TAX UPDATE

For period: 1 January 2020 to 31 March 2020

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1. INTRODUCTION

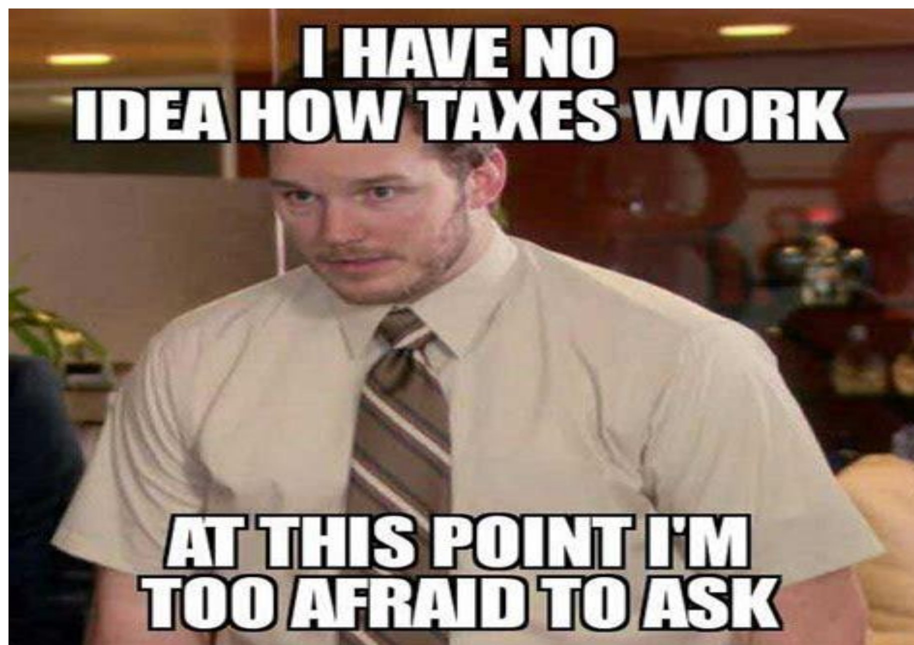
The purpose of this update is to summarise developments that occurred during the first quarter of 2020, specifically in relation to Income Tax and VAT. Johan Kotze, a Tax Executive at Shepstone & Wylie Attorneys, has compiled this summary.

The aim of this summary is for readers to be exposed to the latest developments and to consider areas that may be applicable to their circumstances. Readers are invited to contact Johan Kotze to discuss their specific concerns and, for that matter, any other tax concerns.

Take some time and consider the tax cases.

Interpretation notes, rulings and guides are all important aspects of the developments that took place, as they give taxpayers an insight into SARS' application of specific provisions.

Enjoy reading on!



2. PROMULGATED AMENDMENT ACTS

The following Amendment Acts were promulgated on 15 January 2020:

- Taxation Laws Amendment Act, No. 34 of 2019
- Tax Administration Laws Amendment Act, No. 33 of 2019
- Rated and Monetary Amounts and Amendment of Revenue Laws Act, No. 32 of 2019

3. BUDGET

3.1. Main tax proposals for 2020/21

The main tax proposals for 2020/21 are:

- Providing personal income tax relief through an above-inflation increase in the brackets and rebates.
- Further limiting corporate interest deductions to combat base erosion and profit shifting.
- Restricting the ability of companies to fully offset assessed losses from previous years against taxable income.
- Increasing the fuel levy by 25c/litre, consisting of a 16c/litre increase in the general fuel levy and a 9c/litre increase in the RAF levy, to adjust for inflation.
- Increasing the annual contribution limit to tax-free savings accounts by R3 000 from 1 March 2020.
- Increasing excise duties on alcohol and tobacco by between 4.4 and 7.5%.

3.2. *Personal tax rates*

2020 year of assessment		2021 year of assessment	
Taxable Income	**Rates of tax**	**Taxable Income**	**Rates of tax**
R0 – R195 850	18% of each R1	R0 – R205 900	18% of each R1
R195 851 – R305 850	R35 253 + 26% of the amount above R195 850	R205 901 – R321 600	R37 062 + 26% of the amount above R205 900
R305 851 – R423 300	R63 853 + 31% of the amount above R305 850	R321 601 – R445 100	R67 144 + 31% of the amount above R321 600
R423 301 – R555 600	R97 225 + 36% of the amount above R423 300	R445 101 – R584 200	R105 429 + 36% of the amount above R445 100
R555 601 – R708 310	R147 891 + 39% of the amount above R555 600	R584 201 – R744 800	R155 505 + 39% of the amount above R584 200
R708 311 – R1 500 000	R207 448 + 41% of the amount above R708 310	R744 801 – R1 577 300	R28 139 + 41% of the amount above R744 800
R1 500 001 and above	R532 041 + 45% of the amount above R1 500 000	R1 577 301 and above	R559 464 + 45% of the amount above R1 577 300
Rebates		**Rebates**	
Primary	R14 220	Primary	R14 958
Secondary	R7 794	Secondary	R8 199

Third rebate	R2 601	Third rebate	R2 736
Tax threshold		**Tax threshold**	
Below age 65	R79 000	Below age 65	R83 100
Age 65 and over	R122 300	Age 65 and over	R128 650
Age 75 and over	R136 750	Age 75 and over	R143 850

The personal income tax brackets and the primary, secondary and tertiary rebates increased by 5.2% for 2020/21, which is above expected inflation of 4.4%. This adjustment provides R2 billion in tax relief. The change in the primary rebate increases the taxfree threshold from R79 000 to R83 100.

3.3. *Medical tax credits*

Government proposes an increase in the value of medical tax credits in 2020/21 from R310 to R319 per month for the first two beneficiaries, and from R209 to R215 per month for the remaining beneficiaries. This increases the value of the tax credit by 2.8% It is in line with the announcement in the 2018 Budget Review that the credit would be adjusted by less than inflation to help fund the rollout of national health insurance over the medium term.

3.4. *Tax-free savings accounts*

The annual limit on contributions to tax-free savings accounts will be increased from R33 000 to R36 000 from 1 March 2020

3.5. *Curtailing excessive corporate interest deductions*

Government proposes to restrict net interest expense deductions to 30% of earnings for years of assessment commencing on or after 1 January 2021. This

measure will address a typical form of base erosion and profit shifting by multinational corporations. This practice involves artificially inflating company debt and/or the interest rate on that debt to a related party in another jurisdiction with a lower corporate income tax rate. The resulting interest payments are deducted in South Africa, reducing the domestic tax base and effectively shifting profits to be taxed at a lower rate offshore.

Consultation on the design of this limitation begins today. A discussion document is available on the National Treasury website and the closing date for comments is 17 April 2020.

3.6. *Taxing the digital economy*

In today's digital economy, many businesses are able to generate significant profits in a country, without a physical presence. The Organisation for Economic Co-operation and Development (OECD) secretariat has proposed a unified approach to taxing multinational firms. This approach considers multinationals as a whole, and recognises that consumers and intangible assets contribute to global profits. Under the proposal, multinationals would be required to report a portion of their global profits in all countries where they have a sustained and material market presence. The proposal forms the basis for negotiations and a hoped-for consensus in 2020. South Africa participates in these discussions as a member of the OECD's inclusive framework steering group.

3.7. *Sunset dates for corporates tax incentives*

The National Treasury proposes introducing a 28 February 2022 sunset date for tax incentives dealing with airport and port assets, rolling stock, and loans for residential units. Government will review each of these incentives before the sunset date to determine whether they should be extended. Details are provided in Annexure B.

The section 12I tax incentive relating to industrial policy projects will not be

renewed beyond 31 March 2020. The urban development zone incentive will be extended for one year while a review of the incentive is completed. Government intends to insert sunset dates in additional tax incentives where they do not currently exist to avoid benefits continuing indefinitely without adequate oversight.

Given the fiscal position, government does not intend to extend the tax incentives for special economic zones beyond the six zones already approved by the Minister of Finance.

3.8. Limiting the use of assessed losses to reduce taxable income

When a company's tax-deductible expenses exceed its income, it records an assessed loss. Often, the loss is carried forward to the next year and is offset against taxable income in that year. Over the past few years, there has been an international trend to restrict this practice.

Government proposes broadening the corporate income tax base by restricting the offset of assessed losses carried forward to 80% of taxable income, for years of assessment commencing on or after 1 January 2021. This is viewed as a reasonable approach that affects all businesses equally, rather than restricting the number of years for carrying forward assessed losses, which would disproportionately hurt businesses with large initial investments or long lead times to profitability.

3.9. Transfer duties

The brackets to calculate transfer duties on the sale of property, last adjusted in 2017, will be adjusted for inflation from 1 March 2020. No transfer duty will be liable on the purchase of property with a value below R1 million.

2020 year of assessment		2021 year of assessment	
Property value	**Rates of tax**	**Property value**	**Rates of tax**
R0 – R900 000	0% of property value	R0 – R1 000 000	0% of property value
R900 001 – R1 250 000	3% of property value above R900 000	R1 000 001 – R1 375 000	3% of property value above R1 000 000
R1 250 001 – R1 750 000	R10 500 + 6% of property value above R1 250 000	R1 375 001 – R1 925 000	R11 250 + 6% of property value above R1 375 000
R1 750 001 – R2 250 000	R40 500 + 8% of property value above R1 750 000	R1 925 001 – R2 475 000	R44 250 + 8% of property value above R1 925 000
R2 250 001 – R10 000 000	R80 500 + 11% of property value above R2 250 000	R2 475 001 – R11 000 000	R80 500 + 11% of property value above R2 475 000
R10 000 001 and above	R933 000 + 13% of property value above R10 000 000	R11 000 001 and above	R1 026 000 + 13% of property value above R11 000 000

3.10. Foreign remuneration exemption

Government will increase the cap on the exemption of foreign remuneration earned by South African tax residents to R1.25 million per year from 1 March 2020. Some advisors have recommended emigration, as recognised by the Reserve Bank, as a way to break tax residency.

However, this is only one factor considered by SARS. Government wants to

encourage all South Africans working abroad to maintain their ties to the country. Consequently, this concept of emigration will be phased out by 1 March 2021.

3.11. Tax policy reviews and research

The National Treasury will undertake or complete the following projects during 2020/21:

- Examining the regulation and tax treatment of unlisted real estate investment trusts, in line with the announcements in the 2013 and 2019 Budget Review.
- Reviewing the tax treatment of amounts received by portfolios of collective investment schemes in line with the announcement in the 2019 Budget Review.

3.12. PAYE and personal income tax administration reform

The legal framework and administration of pay-as-you-earn (PAYE) will be reviewed with a view to implementing a more modern, automated process for employers that is easy to understand, access and maintain. The reform is intended to promote accurate and timely withholding from employees and payments to SARS. It is expected to reduce the administrative burden for employers, payroll administrators and SARS. In addition, employees will be able to monitor their tax obligations during the course of the year, and the annual return process for employers will be simplified. Over time, this reform is likely to mean that most individual salaried taxpayers will not have to file personal tax returns.

3.13. *Individuals, employment and savings – Reimbursing employees for business travel*

If an employee spends a night away from home for business purposes, an employer may reimburse the employee for meals and incidental costs. This reimbursement is not taxed, provided the amount does not exceed the amount published by SARS in the notice.

If an employee is away from the office on a day trip, advances or reimbursements are not taxed if the employee can prove that they incurred these expenses on the instruction of the employer, in the furtherance of the employer's trade. An anomaly arises when an employee purchases meals and incurs incidental costs during a day trip for work, but the employer has not explicitly instructed the employee to do so. To address this anomaly, it is proposed that the legislation be amended to exclude reimbursement expenses incurred by an employee for meals and incidental costs during a business day trip, provided the employer's policy allows for such reimbursement.

3.14. *Individuals, employment and savings – Clarifying deductions in respect of contributions to retirement funds*

Paragraphs 5(1)(a) and 6(1)(a) of the second schedule to the Income Tax Act make provision for a deduction of retirement fund contributions that did not qualify for a deduction in terms of section 11F of the Act. These paragraphs refer to 'own contributions', which inadvertently prevents employer retirement fund contributions on behalf of employees (made on or after 1 March 2016) from qualifying for a deduction under either paragraph. It is proposed that the legislation be amended to remove this anomaly.

3.15. *Individuals, employment and savings – Addressing the circumvention of anti-avoidance rules for trusts*

In 2016, anti-avoidance measures were introduced to curb the transfer of growth assets to trusts using low interest or interest-free loans, which was done to avoid estate duty on the asset's subsequent growth in value. In 2017, these rules were strengthened to prevent the transfer of growth assets through low interest or interest-free loans made to companies owned by trusts. Certain taxpayers are undermining the adjusted rules by subscribing for preference shares in companies owned by trusts that are connected to the individuals. To curb this new form of abuse, it is proposed that the rules preventing tax avoidance through the use of trusts be amended.

3.16. *Individuals, employment and savings – Addressing an anomaly in the rollover of amounts claimable under the employment tax incentive*

If the amount available to be claimed by a compliant employer in respect of the monthly employment tax incentive (ETI) is not claimed in that respective month, it can be claimed in the following month. Any unclaimed monthly ETI must be claimed by August or February, whichever is the last month of each reconciliation period. If the monthly ETI is not claimed by that time, the compliant employer forfeits that amount. However, if a non-compliant employer did not claim any ETI for an employee they were entitled to claim for, the employer is able to claim the ETI in any subsequent month when it becomes compliant.

This creates an anomaly because non-compliant employers benefit more than compliant employers. It is proposed that the legislation be amended to address this anomaly.

3.17. Individuals, employment and savings – Addressing an anomaly in the tax exemption of employer-provided bursaries

A number of employer bursary schemes seek to reclassify ordinary remuneration as a tax-exempt bursary granted to the dependants of an employee. Government proposes to close this loophole. These amendments will take effect on 1 March 2020.

3.18. Business (general) – Addressing anomalies on the acquisition of assets in exchange for debt issued

The Income Tax Act sets out rules for the tax treatment of 'share for share' and 'asset for share' transactions, and for curbing value-shifting arrangements under these transactions. The Act contains a rule to determine the base cost of assets acquired by a company in exchange for the issue of debt by that company. The interaction between the specific base cost rule for debt issued on the acquisition of assets and the act's general provisions for determining the base cost creates unintended consequences. Some taxpayers are of the view that the specific rule overrides other anti-avoidance measures dealing with disposals between connected individuals. To address these concerns, it is proposed that the legislation be amended.

3.19. Refining the corporate reorganization rules – Refining the interaction between the anti-avoidance provisions for intra-group transactions

Current corporate reorganisation rules allow for the tax-neutral transfer of assets between companies that are part of the same group. These provisions contain anti-avoidance measures to limit the abuse of these rules through:

- Early disinvestment in transferred assets
- External distribution of intra-group sale proceeds
- Transfers of assets and assumption of related debt
- De-grouping the group of companies that entered into an intra-group sale.

In 2019, the legislation was amended to clarify the interaction between the anti-avoidance rules for degrouping a group of companies and the anti-avoidance rules for the early disinvestment in transferred assets. However, the interaction between the anti-avoidance rules for de-grouping, and rules for the transfer of assets and the assumption of related debt may result in double taxation. It is proposed that the legislation be amended to address this anomaly.

3.20. Refining the corporate reorganization rules – Clarifying rollover relief for unbundling transactions

The Income Tax Act makes provision for rollover relief where shares of a resident company (referred to as an unbundled company) that are held by another resident company (referred to as an unbundling company) are distributed to the shareholders of that unbundling company in accordance with the effective interest of those shareholders. However, these unbundling transactions are subject to an antiavoidance rule that excludes the shareholders and the unbundling company from benefitting from the rollover relief if 20% or more of the shares in the unbundled company are held by non-residents – either alone or together with individuals connected to those non-residents – after the transaction. This rule aims to limit the extent to which taxpayers can distribute tax-free shares in resident companies to non-residents. The current rule creates a loophole. To close this loophole, it is proposed that the legislation be amended to make provision for the 20% rule to apply irrespective of whether nonresident shareholders are connected to each other.

3.21. Taxation of insurance – Tax treatment of deposit insurance scheme

Government is establishing a deposit insurance scheme to protect depositors in the event of a bank failure, which in turn will contribute to the stability of the South African financial system. It is envisaged that each bank will make stipulated contributions to the scheme. It is proposed that tax implications relating to the deposit insurance scheme be considered.

3.22. Taxation of insurance – Clarifying the meaning of 'asset' for the taxation of long-term insurers

The rules in the Income Tax Act dealing with the taxation of long-term insurers make provision for assets to be allocated to the relevant fund and the profit to be taxed when annual transfers are made to the corporate fund. The transfer amounts are calculated by deducting the adjusted International Financial Reporting Standards (IFRS) value of liabilities from the market value of assets in the policyholder and risk policy funds. A problem arises with the treatment of assets that do not have an open market value, for example, prepayments. Prepayments are treated as assets for financial reporting purposes and they cannot be separately disposed of in the open market. To address these concerns, it is proposed that the legislation be amended to make provision for those assets that do not have a market value.

3.23. Taxation of insurance – Reviewing the interaction between rules for the taxation of benefits received by short-term insurance policyholders and the tax treatment of related expenses

The Income Tax Act allows short-term insurance premiums to be deductible provided they are disclosed as expenses for the purposes of financial reporting in line with IFRS 9. The act also makes provision for including short-term insurance policy benefits received or accrued during a year of assessment in gross income. However, another rule prohibits the deduction of any loss or expense, to the extent that it is recoverable under any contract of insurance, guarantee, security or indemnity. It is proposed that the interaction between the different rules for the taxation of benefits received by short-term insurance policyholders and the tax treatment of related expenses be reviewed.

3.24. Refining the tax treatment of doubtful debt – Clarifying the tax treatment of doubtful debt for non-bank taxpayers with security

The Income Tax Act sets out specific criteria for determining a doubtful debt allowance deduction for non-bank taxpayers that are not applying IFRS 9 to debt for financial reporting purposes.

In this case, an age analysis of debt is used to determine a 25% and 40% deduction allowance for the doubtful debt. However, these deductions do not account for the taxpayer's debt security. It is proposed that the determination of deductions in respect of secured debt arrears owed to non-bank taxpayers not applying IFRS 9 should be reviewed.

3.25. Refining the tax treatment of doubtful debt – Clarifying the tax treatment of doubtful debt in respect of certain impairments for banking regulated taxpayers

The Income Tax Act makes provision for the specific tax treatment of doubtful debt owed to taxpayers subject to prudential banking regulations. However, unlike the rules relating to non-banks, bank rules do not only restrict the allowance to be granted to a debt that would have been deductible if it had become a bad debt. As a result, certain impairments such as financial guarantee contracts that would otherwise not be deductible in terms of the act's bad debt deduction provisions are deductible in terms of IFRS 9.

This creates unintended consequences. To address these concerns, it is proposed that the determination of deductions in respect of impairments under IFRS 9 should be reviewed.

3.26. Refining the tax treatment of doubtful debt – Clarifying the tax treatment of doubtful debt in respect of taxpayers operating a leasing business

Taxpayers conducting a leasing business (lessors) and applying IFRS 9 for financial reporting purposes cannot claim a doubtful debt allowance because lease receivables are specifically excluded. This creates unintended consequences. To address these concerns, it is proposed that changes be made in the tax treatment of doubtful debts for both banking regulated and other taxpayers to exclude lease receivables that have not been received or accrued.

