TAX UPDATE

For period: July 2023 to September 2023

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1. FOREWORD

The purpose of this update is to summarise developments that occurred during the third quarter of 2023, 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!

'The hardest thing in the world is to understand the income tax.' — Albert Einstein

'Today, it takes more brains and effort to make out the income-tax form than it does to make the income' — fictitious character in Mad magazine Alfred E. Neuman

'Our new Constitution is now established, everything seems to promise it will be durable; but, in this world, nothing is certain except death and taxes.' — Benjamin Franklin

'Taxes are what we pay for a civilized society.' — U.S. Supreme Court Justice Oliver Wendell Holmes, Jr.

'I'm proud to pay taxes in the United States; the only thing is, I could be just as proud for half the money.' — comedian Arthur Godfrey

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

'TAX RATES HIGH OR LOW: THE ECONOMIC SAGA

High tax rates have caused gargantuan tax-avoidance activities on the part of the rich. By that mechanism, high top tax rates have forces the economy into its periods of substandard performance.

In these periods that form the context of lessened incomes of the rich – as measured by tax reporting and which are indication of corresponding income gains of the nonrich. The next fifteen chapters of *Taxes have Consequences* chronicle this history, and its obverse in the low top-tax-rate eras, striving to relate the phenomenal detail and significance. Here is the snippet view:

1913 – 1923

During the period from the inaugural income tax in 1913 until 1923, there was a short-lived interval of superhigh tax rates on the very rich. In 1918, the highest tax rate was increased to 77 percent, up from 7 percent in 1915. In order to be taxed at the 77 percent rate, the tax filer has to earn upwards of $15 million in today's dollars. The was spent in recession every year from 1918 to 1921. The top 1 percent's average income fell sharply from1916 to 1921, as moneyed people sheltered sheltered their incomes.

1924 – 1928

The big successive drops in top tax rates in the 1920s accompanied an economic breakout: the incredible robust economy of the Roaring Twenties. As the economy roared and tax rates tumbled, the rich submitted much more of what they earned to the lowered tax rates, and virtually everyone was better off. In 1928, with the top tax rate down to 25 percent (from 77 percent a decade earlier), the top 1 percent's average income rose abruptly. Correspondingly, tax revenues from the top 1

1 By Arthur B. Laffer, Brian Domitrovic and Jeanne C Sinquefield, of 2022

percent increased prodigiously.

1920 – 1932

Dramatic declines in tax-reported income at the top began with Hoover's signing of the Smoot-Hawley Tariff bill – the largest tax increase on traded products in peacetime American history – June 1930. In anticipation of the tariff, the stock market began its correction in 1929 with a 35 percent drop in the Dow Jones Industrial Average by year-end. There was a slight slowdown in the real economy in 1929. The decline in the average income of the rich, as tax increases loomed, signaled a worsening economy.

After the tariff bill became law in June 1930, al things unmerciful broke loose. The stock market cratered, tax revenues dove, and unemployment soared. In 1932, an increase in the top individual income tax rate from 25 to 63 percent took effect as unemployment hovered between 20 and 25 percent. The top earners took action to reduce the impact of much higher tax rates – and the consequences were monstrous. High tax rates strongly correlated with a decline in reported income of the rich coincident with an economic collapse.

The United States experimented with very high tax rates during and shortly after World War I. But even those who sponsored these very high rates – up to and including Demoncratic President Woodrow Wilson – recoiled at high tax rates in peacetime and demanded a radical reduction in tax rates once the war was over. Tax rate reductions came in the 1920s. The United States took its top income tax rate down by over two-thirds (from 73 to 24 percent) over the course of the decade. The economy responded with the most legendary run of mass prosperity in history, the Roaring Twenties.

In the 1930s, the United States reversed the policy that had worked so well in the 1920s – the the most disastrous results of all time. In this decade, in the words of economist Emmanuel Saez, the United States came to 'realize that once you had' some experience with high tax rates (as the nation has gained in the teens and early in the 1920s), 'you can crank them up to levels unimaginable just a few years before.' In the 1930s, up went income taxes, inheritance taxes, tariffs, excise taxes,

state and local levies, everything and in most cases by large amounts. There were also new payroll taxes, such as the Social Security tax. The tax-increase sequence of the decade following the Roaring twenties truly was 'unimginable'. The economic event associated with these developments was the Great Depression.

The connection between tax increases and the Great Depression is clear and easy to show. Yet this connection is hidden in plain sight. The typical interpretation of the Great Depression is that it represented a 'crisis of capitalism'. The private sector failed of its own accord and caused the horrible event. This view is incorrect. The chief cause of the Great Depression was taxation. … high and rising tax rates called the Great Depression into being and and guided it at every turn.

Text books … have argued that the 'paradox of the thrft', the money stock, the international payments system, and the gold standard were the main agents in causing the Great Depression. All these theories are interesting. They have certainly had their say in the journals, in education, and in public policy debate. … This is the well-intentioned but mistaken attempt economist have made in emphasizing monetary phenomena as the central manner in the coming of the Great Depression.

… 1930, 1931 and 1932. In these three years, the United States saw a concentration of peacetime tax increases that was at once enormous and unprecedented. There were two tax increases in this brief period, each gigantic. The first was the Tariff Act of 1930, the tax increase on traded prouducts the nation has ever seen. The second was the Revenue Act of 1932, easily the largest increase (on a percentage basis) in the income tax in peacetime history. As economy that was roaring in the 1920s barreled into the 1930s and ran into these two dawnting tax obstacles. The tax obstacles won.

How policymakers could raise taxes punishingly in response to a glorious economic roll is a difficult question to confront. The tax-increases killed off the Roaring Twenties and gave us the Great Depression. The Depression then has its spawn in the geoplotical affairs, World War II. The first step to take in interpreting how this happened is to lay out what happened. The basic course of events is simple enough. The United States passed a large and comprehensive tarrif in Juen

1930. That its effects were negative was at first not apparent but became increasingly clear as the months wore on. In 1931, policymakers confronted an economy badly slowing, and federal receipts flagging, on account of the tariff. Casting about for what to do throughout that year and early in 1932, the settled on truing to remedy the problem with through a huge retroactive domestic tax increase. This was the Revenue Act of 1932. The economy responded with harrowing shrinkage.

A big tax increase that failed, followed by unenlightened debate, followed by a big tax increase that failed even more, followed by the Great Depression plunging into the abyss – this is the sequence of American political economy over 1930, 1931 and 1932. How different it was for the 1920s. The order of things then had been successive tax cuts that kept leading to economic growth, a federal budget surplus, and a decreasing proportion of the size of the government with respect to the economy at large.

…

THE GREAT CONTRACTION, PART I: THE SMOOT-HAWLEY TARIFF

The first devastating tax increase was the tariff on trade products, the Tariff Act of June 1930. Often, this law goes by the name of the Smoot-Hawley Tariff, after the surnames of its sponsors, … Typical for tariffs of its day, the Smoot-Hawley Tariff had three parts. The first, the longest, was a list of products taxed at rates specific to them. The second was a blanket rate for all manufactured items left off the specific list. The third was a list of products exempt from the tariffs – called the ‘free list’. The average tax rate in the first part was about 60 percent. The blanket list was 20 percent.

The Smoot-Hawley Tariff was very long, ninety-some ages of dense script enumerating the specific taxes. Like all tariffs, it makes for curious reading. The specificity was microscopic, as in this representative passage:

> ‘Handkerchiefs, wholy or in part of lace, and handkerchiefs embroidered (whether with a plain or fancy initial, monogram, or otherwise, and whether or not the embroidery is on a scalloped edge), tamboured, appliquéd, or

> from which threads have been omitted, drawn, punched, or cut, and with the threads introduced after weaving to finish or ornament to open work, not including one row of straight hemstitching adjoining the hem; all the foregoing, finished or unfinished, of whatever material composed, valued at not more than 70 cents per dozen, 3 cents each and 40 per centum ad valorem'

On and one the tariff statute went in this vein, describing all imaginable products that could be imported and assigning them a duty rate.

THE GREAT CONTACTOIN, PART II: THE BIG RETROACTIVE 1932 INCOME TAX HIKE

Per the November 1931 Treasury report:

> 'During the fiscal year ended June 30, 1931, the Federal finances for the first time reflected in a marked degree the decline in business activity which has continued with only minor interruptions since the middle of 1929. A very considerable decrease in Federal revenues, together with an increase in expenditures, resulted in a deficit of [$903 million], as contrasted with a surplus … in the preceding fiscal year … Total ordinary receipts at [$3.3 billion] were [$861 million] less than in the preceding fiscal year.'

The report went on to detail that during the period of July 1930 – June 1931, receipts from customs had declined by 36 percent, receipts from corporate income taxes by 31 percent …

It is remarkable that, as business, banking, housing, trade, and the like in the United States was contracting to an unprecedented and harrowing degree through early 1932, Congress was considering a serious tax-increase bill. Treasury Secretary Mills's testimony in favor of the bill before the Senate indicated the strange rational:

> 'I want to say to you gentlemen, with all of the earnestness of which I am capable, that I consider the balancing of this Budget as essential to the national welfare of our country … There is not time to debate, and there is nothing more to be learned from debate … Every phase of this tax situation

> is known … In view of this great – what I considered a great and real emergency – and I must ask you to take my word for that – I urge you to find these $280 000 000 [via the tax inceases and new taxes under consideration] …. [And] I tell you that is the easiest and best way of raising the revenue, in the existing situation, and it will carry to the country, as not other tax can, the absolute assurance that the Budget is going to be balanced, for it rests on so broad a base that one can estimate its yield with considerable confidence … What I want is a balanced Budget; a balanced budget at all costs … [T]he one thing the country wants to know is that the finances fo the country are on a firm basis for the next 12 months. I think if that word went out it would electrify the country … I for one am confident that the day the Budget of the United States Government is balance beyond all question, conditions are right for a turn.'

…

The bill the House undertook in January 1932 considered the Treasury's proposals as a floor for the new tax regime, as the Senate would in April. The final work has a phony aspect of symmetry. It was fecklessness in the terrible economic considitons of the winter and spring of 1932. The top income tax rate per the law rose not to 46 persent as the Treasury had suggested (and the 1924 rate), but to 63 percent. It was a clean 150 percent increase, 25 percent times 2.5, rounded up to the whole number. Similar gains played with estate tax. It would go up by a clean 125 percent, from 20 percent to 45 percent. …

At last, the Senate came up with a cherry on top. The Senate would make the income tax increases of the bill retroactive.The measures on the income tax side would apply not at the date the bill was to be signed by Hoover … but back to the first of the year, January,1, 1932. …

3. MEDIA STATEMENT: PUBLICATION OF THE 2023 BUDGET DRAFT TAX BILLS AND DRAFT REGULATIONS

- **2023 draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (2023 draft Rates Bill)**
- **2023 draft Taxation Laws Amendment Bill (2023 draft TLAB)**
- **2023 draft Tax Administration Laws Amendment Bill (2023 draft TALAB)**
- **Draft Regulations in terms of paragraphs (d) and (e) of the definition of 'Research and Development' in section 11D(1) of the Income Tax Act,1962**
- **Draft amendments to the Regulations on domestic reverse charge relating to valuable metal in terms of section 74(2) of the VAT Act, 1991; and**
- **draft Carbon Offset Regulations**

The National Treasury and SARS on 30 July 2023 published, for public comment, the 2023 draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (2023 draft Rates Bill), the 2023 draft Taxation Laws Amendment Bill (2023 draft TLAB), the 2023 draft Tax Administration Laws Amendment Bill (2023 draft TALAB), draft Regulations in terms of paragraph (d) of the definition of 'Research and Development' in section 11D(1) of the Income Tax Act, 1962, on additional criteria for multisource pharmaceutical products, draft Regulations in terms of paragraph (e) of the definition of 'Research and Development' in section 11D(1) of the Income Tax Act, 1962, on criteria for clinical trials in respect of deduction for research and development; draft Regulations on domestic reverse charge relating to valuable metal in terms of section 74(2) of the Value-Added Tax Act, 1991 and draft Carbon Offset Regulations.

These draft tax bills and draft Regulations give effect to the 2023 Budget tax

proposals, which were outlined in Chapter 4 and Annexure C of the 2023 Budget Review. In addition, draft Explanatory Memoranda containing a comprehensive description of the proposed tax amendments contained in the 2023 draft TLAB and regulations are published, to assist the public on the background and reasons for any proposed change, and the proposed amendments. A Draft Memorandum on the Objects on the TALAB is also published to assist the consultation process.

- **2023 Draft Rates Bill**

The 2023 draft Rates Bill was first published on Budget Day (22 February 2023) but is published for the second time for public information. The 2023 draft Rates Bill contains tax announcements made in Chapter 4 of the 2023 Budget Review that deal with changes to the rates and monetary thresholds and increases of the excise duties. Key tax proposals contained in the 2023 draft Rates Bill include the following:

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

2023 Draft TLAB

The 2023 draft TLAB contains the necessary legislative amendments required to implement the more complex tax announcements made in Chapter 4 and Annexure C of the 2023 Budget Review (i.e. those not dealing changes in a rate or threshold of a tax) that involves more complex policy and technical amendments and requires greater consultation with affected stakeholders and the public. Key tax proposals contained in the 2023 draft TLAB include the following:

- Rooftop solar tax incentive
- Renewable energy tax incentive
- Research and Development tax incentive
- Urban Development Zone tax incentive

- Adjusting the minimum royalty rate for oil and gas companies
- Reviewing principles contained in Practice Note 31 of 1994
- Clarifying anti-avoidance rules dealing with third-party backed shares
- Refining the provisions applicable to unbundling transactions
- Tax treatment of deposit insurance scheme
- Clarifying the foreign business establishment exemption for controlled foreign companies
- Refining the participation exemption for the sale of shares in foreign companies
- Reviewing the VAT treatment of specific supplies in the short-term insurance industry
- Clarifying the VAT treatment of prepaid vouchers in the telecommunications industry

2023 Draft TALAB

The 2023 draft TALAB contains the legislative amendments dealing with tax administration announced in Chapter 4 and Annexure C of the 2023 Budget Review, that also require greater consultation with the affected stakeholders and the public. Key tax proposals contained in the 2023 draft TALAB include the following:

- Advance Pricing Agreement Programme
- Employees' tax registration requirement for non-resident employers
- Variation of employees' tax withholding in respect of remuneration
- Expanding the general disclosure provisions for section 18A approved organisations
- Single window for advance passenger information and passenger name record data

- Enabling SARS' new online traveller management system
- Expending the time period to submit a return where taxpayers disagree with an autoassessment.
- Alignment with anti-money laundering and combatting terrorism developments.

Draft Regulations in terms of paragraph (d) of the definition of 'Research and Development' in section 11D(1) of the Income Tax Act on additional criteria for multisource pharmaceutical products

The draft Regulations in terms of paragraph (d) of the definition of 'Research and Development' in section 11D(1) of the Income Tax Act contain consequential technical amendments aimed at aligning the wording of the Regulations with the proposed changes on Research and Development tax incentive, announced in Chapter 4 of the 2023 Budget Review.

Draft Regulations in terms of paragraph (e) of the definition of 'Research and Development' in section 11D(1) of the Income Tax Act on criteria for clinical trials in respect of deduction for research and development

The draft Regulations in terms of paragraph (e) of the definition of 'Research and Development' in section 11D(1) of the Income Tax Act contain consequential technical amendments aimed at aligning the wording of the Regulations with the proposed changes on Research and Development tax incentive, announced in Chapter 4 of the 2023 Budget Review.

Draft Regulations on domestic reverse charge relating to valuable metal in terms of section 74(2) of the VAT Act, 1991

The draft Regulations on domestic reverse charge relating to valuable metal contain the following key tax proposals announced in Annexure C of the 2023 Budget Review:

- Clarifying the definition of 'residue'
- Clarifying the definition of 'valuable metal'

- Clarifying the exclusions from the definition of 'valuable metal'
- Introducing a de minimis rule in the definition of 'valuable metal'
- Aligning the definition of 'valuable metal' with the Precious Metals Act, 2005
- Clarifying the transitional measures
- Clarifying the responsibilities of the recipient of valuable metal

Draft Carbon Offset Regulations

The draft Carbon Offset Regulations contain the following key tax proposal announced in Annexure C of the 2023 Budget Review:

- Aligning the utilisation period in the Carbon Offset Regulations with the extension of the first phase of the carbon tax, i.e., from 1 January 2023 to 31 December 2025.

The public consultation process for tax proposals is a critical element of the tax legislative process and differs from the consultative processes for other money bills.

After receipt of written comments, National Treasury and SARS normally engage with stakeholders through public workshops to discuss the written comments on the draft tax bills and draft regulations.

With regard to the 2023 draft tax bills, the Standing Committee on Finance (SCoF) and the Select Committee on Finance (SeCoF) in Parliament are expected to make a similar call for public comment and convene public hearings on the 2023 Rates Bill, 2023 draft TLAB and 2023 draft TALAB before their formal introduction in Parliament. Thereafter, a response document by the National Treasury and SARS will be presented on the comments received to the parliamentary committee meetings, after which the draft bills will then be revised, taking into account public comments and recommendations made during committee hearings, before they are introduced formally in Parliament for its consideration. For legal reasons, the draft tax amendments continue to be split into two types of bills, namely a money bill (section 77 of the Constitution) dealing with money bill issues and an ordinary

bill (section 75 of the Constitution) dealing with issues relating to tax administration.

With regard to the draft regulations, National Treasury and SARS will also engage with stakeholders through public workshops to discuss their written comments. The Notices on Regulations in terms of paragraph (d) of the definition of 'Research and Development' in section 11D(1) of the Income Tax Act, 1962, on additional criteria for multisource pharmaceutical products, Regulations in terms of paragraph (e) of the definition of 'Research and Development' in section 11D(1) of the Income Tax Act, 1962, on criteria for clinical trials in respect of deduction for research and development; Regulations on domestic reverse charge relating to valuable metal in terms of section 74(2) of the Value-Added Tax Act, 1991 and Carbon Offset Regulations will then be published in the Government Gazette after taking into account public comments received.

The 2023 draft tax bills, the accompanying draft Explanatory Memoranda containing a

comprehensive description of the proposed tax amendments contained in the 2023 draft TLAB and TALAB, and draft Regulations can be found on the National Treasury (www.treasury.gov.za) and SARS (www.sars.gov.za) websites.

More general information underlying the changes in rates, thresholds or any other tax amendments can be found in the 2023 Budget Review, available on the National Treasury website.

Due date for public comments on the 2023 draft tax bills and draft regulations

National Treasury and SARS hereby invite comments in writing on the 2023 draft Rates Bill, the 2023 draft TLAB, 2023 draft TALAB, the draft Regulations in terms of paragraph (d) of the definition of 'Research and Development' in section 11D(1) of the Income Tax Act, 1962, on additional criteria for multisource pharmaceutical products, the draft Regulations in terms of paragraph (e) of the definition of 'Research and Development' in section 11D(1) of the Income Tax Act, 1962, on criteria for clinical trials in respect of deduction for research and development; the draft Regulations on domestic reverse charge relating to valuable metal in terms of

section 74(2) of the Value-Added Tax Act, 1991 and the draft Carbon Offset Regulations.

Please forward written comments to the National Treasury's tax policy depository at 2023AnnexCProp@treasury.gov.za and SARS at acollins@sars.gov.za by close of business on 31 August 2023.

ISSUED BY NATIONAL TREASURY ON 30 JULY 2023

4. DRAFT EXPLANATORY MEMORANDUM ON THE DRAFT TAXATION LAWS AMENDMENT BILL, 2023

4.1. Apportioning the tax-free investment contribution limitation and limiting the retirement funds contribution deduction when an individual ceases to be a tax resident

[Applicable provisions: Sections 11F and 12T of the Income Tax Act, No. 58 of 1962 ('the Act')]

Background

In 2022 changes were made in the Act to provide that when an individual ceases to be a South African tax resident, the annual interest exemption available to individuals in terms of section 10(1)(i) is apportioned; and the capital gains tax annual exclusion available to individuals in terms of paragraph 5(1) of the Eighth Schedule to the Act is limited.

The main aim of the above-mentioned changes was to address an anomaly that arises because of the two years of assessment which are created during a single 12-month tax period when an individual ceases to be a South African tax resident. By way of illustration, when an individual ceases to be a South African tax resident on 1 June 2022, his or her year of assessment as a South African tax resident would have begun on 1 March 2022 but would be deemed to have ended on 31 May 2022, this constitutes a 3-month year of assessment as a South African tax

resident. The individual's year of assessment as a non-South African tax resident would have thus begun on 1 June 2022 and ended on 28 February 2023, constituting a 9-month year of assessment as a non-tax resident. Both years of assessment (the 3-month and 9-month periods respectively) would fall within a single 12-month tax period.

Reasons for change

It has come to Government's attention that there are other provisions in the Act that contain inconsistencies which result in two years of assessment being created during a single 12-month period when an individual ceases to be a South African tax resident. These provisions include the following:

- section 12T(4)(a) of the Act, which provides that for the exemption of returns earned from a Tax-Free Savings Account to apply, aggregate contributions made into said account should currently not exceed R36 000 during a year of assessment; and
- section 11F(2) of the Act which makes provision for a deduction of aggregate amounts contributed to a retirement fund during a year of assessment. One of the criteria as relates to this deduction is that such deduction is limited to, and should not exceed R350 000 in any year of assessment.

As a result of an individual having two years of assessment in a single 12-month tax period when he or she ceases to be a South African tax resident, the individual may double-up on the Tax-Free Savings Account annual contribution limitation of R36 000 as well as the R350 000 utilised to calculate the allowable section 11F deduction (as the respective limitations are available per year of assessment, and are currently not apportioned in instances where the year of assessment is less than 12 months). This is contrary to the policy rationale for sections 11F and 12T of the Act. As such, an individual would currently be able to contribute R72 000 to a Tax-Free Savings Account while enjoying tax-free status on returns received from that Tax-Free Savings Account (R36 000 for the 3-month period and another R36 000 for the 9-month period), as well as a current possible maximum section 11F

deduction of R700 000 (R350 000 for the 3-month period and R350 000 for the 9-month period) during the 12-month period 1 March 2022 to 28 February 2023.

Proposal

To address this anomaly and ensure alignment with other provisions of the Act, it is proposed that the following changes be made in the Act:

- Apportioning the annual Tax-Free Savings Account contribution limitation:

  Section 12T(4)(a) of the Act - Where any person's year of assessment is less than 12 months, the contribution limitation that shall apply in terms of section 12T(4)(a) of the Act (which is currently R36 000), shall be the amount that bears to the amount referred to in section 12T(4)(a) of the Act, the same ratio as the number of days in that year of assessment bears to 365 days.

- Limiting the amount utilised to calculate the allowable retirement contribution deduction:

  Section 11F(2)(a) of the Act - Where any person's year of assessment is less than 12 months, the amount stipulated in section 11F(2)(a) of the Act as utilised to calculate the allowable retirement contribution deduction (which is currently R350 000), shall be the amount that bears to the amount referred to in section 11F(2)(a) of the Act, the same ratio as the number of days in that year of assessment bears to 365 days.

Effective date

The proposed amendments will come into operation on 1 March 2024 and apply in respect of years of assessment commencing on or after that date.

4.2. Clarifying anti-avoidance rules for low-interest or interest-free loans to trusts

[Applicable provision: Section 7C of the Act]

Background

In 2016 anti-avoidance measures aimed at curbing the tax-free transfer of wealth to trusts using low interest or interest free loans, advances or credit were introduced in section 7C of the Act. The tax avoidance structures involved taxpayers transferring assets to trusts where the purchase price that the trust owes in respect of the assets is left outstanding on loan account in favour of that taxpayer but in respect of which no interest or very low interest is charged. As an alternative, taxpayers would advance a low interest or interest-free loan, advance or credit upfront to a trust in order for the trust to use the money to acquire assets.

Since the introduction of these anti-avoidance measures, taxpayers have been devising variations to the abovementioned structures. For example, companies were introduced in the avoidance structures wherein taxpayers would advance interest free or low interest loans to companies owned by trusts because initially the anti-avoidance measures focused solely on interest free or low interest loans, advances or credit that were made by a natural person or a company (at the instance of a natural person) to trusts. Changes were consequently made in section 7C of the Act in 2017 to strengthen these rules so that interest free or low interest loans, advances or credit that are made by a natural person or a company (at the instance of a natural person) to a company that is a connected person in relation to a trust are also subject to the anti-avoidance measure. In 2020, further changes were made in section 7C of the Act to curb the use of further schemes that avoided the application of the anti-avoidance measures by way of natural persons subscribing for preference shares with no or a low rate of return in a company owned by a trust that is a connected person to those individuals.

Reasons for change

A. Determination of the deemed donation in respect of debt denominated in foreign currency

Where the provisions of section 7C of the Act apply, any interest foregone in respect of low interest or interest free loans, advances or credit owed by any trust or company is deemed to be a donation that is subject to donations tax. The deemed donation is calculated as the amount by which the official rate of interest exceeds any amount of interest incurred in this regard. However, in instances where the low interest or interest free loan, advance or credit owing by any trust or company is denominated in foreign currency, the provisions of the anti-avoidance measure do not provide guidance to taxpayers on how and when this amount should be translated to South African rands.

B. Exclusion of primary residence from the application of the anti-avoidance measure

A deemed donation is not triggered under the provisions of section 7C of the Act where certain exclusions contained in the provisions apply. For example, there is an exclusion for where the low interest or interest free loan, advance or credit is used by a trust or company to facilitate the acquisition of a primary residence for a person advancing that low interest or interest free loan, advance or credit or a spouse of such person. It has come to Government's attention that this exclusion in respect of a primary residence does not fully encompass what constitutes a primary residence in terms of the Eighth Schedule of the Act when it was intended that the meanings should be aligned.

Proposal

A. Determination of deemed donation in respect of debt denominated in foreign currency

It is proposed that changes be made in the legislation to provide guidance on the determination of any deemed donation that is triggered by the

application of the anti-avoidance measure in respect of low interest or interest free loans, advances or credit that are denominated in any currency other than South African Rand. It is proposed that for purposes of determining the amount to be treated as a donation, any foreign denominated debt outstanding at the end of the year of assessment of the trust or company that owes the tainted loan, advance or credit or any foreign denominated interest incurred during any year of assessment of such trust or company must be translated to the currency of the Republic by applying the spot rate on the last day of that year of assessment of that trust or company.

D. Exclusion of primary residence from the application of the anti-avoidance measure

It is proposed that the exclusion for the acquisition of a primary residence be clarified by also including funding of improvements to the primary residence and by applying the limitations in paragraph 46 relating to the land on which the primary residence is situated to the primary residence.

Effective date

The proposed amendments will come into effect on 1 January 2024 and applies in respect of any amount owed by a trust or company in respect of a loan, advance or credit provided to that trust or that company before, on or after that date.

4.3. Solar energy tax credit

[Applicable provisions: New section 6C and section 25 of the Act]

Background

The tax system does not generally allow for deductions in respect of personal consumption, for example, expenses/ incurred in respect of a motor vehicle used for private purposes or expenses incurred in respect of a salary paid to a domestic worker.

However, in certain circumstances, either for purposes of encouraging individuals to save for retirement or for philanthropic purposes, or in instances where the expenditure is directly linked to employment income, the Act allows individuals who derive employment income, and or passive income, a credit or deduction in respect of a limited number of expenses, such as:

- Contributions to retirement funds;
- Medical scheme contributions and other medical expenses;
- Donations to approved Public Benefit Organisations;
- Home office expenses under certain qualifying criteria;
- Wear and tear in respect of certain assets;
- Amounts received for services rendered that are subsequently refunded;
- Bad and doubtful debts that are related to employment subject to certain conditions;
- Legal costs under certain qualifying circumstances;

On the other hand, an individual who carries on a business is also eligible for deductions and allowances provided for in the Act in respect of his or her business expenses.

Reasons for change

In response to the severe energy crisis currently being experienced by the country, Government is proposing various policy measures to the renewable energy mix to improve energy efficiency and reduce pressure on the electricity grid. To encourage households to invest in clean electricity generation capacity, which can supplement electricity supply, Government proposed, in the 2023 Budget Review, a rooftop solar tax incentive for individuals who invest in solar photovoltaic (PV) panels.

Proposal

It is proposed that individuals who are liable for personal income tax be granted a solar energy tax credit, which will apply as follows:

A. Solar PV panels eligible for the solar energy tax credit

The solar energy tax credit will apply to solar PV panels:

- which are new and unused, acquired by the individual and brought into use for the first time by the individual on or after 1 March 2023 and before 1 March 2024;
- which have a minimum generation capacity of not less than 275W each;
- which form part of a system that is connected to the distribution board of a residence that is mainly (more than 50 per cent) used by the individual for domestic purposes; and
- in respect of which an electrical certificate of compliance is issued to the individual in terms of Electrical Installation Regulations, 2009 after the solar PV panels have been installed.

B. Time period for the solar energy tax credit

To encourage individuals to invest in clean electricity generation capacity as soon as possible, the solar energy tax credit will only be available for a period of 1 year and will apply to new and unused solar PV panels that are acquired by the individual and brought into use for the first time on or after 1 March 2023 and before 1 March 2024.

C. Amount of the solar energy tax credit allowed as a deduction

The amount of the solar energy tax credit allowed as a deduction to an individual is 25 per cent of the cost of the solar PV panels described above, up to a maximum of R15 000.

D. Meaning of residence for solar energy tax credit

As indicated above, the energy tax credit applies to new and unused solar PV panels that are installed at a residence that is mainly used by an individual for domestic purposes. This implies that the energy tax credit will apply to individuals who:

- own, rent or occupy residences and acquire new and unused solar PV panels for installation at residences that are mainly used for domestic purposes;
- incur the cost to acquire the solar PV panels.

E. Limitation of solar energy tax credit in respect of assets granted an allowance in terms of section 12B or 12BA of the Act

To ensure that there is no duplication of tax incentives in respect of a solar PV panel, the energy tax credit shall not be allowed for a solar PV panel in respect of which an allowance is granted in terms of section 12B or 12BA of the Act.

F. Recoupment of solar energy tax credit on the sale of solar PV panels

Where an individual sells a solar PV panel on or before 1 March 2025 that qualified for a solar energy tax credit, the amount of the solar energy tax credit that was allowed as a deduction in respect of the solar PV panel will be regarded as an additional amount of normal tax payable by that individual in the year of assessment in which he or she sold the solar PV panel.

However, there will be no recoupment of the amount of the solar energy tax credit that was allowed as a deduction if the individual disposes of or vacates the residence to which the solar PV panel is affixed.

Effective date

The proposed amendments will be deemed to have come into operation on 1 March 2023 and apply in respect of years of assessment commencing on or after 1 March 2023.

4.4. Clarifying the amount of employer contribution to a retirement fund to be deductible

[Applicable provision: Section 11F of the Act]

Background

Section 11F(4) of the Act, read together with paragraphs 2(h), 2(l), 12D and 13 of the Seventh Schedule to the Act makes provision for contributions made by the employer to a retirement fund, made on behalf of an employee, to be regarded as an amount equal to the cash equivalent of the value of the taxable fringe benefit and also taxable in the employee's hands.

In accordance with section 11F(4) of the Act, amounts paid or contributed by an employer to a retirement fund on behalf of an employee are deemed to have been contributed by the employee and are therefore taken into consideration when determining the employee's allowable deduction in terms of section 11F of the Act.

Reasons for change

Currently, section 11F(4) of the Act does not have a requirement that the cash equivalent (so calculated as employer contributions to a retirement fund on behalf of an employee) be included in the employee's income when determining the allowable deduction in terms of section 11F of the Act. As a result, even if an employer's contribution to the retirement fund is not subject to fringe benefit tax because the employee's remuneration qualifies for income tax exemption in terms of section 10(1)(o)(ii) of the Act, the employee may still be entitled to a deduction in terms of section 11F of the Act.

This anomaly therefore creates a scenario where an employee may be entitled to a deduction of the employer contribution in terms of section 11F of the Act, even though the employee was not subject to fringe benefit tax on that contribution. Further to the above, if all their income is tax exempt, the employer contribution may be carried forward to retirement or withdrawal from their respective retirement fund and be allowed as a deduction against the employee's lump sum or annuity, this again, without the employee having been taxed on such employer contribution.

The above anomaly goes against the policy intent. As is evident in sections 6A and 6B of the Act (which deal with the allowable medical tax credits), the policy intent is for a deduction or tax credit to only be afforded to amounts included in the taxpayer’s income (i.e., a deduction or tax credit should not be available for tax exempt amounts).

Proposal

To address this anomaly and ensure parity with other provisions of the Act, it is proposed that changes be made in section 11F(4) of the Act so that the deduction in terms of this section only apply to the extent that the cash equivalent (so calculated as employer contributions to a retirement fund on behalf of an employee) is included in the employee’s income as a taxable benefit in terms of paragraphs 2(l) and 12D of the Seventh Schedule to the Act.

Effective date

The proposed amendments will come into operation on 1 March 2024 and apply in respect of years of assessment commencing on or after that date.

4.5. Transfers between retirement funds by members who are 55 years or older

[Applicable provisions: Section 1(1) of the Act: definitions of ‘pension fund’ and ‘provident fund’ and paragraph 6A of the Second Schedule to the Act]

Background

Paragraph 2(1)(c) of the Second Schedule to the Act regulates the amount to be included in gross income for any year of assessment, namely, any amount transferred for the benefit of a member of a retirement fund on or after normal retirement age (as defined in the rules of the fund), but before retirement date (as defined in section 1(1) of the Act), less any deductions allowed under paragraph 6A of the Second Schedule to the Act.

Prior to 1 March 2022, paragraph 6A of the Second Schedule to the Act permitted the following deductions when calculating the retirement fund lump sum benefit to be included in gross income:

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

With effect from 1 March 2022 transfers into a similar fund by a member of a pension preservation or provident preservation fund (who has reached normal retirement age in terms of the fund rules but has not yet opted to retire from the respective fund) were also included in the ambit of Paragraph 6A of the Second Schedule to the Act. As a result, any individual transfers between preservation funds where the transfer is between similar funds and the member involved has reached normal retirement age in terms of the fund rules but has not yet opted to retire from the relevant fund are tax-free.

Reasons for change

It has come to Government's attention that there are some instances where active contributing pension and provident fund members (who have reached normal retirement age in terms of the fund rules but have not yet opted to retire from the respective fund) are being subjected to involuntary transfers to another pension or provident fund, and such transfers are being subjected to tax.

