TAX UPDATE

For period: 1 April 2017 to 30 June 2017

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1. INTRODUCTION

The purpose of this update is to summarise developments that occurred during the second quarter of 2017, 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 clients, colleagues and friends alike to be exposed to the latest developments and to consider areas that may be applicable to their circumstances. The reader is invited to contact Johan Kotze to discuss their specific concerns and, for that matter, any other tax concerns.

For most of the readers the dates on which income tax returns have to be filed and the improvements to the dispute management process should be of importance.

Non-executive directors should take note of the clarification of their potential VAT registration obligation.

The Marshall case and ITC 1892 are both VAT cases and rather important in the VAT landscape.

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. It is however important to note that these publications are not law, but may bind SARS. Taxpayers should nonetheless consider these publications carefully to determine whether, and how, they are actually applicable to their own circumstances.

Enjoy reading on!

2. MEDIA RELEASES

2.1. Further clarification on the VAT registration of non-executive directors

Pretoria, 5 May 2017 – SARS has clarified certain aspects regarding the liability of non-executive directors (NEDs) of companies to register for and charge VAT.

On 10 February 2017, two binding general rulings (BGR) – BGR No's 40 and 41 were issued confirming the application of the law as from 1 June 2017 in connection with VAT registration and employees' tax (PAYE). Subsequently, a further media statement was issued on 14 February 2017 to alert the public of the BGRs, as there was apparently some uncertainty on how the tax laws apply to NEDs.

In order to further clarify the position regarding VAT registration for NEDs, an updated version of BGR 41 was published on 4 May 2017.

The updated BGR 41 clarifies that:

- A NED who is liable to register for VAT but has not done so yet, must register and account for VAT with effect from 1 June 2017 unless an earlier date of liability is chosen.
- A NED who was actually registered for VAT before 1 June 2017 for other activities, but did not charge VAT on the NED fees must charge VAT with effect from 1 June 2017 unless that person chooses to account for VAT on those fees from an earlier date.

This applies regardless of whether the fees earned by NEDs were subject to PAYE or not.

2.2. Returns to be submitted

1. General

1.1 Any term or expression in this notice to which a meaning has been assigned in a **'tax Act'** as defined in section 1 of the Tax Administration Act, 2011, has the meaning so assigned, unless the context indicates otherwise and the following terms have the following meaning -

'2017 year of assessment' means—

(a) in the case of a company, the financial year of that company ending during the 2017 calendar year; and

(b) in the case of any other person, the year of assessment ending during the period of 12 months ending on 28 February 2017; and

'income tax return' means a return for the assessment of normal tax in respect of the 2017 year of assessment.

1.2 Notice is hereby given in terms of section 25 of the Tax Administration Act, read with section 66(1) of the Income Tax Act, that a person specified in terms of paragraph 2 is required to submit an income tax return within the period prescribed in paragraph 4.

2. Persons who must submit an income tax return

The following persons must submit an income tax return:

(a) every company, trust or other juristic person, which is a resident;

(b) every company, trust or other juristic person, which is not a resident—

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

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

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

(c) every company incorporated, established or formed in the Republic, but which is not a resident as a result of the application of any agreement

entered into with the Government of any other country for the avoidance of double taxation;

(d) every natural person who–

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

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

(e) every natural person who—

(i) was paid or granted an allowance or advance as described in section 8(1)*(a)*(i) of the Income Tax Act (other than an amount reimbursed or advanced as described in section 8(1)*(a)*(ii)) and whose gross income exceeded the thresholds set out in item (ix);

(ii) was granted a taxable benefit described in paragraph 7 of the Seventh Schedule to the Income Tax Act and whose gross income exceeded the thresholds set out in item (ix);

(iii) is a resident and had capital gains or capital losses exceeding R40 000;

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

(v) is a resident and held any funds in foreign currency or owned any assets outside the Republic, if the total value of those funds and assets exceeded R225 000 at any stage during the 2017 year of assessment;

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

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

(viii) is issued an income tax return form or who is requested by the Commissioner in writing to furnish a return, irrespective of the amount of income of that person;

(ix) subject to the provisions of paragraph 3, at the end of the year of assessment—

(aa) was under the age of 65 and whose gross income exceeded R75 000;

(bb) was 65 years or older (but under the age of 75) and whose gross income exceeded R116 150; or

(cc) was 75 years or older and whose gross income exceeded R129 850;

(f) subject to the provisions of paragraph 3, every estate of a deceased person that had gross income;

(g) every non-resident whose gross income included interest from a source in the Republic to which the provisions of section 10(1)*(h)* of the Income Tax Act do not apply; and

(h) every representative taxpayer of any person referred to in subparagraphs *(a)* to *(g)* above.

3. Persons not required to submit an income tax return

A natural person or estate of a deceased person is not required to submit an income tax return in terms of paragraph 2*(e)*(ix) or *(f)* if the gross income of that person consisted solely of gross income described in one or more of the following subparagraphs:

(a) remuneration paid or payable from one single source, which does not exceed R350 000 and employees' tax has been deducted or withheld in terms of the deduction tables prescribed by the Commissioner;

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

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

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

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

(c) dividends and the natural person was a non-resident throughout the 2017 year of assessment; and

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

4. Periods within which income tax returns must be furnished

Income tax returns must be submitted within the following periods:

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

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

(i) on or before 22 September 2017 if the return is submitted manually;

(ii) on or before 24 November 2017 if the return is submitted by using the SARS eFiling platform or electronically through the assistance of a SARS official at an office of SARS;

(iii) on or before 31 January 2018 if the return relates to a provisional taxpayer and is submitted by using the SARS eFiling platform; or

(iv) where accounts are accepted by the Commissioner in terms of section 66(13A) of the Income Tax Act in respect of the whole or portion of a taxpayer's income, which are drawn to a date after 28 February 2017 but on or before 30 September 2017, within 6 months from the date to which such accounts are drawn.

5. Form of income tax returns to be submitted

The forms prescribed by the Commissioner for the submission of income tax returns are obtainable on request *via* the internet at www.sarsefiling.co.za or from any office of SARS, other than an office which deals solely with matters relating to customs and excise.

6. Manner of submission of income tax returns

Income tax returns must—

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

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

(i) submitted electronically by using the SARS eFiling platform, provided the person is registered for eFiling, or electronically through the assistance of a SARS official at an office of SARS;

(ii) forwarded by post to SARS;

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

(iv) delivered to such other places as designated by the Commissioner from time to time.

2.3. The Income Tax return for trusts (IT12T) - Enhancements

SARS introduced enhancements to the Income Tax Return for Trusts from 15 May 2017.

The following are the critical changes made to the ITR12T:

- One will no longer be allowed to claim a foreign tax credit for services rendered in South Africa which was taxed outside South Africa. However, you will be able to claim a deduction from income for services rendered in South Africa which was taxed outside of the Republic. The ITR12T is updated to cater for repealed section 6quin fields.
- The Income Tax Act (section 11D) provides for a deduction in terms of Research and Development which is meant only for companies and has therefore been removed from the ITR12T.

- The enhancements to the ITR12T are an extension of those implemented during Tax Season 2016:
    - The Statement of Assets and Liabilities now distinguishes between Interest Bearing and Interest Free loan accounts.
    - The sections dealing with rental and farming income have also been enhanced.

Various other changes were made including changes to the:

- Rental Income declaration; and
- ITA34.

One will not be able to change or delete any IRP5 data that has been received from a third party and pre-populated on the return.

If you notice any incorrect pre-populated information on the return, you are advised to contact the employer or service provider in order for them to rectify it as you will not be able to change or delete any IRP5 data received from a third party.

2.4. Introduction of improvements to the dispute management process

On 15 May 2017 SARS introduced important changes and improvements to its current dispute management process as part of our ongoing commitment to delivering a better service to taxpayers.

Please take note of the following:

- **Request for Reasons**

  SARS has, for the very first time, implemented an electronic Request for Reasons via eFiling and the SARS branches. The Request for Reasons

automated functionality has been implemented for Personal Income Tax (PIT), Company Income Tax (CIT) and Value-Added Tax (VAT).

The Request for Reasons functionality allows taxpayers to request reasons for the assessment where the grounds provided in the assessment do not sufficiently enable a taxpayer to understand the basis of the assessment and to formulate an objection, if the taxpayer is aggrieved by the assessment. Once the system has identified that a valid Request for Reasons has been submitted, the period within which an objection must be lodged will be automatically extended for the period permitted by the Dispute Resolution Rules. The Request for Reasons case management workflow further allows SARS to improve its tracking and management of request for reason requests.

- **Request to allow late submission of a dispute for PIT, CIT and VAT**

The new dispute management process introduces a separate condonation workflow whereby the taxpayer is now allowed to submit the Request for Reasons, Notice of Objection (NOO) or Notice of Appeal (NOA) after the periods prescribed by the Dispute Resolution Rules have lapsed. Prior to the introduction of the separate workflow, the condonation process was included in the actual dispute process. Where the request for late submission of a Request for Reasons, NOO or NOA was not successful, the current dispute process caused confusion regarding the outcome of the dispute and what the next available step in the dispute process was.

The new automated condonation process allows for SARS to attend to the request for late submission before the Dispute or Request for Reasons case can be created and considered by SARS. If the Request for Reasons, NOO or NOA was submitted late, the taxpayer will be prompted to provide reasons for the late submission. The new condonation process will ensure that the request for late submission is aligned with legislation as SARS will now inform the taxpayer upfront that the submission is late instead of classifying the dispute as invalid.

- **Suspension of payments on VAT**

  Taxpayers are now able to request suspension of payments pending the outcome of a dispute on VAT via eFiling or at a SARS branch. This is in line with already implemented suspension of payments that was implemented for PIT and CIT in 2015.

- **eFiling Guided Process (PIT, CIT and VAT)**

  To assist taxpayers in following the correct dispute sequence and complete all the information required, eFiling has been made an entirely guided process. The eFiling guided process will ensure that the dispute is submitted according to legislative requirements and thereby eliminating any invalid disputes from being submitted to SARS.

3. CASE LAW

3.1. C:SARS v Marshall NO and others

Appellant was the Commissioner for SARS.

Respondents were the seven trustees of the South African Red Cross Air Mercy Service Trust (the Trust) which was a non-profit organisation that was an approved public benefit organisation (PBO) in terms of section 30 of the Income Tax Act and its receipts and accruals were exempt from income tax in terms of s 10(1)(*c*N) of the Income Tax Act and it was registered for VAT as a vendor in terms of the Value-Added Tax Act.

The Trust provided an aero-medical service within the country and this service, which it had rendered since 1994, consisted of a flying doctor and rural health outreach service, an air ambulance service, and a rescue service.

The Trust, in 2006, concluded a written agreement (the aeromedical contract) with the Department of Health of the Western Cape Provincial Government and it also concluded similar agreements with other provincial government health departments

within the country.

In terms of the aforementioned agreements, the Trust rendered, on behalf of the provincial health departments, a 'comprehensive aero-medical service' which entailed providing specialised intensive care, support and transfer of patients to and from hospitals, medical rescue services, air ambulance services and training and support to health workers.

As consideration for the services rendered the provincial governments paid the Trust a 'monthly availability fee for three aircraft' in terms of a schedule of tariffs for each flight undertaken as part of the service rendered under the contract.

