TAX UPDATE **PREPARED BY: JOHAN KOTZE**

FOR PERIOD: 1 JANUARY 2014 – 31 MARCH 2014

INDEX

1. INTRODUCTION

The purpose of this update is to summarise the developments that occurred during the first quarter of 2014 (i.e. 1 January 2014 to 31 March 2014) specifically in relation to Income Tax and VAT. Johan Kotze, Bowman Gilfillan's Head of Tax Dispute Resolution, has compiled this summary.

The aim of this summary is for clients, colleagues and friends alike to be exposed to the latest developments and to consider areas that may be applicable to their situation. The reader is invited to contact any of the members of Bowman's tax team to discuss their specific concerns and, for that matter, any other tax concerns.

The first quarter always contains the Budget proposals and in this regard readers should take note of the various proposals. The tax-preferred savings accounts and retirement savings reforms may be of particular interest.

The Tax Administration Act Laws Amendment Act was promulgated during this period and although it makes numerous amendments to the various tax acts, section 270(6) to (6D) of the Tax Administration Act is the only amendments reflected in this update, because of its importance to understatement penalties.

The case of Roshcon v Anchor Auto Body Builders is quite interesting with Judge Wallis explaining what Lewis JA's *actual* intention was by giving her judgment in the NWK case.

Interpretation notes, rulings and guides are all important aspects of the developments that took place, as they give taxpayers an insight into SARS' application of specific provisions. It is however important to note that these publications are not law, but may bind SARS. Taxpayers should nonetheless consider these publications carefully to determine whether, and how, they are actually applicable to their own circumstances.

Enjoy reading on!

2. BUDGET

2.1 Main tax proposals

Tax proposals

The main tax proposals include:

- Personal income tax relief of R9.3 billion
- Measures to encourage small enterprise development
- Clarity on valuation of company cars for fringe-benefit tax purposes
- Reforms to the tax treatment of the risk business of long-term insurers
- Amending the rules for VAT input tax to combat gold smuggling
- Increases in fuel and excise taxes
- Measures to address acid mine drainage
- Adjustment of the proposed carbon tax and its alignment with desired emission-reduction outcomes to be identified by the Department of Environmental Affairs.
- Tax-free savings accounts will be implemented, creating a mechanism to increase household savings and support financial inclusion.
- The employment tax incentive, introduced at the beginning of 2014, will help unemployed youth gain skills and experience in the workplace.

2.2 Individual's tax rates

2013 year of assessment		2014 year of assessment	
Taxable Income	**Rates of tax**	**Taxable Income**	**Rates of tax**
R0 – R160 000	18% of each R1	R0 – R160 000	18% of each R1
R160 001 – R250 000	R28 800 + 25% of the amount above R160 000	R165 601 – R258 750	R29 808 + 25% of the amount above R165 600
R250 001 – R346 000	R51 300 + 30% of the amount above R250 000	R258 751 – R358 110	R53 096 + 30% of the amount above R258 750
R346 001 – R484 000	R80 100 + 35% of the amount above R346 000	R358 111 – R500 940	R82 904 + 35% of the amount above R358 110
R484 001 – R617 000	R128 400 + 38% of the amount above R484 000	R500 941 – R638 600	R132 894 + 38% of the amount above R500 940
R617 001	R178 940 + 40% of the amount above R617 000	R638 601	R185 205 + 40% of the amount above R638 600
Rebates		**Rebates**	
Primary	R11 440	Primary	R12 080
Secondary	R6 390	Secondary	R6 750
Third rebate	R2 130	Third rebate	R2 250
Tax threshold		**Tax threshold**	
Below age 65	R63 556	Below age 65	R67 111
Age 65 and over	R99 056	Age 65 and over	R104 611
Age 75 and over	R110 889	Age 75 and over	R117 111

2.3 Medical tax credits

Monthly medical scheme contribution tax credits will be increased from R242 to R257 per month for the first two beneficiaries, and from R162 to R172 per month for each additional beneficiary, with effect from 1 March 2014.

2.4 Tax-preferred savings accounts

Tax-preferred savings accounts, first mooted in the 2012 *Budget Review* as a measure to encourage household savings, will proceed. As previously announced, these accounts will have an initial annual contribution limit of R30 000, to be increased regularly in line with inflation, and a lifetime contribution limit of R500 000. The account will allow investments in bank deposits, collective investment schemes, exchange-traded funds and retail savings bonds. Eligible service providers will include banks, asset managers, life insurers and brokerages.

2.5 Retirement savings reforms

Reforms over the past two years have aimed to encourage more people to save for retirement and to preserve their savings throughout their working lives. A document that briefly describes the changes up to this point and sets out anticipated future reforms will soon be released. The proposals below support the broader package of retirement reforms, and are intended to make the system simpler and fairer.

Changes to the taxation of contributions to retirement funds in line with the Taxation Laws Amendment Act (2013) will provide additional relief to most retirement fund members and encourage them to save for retirement.

Employer contributions are deemed to be a fringe benefit in the hands of the employee. Both employee and employer contributions will be deductible, up to a limit, for income-tax purposes by the employee. For defined benefit plans, the formula used to estimate the contribution amount was legislated in 2013. The methodology for calculating the formula will be detailed by way of regulation in 2014. In addition, the policy approach for the timing of accrual of retirement fund benefits will be reviewed to provide certainty and ease practical application.

Retirement fund lump-sum tax tables

Lump-sum benefits are taxed according to two tables – pre-retirement withdrawals (mainly following resignations) and at retirement. The former has not been adjusted since its introduction in 2007, while the latter was adjusted once, in 2011.

The taxable income brackets are increased by about 10%. There is a larger increase in the bottom bracket for the retirement lump-sum table to avoid instances where lower-income workers may be required to pay tax on their lump sum, even though they did not benefit from a deduction due to their taxable income falling below the tax-free threshold. The proposed revisions to these tables, effective 1 March 2014.

