The following goods are excluded from the application of DRC Regulations:

  - Supplies of goods produced from raw materials by any 'holder' as defined in section 1 of the Mineral and Petroleum Resources Development Act 28 of 2002, or any person contracted to such 'holder' to carry on mining operations in respect of the mine where the 'holder' carries on mining operations;
  - Supplies contemplated in section 11(1)(f), (k) or (m) of the VAT Act, 1991.
  - That said, the exclusions do not widen the ambit of the Regulations to all valuable metal in its entirety.

- Workings of the DRC Regulations

  The DRC Regulation is conceptualised on the following basis:

  - The acquiring vendor (recipient) of valuable metal and supplying vendor (supplier) of valuable metal must be registered vendors.
  - The supply of valuable metal must be a supply chargeable with VAT at the standard rate.
  - The recipient of valuable metal becomes the vendor liable to account for and pay the VAT (on behalf of the supplier) to the fiscus.
  - The recipient of valuable metal (if entitled to deduct input tax, subject to sections 16, 17, 20 and 21 of the VAT Act) is only allowed to deduct the input tax on the acquisition, if the recipient has accounted for and paid to SARS the VAT charged by the supplier in accordance with the principles prescribed by the DRC Regulations.
  - The supplier of valuable metal will not be entitled to input tax on irrecoverable debts as the recipient will account for and pay the VAT to SARS, on behalf of the supplier.
  - The supplying vendor remains liable to levy/charge the VAT on the supply of valuable metal but will not collect such VAT from the recipient vendor. The remittance of that VAT to the fiscus, is now an obligation placed on the recipient vendor. Hence, the VAT payable on the supply of valuable metal is aligned with the recipient's entitlement to deduct input tax.
  - If the supply of valuable metal is made to an end user, e.g., a fully exempt business or a person not registered for VAT, the VAT is to be charged, accounted for and remitted under the rules prescribed in the present VAT system, i.e. the DRC

Regulations will not apply to transactions between such persons, as they are not transactions between vendors.

- The supplier of valuable metal must take reasonable steps to verify the VAT registration status of the recipient.
- The supplier of valuable metal is required to maintain and retain, as part of VAT recordkeeping, a list of all supplies subject to the DRC Regulations.
- The recipient, after having received the tax invoice from the supplier, or in the case of recipient-created tax invoices, being issued by the recipient vendor, must notify the supplying vendor in writing by means of a statement within 21 business days of the end of the calendar month during which the output tax was declared, where the supply of valuable metal is subject to the DRC, with the particulars prescribed in the Regulations.
- The supplier and recipient of valuable metal must compulsorily inform SARS that they engage in transactions that fall within the ambit of the DRC Regulations, by updating their VAT registration status.
- If the recipient, inter alia, omits to account for and pay the domestic reverse charge VAT, the supplier and recipient shall be held jointly and severally liable for any VAT loss suffered by the fiscus. The supplier will not be held liable if it meets the prescribed administrative requirements, such as taking reasonable steps to verify the recipient's VAT registration status, obtain, and retain the required records, including a list of all supplies subject to the DRC Regulations.
- The issuing of a tax invoice, debit and credit note will follow the normal VAT rules. The DRC Regulations prescribe

additional information to be reflected on these documents. The DRC Regulations further prescribe the accounting, reporting and payment obligations of the supplier and the recipient, respectively.

4. EFFECTIVE DATE

The proposed DRC Regulations will come into operation on 1 July 2022. A registered vendor will be allowed a period of one month from 1 July 2022 to ensure that it complies with the requirements of these Regulations. This means that a registered vendor, being a recipient, will be allowed to account for and pay the VAT in respect of transactions that became subject to these Regulations in the tax period covering August 2022.

3. NOTICES / REGULATIONS

3.1. Release of revised draft rates and monetary amounts and amendment of revenue laws bill to include the temporary reduction in the general fuel levy and to revise the effective date for the increase in the health promotion levy

1 April 2022

The Minister of Finance and the Minister of Mineral Resources and Energy yesterday announced a temporary reduction in the general fuel levy, which is to be funded by a liquidation of a portion of the strategic crude oil reserves. The general fuel levy for petrol and diesel will be reduced by R1.50 per litre between Wednesday 6 April 2022 and 31 May 2022.

In the 2022 Budget, the Minister of Finance announced an increase in the health promotion levy of 4.5 per cent to 2.31 cents per gram of sugar for sugary beverages with more the 4 grams of sugar per 100 ml. The increase was to be effective from 1 April 2022. The Minister also announced that consultations will be initiated to consider lowering the 4g threshold and extending the levy to fruit juices.

To allow for the consultation process, it is proposed that the effective date of the increase be postponed to 1 April 2023.

The 2022 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (2022 Draft Rates Bill) includes the tax rate and threshold adjustments that were announced in the 2022 Budget, and includes changes to the personal income tax brackets and rebates, the employment tax and excise duties on alcohol and tobacco, amongst others.

The revised version of the 2022 Draft Rates Bill published today includes the temporary reduction in the general fuel levy and consequential amendments to the levy on biodiesel, which will temporarily decrease to R1.10 per litre over the two-month period between 6 April 2022 and 31 May 2022, alongside similar reductions in the value of diesel refunds for farming, mining and other eligible activities. It also contains the postponement of the date of the increase of the health promotion levy to 1 April 2023.

3.2. Rates at which interest-free or low interest loans are subject to income tax

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%
1 April 2022	Until change in Repo rate	5,25%

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

3.3. Tables 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 September 2020	31 October 2020	7,25%
1 November 2020	28 February 2022	7%
1 March 2022	30 April 2022	7,25%
1 May 2022	30 June 2022	7,50%
1 July 2022	Until change in the Public Finance Management Act rate	7,75%

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

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

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%

1 April 2022	31 May 2022	5,25%
1 June 2022	Until change in Repo rate	5,75%

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

3.4. Distribution of funds to non-resident trusts by resident trusts

8 April 2022 – It has been the practice of SARS not to approve the release of funds when resident Trusts make distributions to non-resident Trusts. Following numerous queries in this regard, SARS herewith re-iterates its stance on the matter and herewith confirms that it will not approve the release of funds vested and distributed to non-resident Trusts.

SARS is currently investigating other options related to the distribution of funds/amounts to non-residents and is in discussions in this regard. SARS takes note of the fact that the SARB has relaxed certain exchange control requirements but has decided, based on the risks involved, not to approve the release of funds to non-resident Trusts.

This does, however, not preclude a resident Trust from vesting amounts in non-resident individuals and to apply for the relevant approvals, as per the current approved practice.

3.5. Update on Disputes issue on eFiling

17 May 2022 – As previously indicated, SARS is aware of issues with submitting disputes on eFiling which has resulted in some disputes being rejected.

A fix was implemented on 13 May 2022 to address this matter. The team is working on resolving any remaining issues.

Where a taxpayer or Practitioner had submitted a dispute between 22 April 2022 and 14 May 2022, please check your dispute history on eFiling to verify if your dispute is reflecting as received or rejected. If the dispute is rejected, may you kindly submit this dispute to SARS as soon as possible.

SARS apologises for the inconvenience.

3.6. Income tax returns to be submitted

Per the Government Gazette and Notice No. 2130 of 3 June 2022:

Persons who must submit an income tax return

The following persons must submit an income tax return:

(a) Every company or other juristic person, which was a resident during the 2022 year of assessment that—

   (i) derived gross income of more than R1 000;

   (ii) held assets with a cost of more than R1 000 or had liabilities of more than R1 000 at any time;

   (iii) derived any capital gain or capital loss of more than R1 000 from the disposal of an asset to which the Eighth Schedule of the Income Tax Act applies; or

   (iv) had taxable income, taxable turnover, an assessed loss or an assessed capital loss;

(b) Every trust that was a resident during the 2022 year of assessment;

(c) Every company, trust or other juristic person, which was not a resident during the 2022 year of assessment, that:

(i) carried on a trade through a permanent establishment in the Republic;

(ii) derived income from a source in the Republic; or

(iii) derived any capital gain or capital loss from the disposal of an asset to which the Eighth Schedule to the Income Tax Act applies;

(d) Every company incorporated, established or formed in the Republic, but that was not a resident as a result of the application of any agreement entered into with the Government of any other country for the avoidance of double taxation during the 2022 year of assessment;

(e) Every natural person who during the 2022 year of assessment:

(i) was a resident and carried on any trade (other than solely in his or her capacity as an employee); or

(ii) was not a resident and carried on any trade (other than solely in his or her capacity as an employee) in the Republic;

(f) Every natural person who during the 2022 year of assessment:

(i) was a resident and had capital gains or capital losses exceeding R40 000;

(ii) was not a resident and had capital gains or capital losses from the disposal of an asset to which the Eighth Schedule to the Income Tax Act applies;

(iii) was a resident and held any funds in foreign currency or owned any assets outside the Republic, if the total value of those funds and assets exceeded R250 000 at any stage during the 2022 year of assessment;

(iv) was a resident and to whom any income or capital gains from funds in foreign currency or assets outside the Republic was attributed in terms of the Income Tax Act;

(v) was a resident and held any participation rights, as referred to in section 72A of the Income Tax Act, in a controlled foreign company;

(vi) was a resident and had taxable turnover; or

(vii) at the end of the 2022 year of assessment:

(aa) was under the age of 65 and whose gross income exceeded R87 300;

(bb) was 65 years or older (but under the age of 75) and whose gross income exceeded R135 150; or

(cc) was 75 years or older and whose gross income exceeded R151 100;

(g) Subject to the provisions of paragraph 3, every estate of a deceased person that had gross income during the 2022 year of assessment;

(h) Every non-resident whose gross income during the 2022 year of assessment included interest from a source in the Republic to which the provisions of section 10(1)(h) of the Income Tax Act do not apply;

(i) Every person that is issued an income tax return form or who is requested by the Commissioner in writing to furnish a return, irrespective of the amount of income or nature of receipts or accruals of the person; and

(j) Every representative taxpayer of any person referred to in subparagraphs (a) to (i) above.

Persons not required to submit an income tax return

(1) A natural person or estate of a deceased person is not required to submit an income tax return in terms of paragraph 2(f)(vii) or (2)(g) if the gross income of the person during the 2022 year of assessment consisted solely of gross income described in one or more of the following subparagraphs:

(a) Remuneration paid or payable from one single source, which does not exceed R500 000 and employees' tax has been deducted or

withheld in terms of the deduction tables prescribed by the Commissioner;

(b) Interest (other than interest from a tax free investment) from a source in the Republic not exceeding:

(i) R23 800 in the case of a natural person below the age of 65 years at the end of the year of assessment;

(ii) R34 500 in the case of a natural person aged 65 years or older at the end of the year of assessment; or

(iii) R23 800 in the case of the estate of a deceased person;

(c) Dividends and the natural person was a non-resident throughout the 2022 year of assessment; and

(d) Amounts received or accrued from a tax-free investment.

(2) Subparagraph (1) does not apply to a natural person:

(a) who was paid or granted an allowance or advance as described in section 8(1)(a)(i) of the Income Tax Act other than an amount reimbursed or advanced as described in section 8(1)(a)(ii) or an allowance or advance referred to in section 8(1)(b)(iii) that does not exceed the amount determined by applying the rate per kilometre for the simplified method in the notice fixing the rate per kilometre under section 8(1)(b)(ii) and (iii) to the actual distance travelled;

(b) who was granted a taxable benefit described in paragraph 7 of the Seventh Schedule to the Income Tax Act; or

(c) who received any amount or to whom any amount accrued in respect of services rendered outside the Republic.

(3) A natural person is not required to submit an income tax return in terms of paragraph 2(f)(vii) if:

(a) the person is notified by the Commissioner in writing that he or she is eligible for automatic assessment; and

(b) the person's gross income, exemptions, deductions and rebates reflected in the records of the Commissioner are complete and correct as at the date of the assessment based on an estimate to give effect to automatic assessment.

Periods within which income tax returns must be furnished

Income tax returns must be submitted within the following periods:

(a) in the case of any company, within 12 months from the date on which its financial year ends; or

(b) in the case of all other persons (which include natural persons, trusts and other juristic persons, such as institutions, boards or bodies)—

(i) on or before 24 October 2022 if the return is submitted electronically through the assistance of a SARS official at an office of SARS or manually;

(ii) on or before 24 October 2022 if the return does not relate to a provisional taxpayer and is submitted by using the SARS eFiling platform;

(iii) on or before 23 January 2023 if the return relates to a provisional taxpayer and is submitted by using the SARS eFiling platform; or

(iv) where accounts are accepted by the Commissioner in terms of section 66(13A) of the Income Tax Act in respect of the whole or portion of a taxpayer's income, which are drawn to a date after 28 February 2022 but on or before 30 September 2022, within 6 months from the date to which such accounts are drawn.

Form of income tax returns to be submitted

The forms prescribed by the Commissioner for the submission of income tax returns are obtainable on request via eFiling at https://www.sarsefiling.co.za or downloadable from the SARS website at https://www.sars.gov.za/find-a-form/ .

Manner of submission of income tax returns

(1) Income tax returns must:

(a) in the case of a company, be submitted electronically by using the SARS eFiling platform;

(b) in the case of natural persons or trusts be submitted electronically:

(i) by using the SARS eFiling platform, provided the person is registered for eFiling; or

(ii) through the assistance of a SARS official at an office of SARS;

(c) in the case of institutions, boards or bodies be:

(i) submitted electronically by using the SARS eFiling platform, provided the person is registered for eFiling;

(ii) submitted electronically through the assistance of a SARS official at an office of SARS;

(iii) forwarded by post to SARS; or

(iv) delivered to an office of SARS, other than an office which deals solely with matters relating to customs and excise.

(2) Returns for turnover tax must be forwarded by post to SARS or delivered to an office of SARS, other than an office which deals solely with matters relating to customs and excise.

(3) SARS may agree that a person, who is required to submit a return in the manner prescribed in subparagraph (1) or (2), may submit the return in an alternative manner.

4. TAX CASES

4.1. Clicks Retailers (Pty) Ltd v C:SARS (84 SATC 71)1

Clicks Retailers (Pty) Ltd sold merchandise, primarily in the pharmacy, health and beauty categories, to the public.

Clicks ran the Clicks ClubCard programme (loyalty programme) in terms of which participating customers received loyalty points for shopping at Clicks that could be translated into cash back vouchers, which were not redeemable for cash, but which may be off-set against the cost of Clicks merchandise, provided that the customer accumulated the requisite number of loyalty points within a qualification period.

Clicks offered loyalty programme membership free of charge to its customers and a customer was required to apply in writing or telephonically to become a member. A contract between Clicks and the customer came into existence when the customer completed and submitted the enrolment form (ClubCard contract). Upon acceptance of the customer's application, Clicks issued a ClubCard to the customer and the customer agreed to be bound by the terms and conditions of the ClubCard contract.

In order to qualify for loyalty points at least R10 must be spent by the customer in a single purchase transaction at Clicks or one of its affinity partners. A customer thereafter earned one loyalty point for every R5 spent. Affinity partners were third party merchants from which members of the loyalty programme may earn loyalty points which could be redeemed at Clicks stores and each of which had concluded an agreement with Clicks for the payment of commission relating to sales at those entities.

Clicks deducted from its taxable income the cost of the merchandise that would be provided to customers on redemption of their cash back vouchers and the amount that Clicks sought to claim under section 24C of the Act formed part of the stated case and was not in dispute.

1 Constitutional Court, 2021 (4) SA 390 (CC), 2021 (10) BCLR 1102 (CC)

Clicks returned 2% of the value of all qualifying purchases (that is, purchases where the customer presented their ClubCard and earned loyalty points) to customers. The question whether Clicks was entitled to defer taxation on that value had significant ramifications for its tax treatment and the cash flow of its business. For the 2009 tax year, 2% of all qualifying purchases equated to around R58.5 million, in respect of which Clicks, if successful, would be entitled to claim a deduction of approximately R36.18 million. Clicks maintained that deferring this deduction to a subsequent year would support it to, among other things, fund its operations and investments.

Clicks, in its income tax return for the 2009 tax year, had included an amount of R58 550 602 in its gross income and had disclosed it as 'ClubCard deferred income.' It claimed an allowance of R44 275 965 for future expenditure against this amount in terms of section 24C of the Income Tax Act.

Clicks, in broad terms, had claimed the section 24C allowance on the following basis. When a loyalty programme member made a purchase above the stipulated value threshold at a Clicks store and presented her ClubCard at checkout, a contract of sale was concluded and income accrued to Clicks. By doing so, the member earned loyalty points which could later be redeemed for Clicks merchandise. This imposed an obligation on Clicks to finance future expenditure, as envisaged in section 24C of the Act, in that it must later give away (for no further consideration) stock to the value of the loyalty points when the points were redeemed and the redemption took place when the member entered into a further contract of sale and received discounted merchandise purchased in terms of that further contract (redemption contract).

Section 24C(2) of the Income Tax Act 58 of 1962 provided at the relevant time:

> 'If the income of any taxpayer in any year of assessment includes or consists of an amount received by or accrued to him in terms of any contract and the Commissioner is satisfied that such amount will be utilised in whole or in part to finance future expenditure which will be incurred by the taxpayer in the performance of his obligations under such contract, there shall be deducted in the determination of the taxpayer's taxable

> income for such year such allowance (not exceeding the said amount) as the Commissioner may determine, in respect of so much of such future expenditure as in his opinion relates to the said amount.'

Clicks, over the course of its dispute with SARS had clarified its position on which contract generated income and which contract was the source of its obligation to finance future expenditure. Its later submission was that when a participating customer joined the loyalty programme, a 'composite contract' came into existence. This contract, which was 'indivisible by nature' was constituted by the ClubCard contract and a contract of sale entered into by a member who presented her ClubCard at the time of the transaction. The contract of sale was 'a performance requirement' in terms of the ClubCard contract to the extent that if a customer did not conclude a sale contract, the loyalty programme was rendered a nullity. Accordingly, the contract of sale cannot be viewed as an independent contract for purposes of the loyalty programme and Clicks thus contended that the requirements of section 24C(2) were met in that both the obligation to finance future expenditure and the accrual of the income was in terms of a single composite contract.

SARS had disallowed Clicks' section 24C deduction for the 2009 tax year on the ground that a section 24C allowance can be claimed only where SARS 'is satisfied that the income received or accrued in terms of a contract will be used to fully or partly finance the future expenditure which will be incurred as a result of performing under the same contract.'

SARS maintained that section 24C only permits an allowance when the income and the obligation to finance future expenditure arise under the same contract and that in Clicks' case, the income and the obligation to finance future expenditure arose from different contracts. Each transaction in terms of which a customer purchased goods at a Clicks store represented a separate contract, which was independent and distinguishable from the ClubCard contract and the obligation to finance future expenditure arose under the ClubCard contract whereas the income accrued to Clicks in terms of the contract of sale.

Clicks successfully appealed SARS' decision to the Cape Town Tax Court (see ITC 1915 81 SATC 214 per Nuku J) where the sole issue was whether Clicks was entitled to an allowance under section 24C having regard to the basis on which SARS had disallowed the deduction. It found that the contract of sale resulted in two things, namely, the earning of income and the obligation to finance future expenditure and thus the contract that gave rise to both the income and the obligation to finance expenditure was the sale contract.