The Trust, in 2012, had applied to SARS, in terms of section 41B of the Value-Added Tax Act, for a binding private VAT ruling to be issued, clarifying the class of payments it received from the provincial departments of health for the services it had rendered on their behalf as it had been of the view that these payments qualified for a VAT zero-rating under section 11(2)(*n*) of the Act.

The Trust had been of the view that because it was a welfare organisation as defined in section 1 of the VAT Act and, as such, was a 'designated entity' as also defined in section 1 of the VAT Act, and because the services it rendered to the provincial health departments were in that capacity, it qualified for the exemption provided for by section 11(2)(*n*) of the Act as the services supplied by the Trust were 'deemed services' under section 8(5) of the Act which qualified to be zero-rated in terms of section 11(2)(*n*).

SARS took a different view and, pursuant to the application by the Trust, he issued a binding private ruling in terms of section 41B stating that the services rendered by the Trust to the provincial health departments were 'actual' services rather than 'deemed' services and they fell outside the provisions of section 8(5) of the VAT Act and were subject to VAT at the standard rate of 14% in terms of section 7(1)(*a*) of the VAT Act.

SARS stated that the provisions of section 8(5) providing for the deeming of a supply of services only applied to instances where designated entities received payments which were not made in consideration for the actual supply of goods and services.

Before the ruling referred to above, the Trust had paid VAT on the remuneration received from the health departments for services supplied by it and had claimed deductions for VAT inputs in relation to those services.

The Trust, aggrieved at the aforementioned ruling, then launched an application in the Gauteng Division of the High Court, Pretoria (see *Marshall NO and Others* v *C: SARS* 77 SATC 395 *per* Pretorius J), seeking a declaratory order confirming that the services supplied fell within section 8(5), i.e. that section 8(5) applied not only to services deemed to be rendered but also to actual services rendered and hence that the services rendered by or on behalf of the Trust should be zero-rated in terms of section 11(2)(*n*) of the VAT Act.

The court *a quo* found in favour of the Trust and did not agree that 'deem' in section 8(5) meant that this section did not deal with actual services. The payment received by the Trust from the provincial governments, being public authorities as defined, had been received in the furtherance of the enterprise activities of the Trust, being a designated entity as defined and were subject to VAT and hence section 11(2)(*n*) applied as the services rendered by the Trust qualified for the zero-rate of VAT.

SARS then appealed to the Supreme Court of Appeal with the leave of the court *a quo*.

The issue to be determined by this court was whether the aero-medical services supplied by the Trust to provincial health departments were a 'deemed supply' of services in terms of the provisions of section 8(5) of the VAT Act and whether payments received in respect thereof thus qualified to be zero-rated in terms of section 11(2)(*n*) of the VAT Act.

SARS submitted that the provisions of section 8(5) applied only in respect of unrequited or gratuitous payments made by a public authority or municipality to a designated entity. These would be payments received as donations, subsidies and grants. He submitted that the provisions of section 8(5) did not apply in respect of services actually rendered by a designated entity and that payments received by a designated entity from a public authority or municipality for such services constituted 'consideration' for taxable supplies in terms of section 7(1)(*a*) of the

VAT Act and hence VAT was payable at the standard rate.

The Trust submitted that to limit the application of section 8(5) to unrequited or gratuitous payments as contended for by SARS militated against the clear wording of section 8(5), particularly the words 'any payment' and more specifically the word 'any' as a word of 'wide and unqualified generality'. It submitted that the legislature must have intended that the deeming provision (section 8(5)) be applicable in respect of all payments received by a designated entity from a public authority or municipality. He also submitted that the submission on behalf of SARS had misconstrued the definition of 'consideration.' Further, that if the legislature had intended to limit the application of section 8(5) to grants and subsidies, which were defined in the VAT Act, it would have expressed itself accordingly.

Judge Dambuza held the following:

(i) That section 11(2)(n) of the VAT provided for zero-rating of VAT payable in respect of certain payments received for the deemed supply of services provided for in section 8(5), which section provided that 'a designated entity shall be deemed to supply services to any public authority or municipality to the extent of any payment made by the public authority or municipality concerned to or on behalf of that designated entity in the course or furtherance of an enterprise carried on by that designated entity'.

(ii) That section 8(5) therefore was the gateway to a zero-rating under section 11(2)(*n*) and under section 11(2)(*n*) a zero-rating will be granted if the services constitute the carrying on of activities of a welfare organisation by a welfare organisation and the services are a deemed supply to a public authority in terms of section 8(5) of the VAT Act.

(iii) That it was common cause that the Trust was a welfare organisation and the issue was whether its supply of services was a deemed service under section 8(5). The principles applicable in the process of ascertaining the meaning of legislative provisions have been repeatedly stated by the Supreme Court of Appeal and it was settled law that the process entailed attributing meaning to the relevant statutory provision, in the light of the language used, the context in which the provision was set, including the

material known to the drafters, and the purpose which the provision was intended to serve and these factors were not mutually exclusive.

(iv) That the contention by the Trust that the words 'any payment' must be given a literal meaning to the exclusion of the remaining words of section 8(5) was untenable and it was inconsistent with the established approach to interpretation of documents. It ignored the distinction between the actual supply of goods and services catered for by section 7(1)(*a*) and the deemed supply of services as provided for in section 8(5).

(iv) That the supply of goods and services by the Trust to the provincial health department constituted 'performance' in terms of the written agreement. The payments received were fees charged in terms of the tariff set out in the agreement and it was only where a payment cannot be linked to any performance on such basis that it became necessary to 'deem' it to be provided in terms of section 8(5).

(v) That the use of the undefined word 'payment' in section 8(5) was not coincidental. The legislature must have intended to distinguish the 'payment' contemplated in section 8(5) from 'consideration' which is defined in section 1, in relation to a supply of goods and services, as including any payment made 'in respect of, or in response to, or for the inducement of, the supply of any goods or services'. The legislature must have intended that the 'payment' contemplated in section 8(5) would be an unrequited payment such as a grant, subsidy or a donation to a designated entity.

(vi) That it will be seen that the common feature between the terms 'grant' and 'donation' was the absence of a (commensurate) direct benefit and in using the term 'payment', the legislature must have intended the provisions of section 8(5) to be applicable in respect of these sorts of payment.

(vii) That *Interpretation Note* 39, issued by SARS on 8 February 2013, sets out the VAT treatment of public authorities prior to and after April 2005 and explains the rationale behind the current wording and application of sections of the Value-Added Tax Act. The *Note* states the following regarding the position of welfare organisations: 'A welfare organisation is

also a 'designated entity', but the zero-rate applies in this case to unrequited payments which it receives from any public authority, constitutional institution or municipality, if it does not constitute consideration for a taxable supply in terms of section 7(1)(*a*).'

These *Interpretation Note*s, though not binding on the courts or a taxpayer, constitute persuasive explanations in relation to the interpretation and application of the statutory provision in question.

(ix) That the Trust's contention that in terms of section 8(5), (i) services supplied to persons in distress and (ii) goods actually supplied to a public authority, were deemed to be services supplied to a public authority was flawed and self-destructive. First, in this matter the services were rendered to the provincial health departments themselves in terms of written agreements. Second, there was no discernible reason for the actual supply of goods to be deemed to be a supply of services. And finally, on the Trust's own argument, services actually supplied to the public authority, were not deemed to be anything other than what they actually were, and could therefore not be zero-rated in terms of section 11(2)(*n*).

(x) That, in summary, the scheme of the VAT Act was such that generally, the supply of goods and services attracted an obligation to pay VAT at the standard rate of 14% and in certain cases a zero VAT rating is applicable where payment is not linked to an actual supply of goods and services. The deeming provision operates to create an imagined supply of goods and services, which may qualify for a zero-rating. Already, grants and subsidies provide a substantial incentive for PBO's to supply goods and services on behalf of public authorities. Zero-rating is the most favourable treatment for any transaction in the VAT system and vendors making zero-rated supplies are usually owed refunds by SARS but there is no conceivable reason why, where PBO's engage in commercial activities they should be treated differently from other commercial entities.

(xi) That it was clear from the above that payment received by a designated entity such as the Trust in this case, from a public authority such as a

provincial health department, for actual supply of services taxable under section 7(1)(*a*) of the Act, fell outside the scope of section 8(5). Therefore the deeming provision was not applicable to them and they did not qualify for zero-rating under section 11(2)(*n*). To hold otherwise would be to do violence to the fundamental architecture of the Value-Added Tax Act, create uncertainty and impact negatively on the *fiscus* and its ability to assist the government in service delivery.

Appeal upheld with costs.

3.2. ITC 1890

The taxpayer was a private company conducting the business of managing and administering retirement villages and their frail care centres.

The taxpayer, during 2006, had acquired four retirement villages and their frail care centres through an amalgamation transaction from the developers of the retirement villages and monthly levies were payable to the Body Corporate by residents who owned units in the village.

The taxpayer was a party to a deed of sale in terms of which units in the village were sold and transferred from an existing resident owner ('the seller') to a new owner ('the purchaser') and it earned a profit when a sale was concluded but, according to the taxpayer, it also became contractually obliged to incur future expenditure on behalf of the purchaser.

In order to purchase or sell a unit in the village, a party had to conclude a standard form written contract of sale ('standard form contract') and the parties to the contract were the seller (the resident owner), the purchaser (the new owner) and the taxpayer.

The deed of sale by which a purchaser acquired a unit provided that the owner must pay a levy to the taxpayer, out of which the taxpayer undertook to pay to the body corporate a monthly subsidy towards certain expenses actually due by the owner, these being insurance, maintenance, security, common electricity and water, management of accounts, investments and cash, reception facilities,

primary health care and transport.

The deed of sale by which the owner disposed of a unit, provided that the taxpayer was entitled to 40% of the enhancement in value, hence every unit owner was entitled to only 60% of any increase in value of the unit on disposal and it followed that the taxpayer was a party to every sale of a unit.

The taxpayer and SARS referred to the contract in terms of which a person acquired a unit as the first contract, and the one in terms of which the owner disposed of that unit as the second contract.

The terms of the standard form contract made it a condition that the contract of sale between the seller and the purchaser (the second contract) shall be effected on the same terms and conditions as the standard form contract in terms of which the seller originally purchased the unit (the first contract).

The taxpayer contended that its right to 40% of the enhancement in value had accrued in terms of the second contract and coterminously with this accrual the taxpayer had accepted an obligation to pay the monthly subsidies to the body corporate for the benefit of the new owner and this future obligation, according to the taxpayer, brought it within the terms of section 24C of the Income Tax Act.

The taxpayer had claimed an amount of R9 354 458 as a deductible allowance in terms of section 24C in respect of its 2011 year of assessment.

SARS had subsequently conducted an audit on the taxpayer during January 2014 and had notified the taxpayer hat the section 24C allowance had been incorrectly claimed by it because the provisions of this section were not applicable to the amount of income received by the taxpayer in that year and the taxpayer was therefore liable to pay tax in the amount of R2 619 248.

SARS had also levied an understatement penalty of R261 924,80 in terms of section 222 of the Tax Administration Act 28 of 2011.

The taxpayer's notice of objection against the tax and the penalty had been disallowed and the taxpayer then appealed against the SARS' disallowance of its objection to the Cape Town Tax Court.