Pre-retirement lump-sum taxation:

2014 year of assessment		**2015 year of assessment**	
Taxable Income	**Rates of tax**	**Taxable Income**	**Rates of tax**
R0 – R22 500	0%	R0 – R25 000	0%
R22 501 – R600 000	18% of taxable income above R22 500	R25 001 – R660 000	18% of taxable income above R25 000
R600 001 – R900 000	R103 950 + 27% of taxable income above R600 000	R660 001 – R990 000	R114 300 + 27% of taxable income above R660 000
R900 001 +	R184 950 + 36% of taxable income above R900 000	R990 001 +	R203 400 + 36% of taxable income above R990 000

Retirement lump-sum taxation:

2014 year of assessment		2015 year of assessment	
Taxable Income	**Rates of tax**	**Taxable Income**	**Rates of tax**
R0 – R315 000	0%	R0 – R500 000	0%
R315 001 – R630 000	18% of taxable income above R315 000	R500 001 – R700 000	18% of taxable income above R500 000
R630 001 – R945 000	R56 700 + 27% of taxable income above R630 000	R700 001 – R1 050 000	R36 000 + 27% of taxable income above R700 000
R945 001 +	R141 750 + 36% of taxable income above R945 000	R1 050 001 +	R130 500 + 36% of taxable income above R1 050 000

2.6 Company car fringe benefits

Use of a company car by an employee is a taxable fringe benefit based on the market value of the vehicle. However, car manufacturers that import vehicles calculate the fringe benefit at cost. To align the treatment of company car fringe benefits for all employees (whether or not they work for a vehicle manufacturer), government proposes that actual retail market value be used in all cases.

This reform will be phased in over four years. Adjustments are also proposed to treat employees who bear the costs relating to fuel and the upkeep (maintenance, insurance and licence) of their company car in a more equitable manner.

2.7 Philanthropic foundations

The Income Tax Act (1962) provides a tax incentive for donations to qualifying public-benefit organisations, including philanthropic foundations.

Such foundations aim to build up and maintain sufficient capital to provide financial support to worthy causes carried out by public benefit organisations. The act requires philanthropic foundations to distribute up to 75% of the money they generate within a year unless they can demonstrate to SARS that the funds accumulated will be used for specific qualifying purposes. This requirement affects the sustainability of foundations. Government proposes to relax this requirement while ensuring that foundations do distribute accumulated capital to worthy causes within a reasonable period.

2.8 Small and medium enterprise development

Entrepreneurship and business development are important building blocks for a growing, sustainable economy. Most developing economies have strong informal sectors that draw people into economic activity. South Africa's informal sector is poorly developed given the country's size and level of development. Moreover, the broader business environment is characterised by market concentration and relatively high profit margins.

Government aims to create an environment that supports both informal traders and entrepreneurs who seek to develop small businesses into larger enterprises. Policies are designed to promote the development of basic entrepreneurial skills and facilitate a greater degree of self-determination for those lacking formal opportunities. Red tape and bureaucracy are hindrances to doing business, especially for small and medium-sized firms.

Government aims to streamline the regulatory regime. Proposed reforms would reduce compliance costs and facilitate access to equity finance.

Turnover tax regime for micro businesses

The turnover tax regime is targeted at businesses with an annual turnover of up to R1 million. Subject to public consultation, government accepts the recommendation of the Tax Review Committee that this regime should be retained, but that the requirements should be simplified, and thresholds and tax rates adjusted. The committee also proposes that turnover up to R335 000 should not be taxed (a zero tax rate) and the maximum tax rate should be reduced from the current 6% to 5%. Other suggestions include doing away with the requirement for businesses to opt in to the regime for three years and requiring annual, rather than biannual, tax returns.

Small business corporation tax relief

The Tax Review Committee has concluded that the lower tax rates for small business corporations are not effective, do little to support the objective of small business growth and do not address tax compliance costs. The current regime provides tax relief to only 50 000 businesses and (in some instances) to professions not originally intended as beneficiaries.

The committee recommends replacing the reduced tax rate regime with an annual refundable tax compliance rebate (subject to certain conditions).

Government accepts this recommendation, subject to public consultation.

2.9 Tax Review Committee to publish its first report in 2014

The Minister of Finance appointed the Tax Review Committee in July 2013. The committee, headed by Judge Dennis Davis, has a broad brief to investigate aspects of the tax system and make recommendations for possible reforms. The committee's first interim report, which examines how the tax system affects small and medium-sized enterprises (SMEs), will be published for public comment soon.

Judge Davis summarises the committee's progress as follows:

> A report on small and medium enterprises was completed and delivered to the Minister of Finance in January 2014. The report was compiled after numerous representations from small business organisations and experts were carefully considered. It engages with the role of SMEs in the economy and examines their role as part of the National Development Plan. A series of

recommendations have been made for consideration by the Minister.

A draft document containing the committee's preliminary views on the appropriate normative framework for tax policy has been completed. It attempts to ground the discussion of an appropriate tax policy in solid data and best international practice. The aim is to strengthen tax policies that will be perceived to be 'fair' and help build social cohesion, while supporting inclusive growth.

The committee is looking into the effect of base erosion and profit shifting on the domestic tax base, the manner in which the tax system responds to increased cross-border activity and aggressive tax planning by multinational corporations. This includes consideration of transfer pricing, e-commerce, 'treaty shopping' to reduce tax liability and the use of debt and hybrid instruments. These inquiries should be completed by June 2014.

Three further investigations have commenced. On value-added tax the committee is considering questions such as does the present system achieve a justifiable balance between direct and indirect taxes, what are its retrogressive effects, is the system efficient and what challenges are posed by e-commerce? A second area is a review of the current system of mining taxes. This will involve wide consultation with all relevant stakeholders. Third is the role of wealth taxes in the tax system, including the position of estate duty, its relationship with capital gains tax and the broader role of wealth taxes in a system aiming to balance efficiency and equity.

2.10 Grant funding by non-business entities

Lack of adequate commercial skills and access to funding are major factors influencing the success of many small and medium-sized businesses. To encourage equity investment in such enterprises on a commercial basis, funders investing through a venture capital company can claim a tax deduction on their investment. In addition, certain entities providing support and financial assistance to micro enterprises (classified as poor and needy) can obtain public-benefit organisation status.

Some organisations, such as foundations, promote small enterprise development through grants. To support entrepreneurial development, government is considering options to provide tax relief to organisations involved in such activities. These options may include tax relief through the public-benefit organisation channel or a more dedicated tax provision.

2.11 Tax treatment of grants

Government proposes to make grants received by small and medium-sized enterprises tax exempt, regardless of the source of funds. The nature of such concessions will be considered, while taking care to prevent abuse of and avoid inconsistency within the tax system.

2.12 Venture capital company regime

The venture capital company tax regime aims to encourage investment into small businesses and junior mining companies. Since inception in 2008, uptake has been very limited, despite amendments in 2011. Following consultation with interested parties, government will propose one or more of the following amendments:

- Making deductions permanent if investments are held for a certain period of time.
- Allowing transferability of tax benefits when investors dispose of their holdings.
- Increasing the total asset limit for qualifying investee companies from R20 million to R50 million, and from R300 million to R500 million in the case of junior mining companies.
- Waiving capital gains tax on the disposal of assets, and expanding the permitted business forms.