SARS then appealed to the Supreme Court of Appeal (see C: SARS v Clicks Retailers (Pty) Ltd 82 SATC 167) where Clicks persisted with the contention that it had earned income and had incurred an obligation to finance future expenditure in terms of the same contract, namely, the sale contract in terms of which a qualifying purchase was made and the sale contract was thus both income-earning and obligation-imposing.

The issue before the Supreme Court of Appeal was whether it was the sale contract that gave rise to the obligation to grant rewards and finance future expenditure, as opposed to either the ClubCard contract or the redemption contract. If the contract of sale was the source of both income and the obligation to finance future expenditure, the same-contract requirement would be satisfied.

The Supreme Court of Appeal held that Clicks earned income in terms of the sale contract but incurred the obligation to finance future expenditure in terms of the ClubCard contract and it concluded that the 'same-contract requirement' provided for in section 24C of the Act was not satisfied and the court deemed it to be irrelevant that the contracts 'may be…inextricably linked' and it upheld SARS' appeal and set aside the order of the Tax Court.

Shortly before the hearing in the Supreme Court of Appeal that court had handed down judgment in the case of C: SARS v Big G Restaurants (Pty) Ltd 81 SATC 185 in which it had also been called upon to interpret and apply section 24C of the Income Tax Act and it confirmed that section 24C(2) did not envision different income-earning and obligation-imposing contracts. The court expressly rejected the notion that section 24C applied where two or more different contracts were 'inextricably linked' as the operative concept was 'contract' and it held that section

24C 'required that the taxpayer incur the expenditure in the performance of its obligations in terms of the same contract as the contract under which it received income.'

The Supreme Court of Appeal's decision in Big G was subsequently taken on appeal to the Constitutional Court (see Big G Restaurants (Pty) Ltd v C: SARS 82 SATC 403) where the court found that the requirement of contractual sameness in section 24C could be achieved either on a same-contract basis (where the income-producing contract and the obligation-imposing contract are literally the same contract) or on a sameness basis (where the income and obligation to finance expenditure are sourced in two or more contracts that are so inextricably linked that they meet the requirement of sameness).

Clicks in the present case then approached the Constitutional Court seeking leave to appeal and where the crisp issue for determination was whether Clicks could claim an allowance under section 24C in respect of income that it earned in terms of its loyalty programme.

Following the Constitutional Court's decision in Big G, supra, a section 24C allowance may be claimed either when the traditional same-contract requirement was met or when the income and the obligation to finance expenditure arose from two or more contracts that were so inextricably linked that they met the requirement of 'sameness.'

Clicks sought leave to appeal against the Supreme Court of Appeal's judgment on the basis that the matter engaged the Constitutional Court's general jurisdiction under section 167(3)(b)(ii) of the Constitution in that leave to appeal ought to be granted because it raised an arguable point of law of general public importance which ought to be considered by it.

Judge Theron held the following:

<u>As to jurisdiction and leave to appeal</u>

(i) That in Big G Restaurants (Pty) Ltd v C: SARS 82 SATC 403 the majority held that the question whether a contract that imposes an obligation to incur future expenditure is so interlinked to a contract in terms of which income is

earned that the income earned in terms of the latter contract can be held to be income that accrues in terms of the former contract is a 'quintessential point of law.' This finding accords with the accepted approach in our law that the interpretation of contracts is a matter of law and not of fact.

(ii) That, so, while the matter ostensibly involves the 'mere' application of a legislative provision, the application of that provision turns on the nature of the relationship between Clicks' ClubCard contracts. That, in turn, required the court to interpret those agreements and it was also trite that the interpretation of legislation was a legal issue.

(iii) That in this case the court must go further and ask: what does it mean for two or more contracts to be so inextricably linked that they meet the requirement of 'sameness' as introduced in Big G, supra? In other words, this court must 'put meat on the bones' of the sameness test in the context of inextricably linked contracts. In the same way common law rules are developed incrementally through their application to novel factual scenarios, the court must now determine how, if at all, the interlinked contracts at issue here meet the requirements of sameness.

(iv) That the question whether, on a proper interpretation of section 24C(2) and Clicks' loyalty programme contracts, Clicks was entitled to claim a deferred income allowance was arguable. The answer to this question was not readily apparent, which was evidenced by the divergent approaches taken by the Tax Court and the Supreme Court of Appeal.

(v) That, as to whether this matter was a legal question of general public importance, a decision in this matter implicates not only the interests of Clicks but also the interests of all other retailers who offer similar loyalty programmes and, as stated, this appeal involves issues of general public importance and the outcome of this court's decision will likely have implications on the tax positions of other entities that operate similar loyalty programmes and for these reasons leave to appeal should be granted.

As to the meaning of section 24C(2)

(vi) That, distilled to its essence, section 24C(2) has three requirements. There must be (a) income earned by a taxpayer in terms of a contract (the income-producing contract); (b) an obligation on the taxpayer under a contract that requires future expenditure, which will be financed by this income (the obligation-imposing contract); and (c) contractual sameness. In the wake of Big G, supra, this third requirement can be achieved either on a same-contract basis (the income-producing contract and obligation-imposing contract are literally the same contract) or on a sameness basis (the income and obligation to finance expenditure are sourced in two or more contracts that are so inextricably linked that they meet the requirement of sameness) and Clicks contends that it can claim a section 24C allowance on either a same-contract basis or a sameness basis.

(vii) That the parties have proceeded on a stated case and there was no dispute that (a) the contract of sale generates income and (b) the issuing of points under the ClubCard contract gave rise to an obligation to finance future expenditure by Clicks. The parties had also agreed on the quantum of the section 24C allowance to which Clicks would be entitled in the event that the court found in its favour.

As to whether Clicks could claim a section 24C allowance

(viii) That if a customer has concluded a ClubCard contract and presents the card at the point of sale, Clicks incurs an obligation under the ClubCard contract to award them points. In order to be entitled to a discount equal to the number of points earned during a given qualification period, a customer must conclude a ClubCard contract which was the contract that entitled the customer to the discount and, if Clicks were to renege on its obligation to honour the redemption of points, the customer's cause of action would be based on the ClubCard contract. The sale contract was closely linked to the ClubCard contract because (subject to sufficient points being earned) it triggered Clicks' obligation under the ClubCard contract. But while the obligation to honour a redemption of points and the earning of income may

occur simultaneously, the obligation was sourced in the ClubCard contract and the income accrued in terms of the sale contract. For these reasons Clicks cannot claim a section 24C allowance on a same-contract basis.

(ix) That, however, the import of Big G, supra, was that a taxpayer can now claim a s24C allowance even if the income and the paired obligation to finance future expenditure are generated by different interlinked contracts, as long as those contracts satisfy the requirement of sameness and the operative word was therefore sameness.

(x) That while Clicks had focused on whether the loyalty programme contracts were inextricably linked, that approach had misunderstood Big G, supra, which did not say that all the taxpayer needs to show is that the income-generating contract and obligation-imposing contract were inextricably linked. What this court said in Big G was that the taxpayer must show that the inextricable link between two contracts was such that the contracts met the section 24C(2) sameness requirement.

(xi) That this did not render the 'inextricable link' factor irrelevant. If the contracts are not inextricably linked to each other, the criterion of sameness is not likely to be satisfied. Also, logically, one cannot ascertain whether there is sameness between two contracts until the links between them are examined. But a finding that the sale contract and ClubCard contract are inextricably linked will not be the end of the matter. The determinative question is whether they are so inextricably linked that they satisfy the requirement of sameness.

(xii) That our jurisprudence establishes that there is an 'inextricable link' when an issue, claim, contract or conduct cannot be determined or assessed without another, or the legal consequence of the one cannot be understood or measured without reference to another. In the court's assessment there was an inextricable link between the sale contract and the ClubCard contract to the extent that both contracts operate together to give effect to Clicks' loyalty programme. While it was true that the ClubCard contract was the foundation of the contractual arrangement that gave effect to Clicks' loyalty programme, it was the contract of sale that lent specificity and

content to the terms of the ClubCard contract, effectively establishing the specific ambit of the obligation incurred by Clicks.

(xiii) That, thus, within the context of the loyalty programme, the two contracts were inextricably linked but the question was whether the links between the two contracts gave rise to a sameness between them?

(xiv) That whatever the outer limits of the concept of sameness in this context may be, at a minimum both the earning of income and the obligation to finance future expenditure must depend on the existence of both contracts. If either contract can be entered into and exist without the other, they can hardly achieve sameness.

(xv) That it was so that the accrual of income under a sale contract triggered and quantified Clicks' obligation to finance future expenditure but again, the actual obligation is sourced in the ClubCard contract and did not depend on the existence of a sale contract. Likewise, the sale contract did not owe its existence to the ClubCard contract. Income earned under the sale contract did not accrue to Clicks necessarily because it had undertaken an obligation to honour the redemption of loyalty points in the event that its ClubCard members earn points and become entitled to a discount. Clicks earned income through the sale of merchandise and not through entering into ClubCard contracts with its customers. Of course, the existence of a ClubCard contract may drive sales of Clicks' merchandise, but income that accrued, in legal terms, was attributable to the relevant contract of sale. Clicks would earn income regardless of whether there was a ClubCard contract in place.

(xvi) That there were many other respects in which the contracts functioned independently. Each contract of sale constituted a complete contract on its own, with terms that were different from the ClubCard contract. In fact, the terms of each sale contract were the same regardless of whether the purchaser was a loyalty programme member and regardless of whether a ClubCard was presented. The generation of income was not regulated by the ClubCard contract and no aspect of the sale contract was dictated by the ClubCard contract.

(xvii) That the two contracts relied on to found Clicks' claim for a section 24C allowance functioned in tandem to give effect to the loyalty programme. This functional relationship manifested in a number of factual and legal links between the two contracts, but these links did not render either contract dependent on the other for its existence, nor is their effect that income can only accrue to Clicks if both contracts are in place. The contract under which income accrued (the contract of sale) and the contract under which the obligation to finance future expenditure arose (the ClubCard contract) were simply too independent of each other to meet the requirement of contractual sameness. Whilst they may operate together within the context of the loyalty programme, and in that sense were inextricably linked or connected, this link was not sufficient to render the contracts the same for the purposes of section 24C of the Act and the contracts therefore fell short of the sameness that was required by section 24C of the Act and hence Clicks could not claim a section 24C allowance on either a same-contract basis or on a sameness basis.

Appeal dismissed.

4.2. Peri Formwork Scaffolding Engineering (Pty) Ltd v C:SARS (84 SATC 91)2

Peri Formwork Scaffolding Engineering (Pty) Ltd (Peri) was a registered company that provided products and services related to scaffolding and formwork to contractors in the construction industry.

Peri, an employer, had filed and submitted its Employer Reconciliation Declaration which was due on 31 December 2017, on Monday 18 December 2017. An amount of R10 648 340.93 was due and payable in terms of this return to SARS.

Peri had submitted the instruction for payment on e-filing on the same day as the return was filed to their bank, Nedbank, for payment on 3 January 2018 as Peri's

2 Western Cape Division, Cape Town

business was closed for the holiday season from 15 December 2017 and only re-opened on 3 January 2018.

Third party payments were authorised on Nedbank electronically by Peri's cash book administrator and an accountant when it was sent from SARS e-filing to Nedbank. However, in this instance, the cash book administrator and the accountant were unable to release the payment on 3 January 2018 as there were insufficient funds available to make the payment.

Peri eventually made payment of R10 648 340.93 and it was received by SARS on Monday 8 January 2018, although the payment was ostensibly due on Saturday, 6 January 2018.

According to Peri the reason advanced for the late payment was that it was waiting for its debtors to make payment to it and that, based on historical payments, it had projected that payments received would cover its liability to SARS. However, this did not materialise and Peri requested a R5 million overdraft from Nedbank in order for it to service its indebtedness to SARS.

The overdraft was approved on 5 January 2018 and this resulted in an available balance of R10 510 079.65 but was still not the required amount and Peri attempted to fill the shortfall and payment could still not be released on 6 January 2018. However, on Monday 8 January 2018 there were sufficient funds to meet the shortfall and payment to SARS of the full amount due was released.

SARS had imposed a 10% penalty of R1 064 607.69 on Peri for a late payment of employees' tax pursuant to par. 6(1) of the Fourth Schedule to the Income Tax Act and interest thereon in terms of s 89bis(2) of the Income Tax Act read together with section 213 of the Tax Administration Act.

The court had to determine two issues:

(a) The correct computation of the time periods as provided for in the Income Tax Act and the Tax Administration Act within which an employer must pay PAYE to SARS; and

(b) Whether reasonable grounds existed for making the late payment of PAYE to SARS that would justify a remittance of a late-payment penalty and interest.

Peri had requested a remittance of the penalty in terms of section 217(3) of the Tax Administration Act but the request was rejected by SARS and this led to Peri approaching the Cape Town Tax Court (see ITC 1928 (2019) 82 SATC 252 per Goliath DJP) which had held that Peri had failed to establish reasonable grounds for the late payment of employees' tax. Peri then noted the present appeal to a full bench of the Western Cape High Court.

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

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

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

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

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

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

Judge Kusevitsky held the following:d

As to the computation of the seven-day period

(i) That section 213 of the Tax Administration Act is titled 'Imposition of percentage-based penalty' and it was common cause that SARS had imposed the penalty appealed against in this matter in terms of section 213(1) which provided that 'If SARS is satisfied that an amount of tax was not paid as and when required under a tax Act, SARS must…impose a 'penalty' equal to the percentage of the amount of unpaid tax as prescribed in the tax Act.'

(ii) That par. 2(1) of the Fourth Schedule to the Income Tax Act required payment of declared amounts 'within seven days after the end of the month during which the amount was deducted or withheld.' According to par. 6(1) of the Fourth Schedule the failure by an employer to pay any amount of tax within the period allowable for such payment will result in the imposition of a penalty equal to 10% of such amount, and SARS had imposed a penalty of R1 064 834 on Peri in terms of section 213 of the Tax Administration Act on 6 January 2018.

(iii) That Peri contended that whenever a period is prescribed by statute (or contract) within which a certain act must be performed, or after expiry of which a legal disability is imposed, or before the expiry of which a legal step

is incompetent, the legal rules relating to the computation of time were relevant.

(iv) That the general rule is that the ordinary civilian method of computation of time is applicable unless a period of days is prescribed by law. In that case, the provisions of section 4 of the Interpretation Act, the so-called 'statutory method' applied. The statutory method will not apply to the calculation of a period of days prescribed by a law only where there are clear indications by the legislator that it intended another method of calculation to be used, or where its application will result in a repugnancy.

(v) That, applying the general rule, Peri submitted that the last day of the seven day period referred to ought to be reckoned using the statutory method. Peri also submitted that due to the use of the word 'after' in par. 2(1) of the Fourth Schedule, the first day of the seven day period was 1 January 2018.

(vi) That section 4 of the Interpretation Act provided that where any particular number of days were prescribed for the doing of any act, the days must be counted exclusive of the first and inclusive of the last day of the period within which to do so, unless the last day happens to fall on a Sunday or a public holiday and in that case that last day must be excluded from the reckoning and the next Monday or ordinary day counted as the last day.

(vii) That Peri submitted that in applying sections 1 and 4 of the Interpretation Act to the wording of par. 2(1) of the Fourth Schedule when one calculated the seven-day period within which payment of the declared amount was to be made, one would clearly exclude the last day of December 2017, starting the calculation of the seven days on 1 January 2018 and thus the counting of the seven-day period started on 1 January 2018, and the last day of the seven-day period in this case was the seventh day after the last day of December 2017, i.e. Sunday 7 January 2018.

(viii) That, applying the latter portion of section 4 of the Interpretation Act, Sunday 7 January 2018 must be excluded from the counting of the seven-day period as it was the last day of the period which happened to fall on a Sunday. The immediately following 'ordinary day' was then inclusively taken

to be Monday 8 January 2018, when Peri made payment of the declared amount.

(ix) That Peri therefore submitted that the declared payment was not made outside of the seven-day period within which Peri was allowed to pay the amount to SARS and accordingly it was at all times compliant with the provisions of the Fourth Schedule and the Tax Administration Act and the penalty should not have been imposed at all.

(x) That it was apparent that the court a quo had reasoned that section 244 of the Tax Administration Act titled 'Deadlines' demonstrated a clear intention that the legislature had intended that a method other than the statutory method of computation had to be adopted in reckoning the seven-day period allowed for payment of payroll taxes in terms of par. 2(1) of the Fourth Schedule. The relevant part of section 244 stated that 'If the last day of a period within which payment under a tax Act must be made, falls on a Saturday, Sunday or public holiday, the action must be done not later than the last business day before the Saturday, Sunday, or public holiday.'

(xi) That Peri had submitted that the court a quo had failed to apply the relevant legal principles as had it done so then it was clear that the statutory method was the correct method of computation to be adopted in reckoning the seven-day period allowed for payment of the declared amount and its decision that the statutory method was inapplicable was in conflict with the policy requirement of legal certainty.

(xii) That in the court's view there was no repugnancy and no indication from the context or circumstances, clear or otherwise, that the legislature had intended that another method of computation was intended to be used, and if so, which method.

(xiii) That section 244(1) of the Tax Administration Act deals with the calculation of days specified in the Tax Act for payment, submission or any other action under the Tax Act. It clearly states that if the last day of a period in which the taxpayer is meant to inter alia make payment falls on a Saturday, Sunday or public holiday; such payment should be done no later than the

last business day before such Saturday, Sunday or public holiday and thus, in the court's view, the legislation was very clear.

(xiv) That it was trite that for purposes of computing days in a statute, ordinary calendar days are included in the calculation of such time periods. It is also trite that section 4 of the Interpretation Act only becomes applicable if the statute is silent about the method of computation of days and hence if the applicable statutes are clear and unambiguous, then section 4(1) of the Interpretation Act finds no application.

(xv) That Peri's application of sections 1 and 4 of the Interpretation Act to the wording of par. 2(1) of the Fourth Schedule when calculating the seven-day period, flies in the face of the clear provisions in the statute. Section 244 clearly makes provision for eventualities where payments fall due on such days and specifically states that in such event it calls for payment on the last day preceding such a day, be it a weekend or public holiday. There was nothing ambiguous about this provision and it created certainty for the taxpayer.

(xvi) That, accordingly, according to section 244(1) of the Tax Administration Act, Peri was supposed to pay the declared PAYE on Friday 5 January 2018, being the last day business day before the Saturday, Sunday or public holiday and the payment on 8 January 2018 was a late payment.

(xvii) That the court was in agreement that the intention of the legislature was clear and that there was no ambiguity in the interpretation of the computation or formulation of the calculation of the time periods which would warrant the activation of section 4 of the Interpretation Act. In other words, section 4 of the Interpretation Act found no application in this instance and, accordingly this ground of appeal must fail.

<u>As to whether reasonable grounds existed for late payment</u>

(xviii) That Peri, in its grounds of appeal, submitted that the court a quo had erred in its finding that it had failed to show that reasonable grounds existed for making the late payment to SARS in contravention of the Income Tax Act

and that it was therefore entitled to the relief as provided for in section 217(3) of the Tax Administration Act.