3.27. Curbing potential tax avoidance caused by dividend deductions

A bank or other 'covered person' must, subject to exclusions, include in or deduct

from their statement of comprehensive income all amounts from qualifying financial assets and financial liabilities that are recognised as profits or losses. One of the exclusions is a dividend or foreign dividend received by or accrued to a 'covered person'. Some covered individuals are providing investment opportunities to investors by inserting a special purpose vehicle in a banking group between an investor and a 'covered person'. This vehicle issues shares (a financial liability) to the investors that yield dividends while it receives interest or other income on its financial assets. The special purpose vehicle effectively converts income to dividends for the benefit of investors. To close this loophole, it is proposed that the exclusions from the rules for the taxation of covered individuals be extended to dividends declared.

3.28. Refining the taxation of real estate investment trusts – Clarifying the definition of real estate investment trusts (REITs)

The current definition of REIT in the Income Tax Act refers to the approval of listing requirements by the appropriate authority under the Financial Markets Act (2012) in consultation with the Minister of Finance. This definition needs to be updated to be in line with the Financial Sector Regulation Act (2017). In addition, it is proposed that the consultation requirements regarding listing criteria in an approved exchange should be reviewed.

3.29. Refining the taxation of real estate investment trusts – Clarifying the meaning of a share in the definition of REITs

To qualify as a REIT for tax purposes, the entity must be a resident and the trust's shares must be a listed on an exchange as defined in section 1 of the Financial Markets Act and licensed under section 9 of that act. However, it has come to government's attention that some REITs wish to issue and list preference shares. It

was never envisaged that holders of preference shares should benefit from the REIT tax dispensation because preference shares are mainly used for financing, and not to provide full equity exposure to investors. It is proposed that the legislation be clarified to exclude preference shares and non-equity shares from the shares that must be listed on an exchange to qualify as a REIT.

3.30. Refining the taxation of real estate investment trusts – Amending the anti-avoidance provision regarding taxation of foreign dividends received by REITs

A REIT holding shares in a non-resident property company qualifies for a participation exemption in terms of the Income Tax Act in respect of foreign dividends from that non-resident company. The REIT also gets a full deduction when it distributes profits from those foreign dividends. To address this mismatch, it is proposed that the legislation be amended so that the full dividend is subject to tax if the recipient company is a REIT.

3.31. Refining the tax treatment of transfer of collateral in securities lending arrangements

The Income Tax Act contains rules to address dividend tax avoidance transactions whereby listed shares are lent or transferred as collateral from a person that would be liable for the tax to a tax-exempt person. The borrower or recipient of the collateral receives the exempt dividend and pays a manufactured dividend to the lender or provider of the collateral. It is proposed that the anti-avoidance rules be extended to also cover situations where additional exempt parties are involved to facilitate the avoidance transactions.

3.32. Business (incentives): Reviewing the special economic zone tax incentive regime

The special economic zone (SEZ) tax incentive regime rules are contained in two separate provisions of the Income Tax Act. The first deals with the criteria for determining what constitutes a company, under the SEZ tax regime, that qualifies to be taxed at a rate of 15% instead of 28%. In addition, this provision includes a sunset clause. The clause originally stated that the provision will no longer apply for years of assessment starting on or after 1 January 2024. Following the late enactment of the Special Economic Zones Act (2014), the clause was amended to add that the provision will no longer apply for years of assessment after a 10-year period determined from the date when a qualifying company started trading in an SEZ.

The second provision provides for an accelerated capital allowance for a building owned and used by a qualifying company in the production of its income within an SEZ. This provision has a sunset clause of the year of assessment starting on or after 1 January 2024. Government proposes to amend the sunset clauses for sections 12R and 12S to clearly stipulate an end date for these incentives. No company would be eligible for approval beyond these dates. The end date would also provide government with a natural point for reviewing these incentives to determine whether they should be continued.

3.33. Business (incentives): Reviewing the venture capital company tax incentive regime

The venture capital company tax incentive regime has a sunset clause of 30 June 2021. Government will review the effectiveness, impact and role of this regime to ascertain whether the incentive should be discontinued.

Over the past two years, changes were made in the venture capital company incentive tax regime to curb abuse and limit the regime’s revenue costs. There are

potential unintended consequences within the current legislation that may affect the successful closure of legitimate venture capital companies. It is proposed that the legislation be amended to address these unintended consequences.

3.34. Mining capital expenditure – Addressing the tax treatment of allowable mining capital expenditure

The Income Tax Act makes provision for any taxpayer that derives income from mining operations to be allowed an accelerated capital expenditure deduction. At issue are the definitions of mining and mining operations for purposes of claiming the capital expenditure deductions, and whether a contract miner – who excavates for a fee – and the mineral rights holder – as principal – should both qualify for accelerated capital expenditure deductions. To address these concerns, it is proposed that the provisions dealing with allowable mining capital expenditure be reviewed.

3.35. Mining capital expenditure – Removing the Minister of Finance's discretion in ring-fencing capital expenditure per mine

The tax-deductible capital expenditure incurred on a mine may not be used to reduce the taxable income of another mine, unless the Minister of Finance, in consultation with the Minister of Mineral Resources and Energy and having considered the relevant fiscal, financial and technical implications, decides otherwise. The application of this discretion has proven problematic, so it is proposed that the discretion be reviewed with the aim of its removal or restructuring.

3.36. Aligning imunity from taxation of internation organisations

South Africa is a member of many internationally recognised organisations. The international agreements underpinning these memberships make provision for these international organisations to be immune from taxation in South Africa. The Income Tax Act makes provision for such exemptions, but it is proposed that amendments be made to all tax acts to make provision for these exemptions and ensure South African legislation aligns with international agreements.

3.37. Refining tax treatment of foreign donor-funded projects

In 2006, changes were made to the Income Tax Act to make provision for the tax treatment of foreign donor-funded projects in terms of the Official Development Assistance Agreement. Given that some of these projects were entered into long ago, it has come to government's attention that the interaction between the provisions of the act and the provisions of the Official Development Assistance Agreement creates unintended consequences. It is proposed that amendments be made to the legislation to address these concerns.

3.38. Reviewing expenditure deductions incurred related to the National Key Points Act

The National Key Points Act (1980) makes provision for deduction of expenditure incurred by taxpayers in respect of any national key point. The act will be repealed when the Critical Infrastructure Protection Act (2019) comes into effect. It is proposed that the current expenditure deduction for national key points be reviewed to ascertain whether this deduction should be discontinued or aligned with the Critical Infrastructure Protection Act, but with certain limitations.

3.39. International – Amending the anti-avoidance provision regarding change of residence

Capital gains tax is levied when a person ceases to be a South African tax resident. When a company ceases to be a resident, there is a deemed disposal of its assets that triggers capital gains tax. Despite these rules, residents that hold shares in the company could subsequently dispose of the shares and qualify for a participation exemption for the sale of company shares. It is proposed that amendments be made to the legislation to close this loophole.

3.40. International – Changing the anti-avoidance provision regarding taxation of foreign dividends received by residents

The participation exemption rules for foreign dividends do not contain a similar limitation for general foreign dividends exemption rules (in the Income Tax Act). This limitation denies tax exemption for foreign dividends if there is a deductible expense or reduction that is determined directly or indirectly with reference to a dividend. For example, where a resident owns 20% of the shares in an unlisted foreign company, no tax is imposed on the foreign dividends, even though these dividends arose from amounts that previously qualified for a tax deduction. To address this concern, it is proposed that changes be made to the legislation.

3.41. International – Refining the definition of an 'affected transaction' in the transfer pricing rules

Transfer pricing rules apply if a taxpayer or a controlled foreign company enters into a transaction with a non-resident 'connected person', on terms and conditions that are not at arm’s length, and derives a tax benefit from that transaction. In the case of a transaction between a controlled foreign company and a non-resident

'connected person', a tax benefit may not be derived by the foreign company, but may be derived by a South African resident shareholder as a result of a lower inclusion of controlled foreign company net income for the resident. To address this situation, it is proposed that the legislation be amended to refer to a tax benefit that may be derived by a person, in relation to a controlled foreign company, that is a resident.

3.42. Refining the tax treatment of capital flows – Restricting the artificial reduction of dividends and capital gains tax

The current exchange control provisions restrict the use of loop structures, in part to protect the tax base. Tax legislation is a more appropriate tool to combat tax avoidance. For example, if a resident individual or trust holds at least 10% of the total equity shares and voting rights in a foreign company, they qualify for a participation exemption and all foreign dividends received are exempt from tax. If the resident shareholding is more than 50%, the foreign company is a controlled foreign company and all of the controlled foreign company's dividend income is exempt from tax. If loop structures are no longer restricted, it would be possible to set up a structure where the controlled foreign company owns a South African company, and any dividends flowing from the resident company to the resident individual or trust through the controlled foreign company are exempt for the individual or trust. This would enable the resident individual or trust to reduce their dividend tax liability in respect of dividends declared by a resident company from 20% to, in some instances, zero.

A further loop structure risk exists if a resident disposes of shares in a controlled foreign company that owns South African assets. The unrealised gains attributable to the South African assets may not be taxed if the resident qualifies for the participation exemption for capital gains. Government proposes that the controlled foreign company legislation be amended to limit the dividend exemption available to a resident individual or trust relating to the accrual or receipt of dividends from a resident company to a controlled foreign company. As a result, such dividends

would be taxed at an effective rate of 20%, in line with cases where resident individuals receive dividends from resident companies.

In addition, it is proposed that the participation exemption for capital gains on the disposal of shares in controlled foreign companies by residents should not apply to the extent that the value of those shares is derived from South African assets.

3.43. International – Withdrawing retirement funds upon emigration

Individuals are currently able to withdraw funds from their pension preservation fund, provident preservation fund and retirement annuity fund upon emigrating for exchange control purposes through the Reserve Bank. As a result of the exchange control announcements in Annexure E, the concept of emigration as recognised by the Reserve Bank will be phased out. It is proposed that the trigger for individuals to withdraw these funds be reviewed. Any resulting amendments will come into effect on 1 March 2021.

3.44. International – Transferring dual-listed shares abroad

A resident individual or company that owns a listed domestic security is not permitted to export that security without approval. This approval requirement is one of the exchange control provisions that will be phased out. As a result, government proposes that these events be deemed a disposal that would attract capital gains tax or normal tax. If the person or company remains a tax resident, they would be liable for tax on further gains when the security is sold in future.

3.45. VAT – Revising the definition of 'telecommunication services' for electronic services regulations

With effect from April 2019, the regulations prescribing electronic services were

changed to broaden the scope of electronic services that are subject to South African value-added tax (VAT). However, the definition of 'telecommunication services' in the regulations currently contains an incorrect reference that creates unintended consequences. It is proposed that further changes be made to the regulations to address these consequences.

3.46. VAT – Reviewing the VAT accounting basis option available for an intermediary

In terms of section 54(2B) of the VAT Act (1991), certain supplies made by an underlying foreign electronic services supplier are deemed to be made by the intermediary, who is then required to levy and account for South African VAT on these supplies. Section 15(2)(a)(vii) of the VAT Act allows a vendor that is a foreign electronic services supplier to apply to the SARS Commissioner to account for VAT on a payment basis. However, it does not allow a vendor that is an intermediary to account for VAT on this basis. It is proposed that an intermediary vendor be allowed to account for VAT on a payment basis.

3.47. VAT – Changing the VAT treatment of transactions under the corporate reorganization rules

Section 8(25) of the VAT Act ensures that transactions entered into between a group of companies have no VAT consequences. This is achieved by treating the supplier and the recipient of goods or services as the same person, provided the relevant rollover relief provisions of the Income Tax Act are met. The income tax relief provisions may not apply to the transfer of certain assets, which means that their transfer will also not qualify for the VAT relief, even though the assets form part of the entire transaction.

This limitation of relief creates unintended consequences for VAT. The entire transaction could qualify for VAT relief under the going-concern provisions, but are

excluded because the transaction falls within the ambit of the corporate reorganisation rules, which a utomatically require the provisions of section 8(25) of the VAT Act to apply. It is proposed that changes be made in the relief provisions in section 8(25) of the VAT Act to address these limitations.

3.48. VAT – Reviewing section 72 arrangements and decisions

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

3.49. VAT – Clarifying the VAT treatment of irrecoverable debts

Where a vendor, who is required to account for VAT on an invoice basis, has made an input tax deduction for the VAT they were charged on a taxable supply and that vendor has not paid the full consideration within a 12-month period, that vendor will be required to account for output tax on the unpaid amount.

The VAT Act provides clarity on the time of supply within which such output tax is to be declared. However, there is uncertainty regarding the value of supply rule that applies in certain circumstances. It is proposed that clarity be provided in the legislation to address the uncertainty.

3.50. VAT – Introducing measures to address undue VAT refunds on gold

Schemes and malpractice to claim undue VAT refunds have been detected in the value chain relating to gold exports. The schemes and malpractice generally involve the import of coins, purchase of Krugerrands and illicit gold. It is proposed that appropriate regulations be considered or legislation be amended to address this.

3.51. Tax Administration – Failure by PBOs approve to receive tax deductible donations to submit audit certificates

If a public benefit organisation fails to comply with specific requirements for receiving tax-deductible donations, SARS may regard these donations as taxable income for the organisation. If the failure is not addressed within a reasonable period, the receipts issued by the organisation will no longer be valid for claiming tax deductions. The sanctions do not apply to the requirement that an organisation conducting mixed activities, some of which qualify for the issue of receipts and some of which do not, obtain an audit certificate for the use of the funds for which receipts have been issued. It is proposed that this be corrected.

3.52. Tax Administration – Refunds of withholding tax on royalties where the royalty becomes irrecoverable

The interest-withholding tax provisions provide for a refund of tax withheld when interest became due and payable if the interest subsequently becomes irrecoverable. It is proposed that the same principle should apply in cases where royalty-withholding tax was paid and the royalty becomes irrecoverable.

3.53. Tax Administration – Aligning the Mineral and Petroleum Resources Royalty (Administration) Act and the Tax Admnistration Act

Chapter 12 of the Tax Administration Act (2011) created a framework to support the modernisation of the SARS accounting system for interest. Due to the similarities in the interaction between provisional and income tax on the one hand and the estimation and final payment of royalties for mineral and petroleum resources on the other, it is proposed that the Mineral and Petroleum Resource Royalty (Administration) Act (2008) and Chapter 12 of the Tax Administration Act be amended to ensure they align. This includes aligning interest payable for royalties, for the first and second payment, with provisional tax interest under Chapter 12.

3.54. Tax Administration Act – Estimated assessments for non-compliance

SARS may issue an estimated assessment to a taxpayer who does not file a return. The assessment may only be disputed where the relevant return is filed and SARS has failed to revise the assessment in light of the return. This ensures that all the facts are available when the assessment is revisited and that the dispute resolution timelines that would otherwise apply may be relaxed in appropriate circumstances. It is proposed that this approach be extended to cases where specific relevant material was requested from a taxpayer on more than one occasion, without an adequate response.

3.55. Tax Administration – Withholding PAYE refunds where returns are outstanding

In terms of the Income Tax Act, SARS may refuse to authorise a refund until a

taxpayer furnishes any outstanding returns. A similar but broader provision exists in the Employment Tax Incentive Act (2013).

Given the tight integration between the PAYE, skills development levy, unemployment insurance contributions and employment tax incentive systems, it is proposed that this power also apply to the Skills Development Levies Act (1999) and the Unemployment Insurance Contributions Act (2002). It is also proposed that the similar provisions across tax legislation be reviewed to determine if they can be consolidated into a single provision applicable to all tax types under the Tax Administration Act.

3.56. Tax Adminitration – Withholding refunds where a matter is under criminal investigation

The Tax Administration Act provides that SARS may withhold a refund until such time that the refund is verified, inspected or audited. It is proposed that this provision be extended to include criminal investigations.

4. REGULATIONS

4.1. Official rate of interest

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

DATE FROM	DATE TO	RATE
1 March 2019	31 October 2019	10.25%
1 November 2019	30 April 2020	10.00%
1 May 2020	Until change in the Public Finance Management Act	9.75%

Interest rates payable on credit amounts (overpayment of provisional tax) under section 89quat(4) of the Income Tax Act 58 of 1962

DATE FROM	DATE TO	RATE
1 March 2019	31 October 2019	6.25%
1 November 2019	30 April 2020	6.00%
1 May 2020	Until change in the Public Finance Management Act	5.75%

The term 'official rate of interest' is defined in section 1(1) of the Income Tax Act.

Where a loan is obtained by an employee from his or her employer in terms of which no interest is payable or where the interest payable is less than the 'official rate of interest', the difference between the amount which would have been payable if the loan was granted at the official rate and the amount actually paid by the employee, is taxed as a fringe benefit.

DATE FROM	DATE TO	RATE
1 December 2018	31 July 2019	7.75%
1 August 2019	31 January 2020	7.50%
1 February 2020	Until change in Repo rate	7.25%

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

4.2. Fixing of rate per kilometer in respect of motor vehicles for the purposes of section 8(1)(b)(ii) and (iii) of the Income Tax Act

Definition

In this Schedule, 'value' in relation to a motor vehicle used by the recipient of an allowance as contemplated in section 8(1)(b)(ii) and (iii) of the Income Tax Act, 1962, means:

(a) where that motor vehicle (not being a motor vehicle in respect of which paragraph (b)(ii) of this definition applies) was acquired by that recipient under a bona fide agreement of sale or exchange concluded by parties dealing at arm's length, the original cost thereof to him/her, including any value-added tax but excluding any finance charge or interest payable by him/her in respect of the acquisition thereof;

(b) where that motor vehicle:

(i) is held by that recipient under a lease contemplated in paragraph (b) of the definition of 'instalment credit agreement' in section 1 of the Value-Added Tax Act, 1991; or

(ii) was held by him/her under such a lease and the ownership thereof was acquired by him/her on the termination of the lease,

the cash value thereof as contemplated in the definition of 'cash value' in section 1 of the Value-Added Tax Act; or

(c) in any other case, the market value of that motor vehicle at the time when that recipient first obtained the vehicle or the right of use thereof, plus an amount equal to value added tax which would have been payable in respect of the purchase of the vehicle had it been purchased by the recipient at that time at a price equal to that market value.

Determination of rate per kilometre

The rate per kilometre referred to in section 8(1)(b)(ii) and (iii) must, subject to the

provisions of paragraph 4, be determined in accordance with the cost scale set out in paragraph 3, and must be the sum of:

(a) the fixed cost divided by the total distance in kilometres (for both private and business purposes) shown to have been travelled in the vehicle during the year of assessment: Provided that where the vehicle has been used for business purposes during a period in that year which is less than the full period of that year, the fixed cost must be an amount which bears to the fixed cost the same ratio as the period of use for business purposes bears to 365 days;

(b) where the recipient of the allowance has borne the full cost of the fuel used in the vehicle, the fuel cost; and

(c) where that recipient has borne the full cost of maintaining the vehicle (including the cost of repairs, servicing, lubrication and tyres), the maintenance cost.