2.13 Employment tax incentive

Government introduced the employment tax incentive on 1 January 2014 to help reduce youth unemployment. Currently, excess amounts can be set off against future PAYE liabilities. To enhance this incentive, SARS is developing a mechanism to reimburse firms in instances where the incentive exceeds PAYE payable. The refund system will become effective during the fourth quarter of 2014.

Government will monitor implementation of the incentive and may, if necessary, strengthen measures to protect workers from practices that abuse its intent.

2.14 Debt reduction rules

The Income Tax Act contains uniform rules covering the tax implications of debt reductions or cancellations. This system covers rules relating to ordinary revenue and capital gains. In terms of the new Companies Act (2008), creditors can vote to implement a business rescue plan, allowing a debt to be partially or fully discharged. This reduction or discharge can potentially result in a tax charge – circumventing the purpose of the business rescue concept by increasing the tax liability. Tax relief measures for companies undergoing business rescue and other forms of debt compromise will be considered.

2.15 Public-private partnerships

Government sometimes enters into public-private partnerships (PPPs) that involve making land available to private parties. These arrangements are designed to support public-sector infrastructure projects while maintaining state ownership of the land on which the project takes place. The Income Tax Act requires ownership of land before any depreciation can be claimed for improvements on that land. This stipulation does not take into account how depreciation or capital allowances may affect the viability of PPPs. Government proposes that relief be afforded to improve the financial viability of these projects. In addition, the requirement of land ownership limits the incentive for improvements in urban development zones and industrial policy projects. The merits of allowing deductions where the taxpayer is not the owner of the land will be considered.

2.16 Long-term insurance risk policies

Long-term insurers issue both risk and investment policies. Currently, all activities of long-term insurers are taxed in one of four funds – the individual policyholder fund, the company policyholder fund, the untaxed policyholder fund and the corporate fund. Where profits are taxed in one of the two taxable policyholder funds, the insurer is taxed as a trustee of the policyholders, since profits attributable to policies will in future be paid to the policyholders 'tax free'.

Government proposes that profits from the risk business of an insurer be taxed in the corporate fund similar to the manner in which short-term insurers are taxed. This will ensure that the corporate fund, rather than one of the policyholder funds, will be taxed on the risk policy business and profits. Government will also review the fairness of the taxation of the individual policyholder fund, where a 30% tax rate is applied, irrespective of the income level of policyholders.

2.17 Foreign reinsurance

Some long-term insurers reinsure policyholder liabilities with non-resident reinsurers. Policyholders of the South African long-term insurer often elect the underlying offshore investments to which the growth on their policies will be linked. Returns earned on the investments held by the reinsurer and paid as reinsurance benefits are not taxed in South Africa because reinsurance premiums and claims are wholly disregarded in determining the tax liability. Government proposes that net returns from foreign reinsurance be included in the tax calculation of the insurer.

2.18 VAT amendments - Second-hand goods – precious metals

A notional input tax is allowed when a VAT vendor acquires second-hand goods from a non-VAT vendor, allowing for the unlocking of part of the VAT on goods previously paid by final consumers as those goods re-enter the formal supply chain. Sales of certain gold coins are zero-rated for VAT. While the resale of gold jewellery by non-VAT vendors to VAT vendors should allow for the deduction of notional input VAT, in practice such jewellery is smelted along with gold coins and illegally acquired raw gold. This has created an enabling environment for fraudulent input tax deductions. Government proposes that second-hand goods made from precious metals be excluded from obtaining the notional input tax.

2.19 Four-monthly VAT category

This category of vendors was introduced in 2005 to assist small retailers. Vendors qualify if taxable supplies constitute R1.5 million or less during a 12-month period. Fewer than 1 000 vendors, with only R44 million output VAT and R23 million input VAT, were registered for this provision in 2012/13. Government proposes to eliminate this category and to bring registered vendors into the bimonthly VAT system.

2.20 Temporary write-off of disputed tax debt

Section 194 of the Tax Administration Act (2011) prevents SARS from temporarily writing off a debt while it is under dispute by a taxpayer. Government proposes to lift this prohibition.

2.21 VAT interest calculations

Under the VAT Act (1991), interest is charged on late VAT payments for a period in excess of the actual number of days between the due date and the date of payment. It is proposed that the interest rules under the Tax Administration Act (excluding monthly compounding) be activated for this category, ensuring that interest is imposed and paid on a fair basis.

2.22 Tax policy research projects

The following items are on the National Treasury's research agenda over the next two fiscal years, with some research having already started:

- A study of effective tax rates for companies in different sectors, including a review of the effectiveness of some tax incentives.
- A review of the VAT zero-rating provision for housing subsidies to eliminate practical anomalies. VAT standard-rating of these grants is under consideration, with an equal increase in the value of the grant.
- A review of how educational services and public transport are treated for VAT purposes.
- A review of the sustainability of the local government fiscal framework.
- A review of the taxation of cooperatives.

2.23 Personal insurance policies

The tax treatment of life and disability premiums and policy proceeds was aligned in 2013, with effect from 1 March 2015. The premiums will not be deductible and the policy proceeds will be tax free. However, the wording prohibiting the deduction of the premium for tax purposes does not cover all circumstances, which may allow providers to argue that certain structured products fall outside the ambit of the legislation. It is proposed that the wording be clarified so that premiums paid on all personal insurance policies not be allowed as a deduction against income, and that the policy proceeds from such policies are tax free.

The 'loss' requirement for keyperson policies: 'Keyperson' refers to a person who is key to the success of a business. In 2011, the tax regime for keyperson policies was changed to allow the taxpayer to elect a deduction for the premium on incurral and taxable policy proceeds or to accept the default non-deductible premium with tax-free policy proceeds. Most employers opted to accept the default option.

One of the requirements for an employer policy on a keyperson to qualify for the election is that the employer must be insured against any loss due to the death, disablement or severe illness of an employee or director. The policy will therefore not qualify if it protects the employer against, not a business loss, but a contingent liability such as the repayment of a loan should the employee or director die before the loan is repaid. A deduction relating to the cession of that policy contradicts the policy intent. It is proposed that the wording relating to the policy cession be deleted to confirm that an insurance policy will not qualify if it is not intended to insure the employer against a loss suffered as a result of the death, disablement or severe illness of an employee or director.