SARS had disallowed the Appellant's section 24C claim and its subsequent

objection on the following grounds:

The enhancement had accrued to the taxpayer in terms of the first contract because it was an obligation which the resident owner had to discharge if the unit was ever sold, and the amount paid by him and not by the new owner.

No future expenditure had to be incurred by the taxpaeyr which related to the enhancement income received by the taxpayer when the unit was sold because the resident owner had departed and all obligations of both the resident owner and the taxpayer had been discharged.

The enhancement income was therefore not income against which future expenditure would be incurred as contemplated in section 24C.

Section 24C was therefore not applicable and the taxpayer was not entitled to claim a section 24C allowance against the enhancement.

Section 24C provided for relief in respect of future expenditure on contracts and future expenditure in relation to any year of assessment was an amount of expenditure which SARS was satisfied would be incurred after the end of the year and would be deductible. If the income of a taxpayer in the current year of assessment includes an amount received or accrued in terms of any contract and SARS is satisfied that the taxpayer will use some or all of the amount to finance future expenditure in the performance of obligations under the contract, SARS will determine a deduction to be permitted in the current year in respect of the future expenditure.

The taxpayer contended further, in regard to the understatement penalty levied, and in the event of the appeal being refused, that it would seek an order that it be excused from paying the penalty on the basis that the alleged understatement was a result of a *bona fide* inadvertent error of the kind contemplated in section 222(1) of the Tax Administration Act and that it had acted on the strength of the tax advice that it had received and that its section 24C claims had been previously allowed by SARS and therefore had reason to believe that the basis upon which it had claimed the allowances was correct and accepted by SARS and there was accordingly nothing preventing it from claiming such allowances in subsequent years of assessment.

It had appeared from the papers that the taxpayer had been assisted by a partner in a firm of accountants and had also obtained a tax opinion from a tax specialist.

The issue for determination in the case was whether the taxpayer was entitled to claim a deductible allowance for such future expenditure in terms of section 24C of the Income Tax Act for its 2011 year of assessment and the case turned on the interpretation of section 24C in relation to the two agreements.

Judge Boqwana held the following:

As to the application of 24C

(i) That section 24C was introduced as a measure to relieve a taxpayer who had received an advance payment in terms of a contract and who will incur expenditure under that contract in future. It was to deal with a situation where an anomaly would arise when income is received in one year and expenditure occurs or is incurred in the subsequent year. Absent section 24C, the income would be fully taxable in the year received without any deduction for future expenditure. The section seeks to place the taxpayer in the same position as he or she would have been had the income earned and expenditure incurred occurred in the same tax year.

(ii) That, as the first requirement, in terms of section 24C, the income of the taxpayer in a particular year of assessment must include an amount received by or accrued in terms of any contract. Secondly, the Commissioner must be satisfied that such amount will be utilised in whole, or in part to finance future expenditure which would be incurred by the taxpayer in the performance of his or her obligations under such contract. Thirdly, such expenditure must be expenditure that would be allowed as a deduction from income when incurred in a subsequent year of assessment.

(iii) That there were two contracts under consideration in this matter – the first contract was one between the original seller and first purchaser ('Owner 1/resident owner') and the second contract was between the resident owner, subsequent purchaser and the taxpayer ('the purchaser/new owner').

(iv) That in terms of the second agreement the resident owner sells his/her ownership of a unit to the purchaser. The taxpayer performs certain administration and related services for the purchaser against payment of a levy, which is paid monthly in advance by the purchaser to the taxpayer. The second agreement, as is the first contract, contains an undertaking by the purchaser to pay enhancement income to the taxpayer when he or she (the purchaser) sells the unit in the future with the inclusion of the terms and conditions or the related clause in a future agreement in respect of sale. These two agreements are incorporated in one deed of sale for purposes of tax despite them being two separate agreements.

(iv) That the taxpayer had contended that whilst the first contract provided for the occasion or the opportunity for the result to be produced, i.e. a unit must be sold for the enhancement value to be payable, it was the second contract that actually produced the result or that positively contributed to the production of the result in that the taxpayer could never receive the enhancement amount until another deed of sale was concluded and this was because until there was a purchase price in terms of the second contract, there could never be an enhancement value. Furthermore, it was in terms of the second contract that levies were expended by the taxpayer on behalf of the purchaser and that occurred only after the income had been received.

(v) That this case turned on the interpretation of section 24C in relation to the two aforementioned agreements and that involved the proper construction of the section in accordance with ordinary principles of statutory construction and 'the words of the section provide the starting point and are considered in the light of their context, the apparent purpose of the provision and any relevant background material.' (Natal Joint Municipal Pension Fund v Endumeni Municipality (SCA) at para 18.)

(vi) That, applying the aforementioned principle of interpretation, and from the wording of the section, it was clear that the contract being evaluated must contain both income and the obligation of future expenses and in order for the taxpayer to come home on the requirements of section 24C, it must

show that the first and second contracts were, within the context of section 24C, inextricably linked so as to be interpreted as a whole.

(vii) That it has been held that both income and future expenditure must be from the same contract and, thus, there must be a link between the 40% enhancement value and the obligation that the taxpayer was to discharge for the payment of the levies. This point was illustrated in ITC 1697 63 SATC 146 at 158 where the court observed that for the allowance to be available in terms of section 24C, 'it must be in terms of the very contract in respect of which the income is received that the future expenditure is payable.'

(viii) That it was common cause that the right to claim the enhancement income emanated from the first contract between the Appellant and the seller. The calculation was deferred until the seller sold the unit. The party making payment of the enhancement value once the unit was sold was the seller, upon payment of the purchase price and not the purchaser and that obligation was in terms of the first contract and that was an important issue. The purchaser never makes payment of income to the taxpayer when the unit is sold to him or her by the seller and he or she only does so in future when he or she sells the unit again.

(ix) That it seemed that the only connection that arose between the two agreements was that the conclusion of the second contract merely activated the application of clause 17 in the first contract in terms of which the 40% enhancement value was payable by the seller who made that undertaking to the taxpayer but the mere conclusion of the second contract which had the effect of triggering a consequence in the first contract could not mean, without more, that the two agreements were inextricably linked.

(x) That the object of section 24C contemplated receipt of income before the actual expenditure but the sequence in this case would mean that expenditure (i.e. payment of levies on behalf of the current owner) is incurred before the income is being incurred (i.e. at the sale of the unit) and which thus conceptually did not accord with the section. Therefore, even if

there was any link between the two agreements, the link must fulfil the requirements of section 24C, i.e. the relationship between the income received and obligation to finance future expenditure. The only link that can be shown in this case is the triggering of the payment of the enhancement value undertaken in the first contract, at the sale of the unit and nothing more.

(xi) That it could not be said that the two agreements were so intertwined so as to be viewed as the 'any' or 'such' contract contemplated by section 24C, taking into account the context of that section. Furthermore, the obligation must be imposed against 'such income'. The taxpayer received payment of income from the seller as per the first contract with him or her, having subsidised levies for the seller during the duration of that contract. When the unit is sold, the purchaser makes no payment in respect of that sale to the taxpayer, in terms of which he might incur future expenditure and, there being no payment made by the purchaser to the taxpater, the section 24C allowance cannot be claimed and thus it cannot be said that the expenditure incurred by the taxpayer was in the performance of its obligations in terms of the same contract from which the income was received.

(xii) That, accordingly, for the aforementioned reasons, the court found that the taxpayer was not entitled to deduct the allowance in terms of section 24C of the Act.

<u>As to the understatement penalty</u>

(xiii) That section 222(1) of the Tax Administration Act provided that where there has been an understatement, the taxpayer must pay the understatement penalty determined unless the understatement resulted from a bona fide inadvertent error. In terms of section 221 an 'understatement' meant any prejudice to SARS in respect of a tax period as a result of a default in rendering a return, an omission from a return, an incorrect statement in a return, or a failure to pay the correct amount of tax where no return is required. The use of 'must' denotes that once the requirements have been

met, the penalty must be imposed and there is no definition of a bona fide inadvertent error.

(xiv) That a bona fide inadvertent error had to be an innocent misstatement by a taxpayer on his or her return, resulting in an understatement, while acting in good faith and without the intention to deceive.

(xv) That in the present matter there was no doubt that the taxpayer had acted in good faith with no intention to deceive, the question was whether it had made a mistake by relying on the advice of the tax experts. While in the court's assessment the wording in section 24C was simple, the complexity may have been created by the tax opinion given to the taxpayer that caused it to believe that two contracts were inextricably linked and could be interpreted as 'any contract' or 'such contract' within the meaning of section 24C.

(xvi) That the tax expert in question went as far as to interpret the law by referring to case law on the interpretation of contracts, some of which had been relied on by the taxpayer's counsel in his argument and this could have given an impression that this position would more than likely be upheld in court. Furthermore, it could be argued that the tax expert's opinion went beyond giving a tax opinion on what section 24C meant and he possibly also strayed into offering a legal opinion.

(xvii) That whilst a line may sometimes be fine, the court was doubtful that such was the case in the present matter and, having said that, there was merit in excusing the taxpayer for its reliance on the tax expert's opinion on the basis of it being lay on issues of tax and the law and hence the appeal against the understatement penalty was upheld.

Appeal dismissed on the section 24C issue with no order as to costs.

3.3. *ITC 1891*

The taxpayer was a duly registered company carrying on the business of providing specialist medical services to members of the public and was based in Harare, Zimbabwe.

Respondent was the Commissioner General of the Zimbabwe Revenue Authority (ZRA) whose authority to collect taxes was authorised by the Zimbabwe Revenue Authority Act.

It was common cause between the parties that a theft had occurred in the taxpayer's business in the sum of $93 459 and that such theft had constituted a loss sustained by the taxpayer.

Whilst the taxpayer had been unable to ascertain the identity of the person or persons responsible for such theft, the theft had not been perpetrated by a shareholder or any person having a direct interest in the business of the taxpayer.

Persons having access to monies on a day-to-day basis were a systems administrator and a bookkeeper and there was no direct evidence to implicate these persons in the theft.

The taxpayer had engaged the services of an independent firm of accountants to conduct an investigation and the report confirmed the theft of the amount aforesaid, but such investigation could not identify the person or persons responsible for the theft. The report, amongst other things, established that the taxpayer was not banking the foreign currency receipts that it received but was keeping them in a locked bag which was in turn kept in a locked safe.

At all material times all persons requiring services from the taxpayer were obliged to pay and did pay for such services in cash as the state of the economy then had resulted in medical aid providers experiencing difficulty in meeting claims and claims made on them were frequently not met.

The taxpayer was at that time one of the few providers of such services in the country and was thus particularly busy.

The cash was collected and receipted by a cashier who then handed over the cash

to her superior from time to time.

At all material times, therefore, there was a real risk of the misappropriation of funds occurring given the state of the economy and the dire need for services and the theft suffered was incidental to the carrying on of the taxpayer's business activities and was inseparable therefrom.

ZRA had issued an amended assessment for income tax on the taxpayer for the tax year ended 31 December 2010 whereby the Appellant's taxable income had been increased and, in addition, ZRA had imposed a penalty in the sum of $41 856,65.

The taxpayer objected to the amended assessment on the basis that the theft of the monies by managerial or subordinate non-managerial employees who were not shareholders was an unavoidable inherent risk sustained in the generation of taxable income that was deductible.