Proposal

To address this issue and ensure parity amongst members of retirement funds who have reached normal retirement age in terms of the fund rules but have not yet opted to retire from their respective fund, and are subject to an involuntary transfer, it is proposed that the following changes be made in the Act:

- members of pension or provident funds who have reached normal retirement age as stipulated in the fund rules, but have not yet opted to retire from said fund, and are subject to an involuntary transfer, are able to

have their retirement interest transferred from a less restrictive to a more restrictive retirement fund without incurring a tax liability; and

- the value of the retirement interest, including any growth thereon, will remain ring-fenced and preserved in the receiving pension or provident fund until the member elects to retire from that fund. This means that these members will not be entitled to the payment of a withdrawal benefit in respect of the amount transferred.

Effective date

The proposed amendments will come into operation on 1 March 2024 and apply in respect of years of assessment commencing on or after that date.

4.6. Reviewing the principles of practice note 31 of 1994

[Applicable provision: New section 11G of the Act]

Background

In 1994, the South African Revenue Service issued Practice Note 31 of 1994, entitled 'Interest paid on moneys borrowed'.

Practice Note 31 of 1994 provides a concession to taxpayers that accrue interest income by enabling them to obtain a deduction in respect of expenditure incurred in production of interest without the taxpayer having carried on a trade. Such deductions are limited to the taxable interest income as it is intended that they do not give rise to losses.

Reasons for change

On 16 November of 2022, SARS issued a notice of its intention to withdraw Practice Note 31 of 1994 and Practice Note 37 of 1995 with effect from 1 March 2023 with such withdrawal applying in respect of years of assessment commencing on or after that date. Taxpayers were given an opportunity to make representation for legislative amendments as part of National Treasury's Budget 2023 Annexure C in respect of which taxpayer workshops were held in December 2022.

It is still Government's policy that deductions should be allowed where the taxpayer is carrying on a trade. Under the general deduction formula, deductions are not limited to the income of the taxpayer, however, the trade requirement operates as a safety net that the fiscus will not simply carry excess expenditure and losses without hope of any tax collection in a future year of assessment. As such, Government seeks to not allow concessions that will enable the circumvention of the trade requirement in allowing for deductions in the business context.

Furthermore, the abuse of Practice Note 31 of 1994 is worsened by taxpayers entering into transactions that are structured to maximise the deduction of interest or other expenditure incurred whilst there is no corresponding inclusion in gross income for the related recipient or where debt funding is ultimately used to fund non-income producing activities or assets. However, it is not in the best interest of the fiscus that efficient access to funding for businesses should be hampered, with particular emphasis on the existing practice for groups of companies to raise funding centrally in a non-trading treasury company and on-lending to a fellow group company in return for interest.

After reviewing public comments received, in the 2023 Budget Review, an announcement was made that Government will consider and review the impact of the proposed withdrawal and whether changes could be made in the tax legislation to accommodate legitimate transactions affected by the withdrawal. In view of this Budget announcement, SARS delayed and aligned the withdrawal of the Practice Notes with the effective date of any legislation arising from the proposed considerations.

Proposal

Certainty is one of the cornerstones of a good tax system and clearly legislated tax policies are imperative in ensuring certainty for both taxpayers and SARS. As such, Government proposes that Practice note 31 of 1994 be withdrawn and proposes to only provide legislative guidance to the extent that deductions dealt with in terms of Practice note 31 of 1994 align with currently prevailing policy.

It is proposed that a company may deduct expenditure it incurs in the production of interest income accruing from another company that forms part of the same group of companies (as defined in section 1(1) of the Act) as that company if the following requirements are met:

- The expenditure incurred by that company must be in respect of amounts owing for purposes of providing funding directly or indirectly to one or more companies that form part of the same group of companies as that company;
- The other company must use or have used the funds advanced or credit made available by that company for purposes of its trade to produce income; and
- The deduction of the expenditure incurred by that company during any year of assessment must be limited to the interest income accruing directly or indirectly from that other company during that year of assessment.

These requirements are aimed at ensuring that where funding is raised by one group company for purposes of another group company for productive purposes, no tax leakage arises. Where the funds are used within the group for non-income producing purposes, a deduction will not be allowed, and other specific provisions must be considered (i.e., section 24O of the Act).

Effective date

The proposed amendments will come into effect on 1 January 2024 and apply in respect of years of assessment commencing on or after that date.

4.7. Clarifying anti-avoidance rules dealing with third-party backed shares

Background

Hybrid instrument anti-avoidance measures were introduced by Government to address concerns of undue tax advantages obtained through the merging of equity

instruments with debt instruments to effectively change the nature of taxable interest into tax-exempt dividend income.

More specifically, third-party backed share anti-avoidance rules were introduced by Government during 2012 to deal with concerns regarding preference shares with dividend yields backed by third parties. These anti-avoidance rules deem dividend yields of third-party backed shares to be treated as income unless the funds derived from the issue of the third-party backed shares are used for a qualifying purpose.

A qualifying purpose for the use of funds derived from the issue of a preference share can include the:

(a) direct or indirect acquisition of equity shares in an operating company;

(b) acquisition or redemption of any preference shares previously used for any qualifying purpose;

(c) settlement of debt used for the purposes set out above and any interest accruing on such debt; or

(d) payment of any dividend, foreign dividend as it relates to (b) above.

More specifically, the first qualifying purpose exception above to the third-party backed share antiavoidance only applies when there is a direct or indirect acquisition of an equity instrument in a company that is an operating company at the time of the receipt or accrual of any dividend or foreign dividend in respect of that equity instrument (the qualifying purpose test).

Reasons for change

The concept of the qualifying purpose exceptions to the third-party anti-avoidance rules was introduced in an effort by government to mitigate certain identified adverse tax consequences, affecting legitimate business acquisition transactions. These exceptions recognise the need for preference share financing in respect of share acquisitions because South African tax law does not generally allow for deductible interest when debt is employed to finance a share acquisition.

Essentially, the introduction and amendment of these exceptions meant that preference share funding could continue as a means for acquiring an ownership interest in active operating or startup companies.

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

The qualifying purpose definition has been amended several times since its inception after engagement with taxpayers and financial sector participants. However, these targeted amendments over a period and especially the legislative wording and structure used to achieve certain results has unintentionally narrowed the qualifying purpose test by not emphasising all aspects of the policy rationale.

Example: The definition of a qualifying purpose was amended in 2016 to specifically cater for the investment of funds derived from preference share issues in equity shares of start-up companies, by applying the qualifying purpose test whether the company is an operating company at the time of the receipt or accrual of any dividend in respect of those preference shares.

This may lead to a scenario where the qualifying purpose test is considered without the ownership of the equity shares in an operating company that underpins the qualifying purpose exemption.

Proposal

The current wording of the Act could result in certain dividends or foreign dividends received by or accrued in respect of a third-party backed share not being deemed as income when the shares in that operating company are no longer held by the person who initially acquired them.

It is proposed that the legislation be amended to specifically introduce an ownership requirement, of the equity shares in the targeted operational company by the person that acquired those equity shares, at the time of the receipt or accrual of any dividend or foreign dividend.

<u>Effective date</u>

The amendment is deemed to have come into operation on 31 July 2023 and applies in respect of any dividends or foreign dividends received or accrued during years of assessment ending on or after that date.

4.8. Addressing the abuse of the definition of contributed tax capital

[Applicable provision: section 1(1) of the Act: ‘contributed tax capital’ definition]

<u>Background</u>

Contributed tax capital (CTC) is a calculated amount for tax purposes that is the amount of tax capital of a class of shares of a company, ensuring that no tax is paid on the return of that amount to shareholders.

An amount of CTC is determined by either: (1) the consideration received by or accrued to a resident company in exchange for the issue of shares of a particular class by that resident company; or (2) the aggregate of the market value of a foreign company when it becomes a tax resident in South Africa together with the consideration allocated on a particular class of shares after the date on which a foreign company becomes a tax resident of South Africa. However, CTC is reduced by any amounts, referred to as capital distributions, transferred by the company to the shareholders.

<u>Reasons for change</u>

Government has identified a structure where a foreign holding company that holds shares in a valuable South African operating company through a foreign intermediary could avoid dividends tax by changing the tax residency of that foreign intermediary to South Africa. When this takes place, the deemed CTC amount of that foreign intermediary is equal to the market value of all the shares in that foreign company of that class immediately before the date on which that foreign intermediary becomes a resident. The South African operating company

then distributes dividends to the new South African tax resident company, and those dividends are exempt from tax because dividends between South African companies are not subject to tax. When the new South African company makes distributions to the foreign holding company, the distributions are shielded by CTC and regarded as capital distributions. The capital distributions are not subject to dividends tax and are also not subject to capital gains tax in the foreign holding company if the underlying investment in South Africa is not in immovable property.

The offending structure does not create any additional investment or benefit into the South Africa economy but merely changes the tax status of the foreign intermediary to that of a South African tax resident by replacing its foreign directors with SA directors which effectively changes its place of effective management to South Africa. This leads to a permanent erosion of the South African tax base as these capital distributions are now not subject to tax.

Proposal

To address the abuse of the CTC regime, it is proposed that the market value of shares in a foreign company for contributed tax capital purposes be limited when that company becomes a South African tax resident.

The market value of the shares must be reduced by the market value of shares that the foreign company holds in South African resident companies immediately before the date on which that foreign company becomes tax resident.

It is proposed that the anti-avoidance measure only applies to the extent the foreign company holds shares in:

- South African resident companies that are connected persons in relation to that foreign company; and
- the market value of those resident companies referred to above exceeds 50 per cent of the market value of shares in that foreign company,

immediately before the foreign company becomes a resident.

Effective date

The proposed amendment will come into operation on 1 January 2024.

4.9. *Translating contributed tax capital from foreign currency to rands*

[Applicable provision: New section 25E of the Act]

Background

Contributed tax capital, in the case of a foreign company, is an amount equal to the market value of all the shares in that company of that class immediately before the date on which that company becomes a resident and the consideration received by or accrued to that company in exchange for the issue of shares of a particular class, on or after the date on which that company became a resident of South Africa. It is reduced by any amounts referred to as capital distributions, transferred by the company to the shareholders.

Reasons for change

A company may have more than one place of business, but it can only have a single place of effective management at any one time. As such a company can have its place of effective management in one country and conduct its business operations in another country or countries.

When a company changes its tax residence to South Africa, it is possible for that company's functional currency and share capital to be denominated in a currency other than the Rand.

The Act contains specific rules dealing with the translation of amounts received by or accrued to, or expenditure or loss incurred by a person, denominated in foreign currency to Rands. However, these rules do not specifically cater for the translation of contributed tax capital to Rands.

Proposal

It is proposed that rules be introduced for the translation of the elements of contributed tax capital from a foreign currency to the currency of the Republic. More specifically, the proposed amendments will require that companies to apply

the applicable spot rate on the date that the relevant amount is recognised for income tax purposes, for:

- the calculation of the market value of all shares in that company of that class when that company becomes resident;
- the consideration received by or accrued to that company for the issue of that class of shares on or after that company becomes resident; or
- the transfer of that contributed tax capital through capital distributions to shareholders on or after that company become resident.

Effective date

The proposed amendments will come into operation on 1 January 2024.

4.10. Clarifying the interaction between the debt forgiveness rules and the disposal of assets exclusion rule for dormant group companies

[Applicable provisions: section 19 of the Act and paragraph 12A of the Eighth Schedule to the Act]

Background

In 2018 changes were made to the debt relief rules in section 19 of the Act and paragraph 12A of the Eighth Schedule to the Act. Section 19 of the Act deals with income tax implications for debt that was previously used to fund tax deductible expenditure, such as operating expenses and the acquisition of assets where deductions may be claimed for assets such as trading stock and allowance assets. On the other hand, paragraph 12A of the Eighth Schedule to the Act deals with capital gains tax implications for debt that was used to acquire capital or allowance assets.

The debt relief rules contain several exclusions. One of the exclusions is the dormant company exclusion, which applies when a debt is owed between

companies that form part of the same group of companies. A debtor company is regarded as being dormant if it has not conducted trading activities in the year of assessment in which the debt benefit arose nor in the year of assessment preceding that year. The dormant company exclusion was intended to ease the winding up of dormant companies that had irrecoverable group debt in respect of which tax arising from a possible recoupment would not be collectable by SARS.

However, the dormant company exclusion does not apply if the debt was used to fund an asset that was subsequently disposed of in terms of a corporate reorganisation transaction provided in Part III of Chapter II of the Act or a debt that was incurred to refinance another debt owed between companies that form part of the same group of companies. These types of arrangements were viewed as not justifiably debt funded and raised tax avoidance concerns as, in the first instance, asset transfers within the corporate reorganisation rules do not require consideration other than shares, particularly unaffordable debt funding between companies belonging to the same group of companies and the assumption or settlement of a debt between companies that form part of the same group of companies is expected to have been well considered to not necessitate a subsequent waiver.

Reasons for change

Concerns have been raised on the wording of the provisions giving effect to the dormant company exclusion. At issue is whether the disposal in terms of the corporate reorganisation transactions is envisaged to take place subsequent to the asset's acquisition, but prior to the debt reduction, or whether the disposal is meant to take place subsequent to the acquisition and the debt reduction.

Proposal

When the changes were made to the debt relief rules in 2018, the policy rationale was that the exclusion from applying the dormant company rules should not restrict the timing of the disposal under the corporate reorganisation rules. As such, it is proposed that clarification be made in the legislation to reflect the above-mentioned policy rationale.

Consequently, it is proposed that the following change should be made in the legislation:

- To provide for a denial of the dormant company exclusion when an intra-group debt that previously funded an asset that is subsequently disposed of in terms of the envisaged corporate reorganisation rules is forgiven prior to or after such disposal.
- In instance that a debt benefit is triggered prior to the disposal of an asset in terms of sections 42, 44, 45 or 47 of the Act, a deeming rule should be included to ensure that a debt benefit in a prior year of assessment is accounted for in a subsequent year of assessment should the dormant company later fall foul of the requirements of the exclusions and subsequently dispose of the asset in terms of sections 42, 44, 45 or 47 of the Act.

Effective date

The proposed amendment will come into operation on 1 January 2024 and applies in respect of

years of assessment commencing on or after that date.

4.11. Clarifying the interaction of provisions on the acquisition of assets in exchange for shares

[Applicable provision: Section 40CA of the Act]

Background

A. Deemed base cost for assets acquired in exchange for shares issued

Provisions that establish base cost in respect of asset-for-share and asset-for-debt transactions were first introduced in section 40CA of the Act in 2012, following the decision of the Supreme Court of Appeal in C: SARS v Labat Africa Ltd (669/10) [2011] ZASCA 157 (the Labat case). In the Labat case, the Court had to determine whether the issue of shares by a

company as onsideration for the acquisition of a trademark amounts to 'expenditure actually incurred' by the issuing company. The Court held that since the issue of shares does not give rise to any diminution in the assets of the issuing company, the issue of shares as consideration for the acquisition of the asset in that case (a trademark) does not amount to 'expenditure'. This decision meant that, in the absence of base cost rules for asset-for-share transactions, taxpayers would have a zerobase cost in respect of assets acquired in exchange for the issue of shares by the acquiring company. In 2020, changes were made to these rules to remove deemed base cost for assets acquired for debt issued as these transactions do not give rise to a zero-base cost as 'expenditure' arises in the case of debt issued since a diminution of the assets of the issuing party arises.

B. Roll over base cost rule under corporate reorganisation rules

The corporate reorganisation rules in Part III of Chapter II of the Act allow for the tax neutral transfer of assets between companies by allowing tax consequences to be rolled over to a future transaction that falls outside of the corporate reorganisation rules.

C. 2021 changes to the tax legislation

In 2021, changes were made in the tax legislation for better interaction between the anti-value shifting rules in sections 24BA, 40CA and the corporate reorganisation rules Part III of Chapter II of the Act. The 2021 changes made provision for the corporate reorganisation rules to prescribe that qualifying asset-for-share transactions are subject to anti-value shifting rules contained under section 24BA of the Act and the deemed base cost rules for asset-for-share transactions under section 40CA of the Act. In particular, the 2021 changes were aimed at ensuring that any capital gain arising from the operation of the anti-value shifting rules contained in section 24BA of the Act is added to the base cost of an asset transferred under the corporate reorganisation rules. As a result, section 40CA of the Act prescribes a base cost for assets acquired by companies in exchange for the issue of their shares to the seller of those assets that is equal to the

sum of the market value of the shares it issued and (if any) the amount of the capital gain triggered by the application of the provisions of section 24BA of the Act to ensure that there is no double taxation on the future disposal of the assets.

Reasons for change

When the above-mentioned changes were made in the tax legislation in 2021, the policy rationale set out in the accompanying explanatory memorandum was that a company will be deemed to have incurred expenditure equal to the triggered deemed capital gain immediately before a subsequent disposal of an asset previously acquired in terms of the sections 42, 43 and 44 of the Act in a subsequent transaction that falls outside of Part III of Chapter II of the Act. This policy rationale was based on the fact that in a transaction that falls outside of the corporate reorganisation rules ordinarily past allowances are recouped, whereas, where the operation of one of the corporate reorganisation rules is at play, no recoupment arises and therefore it is not justified that tax allowances may be claimed with reference to a higher base cost. However, the current provisions in the legislation do not expressly set out the intended timing of the base cost uplift but rather provides for an uplift on the day of the corporate reorganisation transaction. At issue is whether following a tax deferred transaction in terms of section 42, 43 and 44 of the Act, a company can claim allowances based of the increased base cost even prior to a transaction that falls outside of the corporate reorganisation rules under which a recoupment may arise.

Proposal

To clarify the above-mentioned policy rationale, it is proposed that changes be made in the tax legislation to provide that the additional base cost equal to any deemed capital gain resulting from the application of the anti-value shifting rules in section 24BA of the Act may only be added immediately before a subsequent disposal of an asset previously acquired in terms of the abovementioned reorganisation provisions in a transaction that falls outside of Part III of the Act (i.e. the corporate reorganisation rules set out in Part III of Chapter II, sections 41 to 47 of the Act).

Effective date

The proposed amendment will come into operation on 1 January 2024 and applies in respect of any disposal of an asset on or after that date.

4.12. Refining the provisions applicable to unbundling transactions

[Applicable provision: Section 46 of the Act]

Background

The corporate reorganisation rules for unbundling transactions in sections 46 of the Act allow for a tax neutral transfer of shares where shares of a resident company (unbundled company) that are held by another resident company (unbundling company) are distributed to the shareholders of that unbundling company in accordance with the effective interest of those shareholders. Under these provisions, the distribution of shares is disregarded for purposes of determining the taxable income, assessed loss or net income of an unbundling company and no Dividends Tax or reduction of contributed tax capital is triggered.

Prior to the 2020 changes to tax legislation, tax deferral was denied if immediately after the distribution of shares in terms of an unbundling transaction, 20 per cent or more of the shares in the unbundled company are held by disqualified persons either alone or together with any connected persons (who is a disqualified person) in relation to that disqualified person. For purposes of this exclusion 'disqualified persons' is defined to include a person that is regarded as a non-resident in terms of the South African tax legislation or exempt persons in terms of South African tax legislation (they are the government of the Republic in the national, provincial or local sphere contemplated in section 10(1)(a) of the Act, a public benefit organisation as defined in section 30 of the Act, a recreational club as defined in section 30A of the Act, a mining rehabilitation company or trust contemplated in section 37A of the Act, a pension fund, a provident fund, a retirement annuity fund, a benefit fund contemplated in section 10(1)(d)(i) or (ii) of the Act or a person

contemplated in section 10(1)(cA) or (t) of the Act). In this form, the exclusion created a loophole in that the 20 per cent exclusionary rule did not apply as intended to deny roll-over relief where tax exempt or non-resident shareholders are not connected persons in relation to each other, thus effectively resulting in a tax exemption instead of a tax deferral as future disposals of shares by tax exempt or non-resident shareholders would not be subject to tax in South Africa.

In 2020, changes were made to the tax legislation so that tax deferral does not to apply in respect of any equity share that is distributed by an unbundling company to any shareholder that is a disqualified person and holds at least 5 per cent of the equity shares in the unbundling company immediately before an unbundling transaction. Furthermore, in 2021 changes were made to the tax legislation so that shareholders in an unbundling company that qualifies for tax deferral for an unbundling transaction should receive additional base cost that is reflective of the tax paid by the unbundling company in respect of their shares in the unbundled company, in accordance with their respective shareholding.

Reasons for change

The additional base cost is currently provided for by including any tax paid by the unbundling company in respect of a distribution to disqualified persons under the definition of 'expenditure' which is applied to allocate expenditure attributable to equity shares in the unbundling company to both equity shares in the unbundling company and equity shares in an unbundled company.

This mechanism of splitting the expenditure is appropriate for historic expenditure attributable to unbundling shares, as after an unbundling transaction a shareholder that previously only held unbundling shares now directly holds unbundling shares and unbundled shares. However, the tax paid by the unbundling company on account of the denial of tax deferral in respect of a distribution of unbundled shares to disqualified persons and the resultant negative effect on the shareholders that are not disqualified persons should only be applied to alleviate the tax effect in respect of the unbundled shares, without taking into account the impact on the market value of the unbundling company due to the tax payable.

Secondly, it is noted that to the extent that tax deferral applies in terms of section 46(3) of the Act, the unbundling company must disregard a qualifying distribution for purposes of determining its taxable income, assessed loss or its net income as contemplated in the controlled foreign company rules in section 9D of the Act. In the instance that an unbundling company is not in a loss position, an uplift with reference to the amount of tax paid may be reasonable. However, if an unbundling company is in an assessed loss position, the net effect of any denial of tax deferral would be a reduction of its assessed loss. Practically, the tax is determined in the unbundling company even through taxpayers have put the case forward that the shareholders holding the unbundling shares and the unbundling shares proportionately have all borne the tax effect of such a denial for tax deferral. At issue is whether any additional base cost for shareholders that are not disqualified persons should be an amount reflecting the proportionate tax effect of a denial in tax deferral (i.e., proportionate increase taxable income, assessed loss or net income as result of the denial of tax deferral of the distribution to disqualified persons.

Proposal

It is proposed that changes be made to the tax legislation on the application of the additional base cost should be reversed and a new mechanism should be introduced in its place. In this regard, it is still proposed that there should be additional base cost only where tax is payable. This is because, only where tax is payable, is a shareholder that is not a disqualified person is most adversely affected by the outlay of tax payable by the unbundling company where tax deferred is meant to apply. Furthermore, the new uplift will not be allocated between unbundling shares and unbundled shares but will be treated as additional expenditure in respect of only the unbundled shares.

Effective date

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

4.13. Clarification of the interest limitation rules

[Applicable provision: Section 23M of the Act]

<u>Background</u>

In 2021, changes were made to the Act as part of the corporate income tax package to broaden the tax base and reduce the headline corporate income tax rate in a revenue neutral manner. One of these measures included strengthening the rules dealing with the limitation of interest deductions for debts owed to certain persons not subject to tax in section 23M of the Act.

<u>Reasons for change</u>

A. Clarifying the definition of 'adjusted taxable income'

The definition of 'adjusted taxable income' in section 23M(1) of the Act means taxable income calculated before applying the interest limitation rules, including the addition of any assessed loss or balance of assessed loss allowed to be set off against income in terms of section 20. There is uncertainty stemming from the inclusion of the terms 'assessed loss' and 'balance of assessed loss'.

B. Introducing a definition of the term 'creditor'

Currently, section 23M(1) of the Act defines 'debt' and 'debtor', but it does not define the term 'creditor'.

C. Clarifying the treatment of exchange gains and losses

Section 23M(7) of the Act provides that any exchange difference deducted from the income of a person as contemplated in sections 24I(3) or (10A) of the Act is deemed to have been incurred by that person. While section 23M(7) of the Act deems exchange losses to be incurred, a corresponding deemed accrual does not apply to exchange gains. This could result in exchange gains not being taken into account as interest received or accrued for purposes of section 23M of the Act.

D. Reviewing the outcome of the interaction between the 'controlling relationship' definition in section 23M(1) of the Act and the rule in section 23M(2)(c) of the Act

In 2021, changes were made to the definition of 'controlling relationship' in section 23M(1) of the Act by adding a connected person test to ensure that fragmentation of ownership to circumvent the rules is dissuaded. In addition, further changes were made to section 23M(2)(c) of the Act by inserting a group companies test in instances where the creditor is not in a controlling relationship with the debtor. Government has considered how the definition of 'controlling relationship' in section 23M(1) of the Act and the provisions of 23M(2) of the Act interact in light of the intended policy outcome.

E. Clarifying the application of the proviso to section 23M(2) of the Act

The proviso to section 23M(2) of the Act contains a formula that reduces the amount of interest disallowed for deduction based on the extent to which withholding tax on interest must be withheld. However, it does not adequately specify that this adjustment should only apply in the case of interest flowing to non-residents.

F. Extending the provisions of section 23M(6) of the Act to apply to South African banks

Section 23M(6) of the Act generally makes provision for the exemption from the application of interest limitation rules where the creditor provides a loan to a taxpayer with funds granted by a lending institution, in this instance, a foreign bank.

Proposal

Based on the above, Government proposes the following:

A. Clarifying the definition of 'adjusted taxable income'

Government proposes that the legislation be amended to align with the policy intent that only the balance of assessed losses from prior years be

added to taxable income (before applying this section) to calculate adjusted taxable income. As such, it is proposed that paragraph (b)(iii) under the definition of 'adjusted taxable income' be deleted. Instead, the starting point for 'adjusted taxable income' should be taxable income calculated before applying this section and before setting off any balance of assessed loss.

B. Introducing a definition of the term 'creditor'

Government proposes including a definition for the term 'creditor' into section 23M of the Act. The definition aims to clarify that any person to whom interest is payable is deemed to be a creditor for the purposes of section 23M of the Act.

C. Clarifying the treatment of exchange gains and losses

Government proposes that exchange gains be classified as interest received or accrued for the purposes of section 23M of the Act.

D. Reviewing the outcome of the interaction between the 'controlling relationship' definition in section 23M(1) and the rule in section 23M(2)(c) of the Act

Government has reviewed the interaction between these provisions and proposes to retain the current stance. While the connected person test aims to cater for instances of ownership fragmentation, the group test in section 23M(2)(c) aims to cater for a scenario where there is no shareholding between a debtor and creditor who are connected persons, for example, when two sister companies enter into a lending arrangement with one being the debtor and the other the creditor.

Within the controlling relationship definition, it is proposed that the words 'in relation to that person' be deleted.

E. Clarifying the application of the proviso to section 23M(2) of the Act

Government proposes that the legislation be clarified to make it clear that the proviso is only applicable to interest where the recipient is a non-resident.

F. Extending the provisions of section 23M(6) of the Act to apply to South African banks

Government proposes that section 23M(6) of the Act be amended to extend this exemption to apply to South African banks.

Effective date

The proposed amendments will come into effect on 1 January 2024 and apply in respect of years of assessment commencing on or after that date.

4.14. Tax treatment of deposit insurance scheme

[Applicable provision: section 10 of the Act]

Background

Currently, there are no explicit arrangements in place to protect depositors in the event of a bank failure. In the past, government compensated depositors for their losses on a case-by-case basis, which meant that depositors had to bear the cost of the failure of individual commercial enterprises.

Broadly, the amendments made by the Financial Sector Laws Amendment Act, No. 23 of 2021 to the Financial Sector Regulation Act, No. 9 of 2017 ('the Financial Sector Regulation Act') are aimed at providing for the establishment of a framework to protect less financially sophisticated depositors in the event of a bank failure, thereby contributing to the stability of the South African financial system. In addition, the South African Reserve Bank (SARB) was designated as the resolution authority; and the Corporation for Deposit Insurance and a Deposit Insurance Fund was established on 24 March 2023 to assist with the stability of the financial system in the event of a bank failure. This Corporation is a subsidiary of the SARB, making it a separate legal entity with its own legislative framework and governance requirements.

In essence, section 166BC of the Financial Sector Regulation Act provides for the Corporation for Deposit Insurance, established in terms of section 166AE of that

Act, to charge members of the Corporation who are banks, a deposit insurance levy in accordance with legislation that empowers the administration of levies.

The SARB is responsible for the collection from the banks and administration, on behalf of the Corporation, of the deposit insurance levy referred to in sections 9 and 12 of the Financial Sector and Deposit Insurance Levies Act, No.11 of 2022 read with Schedule 6 to that Act and section 166BC of the Financial Sector Regulation Act, to provide for the funding of the operations of the Corporation and the administration of the Fund.

The SARB is also responsible for the collection from the banks and administration, on behalf of the Corporation, of the deposit insurance premium referred to in section 166BG of the Financial Sector Regulation Act read with Schedule 5 to that Act.

Reasons for change

As stated above that currently, there are no explicit arrangements in place to protect depositors in the event of a bank failure. In the past, government compensated depositors for their losses on a case-by-case basis, which meant that taxpayers had to bear the cost of the failure of individual commercial enterprises.

Proposal

To provide a rule for the tax treatment of the Corporation for Deposit Insurance, it is proposed that the receipts and accruals of the Corporation for Deposit Insurance be exempt from income tax.

Effective date

The proposed amendment comes into operation on 1 April 2024 and applies in respect of years of assessment ending on or after that date.

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4.15. Refining the provisions dealing with the impact of international financial reporting standard 17 insurance contracts on the taxation of insurers

[Applicable provisions: Sections 28 and 29A of the Act]

Background

In 2022 changes were made in the tax treatment of short-term and long-term insurers in sections 28 and 29A of the Act. The main aim of these changes was to accommodate the new accounting standard for insurers, International Financial Reporting Standard 17 Insurance Contracts (IFRS 17), update the terminology of the sections so they are in line with IFRS 17 and to mitigate the tax impact as a result of the difference between the methodologies applied in IFRS 4, which is the old accounting standard for insurers, and IFRS 17.

Reasons for change

It has come to Government's attention that there may be uncertainties regarding certain third-party cell captive arrangements that are treated as reinsurance arrangements for IFRS purposes. As a result, there are reinsurance assets and liabilities recognised for IFRS purposes in relation to a portion of cell profits due to or from the cell owner. On the other hand, for tax purposes, these third-party cell captive arrangements are not true commercial reinsurance arrangements these balances should be disregarded in determining a cell captive insurer's taxable income.

In addition, cell captive arrangements effected in terms of preference share arrangements may be accounted for under IFRS 17 or IFRS 9. Currently, insurance contract liabilities under IFRS17 and investment contract liabilities under IFRS 9 are both included in the 'adjusted IFRS value' definition in section 29A of the Act.

Moreover, where a separate liability is recognised in respect of profits due to the cell owner, it may be possible that such a liability may also be included in the 'value of liabilities' definition in section 29A of the Act, resulting in the double-counting of

the liability because the current definition of 'value of liabilities' in respect of a policyholder fund and a risk policy fund is the sum of 'adjusted IFRS value' plus all other liabilities.

Proposal

To address the issues mentioned above, Government proposes that reinsurance contract assets and liabilities relating to a cell owner as contemplated in the definition of 'cell structure' in section 1(1) of the Insurance Act, No.18 of 2017 be disregarded in symbol 'L' of the 'adjusted IFRS value' definition in section 29A of the Act.

It is further proposed that this change be mirrored in section 28(3A) of the Act to cater for foreign long-term insurers that conduct insurance business through a branch in South Africa and fall under the ambit of section 28 of the Act.

In addition, it is proposed that a change be made to the definition of 'value of liabilities' in section 29A of the Act to exclude all other liabilities relating to a cell owner.

Effective date

The proposed amendments are deemed to have come into operation on 1 January 2023 and apply in respect of years of assessment commencing on or after that date.

4.16. Clarifying the meaning of 'person' in the provisions dealing with public benefit organisations, recreational clubs and associations

[Applicable provisions: Sections 30, 30A and 30B of the Act]

Background

Public benefit organisations, recreational clubs and certain dedicated associations ('the establishments') are all generally engaged in activities of either a benevolent or supportive nature with a sole or principal object of prioritising the needs,

interests and well-being of the general public, group of persons or contributing members.

As such these establishments all enjoy a special tax benefit in an effort by Government to support these shared responsibilities for the social and developmental needs of the country. The tax benefit is structured as a partial or complete exemption from income tax on the receipts and accruals of these establishments and in certain instances as a tax deduction for the originators of the funding to these establishments.

Reasons for change

In order to ensure that the above-mentioned tax benefit obtained in respect of the establishments are utilised for its intended purpose, Government requires stringent accountability and stricter governance, including requirements that the establishment must have three unconnected persons who accept fiduciary responsibility and that no single person may directly or indirectly control the decision-making powers of the establishment.

At issue is the application of interpretation on the word ‘person’ and whether in the fiduciary requirements of the establishments above it refers to a natural person or a juristic person.

Section 30C of the Act already makes the distinction between natural or juristic persons as it relates to fiduciary responsibility for small business funding entities.

Proposal

It is proposed that legislation be amended to clarify that only natural persons can accept the fiduciary responsibility for public benefit organisations, recreational clubs and certain dedicated associations.

Effective date

The proposed amendments will come into operation on 1 January 2024 and apply in respect of years of assessment commencing on or after that date.

4.17. Refinements to the royalty rate for oil and gas companies

[Applicable provisions: Sections 3 and 4 of the Mineral and Petroleum Resources Royalty Act, No. 28 of 2008 ('the MPRRA') and section 19 of the Mineral and Petroleum Resources Royalty (Administration) Act, No. 29 of 2008]

Background

In terms of Government's current mineral and petroleum resource development policy, a royalty will be levied on extractors to compensate government for the extraction of non-renewable mineral and petroleum resources within the Republic. Existing legislation further distinguishes the determination of a royalty between refined (e.g., platinum group metals or oil and gas) and unrefined mineral resources (aggregates or coal).

For oil and gas companies, the applicable refined royalty rate has been based on a formula contained in section 4(1) of the MPRRA. The existing variable royalty rate adjusts based on the oil and gas company's profitability, which is measured by dividing earnings before interest and taxes (EBIT) by gross sales. The rate applied to the royalty base (gross sales) ranges from a minimum of 0.5 per cent to a maximum of 5 per cent in the case of oil and gas companies.