(xix) That in terms of section 213 of the Tax Administration Act the late payment of a tax debt attracts a percentage-based penalty and in the case of late payments of, inter alia, PAYE, late payment penalties amounting to 10% of the amount that is unpaid will be imposed. Such penalties may be remitted in circumstances where the penalty has been imposed in respect of a 'first incidence' of non-compliance, in other words, where no other fixed-amount or percentage-based administrative penalty has been used during the preceding 36 months, or, where exceptional circumstances exist, which rendered the taxpayer incapable of complying with the relevant obligation under the relevant tax Act.

(xx) That SARS had contended in its opposition to the submission that reasonable grounds existed which would entitle Peri to a reprieve in terms of section 217(3)(b) of the Tax Administration Act (a) that par. 2(1) of the Fourth Schedule to the Income Tax Act established a fiduciary relationship between SARS and an employer and (b) that Peri had failed to act in a manner of the highest degree of care in collecting and paying over the amounts due to SARS.

(xxi) That the court was not in agreement that the relationship between an employer and SARS was akin to a fiduciary relationship which would elevate the obligation by an employer to pay over monies that was collected on behalf of it to SARS to that of, for example, principal and agent.

(xxii) That the penalties as directed by section 213 of the Act were peremptory and had to be imposed by SARS without any discretionary powers. If one started to implement various degrees of penalties in relation to the various degrees of lateness, this would cause uncertainty and confusion in the offices of SARS and it would potentially expose SARS to a plethora of litigation and open a flood gate of challenges to reviews of decisions taken exercising discretionary powers in evaluating an appropriate penalty for the degree of lateness.

(xxiii) That it was not disputed by SARS that Peri had a clean record with SARS and that this would qualify it under a first incidence of non-compliance and that it had also rectified the non-compliance as required by section 217(3) of the Act.

(xxiv) That Peri's reliance on the facts in Attieh v C: SARS [2016] ZAGPJHC 371 was misplaced in this matter as Attieh had relied on the expert advice of a tax consultant in the determination of his liability for capital gains tax. However, in casu, given the fact that Peri knew that payment to SARS fell at a particularly precarious time of the year it should have in fact predicted that payment by its trade debtors would be sporadic and reliance on payments from third parties to ensure sufficient cash flow to comply with its payment obligations to SARS, was therefore unreasonable.

(xxiv) That section 217(3) of the Act envisaged a mechanism to come to the assistance of an aggrieved first incidence non-complying taxpayer who had, in addition, satisfied two further requirements, most notably, that it had satisfied SARS that reasonable grounds existed for the non-compliance. In this instance a factor that SARS had failed to consider, which could render it as a reasonable ground, was the manner in which Peri, when it realised that it would be unable to comply with the payment instruction on 3 January 2018, had attempted to rectify the deficiency.

(xxv) That there had been no prejudice to SARS and neither was there any mala fides indicated. To the contrary, every effort was made by Peri to comply with its obligations to SARS and this, in the court's view, evidenced reasonable grounds for the penalty imposed to have been remitted, especially given the fact that it was a first incidence of non-compliance and, hence, in the circumstances, the appeal must succeed.

(xxvi) That since the court found that the court a quo had failed to properly exercise its discretion regarding the remission of the penalty in terms of section 217(3) of the Act, a remittance of the matter to SARS in terms of section 129(2)(c) of the Act would only serve to delay the matter. In any

event since the court found that there had been an unreasonable exercise of its discretion by SARS, this court was obliged to uphold the appeal.

Appeal upheld.

4.3. ITC 1948 – Understatement penalty

The taxpayer was a close corporation that appointed and employed a firm of professional accountants to prepare and complete its tax returns for the 2016 tax year.

On the advice of its accountants a decision was made to change the taxpayer'section property, plant and equipment accounting policy to bring it in line with the wear-and-tear rates of the SARS.

The change of the accounting policy involved the long-term realignment of the depreciation policy of the taxpayer, to the official wear and tear rates of SARS that were allowed as a tax deduction and the aim was to neutralise the effects of deferred tax in the books of the taxpayer.

The extent thereof in the short-term was that the taxpayer had increased its depreciation expense over and above the official wear-and-tear rates of SARS, in order to neutralise the short-term differential, which had created a current deferred tax consequence.

This change in the taxpayer'section accounting policy, which was motivated by the fact that it was less complicated, was thereafter reflected in the financial statements of the taxpayer that were prepared by the accountants.

However, when the accountants did a tax computation in preparation of the submission of the taxpayer'section tax return, they omitted to add back the wear-and-tear adjustment made in line with the change in accounting policy. Adding it back would have resulted in the assessed loss of the taxpayer to be reduced during the 2016 tax year. This failure to add the adjustments back into the tax computation resulted in it being omitted from the tax return completed by the accountant and submitted to SARS and this resulted in an overstatement of the

taxpayer'section assessed loss and consequently the understatement of future taxable profits and the amount in question was R12 696 518.

SARS subsequently conducted an audit of the taxpayer'section tax affairs for the tax years 2012 to 2016 and during the audit the discrepancy was noted and the accountants were informed that the wear-and-tear deduction reflected in the taxpayer'section tax return was incorrectly calculated.

SARS then adjusted its assessment for the tax period in question accordingly and the taxpayer did not dispute the incorrect statement in its return and agreed to the adjustment.

SARS considered the aforementioned discrepancy to constitute an understatement as envisaged in section 221 of the Act and proceeded to impose an understatement penalty.

In applying the Understatement Penalty Percentage Table ('the Table') in section 223(1) of the Act, SARS categorised the taxpayer's behaviour as falling under item (ii), i.e. 'Reasonable care not taken in completing return.' It considered the taxpayer's case to be a standard one, and imposed an understatement penalty percentage of 25%, amounting to R890 926.26.

The taxpayer thereafter lodged an objection to the imposition of the penalty as it contended that there was no prejudice to SARS by reason of its failure to reflect the wear-and-tear component in its return.

The taxpayer further contended that its omission to do so was a bona fide inadvertent error as contemplated in section 222(1) of the Act, and consequently that it must be excused from paying an understatement penalty.

SARS disallowed the objection and the taxpayer then lodged an appeal to the Port Elizabeth Tax Court on the same grounds.

Section 222(1) of the Act provided at the relevant time:

> 'In the event of an 'understatement' by a taxpayer, the taxpayer must pay, in addition to the 'tax' payable for the relevant tax period, the

understatement penalty determined under subsection (2) unless the 'understatement' results from a bona fide inadvertent error.'

The present appeal raised two questions: the first was whether there had been any prejudice to SARS as a result of the incorrect statement in the taxpayer's tax return and if SARS was found to have been prejudiced, the next question was whether the taxpayer should be excused from paying the penalty on the basis that the understatement was as a result of the bona fide inadvertent error of the kind contemplated in section 222(1) of the Act.

Judge van Zyl held the following:

<u>As to prejudice to SARS or the fiscus</u>

(i) That in terms of section 102(2) of the Act, the burden of proving the facts on which the imposition of an understatement penalty was based was upon SARS. Section 129(3) of the Act in turn obliged the court to decide an appeal against an understatement penalty on the basis that the burden of proof was on SARS.

(ii) That in Purlish Holdings (Pty) Ltd v C: SARS 81 SATC 204 at para [20] it was held that, by reason of the position of the burden of proof, it was incumbent on SARS to 'not only show that the taxpayer committed the conduct set out in items (a) and (b) of the definition of 'understatement' in section 221 of the TAA, but also that such conduct caused it (SARS) or the fiscus to suffer prejudice.'

(iii) That it was common cause that the submission of incorrect information in the taxpayer's tax return fell within the provisions of par. (c) of the definition of 'understatement'. It was also not in dispute that the taxpayer did not stand to derive any immediate financial benefit from the incorrect statement in its tax return. The reason was that the understatement of the assessed loss did not operate to reduce the taxpayer's tax liability in the 2016 tax year.

(iv) That the taxpayer had submitted in argument that there was no prejudice to SARS as envisaged in section 221 of the Act as the error was discovered

during the audit process and the error was corrected and, consequently, that it did not have any impact on SARS in its collection of taxes. That the incorrect statement was detected and rectified by the issuing of an adjusted assessment was not of any consequence. The premise of the provision for the imposition of a penalty in section 221, was the existence of an incorrect statement, or one of the other acts or omissions in the definition of understatement. It presupposed that the incorrect statement had come to the knowledge of SARS and knowledge thereof would in turn, as in the present matter, no doubt result in its correctness, and the issuing of an adjusted assessment to eliminate the effect of the misstatement on the tax position of the taxpayer.

(iv) That in the Purlish judgment already referred to, it was held that prejudice as contemplated in the definition of an understatement in section 221 of the Act, was not only determinable in financial terms. This finding was consistent with the word 'any' prejudice in the section which must be given a wide meaning.

(v) That there was nothing in the context provided by the provisions in Chapter 16 of the Act, either individually or as a whole, that was indicative of limiting prejudice to immediate financial prejudice to SARS. 'Any prejudice' was in the court's view wide enough to include the existence of a real risk that the misstatement will hamper the ability of SARS to effectively and/or efficiently administer the provisions of the tax legislation, and to perform its functions in terms thereof by assessing and collecting taxes which are due to it.

(vi) That the case made out by SARS in its statement in terms of Rule 31 opposing the appeal, was that the prejudice suffered by SARS was that, if it had 'allowed the assessed loss, it would have been offset against income that the taxpayer would have received in subsequent years, thus benefitting the taxpayer'. In her evidence SARS' witness identified the prejudice as the potential benefit to the taxpayer of utilising the overstated assessed loss to reduce its tax liability in ensuing tax years.

(vii) That the prejudice on which SARS relied was accordingly prospective or potential, in the sense that it stood to suffer actual financial prejudice in the ensuing year if the incorrect statement in the taxpayer's return was not detected. The existence of potential prejudice, like actual prejudice, was a factual question to be decided on the evidence of a particular case. In answering this question the point of departure must be that the onus was on SARS to prove the facts on which it based its decision to impose an understatement penalty. In the context of the present matter, SARS would therefore have to show that on the probabilities there existed the potential for it to suffer prejudice in the ensuing tax years. The existence of that potential, on the facts of this matter, translated to an assessment on the evidence of whether the understatement of the assessed loss would have remained undetected in subsequent tax years.

(ix) That in her evidence SARS' witness acknowledged, quite correctly so, that once one had regard to what was contained in the financial statements of SARS, it was evident that the result of the failure to reflect the change in the accounting policy from a deferred tax liability to the wear-and-tear policy of SARS in the taxpayer's tax computation, was that the taxpayer had overstated its assessed loss in its tax return. What was put to SARS' witness was essentially that this mistake was such an obvious one, that it would have been picked up in the following tax year, and corrected. The witness in her response could put it no higher than that there were no guarantees that that would have been the case.

(x) That, however, while the overall burden of proof remained on SARS, the taxpayer's contention that it would itself have detected the error in the subsequent tax year and corrected it, shifted an evidentiary burden to it to place evidence before this court so as to enable it to make an assessment of the probabilities.

(xi) That the taxpayer's only witness had testified that he was 'very confident' that the failure to reflect the change in tax policy in the tax computation and the tax return would have been picked up when they did the 2017 financial

statements, and 'in reconciling the profits and the tax positions.' This statement was premised on the accountants exercising reasonable care in the succeeding tax year, and going back to the financial statements of the previous year verifying that the assessed losses were correctly stated.

(xii) That the incorrect statement in the 2016 return was the result of a failure to exercise the diligence required in the circumstances. SARS submitted that the level of the lack of care displayed by the taxpayer and its accountant was such that it could not be said with any confidence that the mistake would have been detected in the succeeding year and the court agreed with this submission. The probability that the mistake would have been detected must be assessed against the serious lack of care displayed previously.

(xiii) That the court was accordingly not convinced that on the probabilities the mistake would have been detected and corrected in the subsequent year and hence there had been prejudice to SARS as a result of the incorrect statement in the taxpayer's tax return.

(xiv) That there were two reasons why there was in the court's view no merit in SARS' submission that it was also prejudiced by having to utilise its resources to conduct an audit of the taxpayer's tax affairs. To this end reliance was placed on the finding in Purlish, supra, that the use of additional SARS resources for purposes of auditing the taxpayer's tax affairs constituted prejudice, as such resources could have been utilised for other matters.

(xv) That the first reason was that the issues for determination in the appeal were confined by Rule 34 to those stated in the Rules 31 and 32 statements of the parties and SARS, on whom the onus rested, did not place any reliance in his Rule 31 statement on prejudice arising from the utilisation of its resources for purposes of auditing the taxpayer's tax affairs.

(xvi) That the second reason was that it was evident from a reading of the judgment in Purlish, supra, that this finding was made on the evidence placed before the Tax Court. The witness for SARS in that case had

pertinently identified the prejudice to SARS as the time, resources and costs incurred in considering the taxpayer's request for a refund. In this matter there was no such evidence. Further, on a reading of section 221 of the Act, it was evident that the prejudice must be the result of one of the acts specified in para. (a) to (d) of the definition of 'understatement.' It was accordingly incumbent upon SARS, who bore the onus, to show not only that there was prejudice, but that there was a causal link between the action or inaction of the taxpayer, and the alleged prejudice.

(xvii) That in the present matter the understatement penalty was imposed in respect of an incorrect statement made in the 2016 tax year. The audit however covered the tax years 2012 to 2016. There was no evidence as to what had prompted SARS to conduct this audit. Otherwise than in the Purlish case, supra, there was no evidence that was it not for the audit, the understatement would not have been discovered.

<u>As to whether there had been a bona fide inadvertent error</u>

(xviii) That the court then had to deal with the question as to whether the failure of the taxpayer to correctly reflect its assessed loss in the tax return had resulted from a 'bona fide inadvertent error.' The term 'bona fide inadvertent error' was not defined in the Tax Administration Act 28 of 2011. The words 'bona fide' and 'error' were relatively unproblematic. The meaning of good faith in a legal context is reasonably straightforward, namely a sincere, honest intention or belief that represents the mental and moral state regarding the truth. The dictionary meaning of the word 'inadvertent' on the other hand was linguistically not that straightforward.

(xix) That an 'inadvertent' error can however not include any error that is the result of neglect. The reason simply is that it would be inconsistent with the nature of the wrongdoing for which the taxpayer is responsible in the Table and which was determinative of the quantum of the understatement penalty that must be imposed. The penalty is higher or lower depending on the level of blameworthiness attributed to the taxpayer's conduct. The scale of blameworthiness attached to the conduct of the taxpayer in the Table

includes the punishable behaviours of 'reasonable care not taken in completing return', as well as 'gross negligence'. The meaning to be attributed to the word 'inadvertence' can accordingly not include negligence as a standard of conduct that is excusable.

(xx) That a sound approach to interpretation in the present circumstances is to consider whether there is a sensible interpretation that can be given to the phrase that will avoid any anomalies.

(xxi) That the context of what will classify as an honest mistake must be provided by the provisions which follow on sub-section (1) of section 222, and more specifically what the legislature has identified in the Table as constituting punishable behaviour. This was in the court's view an instance where the determination of what an inadvertent error is, must be done with reference to what it was not, that is, it was to be defined in the negative. In other words, an error is not inadvertent, and therefore inexcusable, where the taxpayer's action or omission can be classified as a failure to take reasonable care in the completion of his or her tax return, or as being intentional or grossly negligent. This approach to the question was consistent with the dictionary definitions of the word 'inadvertence' in that the meanings ascribed thereto are generally concerned with the nature of the attitude or disposition with which the person concerned acts or fails to act and this was in turn consistent with what underlies the forms of legal blameworthiness set out in the Table.

(xxii) That the conduct on which SARS relied was the alleged failure of the taxpayer to take reasonable care in completing its tax return. Taking reasonable care in the context of rendering a tax return to SARS accordingly meant giving appropriately serious attention to complying with the obligations imposed under the tax legislation. At its lowest end, a bona fide inadvertent error, stated positively, was on the court's approach to the meaning to be attributed thereto, an honest mistake in the tax return of a taxpayer that occurred notwithstanding the maintenance of procedures reasonably adopted to avoid such errors.

(xxiii) That it could be accepted on the evidence that the incorrect statement in the taxpayer's tax return was an honest mistake. The question was whether the mistake was also inadvertent. The focus was accordingly on the standard of care taken by the taxpayer and the measures adopted by it to avoid errors in the submission of its tax return. Consistent with its meaning in other fields of law, reasonable care would require the taxpayer to take the degree of care that would be expected of a reasonable and prudent taxpayer in the position of the taxpayer concerned to fulfil his or her tax obligations. The question was whether on an objective analysis there had been a failure by the taxpayer to take reasonable care and it was a factual question that must be decided on the facts of each case. Reasonable care does not mean the highest level of care or perfection.

(xxiv) That in the present matter the taxpayer employed a firm of accountants to complete its tax return. The appropriate benchmark in determining whether a person having special skill or competence has breached the standard of reasonable care, is that level of care that would be expected of an ordinary and competent practitioner practicing in the field.

(xxv) That the taxpayer's accountant had clearly failed to act with the diligence expected of him in the circumstances which were that the accountant advised the taxpayer to effect a change to its accounting policy, but then failed to ensure that the change was reflected in the tax computation and in the tax return. That the mistake was carried over into the tax return was indicative of the fact that the return was prepared solely with reference to what was in the tax computation, and without verification of its correctness against the financial statements.

(xxvi) That these failures speak of an absence of reasonable measures and/or the implementation of such measures to avoid the obvious mistake in question. There was no direct evidence with regard to the existence of any control measures that the firm of accountants put in place to check that the calculations in the tax computation were correct.

(xxvii) That the question was, however, not whether the accountant's conduct must be imputed to the taxpayer, and that it must be held liable for the payment of the understatement penalty by reason of the failure of its accountant to exercise reasonable care in correctly completing its tax return. The general rule of our law is that an employer is not liable for the negligence or the wrongdoing of an independent contractor employed by him or her. The question was whether the taxpayer had exercised the standard of care and diligence expected of a reasonable taxpayer in the completion and submission of its tax return. The answer as to what steps could be expected of a taxpayer will be determined by what was reasonable in all the circumstances of the particular case.

(xxviii) That the standard of care expected of a reasonable taxpayer must be informed by the duty placed on a taxpayer by the tax legislation. The duty to timeously file a correct tax return is that of the taxpayer and 'there can be no exception to this at all.' In terms of section 25 of the Act a tax return must be 'a full and true return' and the person signing the return is for all purposes 'in connection with a tax Act to be cognisant of the statements made in the return.'

(xxix) That in complying with his duty to submit a correct tax return the circumstances relevant in determining if a taxpayer who made use of the services of an accountant had exercised reasonable care, will include, but is not limited to, the nature of the matters which the accountant was asked to deal with. It may be reasonable for a taxpayer in the circumstances, and absent any reason to believe it to be wrong, to rely on professional expert advice and guidance on the appropriate tax treatment of differing heads of income and profit and loss which are not straightforward and of which the taxpayer has no or little knowledge.