Cost scale

Where the value of the vehicle -	Fixed cost R	Fuel cost c/km	Maintenance cost c/km
does not exceed R95 000	31 332	105.8	37.4
exceeds R95 000 but does not exceed R190 000	55 895	118.1	46.8
exceeds R190 000 but does not exceed R285 000	80 539	128.3	51.6
exceeds R285 000 but does not exceed R380 000	102 211	138	56.4
exceeds R380 000 but does not	123 955	147.7	66.2

exceed R475 000			
exceeds R475 000 but does not exceed R570 000	146 753	169.4	77.8
exceeds R570 000 but does not exceed R665 000	169 552	175.1	96.6
exceeds R665 000	169 552	175.1	96.6

Simplified method

Where:

(a) the provisions of section 8(1)(b)(iii) are applicable in respect of the recipient of an allowance or advance; and

(b) no other compensation in the form of a further allowance or reimbursement (other than for parking or toll fees) is payable by the employer to that recipient, that rate per kilometre is, at the option of the recipient, equal to 398 cents per kilometre.

Effective date

The rate per kilometre determined in terms of this Schedule applies in respect of years of assessment commencing on or after 1 March 2020.

4.3. Determination of the daily amount in respect of meals and incidental costs for purposes of section 8(1) of the Income Tax Act

The following amounts will be deemed to have been actually expended by a recipient to whom an allowance or advance has been granted or paid:

(a) where the accommodation, to which that allowance or advance relates, is in the Republic and that allowance or advance is paid or granted to defray:

(i) incidental costs only, an amount equal to R139 per day; or

(ii) the cost of meals and incidental costs, an amount equal to R452 per day; or

(b) where the accommodation, to which that allowance or advance relates, is outside the Republic and that allowance or advance is paid or granted to defray the cost of meals and incidental costs, an amount per day determined in accordance with the 'Table: Daily Amount for Travel Outside the Republic' under Notice 268 published in Government Gazette No. 42258 dated 1 March 2019.

The amounts determined in this notice apply in respect of years of assessment commencing on or after 1 March 2020.

4.4. VAT exemption not covering hostile acts constituting robbery and theft

Schedule 1 to the Value-Added Tax Act, 1991 (Act No. 89 of 1991), is hereby

amended by the amendment in paragraph 8 of item no. 412.09/00.00/01.00 with the following:

412.09/00.00/01.00 Goods in respect of which the customs duty, together with the fuel levy (where applicable), amounts to not less than R2 500, proved to have been lost, destroyed or damaged on any single occasion in circumstances of ***vis major*** or in such other circumstances as the Commissioner deems exceptional while such goods are:

(a) in any customs and excise warehouse or in any appointed transit shed or under the control of the Commissioner;

(b) being removed with deferment of payment of duty or under rebate of duty from a place in the Republic to

any other place in terms of the provisions of this Act; or

(c) being stored in any rebate storeroom: **[Provided that-]**

Provided that –

(i) no compensation in respect of the customs duty, fuel levy or VAT on such goods has been paid or is due to the owner by any other person;

(ii) such loss, destruction or damage was not due to any negligence or fraud on the part of the person liable for the duty or VAT; and

(iii) such goods did not enter into consumption and the importer of those goods was not liable for the tax imposed in terms of section 7(1)(b) when those goods were initially imported; **and**

provided further that circumstances contemplated in this item exclude a hostile act by a third party constituted by robbery or theft.

5. TAX CASES

5.1. BMW South Africa (Pty) Ltd v C:SARS

BMW, a world-wide organisation who from time to time seconded its expatriate employees from their home countries to work in South Africa for a short or medium term period.

Material to the secondment and by agreement between BMW and the expatriate employees was that BMW would settle the expatriate employees' tax liability during the expatriate employees' secondment to South Africa and the objective was to ensure that the expatriate employees remained tax neutral and were in no worse a

position in South Africa and this practice was commonly known as tax equalisation.

The expatriate employee was required to comply with the relevant tax legislation of both the host country and that of South Africa and BMW, in order to facilitate tax compliance by their expatriate employees in South Africa, had engaged the services of certain tax consultancy firms to *inter alia* complete their registration as taxpayers and assist the employees with their tax returns and it was common cause that the reason for engaging their services was that the tax regime, insofar as it applied to expatriate employees, was fairly complex.

In terms of the agreement between the expatriate employees and BMW, BMW had to instruct a tax consultancy firm, in this case KPMG, PWC and Raffray Tax Consultant CC ('the consulting firms) for taxation services and professional fees rendered by the consulting firm were paid by BMW for taxation services provided in respect of the expatriate employees of BMW.

SARS had issued assessments for the expatriate employee's tax for the period 2004-2009 on the basis that the payments to the consulting firms constituted taxable benefits which accrued to the expatriate employees in terms of par. (*i*) of the definition of 'gross income' in section 1 of the Income Tax Act read with par. 2(*e*) and 2(*h*) of the Seventh Schedule to the Act.

BMW had objected to SARS' assessments and it had disputed that the payments in issue had constituted a benefit or advantage that formed part of gross income.

BMW had explained in its objection that expatriate employees invariably remained residents in their home countries and would continue to submit tax returns in those countries.

Furthermore, the fact that the expatriate employee was required by BMW to serve in a foreign country resulted in additional costs that needed to be incurred before the expatriate employee may legally serve BMW in that country and that included work permits, visas and, in this case, the correct filing of local tax returns.

Moreover, since the expatriate employee was merely complying with the instructions of its employer, i.e. BMW, it was agreed that a so-called 'tax equalisation' process would be applied which was standard practice within BMW

group and this meant that the employee's effective rate of tax would be exactly the same as it would have been, had the employee remained in his or her home country.

After BMW's objection had been disallowed it appealed to the Johannesburg Tax Court (see *ITC 1894* 79 SATC 167 *per* Keightley J) who had found that the payments for professional fees fell within the ambit of par. (*i*) of section 1 of the Income Tax Act read with par. 2(*e*) of the Seventh Schedule to the Act.

BMW then appealed to a full bench of the Gauteng Local Division (see *BMW South Africa* (*Pty*) *Ltd* v *C:SARS* 81 SATC 157) where the court was required to determine whether or not SARS was correct in his determination that the professional fees paid by BMW to the consultancy firms amounted to taxable benefits in terms of par. (*i*) in section 1 of the Act read with par. 2(*e*) of the Seventh Schedule.

BMW had contended there that if no cash equivalent was included in the expatriate employees' remuneration, then the expatriate employees did not receive 'a benefit or advantage' and therefore par. (*i*) in section 1 of the Act did not apply.

BMW had conceded that if local employees of the BMW group were given the same services as expatriate employees then for all intents and purposes such services in respect of local employees would amount to a taxable fringe benefit. However, BMW contended that expatriate employees were different primarily because of the taxable equalisation policy to the extent that expatriate employees received the sameremuneration as if they were in their home country. The professional services rendered did not place the expatriate employees in an advantageous position and, that being so, the payments to the consultancy firms did not affect the expatriate employees' remuneration and, therefore, 'no benefit or advantage' as contemplated in par. (*i*) in section 1 of the Act was received.

BMW had further contended that the court *a quo* had incorrectly approached the matter when it compared the position of the local employees to that of the expatriate employees and it submitted that the consultancy firms had only rendered professional services to expatriate employees and not to local employees.

The full bench had agreed with the conclusions of the Tax Court and it had understood BMW's case to be that since there was no cash equivalent of the consultancy services included in the cash remuneration of the expatriate employees, no benefit or advantage as contemplated in section 1(*i*) of the Act was therefore received.

The full bench rejected BMW's submission that expatriate employees were differently placed in relation to local employees because of the tax equalisation policy and that the consulting services therefore did not place them in a more advantageous position so as to bring them within the ambit of gaining a benefit or an advantage as contemplated in section 1(*i*) of the Act.

The full bench had concluded that 'the expatriate employees received a benefit or advantage when BMW paid the tax consultancy firms for tax services.' It went on to consider whether the benefit fell squarely within the ambit of par. 2(*e*) of the Seventh Schedule to the Act and, in this regard, it had rejected BMW's contention that the consultancy services were not for the expatriate employees' private or domestic use and it found that there was no evidence that KPMG had rendered any services to BMW.

BMW, before the Supreme Court of Appeal, argued that no causal link had been shown between the employment as contemplated in par. 2 of the Seventh Schedule and 'the benefit, advantage or reward allegedly received by expatriate employees by reason of the services of the tax consultancy firms.'

BMW contended that the services of the consultancy firms were procured by it in pursuit of its tax equalisation policy and thus, so it was submitted, the firms' services were, at least in part, rendered for the benefit of BMW 'which utilised such services to ensure that it paid the correct amounts of income tax, and deducted the correct amounts of employees' tax, on behalf of expatriate employees.'

The central issue in the appeal was whether the aforementioned payments made by BMW to certain tax consulting firms in relation to services rendered to expatriate employees in respect of their domestic tax obligations, constituted a taxable benefit and consequently formed part of gross income in respect of which the employees

were liable to taxation.

Judge Navsa held the following:

(i) That it was correct that the benefit or advantage contemplated in the definition of 'gross income' in section 1(*i*) of the Income Tax Act must have been granted in respect of employment or to the holder of any office.

(ii) That the court had regard to BMW's general engagement letter of the firms of tax consultants and considered the nature of the services rendered, which included:

- Registration/deregistration of expatriate employee as a taxpayer with SARS;
- Preparation and submission of annual income tax return and review of annual income tax assessment from SARS;
- Letter of objection to address any inaccuracies reflected on the assessment and these include section 79A requests for amendment of an assessment or lodging an objection where amounts have been erroneously included or omitted by SARS from the expatriate employee's IT34 assessment;
- Preparation and submission of provisional tax returns.

(iii) That the services rendered by the firms to expatriate employee were to ensure that the latter met their obligations to SARS. It was undisputed that the amount constitutes payments by BMWSA for the services rendered to the expatriate employees. That payment was made in terms of the contract of employment. These were services that the expatriate employees would otherwise have had to pay for personally. The ineluctable conclusion is that the services provided are a benefit or advantage as contemplated by section 1 of the Act, read with par. 2(*e*) of the Seventh Schedule to the Act.

(iv) That there might have been some peripheral advantage to BMW in that the tax returns of the expatriate employers and the results of the other services rendered to them could be utilised in checking the accuracy of their own

calculation and otherwise utilising the data was irrelevant. The statement by D Davis *et al Juta's Income Tax*, Volume 3, Schedule 7, par. 2-5, and relied on by BMW, stating that 'The use must be wholly private or domestic – if used partially for the business or affairs of the employer, it falls outside this provision' was too strongly worded.

(v) That there will be instances in which benefits or advantages contemplated within section 1(i) read with the Seventh Schedule have some residual or marginal advantage for an employer. The primary question however, is whether an advantage or benefit was granted by an employer to an employee and whether it was for the latter's private or domestic purposes. In the present case the compelling conclusion is that the services were correctly valued and utilised for the employees' private or domestic purposes as contemplated by section 1 of the Act read with par. 2(*e*) of the Seventh Schedule to the Act.

(vi) That the court agreed with the Tax Court that the confirmation of the assessment will not lead to the expatriate employees being worse off in terms of their employment with BMW. In terms of their tax equalisation policy, they will have to bear the additional tax burden on behalf of the expatriate employees. BMW's policy and terms of employment cannot dictate the application of the provisions of the Income Tax Act and the conclusions by the Tax Court and the High Court confirming the assessment could not be faulted.

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

5.2. C:SARS v Pieters and others

Respondents were the liquidators of a large transport business, Slabbert Burger Transport (Pty) Ltd (the company) with its main place of business in Wellington in the Western Cape.

The company was finally wound up in the Cape Town High Court on 8 February

2013 on the basis that it was unable to pay its debts and hence its winding up was subject to insolvency law as contemplated by section 339 of the previous Companies Act.

The company had some 700 employees and their employment contracts were suspended in terms of section 38(1) of the Insolvency Act on the date of the commencement of the winding-up on 7 December 2012.

The aforesaid contracts came to an automatic end 45 days later by virtue of the provisions contained in section 38(9) of the Insolvency Act.

At the time of the commencement of the company's winding-up, leave pay had accrued to the employees.

The three Respondents were appointed provisional liquidators of the company on 12 December 2012, with their appointments made final on 19 March 2013.

Respondents had prepared a liquidation and distribution account (the L &D account) and prior to the confirmation thereof they had awarded and paid to the company's employees certain amounts which had included salaries, leave and severance pay.

Respondents did not deduct any employees' tax in accordance with par. 2 of the Fourth Schedule to the Income Tax Act and the payments totalled R9 580 319, 12.

SARS objected to the confirmation of the L & D account on the ground of the Respondents' failure to deduct employees' tax (PAYE) from the said amounts.

The Master's decision was that the Respondents were statutorily obliged to effect PAYE deductions from the payments made to the employees. He took the view that the liquidators were representative employers as contemplated in the Fourth Schedule and that PAYE was payable by them in respect of the remuneration of the employees.

Respondents then successfully approached the Western Cape Division of the High Court for the review and setting aside of the Master's decision and directions and this appeal was with the leave of the High Court.

The central issue for determination was whether payments made in terms

of section 98A of the Insolvency Act were subject to the deduction of PAYE as contemplated in par. 2(1) of the Fourth Schedule to the Income Tax Act.

It was common cause that the payments in question related to salaries, accumulated leave and severance pay.

Judge Majiedt held the following:

(i) That section 98A (salaries or wages to former employees of insolvent) was inserted into the Insolvency Act by section 2 of the Judicial Matters Amendment Act and the section affords a preference to the payment of the amounts in question to employees. The amounts are subject to limitations and the amounts presently thus determined by the Minister were relatively small and the claims of employees envisaged in section 98A(1)(*a*) need not be proved (section 98A(3)).

(ii) That par. 2(1) of the Fourth Schedule to the Income Tax Act places an obligation on an employer or a representative employer who is not a resident, to deduct or withhold from an employee's remuneration an amount of employees' tax and the court was of the view that no such obligation arose in respect of the payments made to the employees in this case.

(iii) That the preference afforded the aforesaid payments in section 98A must be understood against the backdrop of the importance of a *concursus creditorum*, which is generally recognised as a foundational concept in our law of insolvency as the object of the Insolvency Act was to ensure a due distribution of assets among creditors in the order of their preference and a liquidator is enjoined to safeguard the integrity of the *concursus creditorum* and sections 96 to 102 of the Act constitute a *numerus clausus* of the ranking of statutory preferences in respect of the distribution of the free residue.

(iv) That the provisions of section 98A of the Insolvency Act can rightly be described as having a social justice objective as they are clearly aimed at alleviating the plight of employees who are left unpaid by the financial woes of their liquidated employer company. More often than not, as the present

instance demonstrates, these would be vulnerable blue-collar employees and the Legislature plainly deemed it necessary to attenuate the impact which liquidation may have on a company's employees.

(iv) That the limited relief proffered by section 98A of the Act had the effect that employees have to stand at the end of the order of preference queue for the balance of their salaries (i.e above the three month limit and the cap) and, self-evidently, employee tax deductions would reduce the modest amounts under section 98A of the Act.

(v) That, against this backdrop, it was difficult to conceive how PAYE deductions would apply to these modest amounts, legislated to relieve the burden on vulnerable, mostly blue-collar workers, left stranded by a financially distressed employer company.

(vi) That a close analysis of par. 2(1) of the Fourth Schedule to Act led to the compelling conclusion that its provisions did not apply to section 98A payments. The insertion of section 98A into the Insolvency Act during 1998 caused a striking re-arrangement of the order of preference. Prior to its insertion, preference under certain statutory obligations (including PAYE under the Schedule) ranked above the salaries and wages of employees. That order was reversed by the insertion and the salaries and wages of employees now rank just below the costs of execution and above preference under certain statutory obligations, which includes PAYE under the Schedule and the change was plainly deliberate.

(vii) That section 99(1)(*a*)(iv) of the Insolvency Act deals with employees' tax and it provides that SARS holds a preference to 'any amount which the insolvent…has under the provisions of the Fourth Schedule to the Income Tax Act deducted or withheld by way of employees' tax from remuneration or any other amount paid or payable by him to any other person…' It was common cause that there is no indication that prior to its liquidation the company had deducted or withheld any amounts in respect of employees' tax contemplated in this section and the subsection therefore finds no application here.

(ix) That, ordinarily, PAYE would be calculated with periodic deductions utilising the relevant tax tables, based on the contemplated annual income. Liquidation would usually occur in an intervening period of a particular tax year. A correct calculation of the tax actually due or which SARS may have to refund to the taxpayer, would in such circumstances only be able to be properly calculated after the end of the tax year and this was a further reason why the Commissioner's contentions could not be upheld in the present case.

(x) That it was striking that a clear distinction was made in the definitions contained in Part 1 of the Fourth Schedule to the Income Tax Act between the trustee in an insolvent estate, who is expressly included in the definition of an 'employer' and the liquidator of a company who is expressly included in the definition of a 'representative employer.' The argument on behalf of SARS therefore fails at first base. The unequivocal distinction by the Legislature supports the earlier judgment in *Van Zyl NO* v *CIR* 59 SATC 105.

(xi) That it was forcefully contended that the interpretation advanced on behalf of SARS that section 98A payments were subject to PAYE under the Fourth Schedule would not violate the statutory order of preference in the Insolvency Act but this contention was unsound for the reasons set out earlier. There was nothing in the relevant provisions of the Fourth Schedule which bore out an intention to include a preference in the closed list of preferences in sections 96 to 102 of the Insolvency Act not expressly mentioned there.

(xii) That if the section 98A payments were to be subject to PAYE, as SARS contended, they would rank ahead of section 99(1)(*b*)(ii) PAYE amounts and this distinction in the ranking of PAYE payments is devoid of any reason and was untenable in law. The startling discrepancy does not arise if, as the court holds, section 98A payments are not subject to PAYE in terms of par. 2(1) of the Fourth Schedule.

(xiii) That section 98A(1)(*a*) merely provides that the remuneration which must

be paid ranks as a preferent claim and it does not elevate the statutory obligation to deduct PAYE as a preference above the section 98A payment.

(xiv) That the PAYE obligation cannot constitute costs of administration. PAYE is a tax on employees' remuneration. At the commencement of liquidation the employees' contracts of employment were suspended and their claim for payment in respect of each of the three categories therefore emanated from the period prior to liquidation.

(xv) That to categorize PAYE as costs of administration would have the effect that income tax, attributable to the company's trade before liquidation and which thus became payable prior to liquidation, would also be a cost of administration and that was plainly untenable.

(xvi) That, accordingly, the Master should have dismissed the objection to the Liquidation and Distribution Account.

Appeal dismissed with costs.

5.3. Wingate-Pearse v C:SARS and others

Wingate-Pearse, a businessman, was a shareholder, *inter alia*, in a mid-tier cigarette manufacturer and a member and director of various other entities with interests in the clothing industry.

The litigation in this matter emanated from additional estimated income tax assessments which the SARS had issued during April 2006 in respect of the 1998 to 2005 years of assessment being the relevant period of assessment of Wingate-Pearse.

SARS had investigated his tax affairs, had established non-compliance and had estimated his alleged under-declared taxable income for the relevant period of assessment in terms of section 78 of the Income Tax Act.

Where applicable, SARS had re-opened the original assessments older than three years as provided for in section 79 of the Income Tax Act.