The taxpayer further objected to the imposition of the 100% penalty as being punitive and shocking on the ground that it had fully disclosed the cash discrepancy and did not intend to avoid or postpone the payment of tax.

ZRA had rejected the objection but had allowed a reduction of the penalty from 100% to 30%.

ZRA did not dispute the discovery of the cash discrepancy in the report of the independent firm of accountants which had established that the systems administrator and after her the bookkeeper together with the managing director had access to the cash locked in the bag that was in turn locked in the safe. And in addition, the systems administrator, the credit controller and the managing director were the only ones with access to the safe where the lockable bag was kept.

ZRA was of the view that the taxpayer had failed to exclude managerial employees from the theft and he reduced the penalty from 100% to 30%.

The taxpayer then noted an appeal to the Special Court for Income Tax Appeals.

The parties had conceded that the taxpayer's managing director was not one of the possible defalcators of the cash.

The existence of the cash discrepancy depended upon the accuracy of the books of account that were at hand during the verification exercise conducted by the independent firm of accountants. The report established that the systems administrator did not keep a proper record of all the payments she purportedly made on behalf of the taxpayer.

The report of the independent firm of accountants further established an acute failure by the taxpayer to keep proper books of account for foreign currency transactions between July 2008 and August 2009.

Their methodology involved interviewing key staff and seeking corroboration of their versions. They studied the cash payments cycle and the receipting and banking system of the taxpayer and the key staff interviewed were the systems administrator and the bookkeeper.

The evidence revealed that the keys to the lockable bag where the cash was kept were in the custody of the systems administrator and the managing director and these were the only two people who could unlock the bag. The keys to the safe were in the custody of a credit controller and the managing director and these were the only two people who could unlock the safe. The bookkeeper had a safe in her office and the keys to this safe were kept by the managing director and herself.

The court was of the view that the evidence before it had not established that a theft had occurred and it was not satisfied that the taxpayer had demonstrated on a balance of probabilities that the cash discrepancies noted in the independent accountants report constituted a loss by theft of the taxpayer's foreign currency receipts.

The court also had difficulty with the concession made in oral argument that the managing director was not one of the possible defalcators of the cash and the parties merely excluded the involvement of a shareholder or anyone with a direct interest in the business of the taxpayer from the theft.

The sole issue for determination by the court was whether or not an employer who suffers a loss in consequence of a theft of monies which is perpetrated by a person or persons other than a shareholder, or an owner and such theft occasions loss to his business, is entitled to a deduction under section 15(2)(*a*) of the Income Tax

Act [*Chapter 23:06*].

Judge Kudya held the following:

<u>As to whether a loss or a theft was established</u>

(i) That it did not seem to the court that the statement of agreed facts as read with the annexures A and B had established that a theft had occurred and in the absence of a properly maintained cash book it was difficult to find that cash payments that constituted the unaccounted funds were not made in the course of business. They may very well have been made and not recorded by both the systems administrator and bookkeeper whose duty it was to do so.

(ii) That on the evidence deposed in the independent accountants report the court was not satisfied that the taxpayer had demonstrated on a balance of probabilities that the cash discrepancies noted therein had constituted a loss by theft of the taxpayer's foreign currency receipts. The agreed fact that at all material times there was a real risk of the misappropriation of funds occurring given the state of the economy and the dire need for services, and the theft suffered was incidental to the carrying on of the taxpayer's business activities and inseparable therefrom would have been relevant had the loss or the theft been proved on a balance of probabilities.

(iii) That the claim for a deduction based on the alleged existence of a cash discrepancy therefore had to fail and the court would dismiss the appeal on that basis.

<u>As to the validity of the exclusion of the managing director</u>

(iv) That a concession had been made in oral argument that the managing director was not one of the possible defalcators of the cash but the removal of the managing director from possible suspicion was not based on any averment in the statement of agreed facts and it was not hinted in the sole issue referred for determination of the stated case. The agreed facts indicated that the modus operandi of the theft and the identity of the thief could not be established by the taxpayer or the investigation by the

independent firm of accountants and the parties merely excluded the involvement of a shareholder or anyone with a direct interest in the business of the taxpayer from the theft.

(iv) That the basis for excluding the managing director was not revealed to the court in argument and the concession in regards to the managing director ran contrary to the attitude adopted by ZRA before the statement of agreed facts was reached and to the statement of agreed facts and issue referred for determination.

(v) That the parties did not take the court into their confidence on the basis for the exclusion and in the absence of such basis the court was unable to hold that the concession had been properly made.

As to the sole issue referred for determination

(vi) That the sole issue for determination was whether or not an employer who suffers a loss in consequence of a theft of monies which was perpetrated by a person or persons other than a shareholder, or an owner and such theft occasioned loss to his business, was entitled to a deduction under section 15(2)(a) of the Income Tax Act [Chapter 23:06].

As to the onus in the case

(vii) That in terms of section 63 of the Income Tax Act and the case law the onus lay on the taxpayer to prove on a balance of probabilities that ZRA was wrong in disallowing the deduction of the sum of $93 459.

(ix) That the non-exclusion of the managing director from the list of possible defalcators would be fatal to the taxpayer’s case as in our jurisdiction misappropriations by a managing director are excluded from deduction as losses on the ground that they are not regarded as a necessary incident or inseparable from the taxpayer’s trading activities.

(x) That the taxpayer had failed to validly exclude the managing director from the possible list of defalcators and the court would also dismiss the appeal on this basis.

(xi) That while the taxpayer contended that it was entitled to the deduction as

the theft was occasioned by some unknown employee of the taxpayer who was not the managing director, or director or shareholder or a manager in the position of a proprietor, ZRA contended that the law did not permit a deduction for a theft occasioned by a manager and he contended that the taxpayer had failed to discharge the onus on him to establish on a balance of probabilities firstly that the thief or thieves were not managers of the company and, secondly, that they were not managers who could be equated to the managing director.

As to whether theft by a manager was deductible

(xii) That in Zimbabwe the distinction in the tax deductibility of a loss due to theft by a manager and a non-managerial employee appeared to have been suggested for the first time by Fieldsend J in ITC 952 24 SATC 547 where he suggested that a distinction could be made between the embezzlement committed between ordinary servants on the one hand and managers and managing directors on the other. The second case that set the clear position in Zimbabwe was COT v Rendle 26 SATC 326 and these two positions constituted the black and white parameters set by the law and between them was a grey area in which the courts disallowed the deduction of a loss occasioned through the acts of a managing director or a manager of a company who 'is in the position of a proprietpor.'

(xiii) That, therefore, a deduction was denied of the loss occasioned by the wrongful acts of a proprietor, including a partner, and through the acts of a managing director or a manager of a company who 'is in the position of a proprietor.' (COT v Rendle, supra.)

(xiv) That the onus was on the taxpayer to establish that the systems administrator and bookkeeper were not managers but it had failed to discharge such onus and the court found that they were managerial employees.

(xv) That, similarly, the systems administrator and the bookkeeper were managers in the position of a proprietor or managing director as the impression left by their conduct, but especially the bookkeeper, was that

they were unaccountable independent centres of power and authority in the taxpayer's company. They behaved and were permitted to behave as managers in the position of a proprietor who would appear to have wide latitude to do as he pleases especially with the money in his business and the cumulative impact of these factors was that the managers who stole the money were managers in the position of a proprietor.

(xvi) That, accordingly, taxpayer had failed to discharge the onus on it to show on a balance of probabilities that the systems administrator and bookkeeper were not managers in the position of a managing director or a proprietor and hence the taxpayer was not entitled to the deduction in terms of section 15(2)(a).

Appeal dismissed and the amended assessment issued by the Commissioner on 7 February 2012 was confirmed.

3.4. ITC 1892

The taxpayer was duly registered as a VAT vendor in terms of the VAT Act and carried on a fast foods delivery business.

The taxpayer contracted with fast food outlets and takeaway restaurants to advertise their menus in a booklet or catalogue, which it had printed and distributed to households in the areas in which it made deliveries. The booklet was apparently referred to by the taxpayer as its 'menu guide' and the guide needed regular updating to keep abreast of changes to menus, prices, participating food outlets, delivery prices and the like.

Customers wishing to order fast food from any of these outlets for off-site consumption were able to place a telephonic order for the food with the taxpayer and its booklet contained a guide on 'how to order' and it also set out, immediately under the 'how to order' instructions, certain terms of business, which included the provision: '[The taxpayer] delivers goods for a third party and are not responsible for quality and quantity of such goods.'

There was a table in the booklet in which were set out the 'Delivery areas and

charges' and the information in the table was subject to a qualification stating that 'Delivery charges may fluctuate with petrol increases.'

The customer was thus able to determine from the booklet how much he would have to pay for any food order delivery and the amount will be the sum of the indicated menu price of the food ordered and the indicated 'delivery charge' for deliveries to addresses in the area in which the customer resided, or wished the food to be brought to.

The evidence suggested that the operator at the taxpayer's premises that took a customer's order over the telephone would, in the course of the telephone conversation, confirm the total amount that the customer would be charged.

Upon receipt of an order from a customer, the taxpayer's staff passed on the details to the relevant fast food outlet and despatched a driver to that outlet to collect and pay for the food that had been ordered. The driver was provided by the taxpayer with a cash float for that purpose and the driver then took the ordered food to the taxpayer's customer and collected payment, which could be made by cash or credit card and the driver was required to wear clothing specially branded to identify him or her with the taxpayer's business.

The customer was presented with an invoice by the driver when the food order was delivered and payment collected and the invoice that was presented described itself as a 'Tax Invoice' and it bore the taxpayer's business logo in the top left corner and its VAT registration number in the top right corner.

The contracts entered into by the taxpayer with its customers entailed the service of purchasing items from the menus of participating food outlets at their behest and having the food delivered to them. The taxpayer did not mark up the price of the food it purchased for its customers. It negotiated a commission with the food outlets and takeaway restaurants that advertised in its booklet. The commission was calculated as an agreed percentage of the price of the food purchased by it for its customers and value-added tax was accounted for by the taxpayer on those commissions. The commission plainly constituted consideration received by the taxpayer for a service supplied by it to the participating restaurant and the service consisted of soliciting and executing orders for food for off-site consumption from

the participating restaurants. The collection and delivery of the food constituted a separate service, which was supplied to the taxpayer's customers.

The drivers who collected and delivered the food ordered by the taxpayer's customers were engaged by the taxpayer in terms of a *pro forma* contract entitled 'Memorandum of Agreement for the Provision of Services by an Independent Contractor.'

The evidence indicated that the driver would retain that part of the payment received from the customer that comprised the 'drivers petrol money', less the R1 that the driver was committed to contribute to a kitty that the taxpayer stated that it administered as a sort of welfare fund for drivers. This obviously did not apply in cases in which the payment was made by credit card or through an intermediary service such as SnapScan. In those cases the taxpayer paid the cash amount of the petrol money to the driver at the end of the driver's shift. The taxpayer also paid the commission charges incurred by the use of credit cards and Snapscan. No part of these commission charges were apportioned to the drivers' petrol money component of the payment received by the taxpayer and the amount of the 'drivers petrol money' was fixed by the taxpayer and it was reviewed from time to time primarily to take account of the price of fuel.

The fundamental issue that fell to be determined in this appeal was whether the delivery of food orders to the taxpayer's customers constituted a service supplied by it within the meaning of that word as defined in the VAT Act for consideration in the course, or in furtherance of its enterprise and to that end it was necessary to describe in some detail how the taxpayer's business was conducted.