(xxx) That a reasonable taxpayer in circumstances where there is need for expert advice will obtain such advice with a view of ensuring that his tax return is correct. However, where the function that is assigned to the accountant is the completion and filing of the taxpayer's tax return, the taxpayer's duty to

render an accurate return would require him or her to take such steps as may be reasonable in the circumstances to avoid, as in the present instance, any obvious errors in the return.

(xxxi) That the issue in the present matter was not whether the taxpayer concerned took reasonable care in relying on specialist tax advice, but rather whether it took reasonable care in completing its tax return. The failure to render a correct tax return was not the result of the taxpayer having taken a tax position on expert advice. It was simply the result of a failure to correctly complete the taxpayer's tax return as opposed to intentionally taking a tax position that later proved to be incorrect. Put differently, the causa of the error was not the taxpayer's reliance on the advice of its accountants to bring its accounting policy in line with the wear-and-tear rates of SARS. In fact, there was nothing wrong with that advice. Rather, it was the failure to implement the advice, and to reflect the change in policy in the tax return, that resulted in an incorrect statement in the return.

(xxxii) That in this matter a reasonable taxpayer would at the very least have taken steps to satisfy itself that the accountant did not make an obvious error in the return. The taxpayer was not free from blame and that in the circumstances of the case it should have been alerted to the need to take reasonable care.

(xxxiii) That before the submission of its tax return, the taxpayer would in the normal course of events have been required to sign off on the tax return prepared by its accountant. In the previous tax year the taxpayer had made a profit of R9 million and in the tax year concerned it was recorded to have suffered a loss in excess of R37 million. A diligent taxpayer would have been alerted by this and would have questioned it. The inescapable inference, in the absence of any evidence to the contrary by the taxpayer, was that it had failed to scrutinise the tax return before its submission.

(xxxiv) That, accordingly, the incorrect statement in the taxpayer's tax return did not constitute a bona fide inadvertent error as envisaged in section 222(1)

of the Act and that the taxpayer had failed to take reasonable care in completing its tax return.

Appeal dismissed with costs.

4.4. ITC 1949 – Understatement penatly

The taxpayer, being a close corporation that traded in properties and building work, had concluded a written sale agreement ('the agreement) with a purchaser in terms of which it sold to the latter an immovable property for R25.2 million including VAT.

At the time of the sale the property consisted of a piece of land with development rights for subdivision into 72 erven and the agreement provided that the purchase price was payable in tranches of R350 000 '...on transfer of each erf to the end user purchaser' from the purchaser.

Registration of transfer to the purchaser was subsequently effected on 27 October 2016.

The agreement was thus concluded and transfer of the property was effected during the taxpayer's 2017 year of assessment.

However, the taxpayer did not declare the capital gain of the sale proceeds in its 2017 income tax return since it was of the view that the capital gain on the sale would only accrue to it on transfer of the individual erven to third party end users.

SARS conducted an internal audit on the taxpayer and included the capital gain on the sale proceeds in the taxpayer's taxable income for the 2017 year of assessment in terms of section 26A of the Income Tax Act.

SARS accordingly issued an additional assessment on 29 March 2018 in which, inter alia, it had imposed a 25% understatement penalty of R798 372 in terms of section 222 as read with section 223 of the Tax Administration Act.

SARS in its Rule 31 statement stated that the omission of the proceeds of R22 105 263 (vat excluded) from the disposal of an asset in the taxpayer's income tax return for the 2017 year of assessment for capital gains purposes, resulted in a

loss to the prejudice of the fiscus, rendering the taxpayer liable for the payment of an understatement penalty at the rate of 25% for a behaviour category of 'reasonable care not taken in completing a return' on a standard case imposed in terms of section 222 read with section 223 of Act.

The issues to be determined by the Tax Court were:

- Whether there was an understatement properly classified (in the form of an omission from a return) which caused prejudice to SARS or the fiscus as provided for in the definition of 'understatement' in section 221;
- If so, whether the understatement arose from (a) behaviour on the part of the taxpayer which may appropriately be described as 'reasonable care not taken in completing a return'; (b) unreasonable actions on the part of the taxpayer; or (c) a bona fide and inadvertent error on its part.

During the hearing the second leg of the dispute narrowed down to SARS' sole reliance on 'reasonable care not taken in completing a return' and the parties were ad idem that SARS bore the onus of proving the facts upon which it had relied in imposing the penalty in question.

It was also common cause that the taxpayer, in its IT14SD for the 2017 year of assessment, had provided a VAT reconciliation schedule which disclosed total gross sales of R25 176 200 in relation to the property in question. Similarly in its VAT 201 for the 10/2016 VAT period the taxpayer disclosed standard rated supplies of R25 316 449 inclusive of the proceeds from the sale of the property in question.

SARS had relied, inter alia, on the aforementioned disclosures in contending that the taxpayer was precluded from claiming that the capital gain did not accrue during the 2017 year of assessment.

SARS contended that the taxpayer became entitled to the full proceeds of the sale once the property was sold and transferred to the purchaser during the 2017 year of assessment and, as such, the proceeds were a capital gain to the taxpayer during that year and ought to have been disclosed as part of its taxable income and its failure to make this disclosure constituted an omission from its tax return.

SARS further contended that this omission caused prejudice to it because the tax on the capital gain was not collected from the 2017 year of assessment and it also had to use its resources for this specific case to be audited.

SARS submitted that the failure to take reasonable care in completing the return lay in the disclosure of that gain for VAT purposes on the one hand and the omission in disclosing it for income tax purposes on the other, since both arose from the same transaction.

Judge Cloete held the following:

<u>As to whether there had been an understatement in terms of section 221 of the Act</u>

(i) That in CIR v People's Stores (Walvis Bay) (Pty) Ltd 52 SATC 9 it was confirmed by the Supreme Court of Appeal that 'income', although expressed as an 'amount' in the definition of 'gross income' in section 1 of the Income Tax Act, need not be an actual amount of money but may be 'every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value…including debts and rights of action' and hence 'any right (of a non-capital nature) acquired by the taxpayer during the year of assessment and to which a money value can be attached forms part of the 'gross income' irrespective of whether it is immediately enforceable or not, but that its value is affected if it is not immediately enforceable.'

(ii) That the aforementioned case disposed of the taxpayer's argument that the accrual in issue did not take place during the 2017 year of assessment. The taxpayer also ultimately accepted that its failure to disclose or declare the capital gain in question in its 2017 income tax return constituted 'an omission' for purposes of section 221 of the Tax Administration Act or, alternatively, 'an incorrect statement in a return'.

(iii) That, however, the taxpayer had disputed that this had resulted in any prejudice to SARS or the fiscus, submitting that SARS had placed no evidence before the court to this effect and that by 2020 all the erven would have been sold and full payment would have been received and SARS would have recovered the tax due on the full capital gain by that date and

hence any financial prejudice to SARS would then have been only temporary.

(iv) That the court disagreed with the taxpayer's submission concerning the absence of any evidence regarding prejudice. It was not disputed that the risk which ultimately resulted in the imposition of the understatement penalty was identified, not by the risk engine, but by SARS' witness herself during the course of conducting a verification process in relation to the other risks. Moreover the taxpayer was not able to materially dispute the time spent by SARS' witness in relation to this part of the additional assessment and her testimony in this regard was both clear and consistent, ie had she not been obliged to spend the considerable amount of time which she did on this matter, she would have been able to attend to other matters for SARS.

(iv) That the evidence of SARS' witness that income tax would have been recovered earlier from the 2017 year of assessment, had the capital gain been declared, went unchallenged. Moreover, no reliance was placed on the case of Lategan v CIR 2 SATC 16 by the taxpayer during argument before the court and the court therefore had to accept that the fiscus had suffered some form of financial prejudice as a consequence, even if not quantified in terms of the reduction in the monetary value of the accrual.

(v) That, based on the testimony of SARS' witness, the delay in paying tax when due caused prejudice to SARS or the fiscus. In each year SARS is given a target by National Treasury to collect a certain amount of taxes. In order to reach that particular target, every cent surely counts. Where taxes are due in a particular year and are not recovered in that year, the delay must logically affect SARS' ability to collect the revenue as mandated by Treasury, which ultimately affects the government's ability to fulfil its constitutional obligations to its citizens.

(vi) That the government allocated yearly budgets based on what was in its coffers and it was thus important for SARS to collect taxes when they were due and not when taxpayers believe they should pay them. Further, the

fiscus would have suffered a loss if SARS had not conducted the audit to ascertain that the disposal of the asset resulted in the accrual of proceeds in the hands of the taxpayer in the 2017 year of assessment. Given its extent, the audit undoubtedly entailed a resource allocation in the form of additional time and human capital.

(vii) That the court was accordingly persuaded that: (a) there had been an omission from the taxpayer's 2017 income tax return; (b) which had resulted in prejudice to SARS or the fiscus; and (c) which qualified as an understatement for purposes of section 221 of the Tax Administration Act 28 of 2011 and the Commissioner thus became entitled to impose an understatement penalty in terms of section 223 of the Act.

As to whether the understatement had been correctly categorised

(ix) That the next question that arose was whether SARS had correctly categorised the understatement as being the result of 'reasonable care not taken in completing a return' in terms of section 222 read with section 223 of the Tax Administration Act and which set the penalty at the rate of 25%.

(x) That although SARS had categorised the understatement as being the result of 'reasonable care not taken in completing a return' in its Rule 31 statement, the evidence established that the cause of the understatement was, in SARS' view, a tax position based on unreasonable grounds. The court refrained from making any finding thereon since it was not required to adjudicate upon this but it was bound to conclude, in the circumstances, that on its own version SARS had erred in imposing the understatement penalty in item (ii) at 25% as opposed to item (iii), ie 'no reasonable grounds for 'tax position' taken' at 50% in the understatement penalty percentage table contained in section 223(1) of the Act.

(xi) That Counsel were then given the opportunity to file supplementary heads of argument dealing with, inter alia, the question of whether the court had the discretion to increase the penalty from 25% to 50% in terms of section 129(3) of the Act which provided that, in the case of an appeal against an understatement penalty imposed by SARS under a tax Act, the Tax Court

may reduce, confirm or increase the understatement penalty imposed. The short answer, stated the court, was that it was precluded from doing so on the basis of the decision of the Supreme Court of Appeal in Purlish Holdings (Pty) Ltd v C: SARS 81 SATC 204 at para [25] in which it was held that the Tax Court was only entitled to increase the understatement penalties levied by SARS if the issue had been properly raised for adjudication before that court as determined by Rule 34 of the Tax Court Rules which provided that 'the issues in an appeal to the tax court will be those contained in the statement of the grounds of assessment and opposing the appeal read with the statement of the grounds of appeal and, if any, the reply to the grounds of appeal.'

(xii) That, as SARS had never raised the issue of the increase of the penalties for adjudication before the Tax Court as provided for in Rule 34, it followed that it was incompetent for the Tax Court to have increased the penalty of 25% to 50%.

(xiii) That, on the court's interpretation of para [25] in the Purlish case, supra, this did not mean that the taxpayer then escaped liability for the penalty imposed by SARS, but simply that it nonetheless remained liable for the reduced 25% penalty.

Appeal dismissed.

No order made as to costs.

4.5. C:SARS v Raphela and others (84 SATC 143)3

Second Respondent, being the principal taxpayer involved in this dispute ('PSR'), took its name from its sole director, Mrs Pheladi Suzan Raphela, who was cited as the First Respondent.

PSR was awarded a tender to supply 1.5 million facemasks at R30 per mask, apparently for use by the South African Police Service ('SAPS'). The tender value

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was R45 million and should have attracted output VAT in the amount of R5 869 562.21 to be paid to SARS in terms of the VAT Act.

It appeared that neither the First Respondent nor PSR had the funds to acquire the face masks in order to fulfil the tender and, through a third party, Mrs Thembeka Koeki Mdlulwa, the Third Respondent in the case, was approached for funding and this was four days prior to the expiry of the tender.

Thereafter Mdlulwa paid the amount of R19 939 000 to the suppliers of the facemasks and after the fulfilment of the tender by way of delivery of the facemasks paid for by Mdlulwa, PSR paid her R33 154 000 on 21 April 2020 from the proceeds of the tender, resulting in a neat profit for Mdlulwa in excess of R13 million in seven days.

Apart from the more than R33 million paid to Mdlulwa, PSR made other payments to, inter alia, the First Respondent (approx. R1 million), the third party (R1 million), and further payments on behalf of the First Respondent (approx. R3.7 million).

PSR had not fulfilled its tax obligations to SARS in respect of the aforementioned transactions and, in particular, had neither disclosed the transaction in VAT returns nor had any VAT been paid thereon.

SARS' provisional calculation (not yet being an actual assessment) indicated that the amount due by PSR in respect of VAT, late payment and non-disclosure penalties amounted to R14.5 million and was outstanding and continued to accrue and by the end of July 2020 PSR had only R110 377.72 left in its bank account.

Based on all of the above the SARS was satisfied that reasonable grounds existed that tax may be due or payable and that a preservation order was needed in order to secure realizable assets from being disposed of or removed which may frustrate the collection of tax and SARS applied on an urgent basis to the High Court for a preservation order, which was granted provisionally, and whereby a curator bonis was appointed with extensive powers, as contemplated in the Tax Administration Act in order to seize assets for the preservation thereof in terms of section 163 of the Act.

Section 163(1) provides that a senior SARS official may, in order to prevent any realisable assets from being disposed of or removed which may frustrate the collection of the full amount of tax that is due or payable or the official on reasonable grounds is satisfied may be due or payable, authorise an ex parte application to the High Court for an order for the preservation of any assets of a taxpayer or other person prohibiting any person from dealing in any manner with the assets to which the order relates.

Section 163(2) provides that SARS may, in anticipation of the aforementioned application seize the assets pending the outcome of an application for a preservation order, which application must commence within 24 hours from the time of seizure of the assets or the further period that SARS and the taxpayer or other person may agree on.

Section 163(7) provided for the granting of ancillary orders including, inter alia, the appointment of a curator bonis and the realisation of the assets in satisfaction of the tax debt.

Section 183 provided that if a person knowingly assists in dissipating a taxpayer's assets in order to obstruct the collection of a tax debt of the taxpayer, the person is jointly and severally liable with the taxpayer for the tax debt to the extent that the person's assistance reduces the assets available to pay the taxpayer's debt.

Pursuant to the preservation order the curator bonis proceeded to locate assets and he produced an interim report which indicated that PSR and First Respondent's bank accounts contained totally inadequate funds to meet PSR's tax liability.

On the other hand he found that Mdlulwa had been residing in Spain with her family and had emigrated for exchange control purposes and he placed a 'hold' on her accounts at Investec with balances totalling some R24 million and it was this last-mentioned amount which Mdlulwa now claimed in her anticipation application should be released.

Mdlulwa contended, inter alia, that she had received the necessary permission in terms of the Foreign Exchange Control Regulations to expatriate the funds to

Spain and there had been a disproportionality between the extent of the funds that had been 'frozen' in terms of the preservation order, and the extent of the tax liability of PSR and the First Respondent.

Mdlulwa not only denied that she was a mastermind of any sorts behind the tender transactions in issue but averred that she had no relationship with the First Respondent and only became involved as a result of the third party's intervention and hence she could not be regarded as having 'knowingly assisted the taxpayer in dissipating its assets' as provided for in section 183 of the Act.

Judge Davis held the following:

(i) That from the outset one must distinguish between preservation provisions and recovery provisions available to SARS in respect of unpaid amounts. The first are primarily catered for in section 163 of the Tax Administration Act while the latter are contained in a host of other sections of the Act. One of these, obliquely relevant to the present matter, is section 183, dealing with the liability of persons assisting in the dissipation of assets.

(ii) That the order sought and obtained against Mrs Mdlulwa was not on the basis of her tax liability, but that of PSR (and Mrs Raphela) and although SARS had relied on her involvement in the dissipation of funds, it was as recipient and not on grounds such as those contemplated in section 183 of the Act, i.e. as co-perpetrator. SARS has also not claimed that she be held jointly and severally liable and hence her reliance on the applicability of section 183 of the Act was misplaced. Moreover, SARS was currently relying on asset preservation provisions and not on tax recovery provisions of the Act.

(iii) That section 163 of the Act clearly contemplated the granting of the preservation order against a taxpayer or 'other person' and such person was clearly someone other than the taxpayer and this was the only sensible manner in which the words 'other person' could be interpreted in the context of the section as a whole and its intended aim, namely, to prevent further dissipation of assets by the taxpayer which, if not 'followed' and 'preserved' might lead to the tax being unrecoverable. This was particularly

in circumstances such as in the present case where, after such dissipation, the taxpayer appeared to be unable to meet its estimated tax liability.

(iv) That the 'reading in' into section 163 of the requirement of collusion or an intention of dissipation on the part of the 'other person' was not supported by the wording of the section. SARS, in utilising the preservation provisions, is empowered to pursue and preserve assets in order to secure the recoverability of a taxpayer's tax liability, not to punish or attach assets of a person who may (also) be a co-perpetrator, as contemplated in section 183 of the Act.

(iv) That, for this purpose, it has been found that SARS need not prove any intention of such 'other person' in the same manner as may be required for an anti-dissipation interdict (a Mareava injunction in English law). All that SARS had to show, was that there was a material risk that assets which would otherwise be available (or which would otherwise have been available) for the satisfaction of the taxpayer's tax liability would, in the absence of a preservation order, no longer be available.

(v) That in the present case the bulk of the funds from which PSR would have been able to satisfy its tax obligations had already been dissipated to Mrs Mdlulwa and some of those funds had already been expatriated out of the country. It mattered not that such expatriation had been done with compliance with Foreign Exchange Control Regulations as the consequence was that those funds were already no longer recoverable.

(vi) That preserving the funds which had emanated from the taxpayer and which were now in the hands of Mrs Mdlulwa as an 'other person' and which funds were, for the time being, in South Africa, constituted sufficient grounds to indicate the 'practical utility' of a preservation order.

(vii) That Mrs Mdlulwa's contentions that the provisions of section 163 of the Act should not apply to her as an alleged 'innocent' person and should not apply without satisfaction of the requirements of section 183 of the Act, could neither in fact nor in law be upheld.

(ix) That in regard to the alleged disproportionality between the estimated future tax liability of PSR and the amounts frozen in Mrs Mdlulwa's accounts, and taking everything into account, the relevant SARS official contemplated in section 163 of the Act was of the view that the 'amount preserved may not even be sufficient to cover or satisfy the tax liability when it becomes due and/or is levied.' It must further be borne in mind that the preservation order was not final in nature.

(x) That section 163(7)(d) provided that the court, in granting a preservation order, may make any ancillary orders regarding how the assets must be dealt with including the relief of hardship as it provided for a variation of the order upon the satisfaction of certain further disclosure requirements relating to living expenses of the person against whom an order had been made and, in this case, her dependants. Apart from vague allegations, none of the required particulars had been disclosed. SARS had also indicated that he would be willing to consider sufficient alternative forms of security instead of the preservation order but, to date, none had been suggested.