Wingate-Pearse had objected to the assessments, which objections were partially disallowed, and, on 1 August 2007, he filed a notice of appeal to the Tax Court against the partial disallowance of his objections and the dispute before the Tax Court had not yet been finalised (the tax appeal).

Wingate-Pearse, almost a decade later, on 17 August 2015, launched the present review application and in terms of the notice of motion he sought a mix of declaratory and review orders in respect of various alleged actions and decisions taken by SARS. He also sought a declaratory order, a *mandamus* and a structural interdict against SARS and the Fourth Respondent, being the Minister of Finance.

Wingate-Pearse, on 19 April 2018, instituted an interlocutory application in which he applied for his notice of motion in the review application to be amended and for leave to file a supplementary founding affidavit, which affidavit was simultaneously filed.

In terms of the proposed amendment he further sought, *inter alia*, the review and setting aside of SARS' decisions to issue the additional estimated assessments for the relevant period under section 6(1) of the Promotion of Administrative Justice Act (PAJA), an extension, in terms of section 9(1), of the 180-day period prescribed in terms of section 7(1), a declaration that, insofar as he sought the review and setting aside of the impugned actions and decisions under the principle of legality, that the delay in initiating the review application was not undue, or if it was held to be undue, that condonation be granted for the undue delay, and for a declaratory order that the burden to prove that SARS was entitled to issue the additional estimated assessments rested on him and that he had the duty to begin with the leading of evidence in the tax appeal.

SARS and the Minister of Finance opposed the review application and SARS also opposed the interlocutory application.

SARS opposed it, firstly, on the grounds of procedural irregularities and, secondly, he opposed the interlocutory application on the same grounds that he had opposed the review application and, thirdly, that the amendment would still render the review application subject to preliminary objections of lack of jurisdiction and *lis*

pendens.

It was decided that the court should hear and determine both applications at the same time because of the overlapping grounds of objection.

The court proposed to deal with the relief claimed in terms of the notice of motion in its unamended form before dealing with the additional relief that was sought to be introduced in terms of the proposed amendment.

Wingate-Pearse, shortly before the hearing, gave notice that he would not be pursuing the relief sought in the original notice of motion but only the relief introduced in terms of the proposed amendment and this included, as additional relief, the review and setting aside of SARS' decisions to issue additional estimated assessments on the basis that the jurisdictional requirement for raising additional assessments in section 79(1)(*a*) and (*b*) of the Income Tax Act was not met.

SARS had investigated Wingate-Pearse's tax affairs from early to mid-2002 and he had applied for a warrant of search and seizure in terms of section 74D of the Income Tax Act and section 57D of the Value-Added Tax Act and after the introduction of the Tax Administration Act a warrant of search and seizure was issued under Part D of Chapter 5 of that Act.

After a thorough consideration of the seized documentation and an audit of Wingate-Pearse's tax affairs, SARS estimated that he had grossly under-declared his taxable income for the relevant period of assessment as he had received income from sources that he had failed to declare in his tax returns for the relevant period of assessment.

Hence, during April 2006, SARS had issued additional income tax assessments to assess Wingate-Pearse to tax on the estimated under-declared taxable income for the 1998 to 2005 years of assessment and this resulted in Wingate-Pearse's total assessed tax liability increasing from an amount of R350 142.92 to an amount of R41 725 868.29 for the relevant period of assessment.

Wingate-Pearse had filed notices of objection against the additional estimated assessments and SARS had partially allowed and partially disallowed his objections. His total assessed tax liability was reduced first to R22.7 million and

later to R9 267 630.

SARS had filed his statement of grounds of assessment on 13 June 2008 and Wingate-Pearse had filed his statement of grounds of appeal on 11 March 2009.

Wingate-Pearse, on 17 August 2015, had launched the present review application and it was his case that he had been the victim of what he described as SARS' 'covert intelligence unit' that was known as 'Tiger Group', 'Special Projects Unit' or 'SPU' or 'National Research Group' or 'NRG' or 'HRIU' (HRIU). He alleged that the HRIU was established to conduct illegal covert intelligence operations and that SARS had conducted covert surveillance operations of and concerning him and it had intercepted and monitored his communications. He contended that the operations of the HRIU had infringed several of his constitutionally protected rights and hence the relief sought in his notice of motion was appropriate to vindicate the rule of law.

Wingate-Pearse, in his notice of motion, had sought a declaratory order that the establishment by SARS of the investigating unit, HRIU, was without statutory authority, unlawful, inconsistent with the Constitution and invalid. He also contended that the search and seizure was unlawful and unconstitutional and that all documents obtained pursuant thereto were illegally obtained and all actions taken throughout the process were illegal and invalid. The notice of motion also sought the review and setting aside of SARS' decisions to apply for the warrant, to unlawfully investigate Wingate-Pearse and to unlawfully surveil and intercept his communications.

The further additional relief which Wingate-Pearse sought in terms of the proposed amendment was the addition of a new par. 6.4 to the notice of motion in which he claimed the review and setting aside of SARS' decisions to issue additional estimated assessments for the 1998 to 2005 years of assessment and in a further new par. 6B he sought a declaratory order that the delay in bringing the application for the relief set out in the notice of motion was not unreasonable, alternatively, that condonation be granted for such delay in the interests of justice.

The central themes underlying the substantive relief claimed was, firstly, the

alleged illegal intelligence gathering measures that SARS, through its HRIU, allegedly employed against Wingate-Pearse and, secondly, he again raises the alleged unconstitutionality and illegality of the search and seizure operation that followed upon the issuing of the warrant by the High Court on 30 November 2004.

Wingate-Pearse contended that SARS was not legally entitled to rely on the documents seized in its decision to issue additional estimated assessments for the relevant period of assessment as such documents could not establish the required satisfaction as contemplated in section 79(1) of the Income Tax Act for SARS to make additional assessments.

SARS contended that he had acted lawfully throughout the process that ultimately resulted in the raising of the additional estimated assessments for the relevant period of assessment. SARS had conducted an investigation into Wingate-Pearse's tax affairs; it had detected and established that he was not compliant in respect of his tax affairs for the relevant period of assessment; it took steps, including enforcement steps, as it was permitted to do in terms of the empowering legislation, including conducting an investigation into Wingate-Pearse's tax affairs, gathering information from third party sources and using such information *inter alia* to obtain a warrant for search and seizure; it issued the additional assessments after evaluation of numerous documentation obtained during the search and seizure and an audit conducted into Wingate-Pearse's tax affairs by SARS officials with the assistance of PWC and it issued the additional assessments based on what was indisputably an acceptable method of capital reconciliation.

Judge Meyer held the following:

<u>As to material disputes of fact</u>

(i) That this being motion proceedings in which final relief is sought, SARS' version should be adopted as the yardstick in determining whether Wingate-Pearse could succeed with the relief he sought.

(ii) That motion proceedings in which final relief is sought 'cannot be used to resolve factual issues because they are not designed to determine

probabilities' and the court, therefore, had to accept the facts alleged by SARS unless they constituted bald or uncreditworthy denials or were palpably implausible, far-fetched or so clearly untenable that they could safely be rejected on the papers. Such finding 'occurs infrequently because courts are always alive to the potential for evidence and cross-examination to alter its view of the facts and the plausibility of the evidence' and that test for rejecting the facts alleged by SARS was not satisfied.

(iii) That it was SARS' evidence that certain officers of the SAPS' Organised Crime Unit had approached it during early to mid-2002 with information relating to Wingate-Pearse, other individuals and various entities linked to Wingate-Pearse and SARS thereafter investigated the matter. Its investigation was based on the sharing of information as envisaged in section 73 of the Prevention of Organised Crime Act (POCA), and its role in the investigation was limited to an investigation into alleged tax non-compliance. It identified certain risks relating to income tax, VAT and Customs and Excise issues in regard to the taxpayers under investigation, including Wingate-Pearse.

(iv) That Wingate-Pearse cannot succeed with the relief he sought once the Plascon Evans rule is applied and the facts alleged by SARS accepted. The affidavits filed on behalf of SARS refute his hypothesis that there was a tainted process, a conspiracy full of malice and bias, directed at him. But there are further reasons that also compel the dismissal of his review and interlocutory applications and which have a bearing on the appropriate costs order that should be made.

<u>As to the nature of the relief claimed</u>

(v) That the premise from which Wingate-Pearse departs in his quest to have the decisions to raise the additional estimated assessments set aside, is fatally defective and bad in law.

(vi) That even if evidence is irregularly obtained, it is for the court to decide, upon the facts of each case, whether the circumstances are such that

fairness requires the evidence to be excluded.

(vii) That there are, of course, fundamental differences between civil and criminal proceedings which are of considerable importance in the context of improperly obtained evidence. Even prior to the advent of the Constitution, courts recognised a discretion, in a civil case, to exclude improperly obtained evidence.

(viii) That SARS' receipt of information relating to Wingate-Pearse from officers of the SAPS Organised Crime Unit, its decision to investigate his tax affairs, the process of investigation or the decision to apply for the warrant, could not in itself adversely affect the rights of Wingate-Pearse in a manner that had a direct and external legal effect and could hardly be said to constitute an administrative action.

(ix) That Wingate-Pearse's affidavits establish that he is disputing the correctness of the additional estimated assessments, claiming that they are materially wrong and the assessed amounts being materially overstated. Such claims are being asserted in the tax appeal and should best be determined by the Tax Court.

As to the role of the Tax Court and High Court

(x) That it followed from the nature of the disputes raised here that this court in hearing the review will have to evaluate the basis and merits of the assessments. Tax cases are generally reserved for the exclusive jurisdiction of the Tax Court in the first instance. But it is settled law that a decision of SARS is subject to judicial intervention in certain circumstances. One such circumstance is that the High Court has jurisdiction to hear and determine tax cases turning on legal issues.

(xi) That another exception is provided in section 105 of the Tax Administration Act which provided that a taxpayer was thus specifically compelled to make an election in instances where both the Tax Court and the High Court have jurisdiction. However section 105 was amended with effect from 8 January 2016 and now provides that 'a taxpayer may only dispute an assessment or

'decision' as described in section 104 in proceedings under this Chapter [dispute resolution], unless a High Court otherwise directs.' In its amended form section 105 thus makes it plain that 'unless a High Court otherwise directs', an assessment may only be disputed by means of the objection and appeal process.

(xii) That the Tax Court is a specialist tribunal composed of persons presiding who possess expertise not ordinarily possessed by a High Court judge sitting alone. The fact that the determination of Wingate-Pearse's tax appeal might entail the Tax Court considering the legality of an administrative decision, that was integral to the making of the additional estimated assessments, did not deprive that court of its jurisdiction to decide the tax appeal.

(xiii) That this is not a case in which this court ought to exercise the discretion to grant the declaratory relief sought in the paragraphs of the notice of motion under consideration. It is trite that the granting or refusal of declaratory relief is discretionary and it is a discretion that must be exercised with due regard to the circumstances of a particular case.

(xiv) That the Tax Court, consisting of a judge of the High Court, an accountant and a representative of the commercial community, is best suited at first instance to deal with the tax dispute relating to the merits of the additional estimated assessments. The tax dispute here hinges almost exclusively on the factual findings SARS had made as part of the capital reconciliation in determining Wingate-Pearse's alleged undeclared taxable income. It is a technical assessment that Wingate-Pearse wishes this court to undertake, also in the absence of proper evidence. Proof of the claim that the additional estimated assessments are materially wrong and the assessed amounts materially overstated is dependent on evidence which has not been fully and adequately ventilated in the affidavits.

(xv) That the relief that Wingate-Pearse seeks, i.e. that the conduct of SARS vis-à-vis him in utilizing any or all of the specified information in preparation for or during the conduct of the tax appeal, be declared

inconsistent with the Constitution and invalid, ought not to be countenanced. If permitted, it will invariably lead to piecemeal litigation. A further anomaly is that a parallel court is requested to issue binding orders concerning pending litigation in the Tax Court, directing what evidence it should admit or refuse and the Tax Court is the appropriate forum that may decide the question in due course.

(xvi) That the declaration sought by Wingate-Pearse i.e. that the evidence which had been obtained by SARS as a result of the issue and execution of the warrant, was obtained unlawfully, unconstitutionally, in a manner that violated his right to privacy and was inadmissible on the basis that it will render the tax appeal unfair to him and will be detrimental to the administration of justice, was not only factually unsustainable when the Plascon Evans test is applied to the factual disputes in casu, but was a continuation of his flawed premise of departure that evidence is to be excluded if any irregularity is shown to exist in the obtaining thereof.

As to the nature of SARS' discretion to raise additional assessments

(xvii) That SARS' satisfaction that any amount which should have been assessed to tax under an assessment was not so assessed or in terms of which the amount of tax assessed was less than the amount of such tax which was properly chargeable, was, in terms of section 79(1)(a) and (b) of the Income Tax Act , a prerequisite for SARS' power to raise an additional assessment. The taxpayer, however, enjoyed statutory immunity from further assessment once three years had expired since the original assessment, because the proviso to section 79(1) prohibited SARS from raising an additional assessment after the lapse of three years, unless he or she 'is satisfied' that the non-assessment was caused by the taxpayer's fraud or misrepresentation or non-disclosure of material facts. Section 92 of the Tax Administration Act empowered SARS to make an additional assessment if he 'is satisfied' that an assessment does not reflect the correct application of a tax Act to the prejudice of SARS or the fiscus.

(xviii) That Wingate-Pearse contended that the 'satisfaction' contemplated in

section 79(1) of the Income Tax Act and now in section 92 read with section 99 of the Tax Administration Act , sets a very high hurdle for SARS to jump before it may re-open an original assessment and issue an additional one. SARS, he contends, must be satisfied on reasonable grounds, which test according to him is objective, that the original assessment was 'wrong.' He argued that SARS had re-opened the assessments for the relevant period of assessment on the basis that the full amount of the tax chargeable was not assessed due to fraud, material representation or non-disclosure of material facts on his part. He contended that SARS' allegations of fraud, misrepresentation and non-disclosure 'are very heavy allegations that require substantial evidence' and are 'not lightly inferred', which evidentiary burden had not been met.

(xix) That Wingate-Pearse had read too much into Natal Estates Ltd v Secretary for Inland Revenue and Secretary for Inland Revenue v Trow as those judgments did not support his argument on how the jurisdictional prerequisite of SARS' satisfaction for its power to make an additional assessment must be met: whether the jurisdictional fact is objective or subjective.

(xx) That since the advent of the constitutional era, more than the decision-maker's ipse dixit is now required if the subjective prerequisite of his or her being satisfied that a state of affairs exists, is challenged. Section 33(1) of the Constitution implied that the court must be satisfied of the lawfulness of administrative action, including any factual assumptions on which the action is based and that the constitutional principle of legality is to the same effect in relation to the exercise of public powers that do not amount to administrative action. More is now required if the decision-maker's opinion is challenged on the basis that the subjective precondition did not exist. The decision-maker must now show that the subjective opinion it relied on for exercising power was based on reasonable grounds.

(xxi) That subjective language will still be capable of signalling the legislature's desire for deference on the part of the courts in particular cases. That is as

it should be. The real challenge for our courts is to achieve an appropriate balance between heeding that voice and protecting the rights of affected persons.

(xxii) That what will constitute a reasonable decision will depend on the circumstances of each case, much as what will constitute a fair procedure will depend on the circumstances of each case. The court should take care not to usurp the functions of administrative agencies. Its task is to ensure that the decisions taken by administrative agencies fall within the bounds of reasonableness as required by the Constitution. The use of the word 'deference' may give rise to misunderstanding as to the true function of the review Court. This can be avoided if it is realised that the need for courts to treat decision-makers with appropriate deference or respect flows not from judicial courtesy or etiquette but from the fundamental constitutional principle of the separation of powers itself.

(xxiii) That although the words 'is satisfied' used in section 79(1) of the Income Tax Act and now in section 92 read with section 99(1) and (2) of the Tax Administration Act, confer a subjective discretion on SARS, it is accepted that the discretion is not unfettered, and an objective approach must be adopted to that subjective discretion. SARS therefore must show that his subjective satisfaction was based on reasonable grounds. The raising of an additional assessment in the case of income tax 'must be based on proper grounds for believing that there is undeclared income or a claim for a deduction or allowance that is unjustified.' (C:SARS v Pretoria East Motors (Pty) Ltd 76 SATC 293). However, given the wording of section 79(1) and presently of section 92, and the subjective nature of the discretion conferred on SARS, the scope for judicial review is limited.

(xxiv) That SARS' additional estimated assessments were issued after evaluation of numerous documentation obtained during the search and seizure and an audit conducted into Wingate-Pearse's tax affairs by SARS' officials with the assistance of PWC and it raised the additional assessments based on an acceptable method of capital reconciliation. Applying the Plascon

Evans test to the factual disputes in casu, it must be accepted that the additional assessments were issued pursuant to due process involving the engagement of external expertise from PWC.

(xxv) That there was nothing untoward when SARS reduces a taxpayer's assessment when new information comes to light. Section 93 of the Tax Administration Act now specifically provides for instances where SARS may issue a reduced assessment and such is the scheme of the Act.

(xxvi) That the resultant substantial increase in Wingate-Pearse's assessed tax liability for the relevant period of assessment inferentially establishes SARS' required satisfaction that the full amount of tax chargeable was not assessed due to fraud or material misrepresentation or non-disclosure of material facts and the statutory immunity enjoyed by him from further assessment was thus displaced.

(xxvii) That, having regard to the subjective nature of the discretion conferred on SARS and the limited scope for judicial review as well as the principles enunciated in Bato Star, and giving due weight to the finding made by those with special expertise in taxation and accountancy, SARS' decision to issue the additional estimated assessments can, in all the circumstances, not be said to be one that a reasonable decision-maker could not reach. SARS' required subjective satisfaction has been shown to have been founded on reasonable grounds.

(xxviii) That, in regard to the application of the principle of audi alteram partem, ie that SARS had allegedly raised the additional estimated assessments without taking Wingate-Pearse's responses into account, the court was of the view that there was also no merit in this ground of review. There was at the time when SARS raised the additional assessments no statutory right afforded to a taxpayer to be informed of audit findings before an assessment was raised and to respond in order to avoid the assessment. Such rights are now afforded to a taxpayer in terms of section 42 of the Tax Administration Act. Furthermore, on SARS' version it did substantially comply with the common law requirement of audi alteram

partem in that Wingate-Pearse was granted opportunities to comment on the additional assessments and, where he provided grounds that SARS considered sound, these were accepted by SARS.

(xxix) That with effect from 8 January 2016 section 105 of the Tax Administration Act provides that a taxpayer requires the direction of the High Court to dispute an assessment outside the dispute resolution provisions of the Act but here Wingate-Pearse is attempting to dispute the estimated assessments in the Tax Court and in the High Court, which cannot be countenanced.

As to the delay in the initiation of the review application

(xxx) That Wingate-Pearse sought a declaration that, insofar as he sought the review of SARS' impugned actions and decisions under the principle of legality, the delay in the initiation of the review application was not unreasonable, or if the delay was held to be undue or unreasonable, that condonation be granted for the delay in the interests of justice and, insofar as he sought the review of the impugned actions and decisions under PAJA, an extension in terms of section 9(2) of PAJA of the 180-day period prescribed in terms of section 7(1) of the Act. The issue of unreasonableness is pre-determined by the Legislature in that a delay exceeding 180 days is unreasonable per se and a court is then only empowered to entertain a review application under PAJA if the interests of justice dictate an extension in terms of section 9.