2.24 Employer-provided residential accommodation

The value of the fringe benefit for employer-provided accommodation is determined in relation to the 'rental value' representing the value of the use of the accommodation. Depending on the circumstances in which the employer provided the accommodation, different methods are used to calculate the rental value. It is either calculated according to a specific formula using the income of the employee, known as the 'remuneration proxy', and the period that the employee used the accommodation; the aggregate of the total rentals payable and other associated costs; or the portion of the accommodation costs borne by the employer that pertains to the use by the employee. It is proposed that the valuation of the fringe benefit resulting from employer-provided accommodation be reviewed. As a first step, the focus will be on accommodation rented from an unconnected third party, and shared accommodation.

Should the actual value of the use of the accommodation be less than the calculated rental value, the employer may apply for a tax directive from SARS for a lower amount. In instances where the employer provides rental accommodation sourced from a third party to an inbound expat employee, the calculated rental value is often higher than the actual value. As a result, employers often apply for a tax directive to ensure that the employee is taxed as a fringe benefit on the actual (market) value of the use of the accommodation. It is proposed that if employer-provided accommodation is rented by the employer from an unconnected third party, the value of the fringe benefit should be the cost to the employer in providing the accommodation.

In addition, there is no apportionment available where employees share employer-provided accommodation. It is proposed that a form of apportionment be considered.

2.25 Cross-border retirement saving

South African residents working abroad and foreign residents working in South Africa regularly contribute to local and foreign pension funds. With overall retirement reform now in effect, cross-border pension issues need to be reconsidered. Given the complexity of the issues involved, it is proposed that the review take place over two years, with extensive consultation.

On a related matter, certain provisions in the Income Tax Act refer to ‘pension’ or to ‘pensions or an annuity’. The wording excludes lump sum retirement fund benefit pay-outs. It is proposed that the provisions be amended to apply equally to annuities and lump sums.

2.26 Refinancing of third-party backed shares

The third-party backed shares anti-avoidance rule concerns preference shares with dividend yields backed by third parties. The dividend yield of third-party backed shares is treated as ordinary revenue. This anti-avoidance rule also applies to the refinancing of third-party backed shares. However, there are certain exceptions to this rule – it does not apply if the preference shares are used to fund equity share acquisitions in operating companies, because the net impact of the funding is generally neutral to the fiscus. This is also common in the case of preference share funding for black economic empowerment (BEE). Refinancing of third-party backed shares originally used to fund equity acquisitions in operating companies is not covered under the exceptions.

Because there is no policy rationale for excluding refinancing in structures covered under the exceptions to the rule, it is proposed that the refinancing of qualifying transactions be allowed.

2.27 Third-party backed shares used to acquire equity shares in exploration companies

The third-party backed shares anti-avoidance rule does not apply if the funds derived from preference shares are used to acquire equity shares in an operating company. An operating company conducts continuous business activities that result in the provision of goods and services for consideration. Exploration companies do not meet the requirement of operating companies because their business activities do not result in the provision of goods and services for consideration. As a result, preference shares issued to acquire equity shares in an exploration company (usually by BEE parties) fall foul of the rules. It is proposed that exploration companies be specifically included in the definition of ‘operating company’.

2.28 Limited pledges in respect of third-party backed shares

Preference share funders often require limited pledges, especially when funding certain company acquisition transactions. In these cases, the funder requires a pledge of the shares associated with the deal, without requiring any further enforcement rights or obligations. For the third-party backed shares anti-avoidance rule not to apply, a shareholder of the acquiring company (i.e. the preference share issuer) pledging its shares must hold at least 20% of the equity shares in the preference share issuer. However, many of the acquiring company equity shareholders in these cases hold less (directly or indirectly) than 20% in the underlying operating company. As a result, the funder bears all the risk because the value of the preference shares depends on the underlying operating company. It is proposed that the third-party backed shares anti-avoidance rule should not apply where the security provided to the funder is limited to equity shares held by acquiring company equity shareholders directly or indirectly in the underlying operating company.

2.29 Limited interest deductions for reorganisation and acquisition transactions

This rule was introduced to reduce the significant risk to the economy and the fiscus emanating from the use of excessive debt for funding company acquisitions. The rule uses a percentage of an amount calculated for tax purposes representing earnings before interest, tax, depreciation and amortisation (EBITDA) to limit interest deductions used in reorganisation and acquisition transactions. Certain unintended anomalies in the application and impact of these rules have been identified. For example, the taxpayer’s adjusted taxable income for the tax year preceding the transaction is not taken into account in determining the limitation, and the limitation percentage is only adjusted when the average repurchase rate exceeds a level of 10%, not 8%. It is proposed that these anomalies be addressed.

In addition, the formula used to calculate the limitation of the interest deduction currently takes assessed losses carried forward from previous years into account. This results in a further limitation on the base from which the overall limitation is calculated. It is proposed that the interest deduction limitation calculation should not take assessed losses brought forward from previous years into account.

2.30 Dividends tax refinements

An anomaly has been identified concerning the operation of the refund mechanism for non-cash dividends. It is proposed that new provisions addressing this anomaly be introduced.

2.31 Contributed tax capital roll-over for deferred shares

Contributed tax capital is a notional amount derived from contributions made to a company as consideration for its issue of shares. It is reduced by any amount that is subsequently transferred by the company back to one or more shareholders (commonly known as capital distribution).

Contributed tax capital roll-overs are permitted where shares are transferred in certain reorganisation transactions. The law also provides for roll-over treatment in instances where shares of a certain class are converted or substituted for shares of another class.

Deferred shares are issued at a premium and converted to ordinary shares once a company has achieved certain milestones. Roll-over treatment does not apply to deferred shares. As a result, the contributed tax capital on deferred shares will be lost because the class of shares to which it relates differs from the class of shares after conversion. This type of conversion was not considered when the concept of contributed tax capital was introduced. It is proposed that roll-over relief be granted when deferred shares are converted to ordinary shares.

2.32 Instruments – section 24J exclusion

Excluding policies issued by an insurer from the provision dealing with the incurral and accrual of interest on instruments (section 24J of the Income Tax Act): Insurance companies issue policies, such as endowment policies and smoothed or stable bonus products that have a guaranteed value for policyholders. These types of products may inadvertently be treated as instruments in terms of section 24J, which was never the intention. It is proposed that these policies be excluded from the scope of the interest accrual rules.