SARS had made certain findings regarding whether VAT fell to be paid on the taxpayer's delivery charges pursuant to an audit of the taxpayer's affairs during the 2009–2011 assessed tax periods and the audit findings had resulted in the taxpayer being assessed for unpaid value-added tax on the basis of its understatement of output tax in its returns for the relevant periods.

The taxpayer had objected to the assessment on the basis that it was not accountable for the tax on the delivery charges and the question was decided against the taxpayer on appeal by it to the tax board after the disallowance of its

objection.

The taxpayer had been dissatisfied with the tax board's decision and the appeal was subsequently referred to the Tax Court in terms of section 115 of the Tax Administration Act for hearing de novo.

The taxpayer contended that the 'service' of collecting the food from food outlets and delivering it to callers was rendered by independent drivers, who were not employed by it. It contended that the delivery of the food was not a supply made by it as contemplated in section 7(1)(*a*) of the VAT Act.

The taxpayer contended that the only supply that it made was 'the administrative service of receiving the phone call, placing the order with the food outlet and communicating the order to independent drivers.' It did not render a delivery service to callers who placed food orders by phoning it. The callers were not its clients and its clients were the food outlets from which the food was ordered. The commission it earned from the food outlets was the only income that the taxpayer was entitled to for the service that it rendered. It emphasised that it did not earn income from the callers who ordered the food and it contended that no part of the amount reflected on the invoices presented to the customers and paid by them to the drivers was received by the taxpayer for its benefit, least of all the 'Driver's Petrol Money.' To the extent that it handled any such petrol money, it did so as agent.

SARS contended that the taxpayer's enterprise was to deliver food and that in order to be able to do that it needed drivers to make the deliveries, which were to its customers.

SARS contended that the amounts which the customers paid by way of the 'drivers petrol money' in terms of the invoice presented upon delivery of the food constituted consideration for the supply of the delivery service.

SARS stated in brief that:

- the taxpayer made a supply, which supply was the delivery of fast food;
- such supply was done in the furtherance of the taxpayer's enterprise which was a 'fast food delivery service company'; and

- a consideration was charged by the taxpayer for the delivery of the fast food.

Judge Binns-Ward held the following:

(i) That the fundamental issue that fell to be determined in this appeal was whether the delivery of food orders to the taxpayer's customers constituted a service supplied by it, within the meaning of that word as defined in the VAT for consideration in the course, or in furtherance, of its enterprise and the answer is fundamentally a matter of fact.

(ii) That the taxpayer had invested considerable effort during the hearing in seeking to establish that the drivers were independent contractors, and not its employees. Making the distinction entailed a factual enquiry, in which the most important factor was the degree of control that was exercised by the engaging party over the engaged party in the execution of the work the engaged party was contracted to undertake for the engaging party. A high degree of control is indicative of an employer-employee relationship but there was no need to be distracted by that enquiry in the current case and the characterisation was irrelevant.

(iii) That the manner in which the parties involved in the supply of a service formulated their contractual relationships, while it was something that needed to be taken into account, was not necessarily dispositive of how the statutory questions fell to be answered on the facts and if the pertinent question stated above is answered affirmatively, it did not matter whether the taxpayer had used an independent contractor or an employee to carry out the deliveries: it would be liable to account for VAT on the consideration.

(iv) That the case of *Customs and Excise Commissioners* v *Plantiflor Ltd* [1999] STC 51 involved a similar argument to that advanced by the taxpayer in the current case and was closely analogous in material (albeit not all) respects to the current case and the statutory context was in most respects equivalent to that which obtained in South Africa and it was therefore useful for present purposes to pay it detailed attention, if only to illustrate the

different ways in which the pertinent question might be answered.

(iv) That the feature that essentially distinguished the reasoning in the decisions of the VAT Tribunal and the Court of Appeal from those of the High Court in the *Plantiflor* case, *supra*, and the majority in the House of Lords was the influence apparent in the approach of the latter of an assessment of the economic realities that were manifest in the factual context of the transactions involved. The UK Supreme Court has recently acknowledged that 'consideration of economic realities is a fundamental criterion for the application of the . . . system of VAT . . . and . . . where a transaction comprises a bundle of features and acts, regard must be had to all the circumstances in which the transaction in question takes place.'

(v) That considerations of commercial or economic reality palpably also informed the reasoning of Van Zyl J in *National Educare Forum* v *C: SARS* 64 SATC 289 in rejecting a contention by a vendor which was party to a contract with a provincial government 'for the procurement of the supply and delivery of food items to schools' that it did not itself supply the food for consideration and was therefore not accountable for VAT.

(vi) That, applying the approach that prevailed in *Plantiflor*, *supra*, on the facts of the current case would result in a finding that the taxpayer was liable for VAT on the delivery charge or 'drivers petrol money.' The consideration fell to be paid in terms of the contract between the taxpayer and its customer. The taxpayer acknowledged this in the execution of the contract by requiring the drivers to present themselves as the face of the taxpayer, and not as independent contractors; hence the uniforms and the contractual requirement that the driver must identify him or herself as the taxpayer's driver. Those were the contractual requirements of a principal, not of a customer's agent. The customers expected delivery to be effected by the taxpayer, not by a third party. The consideration fell to be paid pursuant to the invoice rendered by the taxpayer to the customer, not in terms of an invoice rendered by the driver to the customer. In the absence of contractual privity between the customer and the driver, the customer could not be regarded as paying the amount to the taxpayer to be passed over on

its behalf to the driver. The driver had no legal right to exact payment of the delivery charge from the customer, only the taxpayer did. Recognition of that fact illustrated that the delivery charges were receivable by the taxpayer, not the drivers, even if it had agreed with the drivers in terms of the discrete engagement contracts that they may deduct the amount due to them from the cash receipts physically collected by them from the customers.

(vii) That the contractual arrangement between the taxpayer and its customers in the current case did not even seek to give the appearance that the taxpayer acted as its customer's agent or intermediary in arranging delivery of the food orders by third party carriers. The *Plantiflor* judgments illustrated, however, that even if it had sought to word its contracts to give such an effect, the wording would prevail only to the extent that it was consistent with the result of a factual enquiry into the supply and the flow of funds in respect of the consideration paid therefor.

(ix) That the provision in the drivers' contracts that the taxpayer did not remunerate them for providing the service as the client would pay a delivery fee directly to the driver was just inconsistent with the facts. The facts were consistent with the acknowledgment in the drivers' contracts that the taxpayer 'outsources its delivery services' and the delivery services were those supplied by the taxpayer. It provided them by using sub-contracted drivers and it financed the delivery by recouping the stipulated charges from its customers and it was irrelevant that the delivery charges did not render a profit.

(x) That the 'economic reality' of the taxpayer's business required it to get the food ordered by its customers delivered to them. The central significance of the delivery service to the taxpayer's business was reflected in its trading name and in the fact that it required the drivers it engaged to identify themselves to its customers as the taxpayer's drivers and to present themselves to the customers looking as if they were an integral part of the business by wearing branded attire and carrying branded hotboxes. If it were not for its delivery service component, the taxpayer's business could

not viably function. It was able to generate the commission income, which was the mainstay of its commercial existence, only by reason of the delivery service it offered, even if that service was characterised as arranging the delivery of the food, rather than actually delivering it.

(xi) That the delivery charges were raised as an incidence of the conduct of the taxpayer's enterprise and the drivers' role in effecting the delivery was an incidence of the supplies made by the taxpayer to its customers. The payments made by the customers in respect of delivery charges or drivers' petrol money were upon a proper analysis of the facts in respect of, or in response to, the service provided by the taxpayer and they were made by the customers to the taxpayer. The drivers' right to appropriate the payments was an incidence of their contracts with the taxpayer, and not with the paying party; the taxpayer had in effect renounced in favour of the drivers part of the consideration it had stipulated to receive from its customers for the services it supplied to the latter and the basis upon which the taxpayer, in terms of its contracts with the drivers, disposed of or made over the consideration did not detract from the character of the payments made by the customers as part of the taxpayer's turnover.

(xii) That output tax was therefore payable by the taxpayer on the delivery charges.

Appeal dismissed with costs.

4. INTERPRETATION NOTES

4.1. Assessed Losses: Companies: The 'trade' and 'income from trade' requirements – No. 33 (Issue 5)

This Note clarifies when a company may forfeit its right to carry forward its assessed loss from the preceding year of assessment as a result of it:

- not carrying on a trade during the current year of assessment, or
- having carried on a trade during the current year of assessment, but not

deriving any income from trade during that year of assessment.

Under section 20(1)(*a*) a company that does not carry on a trade during a year of assessment forfeits the right to carry forward its assessed loss from the immediately preceding year of assessment (the 'trade' requirement). A further question arises whether a company that has traded during the current year but has derived no income from trade during that year is denied the opportunity to carry forward its assessed loss from the preceding year (the 'income from trade' requirement).

SARS is of the view that section 20 contains a trade requirement and an income from trade requirement. Both these requirements must be satisfied before an assessed loss may be carried forward. SARS does, however, accept that this may have some unintended results.

In dealing with the problem SARS will accept that as long as the company has proved that a trade has been carried on during the current year of assessment, the company will be entitled to set off its balance of assessed loss from the preceding year, notwithstanding the fact that income may not have accrued from the carrying on of that trade. This concession is limited to situations in which it is clear that trade has been carried on. SARS will apply an objective test in order to determine that a trade has in fact been carried on. It will not be sufficient that there was a mere intention to trade or some preparatory activities. The fact that no income was earned during the year of assessment must be incidental or result from the nature of the trade carried on by the company.

Although SARS is prepared to accept that the absence of income from trade (that is, gross income less exempt income) should not in all cases prevent the set-off of a balance of assessed loss, a company that derives no income from trade will have to discharge the onus that it did in fact trade during the current year. The absence of income from trade may well indicate that the company did not trade during the year in question.

While the views of SARS as contained in this Note provide direction in interpreting the legislation, each case will be considered on its merits in deciding whether a company has commenced or carried on a trade and much will depend upon the

nature and the extent of the company's activities.

4.2. Pre-trade expenditure and losses – No. 51 (Issue 4)

This Note provides guidance on the deduction of pre-trade expenses (sometimes also called start-up costs) under section 11A.

New business formation is vital to the economy. Before the introduction of section 11A only certain pre-production interest [section 11(bA)] and certain finance charges [section 11(bB)] were permitted as a deduction for start-up costs incurred before the commencement of trade. Sections 11(bA) and 11(bB) have been deleted since the release of the first issue of this Note.

The opening words of section 11 contain a trade requirement while section 23(g) prohibits a deduction for monies not laid out or expended for the purposes of trade. Section 11(a) additionally requires that expenditure and losses be actually incurred in the production of income and not be of a capital nature in order to qualify as a deduction.

The trade requirement of section 24J(2)

> Section 24J(2) does not draw a distinction between interest of a capital or revenue nature. It permits a deduction of the amount of interest which is deemed to have been incurred during a year of assessment, from the income derived from carrying on any trade of the 'issuer' in relation to an 'instrument', if that amount was incurred in the production of the income.

The trade requirement of section 11D(2)

> Section 11D(2) provides for a deduction of research and development expenditure actually incurred by a taxpayer, in the production of income and in the carrying on of any trade. Such expenditure must be directly and solely for research and development undertaken in the Republic.