(xxxi) That insofar as the review application is brought under PAJA, the delay of almost a decade is unreasonable per se. However, an enquiry into the reasonableness remains relevant and the extent of the unreasonableness a factor to be taken into account in determining whether an extension should be granted or not. Application of the undue delay rule in a legality review requires, as a first step, an enquiry into the reasonableness of the delay and it was thus to the question of reasonableness of the delay that the court turned.

(xxxii) That an acceptable explanation, let alone one that covered the entire period of the inordinate delay, was lacking. Where the delay is not satisfactorily explained and justified, as in this case, it is not reasonable. Having regard to all the circumstances of this case and given the extent of the unreasonableness of the delay, the lack of merits of the challenges under PAJA and under the legality principle, the sound judicial policy and public interest requirement that there be finality and certainty in matters, and the prejudice to SARS in its ability to address Wingate-Pearse's contentions evidentially as a result of the inordinate delay. The court was also unable to hold that the interests of justice dictated that an extension in terms of section 9 of PAJA should be granted or that the undue delay should be overlooked and there was no sound basis established for condoning or overlooking the undue or unreasonable delay.

As to the award of costs

(xxxiii) That no good grounds exist for a departure from the general rule that costs follow the event, in other words that the successful party should be awarded its costs. The court was unable to hold that the litigation was undertaken to assert constitutional rights. It was undertaken rather to assert the financial interest of Wingate-Pearse and it was not persuaded that the rule that unsuccessful litigants who have sought, in good faith, to vindicate constitutional rights, ought not to have costs awarded against them, should find application in this case and SARS as the overall successful party is clearly entitled to its costs.

(xxxiv) That, however, the court had to consider SARS' request that costs should be awarded on the scale applicable as between attorney and client.

(xxxv) That this was such a case where the proceedings are vexatious in effect and SARS has been put to unnecessary trouble and expense which it ought not to bear. This conclusion is inevitable when regard is had to the manner in which Wingate-Pearse elected to prosecute the review application, inter alia: in instituting it almost a decade after the alleged events had occurred and the alleged actions and decisions had been taken by SARS and in only

seeking condonation for the inordinate delay almost three years after the institution of the review application without giving an acceptable explanation for the inordinate delays. Justice, in the view of the court, required that SARS should not be out of pocket in respect of the expenses caused to it by this litigation.

Review application was dismissed with costs on the attorney-and-client scale.

Interlocutory application dated 4 April 2018 was dismissed and Wingate-Pearse was to pay SARS' costs of opposition on the attorney-and-client scale, including those of two counsel.

5.4. ITC 1923 – Section 13quin

The taxpayer, being an investment entity, had purchased a commercial property in August 2001 which generated rental income and appellant had, from 2007 to 2012 effected capital improvements to the property.

The taxpayer had never claimed the commercial building allowance in terms of section 13*quin* of the Income Tax Act in the years of assessment between 2007 and 2012 and only in the 2014 year of assessment did the taxpayer claim the section 13*quin* allowance for all those years of assessment.

SARS had disallowed the taxpayer's claim for the commercial building allowance in respect of the 2007–2012 years of assessment and had only allowed the claim for the commercial building allowance in respect of the 2014 year of assessment.

SARS had also imposed interest on the amounts it claimed to be due by the taxpayer and the taxpayer had also appealed against the interest assessed.

SARS had accordingly issued an additional assessment against the taxpayer reflecting the aforesaid decision and the taxpayer appealed against it.

It was not in dispute that the taxpayer was entitled to claim the commercial building allowance in terms of section 13*quin* and neither were the amounts submitted by the taxpayer in dispute.

The issue before the court was whether the taxpayer was entitled to claim the commercial building allowance in terms of section 13*quin* and, in particular, whether section 13*quin*(3), correctly interpreted, allowed for the deduction of the building allowance to which a taxpayer was entitled in the previous year of assessment in a subsequent year of assessment as long as it was not claimed in that previous year.

The taxpayer contended that it had not claimed the commercial building allowance as provided for by section 13*quin* of the Income Tax Act 58 of 1962 between the periods 2007 and 2012 and was therefore entitled to claim same together with the 2013 year of assessment in the 2014 year of assessment.

The taxpayer further contended that it was not its fault that it did not claim the allowance as described as it had not been properly advised by its former accountant to do so.

Moreover, it contended that SARS would not be prejudiced if it were to allow the aforesaid deductions as it would recoup the allowances when the taxpayer sold the property.

The taxpayer further contended that the purpose of introducing section 13*quin* was to put the taxpayer in the same position as other taxpayers who benefit from allowances granted for movable assets and section 13*quin*(3) was ambiguous and therefore needed to be interpreted in favour of the taxpayer.

The taxpayer also contended that, on a proper interpretation of section 13*quin*(3), a taxpayer was entitled to claim allowances for the previous years of assessment relating to the building or improvements as provided for in section 13*quin*.

SARS submitted that the taxpayer had failed to tender any evidence to establish that section 13*quin*(3) was ambiguous and therefore the taxpayer could not invoke the *contra fiscum* rule.

It was also contended that the taxpayer had declared its income for the 2007 to 2012 years of assessment and therefore the provisions of section 13*quin*(3) come into play for those periods.

Tax was an annual event and was for that particular year and therefore, as a deeming provision, section 13*quin*(3) should apply in the case of the taxpayer.

SARS further contended that when considering the provisions of section 13*quin*, it was impermissible for the taxpayer to claim a lump sum of the improvements for the 2008 to 2012 years of assessment and the building allowance for the 2013 year of assessment in the 2014 year of assessment.

SARS contended that it was clear from the provisions of section 13*quin*(3) that if the allowance could not be claimed because the receipts and accruals of the taxpayer were not included in its income, the allowance was nonetheless deemed to have been claimed and allowed and the deeming provision merely provided the taxpayer, who qualifies, to apply the allowances as and when it has to recoup it in terms of section 8(4) of the Act, but does not grant an automatic right to a taxpayer to deduct the previous years' allowances in a subsequent year of assessment.

Judge Twala held the following:

(i) That it was trite that section 13*quin* of the Act was introduced to provide for capital allowances in respect of immovable property depending on the use of the property and the section provided for allowances in respect of commercial buildings that are owned by the taxpayer and used solely for the purpose of the taxpayer's trade.

(ii) That in the present case the crisp issue was whether section 13*quin*(3), correctly interpreted, allowed for the deduction of the building allowance to which a taxpayer was entitled in the previous year of assessment in a subsequent year of assessment as long as it was not claimed in that previous year.

(iii) That the court found itself unable to agree with the taxpayer's contentions. The provisions of section 13*quin*(3) are clear and plain and need not be interpreted any further than the words used in the provision itself and it was clear that if the receipts and accruals were not included in the income of the taxpayer during the previous year of assessment, any deduction which could have been allowed in terms of section 13*quin* during that year shall be deemed to have been allowed in that year and therefore it would be

distorting the meaning of the deemed provisions in section 13*quin*(3) to interpret it otherwise.

(iv) That the court then referred to several judgments of the Supreme Court of Appeal cited in *Novartis* v *Maphil* [2015] ZASCA 111 dealing with the principles of interpretation and stressed that the interpretative process was one of ascertaining the intention of the parties and what they meant to achieve and in doing that the court must consider all the circumstances surrounding the contract to determine what their intention was in concluding it and that a commercial construction is likely to give effect to the intention of the parties and words ought therefore to be interpreted in the way in which the reasonable person would construe them.

(iv) That the court was unable to disagree with SARS that the provisions of section 13*quin* should be construed in the context of the other provisions of the Income Tax Act and, furthermore, the taxpayer had failed to demonstrate that the provisions of section 13*quin*(3) were ambiguous and capable of a different meaning than that ascribed to it and there was no cogent reason why the provisions of section 13*quin*(3) should be interpreted differently from the ordinary meaning of the words used in the provision and to look at them in the context of the whole Act.

(v) That, in regard to the definition of 'year of assessment' in section 1(1) of the Income Tax Act, the court understood the authority as set out in *New Adventure Shelf 122* (*Pty*) *Ltd* v *C:SARS* 79 SATC 233 to mean that tax is an annual event and the year of assessment as the period in respect of which a tax is chargeable.

(vi) That in the light of the taxpayer's failure to claim the building allowances in the 2007 to 2012 years of assessment, the provisions of section 13*quin*(3) deem the allowance as having been claimed and allowed as a deduction for the past years of assessment.

(vii) That, accordingly, the court was unable to disagree with SARS that the taxpayer was precluded from claiming the deduction of the building allowances for the period 2007 to 2012 and it did not make any business

sense for the taxpayer to claim a lump sum after having incurred the expenses over a period of five years and the deeming provisions were inserted in section 13*quin*(3) to prevent taxpayers from delaying in applying for these deductions and to avoid unnecessary cash flow problems.

(viii) That, in regard to the imposition of interest in terms of section 89 of the Income Tax Act, the provisions of section 89(2) made it clear that interest shall be paid by the taxpayer at the prescribed rate on the outstanding balance of such tax in respect of each month. On 27 January 2016 an additional assessment was issued by SARS and that amount of tax remained unpaid and has, in terms of the provisions of section 89, attracted interest at the prescribed rate in respect of each month that it remained outstanding.

Appeal dismissed.

5.5. ITC 1924 – Rule 56, default proceedings

SARS had issued a revised assessment to the taxpayer on 28 November 2013 which was based on the under-declaration of its income.

The taxpayer had objected to the assessment in its Notice of Objection dated 13 June 2014 which had then been disallowed by SARS on 29 October 2014.

The taxpayer, on 19 November 2014, had filed a Notice of Appeal in the Tax Court.

SARS filed his Statement of Grounds of Assessment and opposed the Appeal on 18 July 2017 in terms of rule 31(2) of the Tax Court Rules.

The taxpayer, having received SARS' Statement in terms of rule 31(2), had failed to deliver its rule 32 Statement of Grounds of Appeal within 45 business days of receiving SARS' Statement and which was a specific requirement of the rule had requested an extension of time of almost one year in which to file its rule 32 Statement of Grounds of Appeal until 30 April 2018 and SARS had granted an extension until 15 December 2017 only but the taxpayer's Statement had still not been delivered.

The taxpayer did not apply to the Tax Court for any further extension and on 16 February 2018 SARS filed a notice in terms of rule 56(1)(*a*) which provided for an application for default judgment in the event of non-compliance with the Rules by the other party.

SARS, on 24 July 2018, had filed his application for default judgment in terms of rule 56(1)(*b*) read with section 129(2) of the Tax Administration Act and no response had been forthcoming from the taxpayer.

The taxpayer was then ordered by the Tax Court to deliver its Statement by no later than 27 February 2019, but it did not do so.

Rule 56(1)(*b*) provided that if the defaulting party failed to remedy the default within the prescribed period, the other party could apply, on notice to the defaulting party, to the Tax Court for a final order under s 129(2) of the Act.

The Tax Court heard SARS' rule 56 application on 27 February 2019 and on that date the taxpayer served and filed an application for condonation, postponement and other relief.

The issue before the court was whether SARS was entitled to default judgment and to have his assessment confirmed.

Judge Daffue held the following:

(i) That the taxpayer's rule 32 Statement of Grounds of Appeal did not have to be accompanied by any documentation and the taxpayer had sufficient information with which to lodge an objection and it was also not entitled to expand its grounds of appeal beyond that contained in its objection.

(ii) That rule 36 provided for discovery of documents and the taxpayer should have made use of this rule if it had believed that it needed documents in order to comply with rule 32. The taxpayer failed to act accordingly but in its application relief was also sought to the effect that SARS should comply with rule 36 and this was a totally wrong approach.

(iii) That, notwithstanding legal representation, the taxpayer failed to comply with its statutory duties and, more importantly, had disobeyed an order of court without providing any substantial reason for its non-compliance.

(iv) That the taxpayer had intentionally been delaying the legal processes and again on the morning of 27 February 2019 had tried to gain time in order to prevent the matter from being finalised.

(iv) That it was accepted that the taxpayer had a right to have its dispute resolved in a court of law as enunciated in section 34 of the Constitution but it could not rely on such right when it was using delaying tactics all the time and was preventing the appeal from being heard.

(v) That the Constitutional Court had held recently (see *Psychological Society of SA* v *Qwelane* 2017 (8) BCLR 1039 (CC)) that an application for postponement was not there for the taking and even if the parties agreed to a postponement, the court may insist on dealing with the matter and refuse a postponement.

(vi) That, clearly, the taxpayer's application for a postponement had not been timeously made and it was, in any event, not properly motivated and substantiated.

(vii) That, accordingly, SARS was fully entitled to proceed in the manner he did, i.e. to apply for default judgment against the taxpayer who had not complied with the dispute resolution rules in order to obtain finality.

(viii) That, accordingly, the taxpayer's application for condonation and postponement was dismissed with costs and the assessments were confirmed in terms of section 129(2) of the Tax Administration Act.

Application dismissed with costs.

6. INTERPRETATION NOTES

6.1. Connected Persons – No. 67 (Issue 4)

This Note provides guidance on the interpretation and application of the definition of 'connected person' in section 1(1).

Section 1(1) of the Value-Added Tax Act contains a definition of 'connected persons'. Apart from the fact that the term is defined in the plural, there are a

number of other significant differences between the value-added tax definition and the income tax definition. For example, the value-added tax definition includes the estates of deceased and insolvent persons, a partnership, and in specified circumstances, a branch or division of a person, while the income tax definition does not. Although the two definitions share some common features, this Note focuses on the income tax definition only and should not be relied on for purposes of interpreting the value-added tax definition.

Section 1 of the TA Act defines 'connected person' as meaning 'a connected person as defined in section 1 of the Income Tax Act'.

The Income Tax Act 113 of 1993 introduced the definition of 'connected person' into section 1. This definition is central to specific anti-avoidance provisions that regulate the tax consequences of transactions entered into between related taxpayers. Such related-party transactions are more likely to be open to manipulation in order to secure a fiscal advantage than transactions entered into between unconnected parties, hence the need for specific rules to deal with connected persons.

The definition of 'connected person' in section 1(1) identifies those persons that are connected persons in relation to the following persons:

- A natural person
- A trust
- A connected person in relation to a trust
- A member of a partnership or foreign partnership
- A company
- A close corporation

The definition of 'connected person' also establishes the reverse relationship between the persons that are connected persons in relation to the above persons.

For the purposes of the definition of 'connected person', a portfolio of a collective investment scheme is excluded from a trust and treated as a company.

A deceased estate is deemed to be a natural person under section 25(5) except for the purposes of the rebates under sections 6, 6A and 6B. Under paragraph 40(3) of the Eighth Schedule, the disposal of an asset by the deceased estate of a natural person is treated in the same manner as if that asset had been disposed of by that natural person. Thus, for the purposes of the Eighth Schedule, the disposal of an asset by the deceased estate to a relative of the deceased person would be treated as a disposal to a connected person in relation to the deceased estate.

Under paragraph 83(1) of the Eighth Schedule, the disposal of an asset by the insolvent estate of a person whose estate was sequestrated must be treated in the same manner as if that asset had been disposed of by that person. Thus, for the purposes of the Eighth Schedule, the disposal of an asset by the insolvent estate to a connected person in relation to the natural person whose estate was sequestrated, will be treated as a disposal between connected persons.

A deceased or insolvent estate would be a connected person in relation to a trust under paragraph (b)(i) if it was a beneficiary of that trust, making the trust a connected person in relation to the deceased or insolvent estate under paragraph (e). Other beneficiaries of the trust and the deceased or insolvent estate would be connected persons in relation to one another under paragraph (bA). A deceased or insolvent estate could be a connected person in relation to a company or a close corporation under paragraph (d)(iv) and (vi), making the company or close corporation a connected person in relation to the deceased or insolvent estate under paragraph (e).

The holders of shares in a company are not connected persons in relation to one another by virtue of their holding of shares but may be connected through another relationship which would bring them within one of the paragraphs of the definition of 'connected person'.

The wording of a particular provision of the Act will determine the time at which the existence of any 'connected person' relationship must be determined. It will also determine whether an expanded or restricted meaning of the term as defined in section 1(1) must be applied.

6.2. Exemption from income tax: Foreign employment income – No. 16 (Issue 3)

This Note discusses the interpretation and application of the foreign employment remuneration exemption in section 10(1)(o)(ii).

The exemption under section 10(1)(o)(ii) was introduced in 2000 to prevent double taxation of an individual's income between South Africa and a host country. The exemption creates opportunities for double non-taxation in instances where the host country imposes little or no tax on employment income. This outcome is contrary to the purpose for which the exemption was introduced. It was originally indicated that the impact of the exemption would be monitored with specific focus on whether the exemption is unduly exploited resulting in no foreign tax on foreign employment income. From 1 March 2020 and in respect of years of assessment commencing on or after that date, foreign employment income earned by a tax resident of South Africa will no longer be fully exempt as the exemption under section 10(1)(o)(ii) will be limited to R1 million. Any foreign employment income earned over and above R1 million will be subject to normal tax in South Africa, applying the normal tax rates for the particular year of assessment. All requirements to qualify for the exemption under section 10(1)(o)(ii) remain the same.

The Note discusses the requirements to qualify for the exemption under section 10(1)(o)(ii). The impact of the limitation of the exemption and the correct method of apportionment is also examined, as well as how the exemption affects gains included in income upon the vesting of any equity instrument under section 8C.

6.3. Exclusion of certain companies and shares from a 'group of companies' as defined in section 41(1) – No. 75 (Issue 3)

This Note provides guidance on the application of the proviso to the definition of

'group of companies' in section 41(1).

Under specified circumstances the corporate rules provide relief from income tax when assets are disposed of between companies forming part of the same 'group of companies' as defined in section 41(1). Generally these relief measures defer the income tax on income and capital gains until the asset is disposed of to a third party or until a degrouping occurs. The Act contains two definitions of 'group of companies', namely, a wider definition in section 1(1) and a narrower definition in section 41(1). The narrower definition generally applies for the purposes of the corporate rules but is also used elsewhere in the Act.

The definition in section 41(1) starts with the definition in section 1(1) and then proceeds to exclude specified companies and shares by way of a proviso. This Note is concerned with the application and effect of that proviso.

It is impermissible to interpret the proviso as an independent enacting clause and its provisions must be read as if they formed part of the opening words of the definition of 'group of companies' in section 41(1). The exclusion by the proviso of, for example, a controlling company from a group of companies will accordingly impact on whether its controlled companies remain part of a group of companies under the corporate rules. The exclusion of non-resident companies by the proviso does not constitute discrimination under South Africa's tax treaties.

6.4. Public benefit organsations: Capital gains tax – No. 44 (Issue 3)

This Note:

- provides guidance on the application and interpretation of paragraph 63A which deals with the disregarding of a capital gain or capital loss on the disposal of an asset by a PBO; and
- must be read with Interpretation Note 24 'Income Tax: Public Benefit Organisations: Trading Rules – Partial Taxation of Trading Receipts'.

PBOs became subject to a system of partial taxation with effect from years of assessment commencing on or after 1 April 2006. Under this system a PBO conducting trading activities falling outside the parameters of the prescribed exemptions in section 10(1)(cN), is taxable on receipts and accruals from those activities but retains exemption for its PBAs.