(xi) That, in the premises, the court was satisfied that the jurisdictional requirements for the preservation order had been met and in the circumstances of this case the court found no cogent reason to depart from the customary rule that costs should follow the event.

The provisional preservation order against the Third Respondent (Mrs Mdlulwa) was confirmed.

4.6. *Arena Holdings (Pty) Ltd and others v C:SARS and others (84 SATC 153)4*

Applicants were media organisations who brought a High Court application that challenged the constitutional validity of the statutory prohibition of the disclosure of a taxpayer's tax information held by the SARS in circumstances where such disclosure would reveal evidence of 'a substantial contravention of the law' and would be in the public interest.

Section 69(1) of the Tax Administration Act (TA Act) imposed an obligation on SARS officials to 'preserve the secrecy of taxpayer information' and prohibited the officials from disclosing taxpayer information to a person who was not a SARS official.

'Taxpayer information' would include information submitted to SARS in the prescribed IT12 document by a taxpayer relating to his income received, deductions, tax credits, investment income, foreign income, income from trusts, capital gains, rental income, pension fund, provident fund and retirement annuity contributions and/or pay-outs.

Section 32 of the Constitution provided that everyone has the right of access to any information held by the State and to any information that is held by another person and that is required for exercise or protection of any rights.

Since the enactment of the Promotion of Access to Information Act 2 of 2000 (PAIA), which is the national legislation contemplated in section 32(2) of the Constitution to give effect to the section 32(1) rights, a person can generally not rely on section 32(1) directly to obtain access to information, but must rely on the provisions of PAIA.

Section 11(1) of PAIA provides that access must be given by a public body such as SARS to a record held by such a body (i.e. information must be disclosed) to a 'requester' when such a requester has complied with PAIA's procedural requirements. A request may only be refused when a ground for refusal of such

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access (disclosure) exists as provided for in Chapter 4 of Part 2 of PAIA and this will for instance be when disclosure 'could reasonably be expected to endanger' the safety of an individual where it would impair the security of any system for protecting the public, or where the information relates to crime investigation methods or the security or international relations of the country.

The relevant provisions in the aforementioned Chapter 4 of PAIA relied on by SARS in this matter were sections 34(1) and 35(1). Section 34(1) provides that access to a record may be refused if the record requested contains confidential information of another party and access to the record would involve the 'unreasonable disclosure' of such confidential information. Section 35(1) went further and provided that disclosure of information obtained or held by SARS for the purpose of enforcing legislation concerning the collection of revenue (such as the TA Act) must be refused if that information related to a person other than the requester.

Section 46 of PAIA is referred to as the 'public interest override' section and the provisions contained in this section are at the hub of the present dispute and it operates 'despite any other provision of this Chapter'.

The section provides that the information officer of a public body must grant a request for access to a record of the body if the disclosure of the record would reveal evidence of a substantial contravention of or failure to comply with the law or an imminent and serious public safety or environmental risk and the public interest in the disclosure of the record clearly outweighed the harm contemplated in the provision in question. However, access to the information held by SARS as contemplated in section 35 of PAIA is not one of those categories referred to in section 46 and the 'public interest override' therefore did not apply to the prescribed prohibition of disclosure of 'certain records' held by SARS.

In a nutshell, the statutory framework providing for 'taxpayer secrecy' contained in the TA Act, which was mirrored by provisions of PAIA, provided that taxpayer information disclosed to SARS may not be disclosed to anyone, except in certain very narrowly described exceptions and generally only as part of tax recovery

proceedings and there was no ‘public interest override’ applicable to these non-disclosure provisions.

In addition, the Constitution protects the rights of privacy in section 14 which provides that ‘everyone has the right of privacy which includes the right not to have– (a)…..(b) the privacy of their communications infringed…’

The right of access to information provided for in PAIA was further sourced in the freedom of the press and the media and everyone’s right to receive or impart information, contained in the freedom of expression provision contained in section 16(1) of the Constitution.

Both the rights of privacy and access to information are contained in the Bill of Rights in the Constitution and where two competing constitutional rights intersect, the exercise of one right may result in a corresponding limitation of the other but the Bill of Rights provides in section 36 thereof that any such limitation may only take place in terms of law of general application and only to the extent that it was reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom and then only after taking into account a number of relevant factors.

The following substantial issues required adjudication by the court:

- Whether the impugned prohibition of disclosure in the TA Act limited the rights of access to information provided for in section 32 of the Constitution and/or the right to freedom of expression provided for in section 16(1) of the Constitution;
- If the aforementioned prohibition limited either or both of the aforesaid rights, whether such limitation was justifiable in terms of section 36 of the Constitution.

Applicants’ case was generated by its requests for access to the IT12 documents relating to Mr Zuma for the years that he was president.

Applicants had relied on the averments extracted from a book published in October 2017 entitled The President’s Keepers by Tafelberg Publishers. The averments relied on by the Applicants in their papers were regarding Mr Zuma’s tax affairs

during his presidency and that, inter alia, he did not submit tax returns at all for the first seven years of his presidency and had drawn a six-figure ‘salary’ as an ‘employee’ of a Durban security company for the first few months of his Presidency and it appeared that he had subsequently paid the money back in response to queries.

Some of the allegations were confirmed or corroborated by public documents, such as the findings of personal benefit derived from the upgrades to his Nkandla residence contained in the then Public Protector’s Report, evidence led at the Nugent Commission and the findings made regarding the undermining of SARS by a previous Commissioner and the evidence led at the Commission of Enquiry into ‘State Capture’ chaired by Judge Zondo.

Based on the aforesaid allegations, the Applicants averred that ‘credible evidence’ existed that Mr Zuma was not tax-compliant while he was president.

SARS refused Applicants’ request for Mr Zuma’s IT 12 returns, having relied on section 69 of the TA Act.

Applicants submitted that the tax compliance of a head of state of South Africa, in circumstances where accusations of non-compliance were in the public domain, particularly without any protest about the veracity thereof, entitled them to invoke their rights of access to information and, if those rights were statutorily limited, to challenge the constitutionality of such limitations.

SARS’ opposition to the relief sought by the Applicants was founded on the purpose and importance of taxpayer secrecy and the belief that ‘the guarantee of confidentiality is what the taxpayer gets in return for the compulsion to provide full information to SARS. Without this statutory guarantee of confidentiality, the expectation that the taxpayer will be candid and accurate with SARS diminishes. The compact, written into law, between a tax authority and the public is the foundation of the tax system, without which the tax system cannot properly function.’

In addition, SARS referred to a number of international treaties of which South Africa was a signatory and a number of inter-country agreements of which South

Africa was part and in all these treaties there are prohibitions similar to that contained in section 69 of the TA Act in respect of the secrecy and maintenance of confidentiality in relation to taxpayer information received from SARS' foreign counterparts. Furthermore, these treaties and agreements have, upon their countersigning and acceptance, become part of domestic law.

SARS further submitted that the obligation of a taxpayer to make full and true disclosure, upon an application of the provisions of sections 57 and 72 of the TA Act, deprived a taxpayer of the privilege against self-incrimination and that this was a weighty consideration in favour of taxpayer secrecy.

SARS, however, also pointed out that, despite the 'bargain' regarding taxpayer information secrecy and the applicability of international law, treaties and agreements, the TA Act itself provided for a number of exceptions to the secrecy principle and hence the 'ban' on disclosure was therefore not absolute although these exceptions were narrowly circumscribed. SARS was of the view that the specified exceptions to the concept of taxpayer secrecy struck the necessary balance between such secrecy and the taxpayer's privacy rights on the one hand, and the rights of access to information and freedom of speech on the other hand.

Judge David held the following:

(i) That there were two sets of rights at issue in this matter:

- the first were those asserted by the Applicants, namely the rights of access to information and freedom of speech, and
- the second, the rights of privacy (and possibly also the dignity) of taxpayers.

These can rightfully be labelled 'competing' constitutional rights for, in this case, the more one set of rights is granted absolute protection, the more that same protection limits the other set of rights and vice-versa.

(ii) That there was general consensus that the general limitation of access to taxpayer information held by SARS, imposed by a law of general application (the TA Act) was justified in an open and free democratic society. The Applicants did not seek to do away with that regime. Their

case was rather that the limitation imposed on their rights to publish matters which they said were in the public interest regarding tax offences by public figures should not be absolutely infringed upon (by a blanket prohibition), but that there were less restrictive means whereby their rights could be infringed upon, in this case, the application of the 'public interest override' provisions contained in section 46 of PAIA.

(iii) That once the balance of the competing rights was found to be tilted in the Applicants' favour, the declaration of constitutional invalidity of the statutory limitations should follow. Conversely, should the balance favour SARS and be against the application of a public interest override provision, the statutory regime should be left intact and unaltered.

(iv) That the principle espoused by SARS that without taxpayer secrecy, tax administration could not properly function, was not a universal truth. The research referred to by the experts relied on by the parties, on both sides of the spectrum, indicated that there were many tax regimes in foreign jurisdictions, which had a far lesser degree of prohibition of access to taxpayer information, even by private citizens and on lesser thresholds than those contended for by the Applicants in this case and in those tax regimes where there was less taxpayer secrecy, tax administration was neither hampered nor prevented thereby.

(iv) That the notion that voluntary disclosure and taxpayer compliance was inextricably linked to or dependent on the taxpayer secrecy regime also appeared not to be a universal truth. Academic papers referred to the court appeared to cast some doubt on the assertion by SARS that voluntary compliance, at least as far as disclosure goes, was dependent on the secrecy 'compact' written into law. It appears that there might be far weightier compulsions to voluntary tax compliance than the guarantee of confidentiality at play.

(v) That the 'compact' relied on by SARS, namely that truthful and accurate disclosure is made in exchange for secrecy, is, on the court's reading of the TA Act itself, also open to some doubt. Despite SARS' denial of the threat

of detection and punishment being a driving force, the non-disclosure provisions are not linked to the provisions obliging taxpayers to make truthful and accurate submissions to SARS. On the contrary, the failure to make truthful and accurate submissions were indeed linked to the penalty and criminal sanction provisions as already referred to.

(vi) That, to put it bluntly, there was no direct or factual evidence that taxpayers in South Africa rather make disclosure of their affairs because of the secrecy provisions as opposed to the coercion of the penalties and sanctions which follow upon non-disclosure.

(vii) That the Applicants were at pains to point out that they were not calling for a blanket removal of the confidentiality regime but what they were contending for was that the same 'public override' requirements imposed by section 46 of PAIA, namely where there was reason to believe that the disclosure of the taxpayer information would reveal evidence or failure to comply with the law and where 'public interest in the disclosure….clearly outweighs the harm contemplated in the provision in question', should apply.

(ix) That the 'public interest override' already provided for in section 46 of PAIA applied to a range of 'extraneously sensitive' or otherwise confidential information, such as trade secrets, national security secrets, the details of active police investigations, privileged documents and even information that may threaten the life of an individual. These were all examples of where a limitation of rights to privacy have been limited. Such a limitation would only be constitutionally valid if justified in terms of section 36 of the Constitution.

(x) That the test of whether the limitation claimed by SARS met the test of section 36 of the Constitution was a normative one. The parties relying on such a limitation (i.e. SARS and the Minister) bore the onus to prove that the limitation passes Constitutional muster. Put differently, in the context of this case, have the state's Respondents satisfied the onus that rested on them to show that the limitations on rights of access to information and freedom of speech imposed by taxpayer secrecy provisions were justified in

an open and democratic society based on human dignity, equality and freedom? Section 36(1) lists a number of 'relevant factors' to be taken into account in determining the justification of a limitation such as taxpayer secrecy and the court found it instructive that the Constitutional Court had already in different contexts struck down prohibitions relating to provisions of a sensitive nature or where privacy rights were involved.

(xi) That in weighing up the limit imposed by the absolute taxpayer secrecy on the rights to freedom of speech and access to information when the exercise of those rights were in the public interest against the contentions raised by SARS, the court found the following observation by Cora Hoexter in Administrative Law in South Africa 2ed at p 98 (albeit in a slightly different context) to be apposite: 'the claim [is] that free access to official (state-held) information is a prerequisite for public accountability and an essential feature for participatory democracy.' When this principle is then juxta-positioned to the right of taxpayer confidentiality or personal privacy of those in whose affairs the public have a legitimate interest (such as members of the Executive), the court found that the limitations on the access to information were not justified. The corollary was that the court found that the public interest overrode encroachment or limitation of taxpayer confidentiality is, on the other hand justified.

(xii) That a last objection by SARS to the relief claimed was that the public interest override provision would breach a number of international instruments. In particular SARS referred to Double Taxation Agreements, Tax Information Exchange Agreements and the Convention of Mutual Administrative Assistance in Tax Matters (the CMAA). These international instruments involve a mutual sharing and disclosure of taxpayer information between the revenue administrations of different countries. They were, generally, further premised on the observance of taxpayer confidentiality by the receiving countries. SARS claimed that if the public interest override provision was allowed or adopted, all the DTAs, TIEAs would be breached and the benefit of the CMAA might be lost with the consequential dire

consequences for revenue collection. From a reading of SARS' affidavit, it did not appear that this would automatically be the position. It might or might not follow once disclosure of such exceptions had been made. But there was, to the court's mind, a more fundamental solution to SARS' objections sourced in a point well made by the Applicants: disclosure of taxpayer information which would otherwise satisfy the public interest override, might not be in the public interest if it involved information received in terms of these international instruments and which may lead to a breach of their terms. Notionally then, disclosure of the information can then still be refused.

(xiii) That, accordingly, the blanket prohibitions of disclosure of taxpayer information contained in section 35 of PAIA and section 69 of the TA Act limit the rights of access to information provided for in section 32 of the Constitution and the above limitation was not justifiable in terms of section 36 of the Constitution.

(xiv) That sections 35 and 46 of the PAIA were unconstitutional and invalid to the extent that they precluded access to tax records by a person other than the taxpayer even in circumstances where the requirements set out in section 46 (a) and (b) of PAIA were met.

(xv) That sections 67 and 69 of the TA Act were unconstitutional and invalid to the extent that they precluded access to information being granted to a requester in respect of tax records in circumstances where the requirements set out in section 46(a) and (b) of PAIA were met and they precluded a requester from further disseminating information obtained as a result of a PAIA request.

(xvi) That the decision of SARS, dated 19 March 2019, to refuse the Applicants' request under PAIA for access to the individual tax returns of Mr Jacob Zuma for the 2010 to 2018 tax years is set aside and SARS was ordered to supply the Applicants with the individual tax returns of Mr Jacob Zuma for the 2010 to 2018 tax years within ten days of the order.

4.7. *ITC 1950 – Estate duty*

The taxpayer was the deceased estate of Mr X who had passed away without leaving a Last Will and Testament and consequently died intestate.

The deceased's only daughter, Ms B, was the only heir and was also appointed as the executrix in the estate of the deceased.

The estate included 1673 Kruger Rand coins and the crisp issue in this matter was whether the coins should be valued for estate duty purposes in terms of section 5(1)(a) of the Estate Duty Act as contended by SARS, or in terms of section 5(1)(g) as contended by Ms B.

It was common cause that Ms B had sold the coins in several tranches between 27 May and 25 November 2016.

Section 5(1)(a) would be applicable if the 1673 Kruger Rands had been sold 'in the course of the liquidation of the estate' and if they were not sold in the course of the liquidation of the estate, their value had to be determined at the date of death of the deceased, in terms of section 5(1)(g) of the Estate Duty Act.

It was common cause that the market value of the 1673 Kruger Rands on the date of the deceased's death (18 August 2015) was R24 593 116.73 and it was also common cause that the 1673 Kruger Rands were sold in different tranches between 27 May 2016 and 25 November 2016, for R31 217 453.57.

Section 5(1)(a) provided that, for purposes of its inclusion in the estate, the value of any property disposed of in the course of the liquidation of the estate was the price realised, namely R31,2 million and this was the view of SARS in this matter.

Section 5(1)(g) prescribed that the value of any other property (that is, in effect, property not sold but awarded to the heir) was the value at the date of death of the deceased person and this would be R26,6 million as contended for by Ms B.

The issue to be determined by the court was whether Ms B had disposed of the coins in her capacity as the only heir, and not as the executrix 'in the course of the liquidation of the estate' or whether she had sold them as executrix. Alternatively, if

she had sold them in her capacity as executrix, whether she had done so 'during liquidation'.

The taxpayer contended that the disposal of the 1673 Kruger Rands was not 'in the course of the liquidation of the estate' as the coins were disposed of by Ms B in her capacity as the only heir of the deceased estate and therefore it was not done 'in the course of the liquidation of the estate.' Alternatively, if it was found that Ms B had disposed of the coins in her capacity as executrix, such disposal was not 'in the course of liquidation of the estate' but rather 'during liquidation'.

Section 5(1)(a) of the Estate Duty Act required that there must be a bona fide purchase and sale 'in the course of the liquidation of the estate' and the taxpayer relied on C: SARS v Estate Late H E Streicher 66 SATC 282 in its contention that section 5(1)(g) was applicable in the circumstances of this case and hence the meaning of 'in the course of the liquidation of the estate' had to be determined.

The meaning of the term 'in the course of the liquidation of the estate' was considered in Estate Late H E Streicher and the court in this matter considered the facts of that case in some detail and in the light of that decision it was necessary for the court to establish in what capacity Ms B had disposed of the coins, i.e. whether in her capacity as the sole heir of the estate or in her capacity as the executrix of the estate.

The Supreme Court of Appeal in Estate Late H E Streicher defined 'in the course of the liquidation of the estate' for the purpose of the application of section 5(1)(a) of the Estate Duty Act as follows:

> 'I conclude that a sale 'in the course of the liquidation of the estate' in section 5(1)(a) of the Estate Duty Act means a sale between which and the liquidation process there is some relationship. Put another way, it means a sale effected in the exercise of the functions involved in the liquidation. In short, the sale must be one in implementation of the liquidation process. It must therefore be by the executor or on behalf of the executor, in the latter's capacity as executor, not in the latter's personal capacity as beneficiary.'

Ms B's uncontested evidence was that when she had instructed the investment manager to sell the Kruger Rands in issue, she had acted in her capacity as heir and not as executrix and, furthermore, she was prepared, in her capacity as heir, to accept the responsibility for the estate's liabilities, including estate duty as the estate did not have sufficient cash to meet the liquidation and estate duty costs and Ms B had to provide these from the proceeds of the sales of the coins as she had admitted that part of the reason for the sales had been to pay the liabilities and cover the administration costs of the estate.

Ms B further stated in evidence that she was the only heir in her father's estate and had acquired vested rights to all the assets in the estate and, as the only heir in the estate, had acquired vested rights to inter alia the 1673 Kruger Rands as these rights were transmissible and in her capacity as heir she had the right to dispose of those rights and hence the facts demonstrated that she had acted in her personal capacity as heir when she gave instructions to dispose of a portion of the coins in the period 27 June 2016 to 15 November 2016 and she also had the right to dispose of those vested rights in order to pay the estate duty.

SARS contended, on the other hand, that for Ms B to have sold the assets in her personal capacity, the assets would have to have been distributed to her through the administration of the estate and, if no such distribution had taken place, the assets were never Ms B's property in her personal capacity and accordingly she had no authority to dispose of the assets in her personal capacity.