Reasons for change

On 15 December 2021, a tax policy discussion paper titled 'What is the most appropriate tax regime for the oil and gas industry' was published for public comment by government. In the tax policy discussion paper, it was proposed that a flat-rate royalty replace the current variable royalty rate for oil and gas.

However, Government recognises that a flat-rate royalty is not flexible enough to adequately cater for high-cost projects, such as those in deep waters with tough sea conditions. In the discussion paper, consideration was given to having separate rates for oil and gas, for example, deep versus shallow water extraction. However, this was decided against given the challenges some countries have experienced in this regard, for example, allocating costs to different revenue streams when oil and gas are produced together.

Proposal

Following consultation, Government proposes to retain the flexibility of the royalty rate, which is determined by profitability, rather than opt for a flat rate for these companies. This decision recognises that companies face varying costs and profit levels depending on whether they are, for example, operating in deep or shallow waters.

However, to ensure that the country is adequately compensated for the loss of its finite oil and gas mineral resources, the minimum royalty rate for oil and gas will be increased from 0.5 per cent to 2 per cent, with the maximum remaining at 5 per cent.

It is also proposed that oil and gas mineral resources be recognised as a stand-alone refined

mineral resource in the legislation for purposes of the determination of royalty to accommodate the now difference in the minimum rate applied to the royalty base (gross sales) ranges within the scope of refined mineral resources.

Effective date

The proposed amendment will come into operation on 1 January 2024 and applies in respect of years of assessment commencing on or after that date.

4.18. Extension of the UDZ tax incentive sunset date

[Applicable provisions: Section 13quat of the Act]

Background

The Act contains Urban Development Zone (UDZ) tax incentive in section 13quat of the Act, which came into effect in 2003. This incentive was introduced to increase investment in 16 designated inner cities thereby encouraging property investment in central business districts and to address the problem of urban decay in these central business districts through the promotion of investment in urban renewal. The incentive is in the form of an accelerated depreciation allowance

applicable on the value of new buildings and improvements to existing buildings in the qualifying municipalities demarcated as UDZs.

When the UDZ tax incentive was introduced, it had no sunset date. In 2005 a sunset date of 31 March 2009 was introduced, which was extended to 31 March 2014 in 2008. This sunset date was extended from 31 March 2014 to 31 March 2020 in 2012. In view of the fact that the sunset date of 31 March 2020 fell during the COVID-19 pandemic period, in 2020 and 2021 changes were made to section 13quat of the Act to extend this sunset date by another three years from 31 March 2020 to 31 March 2023, in order to allow for a comprehensive review of the effectiveness of the incentive before it comes to an end.

Reasons for change

It has come to Government's attention that the public consultation as part of the policy review process of the UDZ tax incentive will not be concluded before the incentive's sunset date of 31 March 2023. Further engagement with key stakeholders, especially sourcing and evaluating important data from municipalities on the incentive's uptake, is necessary to assess the contribution of the incentive to achieving its intended objectives.

Proposal

Based on the above, it is proposed that the UDZ tax incentive be extended by another period of two years from 31 March 2023 to 31 March 2025 to allow additional time for the review to be completed.

Effective date

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

4.19. Refinements to the research and development tax incentive

[Applicable provisions: Section 11D of the Act]

Background

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

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

Reasons for change

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

Proposed refinements to the R&D tax incentive were published on 7 October 2022 for public comment. Taking public comments into account, the proposed amendments seek to simplify the definition of R&D to make it easier to understand and adjudicate, thus making the application process easier.

A. Definition of R&D

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

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

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

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

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

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

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

It is envisaged that a revised definition will be simpler to understand and adjudicate, ensuring an easier application process. The proposed changes to simplify the legislation combined with the online system launched at the end of 2022 and an improvement in support for smaller businesses should enhance the uptake of the incentive.

In line with government's stance from the outset, the revised definition is shifted more towards a scientific or technological uncertainty and the systematic investigative or systematic experimental activities that are to be performed (i.e., the particular standard of R&D), with a simplified emphasis

on novelty of products, processes or services, instead of the intellectual property outcomes e.g., invention or design that may occur after the R&D.

B. Internal Business Process (IBP) exclusion

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

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

A number of examples were included in the discussion document to highlight how the current interpretation of the internal business process exclusion potentially disqualifies what would otherwise be deemed eligible activities that encompass the benefits intended by the incentive. If an activity is systematic investigative or systematic experimental with an aim of resolving a scientific or technological uncertainty and it meets the proposed (revised) definition of R&D for the purposes of this incentive, it should be considered R&D – regardless of whether it is intended for sale, or the use thereof is granted to connected parties.

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

An exclusion for business processes that are for management and administrative purposes is no longer considered necessary given the changes to the definition of R&D. The revised definition aims to bring clarity to what is considered eligible R&D and what is not. It is based on a particular standard of R&D – rather than the nature of the activities.

C. Software and computer programmes

In the context of software development, only those software development activities that are systematic investigative or systematic experimental of which the result is uncertain may be eligible. These types of systematic investigative/experimental development activities that exist under the R&D umbrella can at times be confused with high-level product development and pre-production development. This is due to both types of development having stages that may overlap, but with product development and pre-production development still missing a scientific or technological uncertainty. Thus, product development per se is not by definition R&D.

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

D. Additional administrative issues

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

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

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

Disclosure of information by SARS

Currently, section 11D(12)(b)(iv) of the Act allows the committee to monitor all R&D approved to determine whether the objectives of the incentive are being met, and to advise the Minister of Finance and the Minister of Higher Education, Science and Innovation. Section 11D(14) of the Act states that SARS may disclose information to the Minister of Science and Technology as is required for parliamentary reporting or if that information is material in respect of granting approval for the incentive. This does not appear wide enough to enable the committee and DSI employees to obtain information (data) from SARS to carry out a monitoring and evaluation function.

Sanctions for breach of secrecy

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

<u>Proposal</u>

Based on the above, Government proposes the following:

A. Adjustments to the R&D definition

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

- The definition of R&D should be amended to clarify that the intention has always been that the incentive should only apply to activities with an aim of solving a scientific or technological uncertainty. By referring to activities that are aimed at solving a scientific or technological uncertainty in the words of subsection (1) preceding paragraph (a), this intent is made clear. Amongst other things, this requirement will clarify the type of computer software activities that will be deemed to form part of R&D. Further, the words 'scientific or technological' should be included before the words 'research and development' throughout the section.
- The definition should also be amended to clarify that activities will not qualify for the incentive if knowledge to resolve a scientific or technological uncertainty is deducible by a competent professional in the relevant scientific or technological field, having regard to information that is publicly available to such professional. In other words, a test for obviousness (or lack of inventiveness) should be brought into the definition.
- The term 'non-obvious' as it relates to scientific or technological knowledge in section 11D(1)(a) of the Act should be replaced with 'new'. This replacement is necessary as the requirement for non-obviousness is already incorporated by the amendment mentioned above, i.e., that research and development does not include an activity if knowledge to resolve the scientific or technological uncertainty is deducible by a person skilled in the relevant scientific

or technological field, having regard to information that is publicly available to such professional.

- The intellectual property purpose tests in the first part of the definition should be deleted to move away from a focus on the end-result at the time of applying to recognise the uncertainty inherent in R&D. The approach will shift to testing for R&D by considering some of the principles in the Frascati Manual 2015 - Guidelines for Collecting and Reporting Data on Research and Experimental Development published by the Organisation for Economic Co-operation and Development (the OECD Frascati Manual. In line with this, it is proposed that section 11D(1)(b) and (c) of the Act be replaced with a purpose test aligned with the OECD Frascati principles that an R&D activity must be carried on for the purpose of creating or developing new knowledge, or new or significantly improved products, processes or services. The OECD Frascati manual provides an internationally accepted definition on R&D activities based on five core criteria being met, i.e., the activity must be novel, creative, uncertain, systematic and transferable and/or reproducible. In summary, R&D eligibility should be assessed in the context of the type of activities proposed to be performed; the uncertainty addressed, and the new knowledge being sought; or new or significantly improved products, processes or services being created.

B. Internal Business Process (IBP) exclusion

It is proposed that the exclusion for internal business processes be deleted, so that the activities are measured against the requirements set out in the definition of R&D, rather than the nature of the activities and whether they are intended for sale / licensing or not.

C. Additional administrative issues

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

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

For example, if a company has started spending on R&D activities on 16 February 2024, they will have up until 16 August 2024 to submit their application if they would like to be eligible to claim the expenditure already incurred on qualifying R&D activities from the date of 16 February 2024.

Should a business apply within the first 6 months of 2024, the grace period will be limited to expenditure starting from 1 January 2024 onwards.

Disclosure of information by SARS

It is proposed that the circumstances under which of SARS discloses information to the Minister of Higher Education, Science and Innovation be extended to include anonymized information (data) from tax returns that may require fulfilling of duties insofar as they relate to monitoring R&D approved under the incentive and the consideration of proposed amendments and adjustments to the R&D tax incentive, beyond reporting to Parliament. This can be catered for by expanding section 11D(14) of the Act.

Sanctions for breach of secrecy

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

D. Sunset clause and transition clarity

It is proposed that the revised R&D tax incentive apply in respect of applications received and expenditure incurred on or after 1 January 2024 and up to and including 31 December 2033.

The transition will be treated as follows (some examples also indicating the 6-month grace period applicability):

Apply	**Approval**	**Spend**	**Applicable Regime**
1 Nov 2023	5 Dec 2023	1 April 2024	Existing regime
1 Nov 2023	22 Jan 2024	1 April 2024	Existing regime
15 Jan 2024	2 March 2024	1 Jun 2024	New regime (to be made effective by the 2023 Tax Laws Amendment Act)
15 March 2024	1 July 2024	23 Nov 2023	New regime (expenditure incurred can be claimed from 1 Jan 2024)
15 Aug 2024	1 Nov 2024	2 Feb 2024	New regime (expenditure incurred can be claimed from 15 Feb 2024)

E. Other technical amendments

Additional technical amendments include:

- Updating the names of the Department and the Minister in line with the new names throughout the section.
- Updating the applicable regulations throughout.

Effective date

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

4.20. Enhanced deduction in respect of certain machinery, plant, implements, utensils and articles used in the production of renewable energy

[Applicable provisions: New section 12BA, sections 8, 11, 12E, 12N, 12P, 23A, 23G of the Act and paragraph 66 of the Eighth Schedule to the Act]

Background

In 2004 Government introduced an accelerated depreciation allowance for investments in biodiesel and biofuels in section 12B of the Act. To encourage investments in renewable energy and complement carbon mitigation measures like the carbon tax, Government proposed to extend this accelerated depreciation allowance to other forms of environmentally friendly energy sources in 2005. These environmentally friendly energy sources included the generation of electricity from wind, sunlight (later referred to as solar power), gravitational water force to produce electricity of not more than 30 megawatts (later referred to as hydropower) and biomass comprising organic waste, landfill gas or plants. The assets used in the production of electricity using the abovementioned power sources were eligible to benefit from a tax depreciation write-off of 50:30:20 per cent over three years.

In 2012 further amendments were made to the Act to allow necessary and integrated supporting structures, with respect to assets that are used in renewable energy generation, to benefit from a tax write-off of 50:30:20 per cent over three years.

In 2015 Government sought to further encourage the independent generation of electricity through renewable energy sources to alleviate the then-projected electricity shortages in the country. In particular, changes were made to increase the uptake of small-scale embedded solar PV energy production to ease the pressure on the national electricity grid. In this regard, assets used for embedded solar PV renewable energy with a generation capacity not exceeding 1 000 kW or 1 MW were made eligible for an accelerated depreciation of 100 per cent in one year.

Reasons for change

Given the country's continued struggle to produce reliable electricity through the national grid, Government is proposing to enhance the attractiveness of the tax incentive to encourage greater private investment in renewable energy. To encourage rapid private investment to alleviate this energy crisis – in the 2023 Budget Review, Government proposed to temporarily enhance the current renewable energy tax incentive available in section 12B of the Act.

Proposal

To encourage private business investment in renewable energy for electricity production, Government proposes to temporarily enhance the current renewable energy tax incentive as follows:

A. Assets eligible for the enhanced renewable energy tax incentive

The enhanced renewable energy tax incentive will apply to the currently eligible renewable energy sources under section 12B of the Act listed below, but there will be no electricity generation limits for the duration of this temporary incentive. Assets will qualify if they are used in the generation of electricity. While eligibility will be based on facts and circumstances, it is the policy intention that assets will qualify if used to generate electricity from:

- Wind power
- PV solar energy
- Concentrated solar energy
- Hydropower to produce electricity
- Biomass compromising organic wastes, landfill gas or plant material

The enhanced renewable energy tax incentive will also apply to supporting structures as per section 12B of the Act in which the above-mentioned assets are mounted on or are affixed to, provided that:

- the foundation or supporting structure is designed for the above-mentioned asset and constructed in such a manner that it is or should be regarded as being integrated with that asset; and
- the useful life of the foundation or supporting structure is or will be limited to the useful of the asset mounted thereon or affixed thereto.

B. Time period for the enhanced renewable energy tax incentive

The enhanced accelerated allowance is intended to encourage businesses to invest in assets used in renewable energy production sooner rather than later, to assist with alleviating pressure on the national electricity grid. Temporary investment allowances have been shown to induce larger responses sooner. Government recognises that significant projects may require a longer lead time, but also seeks to support smaller businesses in adding generation capacity to the grid.

Furthermore, the incentive aims to encourage those that would not have invested in renewable energy if it were not for the incentive. Remaining prudent with the budget constraint is important to generate as much value for taxpayer's contributions as possible. As such, it is proposed that the enhanced renewable energy tax incentive should be available for a period of 2 years and apply to qualifying new and unused assets brought into use for the first time on or after 1 March 2023 and before 1 March 2025.

C. Rate of depreciation for the enhanced renewable energy tax incentive

Unlike the current renewable energy tax incentive available in section 12B of the Act, which can be claimed over a period of three years at a rate of 50:30:20 per cent (small-scale solar PV projects can obtain 100 per cent write-off in year one), it is proposed that businesses can deduct an upfront deduction of 125 per cent of the cost incurred with reference to eligible assets.

D. Eligibility for the temporary incentive

The general overriding requirements for businesses to deduct a capital allowance are applicable regarding this temporary incentive. These are that (1) the business must own the asset, and (2) it must be used in the production of income. For this reason, lessors in an operating lease scenario will generally qualify for the incentive (assuming other requirements met) because the lessor retains ownership of the assets and is generating an income from conducting a rental trade. If there is a finance lease in place, where ownership transfers to the lessee, the lessee can only qualify for section 12BA of the Act if both the ownership and trade requirements are met. If the lessee is conducting a trade and the asset is leased for a period of at least 5 years, the lessee can qualify for this incentive assuming all other requirements are met.

E. Limitation of enhanced renewable energy tax incentive in respect of assets granted an allowance in terms of section 12B of the Act

To ensure that there is no duplication of tax incentives in respect of the enhanced renewable energy tax incentive, the draft legislation aims to clarify that taxpayers can deduct expenses incurred either in respect of section 12B or 12BA, but not both – in respect of assets brought into use during the two-year period.

F. Interaction between enhanced renewable energy tax incentive in section 12BA of the Act and deduction for small business cooperations in section 12E of the Act

If a business is a small business corporation and qualifies for a deduction under section 12E of the Act, the draft legislation seeks to clarify that these businesses can either claim section 12E or 12BA, not both. The deduction in respect of small business cooperations in section 12E shall not apply in respect of an asset in respect of which the enhanced renewable energy tax incentive is granted in terms of section 12BA of the Act.

G. Interaction between enhanced renewable energy tax incentive in section 12BA of the Act and government grants

If a business purchases qualifying assets with a combination of their own funds and funding in respect of a government grant, the 12BA allowance will only be available in respect of the portion of expenditure incurred using the taxpayer's own funds. For example, if qualifying assets cost R1,000 and R500 was paid for using the business' own funds, the 12BA allowance will equal R500 multiplied by 1.25, which is R625. The provisions of section 12P(4) of the Act will be amended to ensure that the taxpayer can deduct 125 per cent of own expenses incurred.

H. Recoupment of enhanced renewable energy tax incentive

Where a taxpayer disposes of an asset on or before 1 March 2026 in respect of which an enhanced renewable energy tax incentive is granted, the amounts (a maximum of 125 per cent of the cost of the asset) deducted under section 12BA of the Act will be fully recouped in terms of section 8(4)(a) read together with new provision section 8(4)(nA) of the Act.

Consequential amendments

Consequential amendments are proposed in sections 8, 11, 12E, 12N, 12P, 23A, 23G of the Act and paragraph 66 of the Eighth Schedule to the Act.

Effective date

The proposed amendments will be deemed to have come into operation on 1 March 2023 and apply in respect of assets brought into use on or after that date.

4.21. Extending the anti-avoidance provision to cover foreign dividends from shares listed in South Africa

[Applicable provision: Section 10B of the Act]

Background

Currently, section 10B of the Act exempts foreign dividends received or accrued from shares listed on a South African stock exchange from normal tax. The rationale for this exemption is that these foreign dividends are subject to dividends tax and the collection of dividends tax on the basis of withholding taxes is more effective than taxing shareholders receiving those foreign dividends under the income tax system.

In turn, under section 10B of the Act, the exemption is denied for the participation exemption in section 10B(2)(a) of the Act in respect of a foreign dividend determined with reference to a deductible amount paid or payable by any person. Likewise, for the country-to-country exemption in section 10B(2)(b) of the Act if those foreign dividends are directly or indirectly sourced from tax-deductible payments.

Reasons for change

It has come to Government's attention that schemes have been devised to exploit the exemption of foreign dividends received or accrued from shares listed on a South African stock exchange from normal tax. These schemes involve South Africans investing in the shares of a non-resident company listed on a South African stock exchange and the non-resident company directly or indirectly investing in interest-bearing financial instruments in South Africa. The result is that a deduction for an interest expense is not matched with a taxable foreign dividend.

These schemes largely have the effect that the entities that issued interest-bearing financial instruments will get an interest deduction while the interest is not taxed in a non-resident company listed on a South African stock exchange as there is an income tax exemption for non-residents and a withholding tax on interest

exemption for interest paid by certain entities that issue these interest-bearing financial instruments.

Proposal

It is proposed that the round-tripping anti-avoidance provision for foreign dividends be extended to foreign dividends received or accrued from shares listed on a South African stock exchange if the foreign dividends are directly or indirectly funded by amounts that were deductible in South Africa. In order to limit the impact of the round tripping anti-avoidance measures on legitimate transactions, it is proposed that the round tripping anti-avoidance rule in section 10B(4) of the Act only applies in respect of foreign dividends that are declared from profits provided that at least 20 per cent of the profits were generated from transactions with persons that deducted the amounts paid or payable from income.

Effective date

The proposed amendments will come into operation on 1 January 2024 and apply in respect of foreign dividends received or accrued on or after that date.

4.22. Interaction between the anti-avoidance rule and exemption applying to foreign dividends

[Applicable provision: Section 9D of the Act]

Background

Currently, under section 10B(4) of the Act, the participation exemption in section 10B(2)(a) of the Act is denied for a foreign dividend determined with reference to a deductible amount paid or payable by any person. Likewise, for the foreign companies exemption in section 10B(2)(b) of the Act if foreign dividends are directly or indirectly sourced from tax-deductible amounts. The policy rationale for this measure is that a deductible amount should not be received by a resident or a controlled foreign company (CFC) as an exempt amount.

A further exemption that applies to foreign dividends has the effect of limiting the effective tax rate for foreign dividends accruing to residents to a rate of 20 per cent. This exemption has the effect that amounts that are allowed to be deducted for income tax at a rate of 27 per cent or marginal tax rates are taxed at an effective rate of only 20 per cent where the anti-avoidance provision applies.

Reasons for change

The above rules regarding the denial of the exemptions in section 10B(2)(a) and (b) of the Act if those foreign dividends are directly or indirectly sourced from tax deductible amounts and the antiavoidance provision are not properly coordinated with the exemption that applies to foreign dividends to limit the effective tax rate for foreign dividends accruing to residents to a rate of 20 per cent. This lack of coordination potentially leads to a gap in the legislation such that those foreign dividends that have been denied the participation exemption because they are directly or indirectly sourced from tax-deductible payments are taxed at a rate of only 20 per cent where the anti-avoidance provision mentioned above applies.

Proposal

To clarify that the current denial of exemption for foreign dividends that are directly or indirectly sourced from tax-deductible payments will also be denied the partial exemption that currently results in an effective tax rate of 20 per cent, thereby ensuring that those dividends will be taxed at the full normal tax rates. Therefore, it is proposed that the exemption to tax foreign dividends at 20 per cent should not apply where the anti-avoidance rule is applicable.

Effective date

The proposed amendment will come into operation on 1 January 2024 and applies in respect of foreign dividends received or accrued on or after that date.

4.23. Clarifying the foreign business establishment exemption for controlled foreign companies

[Applicable provision: Section 9D of the Act]

Background

As a specific anti-avoidance measure, South African residents have to account for an amount equal to the net income of a CFC on the basis that the net income is calculated as if the CFC were a South African tax resident in terms of certain sections of the Act in terms of section 9D of the Act.

However, as a general rule CFC amounts that are attributable to a foreign business establishment (FBE) of a CFC conducted in a foreign country are excluded from the net income of the CFC.

An FBE is defined in section 9D(1) of the Act to mean–

> ‘(a) a fixed place of business located in a country other than the Republic that is used or will continue to be used for the carrying on of the business of that controlled foreign company for a period of not less than one year, where –
>
> (i) that business is conducted through one or more offices, shops, factories, warehouses or other structures;
>
> (ii) that fixed place of business is suitably staffed with on-site managerial and operational employees of that controlled foreign company who conduct primary operations of that business;
>
> (iii) that fixed place of business is suitably equipped for conducting the primary operations of that business;
>
> (iv) that fixed place of business has suitable facilities for conducting the primary operations of that business; and
>
> (v) that fixed place of business is located outside the Republic solely or mainly for a purpose other than the postponement or reduction of any tax imposed by any sphere of government in the Republic:

Provided that for the purposes of determining whether there is a fixed place of business as contemplated in this definition, a controlled foreign company may take into account the utilization of structures as contemplated in subparagraph (i), employees as contemplated in subparagraph (ii), equipment as contemplated in subparagraph (iii), and facilities as contemplated in subparagraph (iv) of any other company –

(aa) if that other company is subject to tax in the country in which the fixed place of business of the controlled foreign company is located by virtue of residence, place of effective management or other criteria of a similar nature;

(bb) if that other company forms part of the same group of companies as the controlled foreign company; and

(cc) to the extent that the structures, employees, equipment and facilities are located in the same country as the fixed place of business of the controlled foreign company.'

It has come to Government's attention that some taxpayers are retaining certain management functions but outsourcing other important functions for which the CFC is also being compensated by its clients.

Reasons for change

As stated above that, some taxpayers are retaining certain management functions but outsourcing other important functions for which the CFC is also being compensated by its clients. The location of the 'primary operations', referred to in the FBE definition above, is vital in determining whether a company meets the definition of an FBE as defined in the Act. In essence, this determination establishes whether the primary operations have been outsourced, and if so, whether an exemption in terms of section 9D of the Act is still applicable or not.

Proposal

It is proposed that all important functions for which a CFC is compensated should be performed either by the CFC or by another CFC in the same group of

companies that is located and subject to tax in the same country as the CFC's fixed place of business, to qualify for the foreign business establishment exclusion. Therefore, while it is permissible for a CFC to outsource other important functions and be compensated for it, the CFC must still comply with the proviso set out in section 9D(1) of the Act, definition of FBE, and each of the requirements in the subsections (aa), (bb) and (cc) of the proviso have to be met.

Effective date

The proposed amendment will come into operation on 1 January 2024 and apply in respect of foreign tax years of controlled foreign companies ending on or after that date.

4.24. Taxation of non-resident beneficiaries of trusts

[Applicable provision: Section 25B of the Act]

Background

The gradual relaxation of exchange control regulations has led to an increase in applications to SARS for confirmation of tax compliance status of a person for purposes of transferring funds offshore via authorised dealers. Government is concerned about the difference between the rules covering the normal tax treatment of income attributed to beneficiaries of trusts in section 25B of the Act and the rules covering the tax treatment of capital gains in relation to beneficiaries in paragraph 80 of the Eighth Schedule to the Act.

Section 25B of the Act provides that the income of a trust is taxed either in the trust or in the hands of beneficiaries. However, section 25B is subject to section 7 of the Act such that if section 7 of the Act applies, some other person instead of the trust or beneficiaries may be taxed.

Paragraph 80 of the Eighth Schedule to the Act refers to a trust determining a capital gain, which must then be disregarded by such trust and taken into account by the resident beneficiary in whom the asset vests in terms of subparagraph (1) or

any amount derived from the capital gain is vested (but without a right to the asset disposed of) in terms of subparagraph (2).

Reasons for change

Section 25B of the Act does not have a limitation on who the beneficiaries of a South African trust may be; they could be residents or non-residents. The flow through of amounts by South African trusts to non-residents places SARS in a difficult position to collect income tax from those beneficiaries as they may not be taxed on foreign sourced amounts, tax recovery actions may be difficult and in the case of non-resident trusts that are beneficiaries, SARS may not have information on the persons in whom the foreign trusts vest the income.

Proposal

It is accordingly proposed that changes be made to section 25B of the Act to align it with the provisions of paragraph 80 of the Eighth Schedule to the Act by limiting the flow through principle only to resident beneficiaries.

Effective date

The proposed amendments is deemed to have come into operation on 31 July 2023 and applies in respect of any years of assessment ending on or after the date.

4.25. Refining the participation exemption for the sale of shares in foreign companies

[Applicable provision: Paragraph 64B of the Eighth Schedule to the Act]

Background

In 2003, changes were made to the tax legislation to introduce participation exemption relating to foreign dividends from foreign companies in section 10B of the Act as well as participation exemption relating to the sale of shares in foreign companies in paragraph 64B of the Eighth Schedule to the Act. The main aim of these exemptions is to encourage the repatriation to South Africa of foreign

dividends and the proceeds on the sale of shares in foreign companies to nonconnected non-residents.

Reasons for change

Government has identified certain transactions that do not achieve this aim but for which the participation exemption for the sale of shares in foreign companies applies. It has also been identified that the participation exemption is being used in ways that was never intended. These transactions include for example, instances where restructuring of a group of companies entails the sale of shares to recently formed non-resident companies although there is no change in the ultimate shareholders.

Proposal

In order to close the loophole and address the unintended use of participation exemption relating to the sale of shares in foreign companies in paragraph 64B of the Eighth Schedule to the Act, it is proposed that the exclusions to participation exemption contained in paragraph 64B(1) of Eighth Schedule to the Act be extended to include the following:

- Interest disposed of to a non-resident company that formed part of the same group of companies as the company disposing of the shares for an amount that is equal to or exceeds the market value of the interest; or
- Interest disposed of to a non-resident company, the shareholders of which are substantially the same as the shareholders of any company in the group of companies disposing of the shares for an amount that is equal to or exceeds the market value of the interest.

Effective date

The proposed amendments will come into operation on the date of tabling of the Taxation Laws Amendment Bill of 2023 and apply in respect of disposals on or after that date.

4.26. Refining the participation exemption for the foreign return of capital from a CFC

[Applicable provision: Paragraph 64B of the Eighth Schedule to the Act]

Background

Paragraph 64B of the Eighth Schedule to the Act contains participation exemption relating to the sale of shares in foreign company. This participation exemption is subject to certain qualifying requirements. One of those requirements is that the South Africa resident selling the shares in a foreign company should have held those shares for a period of at least 18 months prior to the sale.

Reasons for change

In 2012 changes were made in the Act to extend the participation exemption to apply in respect of the foreign return of capital from a controlled foreign company. At issue is the fact that unlike the participation exemption relating to the sale of shares in foreign company, the participation exemption for the foreign return of capital in a controlled foreign company does not have a similar 18 month holding requirement. This creates an anomaly in the application of the provisions relating to participation exemption.

Proposal

In order to address this anomaly, it is proposed that a similar 18-month holding requirement that currently applies to the participation exemption relating to the sale of shares in a foreign company should be introduced for the participation exemption in respect of the foreign return of capital in a controlled foreign company.

Effective date

The proposed amendment will come into operation on 1 January 2024 and apply in respect of any foreign return of capital received or accrued on or after that date.

4.27. Reviewing the value-added tax (VAT) treatment of specific supplies in the short-term insurance industry

[Applicable provisions: Further proviso to section 8(8) and a new section 8(8A) of the Value-Added Tax Act No. 89 of 1991 ('the VAT Act']

Background

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

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

Reasons for change

In 2013 SARS first issued Binding General Ruling 14 ('BGR 14'), which deals with the VAT treatment of specific supplies in the short-term insurance industry, including the VAT treatment of excess payments. This BGR 14 was updated in 2018 and 2020. BGR 14 stipulates that where an insured pays an excess amount directly to the third-party supplier, the supplier must issue two tax invoices, that is, one to the insured to the extent of the excess payment and one to the insurer to the extent of the trade payment.

Where the insurer pays the full amount, including the excess payment, to the third-party supplier and then recovers only the excess amount from the insured, the receipt of such excess payment from the insured does not constitute

'consideration' as defined in section 1(1) of the VAT Act, since the payment received is not in respect of any taxable supply made by the insurer to the insured. The same question as to what supplies are being made arises where the insurer pays the excess directly to the service provider. One of the fundamental principles of VAT is that it is a tax on the end consumer. As such, as far as possible, businesses must be entitled to input tax credits. Insured VAT vendors in these instances would be required to declare output tax on any amount received from the insurer, but would not be entitled to any input tax credit on the excess amount paid to the insurer.

As such, BGR 14 provided for such an input tax claim and required the insurer to issue a document to the insured which reflects the particulars as stipulated in that paragraph, to enable the insured to deduct the VAT on the excess amount where the insured is a registered VAT vendor. In 2019, changes were made to section 72 of the VAT Act, which related to the SARS Commissioner's discretionary powers over VAT decisions. These changes affected decisions made before 21 July 2019, including BGR 14. In view of the fact that the 2019 changes to section 72 of the VAT Act imply that all rulings issued by SARS before 21 July 2019 are no longer valid after 31 December 2021, at issue is whether changes could be made in the VAT Act to accommodate the ruling dealing with VAT treatment of specific supplies in the short-term insurance industry.

Proposal

In order to address these concerns, it is proposed that changes be made to section 8 of the VAT Act, dealing with deemed supplies rules by introducing new provisions that make provision for a deemed supply to the insured when goods or services are paid for in part by the insured. Since the proposed amendments will deem two supplies to occur, one to the insurer, and one to the insured, the third party will be required to issue two tax invoices (one to the insurer and one to the insured). As such, it is proposed that further changes be made in the VAT Act to limit the insurer's input tax deduction calculated in terms of section 16(3)(a) to the tax fraction of the amount actually paid to the third party supplier.

Effective date

The proposed amendments will come into operation on 1 January 2024

4.28. Clarifying the VAT treatment of prepaid vouchers in the telecommunications industry

[Applicable provision: Section 21 of the VAT Act]

Background

In the early years of the mobile telecommunications industry in South Africa, prepaid subscribers to mobile telecommunication services could use prepaid vouchers only to purchase the services offered by that mobile telecommunications company such as calls and short message services ('SMS'). The evolution and technological advances in the telecommunications industry have made it possible for subscribers to utilise the prescribed services purchased from the telecommunications company to acquire other services from third-party service providers.

Examples include, the supply of financial services (long-term and short-term insurance), downloads of music or movies, and mobile money services.

Prepaid vouchers falling within the scope of section 10(19) of the VAT Act are subject to VAT at the time the prepaid voucher is supplied. This is due to the fact that the goods or services to be supplied in the future were specified on the prepaid voucher or the holder is entitled by usage or arrangement to specified goods or services. The supplying vendor is therefore able to establish the nature of the goods or services to be supplied and therefore the tax treatment of the goods or services to be supplied is known at the time the voucher is sold. The value of the supply of the goods or services supplied upon the surrender of the prepaid voucher is then regarded as nil.

Reasons for change

At issue is the fact that where a subscriber acquires other services, the telecommunications company cannot issue a credit note, as the telecommunications company cannot meet the requirements of section 21(1)(i) of the VAT Act as it was not the supplier that provided the tax invoice to the subscriber.

When the prepaid subscriber acquires services from a third-party supplier, the third-party supplier is required to account for output tax on that supply, provided it is a taxable supply.

The implication, therefore, is that both the telecommunications company and the third-party supplier account for output tax to SARS; the telecommunications company at the point that the prepaid voucher is sold, and the third-party to the extent that services are supplied by the thirdparty. In such instances, the telecommunications supplier transfers the money collected in respect of the supply by the third-party supplier to such supplier, with no remedy for the telecommunications supplier to issue a credit note under section 21 of the VAT Act or write off irrecoverable debts under section 22 of the VAT Act.

Proposal

In order to address these concerns, it is proposed that changes be made in the VAT Act by introducing a provision allowing the telecommunications companies to deduct input tax to the extent that a subscriber acquires services from a third-party supplier, whether taxable or exempt, in instances where the telecommunications company acts as an agent for such supplies.

Effective date

The proposed amendment will come into operation on 1 April 2024.

4.29. Clarifying VAT rules dealing with documentary requirements for gold exports

[Applicable provisions: New section 54(2C) of the VAT Act]

Background

The main purpose of gold refineries is to refine and smelt gold or ore received from various customers, namely depositors. In most instances, the refineries also act as agents and sell or export gold on behalf of these depositors. Gold from more than one depositor is typically required to make up the volume ordered for sale or export. When the depositor delivers their gold to the refinery, the refinery issues a 'Precious Metal Receipt' and later a 'Sale of Gold Certificate' to the depositor and the value of the gold deposited is determined using that day's morning, afternoon or spot London Bullion Market Association gold price. These processes also apply to the refining and sale of silver insofar as it relates to exports.

The refinery and smelter require large quantities of gold or ore to operate effectively and efficiently, and no single depositor provides sufficient quantities of gold or ore. It is accordingly not possible for each depositor to have its gold or ore treated separately from the gold or ore of other depositors. It follows that once a specific depositor's gold or ore enters the refining or smelting process, it is co-mingled with the gold or ore of other depositors and effectively loses its identity as belonging to a specific depositor.