For earlier years of assessment PBOs, once approved under section 30, were generally fully exempt from normal tax on their receipts and accruals and taxable capital gains, regardless of the source from which they were derived. The two key provisions giving effect to the system of partial taxation are section 10(1)(cN) and paragraph 63A (capital gains and capital losses).

For more information on the background to CGT and PBOs before the insertion of paragraph 63A, see issue 1 of this Note which can be found on the SARS website under Legal Counsel / Legal Counsel Archive / Interpretation Notes.

Any capital gain or capital loss made on the disposal of an asset, substantially the whole of which has not been used in the carrying on of a PBA, must be taken into account for CGT purposes.

This Note applies broad principles in interpreting the legislation. Since the facts and circumstances pertaining to specific PBOs may differ, each case must be considered on its own merits.

6.5. Apportionment of surplus and minimum requirements – Pension Funds Second Amendment Act – No. 113

This Note provides clarity on the tax treatment of the actuarial surplus allocations or distributions made to members, former members, existing pensioners and employers by funds under the provisions of sections 15B, 15C, 15D or 15E of the Pension Funds Act.

General Note 29 and Addendum A thereto are hereby withdrawn.

The definition of 'actuarial surplus' and sections 15A to 15K were inserted into section 1 of the Pension Funds Act with effect from 7 December 2001. These

changes enabled a fund to apportion any actuarial surplus between the employers, members, former members and existing pensioners of that fund.

The first surpluses were determined at the effective date of the first statutory actuarial valuation of the fund following 7 December 2001. The first surplus determined is normally referred to as the past surplus.

Section 15B of the Pension Funds Act governs the distribution of the past surplus determined at the surplus apportionment date. The board of trustees of the fund had to determine how the past surplus should be distributed and allocated among the employer, former members, current members and pensioners of a fund. The surplus apportionment scheme had to be approved by the Registrar of Pension Funds before any distribution or allocation could be implemented. There is a difference in the tax treatment of the past surplus distributed and allocated in terms of surplus apportionment schemes approved before 1 January 2006, and schemes approved on or after 1 January 2006.

Paragraph 2C was inserted with effect from 1 January 2006 and provides that surplus distributions that accrue to a taxpayer on or after 1 January 2006, as a result of a surplus apportionment scheme approved on or after that date by the Registrar of Pension Funds, must not be included in the taxpayer's 'gross income'.

Any subsequent actuarial surplus arising in a fund following the approval of the surplus apportionment scheme by the Registrar of Pension Funds is referred to as 'future surplus' and is apportioned under section 15C of the Pension Funds Act.

This Note explains the tax treatment of distributions in terms of past surplus for the two different periods, before 1 January 2006 and on or after 1 January 2006, as well as the tax treatment of the future surplus distributions.

The tax treatment of actuarial surplus allocations or distributions to a member, former member or pensioner depends on whether or not the actuarial surplus is allocated or distributed under a surplus apportionment scheme.

6.6. Limitation of allowances granted to lessors of affected assets – No. 53 (Issue 3)

This Note provides clarity and guidance on the application of section 23A, which ringfences specified capital allowances granted to a lessor for certain aircraft, ships, machinery, plant, implements, utensils and articles ('affected assets').

Section 23A limits the deduction of specified capital allowances on affected assets to a lessor's taxable income derived from the letting of these assets, before taking into account the specified capital allowances. Any specified capital allowances not allowed because of the limitation are carried forward to the next year of assessment and, subject to any section 23A limitation, are available for deduction against any net rental income from the letting of affected assets. Disallowed capital allowances are thus ringfenced, and cannot be deducted against other taxable income earned by the taxpayer.

Section 23A limits capital allowances claimed by a lessor under sections 11(e) and (o), 12B, 12C, 12DA, 14bis or 37B(2)(a) on any 'affected asset' to the net rental income derived from the letting of those assets. The limitation does not apply to an asset let under an 'operating lease' or any asset mainly used during the year of assessment by the lessor in the ordinary course of trade other than letting of such asset. The exclusion from an affected asset, and therefore section 23A, for assets leased under an operating lease does not apply to letting of assets in carrying on the business of banking, financial services or insurance. In determining net rental income from letting affected assets, expenditure relating to both rental income and other income must be apportioned on a reasonable basis. Any specified capital allowances disallowed are carried forward to the succeeding year of assessment when they will again be considered for deduction, subject to limitation under section 23A(2).

7. DRAFT INTERPRETATION NOTES

7.1. Doubtful debts

This Note provides guidance on calculating the section 11(j) doubtful debt allowance. Background Section 11(j) provides an allowance to taxpayers for debts that are due but are considered to be doubtful. Under the previous wording of section 11(j), this section applied to all taxpayers with SARS having the discretion to determine the amount of the debt that was considered doubtful. In practice, SARS generally allowed 25% of a taxpayer's listed doubtful debts as doubtful debt allowance. Taxpayers could apply to SARS for an increased doubtful debt allowance based on their specific facts and circumstances. Owing to the ongoing process to prepare for an income tax selfassessment system and IFRS 9 coming into effect, section 11(jA) was introduced and section 11(j) was subsequently amended. Under the amended section 11(j), the calculation of the allowance that taxpayers (excluding those taxpayers to which section 11(jA) applies) may claim in respect of doubtful debts depends on whether the taxpayer applies IFRS 9 to the debt for financial reporting purposes or whether IFRS are not applied to the debt for financial reporting purposes. The proviso to section 11(j)(i) and (ii) gives SARS the discretion to approve an increase to some of the percentages specified in section 11(j) that are used in calculating the doubtful debt allowance to a percentage not exceeding 85%. A detailed discussion of the workings of IFRS 9 exceeds the scope of this document. It is, however, necessary to provide some discussion and context as IFRS 9 is referenced in section 11(j)(i) for purposes of determining the doubtful debt allowance for a taxpayer that applies IFRS 9 to the debt for financial reporting purposes. Before the introduction of IFRS 9, doubtful debt provisioning for financial reporting purposes was based on IAS 39. IAS 39 models relied on past observations with the further requirement of estimating future recoveries. Following the global collapse of financial institutions, the International Accounting Standards Board set out to correct the perceived weakness of delayed recognition of credit losses on loans and other financial instruments. The International Accounting Standards Board introduced IFRS 9 replacing IAS 39.

While IAS 39 was based on an incurred loss model, IFRS 9 introduced a forward-looking 'expected loss' model, which includes the incorporation of forward-looking information in the recognition of impairments on debts considered doubtful.

Taxpayers that have debts due to them that are considered doubtful are entitled to an allowance in respect of such doubtful debts. The calculation of the allowance for doubtful debts is dependent on whether the taxpayer applies IFRS 9 to debts due for financial reporting purposes or not. The default allowances are 25% and 40% of the base specified in the Act depending on various factors. Taxpayers may apply to SARS for an increased percentage allowance in case of debt initially falling into the category that qualifies for a 40% rate; the increased percentage is limited to 85%. These applications must be made in the manner as prescribed by SARS from time to time.

7.2. Public benefit organisations: Provision of residential care for retired persons

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

Institutional care of older persons1 was in the past prioritised by government and nongovernmental organisations resulting in the establishment of old age homes and care centres. Government policy, however, shifted the emphasis to:

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

The care for older persons has therefore become the responsibility of every citizen.

Older persons who can afford to do so therefore may choose to live in housing schemes built to meet their particular needs, to maintain relative independence and

to secure a comfortable quality of life. These housing schemes typically comprise housing units that range from freestanding houses with private gardens to multi-storey apartments, or flats, or a combination of these. The housing schemes are also normally walled or fenced off to form a separate village or complex and may offer communal facilities such as gyms, tennis courts, swimming pools and bowling greens as well as community centres and laundry services.

Although section 30 or the Ninth Schedule does not define or refer to 'older persons', PBAs aimed specifically at older persons are included in the Ninth Schedule, namely, the:

- care or counseling of poor and needy persons where more than 90% of those persons to whom the care or counseling are provided are over the age of 60 (this PBA will not be discussed in this Note); and
- provision of residential care for retired person if certain requirements are met.

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

- it provides residential care for retired persons;
- more than 90% of the retired persons to whom residential care is provided are over the age of 60;
- nursing services are provided by that organisation;
- residential care for retired persons who are poor and needy is actively provided by that organisation;
- the organisation does not recover the full cost of providing residential care for retired persons who are poor and needy; and
- the receipts and accruals derived by the organisation providing residential care meet the requirements of section 10(1)(cN)(ii).

An organisation bears the onus of proving that it complies with the requirements

relative to the approval as a PBO carrying on PBA 3(c) as discussed in this Note 52 and must retain the necessary evidence to support the view taken.

The burden may be discharged by way of supporting evidence submitted by the organisation, provided such evidence is reasonable.

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

7.3. Withholding tax on interest

This Note deals with the interpretation and application of sections 50A to 50H relating to withholding tax on interest.

South African residents sometimes engage in cross-border transactions either for a trade or a non-trade purpose. Some of these transactions are entered into for the purpose of raising foreign debt capital. The debt capital often incurs an interest charge with the result that repayments comprise both a return of the borrowed capital and the interest incurred. The interest charge incurred may result in a deduction for the resident taxpayer (if legislative requirements are met) while the corresponding interest income may be exempt from tax for the recipient by virtue of section 10(1)(h). This situation results in the erosion of the domestic tax base. In order to address this loss of income to the fiscus, a withholding tax on interest paid to or for the benefit of a foreign person was introduced with effect from 1 March 2015.

The withholding tax on interest provisions were previously contained in sections 37I to 37O. These sections were deleted before they became effective and replaced with sections 50A to 50H. Before the introduction of withholding tax on interest, the South African tax system provided (and still provides) for a blanket income tax exemption for interest payable to non-residents under section 10(1)(h), subject to two exceptions relating to physical presence in South Africa.

The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010

explains the rationale for introducing withholding tax on interest as follows:

> '[T]he current blanket interest exemption does not achieve a fair balance between the attraction of foreign debt capital and the need to protect the tax base against potential erosion. The exemption is also not in line with global practice. Most developed and emerging economies currently exempt cross-border interest relating to mobile portfolio debt (and possibly incidental trade finance). Other forms of cross-border debt remain fully taxable (and subject to a flat rate form of withholding). More generous forms of exemption typically exist only through tax treaties where both countries believe that the cross border interest will remain subject to a relatively high level of global tax. Hence the current blanket exemption employed via domestic South African tax legislation appears to be overly generous from a competitive point of view.'

A prerequisite for the imposition of withholding tax on interest is that the interest must be from a South African source. The withholding tax on interest is a final tax currently levied at a rate of 15%, which may be reduced by the application of a tax treaty. In addition to a legislative amendment to the rate of withholding tax on interest, the Minister may announce a new rate of withholding tax on interest in the national annual budget which will be effective from the date mentioned as the effective date in the Minister's announcement. The new rate will apply for a period of 12 months from the effective date as announced by the Minister pending the passing of legislation by Parliament giving effect to that announcement within that period. Interest payments fulfilling the requirements of section 50D will be exempt from withholding tax on interest. It is not a requirement that the interest incurred must be deductible by the payer before it may be subject to withholding tax on interest.

In summary:

- Withholding tax on interest became effective on 1 March 2015 and applies to interest paid to or for the benefit of a foreign person from a South African source on or after that date. However, because section 50B(2) deems

interest to have been paid on the earlier of the date on which the interest is paid or becomes due and payable, it means that Part IVB of the Act will apply only if the interest is both paid and due and payable after 1 March 2015.

- A foreign person is defined in section 50A(1) and means any person that is not a resident.
- Interest is deemed to be paid to a foreign person on the earlier of the date on which the interest is paid or becomes due and payable.
- Withholding tax on interest is levied at the rate of 15% on the gross amount of the interest paid to the foreign person.
- Under section 9(2)(b) interest is from a South African source if it is payable by a person that is a resident except when it is attributable to a permanent establishment which is situated outside South Africa; or it is received or accrues in respect of the use or application in South Africa by any person of any funds or credit obtained under any form of interest-bearing arrangement.
- It is not a requirement that the interest incurred be deductible by the payer before it may be subject to withholding tax on interest, that is, withholding tax on interest is not subject to a trade requirement.
- While the foreign person is liable for payment of withholding tax on interest, the person who has the obligation to pay the interest also has an obligation under section 50E(1) to withhold withholding tax on interest from that payment.
- The person withholding any withholding tax on interest must submit a return and pay the tax over to SARS by the last day of the month following the month during which the interest was paid.
- The foreign person also has an obligation to submit a return and pay the tax over to SARS by the last day of the month following the month during which the interest was paid, unless the tax has been paid by another person.

- Under section 50D an interest payment to a foreign person may be exempt from withholding tax on interest. The exemption may be subject to certain specific requirements being met which are considered. A payment of interest may also be exempt under an applicable tax treaty. Section 50E(2) imposes certain additional requirements for some of the exemptions which must be met before the payer may refrain from withholding the withholding tax on interest.
- Section 50E(3) provides for withholding tax on interest to be levied at a reduced rate should there be an applicable tax treaty which provides for a reduced rate. The reduced rate at which withholding tax on interest may be levied applies only after the foreign person has submitted the prescribed declaration and undertaking to the payer.
- Withholding tax on interest is refundable under specified circumstances under section 50G, including when interest that is due and payable subsequently becomes irrecoverable.
- Any amount of tax withheld under section 50E(1) denominated in a foreign currency must, for purposes of determining the amount to be paid to SARS, be translated to rand at the spot rate on the date on which the amount was so withheld.

7.4. Withholding tax on royalties

This Note provides guidance on the interpretation and application of sections 49A to 49H which relate to withholding tax on royalties.

An analysis and discussion of the impact of various tax treaties on withholding tax on royalties is beyond the scope of this Note. Should an arrangement between parties be subject to a tax treaty, the specific provisions of that treaty should be considered and applied.

Broadly speaking, withholding tax on royalties applies to royalties from a source within South Africa paid by any person (whether a resident or not) to a foreign

person for the use of intellectual property belonging to that person or for the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render any assistance or service in connection with the application or utilisation of such knowledge or information.

Withholding tax on royalties can potentially be reduced or eliminated by a tax treaty. Withholding tax on royalties was previously contained in section 35, which provided for a withholding rate of 12%. Owing to the need for uniformity between the different types of withholding taxes, the withholding regimes were amended. Section 35 was accordingly repealed and replaced with sections 49A to 49H with effect from 1 July 2013. The withholding rate was increased to 15% with effect from 1 January 2015.

In summary:

- Sections 49A to 49H deal with withholding tax on royalties.
- In essence a royalty is an amount received or accrued for the use of intellectual property as defined in section 23I or for the imparting of scientific, technical, industrial or commercial knowledge or information as well as the rendering of assistance or service in connection with the application or use of such knowledge or information.
- Withholding tax on royalties applies to royalties paid to or for the benefit of a foreign person from a South African-source. A foreign person means any person that is not a resident.
- Although the foreign person to whom a South African-source royalty is paid is liable for the payment of withholding tax on the royalties, the person paying the royalty is obliged to withhold the tax.
- Royalties are deemed for withholding tax purposes to be paid to a foreign person on the earlier of the date on which the royalty is paid or becomes due and payable.
- Withholding tax on royalties is levied at the rate of 15% on the gross

amount of the royalty paid to the foreign person.

- The person withholding any withholding tax on royalties must submit a return and pay the tax over to SARS by the last day of the month following the month during which the royalty was paid.
- The foreign person also has an obligation to pay the tax over to SARS by the last day of the month following the month during which the royalty was paid, unless the tax has been paid by another person, for example, the person paying the royalty.
- Under section 49D a royalty payment to a foreign person may be exempt from withholding tax on royalties. The availability of some of the exemptions is subject to specific requirements being met.
- Section 49E(3) provides for withholding tax on royalties to be levied at a reduced rate in line with a tax treaty if there is an applicable treaty in place between South Africa and the country in which the foreign person is resident. The reduced rate applies only after the foreign person has submitted the prescribed declaration and undertaking to the payer.
- Withholding tax on royalties is refundable under specified circumstances under section 40G.
- Any amount of tax withheld under section 49E(1) denominated in a foreign currency must, for purposes of determining the amount to be paid to SARS, be translated to rand at the spot rate on the date on which the amount was so withheld.

8. BINDING PRIVATE RULINGS

8.1. BPR 337 – Amalgamation transactions involving the assumptionof liabilities only

This ruling determines the income tax effect of an amalgamation transaction for consideration involving the assumption of liabilities only.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 16 July 2019. 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 44.

Parties to the proposed transaction

The applicant: A resident company

Co-applicant 1: A resident company

Co-applicant 2: A resident company

Co-applicant 3: A resident company

Description of the proposed transaction

The applicant and the co-applicants are resident companies and they are whollyowned by a non-resident company.

All the co-applicants carry on active trades.

It is proposed that the co-applicants be restructured so that the assets and liabilities of the applicant and co-applicants 1 and 2 (the 'sellers') are sold to and acquired by co-applicant 3.

The proposed transaction steps are as follows:

- Each of the sellers will dispose of all its assets to co-applicant 3 and in consideration co-applicant 3 will assume all of each Seller's liabilities (including contingent liabilities). The transactions will take the form of merger transactions and written sale of business agreements will be

concluded.

- The sellers will take the necessary steps contemplated in section 44(13) read with section 41(4) to commence their liquidation within a period of 36 months of the sales transactions or within such further time as SARS may permit.

No shares will be issued by co-applicant 3 in consideration for the assets it will acquire.

Conditions and assumptions

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

- The debt that each seller will transfer to co-applicant 3 as part of the proposed transactions, which was incurred within a period of 18 months before the disposal, is attributable to and arose in the ordinary course of each seller's business undertaking.
- All the debt that each seller will transfer to co-applicant 3 as part of the proposed transactions was not incurred by the seller concerned for the purpose of procuring, enabling, facilitating or funding the acquisition by coapplicant 3 of any asset in terms of the relevant proposed transaction.
- Each seller will within a period of 36 months after the date of the relevant transaction, or such further period as SARS may allow, take the steps contemplated in section 41(4) to each liquidate, wind up or deregister.
- Neither seller will at any stage withdraw any step taken to liquidate, wind up or deregister or do anything to invalidate any step so taken with the result that it will not be liquidated, wound up or deregistered.

Ruling

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

- Each of the proposed transactions where the sellers dispose of all their assets (other than assets they may elect to use to settle any debts incurred

in the ordinary course of their businesses and other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to their liquidation) to coapplicant 3 constitutes an 'amalgamation transaction' as defined in paragraph (a) of that definition in section 44(1).

- The sellers and co-applicant 3 will be entitled to the relief contemplated in section 44(2) and (3).
- Section 44(14) does not apply to the proposed transaction.

8.2. BPR 338 – Donations of money made to a public benefit organization at a fundraising event

This ruling determines the tax treatment of payments made to the applicant, a public benefit organisation (PBO) approved under section 30, at a fundraising event.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 17 September 2019. 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 18A.

Parties to the proposed transaction

The applicant: A non-profit resident company approved as a PBO under section 30

Description of the proposed transaction

The applicant will host a fundraising event as a means of encouraging donations towards its public benefit activities. The fundraising event will be managed by an external events management company.