Pre-trade expenses of a capital nature

> Pre-trade expenses often form part of the cost of creating a source of income. These expenses are therefore mostly of a capital nature.

Effect of section 11A

> Under section 11A pre-trade expenses which would have qualified under section 11 [excluding section 11(x)], 11B, 11D or 24J but for the trade requirement in those provisions, are deductible in the year of assessment in which trade commences, subject to certain requirements, irrespective of when these expenses were incurred, but subject to section 23H.

Repeal of section 11(bA)

> Before the deletion of section 11(bA), any interest and related finance charges actually incurred by the taxpayer on any loan, advance or credit used by the taxpayer for the acquisition, installation, erection or construction of specified assets to be used for purposes of the taxpayer's trade, were deductible under section 11(bA) in full during the year in which the asset was brought into use for the first time.

Before the introduction of section 11A, section 11(bA) served a purpose in that it allowed pre-production interest and related finance charges to be claimed as a deduction in the year of assessment in which the qualifying assets were brought into use. Such interest and related finance charges would not have been deductible under section 24J(2) in the year incurred because that provision requires the interest and related finance charges to be deducted from income from trade and to be incurred in the production of the income.

Section 11(bA) was repealed by section 30(1)(a) of the Taxation Laws Amendment Act 24 of 2011. The repeal of section 11(bA) came into operation on 1 January 2012 and applies to years of assessment commencing on or after that date.

Section 11(bA) was repealed because it had become obsolete in light of the introduction of section 11A which also covers the deduction of pre-trade interest and related finance charges.

Section 11(bA) and section 11A differ in at least two respects.

First, section 11(bA) allowed the deduction of pre-production interest and finance charges against income from any trade, while section 11A restricts the deduction of such expenditure to income from the specific trade.

Secondly, section 11(bA) contained the additional requirement that the asset must have been brought into use for purposes of the relevant trade before the interest and related finance charges could be deducted. While section 11A does not require the asset to have been brought into use it does require the specific trade to have commenced and limits the deduction of pre-trade expenses to the income from that trade.

With the repeal of section 11(bA), all deductions relating to pre-production interest and related finance charges will now be dealt with under section 11A.

While this Note provides general guidance on the application of section 11A, the facts and circumstances of each case must be considered in determining when and if pre-trade expenses will qualify for a deduction under this section.

5. DRAFT INTERPRETATION NOTES

5.1. The VAT treatment of supplies of international and ancillary transport services

This Note sets out the:

- VAT treatment of the international transportation of passengers and/or goods;
- VAT treatment of ancillary transport services; and
- rate of tax applicable to each of the aforementioned transportation services.

This Note does not deal with the VAT treatment of exempt passenger transport as envisaged in section 12(g).

The international transportation of goods or passengers is a taxable supply. So is the supply of any ancillary transport services associated therewith. These services must however, be zero-rated under the various provisions contained in section 11(2) subject to the requirements for the zero-rating being met. In this regard, it is important to note that should the vendor fail to obtain and retain the documentary evidence acceptable to SARS set out in Interpretation Note 31 within the

prescribed time periods, the supply will not qualify to be zero-rated. Furthermore, a vendor supplying domestic or ancillary transport services in connection with imported or exported goods must establish whether the vendor has contracted directly with a non-resident, non-vendor, or with the agent of the non-resident non-vendor, before applying the zero or standard rate.

6. BINDING PRIVATE RULINGS

6.1. BPR 268 – Corrective payments

This ruling determines whether payments to be made to correct amounts erroneously invoiced in previous years of assessment will be deductible and whether the receipts of those amounts must be recouped.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 20 February 2017. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of:

- section 8(4)(*a*); and
- section 11(*a*) read with section 23(*g*).

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

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

The Co-Applicant: A South African branch of Company A registered as an external company

Company A: A company incorporated outside South Africa and not a resident

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

The Applicant and Co-Applicant are part of a multi-national group of companies to which Company B, a foreign company within the group, rendered support services in return for a fee (global recharges). The global recharges relating to the South African operations were processed as follows:

- Prior to the 2011 year of assessment, Company B invoiced all the global recharges relating to the South African operations to Company A. Company A then invoiced the Applicant with its portion of the global recharges (approximately 60%) and the Co-Applicant with its portion of the global recharges (approximately 40%).
- For the 2011 to 2015 years of assessment Company B raised the global recharges relating to the South African operations in a couple of different ways, with the Applicant being invoiced its portion of the global recharges either directly by Company B or by the Co-Applicant. In either case the Applicant invoiced approximately 40% of its allocated portion of the global recharges back to the Co-Applicant in the mistaken belief that it was contractually obliged to do so.

During the 2016 year of assessment it was discovered that the Applicant had invoiced the global recharges for the 2011 to 2015 years of assessment to the Co-Applicant in error.

The Applicant treated the global recharges for these years of assessment, net of the amount invoiced to the Co-Applicant, as expenditure deductible under section 11(*a*). The Co-Applicant, likewise, treated the global recharges including the portion invoiced from the Applicant for these years of assessment as expenditure deductible under section 11(*a*).

The Applicant will, in due course, enter into an agreement to reimburse the Co-Applicant for the amounts erroneously received, by issuing credit notes for each financial year to the Co-Applicant. Subsequent to the issuing of the credit notes the Applicant will make a payment to the Co-Applicant equal to the sum of the amounts reflected on the credit notes.

<u>Conditions and assumptions</u>

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

<u>Ruling</u>

The ruling made in connection with the proposed transaction, as specifically

requested, is as follows:

- The payment to be made by the Applicant to the Co-Applicant will be deductible under section 11(*a*) in the year of assessment in which it is made by the Applicant.
- The payment to be received by the Co-Applicant from the Applicant will be taxable in the year of assessment in which it is received, as a recoupment under section 8(4)(*a*).

6.2. BPR 269 – Income tax consequences of a share buy-back between two controlled foreign companies

This ruling determines the income tax consequences of a share buy-back between two controlled foreign companies (CFCs) of a resident company.

In this ruling references to sections are to sections of the Income Tax Act and references to paragraphs are to paragraphs of the Eighth Schedule to the Act applicable as at 14 March 2017. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – Definition of 'foreign dividend' and 'foreign return of capital';
- section 10B; and
- paragraph 64B.

Parties to the proposed transaction

CFC A: A company incorporated in and a resident of foreign country X

CFC B: A company wholly-owned by CFC A which is incorporated in and a resident of foreign country Y

Description of the proposed transaction

CFC A and CFC B are CFCs of a resident company. CFC A incorporated CFC B to acquire assets located in foreign country Y and capitalised it with sufficient share

capital to fund the bulk of the purchase price. Over time the operations of CFC B have generated sufficient cash so that it is no longer necessary to maintain the original share capital. CFC B is not listed on any stock exchange.

The proposed transaction will be as follows:

- CFC B will buy back 53% of its shares in issue from CFC A at market value.
- The share capital of CFC B will be reduced to the extent of the original subscription price of the shares bought back.
- The income tax laws of country Y provide, amongst others, that if, in terms of an off-market share buy-back, the shares are bought out of profits derived by the purchaser, the difference between the full purchase price and the part of the purchase price which is debited against the company's share capital account is 'taken to be a dividend.' The share buy-back price will therefore consist of a dividend component and a capital component.

Conditions and assumptions

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

- The dividend component of the share buy-back will be treated as a dividend or similar payment by CFC B for purposes of the income tax laws of foreign country Y.
- The capital component of the share buy-back will be treated as a distribution (other than a foreign dividend as defined in section 1(1)) by CFC B for purposes of the income tax laws of foreign country Y.

Ruling

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

- The dividend component of the share buy-back will constitute a 'foreign dividend', as defined in section 1(1).
- The foreign dividend will be an exempt receipt by CFC A in accordance with section 10B(2)(*a*).

- The capital component of the share buy-back price will constitute a 'foreign return of capital', as defined in section 1(1).
- Paragraph 64B(4) will apply to the proposed share buy-back. The capital gain in the hands of CFC A determined in respect of the capital component of the share buy-back must accordingly be disregarded.

6.3. BPR 270 – Restructuring of property portfolio under the corporate rules

This ruling determines certain tax consequences resulting from the restructuring of the unlisted property portfolio of a long-term insurer, by making use of the corporate rules.

In this ruling references to sections and paragraphs are to sections of the relevant Income Tax Act and paragraphs of the Eighth Schedule to the Act applicable as at 29 March 2017. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of:

- the Income Tax Act:
    - section 25BB(4);
    - section 29A;
    - section 40CA;
    - section 42; and
    - paragraph 20(1)(*a*).
- the Transfer Duty Act:
    - section 9(1)(*l*)(i).

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

The Applicant: A listed company incorporated in and a resident of South Africa, carrying on business as a long-term insurer

The First Co-Applicant: A company incorporated in and a resident of South Africa and a wholly-owned subsidiary of the Applicant

The Second Co-Applicant: A corporate REIT to be listed on the Main Board of the JSE

Description of the proposed transaction

The Applicant holds unlisted prime real estate with the objective of delivering long-term returns and matching policyholder liabilities. In some instances the Applicant owns 100% of the properties and in others less than 100%. The First Co-Applicant owns a 25% undivided interest in Property X.

The Applicant's funds established and maintained in accordance with section 29A exposed to the property portfolio are:

- the untaxed policyholder fund;
- the individual policyholder fund;
- the risk policy fund; and
- the company policyholder fund.

The Applicant and the First Co-Applicant propose to transfer a portion of the property portfolio and Property X to the Second Co-Applicant.

The proposed steps to implement the restructuring will be as follows:

- The Applicant will dispose of a portion of its undivided interest in the property portfolio, which includes associated letting enterprises, to the Second Co-Applicant in exchange for units in the Second Co-Applicant.
- As the Applicant and the Second Co-Applicant will become co-owners of the property portfolio they will, in instances in which they hold a 100% undivided share in properties, create a separate unincorporated joint venture for purposes of conducting the letting enterprise of the property portfolio.
- The First Co-Applicant will dispose of a portion of its undivided interest in Property X, including the associated letting enterprises, to the Second Co-

Applicant in exchange for units in the Second Co-Applicant.

- As the Second Co-Applicant will become a co-owner of Property X, the Second Co-Applicant will be integrated in the pre-existing unincorporated joint venture for purposes of conducting the letting enterprise of Property X.
- The units in the Second Co-Applicant will be proportionally allocated by the Applicant to the relevant funds in accordance with section 29A.

None of the allowances noted in section 25BB(4) were claimed by the First Co-Applicant prior to the proposed transfer of a portion of its undivided interest in Property X to the Second Co-Applicant.

Conditions and assumptions

This binding private ruling is subject to the additional condition and assumptionthat the Second Co-Applicant complies with the JSE Listing Requirements.