Reasons for change

At issue is the fact that after the refining or smelting, it is difficult to determine which depositor's gold is sold or exported because the gold loses its original identity during refinery and smelting. As a result, depositors find it difficult to obtain the documentary evidence to support the application of the zero rate on a transaction-by-transaction basis in relation to their gold as contemplated in the regulations issued in terms of section 74(1) of the VAT Act read with paragraphs (a) and (d) of the definition of 'exported' in section 1(1) of the VAT Act.

Given that gold is a highly regulated commodity and that the refinery or smelter continuously sells gold as an agent on behalf of the depositors to potential buyers who are limited to the members of the London Bullion Market Association based in London (the Bullion Bank) in the form of export sales (direct or indirect) as envisaged in section 11(1)(a) of the VAT Act, sales to the SARB, the South African Mint Company (Pty) Ltd and Banks registered under the Banks Act, No. 94 of 1990 as envisaged in section 11(1)(f) of the VAT Act, it is important that vendors are able to properly and accurately account for VAT.

Proposal

In order to address these challenges, it is proposed that changes be made in section 54 of the VAT Act, dealing with agents and auctioneers by introducing a provision allowing an agent under the above-mentioned circumstances to retain the necessary documentation and to assume the liability relating to the zero-rating of the export in the event of non-compliance.

Effective date

The proposed amendment will come into operation on 1 April 2024.

5. MEMORANDUM ON THE OBJECTS OF THE TAX ADMINISTRATION LAWS AMENDMENT BILL, 2023

5.1. Purpose of bill

The Tax Administration Laws Amendment Bill, 2023 (the 'Bill'), proposes to amend the Income Tax Act, 1962, the Customs and Excise Act, 1964, the Value-Added Tax Act, 1991, and the Tax Administration Act, 2011.

5.2. *Income Tax Act, 1962: Amendment of section 10 – Mutual Evaluation Report adopted by the Financial Action Task Force*

The Mutual Evaluation Report of South Africa adopted by the Financial Action Task Force (FATF MER) in October 2021, identified a wide range of technical deficiencies in South Africa's Anti-Money Laundering, Combating the Financing of Terrorism and Countering the Financing of Proliferation (AML/CFT/CFP) regime and adopted an action plan for South Africa to address deficiencies.

In order to give effect to the National Strategy on AML/CFT/CFP ('the National Strategy on AML/CTF/CFP'), developed as a response to the FATF MER and give effect to the action plan, Parliament adopted the legislative changes in the Anti-Money Laundering and Combating Terrorism Financing) Amendment Act, 2022 (the GLA Act). The GLA Act amended the Companies Act, Nonprofit Organisations Act (NPO Act) and Trust Property Control Act by inter alia requiring certain non-profit organisations (NPOs) to require disclosure of beneficial ownership (BO) and provide for additional grounds for disqualification for a person to be appointed or continuing to act as a director, office-bearer of a registered NPO or trustee.

In order to align with the National Strategy on AML/CTF/CFP and achieve consistency with the GLA Act, amendments are inserted in the Income Tax Act to provide for similar grounds for disqualification for tax exempt associations, including persons to be appointed or continuing to act as an office-bearer of an organisation approved as a tax-exempt Public Benefit Organisation and for the removal of disqualified officebearers.

5.3. *Income Tax Act, 1962: Insertion of Part IA in Chapter III – Advance pricing agreement programme*

The implementation of an advance pricing agreement (APA) programme is in keeping with international trends, e.g. Action 14 of the OECD/G20's Base Erosion and Profit Shifting Action Plan, and the recommendations of the Davis Tax

Committee. An APA programme will provide taxpayers with a greater level of certainty when embarking on large-scale international transactions that have transfer pricing implications. This is in line with SARS' first strategic objective of providing clarity and certainty to taxpayers to promote voluntary compliance and complements SARS' advance tax rulings system, which provides rulings on the tax implications on proposed domestic transactions.

SARS released a discussion paper on an APA programme for public comment in November 2020, followed by the release of a high-level model and draft legislation in December 2021. The proposed legislation seeks to introduce the enabling framework for the APA programme. The framework is inserted in the Income Tax Act in the light of its close relationship with section 31 and other provisions of the Act. It deals with persons eligible to apply for APAs, fees, pre-application consultation, content of applications, amendment and withdrawal of applications, criteria for rejecting applications, processing of applications, finalisation of APAs, annual compliance reports, extension of APAs, termination of APAs, record keeping and SARS' power to prescribe procedures and guidelines for the implementation of the programme. It also provides for consultation with affected treaty partners at key points of the process.

As the APA programme will require scarce resources, it is envisaged that the programme will commence with a pilot shortly after the legislative framework has been put in place. The pilot will only accept bilateral APA applications, which will allow for learning from other jurisdictions and the managed expansion of capacity before SARS extends the programme. The proposed framework provides a degree of flexibility in eligibility criteria and implementation to cater for the move from a pilot to later stages of the programme, like multilateral APA applications.

5.4. Income Tax Act, 1962: Amendment of paragraph 13 of First Schedule – Cost of livestock purchased

Paragraph 13 of the First Schedule provides that the cost of livestock purchased by farmers in certain instances shall be allowed, at the option of such farmer, as a

deduction in the determination of the farmers taxable income for the year of assessment during which the livestock was so sold, provided the claim for such deduction is made within five years or 10 years after the close of that year of assessment as the case may be. Paragraph 13(6) provides that SARS may, notwithstanding the prescription provisions contained in the Tax Administration Act, 2011, for the issuing of a reduced or additional assessment, raise an assessment for any year of assessment with respect to which a deduction in terms of this paragraph is allowed. This section provides an additional basis for a reduced assessment other than that envisaged in section 93 of the Tax Administration Act. The proposed amendment aims to clarify this position.

5.5. Income Tax Act, 1962: Amendment of paragraph 9 of Fourth Schedule – Vary basis for PAYE

As a result of the amendments to section 10(1)(o)(ii) of the Income Tax Act (which became effective on 1 March 2020) employers may, in terms of paragraph 10 of the Fourth Schedule to the Income Tax Act, request SARS (by applying for an IRP3q tax directive) to vary the basis (as provided in paragraph 9) for determining the amount of PAYE to be deducted or withheld from the employees' remuneration to take into account foreign taxes paid. The PAYE to be deducted or withheld by that employer in terms of paragraph 2 of the Fourth Schedule shall, subject to the provisions of paragraph 11 and section 95 of the Tax Administration Act, 2011, be determined accordingly.

Paragraph 9 in turn states that SARS may from time to time prescribe deduction tables applicable, and the manner in which such tables must be applied and indicates that the PAYE to be deducted from any remuneration must, subject to the provisions of paragraph 10 and 11 of the Fourth Schedule and section 95 of the Tax Administration Act, be determined in accordance with such tables.

In terms of paragraph 11A(4), where the remuneration includes section 8C share gains, the employer must, before deducting the PAYE payable on the gain, ascertain from SARS the amount to be so withheld (by applying for an IRP3s tax

directive). Given the amendments to section 10(1)(o)(ii), as stated above, employers may, in terms of paragraph 10 request a variation in the employees' tax withholding (by applying for an IRP3q tax directive) to take into account foreign taxes paid.

However, under the current wording of paragraph 9 and 10 of the Fourth Schedule, such a variation does not apply to withholding required under paragraph 11A of the Fourth Schedule (namely, share gains under section 8C of the Income Tax Act) and the foreign taxes paid in respect of section 8C gains cannot be taken into account for purposes of determining the tax due on the gain. This could result in cash flow implications for the affected employees (as they will only be entitled to claim a foreign tax credit at the time of completing their ITR12s). The proposed amendment aims to rectify this situation.

5.6. Tax Administration Act, 2011: Amendment of section 1 – 'Beneficial owner'

A definition of 'beneficial owner' of a company, trust and partnership is inserted in order to align with the National Strategy on AML/CTF/CFP in developing a national integrated, interoperable and harmonised beneficial ownership (BO) framework, comprising of BO registries and other sources to provide timely access to law enforcement and other competent authorities, including SARS, to reliable legal ownership and BO information in line with the FATF BO standards and Immediate Outcome 5 of the action plan.

This definition also seeks to achieve consistency with the GLA Act and to take account of other developments related to the FATF MER on South Africa, including commitments by SARS, and the consequent increased monitoring ('grey listing') of South Africa by FATF in view of the country's deficiencies in its AML/CTF/CFP controls and the consequent higher risk of money laundering and terrorism financing being facilitated in South Africa through legal entities such as companies, legal arrangements such as trusts and partnerships and associations such as NPOs.

BO is also crucial for tax administration because it helps ensure transparency and accountability in financial transactions. By identifying the individuals who ultimately benefit from an asset or income, tax authorities can accurately determine tax liabilities and prevent tax evasion, which information may also assist other competent authorities in the investigation of money laundering, and other illicit activities.

Furthermore, BO information facilitates international cooperation and exchange of taxrelated information among jurisdictions. This cooperation is crucial in detecting and addressing cross-border tax evasion and ensuring that taxpayers fulfil their obligations in the appropriate jurisdictions.

5.7. Tax Administration Act, 2011: Amendment of section 69 – List of approved public benefit organisations

In terms of the Tax Administration Act, SARS may disclose a list of public benefit organisations approved in terms of sections 18A and 30 of the Income Tax Act, 1962.

As approval to issue receipts for tax deductible donations in terms of section 18A of the Act may be granted to a broader range of entities than public benefit organisations, the proposed amendments explicitly empowers SARS to disclose all entities with a section 18A approval.

5.8. Tax Administration Act, 2011: Amendment of section 70 – Disclosure of taxpayer information to CIPC, Master of the High Court and NPO

The proposed amendment allows the disclosure of taxpayer information to the Companies and Intellectual Property Commission (CIPC), the Master of the High Court and the NPO Directorate for purposes of duties and functions under the Companies Act, 2008, Trust Property Control Act, 1988, and Nonprofit

Organisations Act, 1997, respectively, similar to such disclosures to the SARB, FIC and FSCA, to allow for the cross verification of beneficial ownership information under the beneficial ownership framework of the National AML/CFT Strategy.

5.9. Tax Administration Act, 2011: Amendment of section 95 – Estimated assessment

SARS may make an assessment based on an estimate where a taxpayer does not submit a return. The taxpayer may, within 40 days from the date of the assessment, request SARS to make a reduced or additional assessment by submitting a true and full return. The proposed amendment empowers SARS to extend the period within which the taxpayer is required to make their request to SARS by public notice. This will allow the deadline for the request to be aligned with the close of the filing season for non-provisional taxpayers.

6. NOTICES / REGULATIONS

6.1. Table of interest

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

DATE FROM	DATE TO	RATE
1 November 2020	28 February 2022	7,00%
1 March 2022	30 April 2022	7,25%
1 May 2022	30 June 2022	7,50%
1 July 2022	31 August 2022	7,75%

1 September 2022	31 October 2022	8,25%
1 November 2022	31 December 2022	9,00%
1 January 2023	28 February 2023	9,75%
1 March 2023	30 April 2023	10,50%
1 May 2023	30 June 2023	10,75%
1 July 2023	31 August 2023	11,25%
1 September 2023	Until change in the Public Finance Management Act rate	11,75%

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	3,00%
1 March 2022	30 April 2022	3,25%
1 May 2022	30 June 2022	3,50%
1 July 2022	31 August 2022	3,75%
1 September 2022	31 October 2022	4,25%
1 November 2022	31 December 2022	5,00%
1 January 2023	28 February 2023	5,75%
1 March 2023	30 April 2023	6,50%

1 May 2023	30 June 2023	6,75%
1 July 2023	31 August 2023	7,25%
1 September 2023	Until change in the Public Finance Management Act rate	7,75%

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

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

DATE FROM	DATE TO	RATE
1 August 2020	30 November 2021	4,50%
1 December 2021	31 January 2022	4,75%
1 February 2022	31 March 2022	5,00%
1 April 2022	31 May 2022	5,25%
1 June 2022	31 July 2022	5,75%

1 August 2022	30 September 2022	6,50%
1 October 2022	30 November 2022	7,25%
1 December 2022	31 January 2023	8,00%
1 February 2023	31 March 2023	8,25%
1 April 2023	Until change in Repo rate	8,75%

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

6.2. Update on the distribution of funds to non-resident Trusts by resident Trusts

1 August 2023 – It has been the practice of SARS not to approve the release of funds when resident Trusts make distributions to non-resident Trusts. Following queries in this regard, SARS herewith clarifies its stance on the matter and confirms that it will consider approval for the release of funds/amounts distributed to non-resident Trusts. The process required to obtain the necessary approval is to apply for a manual letter of compliance at SARS by emailing MLCA@sars.gov.za.

SARS has taken note of the fact that the SARB has relaxed certain exchange control requirements but has decided, based on the risks involved, to introduce the above-mentioned requirement to mitigate the risks.

SARS will perform verification processes to ensure that strict interpretation of the relevant sections of the Act are complied with. Note that the non-resident Trust must be a beneficiary of the resident Trust, and the distribution will only be considered by SARS if it complies with the terms and conditions in the Trust instrument of the resident Trust.

SARS will only allow such distributions if the resident Trust demonstrates that all tax liabilities in respect of the distribution were or will be settled.

Also see the Supporting Documents for Approval of International Transfers (AIT) webpage.

7. DRAFT REGULATIONS - AMENDMENTS TO THE REGULATIONS ON DOMESTIC REVERSE CHARGE RELATING TO VALUABLE METAL, ISSUED IN TERMS OF SECTION 74(2) OF THE VALUE-ADDED TAX ACT, 1991

SCHEDULE

Definitions

1. In these Regulations, 'the Regulations' means the regulations published by Government Notice No. R.2140 of 8 June 2022.

Amendment of regulation 1 of the Regulations

2. Regulation 1 of the Regulations is hereby amended —

(a) by the substitution for the definition of 'residue' of the following definition:

''residue' means any debris, discard, tailings, slimes, screening, slurry, waste rock, foundry sand, beneficiation plant waste or ash derived from or incidental to a mining operation by a 'holder' as defined in section 1 of the Mining and Petroleum Resources Development Act, 2002 (Act No 28 of 2002) or the person contracted to such 'holder' to carry on mining operations in respect of the mine where such 'holder' carries on mining operations'

(b) by the substitution for the definition of 'valuable metal' of the following definition:

''valuable metal' means, any goods in the form of jewellery, bars, blank coins, ingots, buttons, wire, plate, sponge, powder, granules, in a solution, residue or similar forms, containing gold, 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 Mining and Petroleum Resources Development Act, 2002 (Act No 28 of 2002), or by any person contracted to such 'holder' to carry on mining operations in respect of the mine where such 'holder'' carries on mining operations;

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

(c) of valuable metal containing less than 1 per cent of gold in gross weight; or

(d) jewellery plated with gold where the gold is present as a minor constituent only.'

Amendment of regulation 2 of the Regulations

3. Regulation 2 of the Regulations is hereby amended —

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

(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;

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

(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); and

(c) by the addition after paragraph (f) of the following paragraph:

(g) provide full and proper description of the valuable metal as well as the percentage of the gold content contained within the valuable metal.

Amendment of regulation 3 of the Regulations

4. Regulation 3 of the Regulations is hereby amended by the substitution in paragraph (e) for subparagraph (iii) of the following subparagraph:

(iii) full and proper description of the valuable metal;

Amendment of regulation 8 of the Regulations

5. Regulation 8 of the Regulations is hereby amended by the substitution for paragraph (c) of the following paragraph:

(c) A registered vendor will be required to account for and pay VAT for transactions falling within the ambit of the Regulations commencing from the beginning of the tax period covering 1 August 2022.

Amendment of regulation 10 of the Regulations: Short title and commencement

6. These Regulations are called the Domestic Reverse Charge Regulations and are deemed to have come into operation on 1 August 2022.

8. EXPLANATORY MEMORANDUM TO THE PROPOSED AMENDMENTS TO THE REGULATIONS ON THE DOMESTIC REVERSE CHARGE RELATING TO VALUABLE METAL

BACKGROUND

On 8 June 2022, government gazetted the Regulations on domestic reverse charge relating to valuable metal, issued in terms of section 74(2) of the Value-

Added Tax Act, 1991 (Act 89 of 1991) ('the VAT Act'), which was effective from 1 July 2022. The aim of these regulations was to foreclose schemes and malpractices to claim undue- VAT refunds from SARS by vendors operating in the value chain relating to high-risk goods containing gold.

REASONS FOR CHANGE

It has come to the Government's attention that the Regulations require further clarity in certain respects. The rationale for these proposed amendments is to provide that clarity.

DETAILED EXPLANATION OF THE PROPOSED AMENDMENTS

Regulation 1: Definitions

1. Clarifying the definition of 'Residue'

   Currently, Regulation 1 defines 'residue' to mean any debris, discard, tailings, slimes, screening, slurry, waste rock, foundry sand, beneficiation plant waste or ash. It has come to government's attention that there is confusion in the industry as to whether this definition relates only to residue as a result of mining operations or whether it includes residue as a general concept. The proposed amendment clarifies that 'residue' as envisaged relates to any debris, discard, tailings, slimes, screening, slurry, waste rock, foundry sand, beneficiation plant waste or ash as a result of a mining operation by a 'holder' as defined in section 1 of the Mineral and Petroleum Resources Development Act (2002) ('MPRDA') or the person contracted to such a 'holder', and not as a general concept.

2. Clarifying the definition of 'valuable metal'

   Currently, Regulation 1 defines 'valuable metal' to mean any goods containing gold in the form of jewellery, bars, blank coins, ingots, buttons, wire, plate, granules, or in a solution or residue or similar forms, including any ancillary goods or services. This definition excludes supplies of goods produced from raw materials by any holder as defined in section 1 of the MPRDA or by any person contracted to such holder to carry on mining

operations at the mine where the holder carries on mining operations. It also excludes a supply of goods contemplated in section 11(1)(f), (k) or (m) of the VAT Act.

It has come to government's attention that some vendors interpret the phrase 'any goods containing gold in the form of jewellery, bars, blank coins, ingots, buttons, wire, plate, granules' to mean that the gold component must be in the prescribed forms, as opposed to goods containing gold supplied in the prescribed forms. The policy rationale for the proposed amendment, is to provide clarity in this definition. It is further proposed that the definition of 'valuable metal' is amended to include gold in the form of a sponge or powder, as these forms are included in the Precious Metals Act.

3. Introducing a 'de minimis' rule

The definition of 'valuable metal' includes all goods containing gold in the prescribed forms, regardless of the gold content. This has unintended consequences where jewellery or other goods are gold plated with a thin layer of gold. The proposed amendments exclude the supply of valuable metal containing less than 1 per cent of gold in gross weight; and a supply of gold-plated jewellery where the gold is present as a minor constituent only. These amendments exclude the two supplies from the definition of 'valuable metal', which ultimately means that the DRC Regulations will not apply to those supplies (i.e., the normal VAT rules will apply).

Regulations 2 and 3: Clarifying the responsibilities of the recipient of valuable metal

In the DRC Regulations, the recipient of 'valuable metal' is required to issue a statement to the supplier within 21 days of the end of the calendar month during which the tax has been accounted and paid for, detailing, amongst other things, the percentage of the gold content in the 'valuable metal'. Recipients may not always be in a position to determine the gold content of the 'valuable metal' supplied to them. The proposed amendments to the Regulations transfer the responsibility for

declaring the percentage of the gold content in a 'valuable metal' supplied from the recipient to the supplier of the 'valuable metal'.

Regulation 8: Clarifying the transitional measures

The regulations as gazetted allowed vendors a transitional period of one month, from 1 July 2022 to 1 August 2022, to comply with the requirements. This implied that registered vendors were required to account for and pay VAT in accordance with these regulations in respect of all qualifying transactions in the August 2022 tax period. It has since come to government's attention that some vendors do not fully understand the application of the transitional measures. The proposed amendment seeks to provide clarity that the transitional measures require registered vendors to account for and pay VAT for transactions falling within the ambit of the regulations in the tax period covering 1 August 2022.

Regulation 10: Amendment of the effective date

As a consequence of the amendment of the transitional measures, it is proposed that the effective date of the regulations be amended to the 1 August 2022.

EFFECTIVE DATES

1. The proposed amendments to the DRC Regulations will come into effect on the date of promulgation, with the exception of the proposed amendments to regulations 8 and 10.

2. The proposed amendments to regulations 8 and 10 are deemed to have come into effect on the 1 August 2022.

9. TAX CASES

9.1. Nesongozwi v C:SARS (85 SATC 271 – SCA)

Nesongozwi was a mining engineer who was initially the sole director of Umthombo Resources (Pty) Ltd (Umthombo), a company that held coal prospecting and mining rights. Umthombo's sole shareholder was Nesongozwi

Mining Corporation (Pty) Ltd (NMC) and Nesongozwi was, until August 2008, also the sole shareholder of NMC.

Nesongozwi, in August 2008, sold 50% of NMC's shares in Umthombo for R150 million. In October 2009 Nesongozwi sold his remaining shares in NMC for the sum of R547 275 to the Nesongozwi Family Trust. The purchase price was determined on the basis that NMC was not a trading entity but a holding entity and that its only anticipated income would be dividends paid by Umthombo.

SARS in October 2014 issued an additional assessment in respect, *inter alia*, of the 2010 year of assessment, which took into account Nesongozwi's disposal of his NMC shares to the Trust.

SARS determined that Nesongozwi had disposed of the NMC shares at a price below their market value and imposed a donations tax and capital gains tax liability on him of R48 635 677.49.

Nesongozwi then objected to the assessment and SARS disallowed the objection, and Nesongozwi then appealed to the Tax Court, and it was only in respect of the share transaction that this appeal was concerned.

After the commencement of the proceedings, the expert witnesses of both sides met, and agreed on the valuation method as well as the base valuation of the shares, and they differed only in respect of the effect on the value of the characterisation of certain underlying mineral resources and of a consultancy agreement.

The Tax Court had dismissed the appeal, but made certain amendments to the assessment.

Nesongozwi objected to the assessment on the basis that the value of the shares had been 'grossly overstated' by SARS and that, in fact, they had a much lower value. SARS engaged the services of two sets of experts to value the shares afresh and they differed to an extent and SARS accepted the lower valuation of R274 050 000 and on this basis he had dismissed Nesongozwi's objection.

Nesongozwi applied for leave to appeal from the Tax Court and that court granted him leave to appeal to a full court of the Gauteng Division of the High Court, Johannesburg and leave had been sought only in respect of two issues: the effect of the consultancy agreement on the value of the shares and the costs order made by the Tax Court.

Nesongozwi, a day before the appeal was due to be argued before the full court, gave notice of his intention to apply for an amendment of the notice of appeal to introduce two further grounds, namely that the valuation method applied by SARS' experts was an incorrect one and that Umthombo's mineral resources had been incorrectly categorized.

The full court disallowed the amendment in respect of the first issue but allowed it in respect of the second issue, and it concluded, however, that there was no merit in any of the grounds of appeal before it and it dismissed the appeal with costs.

Nesongozwi, with the leave of the Supreme Court of Appeal, appealed once more and the primary issue before that court was whether the valuation method was properly before it.

From Nesongozwi's heads of argument, it appeared that he wished to revisit:

(a) whether the method used to determine the market value of the shares was the appropriate method;

(b) whether the impact of the consultancy agreement between Sumo and Umthombo had been taken into account correctly; and

(c) whether Umthombo's mineral resources had been correctly characterized.

The issue before the Supreme Court of Appeal was the important point of principle anterior to the merits of the case, namely, whether the aforementioned points raised by Nesongozwi were properly before the court as grounds of appeal.

Judge Plasket held the following:

<u>As to the process of objection to an assessment and an appeal</u>

(i) That question raised an important point of principle anterior to the merits, namely whether these points were properly before this court as grounds of appeal. The court pointed this out because the Tax Court was a creature of statute with the result that, as was held in Lion Match Company (Pty) Ltd v C:SARS 80 SATC 383 'the scope of its jurisdiction, its powers and the ambit of any right of appeal from its decisions' were defined in the Tax Administration Act.

(ii) That Corbett JA in Matla Coal Ltd v CIR 48 SATC 223 confirmed the principle that the appellant in an appeal against the disallowance of his objection was limited to the grounds stated in his notice of objection and this limitation was for the benefit of SARS, and may be waived by him. He stressed the importance of adherence to this principle, 'for otherwise the Commissioner may be prejudiced by an appellant shifting the grounds of his objection to the assessment in issue.'

(iii) That the court, in outlining the process of objection to an assessment and appeal, pointed out that when the taxpayer objects, they must, in terms of section 104(3) of the Tax Administration Act, lodge their objection 'in the manner, under the terms, and within the period prescribed in the 'rules''. Those rules were made in terms of section 103 by the Minister of Finance. Rule 7 sets out how a taxpayer objects to an assessment. The objection must be made on the prescribed form, completed in full, and it must 'specify the grounds of the objection in detail', including the part or amount objected to and the grounds of assessment that are disputed. Similar requirements apply to an appeal against an assessment.

(iv) That in terms of Rule 10(3), a taxpayer may not appeal 'on a ground that constitutes a new objection against a part or amount of the disputed assessment not objected to under rule 7.' If they do so, however, SARS may, in terms of Rule 10(4), require, production of the substantiating

documents necessary to decide on the further progress of the appeal, within 15 days after delivery of the notice of appeal.

(iv) That in terms of Rule 32(1) the taxpayer is then required to deliver to SARS, within 45 days of receipt of the Rule 31 statement, a statement of the grounds of their appeal. The taxpayer must, in terms of Rule 32(2), set out 'clearly and concisely' the grounds upon which the appellant appeals, and in terms of Rule 32(3) the taxpayer 'may not include in the statement a ground of appeal that constitutes a new ground of objection against a part or amount of the disputed assessment not objected to under rule 7.'

(v) That section 133 makes provision for an appeal from a decision of a Tax Court and section 134 prescribes the procedure for noting an intention to appeal against a decision of a Tax Court and provides, inter alia, that the notice of intention to appeal must state the grounds of the intended appeal, indicating the findings of fact or rulings of law to be appealed against.

(vi) That, having considered the statutory regime that regulated appeals against assessments to the Tax Court and to the High Court, the court then considered which issues were before the Tax Court and, by extension, the full court.

<u>As to whether the valuation method revisited by Nesongozwi had been properly raised as a ground of appeal before the court</u>

(vii) That Nesongozwi, after receiving the first additional assessment made by SARS, had objected on the basis that 'SARS used incorrect valuations for its assessments' in that the value of the NMC shares was excessive and had to be reduced to account inter alia for Sumo's participation interest in the joint venture. Nesongozwi contended that no value could be ascribed to the NMC shares and consequently no donations tax or capital gains tax liabilities arose.

(ix) That prior to the Tax Court hearing the parties agreed that an independent valuator be appointed who was acceptable to both SARS and Nesongozwi, and after two valuations had been received SARS issued another additional

assessment to which Nesongozwi objected, and that was the assessment of relevance in this matter.

(x) That Nesongozwi, in his Rule 10 notice of appeal, confirmed that his grounds of appeal were precisely the same as his grounds of objection, and further pleaded that the two valuations in question were erroneous because they had failed to take the necessary factors into account and were, because of this flaw, both 'grossly overstated.'

(xi) That it was clear that the parties were in agreement as to the correctness of the method of valuation. They differed in one respect only, and that was on whether the issues relating to the consultancy agreement, the payment of damages to Sumo and the shareholders agreement should have been taken into account in the valuation. The Tax Court found, with reference to the approach to the valuation by Nesongozwi's expert witnesses, that the methodology employed by them and by SARS 'was the same', and that 'this was also the methodology that was proposed by Nesongozwi in his objection of 24 February 2012, and when he testified in court he agreed that was the position.'

(xii) That, pursuant to the Tax Court's order, Nesongozwi filed a notice of his intention to appeal against parts of the Tax Court's order, and he sought leave to appeal directly to the Supreme Court of Appeal, but the court a quo granted leave for him to appeal to the full court instead. In his notice of appeal Nesongozwi initially appealed on the same ground as previously, and later in the notice he made it clear that the valuation of Umthombo's shareholding was not in issue.

(xiii) That, subsequent to leave to appeal being granted, Nesongozwi filed his notice of appeal and, as with the previous notice, the grounds set out mirrored what was said in the previous notice. Up to this point, what was evident was that both SARS and Nesongozwi used the same valuation methodology and worked from the same figures.

(xiv) That the focus of the appeal to the full court changed at the last minute as in his heads of argument two more issues were raised, and the relief sought differed fundamentally from that stated in the notice of appeal. Now, Nesongozwi sought to challenge the valuation methodology in asserting that the market value of the shares was, in fact, never determined. He also sought to re-open the characterisation of Umthombo's mineral resources, and the relief sought was altered to a setting aside of the assessment and a remittal to SARS for a new assessment to be made.

(xv) That, not surprisingly, SARS objected to the new grounds raised in Nesongozwi's heads of argument, pointing out that no application to amend his notice of appeal had been made as the application to amend the notice of appeal had been made from the bar and 'no reasons for the delay or the absence of a formal application were provided.' The full court refused Nesongozwi's application in respect of the valuation method on the grounds, inter alia, that the issue of the valuation methodology had not been canvassed in the Tax Court, in the evidence or in the pleadings, and Nesongozwi's witnesses agreed with the SARS witnesses on the valuation method and on the values, subject to the appropriate characterisation of the mineral resources.

(xvi) That the full court was of the view that a challenge to the valuation method would raise 'substantial new factual issues not canvassed before the Tax Court and Nesongozwi was seeking to build a case on a foundation not previously laid.' Moreover, the principle of finality in litigation would be undermined, and a setting aside and remittal of the assessment would have the effect of nullifying the agreement between the expert witnesses.

(xvii) That it was apparent that there was never, until the filing of Nesongozwi's heads of argument in the appeal to the full court, any suggestion that Nesongozwi disputed the method of valuation adopted by Venmyn and Thayser. It was not a ground of objection, and neither was it a ground of appeal before the Tax Court.

(xviii) That precisely the same held good in this appeal (i.e. the Supreme Court of Appeal). The valuation method was not an issue before the Tax Court or the full court, and consequently, it was not an issue before this court.

(xix) That it was common cause that the valuation method that was used was the correct one. There was also agreement as to the value, subject to the characterisation of Umthombo's mineral resources, and the effect of the consultancy agreement. Both parties applied the same valuation method, and there was thus never a dispute as to the valuation method. This issue was, in effect, settled between the parties.

(xx) That, as a result, it was not permissible for Nesongozwi to raise it, late and opportunistically as he did, as a ground of appeal. The full court was correct to refuse to allow Nesongozwi's application to amend the notice of appeal to include, as a ground, the valuation method as it had been agreed to and consequently was not an issue that could be appealed against.

(xxi) That even on the assumption that the issue had been appealable, Nesongozwi would have had to establish a misdirection on the part of the full court in the exercise of its discretion to disallow the amendment. The full court had furnished a full and complete justification for its decision. The appeal must fail on this point on account of all three of the reasons that the court had given.

(xxii) That, however, it was the court's view that the characterisation of Umthombo's mineral resources was appealable, the court being mindful of Corbett JA's observation in Matla Coal Ltd v CIR 48 SATC 223. While the issue was not raised expressly as an objection, and as a ground of appeal, it was an issue concerned with the proper application of the agreed valuation method, and it was fully canvassed in the evidence.

(xxiii) That in respect of both issues, the reasoning of the Tax Court and of the full court was firmly grounded in the credible evidence of the expert witnesses called by SARS, and could not be faulted.

Appeal dismissed with costs.

9.2. C:SARS v Capitec Bank Ltd (85 SATC 311 – SCA)

Capitec is a registered bank which conducted business as a retail bank focusing on providing essential banking services, such as transactional banking (including savings and credit card facilities) and unsecured lending to its customers.

Capitec, in its unsecured lending business, in terms of which it advanced credit in the form of personal loans to customers under term loan contracts, provided its customers with loan cover, the proceeds of which were applied to settle or reduce the outstanding loan amount due to it in the event of the customer's death or retrenchment. In essence the loan cover is insurance taken out by Capitec which covered it against the risk of outstanding amounts owing under the unsecured loans becoming irrecoverable upon the borrower's death or retrenchment.

Capitec, during the VAT period from November 2014-2015, received payouts and made corresponding payments in respect of the loan cover in the amount of R582 383 753, 66 and claimed R71 520 811, 25 as an input tax deduction in terms of section 16(3)(c) of the VAT Act which constituted the tax fraction of the total insurance payouts recovered by Capitec from its insurers and which it used to settle the outstanding loans owed by its customers or their deceased estates in the event of their retrenchment or death.

SARS on 15 February 2018 issued a VAT assessment in terms of which it had disallowed the amount of R71 520 811.85 claimed by Capitec as a notional input tax deduction in its November 2017 VAT return, on the basis that it did not qualify for deduction in terms of section 16(3)(c) of the VAT Act and it had additionally also levied a 10% late payment penalty for the resultant understatement of Capitec's VAT liability.

Capitec noted an appeal to the Tax Court against the additional VAT assessment raised by SARS for the November 2017 VAT return.

SARS contended that the loan cover payments made by SARS did not qualify for an input tax deduction in terms of section 16(3)(c) of the VAT Act, because the supply of the loan cover did not constitute a 'taxable supply'.

SARS contended that since Capitec did not charge any consideration for the loan cover, and because the loan cover is supplied in the course of Capitec's business of providing credit to its customers, it is an 'exempt supply.'

Capitec, on the other hand, contended that since the borrower had to pay interest and fees, consideration is provided for the loan cover, and alternatively that, even if the loan cover is for no consideration, it still levied a fee, termed a 'taxable supply' in terms of section 10(23) of the VAT Act.

Capitec further contended that although it did not charge a distinct fee for its loan cover, the loan cover is integral to its unsecured lending business, and thus to generating both interest income and fee income, and that the cost of providing the loan cover is recovered through that income.

The Tax Court (see ITC 1945 (2020) 83 SATC 454 per Sievers AJ) held that Capitec is entitled to deduct the aforementioned amount of R71 520 811.85 from its VAT liability by virtue of section 16(3)(c) of the VAT Act and it set aside the additional assessment for the November 2017 VAT return.

The Tax Court directed SARS to refund to Capitec the aforementioned amount together with interest at the prescribed rate from date of payment to date of refund and this appeal by SARS to the Supreme Court of Appeal is with the leave of the Tax Court.