During the fundraising event attendees will make payments to participate in activities as well as make donations of money. The events management company will develop and manage an electronic system that will enable attendees to make

the requisite payments during the fundraising event. This will be done by way of roaming electronic touchscreen devices. The system will distinguish the various payments as either payments to participate in activities or to make donations of money, and it will also tally the various amounts at the end of the fundraising evening.

Each attendee will settle the total amount due in respect of his or her transactions at the end of the evening by a single credit card payment. The applicant will use the reports generated by the system to determine which attendees are eligible to receive a section 18A receipt as well as the amount to be indicated on the receipt.

Only the donations made by each attendee will be reflected on the section 18A receipt.

Conditions and assumptions

This binding private ruling is subject to the additional condition and assumption that the payment tracking system to be used by the applicant at the fundraising event, must as nearly as practicable conform to the one proposed and be easy to verify in respect of its intended function of accounting for donations of money separately from other payments.

Ruling

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

- The donations made to the applicant which have been identified as such by the applicant's proposed payment tracking system at its fundraising event will constitute 'bona fide' donations made to a PBO under section 18A; and the applicant may issue the donors with section 18A receipts in respect of those 'bona fide' donations.
- Nothing in this ruling precludes SARS from exercising the powers under section 30(5), or any amendment or substitution of that provision.

8.3. BPR 339 – Transfer of listed shares to a collective investment scheme in exchange for participatory interests

This ruling determines the tax consequences of a transfer of listed shares to a collective investment scheme (CIS) in exchange for participatory interests in that CIS.

In this ruling references to sections are to sections of the Income Tax Act (the Act) and the STT Act applicable as at 21 October 2019. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of:

- the Act:
    - section 9C; and
    - section 42.
- the STT Act:
    - section 8(1)(a)(i).

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

The applicant: A resident family trust

The fund: A resident CIS as defined in the Collective Investment Schemes Control Act 45 of 2002 (CISCA)

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

The applicant is a resident discretionary investment trust. The assets of the applicant comprise, amongst others, of fixed property and listed shares. The listed shares are held as long-term investments to realise dividend returns as well as capital growth. The current market values of the listed shares exceed their base costs.

Certain of the listed shares have been held by the applicant for at least three years.

Others have been held for less than three years.

The settlor, who is also one of the trustees of the applicant, has been acting as the investment manager in respect of the listed shares. A private client wealth management, stockbroking and portfolio management company attended to the administration of the listed shares.

The trustees of the applicant decided that the listed shares including the related investment management and administration functions should be transferred to a professionally managed and administered investment fund.

The applicant will enter into an agreement to transfer the listed shares to the fund in exchange for the issue of participatory interests in the fund to the applicant.

Conditions and assumptions

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

- The fund constitutes a registered CIS as envisaged in section 1 of CISCA.
- The fund will acquire the listed shares as long-term investments.
- The shareholdings in the various listed companies held by the fund after the proposed transaction described in 4 above will not exceed the thresholds prescribed by the proviso to paragraph (a) of the definition of 'asset-forshare transaction' in section 42(1).

Ruling

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

- Section 9C(2) will apply to the listed shares referred to in 4 above that have been held for three years or longer by the applicant.
- For purposes of section 9C(2), the applicant will be deemed to have acquired the participatory interests in the fund on the dates the listed shares mentioned in 4 above were acquired.
- The proposed transaction described above will qualify as an 'asset-for-

share transaction' as defined in paragraph (a) of that definition in section 42(1).

- No capital gains will arise for the applicant in respect of the disposals of the listed shares as the applicant will be deemed to have disposed of them for proceeds equal to their base costs.
- The applicant will be deemed to have acquired the participatory interests in the fund on the dates when the applicant acquired the listed shares and for the same expenditure incurred by the applicant that is allowable in terms of paragraph 20 of the Eighth Schedule to the Act. For purposes of section 42(2):
    - The market value of the listed shares held for a period of more than three years on 'valuation date' may be included in the expenditure incurred by the applicant in determining the cost at which the applicant will acquire the participatory interests in the fund.
    - The actual expenditure incurred in relation to the listed shares that do not constitute pre-valuation date assets and that is allowable in terms of paragraph 20 may be included in determining the cost at which the applicant will acquire the participatory interests in the fund.
- The proposed transfer of the listed shares will qualify for exemption from STT under section 8(1)(a)(i) of the STT Act.
- The public officer of the fund (being the acquirer of the listed shares) must make the relevant sworn affidavit or solemn declaration as contemplated in section 8(1)(a) of the STT Act.

8.4. BPR 340 – Share buy-back at nominal value

This ruling determines the income tax and donations tax consequences of a sharebuy-back at nominal value pursuant to a proposed cancellation agreement.

In this ruling references to sections are to sections of the Act and references to paragraphs are to paragraphs of the Eighth Schedule to the Income Tax Act applicable as at 27 September 2019. 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) – definitions of 'dividend' and 'gross income';
- section 55(1);
- section 58(1);
- paragraph 11(1)(a);
- paragraph 11(2)(b); and
- paragraph 38(1).

Parties to the proposed transaction

The applicant: A resident company

The co-applicant: A resident trust

Company A: A resident company

Company B: A resident company

Description of the proposed transaction

The applicant's shares are held as follows:

- 44.94% by Company A issued at a total subscription price of R1.00;
- 34.83% by the co-applicant issued at a total subscription price of R1.00; and
- 20.23% by Company B issued at a total subscription price of R1.00.

The subscription prices at which shares were issued to the co-applicant and Company B were determined by the board of directors of the applicant to be adequate consideration for purposes of section 40 of the Companies Act 71 of 2008 ('Companies Act').

The shares issued to the co-applicant were issued in terms of an employee share ownership programme in accordance with the Broad-Based Black Economic Empowerment ('BBBEE') Codes of Good Practice in terms of the Broad-Based Black Economic Empowerment Act 53 of 2003. The main objective of the establishment of the co-applicant was to provide sustainable equity-based participation in the applicant for the benefit of the beneficiaries of the co-applicant; to ensure that the business of the applicant remained sustainable and wellmanaged; and for the applicant to improve its ownership by black people in order to improve the applicant's Black Economic Empowerment rating.

The co-applicant has not yet appointed beneficiaries and the applicant has not declared a dividend since the co-applicant and Company B became shareholders.

The share subscription transaction involving the co-applicant was incorrectly implemented. The intention was that the co-applicant should acquire and hold the shares in the applicant in a nominee capacity only, on behalf of scheme beneficiaries yet to be appointed, but the transaction was structured and implemented in such a manner that the co-applicant holds the shares in the applicant as a discretionary trust only.

On the basis that the transaction was incorrectly structured and implemented, the applicant and co-applicant propose to unwind the transaction by entering into a restitution agreement aimed at terminating the subscription agreement previously entered into, and for each of them to be returned to the position prior to the implementation of the share subscription; and to then implement an employee share ownership plan in terms of which shares will be reserved for issue to qualifying black employees.

The restitution agreement will be effected by the applicant repurchasing all of its shares held by the co-applicant for a consideration of R1.00, which is the price at which the shares were issued. The applicant will cancel the repurchased shares and they will be returned to its authorised and unissued share capital in accordance with section 35(5) of the Companies Act.

Subsequent to the restitution transaction, the applicant will implement an employee

share ownership plan in terms of which it will reserve shares in its authorized unissued share capital for allocation and issue, from time to time, to current and future qualifying black employees of the applicant at a subscription price to be determined by the board of directors of the applicant. The applicant will place restrictions on the vesting of the shares in qualifying employees and on transfer of the shares by the applicant to the employees.

Conditions and assumptions

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

- The board of directors of the applicant must take a resolution authorising the repurchase of all the shares held by the co-applicant for a consideration of R1.00 in aggregate. The resolution of the board of directors must :
  - expressly state the reasons that necessitated the share repurchase and describe the proposed new structure that will be implemented subsequent to the implementation of the share repurchase; and
  - confirm that the share repurchase will reduce the contributed tax capital of the Applicant.
- The shareholders of the applicant must take a resolution approving the decision by the board of directors of the applicant authorising the applicant to repurchase all of the shares held by the co-applicant for consideration of R1.00.
- The trustees of the co-applicant must take a resolution authorising the repurchase of all of its shares held in the applicant for consideration of R1.00. The resolution of the trustees must expressly state the reasons that necessitated the share repurchase and the proposed new structure that will be implemented pursuant to the implementation of the share repurchase.
- The applicant must conclude, implement and give effect to the new employee share ownership plan within a period of 18 months from the date of the binding private ruling issued, or within such further period as may be

approved by the Advance Tax Rulings Unit of SARS on application for an extension of the time-period for which this ruling is valid.

Ruling

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

- The share repurchase by the applicant of its shares from the co-applicant for a consideration of R1.00 will:
  - not constitute a disposal by the Applicant in terms of paragraph 11(2)(b);
  - constitute a disposal by the co-applicant in terms of paragraph 11(1)(a);
  - not, in the specific facts and circumstances, result in the application of paragraph 38(1) to the transaction;
  - not give rise to a 'dividend' as defined in section 1(1);
  - not give rise to an inclusion in the 'gross income' of the Co-applicant as defined in section 1(1);
  - not give rise to a 'donation' as defined in section 55(1); and
  - not give rise to a deemed donation in terms of section 58(1).

9. BINDING CLASS RULINGS

9.1. BCR 9 (Issue 4) – Taxes on income and substantially similar taxes from purposes of South Africa's tax treaties

For the purposes of this ruling:

- 'OECD Model' means the Organisation for Economic Co-operation and Development Model Tax Convention on Income and on Capital;
- 'tax treaty' means an agreement for the avoidance of double taxation; and

- 'treaty relief' means relief from double taxation.

All lists of tax treaty rates referred to in this BGR are available on the SARS website at www.sars.gov.za.

Purpose

This BGR identifies the taxes administered by SARS which in its opinion constitute taxes on income or substantially similar taxes for purposes of South Africa's tax treaties.

Background

A tax treaty generally provides for relief for:

- specified taxes, usually listed under Article 2 of a tax treaty, in existence at the time the tax treaty is entered into; and
- any identical or substantially similar taxes on income that are imposed after the date of signature of the tax treaty in addition to, or in place of, existing specified taxes.

Ruling

Taxes on income

The following taxes as at publication date of this BGR are taxes on income and therefore qualify for treaty relief under South Africa's tax treaties:

- Normal tax on taxable income, which includes a taxable capital gain (section 5)
- Tax on foreign entertainers and sportspersons, a final tax [section 47B(1)]
- Turnover tax on micro businesses (section 48A)
- Withholding tax on royalties, a final tax [section 49B(1)]
- Withholding tax on interest, a final tax [section 50B(1)]
- Dividends tax [section 64E(1)]

For purposes of the above list, the following are not taxes on income but represent advance payments of normal tax:

- Amounts withheld from payments to non-resident sellers of immovable property in South Africa (section 35A)
- Employees' tax (Fourth Schedule to the Act)
- Provisional tax (Fourth Schedule to the Act)

Taxes that are not taxes on income or similar taxes

South African taxes as at the date of publication of this BGR that are not taxes on income or similar taxes, and which do not qualify for treaty relief, include the following:

- Customs and excise duties
- Diamond export levy
- Donations tax
- Estate duty
- International oil pollution compensation fund contributions levy
- Royalty levied on the transfer of a mineral resource extracted from within South Africa
- Securities transfer tax
- Skills development levy
- Transfer duty
- Unemployment insurance contributions
- Value-added tax

The above list is not exhaustive.

10. DRAFT BINDING GENERAL RULINGS

10.1. Unbundling of unlisted company: Impact of non-qualifying shareholders

For the purposes of this BGR:

- 'non-qualifying shareholder' means a shareholder of the unbundling company that does not form part of the same group of companies as the unbundling company;
- 'unbundled company' means the company whose equity shares are distributed to the shareholders of an unbundling company;
- 'unbundling company' means the company that distributes all the equity shares it holds in an unbundled company to its shareholders; and
- 'unbundling transaction' means an unbundling transaction as defined in section 46(1)

Purpose

This BGR provides clarity on what constitutes an unbundling transaction when an unbundling company having non-qualifying shareholders unbundles shares in an unlisted unbundled company.

Background

Section 46 provides roll-over relief when an unbundling company distributes all of its equity shares in an unbundled company to its shareholders under an unbundling transaction. The definition of 'unbundling transaction' contains requirements relating to the unbundling company, unbundled company and shareholders of the unbundling company. This BGR examines the qualifying shareholders requirement in paragraph (a)(i)(bb) of the definition of 'unbundling transaction' in the context of a resident unbundling company holding shares in a resident unlisted unbundled company. The applicable part of the definition reads as follows:

'46. Unbundling transactions.—(1) For the purposes of this section, 'unbundling

transaction' means any transaction—

(a) (i) in terms of which the equity shares in a company (hereinafter referred to as the 'unbundled company'), which is a resident that are held by a company (hereinafter referred to as the 'unbundling company'), which is a resident, are all distributed by that unbundling company to any shareholder of that unbundling company in accordance with the effective interest of the shareholders in the shares of that unbundling company, and if—

(aa) all of the equity shares of the unbundled company are listed shares or will become listed shares within 12 months after that distribution;

(bb) that shareholder to which that distribution is made by that unbundling company forms part of the same group of companies as that unbundling company; or

(cc) that distribution is made pursuant to an order in terms of the Competition Act, 1998 (Act No. 89 of 1998), made by the Competition Tribunal or the Competition Appeal Court; and'

Subitems (aa) and (cc) of the definition do not stipulate any shareholder requirements for the unbundling company when the shares in the unbundled company are listed or will be listed within 12 months after the distribution or when they are distributed pursuant to an order under the Competition Act. However, under subitem (bb) when the unbundled company is unlisted, the shareholder must be part of the same group of companies as defined in section 411 as the unbundling company.

The issue arises as to what effect the wording of subitem (bb) has on an unbundling transaction when the unbundling company has non-qualifying shareholders. More specifically, does the presence of non-qualifying shareholders mean the whole transaction or only part of it does not meet the definition of 'unbundling transaction'.

Discussion

The words in paragraph (a)(i) require the unbundling company to distribute all the shares it holds in the unbundled company to any shareholder of that unbundling company in accordance with the effective interest of the shareholders in the shares of that unbundling company. These words make it clear that the unbundling company may not retain any unbundled shares and also contemplate that all shareholders must participate in the distribution in accordance with their effective interest. Such shareholders include all shareholders holding equity shares in the unbundling company regardless of the size of their holdings. The further requirement in subitem (bb) is that 'that shareholder' to which 'that distribution' is made must be part of the same group of companies as the unbundling company. This wording may create some uncertainty because the opening words contemplate all shareholders of the unbundling company while subitem (bb) contemplates only shareholders forming part of the same group of companies.

The intention of subitem (bb) is to make the distribution to shareholders forming part of the same group of companies as the unbundling company an unbundling transaction, while excluding from an unbundling transaction distributions to shareholders not forming part of that group of companies. In other words, the presence of non-qualifying shareholders does not invalidate the entire unbundling transaction but only that portion relating to the non-qualifying shareholders. Consequently, the part of the distribution to the non-qualifying shareholders must be dealt with outside section 46 under general principles, while the part of the distribution to shareholders forming part of the same group of companies as the unbundling company must be dealt with under section 46, assuming the other requirements of that section are met. The exact tax treatment for the unbundling company and its non-qualifying shareholders will depend on the facts of the particular case but is generally likely to be as follows for a resident unbundling company and its resident non-qualifying shareholders:

- If the unbundling company holds the shares on capital account, it must determine a capital gain or loss under paragraph 75(1)(a) on the portion of the unbundled company shares disposed of to the non-qualifying shareholders, with the proceeds being equal to the market value of the

unbundled company shares on the date of distribution. Alternatively, if the shares in the unbundled company are held as trading stock, the market value of the equity shares distributed to the non-qualifying shareholders must be included in the income of the unbundling company under section 22(8), with the cost price of the unbundled company shares being deducted under section 11(a) (if acquired in the same year of assessment as the disposal) or section 22(2) (opening stock). In addition, a distribution taking the form of a dividend in specie will potentially result in the imposition of dividends tax on the unbundling company, subject to any applicable exemptions in section 64FA.

- Resident non-qualifying shareholders holding their unbundling company shares as capital assets must include the distribution in gross income if it takes the form of a dividend and consider whether it qualifies for exemption under section 10(1)(k). If in the form of a return of capital, the distribution must be dealt with under paragraph 76B by reducing the base cost of the unbundling company shares and treating any excess as a capital gain. The base cost of the unbundled company shares will be established under paragraph 75(1)(b), being equal to their market value on the date of distribution.
- Resident non-qualifying shareholders holding their unbundling company shares as trading stock must include the distribution in their gross income, regardless of whether the distribution takes the form of a dividend or a return of capital. If the distribution takes the form of a dividend, it may be exempt from normal tax under section 10(1)(k). If the unbundled company shares are acquired as trading stock, they will have a cost price under section 22(4) equal to the current market price on the date of acquisition. For purposes of the Eighth Schedule and paragraph 20(1) the unbundled shares will have an expenditure determined under paragraph 75(1)(b) equal to their market value on the date of distribution. Resident non-qualifying shareholders that have included a return of capital in gross income will not be required to reduce the expenditure incurred in respect of their shares in

the unbundling company under paragraph 76B.

- The distribution to non-qualifying shareholders will not qualify for the exemption from securities transfer tax available for an unbundling transaction referred to in section 46 which is provided for in section 8(1)(a)(iv) of the Securities Transfer Tax Act 25 of 2007.

Ruling

When an unbundling company distributes unlisted unbundled company equity shares to a company forming part of the same group of companies as the unbundling company as well as to non-qualifying shareholders, the distribution to shareholders forming part of the same group of companies as the unbundled company will comprise an unbundling transaction, while the distribution to the non-qualifying shareholders will not comprise an unbundling transaction.

11. GUIDES

11.1. VAT 404 – Guide for Vendors

The VAT 404 is a basic guide where technical and legal terminology has been avoided wherever possible. Although fairly comprehensive, the guide does not deal with all the legal detail associated with VAT and is not intended for legal reference.

The information in this guide is based on the VAT Act and the TA Act as at the time of publishing and includes the amendments contained in the Taxation Laws Amendment Act 23 of 2018, the Tax Administration Laws Amendment Act 22 of 2018 and the Rates and Monetary Amounts and Amendment of Revenue Laws Act 21 of 2018. These Acts were all promulgated on 17 January 2018 as per Government Gazettes 42172, 42169 and 42171 respectively.

Some of the more important amendments that have been introduced since the previous issue of this guide are discussed briefly below.

Amendments that came into effect from 19 January 2017:

- Alignment of tax charging provisions

Section 7(4) was introduced to align with similar provisions in other tax Acts. It provides that the Minister of Finance, when tabling the annual national budget, may announce an increase or decrease in the standard rate of VAT with effect from a date specified in that announcement. The VAT Act must be amended within 12 months of that announcement to reflect the new VAT rate. Section 77, which previously allowed the Minister to announce an increase or decrease in the rate of VAT at any time by public notice, has now been repealed.