SARS accordingly concluded that the actions undertaken by Ms B could only have been performed in her capacity as executor as the executor did have an obligation to liquidate assets and the sales in question were undertaken in fulfilment of such obligation.

Judge Seneke held the following:

(i) That the taxpayer's contentions that Ms B sold the property in issue in her personal capacity and took over the liabilities of the estate were unfounded as for Ms B to have been in a position to dispose of the assets in her personal capacity, a disposal of the same assets from the estate to her

must first have taken place. Consequently, the actions undertaken by Ms B could only have been performed in her capacity as executor.

(ii) That in terms of section 35(12) of the Administration of Estates Act the executor is obliged to settle the liabilities of the estate and in the present matter the executor did have an obligation to liquidate assets and the sales in question were undertaken in fulfilment of such obligation. Moreover, the taxpayer has failed to prove that its pleaded claim that the executor was under no instruction or obligation to liquidate the assets of the estate was either relevant or true.

(iii) That the legal argument in Estate Late H E Streicher, supra, on which the taxpayer had attempted to place reliance, centred on whether there was a distinction between 'in the course of the liquidation of the estate', as worded in the statute, and 'during' the liquidation and the revenue authority in that matter submitted that there was no distinction between these concepts.

(iv) That the court in Estate Late H E Streicher, in determining whether the above concepts were distinct, proceeded to provide a definition for 'in the course of the liquidation of the estate' for the purpose of the application of section 5(1)(a) of the Estate Duty Act. The exercise in formulating this definition was said by the court to be a legal and not a factual exercise, and a comparison of the usage of the term 'in the course of' as found in other pieces of legislation was undertaken.

(iv) That the definition provided in Estate Late H E Streicher confirmed that a sale in the course of the liquidation of an estate in terms of section 5(1)(a) must have taken place as a function of the executor and not in the personal capacity of beneficiary for it to be in the course of the liquidation of the estate.

(v) That the taxpayer in this case had admitted that the sale of the Kruger Rands was undertaken to pay the liabilities of the estate and to cover the administration costs of the estate. The management of the liabilities and administration of the estate was inherently the function of the executor and not the responsibility of an heir.

(vi) That the taxpayer's reliance on Estate Late H E Streicher therefore falls at the first hurdle of the legal requirement, as the sales in question were fundamentally in the function of the executor and could not have been undertaken in the personal capacity of the beneficiary.

(vii) That, on the application of its own definition to the circumstances of the case before it, the Supreme Court of Appeal in Estate Late H E Streicher thereafter undertook a factual analysis of the matter to determine if the definition was met and found that the definition was not met and that the sale in that case was not one in the course of the liquidation of the estate. In contrast to Estate Late H E Streicher, in the case at hand, all disposed assets were estate property and were not at any time or in any manner the property of Ms B in her personal capacity.

(ix) That, furthermore, in the case at hand, the taxpayer had admitted that the sale of the coins was necessary to pay the taxes and administrative costs of the estate and therefore it failed to find support in Estate Late H E Streicher on a factual basis and hence in the absence of any legal or factual congruence between the taxpayer's case and the authority, there was no basis on which the taxpayer could rely on Estate Late H E Streicher.

(x) That the case of Estate Late H E Streicher confirmed that SARS' opinion that the sale of the coins was in the course of the liquidation of the estate was correct in that the sale could only have been undertaken by an executor; the sale only involved estate assets which the heir had no ownership over and the sale was necessary to cover the debts of the estate.

(xi) That, in the circumstances, the court agreed with the analysis and approach of SARS that the sale of the Kruger Rands to pay off the administration costs took place in the course of the liquidation of the estate. The case of Estate Late H E Streicher was distinguishable from the current case as the Kruger Rands were assets of the estate and were not at any time or in any manner the property of Ms B in her personal capacity.

(xii) That, accordingly, the objective facts, overall context, and assessment of this case, point towards one outcome and conclusion that Ms B acted in her official capacity as an executrix in disposing of the Kruger Rands to settle the debts and liabilities of the taxpayer. Ms B's attempt to split her role as an executrix and as an heir was not based on a sound factual and legal basis and no evidential weight could be accorded to what amounted to the obfuscation of the objective facts.

Appeal dismissed with costs.

Estate Duty Assessment confirmed.

4.8. ITC 1951 – VAT, Financial Services

The taxpayer had conducted the business of administering funeral policies on behalf of a long-term insurer ('the insurer') and was both a registered VAT vendor and financial services provider.

The taxpayer's business involved negotiating policies on behalf of the insurer; collecting these premiums and paying them over to the insurer; submitting detailed monthly collection reports and processing claims by beneficiaries.

The taxpayer was paid an administration fee for the aforesaid services which was calculated in accordance with the written Administration Agreement ('agreement') concluded between the taxpayer and the insurer on 6 July 2015.

The taxpayer, on 31 October 2016, applied to SARS to be deregistered as a VAT vendor but SARS refused to cancel the taxpayer's VAT registration in terms of section 24(1) of the VAT Act.

The taxpayer, following an unsuccessful objection and appeal to the Tax Board, then approached the Cape Town Tax Court for relief.

The core issue was whether or not the taxpayer was entitled to such deregistration and this involved a consideration of the terms of the aforementioned agreement

concluded between the taxpayer and the insurer, viewed against the relevant provisions of the VAT Act.

It was common cause that the sole business of the insurer was the provision of funeral policies and that the administration services rendered by the taxpayer in terms of the agreement constituted an 'intermediary service' as defined in section 1 of the Financial Advisory and Intermediary Services Act.

However, for purposes of determining the core issue, regard was had only to the deeming provisions of what constituted a 'financial service' in section 2 of the VAT Act and, more particularly, section 2(1)(i) and the proviso to section 2.

The court had to determine whether vendors, such as the taxpayer, who provided selling and administrative services in connection with funeral policies supplied by long-term insurers, had made exempt supplies in terms of the VAT Act.

The VAT Act provided that the supply of a long-term insurance policy was exempt from VAT in terms of section 12(a) read with section 2(1)(i), but the court was here dealing with supplies of administrative services provided by an intermediary.

The agreement stipulated *inter alia* that the taxpayer may not determine the premiums under any policy administered by it as this fell within the sole discretion of the insurer, the business of which, it was common cause, constituted a financial service for purposes of section 2(1)(i) of the Act.

It was also common cause that the taxpayer did not charge the insurer VAT on its fees although there was nothing in the agreement to preclude it from doing so and, in any event, given its VAT registration, the taxpayer had an obligation to charge VAT.

The taxpayer contended that, notwithstanding the repeal of sections 2(1)(m) and 2(1)(n) of the Act, its business nonetheless qualified as a deemed financial service since the proviso to section 2(1) of the Act did not refer to section 2(1)(i) and accordingly the legislature intended that the fees earned by it fell outside the exclusions in that proviso, and were therefore exempt and not taxable in terms of section 12 of theV AT Act.

Judge Cloete held the following:

(i) That the determining factor in this matter was whether or not the taxpayer's business constituted the 'provision…of a long-term insurance policy' in terms of section 2(1)(i) of the VAT Act and, if not, the proviso to section 2 became irrelevant.

(ii) That whilst the taxpayer advanced the services of the long-term insurer, it did so as an independent contractor and this was provided for in Clause 5.3 of the agreement. Furthermore, the parties agreed that the VAT consequences of the agreement had to be determined in light of the terms of the agreement itself. In terms of that agreement it was clear that the services performed by the taxpayer were purely administrative ones for which the taxpayer was paid a fee and the services of the intermediary did not involve the supply of long-term insurance policies as those were supplies made by the long-term insurer.

(iii) That Annexure 'A' to the agreement set out the services which the taxpayer was obliged to render to the insurer and they could perhaps more appropriately have been referred to in the agreement as 'the rights and obligations' of the taxpayer. However, the Annexure made clear that the entering into, varying or renewal of a policy had to be approved by the insurer before it came into force and the taxpayer had no authority to determine the premiums under a policy and the same applied to determining the wording of a policy or the value of policy benefits as these lay solely in the discretion of the insurer.

(iv) That, furthermore, the agreement made clear that the services performed by the taxpayer were purely administrative ones for which the taxpayer was paid a fee and it did not provide a long-term insurance policy as the insurer did that.

(iv) That, accordingly, the activities of the taxpayer could not be deemed to be 'financial services' for purposes of section 2(1) of the Value-Added Tax Act.

(v) That, in regard to costs, section 130(1) of the Tax Administration Act made it clear that a Tax Court had a discretion to award costs in favour of a party

if the other's grounds advanced were held to be unreasonable and/or the Tax Board's decision was substantially confirmed. While the effect of the court's decision was to substantially confirm that of the Tax Board, the court was nonetheless of the view that no order should be made as to costs as neither party had conducted themselves unreasonably, and the issues before the court were hardly clear-cut.

Appeal dismissed.

5. INTERPRETATION NOTES

5.1. Classification of risk policy – No. 102 (Issue 2)

This Note provides guidance on the interpretation and application of the definition of 'risk policy' in section 29A(1) of the Income Tax Act.

The taxable income derived by any insurer in respect of any year of assessment must be determined in accordance with the Act, but subject to sections 29A and 29B.

Every insurer is required to establish five separate funds and to maintain such funds.

These funds form the foundation for the operation of section 29A as a whole.

The taxable income derived by an insurer in respect of the untaxed policyholder fund, the individual policyholder fund, the company policyholder fund, the corporate fund and the risk policy fund must be determined separately in accordance with the Act as if each such fund had been a separate taxpayer.

The risk policy fund was introduced as one of the five funds because of concerns that the taxation of insurers under the previous four funds did not distinguish between investment and risk business. In practice, a risk policy will pay out a specified cash amount on the happening of an event regardless of the amount of investment income earned during the term of the policy. This could result in a loss

in respect of a specific policy. Section 29A was thus amended to provide that risk policies be taxed in the risk policy fund.

Some insurers requested guidance relating to which policies issued on or after 1 January 2016 can be classified as risk policies.

The risk policy fund has been introduced as a fifth fund for insurers to distinguish between investment and risk business. Any policy issued by an insurer during any year of assessment commencing on or after 1 January 2016 meeting the requirements of the definition of 'risk policy' must be allocated to the risk policy fund.

The rights and obligations of each policy will determine whether the requirement of 'substantially the whole' has been met. In order to give effect to the manner in which the insurance business is conducted, products having similar contractual rights and obligations could be grouped together as a class or sub-class of policies.

The respective classes or sub-classes of policies should, however, comply with the 'substantially the whole' requirement to qualify as risk policies.

5.2. Tax treatment of the receipt or accrual of government grants – No. 59 (Issue 2)

This Note deals with:

- the tax consequences of the receipt or accrual of government grants;
- the exemptions from normal tax applicable to government grants; and
- anti-double-dipping rules applicable to expenditure funded by such grants.

Government grants are generally intended to stimulate various aspects of the economy. Allocation of funding can occur in a variety of ways. A grant may:

- be received in advance by a taxpayer for anticipated purchases of goods and services;

- be made directly for goods and services purchased for the benefit of a taxpayer;
- be intended to reimburse the taxpayer after the goods or services have been purchased; or
- be in the nature of a reward for achieving a milestone, such as creating a specified number of jobs.

The income tax rules relating to government grants were spread over a number of sections in the Act which resulted in inconsistent treatment, with some grants being exempted and others not. In order to address this problem, a unified system for exempting or taxing government grants was introduced. Specific exemptions in section 10(1)(zA), (zG), (zH) and (zI) were deleted, while section 12P and the Eleventh Schedule were inserted with effect from years of assessment commencing on or after 1 January 2013. Section 12P exempts specified government grants paid by government in the national, provincial and local spheres, while the previous system exempted only selected grants paid by national authorities.

On or after 1 January 2016 government grants paid to PPPs to effect improvements on land or to buildings owned by any sphere of government or over which any sphere of government holds a servitude are exempt under section 12P(2A).

These grants were previously exempt under section 10(1)(zI) which was deleted with effect from 1 January 2016.

With effect from 19 January 2017, all government grants received by or accrued to a taxpayer must be included in gross income under paragraph (lC) of the definition of 'gross income' in section 1(1), regardless of whether they are of a capital nature.

A government grant received by or accrued to a taxpayer before this date would have to be analysed to determine whether it was of a capital or revenue nature in order to determine whether it should be included in gross income.

The examples in this Note generally consider the treatment in circumstances where a government grant is received to fund a specific asset. The appropriate allocation of a government grant which is received in respect of several assets or expenses will depend on the facts of the specific case, including the contract between the government and the taxpayer.

In determining whether a government grant is subject to normal tax regard must be had to:

- specific inclusions in gross income (for example, farming subsidies and government grants, and recoupments);
- any exemption available, for example, under section 10 or under section 12P and the Eleventh Schedule; and
- the facts and circumstances of the particular case.

In addition, it is important to consider the impact on deductions, allowances and base cost. For example, the specific anti-double dipping rules under section 12P(3) to (6) which are applicable to government grants as contemplated in section 12P(2) and (2A)

5.3. Deductions in respect of improvements to land of buildings not owned by a taxpayer – No. 119

This Note provides guidance on the interpretation and application of the following:

- Section 12N, which facilitates allowances under specified sections of the Act for improvements made to land or buildings not owned by a taxpayer but over which the taxpayer holds a right of use or occupation. The improvement must be effected under a PPP, a lease agreement with the state or certain other taxexempt statutory bodies and the state or that body owns the land or building, or under the Independent Power Producer Procurement Programme.

- Section 12NA, which deals with deductions for improvements effected under a PPP by a person to land or to a building over which the state holds the right of use or occupation.

Other sections in the Act, which potentially provide an allowance on improvements to land or buildings not owned by the taxpayer, include section 11(g) and section 13bis.

These sections are not dealt with in this Note. See Interpretation Note 110 'Leasehold Improvements' and Interpretation Note 105 'Deductions in respect of Buildings used by Hotelkeepers'.

The Act provides for a variety of depreciation allowances for the creation or acquisition of qualifying movable or immovable assets. In order to qualify for these allowances, the taxpayer must generally be the owner of the assets. Under the common law principle of superficies solo cedit (owner by accession), buildings or other structures affixed or attached to land become the property of the owner of the land.

Often lease agreements of immovable property require the lessee to effect improvements on land or to buildings as part of the obligations under the agreement.

The problem with such an arrangement is that the land belongs to the lessor and the improvements become the property of the lessor when effected. The lessor is not entitled to use the improvements until the lease expires and as the lessee is not the owner, many allowances are not applicable. In order to address these issues the Act contains specific provisions relating to leasehold improvements.

In relation to the lessee, section 11(g) provides for a deduction of expenditure actually incurred by a lessee in pursuance of an obligation to effect improvements on land or to buildings under an agreement under which the right of use or occupation of the land or buildings is granted by the lessor.

The allowance under section 11(g) does not, however, apply if the value of the improvements effected by the lessee does not constitute income of the lessor. A taxpayer effecting leasehold improvements to land owned by the state would not

be able to secure a deduction under section 11(g), since the state is exempt from tax under section 10(1)(a). In order to encourage private sector participation in government projects it was therefore necessary to introduce specific legislation to enable taxpayers to secure deductions for leasehold improvements effected to stateowned land or buildings.

Section 12N does not provide for a deduction, however it was introduced to facilitate allowances available under other sections on improvements not owned by a taxpayer.

With effect from 4 July 2013, section 12N was amended to facilitate allowances on expenditure incurred under an obligation or voluntarily by a lessee to effect improvements on leased land or buildings.

With effect from 1 January 2013, section 12NA was introduced to provide for a deduction when a person is under an obligation under a PPP to effect an improvement to land or a building over which the state holds the right of use or occupation.

Under section 11(g) a lessee is entitled to write off obligatory improvements over the period of the lease or 25 years, whichever is the lesser. Section 11(g) does not, however, apply when the lessor is a tax-exempt person and thus excludes, for example, lessees that effect improvements to state-owned property.

Section 12N was introduced to enable a lessee to claim capital allowances on leasehold improvements effected to land or buildings for which the taxpayer has a right of use or occupation and effects the improvements under a PPP, a lease agreement with the state or certain other tax-exempt statutory bodies if the state or entity owns the property, or under the Independent Power Producer Procurement Programme. It deems the lessee to be the owner of the improvements for the purposes of specified allowance provisions and the Eighth Schedule. Banks, financial service providers and insurers are excluded from section 12N. The improvement is deemed to be disposed of on the later of when the right or use or occupation is terminated or the use or occupation terminates. Depending on the

facts, taxpayers may need to consider a potential recoupment or scrapping allowance, and capital gain or loss consequences.

Sub-letting is impermissible except in specified circumstances between members of the same group of companies.

Section 12NA applies when government holds a right of use or occupation for land or buildings and a person effects obligatory improvements to that land or those buildings under a PPP. The amount deductible in any year of assessment is determined on a straight-line basis by dividing the expenditure actually incurred in effecting an improvement by the lesser of the number of years over which the taxpayer will derive income under the PPP agreement or 25 years.

A grant received or accrued for the purposes of effecting the improvements may be exempt from normal tax if it meets the requirements of section 10(1)(zI) (before 1 January 2016). Before 1 January 2016 the person must reduce the cost of the improvements for the purpose of determining the amount that may be claimed as a deduction under section 12NA(3). On or after 1 January 2016 the aggregate amount that may be claimed as a deduction is limited to the cost of the improvements less the amount of the grant under section 12P(4). Banks, financial service providers and insurers are excluded from section 12NA.

5.4. Prohibition of deductions in respect of certain intellectual property – No. 120

This Note provides guidance on the interpretation and application of section 23I which relates to the prohibition of deductions in respect of tainted intellectual property.

The use of intellectual property belonging to another person normally carries a charge in the form of a royalty. Usually, such payment received will fall within the recipient's gross income and the payor will be allowed to claim a deduction under section 11(a) for the expenditure incurred in paying the royalty.

Instances arose in which self-developed intellectual property was sold or transferred to another party connected to a resident developer. The use of the intellectual property was then granted to a resident company and a royalty was paid for the use of the intellectual property. The connected person typically paid no tax or tax at a very low rate on the royalty income either by virtue of such persons being regarded as exempt institutions or non-resident taxpayers. These types of transactions were designed to reduce the group's overall tax liability in South Africa by having the royalty taxed at a lower tax rate and for the resident company claiming a deduction for royalty payments at the higher tax rate. Section 23I was therefore inserted with the aim of preventing the avoidance of tax.

The Explanatory Memorandum on the Revenue Laws Amendment Bill, 2007, provides the following background to the introduction of section 23I:

> 'The disparity in tax rates levied on income between different parties often creates arbitrage opportunities. The purpose of these arbitrage opportunities is to shift income from parties fully within the tax net to parties wholly or partly outside the tax net. In the case of intellectual property, this result is mainly achieved by shifting the intellectual property from a fully taxable party to a party wholly or partly outside the tax net. This shift is usually designed so that the shift triggers little or no tax. After the shift, deductible payments are made from the fully taxable party (now the licensee) to the other party operating wholly or partly outside the South African tax net. In many instances, the tax benefits have no corresponding impact on cash flow as royalty payments are simply returned to the licensee-payor in the form of dividends. Meanwhile, the tax deductions for the licensee-payor may be so large as to effectively wipe-out the payor's tax base.'