2.33 REITs (real estate investment trusts)

One of the tests determining whether a company is a property company refers to the percentage value of the assets attributable to immovable property, as reflected in its financial statements in accordance with the Companies Act. However, the act does not apply to foreign companies. To rectify this, financial statements in line with international financial reporting standards prepared for foreign property companies will be taken into account.

2.34 Further refinements to the oil and gas incentive

An oil and gas company holding an exploration or production right may assign all of its fiscal stability rights to another oil and gas company. Oil and gas companies may wish to enter into a joint venture and only assign a portion of the fiscal stability rights so that both parties are covered by the original fiscal stability agreement. It is proposed that part assignments of fiscal stability rights be allowed.

2.35 Research and development tax incentive – clinical trials

A recent amendment to the Income Tax Act aims to make the first three phases of clinical trials eligible for the research and development tax incentive. However, further amendments will be made to address a barrier to this objective. Recent amendments also led to unintended consequences for entities funding research and development activities carried out by another party.

These anomalies will be removed and both proposals will apply retrospectively of 1 January 2014.

2.36 Depreciation allowances for transmitting electronic communications

Government will review the conditions under which and the period over which depreciation allowances are claimable for lines or cables used to transmit electronic communications.

2.37 Environmental conservation

The incentive for land owners to enter into an agreement with government to declare land as a nature reserve or a national park will be streamlined. A proposal is under consideration to delink this incentive from the provisions of section 18A of the Income Tax Act and allow for a straight line deduction of the adjusted value of the land – at the time of entering into the agreement – over a period of 25 years.

2.38 Secondary adjustment for transfer pricing

Applying the secondary adjustment in the form of a deemed loan is an administrative burden, both for the taxpayer and SARS.

The accounting treatment of the deemed loan's repayment and interest is difficult, because there is no legal obligation to repay the loan. It is recommended that the transfer pricing provision be amended to state that the secondary adjustment is deemed to be a dividend or capital contribution depending on the facts and circumstances.

2.39 Foreign dividends of controlled foreign companies owned by individuals

If a resident individual's controlled foreign company receives a taxable foreign dividend, the effective tax rate on the dividend is 21%. It is proposed that the ratio be changed to reflect the fact that an individual, not a company, is taxed with reference to the foreign dividend.

2.40 High tax exemption for controlled foreign companies

The structure of section 9D of the Income Tax Act, which attributes the net income of a controlled foreign company, requires a high foreign tax exemption to be tested before certain amounts can be excluded. The high tax exemption involves a hypothetical South African tax calculation based on the transactions of a controlled foreign company as if it had been a South African tax resident. If the actual foreign tax is at least 75% of the hypothetical South African tax, then no amount under section 9D is taxed in the hands of the South African resident controlling the foreign company.

In the case of a South African resident company that owns many foreign companies, it is cumbersome to establish whether the high tax exemption applies if most of the income of the controlled foreign companies is attributable to a foreign business establishment. It is proposed that an option be provided to deem the net income of a controlled foreign company to be nil if either the high tax or the foreign business establishment test, when applied to aggregate taxable amounts, is met.

2.41 Currency of reacquisition of assets of individuals ceasing to be resident

A person who ceases to be a resident is subject to a deemed disposal and reacquisition of shares in a property company owning property in South Africa. However, it is not clear in which currency the shares reacquisition takes place.

This has an effect on the tax calculation when the shares are sold or otherwise disposed of by the nonresident.

It is proposed that this should be clarified.

2.42 Fishing vessels registered in South Africa

In 2013, a new tax regime for international shipping was introduced. The rule providing for an allowance for repairs to ships has inadvertently been deleted.

Reinstatement of this provision from the date of its repeal (12 December 2013) is proposed.

2.43 VAT - Going concerns

VAT legislation and an accompanying interpretation note (number 57) on the VAT treatment when a going concern is sold require clarification. The legislation requires the supply to be made to a registered vendor. According to the interpretation note, the recipient must agree that at the effective date it will be a vendor. The legislation will be amended to remove the uncertainty regarding whether a person must be a vendor before the acquisition of the going concern.

2.44 Tax invoices, debit and credit notes

A supplier, being a registered vendor (the principal), is required to issue a tax invoice within 21 days of the date of the supply. This time limit will be extended to agents.

However, there is no specific time limit in which the credit or debit note must be issued. The legislation will be amended to set a time limit.

2.45 Agents

There is uncertainty as to which documentation is acceptable as proof of payment to entitle a vendor to deduct input tax in respect of VAT paid on the importation of goods. Clarity will be provided on which documentation is acceptable.

2.46 Contract prices

A supplier of goods or services is able to recover from the recipient an amount of VAT ‘imposed’ on the supply after the agreement is concluded. The legislation will be amended to exclude suppliers who failed to register as VAT vendors.

2.47 Bargaining councils

Goods and services provided by a bargaining council to its members, based on membership contributions, are exempt from VAT. This will be amended to include the supply of administration services for which the bargaining council receives a separate fee (the interest that it is entitled to in terms of the main collective agreement).

2.48 Zero-rating of goods for agricultural, pastoral or other farming purposes

The VAT Act provides for zero-rating where the supply of goods are used or consumed for agricultural, pastoral or other farming purposes. This concession was intended to provide cash-flow relief to the agricultural sector. However, evidence suggests that some suppliers entered into transactions to obtain fraudulent input tax deductions.

This zero-rating provision will be reviewed in consultation with relevant stakeholders for possible replacement with VAT at the standard rate.

2.49 VAT treatment of legal tender or money

Money issued by the Reserve Bank is exempt from VAT. The definition of money or legal tender in the context of this exemption will be reviewed, taking into account that the printing of money is subject to VAT at the standard rate. The zero-rating of the supply of legal tender or money is under consideration.

3. TAX ADMINISTRATION LAWS AMENDMENT ACT, 2013

3.1 Section 270(6) of the Tax Administration Act

Section 270 of the Tax Administration Act, 2011, is hereby amended by the substitution for subsection (6) of the following subsection:

‘(6) Additional tax, penalty or interest may be imposed or levied as if the repeal of the legislation in Schedule 1 had not been effected and may be assessed and recovered under this Act, if—

(a) additional tax, penalty or interest which but for the repeal would have been capable of being imposed, levied, assessed or recovered by the commencement date of this Act, has not been imposed, levied, assessed or recovered by the commencement date of this Act; or

(b) an understatement penalty, administrative non-compliance penalty or interest under this Act cannot be imposed, levied, assessed or recovered in respect of an understatement as defined in section 221, non-compliance or failure to pay that occurred before the commencement date of this Act.'