Ruling

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

- The disposal of the portion of the property portfolio (including the rights attaching to the property portfolio and the letting enterprises) by the Applicant to the Second Co-Applicant will qualify as an 'asset-for-share transaction' as defined in paragraph (*a*) of the definition of 'asset-for-share transaction' in section 42(1). However, section 42 will not apply insofar as it relates to the untaxed policyholder fund.
- Insofar as the disposal of the portion of the property portfolio relates to the untaxed policyholder fund, the Second Co-Applicant will obtain a base cost for the relevant portion of the property portfolio (including the relevant portion of the rights attaching to the property portfolio and the letting enterprises) equal to the market value of the Second Co-Applicant's units issued to the Applicant immediately after acquiring the property portfolio.
- Insofar as the disposal of the portion of the property portfolio relates to the untaxed policyholder fund, the Applicant will obtain a base cost for the units acquired in the Second Co-Applicant equal to the market value of the

relevant portion of the property portfolio (including the relevant portion of the rights attaching to the property portfolio and the letting enterprises) disposed of.

- The Second Co-Applicant will not be liable for transfer duty as section 9(1)(*l*)(i) of the Transfer Duty Act will apply to the acquisition of the portion of the undivided interest of the Applicant in the property portfolio. However, the public officer of the Second Co-Applicant must make a sworn affidavit or solemn affirmation confirming that the transaction complies with the section.
- The disposal of the portion of Property X (including the rights attaching tothe property and the associated letting enterprises) by the First Co-Applicant to the Second Co-Applicant will qualify as an 'asset-for-share transaction' as defined in paragraph (*a*) of the definition of 'asset-for-share transaction' in section 42(1).
- The Second Co-Applicant will not be liable for transfer duty assection 9(1)(*l*)(i) of the Transfer Duty Act will apply to the acquisition of the portion of the undivided interest of the First Co-Applicant in Property X. However, the public officer of the Second Co-Applicant must make a sworn affidavit or solemn affirmation confirming that the transaction complies with the section.

6.4. BPR 271 – Acquisition of leased property by the lessee pursuant to a liquidation distribution

This ruling determines the tax consequences of the transfer of immovable property, as a liquidation distribution under section 47, to the company renting the property.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 22 March 2017. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 8(5)(*b*); and
- section 47.

Parties to the proposed transaction

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

The Co-Applicant: A company incorporated in and a resident of South Africa that is a wholly-owned subsidiary of the Applicant

Description of the proposed transaction

The Co-Applicant is the owner of immovable property that is being let to the Applicant at a market related rental. The property is the only fixed asset held by the Co-Applicant. The Applicant has been occupying the property for purposes of its trade and has deducted the rental from its income in past years of assessment.

To simplify the group structure, it is proposed that the directors of the Co-Applicant will pass a resolution to liquidate the Co-Applicant and to distribute all its assets to the Applicant.

The proposed liquidation will be in accordance with section 47 and the property will be distributed to the Applicant as a dividend *in specie* in the course of the liquidation.

Conditions and assumptions

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

Ruling

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

- Section 8(5)(*b*) will not apply to the proposed transfer of the property from the Co-Applicant to the Applicant as a dividend *in specie* in pursuance of the liquidation of the Co-Applicant.

6.5. *BPR 272 – Deduction of expenditure incurred to acquire land development rigths*

This ruling determines the income tax consequences arising out of expenditure incurred by the Applicant to acquire rights to develop land on another person's property at the Applicant's own risk and to exploit it for its own account.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 13 December 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definition of 'trading stock';
- section 8(4)(*a*);
- section 11(*a*);
- section 22;
- section 23(*g*);
- section 23H; and
- section 24J.

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

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

Holdco: A company incorporated in and a resident of South Africa, the landowner

Propco: A subsidiary of Holdco, a special purpose vehicle, incorporated in and a resident of South Africa, which will take ownership of the land from Holdco

Subco A: A company incorporated in and a resident of South Africa, and a wholly owned subsidiary of Holdco

Purchasers: The eventual acquirers of the residential units to be developed

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

The Applicant is a residential property developer. It proposes to enter into an

agreement to acquire rights to develop land owned by Propco that will allow the Applicant to build and sell rights to occupy residential sectional title units. The entire project will take place over a ten-year period.

The Applicant's usual *modus operandi* is to acquire land, develop it and sell residential units for profit, the property being held as trading stock.

In this instance the land cannot be sold by the shareholders of Holdco for religious reasons and the Applicant must therefore acquire the land tenure in terms of a 99-year lease.

The proposed steps to implement the proposed transaction are as follows:

- Propco, having acquired the land from Holdco, will grant the right to develop the land in terms of a development rights agreement (the DRA) to Subco A, a fellow subsidiary.
- Subco A will cede to the Applicant the right to develop residential units on the land and to market them at the Applicant's risk and for its account, for which the Applicant will agree to pay Subco A various amounts on the occurrence of various events.
- In order to give the Applicant security of tenure, Propco will also enter into a 99-year lease with the Applicant (the Township Lease), which will be registered against the title deed.
- The residential units held under sectional title will be disposed of to Purchasers in the following manner:
  - Once the Applicant has constructed the residential units, the Applicant will, subject to certain terms and conditions, be entitled to:
    - call on Propco to cancel *pro tanto* the Township Lease with the Applicant in respect of the unit and to conclude a 99-year lease directly with the Purchaser in respect of the residential unit; and
    - receive payment of the purchase price from the Purchaser.
  - The Purchaser's 99-year lease will be registered against the title

deed of the unit.

- At the end of the 99-year period, the lessee will be entitled to renew the lease for a further 99-year period, against payment to Propco of 3,5% of the then fair value of the unit.

- In due course, the Township Lease which the Applicant would have concluded with Propco will lapse and be replaced by the leasehold titles concluded between Propco and Purchasers of the units.
- The consideration for the rights in terms of the DRA requires an initial amount at signature date and payment in instalments of the balance, as the residential units are sold, described as '15% plus VAT of the amount (excluding VAT) payable by a Unit Purchaser for the Leasehold Title in respect of a Unit' subject to stipulated minimum amounts payable by set annual dates, and a stipulated maximum amount. If there is a shortfall at any of the annual dates, it must be made good by the next date, and if there is a surplus it may be deducted from the minimum amount due by the following date.
- The DRA also permits the Applicant an early redemption discount if payment is made in full on or before a certain date in the future, in which case the reduced amount payable is specified. If the early redemption payment occurs after that date, the amount payable is calculated by reference to an interest rate.

Conditions and assumptions

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

Ruling

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

- The payments which the Applicant will make to Subco A in terms of the DRA will be deductible under section 11(*a*) read with sections 22 and 23(*g*).
- Section 23H is not applicable to the deductions mentioned in (a).

- Should the Applicant exercise its right to pay the early redemption discounted amount, there will be a recoupment under section 8(4)(*a*) in respect of the discount received.
- The obligation to make payments in terms of the DRA will not constitute an 'instrument' under section 24J. Section 24J will therefore not be applicable to the payment arrangement.

6.6. BPR 273 – Waiver of a contractual right

This ruling determines the income tax, donations tax, capital gains tax and value-added tax consequences of the proposed waiver of a right to receive an annual quantity of produce in terms of a joint venture agreement.

In this ruling references to sections and paragraphs are to sections of the relevant Acts and paragraphs of the Eighth Schedule to the Income Tax Act applicable as at 29 March 2017. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of –

- the Income Tax Act:
  - section 19;
  - section 55 – definition of 'donation';
  - section 56(1)(*n*) and (*r*); and
  - paragraphs 12A and 38; and
- the VAT Act:
  - section 10(4).

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

The Applicant: A private company incorporated in and a resident of South Africa that is a wholly-owned subsidiary of Company A

The Co-applicant: A public company incorporated in and a resident of South Africa

that is a wholly-owned subsidiary of Company A

Company A: A private company incorporated in and a resident of South Africa.

Description of the proposed transaction

The Co-applicant will unilaterally waive its right against the Applicant to receive anannual quantity of produce. Each year, the quantity of produce was determined in terms of an agreed formula ('the Relevant Quantity'). In consequence of the waiver, the Applicant will no longer be obliged to deliver the Relevant Quantity.

Both the Applicant and the Co-applicant are wholly-owned subsidiaries ofCompany A.

Conditions and assumptions

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

Ruling

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

- No donations tax is payable pursuant to the proposed waiver of the right to the Relevant Quantity.
- Paragraph 38 of the Eighth Schedule is not applicable to the waiver of the Relevant Quantity.
- Neither section 19, nor paragraph 12A, is applicable to the waiver of the Relevant Quantity.
- The waiver of the entitlement to the Relevant Quantity for no consideration does not trigger the application of section 10(4) of the VAT Act to deem the value of the supply of such service to be at open market value.

6.7. BPR 274 – Venture capital company investing in a company providing and expanding plants for the generation of solar electricity

This ruling determines:

- the meaning of 'controlled group company' and 'equity share' for purposes of the definitions of 'qualifying company' and 'qualifying share' respectively in section 12J(1) with reference to an operating company that proposes to issue different classes of ordinary shares;
- whether an Operating Company will be regarded as carrying on an 'impermissible trade' in immovable property as contemplated in paragraph (*a*) of the definition of that term in section 12J(1);
- whether rental income derived by the Operating Company will be 'investment income' as defined in section 12E(4)(*c*) and contemplated in paragraph (*f*) of the definition of 'qualifying company' in section 12J(1); and
- whether the Operating Company will be entitled to claim allowances under section 12B(1)(*h*)(ii)(*bb*) read with sections 12B(2)(*b*) and 12D(2).

In this ruling references to sections are to sections of the Income Tax Act applicable as at 17 May 2017. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1), definition of 'controlled group company' and 'equity share';
- section 12B;
- section 12D; and
- section 12J.

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

The Applicant: A company incorporated in and a resident of South Africa that has been approved as a 'venture capital company' as defined in section 12J(1)

Operating Company: A company incorporated in and a resident of South Africa

Company A: A company incorporated in and a resident of South Africa, and the general partner in an *en commandite* partnership (the Partnership)

Individuals: Natural persons who are residents of South Africa and limited partners in the *en commandite* partnership with Company A

Description of the proposed transaction

Investment in Operating Company

The Applicant intends to invest in Operating Company. The remaining shares are held by the Individuals.

The Individuals subscribed for their shares in Operating Company and paid a nominal amount. These shares are classed as 'A' shares.

The Applicant will subscribe for 20% of the equity shares in Operating Company. These shares will be 'B' shares. The relevant terms of the 'B' shares will be as follows:

- The holders of the 'B' shares will be entitled to receive an aggregate amount of distributions that will result in them receiving an aggregate amount equal to the subscription amount, plus a cumulative nominal annual compounded monthly return.
- Dividends in respect of the 'B' shares must be paid regularly out of excess or free cash.
- 'A' shareholders will not, unless otherwise determined unanimously by the board of directors, be entitled to receive any dividends or distributions until the 'B' shareholders have received the total return as described above.
- Once their return has been received by the 'B' shareholders, the 'A' and 'B' shares will rank *pari passu* in all respects.
- For as long as the return has not yet been paid to the 'B' shareholders, notwithstanding the relative number of 'A' and 'B' shares in issue, the 'B' shares will carry 50% of the total voting

rights. However, once the full amount has been paid to the 'B' shareholders, each 'A' share and 'B' share will carry a single vote.

Trade of the Operating Company

As part of its business operations, Operating Company will acquire an existing Solar Services Agreement (SSA) from the Partnership. The SSA facilitates the provision, maintenance, and expansion of solar electricity at the sites of its customer.

In terms of the sale agreement between the Partnership and Operating Company, it is agreed that Operating Company will acquire, as a going concern, the business of conducting a solar facility at specific sites of its customer. These facilities provide for solar electricity which generates 83 kilowatts and 303 kilowatts at Site 1 and Site 2 respectively.