The following facts were not in dispute:

- Capitec paid out loan cover in the amount of R582 383 753, 66 during the tax periods in question and the tax fraction of the total payments made is R71 520 811, 85.
- The standard written loan agreement between Capitec and its clients included an undertaking in clause 13 that for loans of 6 months or more, if the customer dies or is retrenched, the amount owing to Capitec would be

covered to a maximum of R264 000, save that if the customer is retrenched within 3 months from taking the loan, only half of the amount owing would be covered.

- The agreement stated that Capitec did not charge any fees for the loan cover.
- The agreement recorded the costs of credit as being the initiation fee charged upfront, the monthly services fee, included in the instalment, and interest. Both the initiation fee and monthly service fee included 14% VAT.
- The loan cover which SARS afforded its clients is a discreet contractual obligation and that there is no nexus between such clients and the insurer with whom SARS concluded a contract of insurance to protect itself against the portion of the loss to which it is now exposed in respect of such clients.

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

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

Proviso (v) in the definition of 'enterprise' provided that any activity shall to the extent to which it involves the making of exempt supplies not be deemed to be the carrying on of an enterprise.

An exempt supply is defined in section 1 of the VAT Act as a supply exempt from tax under section 12 of the Act. In terms of section 12(a) the supply of any financial services shall be exempt from the tax imposed under section 7(1)(a). Section 1 defines 'financial services' to mean 'the activities which are deemed by section 2 to be financial services.

Section 2(1)(f) provided that the following activity shall be deemed to be financial services: the provision by any person of credit under an agreement by which money or money's worth is provided by that person to another person who agrees

to pay in the future a sum or sums exceeding in the aggregate the amount of such money or money's worth.

The proviso to section 2(1) provided that the activities contemplated in, *inter alia*, paragraph (f) shall not be deemed to be financial services to the extent that the consideration payable in respect thereof is any fee, commission, merchant's discount or similar charge, excluding any discount cost.

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

Section 1 of the VAT Act defines the term 'insurance' as meaning insurance or guarantee against loss, damage, injury or risk of any kind whatever, whether pursuant to any contract or law, and includes reinsurance; and 'contract of insurance' includes a policy of insurance, an insurance cover, and a renewal of a contract of insurance: provided that nothing in this definition shall apply to any insurance specified in section 2.

Judge Saldulker held the following:

(i) That the central question in this matter is whether the tax fraction of the loan cover payouts qualified for deduction in terms of section 16(3)(c) of the VAT Act. The determination of this issue is largely dependent on whether the loan cover is a taxable supply, i.e. whether it is supplied in the course or furtherance of an enterprise.

(ii) That the definition of 'enterprise' in section 1(1) of the VAT Act is one of the most important definitions in the VAT Act. Its main purpose is to delineate as clearly as possible the type of persons, activities and supplies which were intended to form part of the tax base, as well as those that were meant to be excluded. In terms of par. (a) of this definition, there is a general requirement that enterprises participating in the VAT system must charge a consideration (or price) for the goods or services they supply.

(iii) That VAT is a tax that is ultimately meant to be charged upon the consumer in the supply chain. Thus, the obligation to recover or collect VAT is placed on the vendors who were traders, and whose business it is to add value on

goods and services; in this case, Capitec. The outgoing supply that is made by the vendor, on which it must collect VAT, must be matched with the incoming supply, which is supplied by other vendors to Capitec, and in respect of which input tax is levied and this is referred to by SARS as the 'matching principle.' Thus, in terms of the VAT Act a vendor who supplies taxable supplies is required to collect the VAT on its taxable supplies, and the total of the output tax is collected and is paid out by the vendor on behalf of the national revenue service. Correspondingly, the input tax that is charged to and paid by the vendor may be deducted and recovered from the national revenue service, but this is conditional upon the input tax in respect of the incoming supplies being used by the vendor or acquired for the purpose of making taxable supplies.

(iv) That what could not be ignored is that Capitec is in the business of providing credit and it is not in the business of providing insurance. The provision of credit is an 'exempt supply', because it is deemed a financial activity in terms of section 2(1)(f) of the VAT Act. A minor component of its business is in the form of fees, which is a taxable supply. The question, therefore, is whether the entire business activity of Capitec, which is largely exempt, should be treated as a taxable supply.

(iv) That it followed from the case of C:SARS v Tourvest Financial Services (Pty) Ltd 84 SATC 62 that where a vendor carried on the business of providing financial services, that remained its main business. The fact that there may be some taxable fees that were earned in the course of its business which could be carved out did not convert what is in essence a taxable supply (and what is in the main an exempt supply) into a taxable supply. Thus, the fact that fees charged by Capitec for its services carried VAT did not mean that the activity of supplying credit lost its exempt nature. Instead, the minor part of its business which is the earning of taxable fees may be carved out as such and claimed accordingly.

(v) That, nevertheless, it remained to be determined whether these fees were, in fact, charged by Capitec in the supply of the loan cover to its customers.

This is because although the loan cover is linked to Capitec's main business of supplying credit, for which the fees charged may be taxable, SARS contended that the loan cover is, in fact, supplied for no consideration to the customers, and the fees applied solely to the provision of credit services by Capitec.

(vi) That, from the facts, the clear and unambiguous terms of the loan contract indicated that the client is to receive loan cover from Capitec free of charge, i.e. no consideration is received by Capitec in respect of its supply of the loan cover. Therefore, in the absence of a consideration, the supply of the loan cover did not qualify as an 'enterprise' as envisaged in section 1 of the VAT Act and it is therefore not chargeable with tax in terms of section 7(1)(a) of the VAT Act which charged tax on supplies in the course or furtherance of an enterprise.

(vii) That in terms of the definition of an enterprise in the VAT Act, there is a general requirement that enterprises participating in the VAT system must charge a consideration (or price) for the goods or services they supply. Thus, the implication of not meeting this requirement is that supplies made for no consideration were not made in the course or furtherance of an enterprise, and hence, will not be a taxable supply.

(ix) That it is important to correctly characterise a particular supply as being taxable or not, because the vendor will generally have a right to deduct the VAT incurred on any goods or services acquired for the purposes of making taxable supplies, but will not be able to do so if the supplies were exempt, out-of-scope, or in connection with any other non-taxable activities conducted by the vendor.

(x) That it is important to understand the true nature of the loan cover that Capitec provided to its clients, on the one hand, and the credit insurance policy between Capitec and its insurers, on the other hand. In reality, what the insurance contracts show is that there is only one real ordinary insurance contract, which is between Capitec and its insurers and the

purpose of the contract is to cover the credit risk that Capitec is exposed to in terms of its unsecured lending business.

(xi) That in this scenario the insurance contract had only one consequence, but it benefitted two parties. Simply put, the benefit is that in the event that Capitec's client died or is retrenched, the risk became incurred for Capitec and then the insurer needed to pay out the policy. Notably, that indemnity payout, in the hands of the insurer, qualified for deduction in terms of section 16(3)(c) of the VAT Act, because the insurer is undertaking the insurance business. While the payout of the insurance contracts benefitted both Capitec and its customers – since the payouts from the insurers is credited to the loan account of the customer, the benefit to the customer is incidental.

(xii) That there is only one insurance contract, but with the same benefit arising out of the single insurance contract to both Capitec as the insured and its customer in terms of the loan cover, separately. The insurer paid output tax on the premiums it collected from Capitec. It is allowed a notional tax deduction in terms of section 16(3)(c) of the VAT Act in respect of its payout settlement that it paid to Capitec. In this way the matching principle is satisfied and the books of the insurer are balanced.

(xiii) That, with regard to Capitec, it is allowed an input tax deduction in respect of the premiums it paid to the insurer and when the insurer paid out the indemnity payments it is deemed in terms of section 8(8) of the VAT Act to have supplied to Capitec, Capitec is required to pay output tax on the indemnity payment it received from the insurer. Thus, the equilibrium is achieved in Capitec's books in that both the input tax deduction and the output tax were accounted for.

(xiv) That, however, Capitec wanted to treat that same deemed supply as a new notional input tax deduction. If it did so, this would leave the books of Capitec skewed, as this would result in there being deductions of input tax without any corresponding output tax, because the output tax that is deemed to have been received in terms of section 8(8) is immediately

reversed by this notional deduction. In any event the obtaining of the insurance is not a 'taxable supply' vis a vis Capitec's customer. The only supply between Capitec and its customers is the supply of credit, which is exempt.

(xv) That, furthermore, in terms of the credit insurance policies, Capitec is insured against the 'outstanding loan amount', which is the loss of the capital amount of the credit provided and the capitalised amount of interest and fees. All this constituted the provision of credit to its customers. Thus, on Capitec's own version the purpose of the loan cover is to protect Capitec against the risk that its customers would default on their loan, on account of retrenchment or death. The insurance policy settled that amount, thereby extinguishing the credit risk to Capitec. This is the purpose and effect of the loan cover. Thus, because the provision of credit is an exempt financial service, the loan cover is supplied in the course of making an exempt supply and is therefore not deductible by Capitec in its VAT return. There is thus nothing to the distinction sought to be made between the loan cover between Capitec and its clients and the insurance contracts between Capitec and the insurer. It is the same contract that benefitted both the bank and its customers.

(xvi) That, in the court's view, SARS is correct when it contended that the fact that the credit insurance policies' benefit may include capitalised fees in the circumstances where the client has fallen into default did not mean that the loan cover insured the earning of fees. It did not.

(xvii) That, accordingly, the loan cover is supplied in the course of making exempt supplies, because the credit insurance policies ensured the recovery of the credit advanced to customers. The payouts from the credit insurance policies settled the credit balance owing, and extinguished the credit risk arising in the event of retrenchment or death of the customer and this is the purpose and effect of the loan cover.

(xviii) That Capitec had made an exempt supply of credit available to its clients, which is not deductible, and all other activities involved in doing so were

incidental to the supply of credit, because the supply of the loan cover is not a taxable supply in terms of section 16(3)(c) of the VAT Act. Therefore, the supply of the loan cover is not a taxable supply as required by the first proviso to section 16(3)(c)(i) of the VAT Act. On this basis alone, the tax fraction of the loan cover payouts did not qualify for deduction. Consequently, the main question in this appeal must be answered in favour of SARS.

(xix) That Capitec did not apportion the deduction in its return, nor did it plead apportionment as a ground of objection to SARS' assessment or ground of appeal. In view of Capitec's failure to plead apportionment as a ground of objection and of appeal, there would be no basis to allow an apportionment and SARS is correct to disallow Capitec's deduction of the whole amount, on this basis alone. Capitec bore the onus in the Tax Court, and had to prove apportionment. Capitec did not raise the issue of a mixed supply in the Tax Court. Thus, this court could not decide this issue on appeal. Capitec adopted an all or nothing approach and bore the onus and did not discharge it.

(xx) That it is clear that SARS Interpretation Note 70 (IN70) did not seek to change the principle in the VAT Act that no deduction is permissible in respect of supplies, whether for consideration or not, in the course of making exempt supplies. On this basis, reliance on the pleaded practice generally prevailing by Capitec is misplaced. Capitec had also based its argument on section 10(23) of the VAT Act, which in the court's view is ill conceived. The purpose of section 10(23) of the VAT Act is merely to provide a valuation rule which determined that the value of a supply will be nil in certain instances. The rule cannot be used to characterise a supply as being taxable or non-taxable.

(xxi) That in regard to the matter of the penalty levied on Capitec by SARS for the underpayment of VAT arising from the deduction of notional input tax in respect of the loan cover payouts, this is the first time a penalty had been imposed by SARS on Capitec in the three years preceding the relevant

VAT return. In the court's view there were reasonable grounds for Capitec claiming the deduction: Capitec had obtained a favourable opinion from a senior counsel; and the only way Capitec could reasonably test the issue is to claim the deduction in its tax return. In such circumstances the penalty should be remitted, as it cannot be said that the contesting of the amount is unreasonable.

Appeal upheld with costs, including the costs of two counsel.

9.3. ITC 1965 (85 SATC 331) – Restraint of trade agreement

The taxpayer and Mr A had been directors of Holdings and their relationship as employees of the company had been formalised in March 2009. The letter of appointment of the taxpayer as an employee provided for a restraint of trade covenant after termination of employment.

The taxpayer's relationship with Mr A broke down which resulted in him stopping to work for Holdings in 2010, but he remained a director and kept an office at Holdings until he was removed as a director in 2011.

The taxpayer, following his removal as a director, instituted litigation through the AB Trust in order to 'obtain a value of what I would have built over the years'. The matter was set down for hearing towards the end of 2015 and it was apparent at the hearing of the matter that Mr A had made a settlement proposal to the taxpayer which was followed by an agreement between the parties which in essence was that Holdings would pay the AB Trust the amount of R160 million and R60 million to the taxpayer in consideration of the restraint of trade agreement and hence two separate settlement agreements were concluded between the parties.

The restraint of trade agreement recorded the undertaking by the taxpayer not to compete with companies which were subsidiaries of Holdings for a period of five years, and acknowledged that the taxpayer had been a key employee of the company, had been exposed and had access to certain confidential information.

The agreement further provided that Holdings was to pay the taxpayer the sum of R60 million ‘in settlement of the consideration payable in terms of the Restraint Agreement.’

The taxpayer, after receipt of the aforesaid payment, declared the amount as a capital gain in his return of income and paid the amount of R8 million to SARS towards capital gains tax.

SARS did not agree with the categorisation of the payment as a capital gain and accordingly adjusted it to be gross income falling within the definition contained in section 1(cB) of the Income Tax Act and taxed him accordingly.

SARS disallowed the taxpayer’s objection to the aforementioned adjustment and, aggrieved by this decision, the taxpayer filed an appeal to the Tax Court.

The issues for determination before the Tax Court were:

- whether the R60 million received by the taxpayer from Holdings was a payment in consideration of a restraint of trade falling within par. (cB) of the definition of ‘gross income’ of the Income Tax Act;
- whether the facts on which SARS relied to raise an understatement penalty at the rate of 10% in terms of sections 221 to 223 of the Tax Administration Act were reasonable; and
- whether the taxpayer was liable for the statutory interest on the underpayment of tax in the 2016 year of assessment.

The taxpayer had testified that he was the inventor and originator of the technology upon which the business of Holdings operated and had given it a competitive advantage.

The taxpayer contended *inter alia* that a former employee of SARS had issued a tax directive which in essence confirmed that SARS had received certain documents which revealed that the taxpayer had received the amount of R60 million and had categorised it as capital in nature and the amount to be paid as capital gains tax was reflected in the documents as R8 million.

The taxpayer contended that he was entitled to have the amount of R60 million paid to him in consideration of the restraint of trade agreement assessed as capital gains tax as the restraint was not imposed as a result of his employment, but rather to protect the shares of Holdings.

SARS was unable to verify the tax directive provided by the taxpayer and contended that because the taxpayer was a former employee and director of Holdings, the restraint agreement was by virtue of or in respect of his employment and holding of an office at Holdings and it was on this basis that the said amount was paid to him and was accordingly gross income envisaged in par. (cB) thereof, of the Income Tax Act.

Judge Molahlehi held the following:

<u>As to whether the restraint of trade payment constituted gross income</u>

(i) That a restraint of trade covenant is often used in an employment contract and it is operative even beyond the existence of the employment contract. In other words, it is enforceable even after the termination of the employment contract. The consequence of such a contract is that the employee's freedom to contract and the right to engage in his or her trade or career is constrained upon termination of the employment contract. Put in another way, it is a contract that restricts an employee from engaging in employment or a career that would compete with the former employer's business, and this is generally limited to a specific time period and geographic area.

(ii) That the validity or enforceability of the restraint of trade agreement in casu was never challenged and the existence of the restraint of trade agreement was common cause. It was in fact the taxpayer who had relied on it in categorising the amount of R60 million that he had received from Holdings as capital.

(iii) That payments made in consideration of a restraint of trade contract are now governed by the provisions of section 1 of the Income Tax Act, which defines the concept of 'gross income' in relation to the year of assessment

as 'in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident.' The definition of 'gross income' includes par. (cB) which provides for amounts received as consideration for restraints of trade.

(iv) That the aforesaid section must be understood in the context of the categorisation of the money received by a taxpayer in consideration of a restraint of trade agreement. The first consideration in this regard was whether the money was received by a natural person and not a juristic entity.

(iv) That the other inquiry concerned two related aspects. The first was whether the money was received in respect of or by virtue of his or her employment or holding an office (e.g. as a director). The second inquiry had two levels, namely whether the money received in consideration of a restraint of trade agreement was in respect of or by virtue of the past employment or future employment, this included the holding of an office.

(v) That the burden of proof as to whether money paid under the restraint of trade was income rested with the person who received the payment in terms of section 102(1) of the Tax Administration Act.

(vii) That it was common cause in the present matter that the restraint of trade agreement came into being consequent to the suspensive condition in the purchase and sale of the shares agreement. The purchase and sale agreement was between Holdings and the Trust, and the restraint of trade agreement, on the other hand, was between Holdings and the taxpayer. It was accordingly common cause that the amount paid in consideration of the restraint of trade was paid to a natural person, namely the taxpayer.

(viii) That, furthermore, there could be no doubt that the restraint of trade was to protect the proprietary interest of Holdings and its subsidiaries by protecting the value of the shares and this was in anticipation of the sale of the shares after the termination of the relationship between the parties.

(ix) That it was clear from the proper reading of the restraint of trade agreement that the restraint in issue had a direct link with the employment contract and the position of the taxpayer as a director of Holdings. In this respect the taxpayer had 'acquired knowledge and confidential information by virtue of having been a key employee and director of Holdings.'

(x) That it was further the court's view that the taxpayer's contention that the payment he had received was 'by virtue of the share purchase agreement' was unsustainable. The taxpayer was not a party to the share purchase agreement and except for what appeared to be a quid pro quo arising from the suspensive conditions in the share purchase agreement, there was no evidence to show the link between the two agreements.

(xi) That it was clear, when applying the facts in this case to par. (cB) of the definition of gross income of the Income Tax Act, that the taxpayer had received the payment of R60 million from Holdings in his personal capacity and the payment was in consideration of a restraint of trade imposed on the taxpayer and the restraint of trade was imposed on him by virtue of his employment, thus bringing the restraint of trade within the sphere of par. (cB).

As to the understatement penalty

(xii) That the court had to determine whether the understatement penalty imposed on the taxpayer by SARS at the rate of 10% in terms of sections 221 to 223 of the Tax Administration Act was reasonable in the circumstances.

(xiii) That the issue of the understatement in this matter arose from the amount of the R60 million received from Holdings by the taxpayer who had declared the said amount in his tax return as a capital gain and SARS, in his assessment, had treated the amount as gross income and thus regarded its declaration as capital in the taxpayer's tax return to be an understatement.

(xiv) That the taxpayer had contended that there was no basis for the imposition of the understatement penalty because he had complied with the directive

issued by SARS on 11 June 2015. However, based on the facts and the circumstances of this case, the court found the taxpayer's proposition to be unsustainable for the reasons that it gave.

(xv) That the taxpayer had misrepresented to SARS the true state of affairs concerning the restraint of trade and its relation to the amount received. The document that he relied on was not an assessment and was issued based on what he had told SARS in his letter. The document that he relied on as to why he had declared the R60 million as capital tax in his tax return was suspicious and its validity had been placed in serious doubt by the evidence of the taxpayer's witness, Mr C.

(xvi) That it was important to note that the taxpayer, in preparing his tax return, had been assisted by a tax consultant of twenty-seven years' experience. The conduct of the taxpayer was not a bona fide error which could excuse him for his understatement which was substantial and evidently had prejudiced SARS.

(xvii) That the taxpayer's proposition that his approach to SARS with the documents concerning the payment of the R60 million amounted to 'Voluntary Disclosure' was also unsustainable.

(xviii) That, accordingly, the taxpayer was liable for the understatement penalty at the rate of 10% as a substantial understatement.

Appeal dismissed with costs.

9.4. C:SARS v The Thistle Trust (85 SATC 347 – SCA)

Respondent, being the Thistle Trust, was a beneficiary of various trusts that comprised the Zenprop Group.

The aforementioned trusts, referred to as Tier 1 Trusts, comprised a group of ten vesting trusts that conducted the business of the Zenprop Group, a group of property owners and developers.

In the 2014, 2015 and 2016 tax periods, the Tier 1 Trusts disposed of certain capital assets. The capital gains so realised were distributed, *inter alia*, to the Thistle Trust in the same tax period.

The Thistle Trust, in turn, in the same tax periods, distributed the amounts it received to its beneficiaries and it treated the proceeds received as taxable in the hands of its beneficiaries.

Appellant, being the SARS, raised an additional assessment dated 21 September 2018 for the period 2014, 2015 and 2016, taxing the amounts received by the Thistle Trust as taxable in its hands.

SARS had also imposed an understatement penalty against the Thistle Trust and had required it to pay interest on the assessed liability.

The Thistle Trust filed an objection to the additional assessment on the ground, having regard to the provisions of section 25B of the Income Tax Act 58 of 1962 and par. 80(2) of the Eighth Schedule to that Act, the capital gains in issue ought not to have been taxed as it had derived no taxable income in this regard and such gains were properly taxable in the hands of the Thistle Trust's beneficiaries under those provisions of the Income Tax Act.

SARS had disallowed the objection and in March 2021 the Thistle Trust appealed to the Gauteng Tax Court, see ITC 1941 (2021) 83 SATC 387 per Wright J.

The Tax Court found that the vesting trusts (i.e. the Tier 1 Trusts) had disposed of capital assets and made capital gains. It held that the capital gains distributed to the Thistle Trust and subsequently passed on to its beneficiaries, constituted 'amounts' that fell within the purview of sections 25B(1), 25B(2) and par. 80(2) of the Eighth Schedule to the Income Tax Act. Accordingly, the distribution to the beneficiaries of the Thistle Trust was a distribution of capital gains taxable in the hands of its beneficiaries and the Tax Court, therefore, set aside the additional assessments.

On appeal by SARS to the Supreme Court of Appeal, two crisp issues arose:

- Whether the capital gains accrued as a result of the disposal of capital assets by the Tier 1 Trusts were taxable in the hands of the Thistle Trust or in the hands of the beneficiaries of the Thistle Trust to whom those gains were distributed.
- The imposition of an understatement penalty which arose conditionally in the event that it was found that the gains were taxable in the hands of the Thistle Trust. In that event, the question was whether the circumstances giving rise to the tax treatment by the Thistle Trust of the further distribution to its beneficiaries warranted the imposition of an understatement penalty.

SARS contended that par. 80(2) of the Eighth Schedule applied exclusively and that section 25B of the ITA did not apply and that capital gains tax was expressly dealt with in the Eighth Schedule.

SARS further contended that the proceeds of the disposal of capital assets by the Tier 1 Trusts constituted capital gains in the hands of the Tier 1 Trusts, but those trusts distributed the capital gains to the Thistle Trust and par. 80(2) therefore applied. The Thistle Trust had acquired a vested right to the capital gains distributed to it but acquired no vested right to the disposed capital assets. The Thistle Trust distributed the amount it received to its beneficiaries and, in doing so, it did not determine a capital gain in respect of the disposal of a capital asset as was required by par. 80(2) of the Eighth Schedule.

SARS further contended that, thus, insofar as the beneficiaries of the Thistle Trust were concerned, the provisions of par. 80(2) did not apply and the capital gains had accrued upon the disposal of capital assets by the Tier 1 Trusts and, therefore, were taxable in the hands of The Thistle Trust.

SARS, in regard to section 25B of the ITA, contended that the section did not apply as its provisions concerned the taxation of income that accrued to trusts and their beneficiaries and that the reference to 'amounts' which accrued to trusts did not include amounts or proceeds of a capital nature as those were dealt with in the Eighth Schedule.

The Thistle Trust contended that both paras 80(1) and 80(2) of the Eighth Schedule were applicable. Both supported a 'see-through' approach when dealing with the taxation of capital gains which arose from the disposal of assets by a trust to or for the benefit of the resident beneficiaries. The gains attained were taxable in the hands of the resident beneficiaries.

The Thistle Trust contended that par. 80(2) ought to be read with section 25B and that 'an amount' in the said section was inclusive of capital gains.

Judge Hughes held the following:

<u>As to The Thistle Trust trust's liability for capital gains tax</u>

(i) That when examining sections 25B(1) and 25B(2) to determine what 'any amount' constituted, the sections had to be read as a whole. Section 25B(3) provided insight into the amount that the legislator was concerned with in the application of this section. That amount was the 'taxable income derived by way of any amount.' Section 25B, read in its entirety, demonstrated that the amount was of a taxable income nature and not of a capital gains nature – 'any amount' will thus not include capital gains.

(ii) That it bears mentioning that section 25B was introduced by the legislature in 1991, while capital gains tax came into existence in 2001. Logically, if capital gains did not exist, section 25B could not have been intended to apply to capital gains. Further, the insertion of 'other than an amount of a capital nature which is not included in gross income' in the section after 'any amount', which came about after capital gains was introduced, was yet another indicator that this section did not apply to an amount of the nature of a capital gain.

(iii) That when the provisions are read as a whole and in context, it was apparent that the legislature intended that section 25B be applied to the taxation of income that accrues to a trust or its beneficiaries. In contrast, the Eighth Schedule is to be applied to the taxation of capital gains that accrue to trusts or their beneficiaries. The Tax Court accordingly erred in finding that section 25B applied in this instance.

(iv) That in Armstrong v CIR 10 SATC 1 the conduit-pipe principle was discussed for the first time and the principle became entrenched in our law in SIR v Rosen 32 SATC 249 where Trollip J had cautioned that while the principle was applicable for general application in our tax system, it ought only to be applied in appropriate circumstances to be determined on a case-by-case basis.

(iv) That the facts of this case did not support the application of the 'conduit pipe principle'. The Tier 1 Trusts had vested the capital gains in the Thistle Trust which accordingly held a vested right therein. The distribution to it of the accrued gains resulted in it receiving those gains as of right. The Thistle Trust did not dispose of any capital asset nor determine a capital gain that was distributed to its beneficiaries. Instead, it distributed monies that vested in it as of right and in these circumstances the 'conduit principle' did not apply.

(v) That par. 80(2) of the Eighth Schedule, properly interpreted and applied, required that the capital gains accrued upon the disposal of assets by the Tier 1 Trusts were to be taxed in the hands of the Thistle Trust and not its beneficiaries to whom it distributed those gains. In the circumstances, SARS was correct to raise the additional assessment for the relevant tax periods.

<u>As to the imposition of understatement penalties</u>

(vi) That the imposition of an understatement penalty arose when a taxpayer submits a tax return that understates its taxable or deemed taxable income. In such circumstances, SARS was entitled to levy a penalty based upon the circumstances giving rise to the understatement. The Tax Administration Act 28 of 2011 (the 'TAA') provided that the penalty, as determined by the TAA, was payable unless the understatement arose from a bona fide inadvertent error.

(vii) That in this matter SARS had imposed an understatement penalty of R1 460 092, which translated to a penalty of 50% levied against the Thistle

Trust. As set out in the Table referred to in section 223 of the TAA, a penalty of 50% for a standard case related to a taxpayer having 'no reasonable grounds for the 'tax position' taken by the taxpayer.' It was common cause that the Thistle Trust had obtained a legal opinion which another entity within the Zenprop Group had sought.

(ix) That SARS had initially adopted the position that, in the light of the legal opinion, it should be concluded that the Thistle Trust had consciously and deliberately adopted the position it took when it elected to distribute the amounts of the capital gains as it did. However, during the argument before the court, counsel for SARS conceded, correctly, that the understatement by the Thistle Trust was a bona fide and inadvertent error as it had believed that section 25B was applicable to its case. Though the Thistle Trust had erred, it did so in good faith and had acted unintentionally. In the circumstances, it was conceded that SARS was not entitled to levy the understatement penalty.

(x) That, turning to the matter of interest, as the capital gains tax assessment favoured SARS, the Thistle Trust would be liable for interest accrued, in terms of section 89quat(2) of the Income Tax Act. The Thistle Trust correctly conceded that SARS, if successful, would be entitled to the interest claimed.

Appeal succeeded with costs.

The understatement penalty raised was set aside.

9.5. Forge Packaging (Pty) Ltd v C:SARS (85 SATC 357 – Western Cape Division, Cape Town)

Respondent, SARS, had issued Forge Packaging (Pty) Ltd (Forge) with original assessments in respect of the returns of income made by Forge for the 2014, 2015 and 2016 years of assessment.

SARS, thereafter, addressed a letter to Forge informing it that its return of income for the 2016 period had been selected for 'verification'.

By 'verification' SARS meant a process in which the taxpayer was called upon itself to check and confirm the accuracy and correctness of the return that it had made. A verification process did not extend beyond verifying the information supplied by the taxpayer and therefore did not include an interrogation of the authenticity and completeness of the supporting information and in essence the process was limited to establishing whether the amounts declared by the taxpayer were correct and correctly represented the tax treatment described by the taxpayer.

On the other hand, an audit did more than establish the corroboration of a taxpayer's state of affairs as it interrogated all information supplied by the taxpayer and obtained from other sources in coming to an accurate assessment of the taxpayer's tax position.

SARS subsequently requested Forge to provide him with further information on a number of issues and this led to SARS also re-examining Forge's returns of income for the 2014 and 2015 years and the evidence suggested that SARS undertook that exercise based on the information provided by Forge and not pursuant to an independent inspection of Forge's accounts.

SARS did the re-examination mindful of its obligations in terms of the TA Act (TA Act) that if it was at any time satisfied that an assessment did not reflect the correct application of a tax Act to the prejudice of SARS or the fiscus, it would need to raise an additional assessment to correct the prejudice.

SARS notified Forge of various adjustments that it had made to Forge's assessments issued in respect of the 2014, 2015 and 2016 years of assessment consequent upon its finalisation of the income tax verification for the 2016 period and accordingly issued additional assessments for those years of assessment which led to the imposition of heavy understatement penalties.

Forge submitted objections which addressed all the items referred to in SARS' summary of adjustments and they also placed in issue whether SARS had provided adequate reasons for its imposition of the understatement penalties.

SARS rejected Forge's objections and thereafter Forge lodged its notices of appeal in respect of the adjustments affected to its assessments for each of the years in issue.

SARS thereafter delivered his 'Statement of grounds of assessment and opposing appeal' as prescribed in terms of Rule 31 of the Tax Court Rules.

Forge failed to deliver its statement of grounds of appeal in terms of Rule 32 of the Tax Court Rules and instead it brought an application in the Tax Court for the judicial review and setting aside of the additional assessments.

SARS thereupon applied in terms of Tax Court Rule 42 read with Uniform Rule 30 to strike out the review application as an irregular step on the grounds that it was an impermissible procedure in the Tax Court.

The strike out application was heard by Cloete J in the Tax Court and she upheld SARS' objections and set aside Forge's review application.

However, the learned judge was persuaded to grant an order staying the appeal in the Tax Court pending the determination of equivalent review proceedings to be instituted by Forge in the High Court, provided that such proceedings were instituted within 30 calendar days of the date on which the stay was granted.

The current application was instituted well outside the 30-day period provided for in the Tax Court's staying order.

Forge, in the result, was prosecuting the current application in parallel with its appeal in the Tax Court and both sets of proceedings were directed at obtaining the same result – the setting aside of the additional assessments.

SARS opposed the current review application in the High Court on the following grounds:

- That it was instituted outside the timeframe provided for in terms of the aforementioned order granted by Cloete J in the Tax Court;
- That there had been an unreasonable delay in the institution of review proceedings and the application was brought outside the 180-day limit

provided for in section 7 of the Promotion of Administrative Justice Act 3 of 2000 (PAJA);

- That the review proceeded on the misplaced premise that Forge was subjected to an 'audit' within the meaning of section 42 of the TA Act, when, so SARS alleged, it was clear that SARS had 'conducted an income tax verification and not an audit.'
- That Forge had failed to obtain the required direction from this court in terms of section 105 of the TA Act permitting it to bring the application.

Judge Binns-Ward held the following:

<u>As to whether Commissioner had conducted a 'verification' and not an 'audit'</u>

(i) That the term 'verification' is not defined in the TA Act. The term is used in various sections of the Act and in every instance in which the word is employed it is used in association with, and in apparent contradistinction to, the term 'audit.' The TA Act also does not specially define the term 'audit'.

(ii) That the canon of construction that meaning must be applied to every word used in a statutory provision and the presumption against tautology support interpreting the words 'verification' and 'audit' used in the forementioned provisions of the TA Act to denote discrete and distinguishable exercises. Certainly, on a contextual consideration, no basis for 'functional repetition', such as emphasis, clarity or certainty, were the terms to be construed synonymously, suggests itself. The character of the difference, if any, between the concept of 'verification' and that of 'audit' for the purposes of the TA Act was pertinent to Forge's reliance on SARS' alleged non-compliance with section 42 of the TA Act for the relief sought in para 1 of its Notice of Motion.

(iii) That section 42 of the TA Act sets out a framework for ongoing communication between a SARS official involved in or responsible for an 'audit' and the affected taxpayer. There was no equivalent provision in the TA Act in respect of 'verifications.'

(iv) That the letter informing Forge that its 2016 tax return was being subjected to verification called upon it to review the information set out in the relevant notice of assessment (ITA34) issued by SARS against Forge's '[own] relevant material including the related VAT and/or PAYE returns' and enjoined it, if it found any errors, to correct these by submitting a revised income tax return. Forge was informed that if it did not detect any errors, it was required to complete and submit a supplementary declaration (IT 14 SD).

(iv) That the content of the letter suggested that by 'verification', SARS meant a process in which the taxpayer was called upon itself to check and confirm the accuracy and correctness of the return that it had made. Such a process is entirely consistent with the primary meaning of the word 'verification' as defined in the Oxford Dictionary of the English language, *viz* 'the process of establishing the truth, accuracy, or validity of something.' The ordinary import of the word is neutral as to by whom the process of checking is undertaken; it may be by a third party, or equally by the person who produced the matter that is being checked (as, for example, is done by a claimant in summary judgment proceedings when 'verifying' the basis for its claim). 'Audit', by contrast, implies an independent review process. The Oxford Dictionary of the English Language defines 'audit' to mean 'an official inspection of an organization's accounts, typically by an independent body.'