3.2 Section 270(6A) – (6D) of the Tax Administration Act

Section 270 of the Tax Administration Act, 2011, is hereby amended by the by the insertion after subsection (6) of the following subsections:

'(6A) For the purposes of subsection (6), 'capable of being imposed' means that the verification, audit or investigation necessary to determine the additional tax, penalty or interest had been completed before the commencement date of this Act.

(6B) If a return was due by the commencement date of this Act, the requirement under section 223(3)*(b)*(i) is regarded as having been met for the purposes of remittance of a substantial understatement penalty.

(6C) A person who made a valid voluntary disclosure before the commencement date of this Act, qualifies for the relief referred to in section 229*(b)* if the audit or investigation of the person's affairs has commenced before but only concluded after commencement date of this Act and the requirements of Part B of Chapter 16 have been met.

(6D) If an understatement penalty is imposed as a result of an understatement, as defined in section 221, made in a return submitted before the commencement date of this Act, a taxpayer may object against the penalty under Chapter 9 (whether or not the taxpayer has previously objected against the assessment imposing the penalty) and if the return was required under—

(a) the Income Tax Act, a senior SARS official must, in considering the objection, reduce the penalty in whole or in part if satisfied that there were extenuating circumstances; or

(b) the Value-Added Tax Act, a senior SARS official must reduce the penalty in whole if the penalty was imposed under circumstances other than the circumstances referred to in item (v) of the understatement penalty table in section 223(1).'

4. REGULATIONS / NOTICES

4.1 Media Release – C:SARS v Mark Krok

PRETORIA, 31 JANUARY 2014 – Judgment was delivered earlier today in the Gauteng North High Court confirming a preservation order granted to the SARS over the South African assets of Mr Mark Krok (the respondent).

The respondents were also ordered to pay the costs of two counsel for SARS.

This action is the first mutual collection of taxes action between South Africa and Australia in terms of Article 25A of a Double Taxation Agreement between the two countries and an initial step to combating non-payment of taxes and strengthening the working relationship between South Africa and Australia.

SARS welcomes the Gauteng North High Court judgment as it confirms an important legal principle of mutual assistance and cooperation amongst revenue authorities in different countries. SARS believes the judgment will advance the capability of revenue authorities to combat cross border tax evasion and attempts to conceal or dissipate assets, particularly by high-net worth individuals.

SARS has, in terms of section 185(1)(b) of the Tax Administration (TA) Act, called upon Mr Krok to state whether or not he admits liability for the amount of R235 million or for a lesser amount of debt owed to the Australian Tax Office (ATO). Should Mr Krok fail to respond or comply with the provisions of Section 185 of TA Act, SARS will demand payment of the full outstanding amount of the said tax, which may result in immediate collection steps being instituted by SARS.

Background

During January 2012, SARS received a request in terms of Article 25A of the Agreement between the Government of Australia (represented by the Australian Tax Office – 'the ATO') and the Government of the Republic of South Africa, to provide assistance in the collection of taxes between the respective countries. The purpose of this agreement was to avoid double taxation and the prevention of fiscal evasion in respect of taxes. The request from the ATO indicated that there was a risk of dissipation or concealment of assets by Mr Mark Krok.

The agreement was entered into on 1 July 1999 and amended by a Protocol on 31 March 2008. The Agreement and the Protocol were entered into by the South African Government in terms of s.108(2) of the Income Tax Act, No. 58 of 1962 read with s.231(4) of the Constitution 108 of 1996. The agreement and Protocol became part of South African Law in terms of the Constitution of the Republic, as they were approved by Parliament in terms of s.231(2) of the Constitution and the arrangement was duly published in the Government Gazette of 23 December 2008.

Request from ATO

The request from the ATO to SARS was thus for the tax collection and conservancy of the assets of Mr. Mark Krok in South Africa, pending the collection of the amount alleged to be due by Mr. Krok under the tax laws of Australia. The request was also accompanied by a formal certificate issued by the ATO stating that Mr. Krok owed taxes to the ATO in the amount of AU$ 25,361,875.79 (R235,875,169.19 at the time).

SARS agreed to lend assistance and successfully obtained a provisional preservation order and appointed a *curator bonis* to take control of the South African assets of Mr Krok, in terms of Section 163 of the Tax Administration Acton 18 February 2013. The order effectively secured all assets of Mr Krok to the value of R297 million (including a R40 million property purchased in Clifton) for the collection of the outstanding tax debt of R249 million owed to the ATO, whilst allowing some grace for the release of funds for living and legal expenses.

A further challenge was the intervention of a second party, being Jucool Enterprises Inc. ('Jucool'), a company registered in the British Virgin Islands. Jucool asserted that they were the beneficial owner of the assets forming the subject of the preservation order. SARS argued that Jucool failed to prove its alleged beneficial ownership.

The following two main topics were argued before Gauteng North High Court, on which the court ruled today-

1. **The issue regarding retrospectivity** - whether taxes raised before the amendment of the Protocol and newly inserted Article 25A could be collected. SARS argued that Article 25A had no temporal limitation, i.e. that there is no specification in regard to the period for which taxes are owed. The judge agreed with SARS argument that all taxes due since 1999 could be collected via the new Protocol.

2. **Whether the assets were transferred from Mr Krok to Jucool in terms of South African Law** - questioning whether the transaction was made in order to hide the assets from tax collection by the Australian and South African tax authorities. The Gauteng North High Court found that there was no immediate transfer of rights to Jucool and that Krok intended to create personal rights in favour of Jucool, pending consent being granted.

5. DRAFT REGULATIONS

5.1 Regulations prescribing electronic services for the purpose of the definition of ‘electronic services’ in section 1 of the VAT Act

Definitions

1. In these Regulations, unless otherwise indicated, any word or expression to which a meaning has been assigned in the Act, bears the meaning so assigned, and—

‘electronic agent’ means any electronic agent as defined in section 1 of the Electronic Communications and Transactions Act;

‘electronic communication’ means electronic communication as defined in section 1 of the Electronic Communications and Transactions Act; 2

‘Electronic Communications and Transactions Act’ means the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002);

‘information system’ means any information system as defined in section 1 of the Electronic Communications and Transactions Act;

‘information system services’ means any information system services as defined in section 1 of the Electronic Communications and Transactions Act;

‘internet’ means the internet as defined in section 1 of the Electronic Communications and Transactions Act;

‘internet-based auction service’ means the supply of an online market place through an electronic agent where—

(a) any person as part of an enterprise or any consumer places a description of any goods or services for sale or supply; and

(b) those goods or services are then sold or supplied through a bidding process through that electronic agent;

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

'web site' means any website as defined in section 1 of the Electronic Communications and Transactions Act.