This sale (Phase 1) will, amongst others, involve the Partnership ceding, assigning and transferring all of its rights and obligations in terms of the SSA to Operating Company.

Phase 2 involves Operating Company entering into an installation development contract with Company A as the developer, for the purpose of extending the existing photovoltaic plants. Upon completion of Phase 2, Site 1 will generate 195 kilowatts and Site 2 will generate 808 kilowatts.

The business operations will therefore be outsourced and as a result continue to be supplied by Company A that built and supplied the solar panels. However, all of the assets relating to the supply of solar electricity (the assets), including solar panels, transmission cables and other related facilities, will be owned by Operating Company and supplied to the customer in terms of an operating lease as stipulated in the SSA.

Neither Company A, nor the Individuals (Seller), are directly or indirectly responsible for the financing needs of Operating Company.

Conditions and assumptions

This binding private ruling is subject to the additional condition and assumption that the proposed transaction is not part of or connected with any other transaction,

operation or scheme, other than as set out herein.

Ruling

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

- For purposes of the definition of 'qualifying company' in section 12J(1), Operating Company will not constitute a 'controlled group company' for as long as the number of equity shares which the Applicant holds constitutes less than 70% of the total number of equity shares in issue, irrespective of the fact that the Applicant would have invested more than 70% of the aggregate share capital in monetary terms.
- For purposes of the definition of 'qualifying share' in section 12J(1), the shares held by the Applicant will be equity shares as defined in section 1(1).
- Operating Company will be entitled to claim 100% of the cost to it in the year in which the relevant asset is brought into use by it, both as regards the assets acquired in respect of Phase 1 and those in respect of Phase 2 under section 12B(2)(*b*).
- Operating Company will be entitled to claim the deduction under section 12D of the Act on the basis that any line or cable used for the transmission of electricity is an 'affected asset' as defined, but the deduction is applicable to the assets acquired in respect of Phase 2 only.
- The solar panels are movable assets and therefore Operating Company will not be carrying on an impermissible trade as contemplated in paragraph (*a*) of the definition of 'impermissible trade' in section 12J(1).
- The income derived by Operating Company in terms of its contracts with its customers will not constitute rental derived in respect of immovable property, as contemplated in paragraph (i) of the definition of 'investment income' in section 12E(4)(*c*), so that this amount will not be taken into account in determining the investment income for the purposes of paragraph (*f*) of the definition of 'qualifying company' in section 12J(1).

6.8. BPR 275 – Security arrangements in respect of home loans

This ruling determines certain tax implications arising out of the implementation of security arrangements in respect of home loans.

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 31 May 2017. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definition of "gross income";
- section 24JB; and
- paragraph 1(1) – definition of "asset", "disposal" and "proceeds".

Parties to the proposed transaction

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

The Trust: A trust established in and a resident of South Africa

Co-Applicant: A company incorporated in and a resident of South Africa which is 100% held by the Trust

Customers: Recipients of home loans advanced by the Applicant

Description of the proposed transaction

The Applicant conducts business which includes the advancing of home loans against security by way of a mortgage bond in favour of the Applicant.

It is proposed that, instead of a Customer providing security to the Applicant, the Co-Applicant will provide a guarantee (the Guarantee) to the Applicant for the due fulfilment of the Customer's obligations. The Customer will provide an indemnity to the Co-Applicant and the Customer's obligation to indemnify the Co-Applicant will be secured by a mortgage in the Co-Applicant's favour.

The Trust was settled by the Applicant as the donor, and a separate company appointed as the trustee (Initial Trustee). The Initial Trustee is a resident of South

Africa and not a "connected person" as defined in section 1(1) in relation to the Applicant. In terms of the Trust Deed between the Applicant (in its capacity as donor) and the Initial Trustee, the trustee of the Trust shall be entitled to appoint or remove one director to the board of directors of the Co-Applicant from time to time, who shall be independent of the Applicant. In terms of the Trust Deed, the beneficiary of the Trust is the Applicant or any person in favour of whom the Guarantee has been issued. Initially the Applicant will be the only beneficiary of the Trust.

In terms of the loan agreement (Loan Agreement), the Applicant will advance loans to a Customer subject to the Co-Applicant providing security to the Applicant by way of the Guarantee for the repayment of the loan and the Customer concluding a counter indemnity with the Co-Applicant (the Counter Indemnity) to indemnify the Co-Applicant to the extent that there is any default by the customer in terms of the Loan Agreement. The Counter Indemnity will be secured by the registration of a mortgage bond by the Customer in favour of the Co-Applicant.

In addition, the parties will also conclude the following:

- a deed of cession of some of the Customer's rights to derive income in respect of the mortgaged property to and in favour of Co-Applicant which will be effective on date of default only;
- a deed of cession *in securitatem debiti* of insurance proceeds by the Co-Applicant to and in favour of the Applicant (Cession of Insurance Proceeds Agreement); and
- a deed of cession *in securitatem debiti* of Enforcement Proceeds and Rights as Execution Creditor by the Co-Applicant to and in favour of the Applicant (Enforcement Proceeds Agreement).

The Applicant and the Co-Applicant will also conclude an administration agreement in terms of which all the duties of the Co-Applicant will be sub-contracted to the Applicant.

If a default event as defined in the Loan Agreement occurs, the Guarantee becomes exercisable and the Applicant would lodge a claim under the Guarantee

Agreement for the Co-Applicant to perform under and in terms of the Guarantee Agreement.

Upon receipt of the Applicant's claim the Co-Applicant will, acting in terms of the Counter Indemnity granted in its favour by the Customer, send a notice in terms of section 129(1)(*a*) of the National Credit Act 34 of 2005 to the Customer calling upon the Customer to perform in terms of the Counter Indemnity. If the Customer complies, all sums payable to the Co-Applicant shall be paid into the bank account nominated by the Applicant in reduction of the Customer's Guaranteed Obligations without any set-off, condition or counterclaim whatsoever and free and clear of any deductions or withholdings whatsoever, save as required by law.

If the Customer fails to comply with the notice, the Co-Applicant will be entitled to claim payment of the full amount due, and failing that, levy execution against the property. In terms of the Cession of Insurance Proceeds Agreement and Enforcement Proceeds Agreement, all sums of money which the Co-Applicant collects shall be collected and received by it in its capacity as principal.

The advances in respect of home loans will remain in the books of the Applicant and the only change resulting from the proposed transaction will be the nature of the security for the home loan from secured by mortgage bond to being secured by guarantee.

The Co-Applicant will not recognise any financial assets and financial liabilities in its books of account and no fair value adjustments will be made in its books. Entries in the Co-Applicant's books of account will be limited to share capital and administration expenses.

Conditions and assumptions

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

Ruling

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

- In the event that the Co-Applicant perfects the security by exercising its rights under the mortgage bond (or the additional forms of security

mentioned in 4 above), any resulting amounts will not constitute gross income in the hands of the Co-Applicant.

- No capital gains tax consequences will arise for the Co-Applicant in enforcing its rights under the Counter Indemnity and the mortgage bond (or the additional forms of security mentioned in 4 above) and discharging its obligations under the Guarantee.
- The provisions of section 24JB will not apply to the Co-Applicant.

7. BINDING GENERAL RULING

7.1. BGR 31 – Interest on late payment of benefits (Issue 2)

Purpose

This BGR provides clarity on when an amount constitutes interest, as opposed to forming part of the lump sum benefit, for purposes of the Second Schedule to the Act.

Background

Different practices currently exist in the retirement fund industry relating to the payment of an amount in circumstances when the benefit is paid late. Some administrators include this amount to form part of the lump sum benefit payable to a member, whereas other administrators pay the amount separately to the member as interest.

Ruling

Interest on the late payment of benefits is any interest that is defined, as such, in terms of the rules of the fund.

Any interest that increases a fund's benefit liability does not form a separate component from the benefit that is payable to the member and will be subject to tax under the provisions of the Second Schedule to the Act.

The full amount transferred (including fund growth) from one fund to another is considered to be a lump sum benefit and will be subject to the provisions of the

Second Schedule to the Act

Interest that arises as a result of late payment of the benefit and therefore in addition to the benefit liability must be reflected separately and an IT3(b) certificate must be issued and submitted to SARS as per the prescribed processes.

This ruling constitutes a BGR issued under section 89 of the Tax Administration Act 28 of 2011.

8. DRAFT BINDING GENERAL RULING

8.1. BGR … – Meaning of 160 hours for purposes of section 4(1)(b)

For the purposes of this ruling:

- 'BCEA' means the Basic Conditions of Employment Act 75 of 1997;
- 'ETI' means employment tax incentive;
- 'ETI Act' means the Employment Tax Incentive Act 26 of 2013;
- 'section' means a section of the ETI Act; and
- any other word or expression bears the meaning ascribed to it in the ETI Act.

Purpose

This BGR determines the meaning of the 160 hours stipulated in section 4(1)(b).

Background

Minimum wage requirement

Section 3 sets out the requirements for an employer to be eligible to receive the ETI. Section 4 sets the minimum wage requirement in order to qualify for the ETI. An employer that is thus otherwise an eligible employer is nevertheless not eligible to receive the ETI if the wage paid to a qualifying employee is less than the minimum amounts stipulated in section 4. Section

4(1)(a) applies to an employer that is subject to a wage regulating measure while section 4(1)(b) applies to an employer that is not subject to such a measure.

Section 4(1)(b) distinguishes between an employee who is employed and paid remuneration for at least 160 hours in a month and an employee who is employed and paid remuneration for less than 160 hours in a month.

Although the purpose of section 4(1) is to set a minimum wage requirement, section 4(1)(b)(i) and (ii) refers to 'remuneration' which has a wider meaning than wage. Some uncertainty, therefore, exists as to whether the 160 hours stipulated in section 4(1)(b) relate to only ordinary hours of work or whether overtime is also included.

Meaning of wage

The term 'wage' is fundamental to the purpose and application of section 4(1). Section 1(1) defines 'wage' with reference to the definition of this term in section 1 of the BCEA. The latter Act defines 'wage' as:

> 'the amount of money paid or payable to an employee in respect of ordinary hours of work or, if they are shorter, the hours an employee ordinarily works in a day or week;'.

It is clear from this definition that 'wage' relates to ordinary hours of work. The BCEA defines 'ordinary hours of work' as:

> 'the hours of work permitted in terms of section 9 or in terms of any agreement in terms of sections 11 or 12'.

Section 9 of the BCEA dictates that, subject to certain limited exceptions, an employer may not require or permit an employee to work more than the stipulated hours.

In contrast with the definition 'ordinary hours of work', the BCEA defines 'overtime' as:

> 'the time that an employee works during a day or a week in excess of ordinary hours of work'.

In order to ensure alignment between the determination of a wage regulating measure under section 4(1)(a), 'remuneration for at least 160 hours in a month' under section 4(1)(b)(i) and 'remuneration for less than 160 hours in a month' under section 4(1)(b)(ii), it is necessary to interpret the 160-hour requirement under section 4(1)(b) as the ordinary hours of work. Overtime must thus be excluded when calculating the 160 hours under section 4(1)(b).

Ruling

The 160 hours stipulated in section 4(1)(b) must consist of only ordinary hours of work and do not include overtime.

9. 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.