(v) That SARS, in an answering affidavit, stated that its understanding of 'verification' was that it was a face-value corroboration or confirmation of the information declared by the taxpayer on the declaration or in a tax return. This process involved comparing the information declared by the taxpayer against the financial and accounting records and/or other supporting documents furnished by it. A verification's objective entailed ascertaining the correctness of the information contained in the taxpayer's declaration and whether it represented the taxpayer's tax position fairly and accurately. A verification process did not extend beyond verifying the

information supplied by the taxpayer and therefore did not include an interrogation of the authenticity and completeness of the supporting information.

(vi) That SARS' understanding of an audit was that an audit did more than establish the corroboration of a taxpayer's state of affairs; it interrogated all information supplied by the taxpayer and obtained from other sources in coming to an accurate assessment of the taxpayer's tax position and an audit might entail extending its scope to directly obtaining third party confirmation of tax amounts. This process might entail interrogating the supporting information to obtain an insight into the completeness and authenticity of the information disclosed to SARS.

(vii) That the evidence in the current application suggested that in making the impugned additional assessments SARS had acted entirely upon the basis of the information provided by Forge, and not on the basis of an independent inspection and interrogation of the company's accounts and hence SARS had not conducted an audit which indicated that SARS was not obliged to comply with the peremptory provisions applicable to an audit.

As to whether Forge could seek a review in the High Court

(ix) That Forge had not applied in its papers for a direction in terms of section 105 of the TA Act permitting it to bring this review application in the High Court. As the relief it sought was an order setting aside the assessments, it clearly required such a direction in order to prosecute proceedings to that end at first instance in any jurisdiction other than in the Tax Court.

(x) That it was clear from the judgment in Absa Bank Ltd and Another v C:SARS 83 SATC 401 that the court did regard such an application as necessary and the court there held that the application for a direction could be brought together with, and in the same proceedings as, the application to the High Court for the substantive relief being sought.

(xi) That there was nothing controversial about the finding in Absa Bank, supra, that the TA Act did not oust the jurisdiction of the High Court to decide tax

matters, notwithstanding the establishment by the Act of the Tax Court as a specialised court specifically to deal with them and that finding is well supported by the authorities.

(xii) That, as Sutherland ADJP pointed out in Absa Bank, supra, the concurrent jurisdiction of the High Court was now confirmed in terms by the provisions of Part B of Chapter 9 of the TA Act and there does not seem to be any cogent basis on which to question the validity of Sutherland ADJP's construction of section 105 to the effect that while the Tax Court is the 'default route' for appeals against assessments and 'decisions', the High Court may direct otherwise if it deems meet.

(xiii) That the tenor of section 105 of the TA Act implied that the High Court should deem it meet to 'otherwise direct' only when it was evident that the 'default route' would be less appropriate and resort to the Tax Court in matters in which it had jurisdiction was the ordinarily indicated course for obtaining redress when the setting aside of an assessment was sought.

(xiv) That it was consequently incumbent on any party seeking a direction in terms of section 105 to show good cause why an exception should be allowed from the ordinarily indicated course and it appeared that one of the well-recognised situations in which the High Court will exercise its jurisdiction in tax matters was when the question for determination turned wholly on a point of law.

(xv) That it was not correct that Forge's grounds for impugning the assessments were wholly predicated on points of law and that there were no relevant factual disputes. The alleged non-compliance by SARS with section 42 of the TA Act was only one of the issues in Forge's appeal pending before the Tax Court. Two of the other grounds of appeal involved factual as well as legal rules. Assuming, ex hypothesi, that Forge was correct in its contention that the section 42-related ground of appeal was a purely legal issue, Forge, by seeking to have it determined on review to the High Court rather than in the context of the appeal pending in the Tax Court, was setting up a situation in which the appeal could be determined in piecemeal fashion.

(xvi) That the potential for unwholesome delay and forensic dislocation if one of the issues in the pending appeal in the Tax Court was separated for determination in another jurisdiction was starkly evident. The position in the current matter was quite distinguishable in this respect from those that presented in the Absa Bank case, supra, and Metcash Trading Ltd v C:SARS 63 SATC 13 as in neither of those cases did the taxpayer approach the High Court in respect of relief that was germane in an appeal already pending before the specialist tax court.

(xvii) That the course that Forge seeks to pursue in the peculiar context of the current matter struck the court as being inappropriate and pregnant with undesirable complications. It would be inappropriate in such circumstances for this court to give the direction in terms of section 105 of the TA Act that Forge needed to be able to proceed with the review application in this court.

(xviii) That the court was not persuaded that the issue involved in the contemplated review was purely one of law. The question whether the exercise was a 'verification' as contended by SARS or an 'audit' turned on the determination that a court would have to make based on the factual evidence of what the exercise entailed. The court had indicated that the evidence on the papers suggested that it was not an audit. That prima facie view could, however, well be altered by the effect of a fuller picture given in oral evidence. Oral evidence was exceptional in review proceedings brought on motion in the High Court, but not in appeals in the Tax Court.

(xix) That, accordingly, the court was not persuaded that good cause had been shown for the court to give a direction in terms of section 105 of the TA Act that Forge's intended judicial review application should, exceptionally, be entertained by the High Court.

(xx) That, as regards Forge's related application for condonation for the delayed institution of the review application in terms of section 9 of PAJA, it was established that it was not competent for a court to entertain an application for judicial review brought outside the 180-day limit determined by section 7(1) of PAJA unless it had granted an appropriate extension of time for the

institution of the review proceedings pursuant to an application in terms of section 9(1) of PAJA.

(xxi) That in the current matter the delay had been considerable and the explanation for it was unconvincing. It was by no means obvious that the appropriate remedy on review, even were the alleged non-compliance established, would be a setting aside of the assessments and hence the court was unable to find that Forge's intended review enjoyed good prospects of success.

(xxii) That another important consideration was that there was nothing preventing Forge from relying on SARS' alleged non-compliance with section 42 and section 106(5) in its appeal in the Tax Court. Forge was therefore entitled to rely in the pending appeal on the allegedly vitiating effect of SARS' non-compliance with section 42 and section 106(5) of the TA Act if it was able to establish the fact by way of a defensive or collateral challenge to the legality of SARS' decision (cf Oudekraal Estates (Pty)Ltd v City of Cape Town and Others [2004] 3 All SA 1(SCA). Delay cannot be held against it in that context as the court has no discretion not to hear the challenge and it was clear that the Tax Court was competent to decide such a challenge as an incident of the appeal (cf South Atlantic Jazz Festival (Pty)Ltd v C:SARS 77 SATC 254).

(xxiii) That, for all these reasons, the court would not have granted Forge's application for condonation in terms of section 9 of PAJA had it been successful in obtaining a direction in terms of section 105 of the TA Act allowing it to prosecute and challenge the legality of assessments in the High Court under PAJA rather than in its appeal in the Tax Court.

Application for judicial review was struck from the roll.

9.6. *ITC 1966 (85 SATC 377) – Tax Administration*

The taxpayer appealed to the Tax Court against certain additional assessments that had been levelled against him by the SARS in respect of the 2014, 2015, 2016 and 2017 year of assessment.

The taxpayer was a shareholder in several companies which loaned money to one another and central to this case was the loan account in one of his companies called Holdings (Pty) Ltd and where in an unaudited financial statement for 2014 the taxpayer's loan account was recorded as amounting to R30 179 163.

The taxpayer contended that the aforesaid amount was incorrect, and the financial statements had since been rewritten to correct this and that the correct value was R10 390 949.

SARS was sceptical of the taxpayer's version since it was based on an error in the preparation of the financial statements, and it wanted the matter to be referred back to it for further examination and assessment. What this meant practically was that SARS would conduct a further audit of the companies in the taxpayer's group and other related companies for the purpose of determining the taxpayer's liability.

The taxpayer objected to the re-opening of a further audit of his affairs which was a process which, in any event, was likely to take several months.

The taxpayer maintained that all the material that SARS would need to consider was before the Tax Court as part of the record forming his appeal and he objected to the relief sought by SARS, i.e. the raising of a point *in limine* before the hearing of the appeal that the matter be referred back to SARS for reconsideration and assessment.

The taxpayer accordingly opposed SARS' point *in limine*.

It was common cause that a referral back before the commencement of the hearing as sought by SARS was unique and neither party could point to a case where such a request had been made and decided upon.

The taxpayer, in objecting to the relief sought by SARS, contended that such relief was not competent in terms of the Tax Administration Act (TA Act) and the only

way the matter could be referred back to SARS was if the court hearing the appeal decided that it was necessary to do so.

SARS contended that the court had the power to entertain its point *in limine* before the commencement of the hearing of the appeal in terms of section 129(2)(c) of the TA Act.

Judge Manoim held the following:

(i) That it was necessary to consider the structure of section 129 as a whole and that section needed to be read with section 117(3) of the TA Act. Section 117(3) provided that the Tax Court may hear and decide an interlocutory application or an application in a procedural matter relating to a dispute under this Chapter as provided for in the 'rules'.

(ii) That the court agreed with the taxpayer that SARS was seeking final relief rather than an interim order as it would, if granted, be final relief as when SARS made a new assessment that decision would be final in nature.

(iii) That whilst case law on what constituted final relief had developed over the years, the recent case of Metlika Trading Ltd and Others v C:SARS 67 SATC 15 was apposite in these circumstances. The court held in that case that where an interim order is intended to have immediate effect and will not be reconsidered on the same facts in the main proceedings, it will generally be final in effect.

(iv) That the nature of the relief sought by SARS in its point *in limine* was final in effect as if the investigation was referred back to SARS leading to a revised assessment, that would have an immediate effect on the taxpayer and would not be reconsidered by SARS during the existing proceedings and in that sense the taxpayer was correct.

(iv) That, accordingly, for that reason alone SARS' point *in limine* could not succeed under section 129(2)(c) of the Act.

(v) That, however, there was a further problem with SARS' point *in limine*, i.e. possible disputes of fact in a situation where technically there were no

pleadings and it was difficult to determine the law point on the basis of a disputed record. For these reasons, while the court had some sympathy with the position that SARS found itself in, it did not have the power to make such an order as was sought by SARS.

(vi) That, however, SARS was not without a remedy as if the court, on hearing the matter, was not satisfied, it could still refer the matter back but it may only do so after hearing the matter as was contemplated in section 129.

(vii) That, accordingly, SARS' point *in limine* failed and SARS was ordered to pay the taxpayer's costs.

9.7. ITC 1967 (85 SATC 382) – Tax Administration

The taxpayer in her tax return for the 2021 tax year had claimed home office expenditure in the sum of R137 118.

SARS had issued an original assessment on the same day of filing the return but thereafter it issued an additional assessment after reconsidering the taxpayer's tax return.

The taxpayer, aggrieved by the above decision, filed a notice of objection on 16 September 2021 stating that she had incurred home office expenditure due to Covid-19 in the sum of R100 501 and complained about the additional assessment raised by SARS.

The taxpayer filed another objection on 26 October 2021 as SARS had failed to respond to her earlier objection.

The taxpayer then brought an application to the Tax Court for a default judgment in terms of Rule 56(2) of the Tax Court Rules promulgated in terms of section 103 of the Tax Administration Act (the TA Act) on the ground that SARS had failed to respond within fifteen days of the notices that she had delivered on it in terms of Rule 56 of the Rules.

The taxpayer's case, put in another way, was that SARS did not comply with the time frames provided for in terms of Rule 56 to respond to the notice of objection and therefore the original assessment had to be reinstated.

The taxpayer further contended that the application for default judgment had been properly delivered to SARS and contended further that even if it was not to be accepted that the notice had been served, SARS did, on its version, receive the relevant notice and for this reason the court should order the reinstatement of the original assessment.

SARS contended that the taxpayer's application was unsustainable, because it was not properly before the court in that the proper approach the taxpayer should have followed for filing the application for default judgment was to file the application under Rule 52(1)(b) of the Rules.

SARS further contended that the application for default judgment was unjustifiable, because both the notices in terms of Rules 56(1)(a) and 56(1)(b) had not been delivered to it.

The issue before the Tax Court turned on the question of whether the application had been properly delivered in terms of the Rules, i.e. Rules 56(1)(a) and 56(1)(b).

Judge Molahlehi held the following:

(i) That Rule 50 of Part F of the Rules governed the procedure for delivering documents in relation to applications on notice and this Rule prescribed, amongst others, that documents are to be delivered at the address determined in terms of Rule 2 of the Rules. The public notice for the address at which documents or processes may be delivered to SARS and as envisaged in Rule 2(c)(ii) and c(iii) of the Rules was issued by SARS in the Government Gazette 38666 dated 31 March 2015.

(ii) That Part F of the public notice generally deals with procedures relating to applications on notice and, for the purposes of this judgment, it provided explicitly in clause 50(3)(b) that delivery of a document must be delivered at the address specified in Rule 2(1) of the Rules.

(iii) That in dealing with the question of whether the request for a default judgment by the taxpayer was properly before the court, on a proper application of the facts to the analysis of the court, there was no doubt that the taxpayer did not deliver the notices in terms of Rules 56(1)(a) and 56(1)(b) to the Tax Court Litigation Unit of SARS as prescribed by the public notice issued by SARS on 31 March 2015.

(iv) That it was common cause that the taxpayer had delivered both notices in terms of Rules 56(1)(a) and 56(1)(b) of the Rules to the Registrar of the Tax Court and the notices were not delivered to SARS. In other words, instead of delivering the notices to the email address; taxcourtlitigation@sars.gov.za, the taxpayer had delivered them to the Registrar at the email address; RegistrarTaxCourt@sars.gov.za.

(iv) That the Registrar, who is appointed in terms of section 121 of the TA Act, is not a party to the dispute between the parties but rather was responsible for administering the dispute resolution processes envisaged in the Act. He or she performs his or her function impartially and independently of the parties.

(v) That, accordingly, the taxpayer's application for default judgment stood to fail and the application further stands to fail because of non-compliance with Rule 57(3) of the Rules in that the notice of motion in the application for default judgment was not served on SARS.

(vi) That, in regard to costs in the present matter, the taxpayer had persisted with the application despite advice from SARS that her application had been fatally defective. The conduct of the taxpayer in this regard was reprehensible and the application was unnecessary and thus had placed a financial burden on SARS in having to oppose it and hence the awarding of costs on a punitive scale was justified.

Application dismissed with costs on the attorney and client scale.

9.8. *ITC 1968 (85 SATC 388) – Tax Adminstration*

The taxpayer, in the 2018 year of assessment, had listed an amount of gross income of R320 846 361 in its tax return for that period, thereby declaring that the aforementioned amount of gross income had been received by or had accrued to it in the 2018 tax year.

The taxpayer claimed an amount of R73 215 161 in expense deductions for the 2018 tax year and included therein was an amount of R11 072 237 being 'the disputed amount' which related to the distribution of profits paid to a related party who was referred to in the Annual Financial Statements as the 'Taxpayer B Partnership' or 'the BECP.'

The taxpayer bore the burden in terms of section 102(1)(b) of the Tax Administration Act (TA Act) of proving that the amount of R11 072 237 paid as a profit distribution to the BECP was an allowable deduction meeting the requirements of section 11(a) read with section 23(g) of the Income Tax Act (the IT Act).

SARS had issued an additional assessment to the taxpayer following the finalisation of an audit of the taxpayer's affairs for the 2016-2018 tax years in which there was no adjustment to the taxpayer's assessed gross income for the 2018 tax year, but SARS disallowed the deduction of the R11 072 237 which had been paid as a profit distribution to the BECP on the basis that the taxpayer had failed to discharge the burden of proving that the aforesaid amount was an allowable deduction in terms of section 11(a) read with section 23(g) of the IT Act.

The taxpayer objected to the additional assessment as contemplated in section 104 of the TA Act and the objection was to the effect that SARS had erred in adding back the disputed amount, because such disputed amount met the requirements of the General Deduction Formula (i.e. section 11(a) read with section 23(g) of the IT Act) and therefore qualified as a valid deduction from the taxpayer's taxable income ('the deduction ground').

SARS submitted that the taxpayer did not specifically object to the gross income amount of the assessment and did not allege that the gross income amount

included was incorrect and it appeared from its letter of objection that the objection was against the assessment in the sense that the taxpayer had objected to certain aspects of the assessment on the basis of the delineated grounds set out in the letter of objection and none of those grounds attacked the gross income amount.

The taxpayer's objection had been partially allowed by SARS which resulted in a reduced assessment raised on 29 September 2020, but SARS had disallowed the objection pertaining to the deduction of the disputed amount of R11 072 237.

The taxpayer then filed a notice of appeal to the Tax Court as contemplated in section 107 of the TA Act against the disallowance of the objection.

The notice of appeal indicated that the appeal was lodged against the disputed assessment on the basis of one ground only, namely, the deduction ground in respect of the disputed amount and it did not allege that the gross income amount included as part of the disputed assessment was incorrect.

The taxpayer, in its Statement of grounds of appeal in terms of Rule 32 of the Tax Court Rules, indicated that it had relied on a new ground of appeal not previously relied upon in its objection and notice of appeal, i.e., the new ground of appeal.

The new ground of appeal was to the effect that the disputed amount had neither accrued to nor was it received by the taxpayer as contemplated in the definition of 'gross income' in section 1 of the IT Act, because it was neither a receipt by nor an accrual to the taxpayer on its own behalf or for its own benefit.

SARS elected to file a Statement in terms of Rule 33 which was a Reply to the Statement of grounds of appeal and in its Statement SARS took issue with the taxpayer's reliance on the new ground of appeal on the basis that the taxpayer was prohibited from doing so in terms of Tax Court Rule 32(3) which stated that 'the Appellant may not include in the [Rule 32] Statement a ground of appeal that constituted a new ground of objection against a part or amount of the disputed assessment not objected to under Rule 7.'

The taxpayer contended that Rule 32 expressly catered for and allowed the introduction of new grounds of appeal and that the new ground that it had relied upon fell within the ambit of the Rule in that it did not constitute a new ground of

objection against 'a part or amount of the disputed assessment not previously objected to'. In other words, the new ground of appeal was directed at a part or amount of the disputed assessment against which the taxpayer did object, that is, the inclusion of the disputed amount in the taxpayer's taxable income, and hence the new ground related to an amount already previously objected to.

The distinction between the two grounds was that the deduction ground argued that the disputed amount fell to be excluded from taxable income as a deduction while the receipt-accrual ground argued that the disputed amount should not have been included in the taxpayer's gross income at all and thus fell to be excluded from the taxable income on this basis.

SARS contended that what the taxpayer sought to challenge retrospectively was the gross income amount of the disputed assessment and this was therefore an entirely new issue, namely that the gross income amount which was listed in the taxpayer's declaration and Annual Financial Statement as well as in every assessment issued was incorrect because the deduction amount should never have been included therein and hence the new ground was an objection raised against the gross income amount of the disputed assessment.

The dispute between the parties was thus whether the new ground may be relied upon by the taxpayer in terms of Rule 32(3) or whether it fell beyond the scope of the type of new ground contemplated in Rule 32(3).

The taxpayer brought an interlocutory application in the Tax Court in terms of section 117(3) of the TA Act read with Tax Court Rule 51(2) in which it sought an order directing that it was entitled to rely on a new ground of appeal in its Statement filed in terms of Tax Court Rule 32 and it was in the interests of both parties involved that the taxpayer's entitlement to rely on the new ground be determined at the outset.

Judge Van Zyl held the following:

(i) That the taxpayer had referred to the development of the Tax Court Rules as they related to pleadings filed by parties to Tax Court appeals so as to demonstrate the approach to the admission of a new ground of appeal in

the taxpayer's pleadings. The taxpayer argued that such approach had never been unduly technical or rigid, even when the relevant rules contained a stricter test in this regard than the present Rule 32 did. SARS did not deny the approach taken in the course of the development of the rules, but contended that such development had not resulted in the leeway on which the taxpayer had relied in this case.

(ii) That Rule 32(3), which lay at the heart of this matter, provided as far as the taxpayer was concerned, that an appellant 'may not include in the statement a ground of appeal that constituted a new ground of objection against a part or amount of the disputed assessment not objected to under rule 7.' The inclusion of new grounds by both parties is now permitted within the boundaries indicated by Rules 31(3) and 32(3) respectively. That is of course so – it is common cause between the parties – but the question remains whether the taxpayer's new ground fell within the ambit of Rule 32(3) and, consequently, what, then, was the proper approach to take under the current Tax Court rules?

(iii) That in interpreting Rule 32(3) in the consideration and determination of the dispute, it was thus necessary to consider the content thereof against the backdrop of the principles of statutory interpretation as set out in the case law.

(iv) That the taxpayer had placed heavy reliance on ITC 1912 80 SATC 417 which dealt with the interpretation of Rule 32(3). In that case, too, the taxpayer had included a new ground of appeal in its Rule 32 Statement, that is, a ground that had been included in neither its Rule 7 objection nor in its notice of appeal. The taxpayer expressly stated in its Rule 32 Statement that it was doing so and claimed that the new ground was not prohibited by Rule 32(3) because it related to neither a part nor an amount that had not been objected to under Rule 7. SARS brought an interlocutory application to strike out the new ground on the basis that it was not permissible in terms of the Tax Court Rules, and thus formed the subject matter to be decided by the Tax Court at the hearing of the application.

(iv) That the court did not have any quibble with the judgment in ITC 1912, supra, as far as the general approach to the interpretation of Rule 32(3) and the findings upon the facts of that matter were concerned, but the court had doubts as to whether it supported the taxpayer's case given the particular nature of the new ground in the present case. The taxpayer was relying, the court thought, on an overly-permissive interpretation.

(v) That SARS' resistance to the taxpayer's new ground as set out in its papers and heads of argument encompasses several aspects but the court regarded three of them as particularly pertinent, and as the correct approach in determining whether the new ground should be allowed under Rule 32(3) on the particular facts of this case.

(vi) That the first issue raised by SARS related to the taxpayer's gross income and the objections made in the course of the assessments. Was the taxpayer's objection to the disallowance of the deduction amount effectively the same as an objection to the gross income amount? It was the taxpayer's version throughout the audit and the subsequent dispute between the parties that the payment of the profit distribution to the BECP met the requirements of a valid deduction under sections 11(a) and 23(g) of the IT Act.

(vii) That the taxpayer had never alleged any alternative manner of accounting for the aforementioned payment and it was thus not correct to say, as the taxpayer did, that the dispute between the parties related to the correct tax treatment to be applied to the amount of R11 072 237 which was paid as a profit distribution to the BECP. The taxpayer at all relevant times proposed and declared only one manner of tax treatment for this payment, and that was for it to be regarded as a valid deduction amount in terms of ss 11(a) and 23(g) of the Act.

(ix) That the taxpayer thus never indicated that the payment to BECP did not form part of its gross income and this would have been relevant in the course of the audit as it would have afforded SARS the opportunity to scrutinise the transaction further on the basis that it involved amounts

previously declared as revenue now being alleged to be the income of a third party instead.

(x) That the exercise to determine an expense amount was to be contrasted with the test for determining gross income as the two processes were distinct and the court did not think that it was correct to say that an objection against an expense amount was equivalent to an objection against the gross income amount for the purposes of Rule 32(3).

(xi) That in Matla Coal Ltd v CIR 48 SATC 223 the court had to determine whether the taxpayer should be confined to the case made out in its objection as contemplated under sections 81(3) and 83(7)(b) of the IT Act in operation at the time. Section 81(3) of the Act provided that every objection should specify in detail the grounds upon which it was made and this mirrored the wording of the current Rule 7(2)(b) and the court's interpretation of that section was thus relevant to the present matter.

(xii) That, in this regard, the court in Matla Coal held that it 'should look at the substance of the objection and the issue as to whether it covered the point which the appellant wishes to advance on appeal must be adjudged on the particular facts of the case.' This approach, within the ambit now posed by Rule 32(3), must still be valid, because otherwise new grounds would be permissible irrespective of whether they bear any relation to the pleaded case that gave rise to the pending appeal.

(xiii) That the taxpayer did not have a blanket right to introduce new grounds as its right was limited by Rule 32(3). The wording of Rule 32(3) (as well as Rule 10(3) prescribing the content of a notice of appeal) clearly indicated that a connection should remain between the amounts previously disputed and thus subject to the disputed assessment, and the new ground. In other words, the taxpayer cannot make out an entirely new case on appeal and this limitation was confirmed by the judgment in ITC 1912 80 SATC 417.

(xiv) That in the present matter the new ground essentially related to a different amount (the gross income amount) of the assessment as compared to that

of the objection. The new ground sought alteration on appeal of that different amount of the assessment, even though it used the disputed amount of R11 million as the tool to achieve such alteration. Having regard for the substance of the taxpayer's objection and the facts of the case, it cannot be correct that an objection to the disallowance of an expense amount for failing to meet the requirements of sections 11(a) and 23(g) of the Act, was equivalent to an objection against the gross income amount of the assessment on the basis that this amount was to be reduced because a portion thereof actually accrued to a non-taxpayer third party.

(xv) That SARS' second issue went hand in hand with the first, and related to the taxpayer's claim that it had effectively objected to the whole of the disputed assessment and that there was thus no part or amount of the disputed assessment not objected to under Rule 7. The taxpayer had only objected to certain adjustments which formed part of the disputed assessment and its gross income amount was not adjusted in any assessment issued to it. It therefore did not object to the gross income amount.

(xvi) That it was thus incorrect for the taxpayer to argue that it had objected to the whole of the disputed assessment and that there was no part or amount of the disputed assessment that was not objected to under Rule 7. Even if the taxpayer had for the sake of the argument objected to the whole of the disputed assessment, this would not suffice to prove that it had objected to the gross income amount specifically, which was not adjusted in the assessment and which would require specific identification in the objection to satisfy the requirements of Rule 7.

(xvii) That, with reference to H R Computek (Pty)Ltd v C:SARS 75 SATC 104 where the issue of new grounds of appeal was addressed in relation to a VAT dispute, the court in the present case was of the view that the same applied to the taxpayer's case in the present matter in relation to SARS' second issue of dispute (para (xv) above). The taxpayer never contested the gross income amount until it raised the new ground in the Rule 32

Statement. The court in HR Computek confirmed that a globular objection to a full assessment amount did not by implication constitute an objection to every amount of the assessment. Thus, even if the taxpayer had objected to the whole of the disputed assessment, its failure to specify the objection to the gross income amount in detail in the letter of objection meant that it was precluded at this stage from raising the new ground challenging this amount in the Rule 32 Statement.

(xviii) That SARS' third issue related to the taxpayer's claim that the new ground and the original ground would achieve the same result, if upheld. Rule 32 did not permit new grounds on the basis that the eventual outcome sought by the new ground corresponded with the outcome sought in the original grounds and new grounds are only permissible if they are against a part or amount of the disputed assessment that had been objected to under Rule 7.

(xix) That the original ground sought, as its outcome, the allowance of a deduction amount of R11 072 237 paid as a profit distribution to the BECP. This outcome would be achieved by an upward alteration of the total deductions allowed in respect of the disputed assessment, on the basis that SARS erred in the disallowance of the expense.

(xx) That the new ground, on the other hand, sought an alteration of the gross income amount of the disputed assessment downward so as to reduce the taxpayer's income tax liability. The new ground would achieve this by shifting a portion of the taxpayer's declared gross income to a third party.

(xxi) That SARS' conduct in the course of the assessment cannot be impugned to justify that alteration of the gross income amount in the manner sought through the new ground (because it had not previously been considered and assessed) and the taxpayer made no case in this respect. The outcomes sought, properly considered, were thus not similar. That the final desired result, being the reduction of the taxpayer's income tax liability, was similar was unsurprising but also immaterial, as this was a tax appeal where the taxpayer was disputing its income tax liability as assessed.

(xxii) That although the courts in Matla Coal, supra, and ITC 1912, supra, permitted new grounds of appeal, the courts there were dealing with different approaches to the same issue with the same outcome whereas that was not the case in the present matter. The fact that the outcome may be the same was in any event not sufficient to render the new ground permissible under Rule 32(3) and this was illustrated in Tax Court Case No 13796 (6 September 2019) where the taxpayer sought the same outcome, but based on a new ground that the amounts in question had accrued to a different party. The taxpayer's assessed gross income was therefore being placed in the hands of another by virtue of the proposed new ground and the court there excluded the new ground despite the result sought being the same as upon the original ground.

(xxiii) That neither Tax Court Case No 13796 nor ITC 1912, supra, supported the notion that if a new ground achieves the same result as the original ground, then the new ground is permissible. The taxpayer's case was therefore not supported by ITC 1912 and also not by Matla Coal, supra, where the same amounts were challenged seeking the same outcome on the same legal submissions in the original and the new grounds, the distinction being only the bases on which the consistent designation of a transaction was justified.

(xxiv) That, accordingly, in all of these circumstances, the court found that the new ground did not fall within the ambit allowed by Rule 32(3) for introduction at this stage. This was because, for the reasons set out above in the course of the discussion of SARS' case, the new ground, properly considered, constituted an entirely new case on appeal, aimed at the reduction of an amount previously objected against, namely the taxpayer's gross income. The new ground is not merely a 're-packaging' of the legal basis upon which the taxpayer wished to have the disputed amount disregarded for the purposes of the determination of its income tax liability.

(xxv) That the aforesaid approach adhered to the ordinary meaning of the words of Rule 32(3) and did not give rise to an absurdity. It further contextualised the provisions of Rule 32(3) against the background to the development of

the rules in that it did not cater for an over-wide interpretation that would allow an entirely new case to be dealt with on appeal – a situation that had not been contemplated in the course of the relevant history of the rules.

Application dismissed with costs.

9.9. C:SARS v Coronation Investment Management SA (Pty) Ltd (85 SATC 413 - SCA)

Coronation Investment Management SA (Pty) Ltd (CIMSA) was the holding company for the Coronation Group and was registered and tax resident in South Africa.

CIMSA, during 2012, was the 100% holding company of Coronation Management Company and Coronation Asset Management (Pty) Ltd (CAM), both registered for tax in South Africa. CIMSA was also the 100% holding company of CFM (Isle of Man) Ltd, tax resident in the Isle of Man. CFM (Isle of Man) Ltd, in turn, was the 100% owner of Coronation Global Fund Managers (Ireland) Limited (CGFM) and Coronation International Ltd (CIL), which were registered and tax resident in Ireland and the United Kingdom, respectively. CFM has since been de-registered in the Isle of Man.

The issue in this appeal was whether the net income of CGFM should be included in the taxable income of its South African holding company, CIMSA, or whether a tax exemption in terms of section 9D of the Income Tax Act (the Act) was applicable to the income earned by CGFM and this depended on what the primary functions of CGFM in Dublin, Ireland, were. If the primary operations were conducted in Ireland, then the section 9D exemption applied. Of particular significance was that CGFM had adopted an outsource business model and the attendant ramifications that may have had for its tax status. Aligned to this was whether the primary business of CGFM was that of investment (which was not conducted in Ireland), or that of maintaining its licence and managing its service providers (which was conducted in Ireland).

SARS had assessed the tax liability of CIMSA for the 2012 tax year to include in its income an amount equal to the entire 'net income' of CGFM.

The Cape Town Tax Court (see *ITC 1952* 84 SATC 251 *per* Hack AJ) (the tax court) had upheld CIMSA's objection and found that CGFM was a 'foreign business establishment' (FBE) as defined in section 9D(1) of the Act and, accordingly, had qualified for a tax exemption. It had set aside SARS' additional assessment against CIMSA and had ordered it to issue a reduced tax assessment, in which no amount was included in CIMSA's income under section 9D of the Act pertaining to CGFM's income. Consequently, SARS was not entitled to claim (*a*) understatement penalties in terms of section 222 of the Tax Administration Act (the TA Act); (*b*) understatement penalties for provisional tax under para 20 of the Fourth Schedule to the Act; and (*c*) interest in terms of section 89*quat*(2) of the Act.

SARS, with the leave of the tax court, appealed the aforesaid decision to the SCA.

Section 9D(2) of the Act provided for the imputation of the 'net income' of a controlled foreign company to a South African resident company holding participation rights in that controlled foreign company, unless it fell within the ambit of the FBE exemption. This provided that in determining such net income, any amount 'which is attributable to a foreign business establishment' of that controlled foreign company must not be taken into account.

It was common cause that in the 2012 tax year of assessment CGFM was a CFC as envisaged. Therefore, the income of CGFM would be imputable to CIMSA, unless it fell within the ambit of the FBE exemption provided for in section 9D(9)(*b*) of the Act and this, in turn, depended on whether CGFM was an FBE as defined.

The undisputed evidence on behalf of CGFM was that it was incorporated in Ireland during 1997 to provide opportunities for clients to invest in South African and Irish domiciled collective investment funds (CIS). On 23 October 2007 CGFM applied to the Irish Financial Services Regulatory Authority for authorisation of an Undertaking for Collective Investment and Transferable Securities (UCITS) and on 25 October 2007 it received its licence from the Central Bank of Ireland (CBI) as a

'management company' in accordance with the European Communities Regulations under Investment Services Directive 93/22/EEC 2125.

In its business plan, attached to its licence application, CGFM presented an outsource business model where CGFM concentrated on being a 'product provider.' All non-core functions, such as investment, administration and custodial functions, were outsourced. The provision of investment management services and trading functions were outsourced to specialist investment managers, CAM in South Africa and CIL in the United Kingdom. The fund administration had been sub-contracted to J P Morgan Hedge Fund Services (Ireland) Limited and JP Morgan Administration Services (Ireland) Limited. CGFM had outsourced its distribution function to CIL and CAM, and its custodian function to J P Morgan Bank (Ireland) Plc. According to the business plan, because these functions were outsourced to independent third-party service providers, CGFM was not subject to South African Transfer Pricing rules.

CIMSA asserted that CGFM was not approved to perform investment management, which it sub-contracted to service providers. These were conducted under the oversight, direction and supervision of CGFM as the fund manager. It did not abdicate responsibility for those functions, but exercised oversight and supervision over the conduct of its service providers from Dublin. All this, contended CIMSA, was consistent with the terms of its licence issued by the CBI and since the actual performance of investment trading functions was not envisaged as part of CGFM's business, nor had the CBI approved CGFM to perform these functions, they could not be 'primary operations' as contemplated in the FBE definition. The primary business of CGFM, according to CIMSA was, therefore, not the actual performance of investment management, but 'the managed outsourcing of the investment management functions in accordance with the terms of the licence.'

CIMSA denied that CGFM outsourced functions of 'its business' as referred to in the FBE definition and contended that investment management services were not a necessary part of a fund manager's business. CIMSA stated that its position was bolstered by the fact that the outsourcing of investment functions was common

practice for fund managers in Ireland, Europe and South Africa and it was also recognised as a legitimate practice for fund managers by the CBI.