Essentially, section 23I prohibits, subject to certain exceptions, a deduction of any expenditure incurred for the right or permission to use intellectual property qualifying as 'tainted intellectual property' and other expenditure which is directly or indirectly related to such expenditure.

Save for certain exceptions, section 23I prohibits a deduction of:

- any amount of expenditure incurred for the use of tainted intellectual property; or
- any expenses determined directly or indirectly with reference to the expenditure incurred for the use or right of use of or permission to use any tainted intellectual property,

to the extent that the amount of expenditure does not constitute income received by or accrued to any other person or to the extent that the expenditure does not constitute a proportionate amount of net income of a CFC which is imputed to any resident under section 9D.

The effect of section 23I is that a deduction for expenditure incurred for the use of intellectual property when income is shifted between the contracting parties so as to trigger little or no tax is disallowed.

The section provides for a partial deduction when withholding tax on royalties (Part IVA of the Act) applies.

5.5. Deduction of medical lump-sum payments – No. 121

This Note provides guidance on the interpretation and application of section 12M which relates to the deductibility of a lump-sum amount paid by a taxpayer to or in respect of a former employee or dependants of that former employee for purposes of covering post-retirement medical benefits. The income tax implications of this benefit to the former employee are not considered in this Note.

Employers often provide various incentives to attract and retain employees with scarce skills. One form of benefit is to cover the medical aid contributions of former employees in retirement. This could be an expensive and risky exercise for a taxpayer as medical inflation may exceed general inflation, or a chronic illness of a former employee can be protracted. In order to counter such a risk, taxpayers may seek to settle this liability upfront. Two common approaches to settling the liability upfront are to make a lumpsum payment to an insurer for a policy of insurance or

to make a direct lump-sum payment to the former employee or dependant. Depending on the facts, the taxpayer may transfer their contractual responsibility to provide post-retirement medical benefits to the insurer, former employee or dependant.

Previously the tax treatment of a lump sum paid by a taxpayer to cancel the obligation to provide for the post-retirement medical benefits of a former employee was uncertain and arguably not deductible. Since the introduction of section 12M, a taxpayer can claim an immediate deduction of a lump-sum payment made for purposes of covering the post-retirement medical aid contributions of a specified former employee or dependant if it meets the requirements .

A taxpayer may be entitled to claim a deduction in the year of assessment a lump-sum amount is paid for the purposes of covering post-retirement medical benefits of former employees or dependants of former employees under specified circumstances. A deduction under section 12M will be available if the lump sum is paid by the taxpayer during the taxpayer's year of assessment in the course of taxpayer's trade:

- to:
  - any former employee who retired from the taxpayer's employment on the grounds of old age, ill-health or infirmity or any dependant of such former employee, or
  - to an insurer under a policy of insurance taken out solely in respect of one or more of the above-mentioned former employees or their dependants; and
- to the extent it is paid for the purpose of making any contribution to a medical scheme or medical fund in respect of such former employee or his or her dependants.

The deduction is limited to the extent that the lump-sum payment is for the purpose of making a contribution to a medical scheme or medical fund in respect of the abovementioned former employee or dependant.

No deduction is allowed if the taxpayer or any connected person to the taxpayer retains or has any further obligation, whether actual or contingent, related to the mortality risk of the above-mentioned former employee or a dependant of the former employee.

6. DRAFT INTERPRETATION NOTES

6.1. Persons not eligible to register as a tax practitioner and deregistration of registered practitioners for tax non-compliance

This Note provides guidance on when, due to non-compliance, a person may not register as a tax practitioner, and when SARS must deregister a registered tax practitioner, as well as the period of non-qualification for registration.

Subject to specified exceptions, a natural person who provides advice on the application of a tax Act, or who completes or assists in completing a return on behalf of another person, must register with or fall under the jurisdiction of a recognized controlling body, and must register with SARS within prescribed periods. Persons who are not registered with both a recognised controlling body and SARS, may not practice as a tax practitioner and those who do, are guilty of a criminal offence, which, upon conviction carries a fine or imprisonment of up to two years upon conviction.

Section 240(3) prohibits SARS from registering a person as a tax practitioner and requires that SARS deregisters a registered tax practitioner under certain circumstances, section 240(3)(d) specifically dealing with tax non-compliance.

In accordance with section 256(3), tax compliance is measured against the obligation to register for tax and submit returns, as well as the obligation to pay outstanding tax debts or make arrangements in relation to such returns or debts.

Deregistration of tax practitioners affects livelihoods, business continuity, as well as the taxpayers whom they serve. It is in the interest of persons who wants to

practice as tax practitioners to remain tax compliant or remedy their non-compliance as soon as possible. Prospective or registered tax practitioners are therefore encouraged to act upon a notice by SARS in order to be registered expeditiously, avoid deregistration, or reduce the period of deregistration.

Subject to specified exceptions, a natural person who provides advice on the application of a tax Act, or who completes or assists in completing a return on behalf of another person, must register with or fall under the jurisdiction of a recognized controlling body and must register with SARS, within the prescribed periods.

Section 240(3)(d) prohibits registration as a tax practitioner and requires deregistration of a registered tax practitioner by SARS, if a prospective or registered tax practitioner has not been compliant for an aggregate period of at least six months during the preceding 12-month period, and has failed to demonstrate compliance or remedy the non-compliance.

7. BINDING PRIVATE RULINGS

7.1. BPR 371 – Public benefit activities carried on for the benefit of the general public

This ruling determines whether activities carried on by a public benefit organization will comply with the requirements of the definition of a 'public benefit organisation'.

In this ruling references to sections are to sections of the Income Tax Act as at 3 December 2021. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of paragraph (c)(i) of the definition of 'public benefit organisation' in section 30(1).

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

The applicant: a resident trust

Company A: A resident company and founder of the applicant

Description of the proposed transaction

The applicant was established by company A. The applicant is required, by agreement with a third party donor, to make quarterly contributions to socioeconomic and enterprise development initiatives in neighbouring communities.

The applicant is an approved public benefit organisation. It applies contributions by donors for the benefit of local communities.

Contributions must be directed towards those in need in a specified geographical area. The proximity and need factors are therefore the criteria according to which beneficiaries are selected. The applicant must assist communities in certain focus areas, including:

- socio-economic development;
- enterprise development;
- education and skills development;
- job creation;
- health care; and
- safety and security.

The applicant's funding round starts with a request for proposals from the general public made through established community forums, including community hall initiatives.

A committee established by the applicant reviews the proposals and conducts a detailed evaluation process. A shortlist of projects is then submitted to the trustees for further deliberations.

The feasibility of the projects, as well as their projected social impact on the relevant communities, are evaluated. Projects which are aligned with the applicant's objectives and public benefit activities will be selected based on definite

and quantifiable public benefit being demonstrated by a funding application. Project funding will not be awarded based on any personal or other relationship with the trustees, the applicant, or any of its associated entities.

The proposed transaction will involve the funding of four projects: a bakery, vegetable tunnels, a poultry project and a small manufacturing concern.

The applicant considers that the proposed transaction will benefit the local community as amounts awarded will result in the creation of employment, skills development and the enhancement of local enterprise.

Conditions and assumptions

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

Ruling

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

- The proposed transaction will comply with paragraph (c)(i) of the definition of a 'public benefit organisation' in section 30(1).

7.2. BPR 372 – Withholding tax on foreign royalties

This ruling considers whether lease payments for the use of equipment will constitute royalties in terms of a tax treaty between South Africa and another country, and whether the withholding taxes to be levied will meet the requirements of section 6quat(1A).

In this ruling references to sections are to sections of the Income Tax Act applicable as at 14 December 2021. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of section 6quat(1A).

Parties to the proposed transaction

The applicant: A resident company

The co-applicant: A resident company

Description of the proposed transaction

The applicant and the co-applicant are resident companies that own and let equipment in South Africa. When there is an additional demand in certain other countries, such equipment will, by prior arrangement, be provided on a temporary basis to entities resident in those countries in exchange for rental payments that cover the cost for the applicant and the co-applicant. Each of the foreign countries concerned has entered into a convention with South Africa for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (treaty). In each case the treaty defines a royalty in article 12 as, amongst others, 'payments of any kind received as a consideration for the use of, or the right to use, industrial, commercial or scientific equipment'.

The equipment is made available for an extended period to the foreign entities and the following will be agreed:

- The equipment will remain in the foreign country during the peak season until demand has dropped, as opposed to returning them to South Africa on the completion of each individual lease to an individual customer in the country concerned.
- The foreign entities will:
    - have full access and possession of the equipment to make business related rentals,
    - assume responsibility for any risk as regards damage, theft, etc,
    - take responsibility for repairs, maintenance, insurance, etc,
    - make the equipment available only for business related rentals in the foreign country and not for private or other matters,
    - return the equipment where it makes economic sense for both the applicant and the co-applicant and the foreign entities.

Conditions and assumptions

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

- Neither the applicant nor the co-applicant has a permanent establishment in the foreign countries.

Ruling

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

- The amounts to be paid to the applicant and the co-applicant will constitute royalties as defined in the relevant treaties.
- Any amounts which must be withheld as withholding taxes on those royalties under the laws of the countries concerned will meet the requirements of section 6quat(1A) and the applicant and the co-applicant will therefore be permitted to claim rebates in respect of the withholding taxes which are levied by the other countries in terms of article 12 of the relevant treaty.
- No view is expressed on any potential transfer pricing implications of the proposed transaction.

7.3. BPR 373 – STT treatment of the proposed transfer of listed shares to the applicant in order to hedge its exposure under over-the-counter derivative transactions

This ruling determines whether the transfer of the beneficial interest in listed shares, to the applicant to hedge its exposures under intra-group over-the-counter (OTC) derivative transactions entered into directly with the foreign broker, will be exempt from securities transfer tax (STT).

In this ruling references to sections are to sections of the STT Act applicable as at 13 November 2021. 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 8(1)(q).

Parties to the proposed transaction

The applicant: A resident company which is an 'authorised user' as defined in the Financial Markets Act 19 of 2012 and a member of the JSE Limited

Foreign broker: A non-resident which is a fellow subsidiary of the applicant. The foreign broker serves as the primary broker-dealer for clients outside of South Africa

Description of the proposed transaction

The applicant will offer its clients OTC derivative transactions which can be ordered either through OTC orders or through 'co-location connectivity' as set out below:

- Over-the-counter derivatives with the client
  - The foreign broker offers OTC Derivatives to its clients outside South Africa (clients) that enable the clients to obtain exposure to listed shares and equity indices (client OTC Derivatives Transactions).
  - The foreign broker offers this via both 'high touch' (i.e. taking telephone or email orders from clients) and 'low touch' (i.e. electronic receipt and transmission of orders). 'Low touch' is commonly referred to as Direct Market Access (DMA). DMA is a common means of accessing global markets with the majority of trading jurisdictions currently supporting some form of synthetic DMA product. The products are processed, stored and made available through a worldwide computer and communications network. Under DMA, the clients will not be accessing the market themselves, but the orders will be electronically received and transmitted to the JSE as proprietary orders for electronic execution by the applicant.

- In order to facilitate DMA activity, when the foreign broker receives an order for a long client OTC Derivative Transaction, the foreign broker places a request with the applicant to purchase the listed shares relevant to the client's OTC Derivative Transaction either as an 'on book' trade or as an 'off book' trade. The purchase of listed shares forms the hedge for the applicant, the purchase price is used by the foreign broker to price any subsequent client OTC Derivative. Listed shares purchased by the applicant will be purchased into the applicant's 'unrestricted and security restricted stock account' at the JSE in accordance with the JSE Equities Rules. Similar flow takes place for a short client OTC Derivative, with the applicant selling the listed shares either as an 'on book' trade or as an 'off book' trade.
- At the end of each trading day, the foreign broker will hedge its net exposure under all of its client OTC Derivatives by proposing to enter into OTC Derivatives (Intercompany OTC Derivative) with the applicant in the form of an OTC Derivative.
- At the termination of:
    - a long client OTC Derivative, the applicant will sell listed shares either as an 'on book' trade or as an 'off book' trade; and
    - a short client OTC Derivative, the applicant will purchase listed shares either as an 'on book' trade or as an 'off book' trade.
- STT will, however, be levied on any reallocation of these listed shares from a member's 'unrestricted and security restricted stock account' to a member's general restricted stock account.

- Co-location transactions
    - Co-location is widely marketed by the JSE and is offered by a number of the International Brokers' domestic and international competitors. Co-location allows much greater speed in execution

(i.e. a significant reduction in latency) given the proximity of the software and hardware to the JSE and is therefore of particular interest to latency or volatility sensitive traders and other electronic traders.

- Under co-location, the applicant leases server space from the JSE. These servers are located on the JSE's premises in South Africa and provide direct access to the exchange using the applicant's trading identification. Clients also lease service space in the same data centre at the JSE's premises in South Africa and utilise a crossconnect with the applicant to access the co-location.
- A client's software would typically run an algorithm which would generate buy and sell orders automatically on the JSE. The electronic orders placed by the client would be routed through the applicant and the orders would legally be made by the applicant.
- Absent co-location, the order would initially be received by the foreign broker, who would place an order with the applicant before being routed to the JSE. This order transmission mechanism has a significant latency component that co-location seeks to remove.
- At the end of the trading day, the client requests an OTC Derivative with the foreign broker in relation to the net position in listed shares traded via co-location. Therefore, because the client has to use the trading identification of the foreign broker and applicant when they place the order, using the co-location order mechanism, legally, it is as if the order was placed with the foreign broker who then placed an order with the applicant.
- As with OTC Derivatives with the client, at the end of each trading day, the foreign broker will hedge its net exposures under all its client OTC Derivatives by proposing to enter into an intercompany OTC Derivative with the applicant.
- The purchased listed shares by the applicant are economically a

hedge of its exposure under the intercompany OTC Derivative. These shares will be purchased into the applicant's 'unrestricted and security restricted stock account' at the JSE in accordance with the JSE Equities Rules.

- STT will, however, be levied on any reallocation of these listed shares from a member's 'unrestricted and security restricted stock account' to a member's general restricted stock account.

Condition and assumption

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

- The listed shares purchased must be allocated to the applicant'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 acquisition of listed shares by the applicant to net hedge its exposure under an Intercompany OTC Derivative entered into with the foreign broker, and the 'transfer' of such listed shares to the applicant pursuant to such acquisition, will be exempt from STT under section 8(1)(q) of the STT Act, if the listed shares are allocated to the applicant's 'unrestricted and security restricted stock account'.

- The acquisitions of listed shares by the applicant in consequence of co-location connectivity to net hedge its exposure under intercompany OTC Derivatives entered into with the foreign broker, and the 'transfer' of such listed shares to the applicant pursuant to such acquisitions, will be exempt from STT under section 8(1)(q) of the STT Act if the listed shares are allocated to the applicant's 'unrestricted and security restricted stock account'.

7.4. BPR 374 – Determination of group of companies

This ruling determines the manner in which the definition of group of companies should be applied.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 2 February 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 'group of companies'.

Parties to the proposed transaction

The applicant: A resident company

Co-applicant 1: A resident company

Co-applicant 2: A resident company and a wholly-owned subsidiary of the Co-applicant 1

Company A: A resident company

Description of the proposed transaction

The applicant holds 75% of the ordinary shares in co-applicant 1. Co-applicant 1 holds all of the ordinary shares in co-applicant 2.

It is proposed that co-applicant 2 will acquire shares in a number of companies held by company A (collectively the sale shares). Co-applicant 2 will issue ordinary shares and preference shares to company A in exchange for the acquisition of the sale shares (initial issue shares) on the effective date of the transaction (effective date) and may become liable for deferred compensation comprising of the issue of further preference shares on the first anniversary of the effective date (deferred issue shares) and cash (if any).

The initial issue shares and deferred issue shares (collectively, the issue shares) to be issued to company A may not exceed an agreed maximum percentage which percentage is less than 20% (maximum shareholding) of co-applicant 2's total issued shares on the deferred date.

The terms attaching to the preference shares provide, amongst others, for the automatic conversion of the preference shares to equity shares on the third anniversary of the issue date (interim conversion date). The preference shares not converted on the interim conversion date are convertible to equity shares on the fifth anniversary of their issue (final conversion date).

Depending on the number of issue shares (ordinary and preference shares) issued by co-applicant 2 to company A, and preference shares converted by the final conversion date, company A may hold the maximum shareholding at the end of the day on the final conversion date. Company A may not hold more than the maximum shareholding in co-applicant 2 at any given time from the effective date to the final conversion date.

Conditions and assumptions

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

Ruling

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

- The applicant, co-applicant 1 and co-applicant 2 form part of a ‘group of companies’ as defined in section 1(1) and will, pursuant to the proposed transaction, continue to form part of the same ‘group of companies’ as at the effective date, deferred date, interim conversion date and final conversion date

8. BINDING GENERAL RULINGS

8.1. Allocation of direct and indirect expenses within and between an Insurer's Funds – BGR 30 (Issue 2)

For the purposes of this ruling:

- 'insurer' means any 'long-term insurer' as defined in section 1 of the

Longterm Insurance Act No. 52 of 1998

This BGR determines:

- the allocation of direct and indirect operating expenses within and between the funds that are required to be established by insurers under section 29A and the subsequent deductibility of such operating expenses, and
- the deductibility of expenses against transfers under section 29A(7).

Background

Establishment of the funds

The taxable income derived by any insurer in respect of any year of assessment must be determined in accordance with the Act, but subject to sections 29A and 29B.

Every insurer is required to establish five separate funds and to maintain such funds. These funds form the foundation for the operation of section 29A as a whole. The taxable income derived by an insurer in respect of the individual policyholder fund, the company policyholder fund, the corporate fund and the risk policy fund must be determined separately in accordance with the Act as if each such fund had been a separate taxpayer. The income received by or accrued to an insurer from assets held by it in, and business conducted by it in relation to, the untaxed policyholder fund is exempt from tax.

An insurer is required to re-determine the value of liabilities in each policyholder fund and the risk policy fund within three months after the end of every year of assessment. Where the market value of the assets in the fund exceeds the value of liabilities, assets with a market value equal to the excess must be transferred from such fund to the corporate fund. Where the market value of the assets is, however, less than the value of liabilities, assets with a market value equal to the shortfall must be transferred from the corporate fund to the relevant fund. These transfers are viewed as notional adjustments relevant only for purposes of calculating the insurer's

annual tax liability and do not affect the insurer's legal ownership of the assets concerned.

Allocation of expenses

Section 29A(12) stipulates that in the allocation of any expense to any of the funds an insurer must:

- to the extent to which the expense relates exclusively to business conducted by it in any one fund allocate that expense to that fund; and
- to the extent to which that expense does not relate exclusively to business conducted in any one fund, allocate that expense in a manner which is consistent with and appropriate to the manner in which its business is conducted.