Purpose of Regulations

2. (1) These regulations prescribe those services that are electronic services for the purpose of the definition of 'electronic services' in section 1 of the Act.

(2) These regulations apply to any supply of electronic services in the course or furtherance of an enterprise carried on by a person from a place in an export country—

(a) to a recipient that is a resident of the Republic; or

(b) where any payment to that person in respect of such electronic services originates from a bank registered or authorised in terms of the Banks Act, 1990 (Act No. 94 of 1990).

(3) The services listed in regulation 3 (educational services), regulation 4 (games and games of chance), regulation 5 (information system services), regulation 6 (internet-based auction services); regulation 7 (maintenance services), regulation 8 (miscellaneous services) and regulation 9 (subscription services) are electronic services where such services are supplied by means of any electronic agent, electronic communication or the Internet for any consideration.

Educational services

3. The supply of any—

(a) distance teaching programme;

(b) educational webcast;

(c) internet-based course;

(d) internet-based education programme; or

(e) webinar,

if the person making the supply of the educational services is not regulated by an educational authority in that export country.

Games and games of chance

4. The supply of any—

(a) internet-based game, including any—

(i) electronic game; or

(ii) multiplayer role-playing game;

(b) interactive game, where such interactive game is a—

(i) game of chance;

(ii) game where the result is influenced by the skill of the player; or

(iii) game which is a combination of chance and skill; or

(c) electronic betting or wagering, where such electronic betting or wagering constitutes participation in the activities contemplated in sections 4(1) and (2) of the National Gambling Act, 2004 (Act No. 7 of 2004).

Information system services

5. The provision of any information system services.

Internet-based auction service

6. The supply of an internet-based auction service facility.

Maintenance services

7. The administration, maintenance and technical support of or in relation to any—

(a) blog;

(b) database;

(c) information system;

(d) information system services; or

(e) web site.

Miscellaneous services

8. The supply of any—

(a) **e-book**, which for the purposes of this regulation means, any—

(i) digitised content of any book; or

(ii) electronic publication;

(b) **film**, which for the purposes of this regulation means, any—

(i) broadcast not simultaneously broadcast over any conventional television network in the Republic;

(ii) documentary;

(iii) home-made video;

(iv) live streaming performance;

(v) movie;

(vi) music video;

(vii) program;

(viii) television series; or

(ix) video clip,

and any right to view any item listed in this regulation;

(c) **images**, which for the purposes of this regulation means, any—

(i) desktop theme;

(ii) photographic image;

(iii) pictorial image; or

(iv) screensaver,

and any right to view any item listed in this regulation;

(d) **music**, which for the purposes of this regulation means, any—

(i) audio clip;

(ii) broadcast not simultaneously broadcast over any conventional radio network in the Republic;

(iii) jingle;

(iv) live streaming performance; 5

(v) ringtone;

(vi) song; or

(vii) sound effect,

and any right to listen to any item listed in this regulation;

(e) **software**, including—

(i) application software;

(ii) system software; or

(iii) plugins,

and any update to any software listed in this regulation.

Subscription service

9. Any subscription service to any—

(a) blog;

(b) database;

(c) information system services;

(d) journal;

(e) magazine;

(f) newspaper;

(g) games;

(h) internet-based auction service;

(i) periodical;

(j) publication;

(k) social networking service;

(l) webcast;

(m) webinar;

(n) web site;

(o) web application; or

(p) web series.

Short title and commencement

10. These regulations are called the Electronic Services Regulations and come into operation on 1 April 2014.

6. TAX CASES

6.1 ITC 1867

The taxpayer and its 100% holding company, KL, were SPVs, special purpose vehicles, the sole purpose of the taxpayer being to acquire and hold the FG shares. No other business was transacted, no physical director’s meetings were held and the taxpayer’s only other obligations were those associated with the funding obtained to acquire the FG shares and the normal statutory obligations such as filing tax returns and the preparations of financial statements.

The taxpayer had been funded to the extent of R100 million by virtue of the issue of three year and one day preference shares issued to ABC and ABC required the taxpayer to be a ring fenced SPV which concluded no activity other than the holding of the FG shares which were pledged as security to the bank for the redemption of the preference shares.

The taxpayer was also funded by a shareholder's loan of R150 million, this funding having been advanced by D Ltd to the taxpayer's sole shareholder KL, which, as already noted, was also a SPV.

This appeal primarily concerned the question of whether proceeds of the disposal by the taxpayer of certain shares in the FG (Pty) Ltd ('FG') in the 2005 year of assessment were of a capital or revenue nature. If, as the taxpayer alleges, the proceeds stand to be classified as of a capital nature, the further question arises as to whether the expenditure of R45 123 050 actually incurred and paid by the taxpayer to KL (Pty) Ltd ('KL') and by KL to D Limited ('D Ltd') as a so called 'equity kicker' in respect of loans from D Ltd to KL and from KL to the taxpayer were to be excluded from the capital gain made by the taxpayer on the sale of the FG shares.

If the proceeds were of a capital nature, then the further question arose as to whether an expenditure of R55 million, which the taxpayer contended was actually incurred by it in the 2005 year of assessment, in respect of an indemnity obligation arising as a concomitant of the purchase of the FG shares, ought to be excluded from the capital gain made by the taxpayer on the sale of the FG shares, in that this amount formed part of the base cost thereof.

By contrast, if the gain was to be classified as of a revenue nature, the question then arose as to whether the expenditures of R45 123 050 and R55 million constituted deduction from the revenue gain.

Finally, the question of interest levied by the SARS in terms of the additional assessment of 1 May 2010 for the taxpayer's 2005 year of assessment needed to be considered.

In order to determine the aforementioned questions it was necessary to sketch the chronology in the dispute between the parties.