SARS had accepted that CGFM met the FBE definition, in all respects but one: economic substance. As at 2012, CGFM had offices in Dublin with a staff component of four people and all the staff were resident in Ireland. SARS also accepted that the business was located in Ireland for a reason other than the postponement or reduction of South African tax (section 9D(1)(*a*)(iv)). However, it contended that CGFM did not meet the economic substance requirements, as 'the primary operations' referred to in section 9D(1)(*a*)(ii), (iii) and (iv) were not based in Ireland. Accordingly, the Dublin office was not suitably staffed with employees, not suitably equipped, nor did it have the suitable facilities to conduct 'the primary operations' of CGFM's business.

SARS submitted that the FBE definition required each of the requirements set out in section 9D(1)(*a*)(i) to (v) to be present in a fixed place of business in order for a controlled foreign company to qualify as an FBE. If not, the business was not entitled to a tax exemption under section 9D of the Act. While it was permissible for a controlled foreign company to outsource locational permanence and economic substance, it must then comply with the proviso set out in section 9D, and each of the discreet requirements in the subsections (*aa*), (*bb*) and (*cc*) of the proviso have to be met. Whether CGFM qualified as an FBE, notwithstanding the outsourcing of these primary functions, must be answered with reference to the proviso.

SARS, in this regard, contended that CGFM did not meet the requirements set out in the proviso. Had the investment functions been outsourced to a company which was subject to tax in Ireland – where CGFM was located (subsec (*aa*)), within the same group of companies (subsec (*bb*)), and to the extent that the structures, employees and facilities were located in Ireland (subsec (*cc*)) – it would have qualified as an FBE. But, because CGFM outsourced its investment management functions to CAM and CIL, neither of whom were subject to tax in Ireland, the requirements of subsec (*aa*) and subsec (*cc*) had not been met.

SARS placed no reliance whatsoever on the proviso and denied that outsourcing may only take place in accordance with the proviso. While CGFM did not dispute

that it did not have sufficient staff to conduct investment trading, it stated that its staff complement was sufficient to maintain the licence which was a function of its primary business of fund management.

SARS' position on the CBI licence was that CGFM elected to apply for a licence whereby its investment functions were outsourced, as opposed to an in-source model. This election, however, did not alter the nature of its business, which remained that of investment.

SARS pointed out that the revenue generated by CGFM was percentage based and calculated on the market value of the assets of the Irish fund. Other service costs, such as those in respect of administration, custodial and distribution, were paid out of the fees earned by CGFM.

Judge Nicholls held the following:

As to the applicability of the tax exemption in terms of section 9D of the Income Tax Act

(i) That section 9D had been introduced to address how South African taxpayers should be taxed on their income earned abroad, especially income earned by South African owned foreign entities. A pure anti-deferral regime would immediately deem back all the South African owned foreign company income. As a result, no foreign income would receive any advantage over domestic income. However, international law only allowed South Africa to tax foreign residents on their South African source income, not on their foreign source income, even if the entity was completely owned by South African residents. To address this, section 9D imposes tax on South African owners on the income earned by their foreign entities as if those entities immediately repatriated their foreign income when earned.

(ii) That section 9D also provided for exemptions which allowed certain foreign companies to operate free from tax to the extent that an objective rationale existed for maintaining operations abroad, and when such operations posed no threat to the South African tax base. The purpose of the exemption was to balance the desire for horizontal equity (equity among

South Africans earning income at home versus those earning income abroad) against international competitiveness (allowing South African owned subsidiaries to operate on the same level tax fields as foreign owned rivals operating in the same low-taxed foreign countries). The section 9D exemptions were, therefore, introduced as a balancing mechanism between two competing interests: tax avoidance and competitiveness.

(iii) That the exemption only applied to foreign entities that qualified as a 'controlled foreign company'. Section 9D(2) provided for the imputation of the 'net income' of a controlled foreign company to a South African resident company holding participation rights in that controlled foreign company, unless it fell within the ambit of the FBE exemption. This provides that in determining such net income, any amount 'which is attributable to a foreign business establishment' of that controlled foreign company must not be taken into account. Section 9D(1) of the Act sets out the requirements of an FBE.

(iv) That the location of the 'primary operations' referred to in section 9D(1)(*a*)(ii)-(iv) was pivotal in determining whether CGFM was an FBE as defined. This required a determination as to the nature of CGFM's business in Ireland, and in particular, whether the primary operations had been outsourced, and if so, whether an exemption in terms of section 9D was applicable.

(iv) That the precise nature of the business that CGFM's license approved had to be determined. What was immediately apparent was that CGFM's licence was limited to collective investment management. It did not have the authority to engage in individual portfolio management. However, the fact that it was licenced to perform collective investment management was inconsistent with CIMSA's assertion that it was not licenced to perform any investment management. Instead, it appeared that investment management was integral to its licence as an authorised management company.

(v) That two points were apparent: First, collective portfolio management, which CGFM had been authorised to conduct, included investment

management, administration and marketing. Second, the regulations indicated that the purpose of delegation was to enhance the efficiency of the company's business. It did not detract from the business of the company, nor was it possible for delegation to alter that business. It merely entailed supervision of the core business which, in terms of regulation 23(1)(*e*), was recognised as investment management. In terms of regulation 23(1)(*b*) the management company acted in the best interest of the investors and the liability of the management company was also not affected by the fact that it had delegated its core function.

(vi) That CIMSA had conflated the role of a management company with its outsourcing or delegation of its investment and other functions. By doing so, it had impermissibly elevated the management role. The licence granted to CGFM was for fund management, which included investment management, administration and marketing. That it elected to outsource these functions and merely manage these functions, did not change the nature of the licence or elevate the managerial role into any other than an ancillary one.

(vii) That, therefore, CIMSA's pleaded case that CGFM 'has not been approved by the CBI to perform investment functions' was incorrect, nor was it borne out by its own witnesses. The fact that CGFM did not obtain approval for individual portfolio management, or other core services, did not mean that the licence 'expressly excluded investment management from its ambit.' Indeed, the contrary was true, as the CBI licence authorised 'collective investment management' and if it were to engage in individual portfolio management, then it was required to apply for 'appropriate approval'.

(ix) That, having established that the CGFM's licence entailed investment management, it had to be determined whether the nature of CGFM's business in Ireland was that of an investment company or a management company with 'the managed outsourcing of the investment management functions in accordance with the terms of the licence.' It was common cause that the investment function was not located in Ireland. Therefore, if

its primary business was that of investment, then its net income as a controlled foreign company will be imputable to CIMSA.

(x) That outsourcing was a commercial reality, particularly in Ireland where, according to the evidence, 70-80% of the businesses operate on an outsourcing basis. CGFM's rationale for setting up as a fund manager in Ireland, was to exercise its right to grow internationally and appoint the 'best in the class' investment managers, thereby advancing the best interests of its investors.

(xi) That the meaning to be ascribed to 'primary operations' and 'business' must be contextual, relative to the definition of a FBE, where the words were found. The FBE definition referred to the 'primary operations of that business', which was a direct reference to the business of the controlled foreign company. The phrase 'primary operations' was not defined in either the Act or the TA Act. The dictionary definition of the word 'primary' was, *inter alia*, 'first in importance, chief, leading, main…' 'Operations' means, *inter alia*, 'working activity, the exertion of force or influence, the way in which a thing works.'

(xii) That the notion that investment management was not CGFM's core business was at odds with what was stated in its memorandum of association. The stated objects of CGFM were to carry on the business of establishing specified collective investment undertakings; to promote, establish, manage, regulate and carry on any investment, unit or other trust or fund; and to carry on the business of investment and financial management.

(xiii) That the question was: What then constituted the core function of the business that CGFM operated in Ireland? It obtained its licence in terms of the relevant legislation under the Investment Intermediaries Act in Ireland. Investment management is a function integral to the fund management licence. The Undertakings for Collective Investment and Transferable Securities regulations (UCITS) refer to investment management as a core function of a management company.

(xiv) That, in addition, CGFM paid a fee to CAM and CIL out of the fees derived from investment management in terms of the investment management agreements that it entered into between CAM and CIL, respectively. Notwithstanding the delegation of the investment management to CAM and CIL, the fees in respect of investment was earned by CGFM. That GCFM's primary source of income was from investment was another indication that CGFM's core function was investment management. Having found that CGFM was licensed as an investment management company, the business of the controlled foreign company (in this instance CGFM) was unquestionably that of investment, as was also evidenced from the source documents.

(xv) That the fact that CGFM was permitted to outsource functions did not mean that the scope of its business was confined to supervision of the functions which it had outsourced, together with regulatory compliance. Its operations were determined by those activities for which it sought, and was granted, a licence. That it elected to outsource these functions, did not exclude these functions from the scope of its business. On the contrary, these functions had to fall within the ambit of its business in order to be outsourced. An agent cannot perform a function which does not form part of the business of the principal. In other words, CGFM could not outsource a function that it did not possess in the first place.

(xvi) That the function of investment management was, *per* the licence, a component of fund management, irrespective as to whether it was outsourced or not. The choice of a particular business model cannot alter the primary operations of a company. The nature of CGFM's business was not transformed from an investment business to a managerial one by outsourcing its investment functions. Put differently, the true business of investment management cannot be transformed into 'managed outsourcing of investment management funds', simply because it elected a business model of outsourcing in which the function of investment management was outsourced.

(xvii) That if the key operations of the business have been outsourced (here, investment management), then the fixed place of business in Ireland lacked the staff and facilities to conduct those operations. If these operations are central to the business of CGFM, because they go to the very nature of what this business does, then CGFM does not conduct its primary operations in Ireland. Without the investment management operations, could it be said to conduct its primary operations in Ireland? The answer must be, 'no'.

(xviii) That the FBE definition was not aimed solely at advancing international competitiveness for offshore businesses. Nor is the legislation concerned only to prevent diversionary, passive or mobile income eroding the South African tax base. It was also to limit a situation where an exemption is obtained over earnings in a low tax jurisdiction when the primary operations for the business are not conducted there.

(xix) That the essential operations of the business must be conducted within the jurisdiction in respect of which exemption is sought. While there were undoubtedly many functions which a company may choose to legitimately outsource, it cannot outsource its primary business. To enjoy the same tax levels as its foreign rivals, thereby making it internationally competitive, the primary operations of that company must take place in the same foreign jurisdiction.

(xx) That, accordingly, on these particular facts, the court concluded that the primary operations of CGFM's business (and, therefore, the business of the controlled foreign company as defined) was that of fund management which included investment management. These were not conducted in Ireland. Therefore, CGFM did not meet the requirements for an FBE exemption in terms of section 9D(1) and, as a result, the net income of CGFM was imputable to CIMSA for the 2012 tax year in terms of section 9D(2).

<u>As to the understatement penalty and Under-Estimation of provisional tax</u>

(xxi) That in the event of an understatement, the taxpayer must, in addition to the proper tax that should have been paid, pay an understatement penalty, unless it was the consequence of a '*bona fide* inadvertent error.' SARS bore the *onus* of proving the facts upon which the penalty had been imposed.

(xxii) CIMSA had stated that it relied on a tax opinion procured from a leading tax expert in the country. However, it did not disclose the contents thereof, or make the opinion available to SARS. SARS relied on this non-disclosure to draw a negative inference that the tax opinion did not support CIMSA's claim for an FBE exemption, and that a deliberate and conscious decision had been taken to exclude the net income of CGFM and it was contended that this was not an inadvertent error.

(xxiii) That there was nothing to gainsay CIMSA's evidence that it had prepared and submitted all its tax returns under the guidance of PricewaterhouseCoopers, and that Ernst and Young were the external auditors of CGFM. Nor was there anything to suggest that CIMSA's tax returns were not submitted in the *bona fide* belief that CGFM may be eligible for a section 9D exemption. The fact that this court had now found that this course was not open to it, did not in any manner reflect on the *bona fides* of CIMSA, anymore that it reflected on the *bona fides* of any losing party in litigation. Insofar as the tax opinion was concerned, it was not incumbent on CIMSA to disclose a tax opinion that it had obtained, any more than it would be on any other party which litigated on the basis of a procured legal opinion.

(xxiv) That in *C:SARS* v *The Thistle Trust* 85 SATC 347 an argument was presented on behalf of SARS that the taxpayer in that matter had consciously and deliberately adopted a certain position when it elected to distribute the capital gains. This court held that it was correctly conceded that the understatement was a *bona fide* error and that SARS was not entitled to impose the understatement levy.

(xxv) That to speculate that a tax opinion must have gone against CIMSA merely because it was not produced to SARS, was simply speculative and it was not sufficient to attribute *mala fides* on the part of CIMSA.

(xxvi) That, for these reasons, the claim for understatement penalties and underestimation penalties had to fail.

(xxvii) That, in regard to interest to be charged on the underpayment of provisional tax, interest was payable in terms of section 89*quat*(2) of the Act if the 'normal tax' payable by a taxpayer in respect of its taxable income exceeded the credit amount in relation to such year. Normal tax included any additional amounts payable in terms of section 76 of the Act and para. 20 and 20A of the Fourth Schedule thereto. Here, there had been an underpayment on the normal tax and, accordingly, interest was payable in terms of section 89*quat*(2) of the Act.

Appeal upheld.

9.10. Structured Mezzanine Investments (Pty) Ltd and another v C:SARS (85 SATC 436 – Eastern Cape Division, Grahamstown)

Structured Mezzanine Investments (Pty) Ltd and another (SMI) had brought an interlocutory application in the High Court which, *inter alia*, requested the court that the 'main application' before it be heard *in camera* and the court file be sealed from the public.

The main application was one brought by SARS to compel the SMI to comply with a request issued by SARS on 6 February 2020 in terms of the provisions of section 46 of the Tax Administration Act (TA Act), to respond to requests directed to them for relevant material and in bringing this application SARS was clearly acting in performance of his duties.

SMI had refused to provide the relevant information sought in terms of section 46 of the TA Act which precipitated the launching of the main application.

SMI contended that SARS' founding affidavit in the main application was replete with confidential taxpayer information and that by so doing SARS had breached its statutory duty to preserve the secrecy of same which it may not disclose in terms of sections 67 and 69 of the TA Act.

SMI contended that the information referred to in the main application was confidential in terms of the TA Act and that, for the reasons set out, this warranted an *in camera* hearing.

SMI contended further that SARS had abused or overlooked his constitutional duties by failing to show respect for the right to privacy.

SARS contended that the 'principle of open justice' applied, i.e. that all court proceedings and records by default were open to public scrutiny at all times.

SARS contended further that the crux of the matter was that a taxpayer had to satisfy a court that the main application, in this matter, was an exception to the principle of open justice and justified a departure from the norms of High Court litigation.

Section 32 of the Superior Courts Act provided that–

> 'Save as is otherwise provided for in this Act or any other law, all proceedings in any Superior Court must, except insofar as any such Court may in special cases otherwise direct, be carried on in open court.'

Judge Lowe held the following:

<u>As to the provisions of section 32 of the Superior Courts Act</u>

(i) That what was notably absent in this application was any reference to, or suggestion that, this matter was to be dealt with specially and differently, in terms of the provisions of section 32 of the Superior Courts Act. Indeed, in SMI's heads of argument there was not a single reference to section 32 and no argument was made out that failing reliance on the TA Act, there was a

'special case' to be made out for a hearing other than in open court in terms of section 32.

(ii) That, in the court's view, it was accordingly simply not open to SMI to now change their argument mid-stream, contending for a special case in terms of section 32, being an issue not raised by SMI at all on the papers. There were no facts put up whatsoever that supported the argument that this was a 'special case' as envisaged in that section.

As to the application of the TA Act

(iii) That in summary Chapter 6 of the TA Act applies, *inter alia*, to taxpayer information which is defined and described in section 67(1) and section 67(4) requires a person who receives information under, amongst others, sections 68 and 69, to preserve the secrecy of that information which may only be disclosed to another person if the disclosure was necessary to perform the functions specified in those sections.

(iv) That the relief sought in the main application was to compel SMI to comply with their obligation to respond to the request directed to them by SARS in terms of section 46 of the TA Act '…by furnishing to SARS all the information requested in the section 46 request, free of redaction or alteration.'

(iv) That if the court hearing the main application orders the taxpayer to comply with SARS' section 46 request and to produce to SARS all the information requested therein, those documents when produced will be covered by the secrecy provisions in Chapter 6. The result is that this application is not aimed at the disclosure of the documents sought by SARS but was aimed at the disclosure of the material utilised in the main application, to justify or provide the foundation for such application.

(v) That section 69 of the TA Act, which must be read with section 67, relates to the secrecy of taxpayer information. Section 69(1) provides that a SARS official must preserve the secrecy of taxpayer information and may not disclose this to a person who is not a SARS official. A distinction is drawn

between 'SARS confidential information' and 'Taxpayer information.' There is a clear differentiation between taxpayer information in respect of which the right to privacy applies and in respect of which stricter disclosure rules apply and SARS information which is confidential but with less strict disclosure rules.

(vi) That taxpayer information is that referred to in section 67(1)(b), i.e. any information provided by the taxpayer or obtained by SARS. That is clearly an indication that most, if not all, information that relates to a taxpayer and a taxpayer's affairs is taxpayer information and a SARS official must preserve the secrecy of taxpayer information and may not disclose this to a person who is not a SARS official unless in the course of performance of duties under a Tax Act, such as, inter alia, section 69(2)(a)(iii) or the information is public information (section 69(1) and 69(2)(d)).

(vii) That, in this context, Chapter 5 of the TA Act related to the gathering of information in relation to a taxpayer and was directly relevant to this matter, having regard to section 46 of the TA Act, SARS clearly acting in the course of performance of duties under a Tax Act.

(ix) That, in regard to the Tax Court, which sits for the purposes of hearing a tax appeal, lodged under section 107 of the TA Act, was by virtue of section 124(1) of the TA Act not a public hearing, as stipulated in that subsection. Tax appeals of such a nature are not public hearings inasmuch as it was intended in the TA Act to protect the confidentiality and right to privacy of the taxpayer in such proceedings. That being so, the constitutional imperative in section 34 of the Constitution that everyone has the right to have any dispute that can be resolved by the application of the law decided in a fair public hearing was not violated but only having regard to the specific provisions of section 124(1) of the TA Act.

(x) That, on a proper interpretation of section 124(1) of the TA Act, it was clear that this provision applied strictly and only to a Tax Court established in terms of section 116 of the TA Act, which, in turn, had to be read with

section 117(1) of the TA Act, having jurisdiction only over tax appeals as referred to in section 107 of the TA Act and as set out above.

(xi) That whilst section 124(1) of the TA Act protected confidentiality and the taxpayer's right to privacy, to cast this wider and to apply this to High Court proceedings to enforce the provisions of section 46 of the Act, was certainly not justified or sustainable.

(xii) That it followed that the TA Act had no provision which in any way expressly conveyed or conferred confidentiality or privacy in respect of taxpayer information in respect of High Court proceedings such as in this matter.

(xiii) That, from the main application, it was abundantly clear that the said application related to, and sought only, the furnishing to SARS of the information requested in the section 46 request contained in the TA Act. There was no statutory basis in the TA Act for SMI's contention that all proceedings to enforce the production of section 46 documents were such as to be proceedings to be held in camera, notwithstanding that they fell outside the provisions of section 124 of the TA Act.

(xiv) That the 'principle of open justice' dictated that all court proceedings and records by default were open to public scrutiny at all times and whilst this may be departed from in special cases, there must be a proper basis and justification therefor. The Supreme Court of Appeal had found that the principle of open justice was one of the most pervasive axioms of the administration of common-law systems. That court found that this was now constitutionally protected in terms of section 34 of the Constitution.

(xv) That SMI's difficulty in this matter was simply that unless they were able to point to specific statutory authority entitling the court to order that the matter be held in camera, and in that regard there was none to which the court had been directed, the only alternative was to seek to have recourse to a special case having special circumstances as referred to in section 32 of

the Superior Courts Act – patently not a basis for this application nor the issue raised therein.

Interlocutory application dismissed with costs, including the costs of two counsel.

10. INTERPRETATION NOTES

10.1. Withholding tax on interest – No. 115 (Issue 2)

South African residents sometimes engage in cross-border transactions either for a trade or a non-trade purpose. Some of these transactions are entered into for the purpose of raising foreign debt capital. The debt capital often incurs an interest charge with the result that repayments comprise both a return of the borrowed capital and the interest incurred. The interest incurred may result in a deduction for the resident taxpayer (if legislative requirements are met) while the corresponding interest income may be exempt from tax for the recipient by virtue of section 10(1)(h). This situation results in the erosion of the domestic tax base. In order to address this loss of income to the fiscus, a withholding tax on interest paid to or for the benefit of a foreign person was introduced under sections 50A to 50H with effect from 1 March 2015.

The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010 explains the rationale for introducing withholding tax on interest as follows:

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

> tax. Hence the current blanket exemption employed via domestic South African tax legislation appears to be overly generous from a competitive point of view.'

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

Interest payments fulfilling the requirements of section 50D or section 12Q(4) will be exempt from withholding tax on interest.

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

In summary:

- Withholding tax on interest became effective on 1 March 2015 and applies to interest paid to or for the benefit of a foreign person from a South African source on or after that date. However, because section 50B(2) deems interest to have been paid on the earlier of the date on which the interest is paid or becomes due and payable, it means that Part IVB of the Act will apply only if the interest is both paid and due and payable on or after 1 March 2015.
- A foreign person is defined in section 50A(1) and means any person that is not a resident.

- Interest is deemed to be paid to a foreign person on the earlier of the date on which the interest is paid or becomes due and payable.
- Withholding tax on interest is levied at the rate of 15% on the gross amount of the interest paid to the foreign person.
- Under section 9(2)(b) interest is from a South African source if:
    - it is payable by a person that is a resident except when it is attributable to a permanent establishment which is situated outside South Africa; or
    - it is received or accrues in respect of the use or application in South Africa by any person of any funds or credit obtained under any form of interest-bearing arrangement.
- It is not a requirement that the interest incurred be deductible by the payer before it may be subject to withholding tax on interest, that is, withholding tax on interest is not subject to a trade requirement.
- While the foreign person is liable for payment of withholding tax on interest, the person who has the obligation to pay the interest also has an obligation under section 50E(1) to withhold withholding tax on interest from that payment.
- The person withholding any withholding tax on interest must submit a return and pay the tax over to SARS by the last day of the month following the month during which the interest was paid.
  The foreign person also has an obligation to submit a return and pay the tax over to SARS by the last day of the month following the month during which the interest was paid, unless the tax has been paid by another person.
- Under section 50D an interest payment to a foreign person may be exempt from withholding tax on interest. The exemption may be subject to certain specific requirements being. A payment of interest may also be exempt under an applicable tax treaty or section 12Q(4). Section 50E(2) imposes certain additional requirements for some of the exemptions which must be

met before the payer may refrain from withholding the withholding tax on interest.

- Section 50E(3) provides for withholding tax on interest to be levied at a reduced rate should there be an applicable tax treaty which provides for a reduced rate. The reduced rate at which withholding tax on interest may be levied applies only after the foreign person has submitted the prescribed declaration and undertaking to the payer. Paragraph 3(2) of the Tenth Schedule provides for a rate of 0% in specified circumstances.
- Withholding tax on interest is refundable under specified circumstances under section 50G, including when interest that is due and payable subsequently becomes irrecoverable.
- Any amount of tax withheld under section 50E(1) denominated in a foreign currency must, for purposes of determining the amount to be paid to the Commissioner, be translated to rand at the spot rate on the date on which the amount was so withheld.

10.2. Resident: Place of effective management (companies) – No. 6 (Issue 3)

Purpose This Note provides guidance on the interpretation and application of the term 'place of effective management' in determining the tax residence of a company as one of the considerations under the tie-breaker rule in a tax treaty.

The concept of residency is critical in determining a person's South African tax obligations. Generally, a resident is liable to income tax on gross income derived within and outside South Africa, while a non-resident is liable to income tax only on gross income from a source within South Africa.

A person other than a natural person is a 'resident' as defined in section 1(1) if such person:

- is incorporated, established or formed in South Africa; or

- has its place of effective management in South Africa.

The definition excludes any person that is deemed to be exclusively a resident of another country for purposes of the application of any tax treaty. In addition, special considerations apply to a 'foreign investment entity' as defined in section 1(1).

A company incorporated in South Africa is a 'resident' as defined before considering the implications of an applicable tax treaty. Accordingly, from a domestic law perspective, when determining tax residency, the place of effective management is relevant to companies not incorporated, established or formed in South Africa.

The term 'place of effective management' is not defined in the Act and must be ascribed its ordinary meaning, taking into account international precedent and interpretation. It does, however, not have a universally accepted meaning and various countries, including members of the OECD, continue to attach different meanings to it.

An amendment to Article 4 in the 2017 version of the OECD Model Tax Convention provides that the place of effective management is no longer the only criterion in determining the residency of a person other than an individual if it was a resident of both contracting states. The issue of dual residency of persons other than individuals is now determined on a case-by-case basis and through mutual agreement by the contracting states having regard to the person's place of effective management, the place where it is incorporated or otherwise constituted, and any other relevant factors. In the absence of a mutual agreement, the person will not be entitled to any relief or exemption from tax purely based on the place of effective management, but in a manner as agreed upon by the competent authorities4 of the states concerned.

Although this Note deals with the place of effective management in the context of companies, the underlying principles will generally apply to other entities and bodies of persons that are not natural persons. For example, with a trust the structures involved, and terminology used, may require some adaptation. The

determination of the place of effective management would, however, take into account the same considerations as those discussed in this Note. Depending on the applicable facts, there may be additional considerations that need to be taken into account.

The place of effective management must be supported by the facts. Under section 102 of the Tax Administration Act a company bears the onus of proving its place of effective management and must, under section 29 of that Act, retain the necessary evidence to support the view taken.

A 'place of effective management', in determining the tax residence of a company, is only one of the considerations under the tie-breaker rule in a tax treaty that adheres to Article 4 of the OECD Model Tax Convention and its accompanying Commentary.

A company's place of effective management is the place where key management and commercial decisions that are necessary for the conduct of its business as a whole are in substance made. This approach is consistent with the OECD's commentary on the term 'place of effective management'.

A company may have only one place of effective management at any one time. There are normally multiple facts that need to be taken into account, often involving multiple locations, and from those facts and locations it is necessary to determine a single dominant place where effective management is located.

Definitive rules cannot be laid down in determining the place of effective management, and all relevant facts and circumstances must be examined on a case-by-case basis.

The place of effective management test is one of substance over form. It therefore requires a determination of those persons in a company who actually 'call the shots' and exercise 'realistic positive management'.

10.3. Gains or losses on foreign exchange transaction – No. 101 (Issue 2)

This Note provides guidance on the interpretation and application of section 24I. Section 24I deals with the income tax treatment of foreign exchange gains and losses on exchange items as well as premiums or like consideration received or paid in respect of FCOCs entered into and any consideration paid in respect of an FCOC acquired by certain persons.

The tax treatment of transactions denominated in a foreign currency often requires a consideration of section 24I and other provisions of the Act. This Note identifies some of the situations in which one or more of these provisions may apply. For example, if trading stock, the purchase price of which is denominated in USD, is purchased on credit from a supplier, the provisions of section 25D4 and section 24I are relevant.

The income tax treatment of crypto assets is not considered in this Note.

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

- The Taxation Laws Amendment Act 20 of 2022 which was promulgated on 5 January 2023 (as per Government Gazette 47826).
- The Tax Administration Laws Amendment Act 16 of 2022 which was promulgated on 5 January 2023 (as per Government Gazette 47827).
- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 19 of 2022 which was promulgated on 5 January 2023 (as per Government Gazette 47825).

Section 24I governs the income tax treatment of foreign exchange gains and losses on exchange items as well as premiums or like consideration received or paid in respect of FCOCs entered into and any consideration paid in respect of an FCOC acquired by specified persons.

Although the application of the section is limited to those persons listed in section 24I(2), the ambit of section 24I(2) is wide which results in the section being applicable to a large number of persons and transactions.

Under section 24I, exchange differences calculated for a year of assessment are generally included in or deducted from income whether realised or not and whether of a capital or revenue nature. The legislation was drafted in this manner in line with the view that gains and losses on foreign exchange transactions largely represent finance charges and as a result must be brought to account on a revenue basis for tax purposes at the end of a year of assessment even if not realised.

There are limited circumstances in which the inclusion of a foreign exchange gain or loss calculated in respect of an exchange item in a particular year of assessment is deferred and recognised in a later year of assessment.

Section 24I(3) provides for an inclusion in or deduction from income of an exchange difference on an exchange item as well as any premium or like consideration received by or paid by a person under an FCOC entered into by that person or any consideration paid for an FCOC acquired by a person. The term 'exchange item' of or in relation to a person means an amount in a foreign currency:

- which constitutes any unit of currency acquired and not disposed of by that person;
- owing by or to that person on a debt incurred by or payable to such person;
- owed by or to that person in respect of an FEC; or
- when that person has the right or contingent obligation to buy or sell that amount under an FCOC.

Section 24I applies to the following persons indicated in section 24I(2):

- Any company.
- Any trust carrying on any trade.

- Any natural person who holds any amount in a foreign currency which constitutes a unit of currency, or which is owing to that person on a debt payable to that person, as trading stock.
- Any natural person or trust in respect of any amount in foreign currency:
  - owed by or to that person in respect of an FEC; or
  - when that person has the right or contingent obligation to buy or sell that amount under an FCOC.
- Any of the persons referred to above that are non-resident in relation to an exchange item that is attributable to a permanent establishment of that person in the Republic.
- Any CFC for purposes of determining its net income under section 9D(2A) that must be included in the income of persons that are residents under section 9D(2).

An exchange difference is determined on each exchange item for the year of assessment in which such exchange item arose and every subsequent year of assessment until and including the year of assessment in which such exchange item is realised.

The exchange difference for a specific year of assessment is determined by multiplying the foreign currency amount of the exchange item by the difference between the ruling exchange rate on the commencement date in that year of assessment and the ruling exchange rate on the final date in that year of assessment.

Section 24I(4) provides that, subject to section 11, to the extent that a debt owing to a person on realisation was irrecoverable by reason of becoming bad or the realization of the debt resulted in a loss determined in the foreign currency due to a decline in the market value of that debt, the amount of any foreign exchange gain relating to that debt that is or was included in the income of a person in the current or any previous year of assessment must be deducted from the income of that person, and the amount of any foreign exchange loss relating to that debt that is or

was deducted from the income of that person in the current or any previous year of assessment must be included in the income of that person.

Section 24I(6) prohibits the deduction from or inclusion in income of an amount

referred to in section 24I(3) under any other provision of the Act.

Section 24I(7) provides for the carry-forward of the inclusion in, or deduction from, a person's income of certain exchange differences and premiums or other consideration which arose or were paid or became payable in a year of assessment before the year of assessment during which the assets referred to in section 24I(7)(a) were or are brought into use for the purposes of the person's trade. The foreign exchange gain or loss is generally carried forward to the year of assessment in which the assets to which they relate are brought into use for purposes of that person's trade. In certain circumstances the carried forward exchange difference may be recognised in a year of assessment before the year of assessment in which the relevant asset is brought into use. Special rules apply to mining assets.

Section 24I(8) provides that any foreign exchange loss sustained on a transaction entered into by a person, or any premium or other consideration paid in respect of or under an FCOC entered into or acquired by a person, shall not be allowed as a deduction from such person's income under section 24I(3), if the transaction was entered into or the FCOC was entered into or acquired solely or mainly to enjoy a reduction in tax as a result of a deduction from income.

Under section 24I(10A)(a) an exchange difference arising during any year of assessment in respect of an amount in a foreign currency owing by or to a person on a debt shall not be included in or deducted from the income of that person if at the end of that year of assessment that person and the other party to the contractual provisions of the debt form part of the same group of companies or are connected persons in relation to each other and if certain requirements are met.

Section 24I(12) determines that when a person holds any exchange item and section 24I at any time during a year of assessment:

- becomes applicable to that person, that exchange item shall be deemed to have been acquired at that time for the purposes of section 24I; or
- ceases to apply to that person, that exchange item shall be deemed to have been realised at that time for the purposes of section 24I.

In applying section 24I, regard must be had to other provisions of the Act, amongst others, the definition of 'trading stock' in section 1(1), sections 3(4)(b), 6quat, 8(4)(a), 9(2)(l), 9(4)(e), 9D, 11(a), 11(i), 11(j), 11(jA) 19, 20(2), 22(3)(a)(i), 24J and 25D, paragraphs 12A and 43 of the Eighth Schedule, and paragraph 4(1) of the Tenth Schedule.

10.4. Deduction in respect of certain residential units – No. 106 (Issue 2)

This Note provides guidance on the interpretation and application of section 13*sex* which provides for an allowance on any new and unused residential unit or improvements to a residential unit used for the purpose of trade and an additional allowance on that residential unit if it qualifies as a low-cost residential unit.

Before 21 October 2008 various provisions in the Act allowed for deductions relating to residential buildings, for example, sections 11(t) and 13ter and paragraph 12(5) of the First Schedule. Section 13*sex* replaced these provisions and brought in one simplified and comprehensive provision for low-cost housing from 21 October 2008.

Section 13*sex* is subject to section 36, which means that section 36 takes precedence for the deduction of expenditure incurred in a mining operation for the acquisition, erection, construction, improvement or laying out of housing for residential occupation by the mining operation's employees and the furniture for such housing.

Section 13*sex* provides for an allowance on any new and unused residential unit or new and unused improvements effected to existing residential units that are used by the taxpayer solely for purposes of a trade. The unit or improvement must be

owned by the taxpayer and it must have been acquired, or the erection commenced, on or after 21 October 2008. In addition, the unit must be situated in South Africa and the taxpayer must own at least 5 units in South Africa that are used by the taxpayer for the purposes of trade.

The allowance available under section 13*sex* is equal to 5% per year of the cost of the residential unit or improvement to the residential unit. Cost is the lesser of actual cost or cost in an arm's length transaction. To the extent a taxpayer acquires a residential unit or improvement to a residential unit, which represents part of a building, without erecting or constructing it, the cost of that unit or improvement will be a percentage of the acquisition price as specified in the Act. Once a taxpayer has disposed of a building, that taxpayer is not entitled to a deduction under section 13*sex* during any subsequent year of assessment.

An additional allowance of 5% is available if the residential unit qualifies as a low-cost residential unit.