Expenses which an insurer considers to be incurred to produce the excess assets to be transferred from a policyholder fund or the risk policy fund to the corporate fund and the associated costs attributed to it are to be allocated to such policyholder fund or risk policy fund. The transfer to the corporate fund is essentially a net profit that is derived by deducting all relevant expenses in the policyholder fund and the risk policy fund first.

Expenses allocated to the corporate fund are not regarded to be incurred with a view to obtain the transfer from the policyholder fund or the risk policy fund as the corporate fund will not incur any expense to produce these transfers. Expenses allocated to the corporate fund relate to shareholder activities only.

Expenses that do not relate exclusively to business conducted in any one fund and which have not been classified as direct policyholder expenses, for example, operational overhead costs, general marketing costs, directors' fees, audit fees, are inconsistently treated by insurers in calculating the taxable income of the different funds. The fact that 'the manner in which its business is conducted' referred to in section 29A(12) is not defined in the Act further contributes to the inconsistent treatment of

these indirect operating expenses.

Determination of taxable income

Specific rules are set for the determination of the taxable income of the individual policyholder fund, the company policyholder fund, the risk policy fund and the corporate fund. The expenses and allowances allowed as a deduction in the policyholder funds are limited to the total of:

- the amount of expenses and allowances directly attributable to the income of such fund ('direct expenses'); and
- a percentage of the amount of:
  - all expenses allocated to the fund which are directly incurred during such year of assessment in respect of the selling and administration of policies; and
  - all expenses and allowances allocated to such fund which are not included above ('indirect expenses'), but excluding any expenses directly attributable to any amounts received or accrued which do not constitute 'income' as defined in section 1(1).

The amount referred to above is determined in accordance with the formula set out in section 29A(11)(a)(ii).

The rules for the deduction of expenses by an insurer referred to in section 29A(11)(a) do not apply to the corporate fund. The expenses in the corporate fund are subject to the requirements of section 11 read with section 23.

The determination whether expenses are directly attributable to the income of a policyholder fund or risk policy fund, or directly attributable to amounts which do not constitute income of such a fund, also referred to as direct expenses, is a matter of fact. A direct causal link is required between income earned and the expense incurred to earn the income.

Certain expenses, such as asset management fees, can be attributed to

multiple income streams within a specific fund. Other expenses may relate to a class of assets as opposed to a particular income stream. In these instances it becomes difficult to link a particular expense to a specific fund.

Ruling

In view of the inconsistent treatment of expenses within and between the separate funds of an insurer, the treatment of expenses set out below is accepted for purposes of section 29A(11) and 29A(12):

- Direct expenses must be allocated to the policyholder funds and the risk policy fund in a manner consistent with the way in which the insurer does business.
- Direct expenses relating to shareholder activities only must be allocated to the corporate fund.
- Indirect operating expenses incurred to produce the excess assets to be transferred from the policyholder fund or the risk policy fund to the corporate fund and the associated costs attributable to it are to be allocated to such policyholder fund or risk policy fund.
- To the extent that indirect operating expenses cannot be allocated to any fund in particular:
    - an apportionment of the expense must be made between the corporate fund and the other funds in aggregate, using the average value of liabilities for the policyholder funds and the risk policy fund and the average market value of assets for the corporate fund at the commencement and end of the year of assessment;
    - once expenses have been allocated to the different funds a further apportionment between the individual policyholder fund, company policyholder fund, the untaxed policyholder fund and the risk policy fund must be made using the gross premiums received by the respective funds;
    - the apportioned indirect operating expenses allocated to each

policyholder fund are subject to the expense ratio contemplated in section 29A(11) for the individual policyholder fund and the company policyholder fund;

- the apportioned indirect operating expenses allocated to the corporate fund and the risk policy fund should further be apportioned with reference to the ratio of income in the fund concerned plus the taxable capital gain applicable to the fund concerned over total amounts received or accrued (irrespective of whether these amounts are of a capital or revenue nature), provided that transfers from the policyholder funds at the end of the year of assessment are excluded in this calculation from both the income and the total amounts received or accrued.

Expenses directly attributable to income in the individual policyholder fund and the company policyholder fund are deductible under section 29A(11)(a)(i). Expenses directly attributable to exempt income in the untaxed policyholder fund are not deductible.

Expenses directly attributable to assets that give rise to income in the individual policyholder fund and the company policyholder fund may be claimed under section 29A(11)(a)(i) to the extent they are not of a capital nature. Expenses that are directly attributable to assets that give rise to exempt income will not be deductible. Indirect operating expenses that cannot be directly attributed to assets within a specific policyholder fund and allocated to the particular fund as directed above must be treated as indirect expenses and claimed under section 29A(a)(ii).

The deduction of expenses allocated to the corporate fund and the risk policy fund is subject to the requirements of section 11 read with section 23. No expenses relating to the corporate fund activities are allowed to be deducted in the corporate fund from the transfers contemplated in section 29A(7) since no expense is viewed to be incurred in the corporate fund to produce such transfer.

8.2. Application of the principles enunciated by the Brummeria case – BGR 8 (Issue 3)

For the purposes of this ruling:

- 'the Brummeria case' means the judgment handed down by the SCA in Commissioner, SARS v Brummeria Renaissance (Pty) Ltd 2007 (6) SA 601 (SCA), 69 SATC 205.

This BGR prescribes in which year of assessment the right to use an interest-free loan should be included in the taxpayer's gross income as well as the method to calculate the value of such right.

Background

Issue 1 of the BGR was issued on 30 June 2010 as a result of the judgment in the Brummeria case. Issue 2 of the BGR substituted references to section 76P with references to the TA Act and updated the dates in the examples and Issue 3 updates the dates and the weighted-average prime overdraft rates for banks relating to the relevant year of assessment in the examples. The principles dealt with in this BGR remain unchanged.

Ruling

Agreements in the retirement industry are frequently structured in such a way that one person (the owner of a unit) grants a lifelong right of occupation over that unit to another person (the life-right holder). As compensation the life-right holder advances the owner an interest-free loan for the duration of the period of occupation.

Only amounts received by or accrued to a taxpayer during a particular year of assessment must be included in that taxpayer's gross income for that year of assessment. The value of a right that accrues to a taxpayer in a particular year of assessment must be determined in that year.

In calculating the monetary value of the right to use an interest-free loan in the year in which it is granted, it should be taken into account that the owner of the unit has

given something in exchange to the life-right holders. The quid pro quo is the granting of the lifelong right of occupation of the unit. The owner is therefore left only with the bare dominium of the unit for the full period of the loan. Only when the loan is repaid and the life right is re-united with the bare dominium, will the owner be in a position to deal freely with the complete ownership of the unit.

The value of this quid pro quo given by the owner of the unit to the life-right holder should therefore be determined and taken into account in the valuation of the right to use the interest-free loan.

The right to use an interest-free loan granted by an occupant in a retirement village to the owner of that unit in exchange for the granting of a life right of occupation in respect of that unit usually does not relate to a fixed period. Instead, the period over which the right to the use of the loan is to be enjoyed depends on the life expectancy of the liferight holder and certain other contractually agreed contingencies (such as the possibility that the life-right holder may cancel the loan before his or her death).

In view of the above, it may be accepted that the value of the right to use the interestfree loan should be calculated in the year that the loan is granted using the following formula

$A = (B \times C \times D) - E \times (B \times C \times D)$

with reference to the following factors:

A = The monetary value of the right of use of the interest-free loan which must be included in gross income

B = The amount of the interest-free loan

C = The present value of R1 a year over the life expectancy of the life-right holder*, or in the case of more than one life-right holder, the youngest of them

D = The weighted-average prime overdraft rate for banks relating to the relevant year of assessment

E = 93,1% (The percentage to be allocated to the monetary value of the

life right of a unit, as opposed to the value of the complete ownership of the unit. This average percentage has been determined actuarially and is acceptable to SARS for all life rights granted.) SARS has accepted this method as a basis for calculating the amount to be included in gross income. This deduction compensates the owner of the unit who gives a right to occupy the unit as a quid pro quo for the right to use an interest-free loan.

The life expectancy of the life-right holder and the present value of R1 a year for the life of the life-right holder may be determined by using the life-expectancy table issued under Government Notice No. R1942 of 23 September 1977 under section 29 of the Estate Duty Act No. 45 of 1955.

The monetary value of the right to use the interest-free loan in the year in which it is granted and paid must be determined by multiplying the amount of the loan by the present value of R1 a year for the lifetime of the life-right holder and the weightedaverage prime overdraft rate determined for the relevant year of assessment. The amount so calculated is then reduced by 93,1%. Note: This is a once-off calculation of the amount to be included in the gross income of the borrower in the year of assessment in which the borrower becomes entitled to the right to use the loan. The amount is therefore not re-calculated and included in the borrower's gross income in each subsequent year until the loan is repaid.

Example 1 – Calculation of the monetary value to be included in gross income

Facts:

A retirement village is held under sectional title by the owner. The scheme is governed by the Housing Development Schemes for Retired Persons Act No. 65 of 1988. On 1 June 2020 the owner enters into an agreement, under which the owner grants a life right of occupation over a sectional title unit in the village to a person aged 75.

Under the agreement, the 75-year-old person and that person's spouse will be entitled to occupy the unit in exchange for the grant to the owner of the use of an interest-free loan of R400 000. The life-right holder advanced the

loan on 1 July 2020.

The person turned 75 on 16 February 2020.

According to the life-expectancy table (see Annexure) the present value of R1 a year for the life of the 75-year-old male is 4,59354 (age next birthday = 76).

The interest-free loan is repayable by the owner of the village to:

- the life-right holder upon cancellation of the agreement under various circumstances, which include the life-right holder falling ill and requiring fulltime medical care; or
- his or her estate when he or she dies.

The weighted-average prime overdraft rate for banks during the relevant year of assessment is 7,71%.

The financial year of the owner of the retirement village commences on 1 March 2020 and ends on 28 February 2021.

Result:

The monetary value of the right to the use of the interest-free loan is calculated as follows:

A = (B × C × D) − E × (B × C × D)

= (R400 000 × 4,59354 × 7,71%) − 93,1% × (R400 000 × 4,59354 × 7,71%)

= R141 664,77 − R131 748,23

= R9 916,54

An owner that is obligated to refund only a portion of the loan on death or cancellation of the agreement must include the amount not refundable in gross income in the year of assessment in which the loan is granted and paid by the person acquiring the life right.

Example 2 – Full loan amount not refundable

Facts:

The agreement between the owner and the life-right holder provides that only 80% of the interest-free loan of R900 000 is refundable on death.

Result:

The owner must include R180 000 (20% × R900 000) in gross income in the year of assessment in which the loan is granted and paid by the life-right holder.

In addition, an amount equal to the monetary value, calculated in respect of the right to use the interest-free loan, must be included in the owner’s gross income in the year of assessment in which the loan is granted and paid.

Note: For purposes of calculating the monetary value, symbol 'B' in the formula is 80% x R900 000 = R720 000.

In the case of an interest-free loan, the benefit to retain and use the interest-free loan will accrue to the owner on the date the loan has been granted and paid by the person acquiring the life right.

Example 3 – Date of accrual of an interest-free loan

Facts:

B retired on 30 March 2020 and entered into an agreement with a retirement village owner. Under the agreement, B will be entitled to occupy a particular unit in exchange for the grant of the use of an interest-free loan of R400 000. The agreement is concluded on 15 February 2020. B undertook to pay the R400 000 on receipt of his lump sum benefit from his pension fund. He paid over the R400 000 to the retirement village owner on 12 June 2020. The year of assessment of the owner ends on 31 December 2020.

Result:

The date of accrual for purposes of calculating the monetary value of the right to use the interest-free loan is 12 June 2020.

9. BINDING CLASS RULINGS

9.1. Cancellation of share exchange – No. 79

This ruling determines the tax consequences for former investors in one investment vehicle, who exchanged their participating shares for participating shares in another, who now wish to cancel the original share exchange and to be restored to the position they would have been in, had the share exchange not happened.

In this ruling references to paragraphs are to paragraphs of the Eighth Schedule of the Income Tax Act applicable as at 17 January 2022. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Eighth Schedule.

This is a ruling on the interpretation and application of:

- paragraph 3(c);
- paragraph 4(c);
- paragraph 11(2)(o); and
- paragraph 20(4).

Class

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

Parties to the proposed transaction

The applicant: an authorised financial services provider in South Africa and a distribution partner, sub-investment manager and investment advisor of PC that will resume these roles for IC, following the proposed transaction

IC: An incorporated cell of an incorporated cell company that is a non-resident

PC: A protected cell of a protected cell company that is a non-resident

The class members: The South African tax resident investors of IC who participated in the redemption (see below) and who still hold their shares in PC at the time of implementation of the proposed transaction

Description of the proposed transaction

The class members, with other investors, held voting, participating redeemable shares (participating shares) in IC.

As an incorporated cell of the incorporated cell company, IC is a company in its own right, under its jurisdiction's company law. However, PC is not a company in its own right under such law, but is a protected cell of the protected cell company. PC was formed anew for purposes of the redemption, described below.

A circular was distributed among the shareholders of IC, which proposed a composite offer for a share exchange, designed to move the investment portfolio from the more expensive incorporated cell platform to the less expensive protected cell platform (the redemption).

These transactions were as follows:

- Step 1: IC made an in specie subscription for the shares in PC. The subscription price was settled by transferring all the assets of IC to PC. The subscription was on a net asset value basis, valued on the same day.
- Step 2: PC issued shares to IC.
- Step 3: IC redeemed the participating shares held by the shareholders in IC in exchange for the transfer of PC shares to them pro rata to their participation percentages.

The shareholders of IC were asked to vote on the offer. On the voting date, 99% of these shareholders supported the offer. The acceptance threshold of 75% having been reached, the redemption was implemented for all shareholders of IC, including the class members.

On the redemption effective date IC transferred the assets to PC in exchange for shares in PC. The value of the PC shares was equal to the value of the transferred assets. The PC shares were transferred by IC to the shareholders of IC pro rata to their participation by way of a compulsory in specie redemption of the participating shares.

The remaining shareholders (1%) that neither voted, nor redeemed their participating shares before the redemption effective date, also had their shares automatically redeemed for PC shares. All the participating shares in IC were redeemed and cancelled under the company law of the foreign jurisdiction.

Although all the participating shares were redeemed and IC no longer had any assets, IC was not wound up or deregistered, as management shares issued to the management company of IC remained in place.

The purpose of the redemption was to save costs for the shareholders of IC, because an unincorporated protected cell structure was considered to be more cost efficient than an incorporated cell. However, the capital gains tax consequences of the redemption for the class members were not taken into account. These tax costs far outweighed the expected cost saving, thereby negating the entire business rationale for the redemption. The class members comprise more than 78% of the total shareholders of IC. The parties involved have agreed in principle to cancel the redemption, by way of a reversal of those transaction steps, in the following manner.

- Step 1: PC will make an in specie subscription for freshly issued shares in IC, featuring the exact same terms as the redeemed participating shares (referred to as the new participating shares), and settle the subscription price with the assets currently held by PC;
- Step 2: IC will issue the new participating shares to PC; and
- Step 3: PC will redeem the PC shares currently held by the shareholders of IC in exchange for the new participating shares in IC.

The proposed cancellation transaction will take place on the cancellation effective date. Following the cancellation, the shareholders of IC, including the class members, will once more hold voting, participating redeemable shares in IC and IC will once more hold the portfolio of assets. IC, PC and all the shareholders will be in exactly the same economic position as they would have been in, had the redemption not taken place.

Conditions and assumptions

This binding class ruling is subject to the additional condition and assumption that the class members held their participating shares in IC, as well as the PC shares, and will hold the new participating shares on capital account.

Ruling

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

Since the parties to:

- the redemption are restored to exactly the same position they would have been in, had that transaction not taken place; and
- the proposed cancellation and restitution transaction steps are the same parties that concluded the redemption,

the proposed transaction falls within the ambit of paragraph 11(2)(o) and paragraph 20(4), as the case may be. Accordingly, the following consequences arise:

- The class members who continue to hold PC shares on the cancellation effective date will be treated as not having disposed of –
  - their participating shares (in IC) on the redemption effective date; and
  - their PC shares on the cancellation effective date,

  provided that the redemption effective date and the cancellation effective date fall within the same year of assessment.

- The class members whose year of assessment ended between the redemption effective date and the cancellation effective date must account for:
  - any capital gain realised in relation to the participating shares in IC on the redemption effective date as a capital loss on the cancellation effective date under paragraph 4(c);
  - any capital loss realised in relation to the participating shares in IC on the redemption effective date as a capital gain on the cancellation effective date under paragraph 3(c); and
  - the base cost of the new participating shares acquired in consequence of the cancellation of the redemption in terms of paragraph 20(4)(b). Thus, the base cost of the new participating shares in IC is deemed to be equal to the base cost of the participating shares in IC immediately before the redemption effective date, with the effect that the return of the PC Shares to IC must be ignored.

10. GUIDES

10.1. Comprehensive Guide to Dividends Tax (Issue 5)

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

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

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

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

10.2. Guide on the Determination of Medical Tax Credits (Issue 14)

This guide provides general guidelines regarding the medical scheme fees tax credit and additional medical expenses tax credit for income tax purposes. It does not delve into the precise technical and legal detail that is often associated with tax, and should, therefore, not be used as a legal reference.
Expenditure of a personal nature is generally not taken into account in determining a taxpayer's income tax liability, under South Africa's tax system. One of the notable exceptions relates to medical expenditure. South Africa is aligned with the practice in many other countries of granting tax relief for medical expenditure.

There are a number of reasons that tax systems provide such relief. One of the reasons is that serious injury or illness can present taxpayers with disproportionately high medical bills in relation to income, which can be difficult to meet. The resulting hardship affects a number of economic areas for taxpayers, including the ability to settle obligations to the fiscus, such as a tax bill.

Historically, South Africa utilised a deduction system to facilitate tax relief for medical expenditure. Allowances, subject to certain limits, were permitted to be deducted from income for contributions to medical schemes, as well as for out-of-pocket medical expenditure.

In 2012, tax relief for medical expenditure began a phased-in conversion from a deduction system to a tax credit system. The reason for the change was to

eliminate vertical inequity relating to medical contributions: those at higher marginal tax rates received a larger reduction of tax payable than those on lower marginal rates, in respect of the same amount of medical expenditure. The purpose of the change was to spread tax relief more equally across income groups, thus bringing about horizontal equity – those who pay equal values for medical expenditure receive absolute equal tax relief.

A tax credit system differs from a deduction system in that, instead of permitting a deduction of the medical allowance against a taxpayer's income, the relief is granted as a reduction in tax payable. It therefore operates as a tax rebate.

The new dispensation consists of a two-tier credit system:

- A medical scheme fees tax credit (MTC) that applies in respect of qualifying contributions to a medical scheme.
- An additional medical expenses tax credit (AMTC) that applies in respect of other qualifying medical expenses.

The application of the AMTC system falls into three categories:

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

In order to qualify for the AMTC in the '65 years and older' category, the taxpayer must be 65 years or older on the last day of the relevant year of assessment or, had he or she lived, would have been 65 years or older on the last day of the relevant year of assessment.

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

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

11. 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.