- Documentary proof to substantiate input tax and other deductions

  Section 16(2)(g) was originally introduced as a relief mechanism for vendors to claim input tax or other deductions in certain circumstances if they were unable to obtain the prescribed documentation. See Binding General Ruling (BGR) 36 'Circumstances Prescribed by the Commissioner for the application of Section 16(2)(g)' for further details in this regard. Vendors seeking access to the relief under this provision must now be in possession of a ruling issued by SARS before the deduction can be made on a return. The ruling will also specify the alternative documentary proof that must be held by the vendor to substantiate that particular deduction. This provision may only be used by a vendor as a measure of last resort after all attempts to obtain the required documentation have been failed.

- Exemption for VAT on importation – vis major

  No customs duty or excise duty is payable under the Customs and Excise Act when certain goods are imported under rebate item 412.09 (goods subsequently lost, destroyed or damaged as a result of vis major whilst such goods are under the control of SARS). The VAT Act has been amended so that it now provides an exemption for the VAT on importation of such goods under paragraph 8 of Schedule 1 to mirror the circumstances mentioned in rebate item 412.09.

Amendments that came into effect from 1 April 2017:

- Notional input tax on goods containing gold

The definition of 'second-hand goods' was amended to deal with some unintended negative effects on legitimate traders in second-hand gold as a result of amendments to the definition in 2015. The effect of this amendment was explained in some detail in VAT Connect Issue 7 (December 2017) and BGR 43 'Deduction of Input Tax in respect of Second-hand Gold'.

- Accounting basis for municipal entities

  Previously, section 15(2A) only allowed municipalities that account for VAT on the payments basis to be relieved of the obligation to account for the full output tax when the consideration for a supply is R100 000 or more. Section 15(2A) has now been amended to allow certain municipal entities to have access to the same relief as municipalities under this provision.

- Industrial development zones (IDZs) and special economic zones (SEZs)

  The VAT Act makes provision for certain benefits for vendors operating in a customs controlled area of an IDZ designated by the minister in the Department of Trade and Industry (DTI) as per the IDZ programme. The DTI subsequently developed the SEZ programme which replaced the IDZ programme with effect from 9 February 2016. Various textual amendments were therefore made to the VAT Act to achieve a seamless transition from the IDZ programme to the SEZ programme.

- Low cost housing

  In terms of amendments in 2015, sections 8(23) and 11(2)(s), which deemed certain supplies of low cost housing to be made to the Department of Human Settlements at the zero-rating, were deleted with effect from 1 April 2017. These provisions were, however, re-introduced retrospectively from 1 April 2017, thereby postponing the deletion for a further two years.

- Supplies made by municipalities as a result of municipal boundary changes

  Certain municipalities merged or disbanded as a result of the local government elections held during 2016. The effect was that some

municipalities had to either cancel their VAT registrations or apply for new registrations. In that process, certain supplies between municipalities would have been made. Section 8(28) was therefore introduced to deem the affected municipalities to be one and the same person in certain circumstances so that there would be no supply between them for VAT purposes. Transitional measures explained in BGR 39 (Issue 2) 'VAT Treatment of Municipalities Affected by Changes to Municipal Boundaries' were introduced to deal with these issues before section 8(28) was introduced.

Amendments that came into effect from 1 April 2018:

- Increased VAT rate

  The most significant change in 2018 was the increase in the standard rate of VAT from 14% to 15%. For more detailed information on the VAT rate increase, see the Frequently Asked Questions: Increase in the VAT rate (FAQs) and Pocket Guide on the VAT Rate Increase on 1 April 2018 on the SARS website. A later amendment also provides that the Minister of Finance must evaluate the impact of the VAT rate increase on revenue collection and the poor and then table a report in that regard in Parliament by no later than 30 June 2021.

- International travel insurance

  Section 11(2)(d) provides for the zero rate to apply to services that comprise the insuring or arranging of insurance in respect of international transportation of passengers or goods. The scope of the zero-rating was extended to include situations where the insured person is being transported to and from the original point of departure and when the insured is out of the country, but not actually travelling. Certain new definitions have also been introduced in consequence of this amendment. For more information see BGR 37 'VAT Treatment of International Travel Insurance'.

- Leasehold Improvements

Sections 8(29), 9(12), 10(28) and 18C have been introduced to deal with the VAT implications of leasehold improvements. In terms of these amendments, the lessee is deemed to make a supply of the leasehold improvements to the lessor at a nil value at the time that the improvements are completed. At the same time, the lessor will be required to make an output tax adjustment on the value of the improvements stipulated in the lease, or if no value is stipulated, the open market value thereof. The lessor will, however, not be required to make the adjustment if the leasehold improvements were acquired wholly for taxable purposes.

Amendments that came into effect from 16 January 2019:

- Correcting of material errors on tax invoices

  Section 20(1B) has been inserted to deal with a situation where a material error or deficiency on a document purporting to be a valid tax invoice prevents the recipient from being able to deduct input tax because the document lacks the essential requirements of a tax invoice as contemplated in section 20(4) or 20(5). (This does not apply to any errors concerning the consideration that needs to be corrected by way of debit or credit note). In such a case, the supplier must correct the document within 21 days from the date of the request by the recipient and only then may the recipient deduct input tax. The supplier must obtain and retain sufficient information to identify the transaction concerned. The correction of the tax invoice does not create another tax event for the parties, nor does it change the original time of supply.

- Goods returned after transfer of a going concern

  Section 21(1)(d) now provides that when goods are subsequently returned to a vendor by a customer of the previous owner of the business, and the business concerned was acquired by the new owner as a going concern, then that new owner is deemed to have made the supply concerned. This allows the current owner to issue the required credit note to the customer and to claim a corresponding input tax adjustment, regardless of whether

the supply was made to the customer by the current or previous owner.

- Prescription period for VAT overpaid

  Section 44(11) has been inserted to clarify that any erroneous overpayment of VAT by a vendor prescribes after a period of five years from the date that the overpayment was made to SARS if that vendor does not lodge a refund claim for that overpayment during that period. In addition, any such refund claim is not regarded as being received if the enterprise's banking details have not been provided to SARS within 90 days after submitting the claim.

- Recovery of tax in respect of branches and divisions

  SARS may allow a vendor (single legal entity) to register separately for VAT in respect of any businesses carried on in the form of branches or divisions, in which case, each separate registration is regarded as a separate person for VAT purposes. Section 50 has now been amended to make it clear that as the branches or divisions operate under the same legal entity as the main business, any set-off, debt equalisation or recovery provisions for VAT purposes will apply equally between the main business and any of their separately registered branches.

- Liability of bodies of persons

  Section 51(3) was amended to provide legal certainty that all the members of an unincorporated joint venture that has registered as a vendor for VAT purposes, are jointly and severally liable for the VAT debts of the joint venture and to perform any obligations required under the VAT Act (as is the case for partnerships under that provision). This rule does not apply to a joint venture company that is incorporated as a separate legal entity.

The following amendments came into effect from 1 April 2019:

- Electronic services

  An updated Electronic Services Regulation (ESR) as well as some consequential amendments to the VAT Act in this regard apply with effect from 1 April 2019 for non-resident suppliers of electronic services to South

African customers. The effect is that the previous tax base for 'electronic services' under the Electronic Services Regulations introduced from 1 June 2014 has been substantially expanded. Furthermore, proviso (vii) to the definition of 'enterprise' has been added to include the activities of an 'intermediary' if that person facilitates a supply of 'electronic services' by a non-resident who is not registered for VAT in the Republic 'Facilitates' in this context means, for example, that the electronic services are advertised, sold or otherwise made available via an online marketplace or 'platform' operated by the intermediary in circumstances where the invoicing and collection of the payment for the supply is done by the intermediary. Another amendment is the introduction of section 54(2B), which deems the intermediary to be the supplier of electronic services in certain instances. The effect of these amendments is that the intermediary concerned will be liable to account for the VAT charged on supplies of electronic services if the non-resident principal is not registered for VAT. An intermediary will therefore be required to register and account for VAT if the value of their taxable supplies (including any deemed supplies under section 54(2B)) exceeds the new compulsory threshold of R1 million for suppliers of electronic services (previously R50 000). See also 2.1.5 for more information.

- Exemption for cryptocurrency

  The issue, acquisition, collection, buying or selling or transfer of ownership of cryptocurrency is now treated as an exempt financial service under a new section 2(1)(o). Other fee based services such as a commission for facilitating the sale of cryptocurrency will not fall within the scope of the exemption. For more information in this regard, see the Consultation Paper on Policy Proposals for Crypto Assets as well as the related Media Statement issued on 16 January 2019.

- Additional zero-rated goods

  Three more goods will be subject to VAT at the zero rate from 1 April 2019.

These include sanitary towels (pads) and basic foodstuffs in the form of 'cake wheat flour' and 'white bread wheat flour' as defined in regulation 1 of the Regulations in terms of Government Notice R.405 published in Government Gazette 40828 of 5 May 2017. The list of zero-rated basic foodstuffs in Part B of Schedule 2 to the VAT Act has been amended accordingly to include the two new items. It has also been clarified that brown bread, which is listed as Item 1 on the list of basic foodstuffs, includes 'whole wheat brown bread' as defined in the said Regulations.

11.2. Guide on venture capital companies – Income Tax

This guide provides users with general guidance on venture capital companies and investments in such companies. It does not delve into the precise technical and legal detail that is often associated with tax and should, therefore, not be used as a legal reference.

One of the main challenges facing small and medium-sized businesses, as identified in the 2008 South African National Budget Review, is the difficulty in accessing equity finance. Equity financing is essentially a method used by companies to raise capital by issuing company shares to investors. A share in relation to a company means any unit into which the proprietary interest in the company is divided. The holder of the share does not own the assets of the company, but owns the rights in the company, that is, the right to vote, the right to dividends and the right to capital distributions. The cost of share investments held on capital account is generally not deductible from income. Section 12J was introduced as a tax incentive to encourage equity investment through VCCs in small and medium-sized businesses and junior mining companies. Section 12J allows a holder of shares to claim a 100% deduction of the cost of the shares issued by the VCC, provided certain requirements are met. The section is effective for venture capital shares acquired on or after 1 July 2009 but on or before 30 June 2021. Section 12J has requirements at the level of the VCC and at the level of the 'qualifying company' whose shares are held by the VCC. A VCC is taxed as a

company and does not enjoy any special tax concessions because of its VCC status.

Taxpayers who invest in VCCs may claim a deduction on the amount incurred in acquiring venture capital shares provided that all the requirements of section 12J have been complied with. Before a company can be regarded as a VCC, the requirements of section 12J must be met. Failure to comply with the relevant requirements may result in the VCC's approval being withdrawn. If withdrawn, a VCC must include in income an amount equal to 125% of the expenditure incurred by any person for the issue of shares held in that company. This inclusion in income must take place in the year of assessment in which the status is withdrawn by SARS. In the event of a withdrawal, the VCC will be given a chance to reapply for approval if non-compliance is remedied to SARS' satisfaction.

11.3. Tax guide for share owners – Income Tax (Issue 7)

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

An increasing number of persons have become share owners. Many investors have turned to participation in the stock exchange either directly through share ownership or indirectly through collective investment schemes in an attempt to derive a return that beats inflation.

The proliferation of broad-based employee share incentive arrangements has also contributed to share ownership among South Africans.

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

Non-residents are subject to income tax in relation to their gross income on amounts from a source within South Africa. For example, a non-resident would

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

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

- Immovable property in South Africa or any interest or right of whatever nature to or in such property including rights to variable or fixed payments as consideration for the working of, or the right to work mineral deposits, sources and other natural resources. Equity shares in a land-rich company meeting the requirements set out in paragraph 2(2) (see below) are deemed to comprise an interest in immovable property and are potentially subject to CGT.
- Any asset effectively connected with a permanent establishment in South Africa. A non-resident holding shares as capital assets forming part of a branch in South Africa would therefore potentially be subject to CGT on disposal of those shares. Amounts derived from the disposal of equity shares held as trading stock are deemed to be from a source within South Africa, while for CGT purposes such shares are deemed to be an interest in immovable property if:
    - 80% or more of the market value of those equity shares at the time of their disposal is attributable directly or indirectly to immovable property in South Africa; and
    - the person (whether alone or together with any connected person in relation to that person), directly or indirectly, holds at least 20% of the equity shares in that company.

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

11.4. Basic guide to section 18A approval (guide 3)

This guide has been prepared to assist organisations in understanding the basic

requirements for obtaining and retaining approval under section 18A.

Government has recognised that certain organisations are dependent on the generosity of the public and to encourage that generosity has provided a tax deduction for certain donations made by taxpayers. The eligibility to issue section 18A receipts is restricted to specific organisations approved by SARS that use the donations to carry on or fund specific PBAs in South Africa. The aforementioned, specific, organisations must formally apply to SARS for approval under section 18A to issue section 18A receipts for donations received. A section 18A receipt may be issued by a section 18A-approved organisation only from the date the TEU has confirmed section 18A approval and has issued a reference number for purposes of section 18A that must appear on such receipts.

11.5. Dispute Resolution Guide (Issue 2)

This document is a general guide dealing with the resolution of tax disputes in South Africa. It is an introductory guide and does not deal with all the legal detail associated with dispute resolution. It should therefore not be used as a legal reference.

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12. DRAFT GUIDES

12.1. Draft Guide to Building Allowances (Issue 2)

This guide provides general guidance on building allowances available to owners and lessees of buildings.

This guide provides guidance on the application and interpretation of the various building allowance provisions available to owners and lessees of buildings under the Act for the erection or, sometimes, purchase of buildings or the effecting of

improvements to buildings.

The Act currently makes provision for the following building allowances:

- Section 13 – Buildings used in a process of manufacture, research and development or a similar process
- Section 13(8) – Permanent shipbuilding structures
- Section 13bis – Buildings used by hotel keepers
- Section 13quin – Commercial buildings
- Section 13quat – Buildings in urban development zones
- Section 13ter – Residential units (erection of which commenced on or after 1 April 1982 and before 1 October 2008)
- Section 13sex – Residential units (erection of which commenced on or after 1 October 2008)
- Section 13sept – Deduction for the sale of low-cost residential buildings to employees on loan account
- Paragraph 12(1)(f) of the First Schedule – Buildings used in farming operations other than those used for domestic purposes
- Section 12S – Building in special economic zones

Some of the sections which make provision for building allowances or deductions contain their own recoupment provisions. The general recoupment provisions of section 8(4)(a) will also apply in most but not all cases.

13. DISCUSSION PAPER

13.1. Reviewing the tax treatment of excessive debt financing, interest deductions and other financial payments

Corporate debt bias can be influenced by tax policy design. When in need of capital, businesses – whether purely domestic or multinational – can choose

between debt and equity financing. While many factors influence this decision, tax deductibility of interest payments (but not in respect of dividends or returns on equity) can sway the outcome, particularly in cases where tax avoidance is a primary objective. With tax deductions for interest payments being more valuable in countries with higher corporate income tax (CIT) rates, multinational companies can minimise tax liabilities further by placing the majority of their debt funding in high-tax countries.

While debt capital is an important financing source for investment, it can create opportunities for base erosion and profit shifting (BEPS) in South Africa – the CIT rate is high relative to the global average, and especially in relation to some of our key trading and investment partners. The OECD/G20 BEPS Project produced a report on Limiting Base Erosion Involving Interest Deductions and Other Financial Payments in 2015, providing **a benchmark against which to assess the existing corporate tax regime in respect of its potential impact on the choice between debt and equity financing.**

The OECD/G20 Project considered all the rules in place that limit excessive debt or interest deductions – including transfer pricing rules, thin capitalisation rules, ratios that limit interest deductions and withholding taxes. The consensus recommendation is that the best means of curtailing BEPS is to limit net interest expense deductions to a fixed percentage of earnings before interest, tax, depreciation and amortisation (EBITDA). The OECD recommends using a net interest expense / earnings (NIE/EBITDA) ratio of between 10 and 30 per cent to limit excessive interest deductions and prevent tax base erosion. To constrain those taxpayers that pose the largest BEPS risk, the OECD recommends applying the rule to all entities of a multinational group as a minimum.

Besides the OECD, other international and regional organisations, as well as the Davis Tax Committee, have also contributed to the debate on this issue. The IMF has done a lot of empirical analysis on countries' existing rules. One of the main findings is that interest limitation rules (including thin-capitalisation rules, for example) are more effective when applied to total interest expense – i.e. interest flowing to both connected and independent parties. The United Nations

(2017) Handbook on Selected Issues in Protecting the Tax Base of Developing Countries provides a good overview for why taxpayers use debt, as well as useful thoughts on the OECD recommendations. The African Tax Administration Forum (ATAF) has done a lot of work to assist African countries in this regard – producing a Suggested Approach to Drafting Interest Deductibility Legislation to assist countries in capturing the OECD recommendations in their legislation. The Davis Tax Committee has reviewed the tax treatment of debt financing – agreeing with the OECD in some areas and disagreeing in others. All of the key issues from these parties are discussed in the document.

Many countries have either implemented a version of the recommendations or reviewed their existing rules. Most countries in the European Union have implemented the OECD recommendations already or are in the process of doing so, as they are required to do so under the EU Anti-Tax Avoidance Directive. Some developing countries that have implemented the OECD recommendations include India, Botswana and Vietnam. Australia and New Zealand are retaining their thin capitalisation approaches using balance sheet ratios, rather than opting for interest limitation rules based on earnings.

South Africa's current interest limitation rules have similar design features to the fixed ratio rule recommended by the OECD, but there are differences. The existing rules are comparatively less strict than the OECD recommendations and narrower in application – they are targeted at a smaller set of transactions and the limitation for net interest expense deductions is set at a higher percentage of earnings. There are also other incumbent rules that mitigate the debt bias. In respect of cross-border loans from connected persons, SARS is able to use the arm's length test (transfer pricing rules) to question whether: (1) the quantum of debt is excessive; (2) the transaction labelled as a loan is more akin to equity; and (3) the associated interest rate charged is not excessive. Deviations from the arm's length principle result in a portion of the interest expense being permanently disallowed as a deduction. The withholding tax on interest is set at a standard rate of 15 per cent, but is substantially reduced or nullified for many key investment and trading partners.

In reviewing the existing regime, government (recognising that South Africa is primarily a capital importing country) aims to strike a balance between attracting capital and investment, and protecting the corporate tax base. This brings up the classic tax policy design trade-off between accuracy and simplicity.

National Treasury analysis of SARS administrative data from corporate tax returns reveals NIE/EBITDA ratios for different company types and sizes. Companies are analysed in three groups – South African subsidiaries controlled by foreign multinational companies; group companies (including both South African owned multinational companies and purely domestic groups); and other companies. The companies are also analysed on size, using sales as a proxy.

Based on the analysis conducted, government proposes to implement the OECD recommendations. Illustrative examples show that replacing the existing interest limitation rules (specifically those in section 23M of the Income Tax Act) with the OECD approach will provide a more uniform approach to all interest payments flowing out of the country (regardless of which country the loan emanates from), as well as enhance the level of base protection. Government proposes to restrict net interest expense deductions to 30 per cent of EBITDA.

Government welcomes comments from all interested parties:

Taxpayers are invited to submit comments on the proposals. Each submission should include a highlevel list of the main points being made. Additional information on specific transactions / business models that may be negatively affected is requested so that comments are substantiated. Comments might be made public – please clearly mark any information that is sensitive / should not be made public.

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14. INDEMNITY

Whilst every reasonable care has gone into the preparation and production of this update, no responsibility for the consequences of any inaccuracies contained herein or for any action undertaken or refrained from taken as a consequence of this update will be accepted.