The section makes provision for an allowance on a building and part of a building owned by the taxpayer. A residential unit is defined as a building or a self-contained apartment mainly used for residential accommodation, unless it is used in carrying on a trade as a hotel keeper.

Section 13*sex* is subject to section 36, which means that section 36 takes precedence for the deduction of expenditure incurred in a mining operation for the provision of residential accommodation for employees and the furniture for such accommodation.

A residential unit which qualified for an allowance under section 13ter before 21 October 2008 and continues to meet the requirements of that section will still qualify for an allowance under that section. Section 13*sex* potentially applies to all acquisitions and erections of residential units and improvements to residential units after 21 October 2008.

The total deduction available under section 13*sex* and other sections on a residential unit or improvement to a residential unit is limited to cost. This includes deductions which, although not allowed under section 13*sex* in previous years of

assessment, are specifically deemed to have been allowed for purposes of section 13*sex*.

If a transferor company transfers an allowance asset in an intra-group transaction that meets the requirements of section 45 and the relief applies, the transferor company and the transferee company are deemed to be one and the same person with regards to calculating the amount of any deduction to which the transferee company is entitled and the amount of the recoupment if, for example, the transferee company disposes of the residential unit. Similar provisions are contained in sections 42, 44 and 47.

The deductions claimed under section 13*sex* are subject to potential recoupment under section 8(4)(a). The deductions deemed to have been claimed under section 13*sex*(4) are not subject to recoupment under section 8(4)(a).

The allowance may not be claimed if the cost of the residential unit or improvement to the residential unit, or any part thereof, qualifies or will qualify for a deduction or allowance under any other section of the Act.

11. DRAFT INTERPRETATION NOTES

11.1. Allowance for future expenditure on contracts – No. 78 (Issue 2)

This Note provides guidance on the interpretation and application of section 24C when income is received in advance while the expenditure under the contract will only be incurred in a subsequent year of assessment.

Section 5 provides that income tax is payable annually. An amount that is received by or accrued to a taxpayer in a particular year of assessment must be included in the taxpayer's gross income unless it is of a capital nature. The nature of some taxpayer's business may be such that the taxpayer receives amounts under a contract that will be used to finance expenditure to be incurred in the future in performing under that contract. Generally, expenditure must be actually incurred

before a deduction can be allowed [for example, section 11(a)] and, in addition, section 23(e) specifically prohibits the deduction of income carried to any reserve fund or capitalised in any way. An anomaly therefore arises when income is received in one year and the related expenditure is incurred in a subsequent year of assessment.

Section 24C was inserted in the Act as a relief measure to taxpayers that, because of the nature and special circumstances of their businesses, receive advance income during a year of assessment but only incur related expenditure in a subsequent year of assessment. The explanatory memorandum explains the reason for the insertion of section 24C as follows:

> 'The new section caters for the situation which often arises in the construction industry and sometimes in manufacturing concerns, where a large advance payment is made to a contractor before the commencement of the contract work, to enable the contractor to purchase materials, equipment etc. In a number of instances such advance payments are not matched by deductible expenditure, resulting in the full amounts of the advance payments being subject to tax.'

Although section 24C was originally intended for taxpayers entering into building and manufacturing contracts, it does not mean that the section cannot be applied to taxpayers entering into other types of contracts. In ITC 1697 Galgut J stated the following:

> 'The fact that the allowance might have been intended for building contractors does not mean, however, that it is not available to others. On the contrary, by the particular wording of s 24C the types of trades that the individual taxpayer might carry on, and the types of contracts concerned, are in no way limited. The sole question is whether the provisions of s 24C otherwise apply. . . .'

Section 24C has been and can be applied to businesses in industries other than building and manufacturing provided the detailed requirements of the section are met. For example, the section has been applied to the motor industry, the financial

services industry, publishers, share block schemes and the retail sector.

Section 24C was amended in 2015 to remove SARS' discretion under the section. Much of the case law relating to section 24C dealt with the exercise of SARS' discretion regarding specific requirements under the section. These cases, however, remain relevant as guidance to the correct application and computation of the allowance, as set out in the Note, since the requirements are the same notwithstanding the deletion of SARS' discretion.

An assessment of whether section 24C applies must be performed annually taking upto-date information into account.

Section 24C is subject to objection and appeal in accordance with Chapter 9 of the Tax Administration Act.

In summary:

- Section 24C provides temporary relief, in the form of an allowance which reverses in the following year of assessment, to taxpayers that receive income in advance of incurring the expenditure related to the earning of that income.
- The taxpayer bears the onus of proving the following:
  - the taxpayer's income in a particular year of assessment includes an amount of income received or accrued under a contract;
  - all or part of the advance income will be used to finance future expenditure which will be incurred by the taxpayer in performing the taxpayer's obligations under that contract or under two or more contracts that are so inextricably linked so as to satisfy 'sameness'; and
  - the future expenditure when incurred will qualify for a deduction or, in the case of the acquisition of an asset, will qualify for any deduction under the Act.
- The contract may be a written contract or a verbal contract; however, in the latter case it may be more difficult to prove the existence of a contract and

the rights and obligations flowing from it.

- The words 'will be incurred' indicate that there is a high degree of probability and inevitability that the expenditure will be incurred by the taxpayer. A taxpayer must therefore be able to demonstrate that, although the expenditure is contingent at the end of the year of assessment in question, there is a high degree of certainty that the expense will in fact be incurred in a subsequent year. The facts of each case are critical. The degree of certainty required is unlikely to be met if performance under the contract is not contractually obligatory but is only potentially contractually obligatory because of an act or event other than just the taxpayer's client or customer taking action.
- Assets already acquired do not represent future expenditure.
- Assets falling within the ambit of section 24C are those assets which will be acquired in order to perform under the specific contract giving rise to the advance income. The replacement of assets generally used in the taxpayer's trade fall outside the ambit of section 24C.
- The amount of the section 24C allowance is equal to the amount of advance income which will be used to finance future expenditure, under one and the same contract, or under two or more contracts which may be so inextricably linked that they may satisfy the requirement of 'sameness' under section 24C.
- The section 24C allowance may not exceed the amount of income received or accrued under the contract in a particular year of assessment. The amount of income received or accrued in a current year includes the reversal of the previous year's section 24C allowance.
- The section 24C allowance is based on how much of the advance income will be used to finance future expenditure and may, therefore, never exceed the amount of income even if the contract is running at a commercial loss.
- It is not possible to be prescriptive on the methods used to calculate the

amount of the section 24C allowance. However, in a number of cases the 'gross cost method' will be appropriate.

- Generally, the calculation of the section 24C allowance must be performed on a detailed contract-by-contract basis. However, there are limited circumstances in which it may be appropriate to perform the analysis at a higher level by taking a number of contracts into consideration.
- An assessment of whether section 24C is applicable must be performed annually taking into account up-to-date information.
- A decision made by SARS under section 24C is subject to objection and appeal in accordance with Chapter 9 of the Tax Administration Act.

11.2. Determining the calorific value of coal for purposes of the royalty

This Note clarifies at which stage, that is, AR or AD, the condition specified for coal in Schedule 2 must be determined for the calculation of the royalty.

Mineral and petroleum resources are the common heritage of all the people of South Africa, and the state is the custodian of said resources for the benefit of all South Africans. As custodian of the nation's mineral and petroleum resources the state, acting through the Minister of Finance, may prescribe any levy payable under the MPRDA. The state royalty must be determined and levied under an Act of Parliament. The Act was thus promulgated to provide for the levy of a royalty.

Section 2 provides that a person must pay a royalty in respect of the transfer of a mineral resource extracted from within the Republic.A 'mineral resource' is defined in the Act as a 'mineral' or 'petroleum' as defined in section 1 of the MRDA regardless of whether that mineral or petroleum undergoes processing (as defined in section 1 of hat Act) or manufacturing.7 Having regard to this definition, coal is a mineral source and subject to the royalty under the Act.

Mineral resources subject to the royalty are transferred in either a refined

(Schedule 1) or an unrefined9 (Schedule 2) condition. Schedules 1 and 2 contain a list of mineral resources with either a specified condition or a range for a particular mineral resource. The condition specified represents the point at which the mineral is considered to be in an acceptable condition for transfer and is important in determining the royalty payable under the Act. The gross sales for a particular mineral resource will therefore be determined when that mineral has reached the condition specified in the Schedules.

Coal is listed as an 'unrefined mineral resource' in Schedule 2 and its condition is specified as the CV of 19.0 MJ/kg to 27.0 MJ/kg. The range specified has resulted in inconsistent determination of the CV of coal and in some cases the underpayment of the royalty.

This Note considers the correct determination of the condition specified for coal in Schedule 2. The Note does not consider in detail other aspects of the Act.

The Act imposes a royalty on the transfer of a mineral resource extracted in the Republic. The purpose of the royalty is to compensate the state for a mineral resource extracted from the Republic and not to tax beneficiation of the mineral resource. It is therefore important to establish the value of the mineral extracted at the first saleable point as close as possible to the point of extraction.

The first saleable point of coal after extraction includes washing and crushing thereof even though the latter is considered to be a primary stage of beneficiation the condition of coal at this stage is in its bare and basic form and represents the AR state that must be used to determine the CV of coal for purposes of levying the royalty.

12. BINDING GENERAL RULING

12.1. Temporary application of new dwellings for exempt supplies simultaneously held by developers for taxable purposes – No. 64

For purposes of this ruling:

- 'OMV' means the open market value of the property as defined in section 3;
- 'section' means a section of the VAT Act;
- 'TA Act' means the Tax Administration Act 28 of 2011;
- 'VAT' means value-added tax; and
- 'VAT Act' means the Value-Added Tax Act 89 of 1991.

Purpose

This BGR clarifies the VAT treatment of newly built residential dwellings that have been developed and held for sale under a taxable supply by developers, but that are simultaneously temporarily applied to make exempt supplies of residential accommodation in a dwelling.

Background

Property developers have submitted over the years that they experience certain difficulties in complying with the VAT law when they develop residential properties for sale in difficult economic times. The difficulty arises in that there are high holding costs associated with the development, marketing and sale of properties. As a result, developers often let newly developed dwellings out as residential accommodation to cover some of the holding costs whilst the properties are marketed for sale. When this occurs, section 18(1) will be triggered at the time that any property is applied to make exempt supplies as contemplated in section 12(c) (albeit temporarily). As a result, the developer will be required to declare output tax on the OMV of the property at the time of such change in application.

In order to provide some relief in this regard, the VAT Act was amended with effect from 10 January 2012 by the insertion of a relief provision in the form of section 18B. Under section 18B, the liability of the developer to declare output tax on the change in use adjustment that would have otherwise been required under section 18(1) was suspended for a maximum period of 36 months. Under section 18B(3), the developer would only have to declare output tax at a later date, being the earlier of the date that the temporary letting period had been exceeded, or the property was permanently applied for a non-taxable purpose. Developers that experienced such difficulties were previously allowed to temporarily let the affected properties for a period of up to 36 months during the relief period that commenced on 10 January 2012 and ceased to apply on 1 January 2018.

Section 18B was a temporary measure with a limited lifespan, but a more permanent relief mechanism in the form of section 18D (together with associated provisions, being sections 9(13), 10(29) and 16(3)(o)) has now been introduced with effect from 1 April 2022 to deal with temporary letting by developers. Whilst there are some similarities between section 18B and section 18D, there are also some important differences.

For example:

- the term 'developer' was defined in both sections 18B and 18D, but 'temporarily applied' has only been defined in section 18D;
- the temporary letting period has been reduced from a maximum of 36 months in section 18B, to a maximum of 12 months under section 18D;
- section 18D requires that the adjustment is made at the time the property is temporarily applied for letting, instead of only at the end of the relief period as was the case under section 18B; and
- the consideration used for calculating the required output tax adjustment under section 18D is an amount equal to the adjusted cost to the vendor of the construction, extension or improvement to the fixed property rather than the OMV of the entire fixed property concerned as would have been the case under section 18B.

Discussion

Section 18D applies to any newly developed units of fixed property that are 'temporarily applied' for exempt supplies as contemplated in section 12(c) for the first time on or after 1 April 2022. Section 18D(1) defines the terms 'developer' and 'temporarily applied' for the purposes of section 18D.

The definition of 'developer' as defined in section 18D(1)(a) is a replication of the definition that was previously in section 18B(1) and refers to a person who develops fixed property for sale in the course or furtherance of an enterprise.

The term 'temporarily applied' as defined in section 18D(1)(b) refers, in short, to any leasing of newly developed dwelling units by the developer for use as residential accommodation for a period of 12 months or less whilst the property continues to be marketed for sale. The term 'temporarily applied' is interpreted to mean a fixed period of 12 months or less or shorter periods that, in aggregate, do not exceed 12 months in respect of each unit of property concerned. It is also considered that a monthly lease for an unspecified period also falls within the meaning of 'temporarily applied' but only for a maximum period of 12 months. Should that monthly lease continue beyond 12 months, it means that the developer would have exhausted the relief under section 18D for that particular property and must accordingly make an output tax adjustment on the OMV of that property as required under section 18(1). In the case of a fixed period lease exceeding 12 months from the beginning, section 18D will not apply at all. Instead, the relevant adjustment under section 18(1) must be made on the OMV of the property at the time the property is applied for exempt supplies.

It follows that, only when the supplier is a 'developer' and the property concerned is 'temporarily applied' as defined in section 18(1)(b) for residential accommodation for a period of 12 months or less, can the dispensation under section 18D apply. In all other cases, the change in application from taxable supplies (sale of dwellings by a developer) to exempt supplies (supply of residential accommodation in a dwelling), section 18(1) will apply. The output tax adjustment based on the OMV under section 18(1) will also apply for any temporary letting of dwellings by developers that occurs between 1 January 2018 and 31 March 2022, which is the

period between the date that section 18B ceased to apply and the date that section 18D came into effect.

Section 18D(2) requires that, as soon as the property has been temporarily applied for exempt supplies, the developer must make an output tax adjustment based on the 'adjusted cost' of the construction, extension or improvement to the fixed property.6 No output tax will be payable on the rentals as they constitute consideration paid or payable in respect of exempt supplies.

If a property is sold during the 12-month period that it is temporarily applied for exempt supplies, that supply will remain a taxable supply under section 7(1)(a). The developer will be able to claw back as an input tax adjustment under section 16(3)(o), the same amount that was previously declared as output tax under section 18D(2) on the adjusted cost of the construction, extension or improvement to the fixed property when the unit was first temporarily applied for exempt supplies. The adjustment may be made in the same tax period as the time of supply for the property under section 9(3)(d). Similarly, an input tax adjustment under section 16(3)(o) will become available to a developer if there is any permanent change in intention or application of a dwelling that requires an adjustment to be made on the OMV of the property under section 18(1) during the 12-month period that the property is being temporarily applied for exempt supplies. The adjustment may be made in the same tax period as the time of supply for the change in use under section 18(1).

When the temporary letting ceases altogether within the 12-month period allowed under section 18D, the developer will also be entitled at that time to claw back under section 16(3)(o), the output tax that was previously declared under section 18D(2). However, the developer must, in that case, have proper and convincing documentary proof that the temporary letting has in fact ceased completely during the 12-month period allowed under section 18D. Any subsequent sale of the dwelling will be a taxable supply under section 7(1)(a) read with section 9(3)(d).

A developer must declare output tax under section 18(1) on the OMV of any dwelling units that remain unsold if the property continues to be let for a period exceeding 12 months in aggregate after it was first temporarily applied for exempt

supplies. The adjustment must be made in the tax period covering the first day of the 13th month of letting. However, in this case, the developer will also be able to claw back an input tax deduction under section 16(3)(o) as explained above. Any subsequent sale of the affected properties after the tax period in which the section 18(1) adjustment was required to be made, will not be regarded as taxable supplies. Instead, the purchasers will be liable to pay transfer duty on the transactions concerned.

Ruling

Adjustment for dwellings temporary applied for exempt supplies

A developer that temporarily applies any dwellings for exempt supplies under section 12(c) must make an output tax adjustment under section 18D(2) based on the adjusted cost of the construction, extension or improvement to the fixed property as contemplated in section 10(29). Under section 9(13) the time of supply for the adjustment is the date that the agreement for the letting and hiring of the accommodation in a dwelling comes into effect.

Sale of dwellings whilst being temporarily applied for exempt supplies

The sale of any dwelling referred to during the 12-month period in which it was temporarily applied for exempt supplies under section 12(c) will be a taxable supply as contemplated in section 7(1)(a). The consideration for the supply will be the amount paid or payable for the property, or the OMV of said property, as determined in accordance with section 10(2).The time of supply rule for fixed property under section 9(3)(d) will be applicable.

Adjustment after expiry of the prescribed 12-month period

A developer will be required to make an output tax adjustment based on the OMV of the property under section 18(1) read with section 10(7) if any dwelling referred to above is let for a period in aggregate of more than 12 months. The time of supply under section 9(6) is the day immediately after the 12-month period referred to in the definition of 'temporarily applied' in section 18D(1)(b) has been exceeded. The subsequent sale of such a property will not be a taxable supply under section 7(1)(a), but instead, the purchaser will be required to pay transfer duty.

Claw-back deduction under section 16(3)(o)

Under section 18D(5), the developer in the situations described above will be entitled to claw back the output tax previously declared pursuant to section 18D(2) by way of a deduction under section 16(3)(o). The deduction will therefore only apply if the developer has previously been required to declare output tax as contemplated in section 18D(2). The deduction is calculated by applying the tax fraction to the adjusted cost of the construction, extension or improvement to the fixed property and may be made in the same tax period within which the time of supply of the sale of the fixed property falls or the adjustment under section 18(1) occurs – as the case may be.

The claw-back deduction under section 16(3)(o) is also allowed to the developer if the temporary application of the property for exempt supplies ceases completely within a period of 12 months. The subsequent sale of such a property will be a taxable supply under section 7(1)(a).

No deduction is allowed under section 16(3)(o) in the case of a situation described in section 18D(5)(c). The reason is that the situation referred to in section 18D(5)(c) cannot find application as it is excluded from the definition of 'temporarily applied' by way of the proviso to section 18D(1)(b). Consequently, there could never have been any output tax previously declared under section 18D(2) to recover under section 16(3)(o).

Effective date and scope of application

Section 18D applies only to any newly developed units of fixed property that are 'temporarily applied' for exempt supplies as contemplated in section 12(c) for the first time on or after 1 April 2022.

Section 18D does not apply to:

- any property which is the subject of a fixed period lease exceeding 12 months as contemplated in the proviso to the definition of 'temporarily applied' in section 18D(1)(b);

- any temporary letting of dwellings by developers that were previously subject to the provisions of section 18B; or
- any temporary letting of dwellings by developers between 1 January 2018 and 31 March 2022.

12.2. VAT treatment of rounding difference in cash transactions – No. 65

For the purposes of this ruling:

- 'cash transaction' means a transaction tendered in coins or paper currency that fall in paragraph (a) of the definition of 'money' in section 1(1) of the VAT Act;
- 'rounding difference' means the practice of rounding the total amount due on the sale of goods or services, to the nearest circulated coin, when returning change for cash transactions;
- 'section' means a section of the VAT Act;
- 'TA Act' means the Tax Administration Act 28 of 2011;
- 'VAT' means value-added tax;
- 'VAT Act' means the Value-Added Tax Act 89 of 1991; and
- any other word or expression bears the meaning ascribed to it in the VAT Act.

<u>Purpose</u>

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

Background

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

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

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

The customer makes a cash payment of R50.

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

Discussion

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

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

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

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

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

Ruling

This ruling constitutes a BGR issued under section 89 of the Tax Administration Act 28 of 2011 insofar as it relates to the following items listed.

Supplier

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

- The tax invoice must clearly indicate that due to the rounding difference, input tax can only be deducted on the adjusted amount in the case of a cash transaction.

- The supplier may only make an adjustment [that is, by reducing output tax or making a deduction under section 16(3)] as contemplated in section 21(2), to the extent that it relates to standard rated supplies made.
- The supplier must retain the relevant records to substantiate the adjustment referred to above for the period contemplated in section 55 read with Part A of Chapter 4 of the TA Act.

Recipient vendor

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

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

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

13. GUIDES

13.1. Dispute Resolution Guide: Guide on the rules promulgated in terms of section 103 of the TA Act (Issue 3)

This document is a general guide dealing with the resolution of tax disputes in South Africa. It is an introductory guide and does not deal with all the legal detail associated with dispute resolution.

The right to object and appeal and finalisation within a reasonable time

The importance of the ability of taxpayers to challenge the legality of actions and decisions within the tax system is internationally recognised.

The right to appeal is seen as fundamental to the fairness of the tax system.

International best practice further dictates that a tax review or appeal should be heard within a reasonable time. Although it is difficult to gauge what a reasonable time is as this is peculiar to each jurisdiction depending upon the review structure, its resources and capacity. It is important, however, to require that a tax review or appeal should be heard within a reasonable time, as there is otherwise a danger that the revenue authority or the taxpayer could unnecessarily delay the proceedings to prevent a hearing. It is in the public interest that disputes should come to an end and, if applicable, that tax that is payable by a taxpayer be collected and tax refundable to a taxpayer be refunded. It is therefore important that the right to review or appeal is subject to stipulated time periods. Unless these time periods are clearly set out, they become arbitrary.

For the new rules to have any impact on the average turnaround time on objections or appeals, a stricter compliance with the new rules, and in particular the prescribed time periods, would be required by both SARS and taxpayers.

Fair hearing of objection and appeal

The conduct of an objection or appeal should be subject to due process or a fair hearing. A fundamental requirement for a fair hearing is impartiality on the part of the SARS officials as well as the judicial officers involved.

The impartiality of decision-makers is founded in the rule against bias, i.e. nemo iudex in sua causa, which essentially means no one may be the judge in his or her own cause. This rule is founded in the principles of good administration as decisions are more likely to be sound if the decision-maker is unbiased. Furthermore, the public has more faith in an administrative process if the decision-maker is unbiased.

In the context of disputes, this means in practice that the SARS official involved in the audit and assessment should not be extensively involved

nor have any final say in the dispute of such assessment. This does not mean that such official is necessarily biased, but this approach recognises potential bias at an operational or structural level resulting from the enthusiasm of officials for the successful discharge of their functions and for the purpose at which those functions are directed. This is effected at operational level by what is referred to as 'breaks in the system'. For example, a taxpayer would be identified by a risk analyst, who then refers the matter to an assurance auditor for verification where after the matter may be referred to an auditor who conducts an in-depth audit. The decision if an assessment should be issued, including if penalties should be imposed, requires the approval of a branch assessment and account maintenance committee.

In turn, an objection is decided at branch level by a committee the majority of which comprises officials not involved in the audit and assessment process. An appeal is generally referred to the SARS ADR & Litigation Unit, which a separate division from the business division where the disputed assessment originates. The ADR & Litigation Unit also comprises several committees from where appeals are assigned, conceded, settled or referred for litigation

<u>The Tax Administration Act and the dispute resolution rules thereunder</u>

The drafting of the initial Tax Administration Bill, was first announced in the Budget Review 2005 as a project to incorporate into one piece of legislation certain generic administrative provisions, which are currently duplicated in the different tax Acts. The drafting of the Tax Administration Bill focused on reviewing the current administrative provisions of the tax Acts administered by SARS, excluding the Customs and Excise Act, 1964, and harmonising these provisions across taxes to the extent possible. The TA Act was enacted into law on 1 October 2012.

When taxpayers are aggrieved by an assessment or a decision that is subject to objection and appeal, they have a right to dispute it. Chapter 9 of the TA Act provides the legal framework for these disputes across all tax

types found in the tax Acts and must be read in addition to the rules issued under section 103. These rules (the previous TAA rules) were published by public notice in the Gazette and applied with effect from 11 July 2014. The previous TAA rules and were repealed by public notice in the Gazette , which Gazette promulgated the current new rules (the rules) with effect from 10 March 2023.

The dispute resolution rules under the TA Act were issued to align them with the dispute resolution framework of the TA Act. These rules prescribe the procedures to be followed in lodging an objection and appeal against an assessment or a decision subject to objection and appeal under a tax Act, procedures for alternative dispute resolution, the conduct and hearing of appeals by the tax board or tax court and an application on notice before a tax court regarding a procedural matter arising under the rules. The tax board and tax court are tribunals created under the TA Act and their sittings are generally not public, barring certain exceptions pursuant to section 124. A taxpayer may appeal the judgment of the tax court to the High Court or Supreme Court of Appeal, which are public courts.

The shortening of the time periods in the previous TAA rules and the new rules is in line with the commitment by the then Commissioner to do so when the previous ITA rules were first published in 2003. The strongest remedy afforded by the rules in the event of non-compliance with certain time periods is an application for default judgment under rule 56 in terms of which a party may give notice to the defaulting party of the intention to obtain a final order if the defaulting party fails to remedy the default within 15 days and if the defaulting party fails to remedy the default within the prescribed period, apply on notice to the defaulting part to the tax court for a final order in favour of the applicant party.

The significant differences between the previous ITA rules and the previous TAA rules are reflected in Annexure A. This is useful for purposes of understanding case law that dealt with the previous ITA rules.

The previous rules under the ITA

Section 107A of the Income Tax Act, 1962 (ITA) provided for specific procedures in order to resolve a tax dispute. These rules also applied to various other tax Acts administered by SARS. The objection and appeal procedures and rules relating thereto and the settlement circumstances as contained in the ITA, applied to any dispute in terms of those Acts. Section 107A of the ITA was repealed by the TA Act when that Act commenced. However, until the new TAA rules were issued under the TA Act, the transitional provisions of the TA Act provided that the previous rules issued under section 107A of the ITA applied to disputes that arose before the commencement date of the TA Act on 1 October 2012 until such time that new rules under section 103 of the TA Act are published. In other words, for the period 1 October 2012 until 10 July 2013, disputes were regulated under Chapter 9 of the TA Act and the previous rules issued under section 107A of the ITA. For the period 11 July 2014 to 10 March 2023, disputes were regulated under Chapter 9 of the TA Act and the 1st TAA rules issued under section 103.

The previous and new rules under the TA Act

Background

The previous TAA rules

The draft 1st TAA rules (the previous rules) were reviewed by external counsel during November 2012, prior to their publication for public comment. The then draft rules also underwent intensive internal and external consultation prior to submission of the rules to the then Minister of Justice and Constitutional Development (as it then was) for purposes of consultation.

Section 103 provides that the Minister of Finance may only publish the rules after consultation with the Minister of Justice and Constitutional Development. Interaction with the Department of Justice and Constitutional Development started in September 2013 and written comments were

received by the Department on two occasions, which were duly considered and the necessary changes effected. Final comments by them were resolved during a workshop in May 2014.

Thus for the period 11 July 2014 to 9 March 2023, disputes were regulated under Chapter 9 of the TA Act and the previous TAA rules issued under section 103.

The new TAA rules

Similar to the process followed with the 1ste TAA rules, the new TAA rules also underwent extensive internal and external consultation. Consultation with the Department of Justice and Correctional Services, as required by section 103 and discussed above, was conducted over a period of some 2 years. The Department's input was considered, discussed at various levels and the agreed changes incorporated in the final draft of the new Rules prior to requesting the Minister of Finance's permission to promulgate the new TAA Rules. The new TAA rules were promulgated by the Minister of Finance in Notice No. 3146, published in Government Gazette No. 48188 on 10 March 2023.

What do the new rules regulate?

Essentially, the new rules govern the following:

- The procedures to lodge an objection and appeal against an assessment or decision that is subject to objection and appeal under section 104(2)
- ADR procedures under which SARS and the person aggrieved by an assessment or decision may resolve a dispute in accordance with Part C of the rules
- The conduct and hearing of an appeal before a tax board or tax court.

As set out above, Part G of the new rules contains transitional rules which provide that disputes not finalised at the commencement date of the new

rules, i.e. 10 March 2023, will generally be dealt with and finalised under the new TAA rules.

Most of the procedures under the rules are governed by time periods, a summary of which is reflected in Annexure B. When any particular number of days (i.e. a time period) is prescribed for the doing of any act, or for any other purpose, under the TA Act or the rules, the time period must be calculated exclusively of the first day and inclusively of the last day, unless the last day falls on a Sunday or on a public holiday, in which case the time period must be calculated exclusively of the first day and exclusively also of every such Sunday or public holiday.

13.2. Guide on the determination of Medical Tax Credits (Issue 15)

This guide provides general guidelines regarding the medical scheme fees tax credit and additional medical expenses tax credit for income tax purposes.

Expenditure of a personal nature is generally not taken into account in determining a taxpayer's income tax liability, under South Africa's tax system. One of the notable exceptions relates to medical expenditure. South Africa is aligned with the practice in many other countries of granting tax relief for medical expenditure.

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

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

In 2012, tax relief for medical expenditure began a phased-in conversion from a deduction system to a tax credit system. The reason for the change was to eliminate vertical inequity relating to medical contributions: those at higher marginal

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

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

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

- 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.

13.3. Guide to the Exemption from Normal Tax for Income from films (Issie 2)

This guide provides general guidance on the exemption from normal tax for the receipts and accruals of income derived from the exploitation rights of a film.

Section 12O, provides for the exemption from normal tax of income derived from the exploitation rights of approved films. Section 12O came into effect on 1 January 2012 and applies to all rece ipts and accruals of approved films if principal photography commenced on or after this date but before 1 January 2022.

The exemption under section 12O is still available to new investors after 1 January 2022 for receipts and accruals in respect of films of which principal photography commenced before 1 January 2022. An investor can thus acquire rights to a film after 1 January 2022 provided principal photography on that film commenced before that date but before completion and claiming exemption for the next 10 years. Commencement of principal photography refers to the day on which the actual shooting of the film begins.

Section 12O effectively eliminates income tax on qualifying film receipts and accruals for a 10-year period from the date the film is completed provided principal photography commenced before 1 January 2022. It applies to films that have been approved by the NFVF as a local production or a co-production. The NFVF has introduced a set of qualifying criteria, the South African Film Criteria, that are used to determine whether a film constitutes a local production or a co-production based on a point system. The exemption is limited to investors who acquired the exploitation rights held before the completion date of the film.

Taxpayers may claim a net loss on a film in a year of assessment commencing at least two years after the completion date of the film. The deduction of a net loss also results in a taxpayer being unable to claim the exemption on the particular film going forward.

Section 12O(6) provides that any grant received by or accrued to an SPCV from the state under the DTIC incentive will be exempt from normal tax but subject to

the general recoupment provision under section 8(4). In certain cases, if the grant is passed on to an investor, the investor will also qualify for the exemption. A taxpayer who receives or to whom an exempt DTIC incentive accrues must consider the provisions of section 12P(3) to (6) as there are onsequences on the cost, deductions and allowances available to a taxpayer in respect of related expenditure.

13.4. Transfer Duty Guide (Issue 6)

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

Some of the main topics discussed in this document include:

- the meaning of various definitions;
- the imposition of transfer duty on acquisitions of property;
- different kinds of transactions which are subject to either VAT or transfer duty;
- calculation of transfer duty;
- exemptions; and
- issues relating to the payment of transfer duty, the submission of returns and supporting documentation and other matters generally related to the administration of the Transfer Duty Act.

Brief historical perspective

The Transfer Duty Act was promulgated in Gazette Extraordinary 4193 on 28 July 1949. It came into effect on 1 January 1950 and applies to all acquisitions of property on or after that date. Any acquisitions before 1 January 1950 remain liable to duty under the relevant laws operative at the date of the transaction. Particulars as to any liability and/or rates of duty or exemptions relevant to any such acquisitions may be obtained by referring the matter to the office of SARS.

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

Scope and application

As mentioned in the Preface, this document includes a discussion on the meaning of various definitions, how the imposition of transfer duty works, whether a transaction is subject to VAT or transfer duty, how to calculate the transfer duty which is payable, and how to establish if an exemption applies.

Although this guide is written as far as possible in plain English, its purpose is to provide technical guidance on the application of the Transfer Duty Act on property transactions in the context of the law of property, the law of contract and various other legislative acts with which it is integrally linked. It has therefore been necessary, to a certain extent, to include a discussion on how these other acts and areas of law affect the application of the Transfer Duty Act. This guide does not, however, purport to provide anything more than mere guidance on the application of those other acts and areas of law in so far as they relate to transfer duty matters.

Some areas of the transfer duty law have been explained in more detail than others because of the degree of complexity of the particular topic concerned. It has also been necessary to deal with other taxes such as VAT, Capital Gains Tax (CGT) and income tax to a certain extent, particularly when it concerns the transfer duty exemptions. These other taxes are only dealt with in so far as it is necessary to obtain a basic understanding of their link with transfer duty. The reader will therefore find numerous references to other legislation, case law and guides issued by SARS for more details relating to the tax type concerned.

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

- determine if 'property' has been acquired, or if a transaction or event is otherwise subject to transfer duty in principle, or if an exemption from duty applies;
- determine if a transaction is subject to VAT or transfer duty;

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

Some aspects with regard to policies and procedures on the processing of transactions are mentioned in this guide, but this is not the focus of the publication. More details regarding the submission of returns and the processing of documents and payments can be found in the Transfer Duty eFiling Guide.

Approach of the guide

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

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

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

Chapter 3 – Describes the transactions and events which make up the tax base of transfer duty, being acquisitions of 'property' either by way of a transaction or in

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

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

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

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

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

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

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

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

13.5. Guide to the Voluntary Disclosure Programme

This guide provides general guidance on the voluntary disclosure programme under Chapter 16 of the Tax Administration Act.

The VDP was introduced as a permanent measure to increase voluntary compliance in the interest of enhanced tax compliance, good management of the tax system, and the best use of SARS resources. Intended to encourage taxpayers to voluntarily disclose tax defaults, the VDP is administered under Part B of Chapter 16 and contains the requirements for a valid voluntary disclosure and available relief.

The VDP is applicable to all taxes administered by SARS, except for the customs and excise legislation. Taxpayers qualifying for the VDP will (on the conclusion of a valid voluntary disclosure agreement) be granted relief on applicable understatement penalties, qualifying administrative- penalties, criminal prosecution

in relation to a valid voluntary disclosure, and the conclusion of the voluntary disclosure agreement.

When dealing with provisions creating tax privileges, such as the VDP, a strict interpretation is applied to determine whether an applicant meets all the requirements under Part B of Chapter 16 to qualify for voluntary disclosure relief.

14. INDEMNITY

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