By 2000, M Ltd, a listed company in the retail furniture industry, had encountered serious financial difficulties. At the end of 2001, it owed in excess of R900 million to a certain bank ('ABC'), which was also financially exposed to other companies in the furniture industry. In consequence therefore, ABC was seriously exposed to extremely significant financial risks. ABC therefore sought a rescue plan for M Ltd in order to reduce its financial exposure. According to the evidence of Dr X, a senior executive of ABC, Mr. Y was used as an intermediary to initiate an approach to a prominent German entrepreneur Mr. Z who had previously invested in the South African furniture industry, with the view to Mr. Z investing fresh capital into M Ltd. Mr. Z expressed interest therein but only if the management of M Ltd was taken over by Mr. O of the FG Group, whom he regarded as having the necessary skills 'to turn the M Ltd ship around.' A further condition of Mr. Z's participation was that ABC must agree to provide funding for the proposed transaction by way of preference shares that would be redeemable after three years and one day. According to Mr. Z, both capital and management were required to affect a rescue of M Ltd, which, in turn, would have prevented ABC from incurring a massive financial loss.

Mr. O of the FG Group agreed to take over the interim management of M Ltd, which was in dire straits, and was agreeable to the participation of Mr. Z, but required a commitment from Mr. Z to remain invested at least until the M Ltd ship had been 'turned around', which he estimated would take in excess of three years.

The detailed solution took the form of a rights issue by M Ltd which resulted in R600 million of the debt owed by M Ltd to ABC being converted to equity, followed by a merger whereby M Ltd shares were exchanged for FG shares and an agreement for the sale of FG shares was concluded in which a consortium led by Mr. O ultimately acquired 5/6 thereof, with the remainder being retained by ABC.

In the result, the O consortium acquired some R35 million FG shares for R500 million and, pursuant to this proposal, a series of agreements and amended agreements were entered into, commencing with a memorandum of understanding ('MOU') signed by Mr. Z in Rastede, Germany on 26 June 2002. It was accepted by all the relevant parties that this MOU gave rise to a binding commitment and that the risk and rewards in the contemplated transaction passed to Mr. Z on behalf of a consortium which included himself and the taxpayer with effect from 21 June 2002, being the effective date of the MOU.

It appeared that, when the arrangements were implemented, the price of the shares ultimately acquired by the taxpayer and by Mr. O was fixed at their value on 21 June 2002, and interest was paid by the purchaser with effect from that date.

The ultimate structure which was adopted was that one half of the FG shares were acquired by Mr. Z's German company – O et Cie and the other half was acquired by the taxpayer.

Further delays took place, owing to the need to obtain Competition Commission and Reserve Bank approvals and, in summary; the taxpayer finally acquired its shares on 5 December 2003, pursuant to negotiations which commenced in late 2002 and culminated in the MOU in June 2002 and the agreements and amended agreements which followed thereafter.

The taxpayer's half was to be funded by the issue of preference shares by itself to ABC in the amount of R100 million, and the balance of R150 million was to be paid in cash (which was ultimately funded by D Ltd by way of a loan to KL, the taxpayer's sole shareholder, which in turn lent the R150 million to the taxpayer.

It was a condition of the funding advanced by D Ltd that it would be used to enable the taxpayer to acquire the FG shares and D Ltd obtained a reversionary right in respect of the FG shares pledged to ABC as a partial security for the repayments of the funding advanced by it to KL and in turn by KL to the taxpayer.

The arrangement between Mr. Z and Mr. Y was that Mr. Z would at all times control the full parcel of some 35 million shares in the FG Group. Mr. Z described this arrangement as him being the 'captain of the boat in which Mr. Y was a passenger', and he was adamant that he alone had the right to make all decisions concerning the full block of some 35 million FG shares.

The taxpayer was owned by companies controlled or introduced by Mr. Y although Mr. Y was not a director of the taxpayer at the times material to this appeal. The directors of the taxpayer were Mr. Z and the manager of his South African interests, Mr. DD, as well as Dr X who represented the interests of the ABC (to which the FG shares acquired by the taxpayer had been pledged) and Mr. NN, who represented the interests of D Ltd, which had advanced funding to the taxpayer through the latter's 100% holding company, KL.

Both the taxpayer and its 100% holding company, KL, were special purpose vehicles (SPVs), the sole purpose of the taxpayer being to acquire and hold the FG shares. The taxpayer transacted no business, no physical director's meetings were held, and the taxpayer's only other commercial obligations were those associated with the funding required to pay for the FG shares and the normal statutory obligations such as filing tax returns and the preparation of financial statements. As stated above, the taxpayer was funded to the extent of R100 million by virtue of the issue of three year and one day preference shares issued to ABC. ABC required the taxpayer to be a ring fenced SPV which concluded no activity other than the holding of the FG shares which were pledged as security to the bank for the redemption of the preference shares. The taxpayer was also funded by a shareholder's loan of R150 million, this funding having been advanced by D Ltd to the taxpayer's sole shareholder KL, which, as already noted, was also a SPV.

It was a condition of the funding advanced by D Ltd that it would be used to enable the taxpayer to acquire the FG shares and D Ltd obtained a reversionary right in respect of the FG shares pledged to ABC as a partial security for the repayment of the funding advanced by it to KL and in turn by KL to the taxpayer.

The acquisition of the FG shares carried with it two additional liabilities. In the first place, a liability, initially contingent, arose from the fact that the taxpayer was obliged to assume its share of an indemnity obligation which flowed from the acquisition of the M Ltd shares by ABC which had granted an indemnity of R150 million to FG Group in respect of certain M Ltd liabilities identified in the course of a due diligence exercise performed by its auditors, R125 million of which, in turn, was indemnified by the consortium in favour of ABC, R62.5 million by O et Cie and R62.5 million by the taxpayer respectively after the sale of the FG shares. During the same 2005 year of assessment, the taxpayer assumed an unconditional liability of R55 million in favour of Mr. O in respect of the taxpayer's share of the indemnity and O et Cie assumed full liability under the indemnity to ABC, which enabled the latter to release the funds arising on the sale of the FG shares by the taxpayer rather than retaining funds sufficient to cover the amount of the taxpayer's previous shares of the indemnity.

The second liability which arose was to pay the 'equity kicker' to D Ltd by way of KL, which amount represented D Ltd's share of the gain arising through the sale of the FG shares by the taxpayer.

The taxpayer provided a tax indemnity to ABC pursuant to the acquisition of the FG shares, in respect of potential liabilities that might arise for FG as a result of the acquisition of the M Ltd business. The liability of the taxpayer in terms of this indemnity was limited to R55 million.

During the latter part of December 2003 and the first month of 2004, the Rand depreciated significantly and, according to his evidence, Mr. Z re-assessed his investment portfolio, which he regarded as having been disproportionately exposed to the South African Rand and his large exposure to the South African currency together with structural economic factors which, in his view, increased the risk of investments, resulted in Mr. Z, seeking to realise certain of his South African investments.

In November 2003, evidence, which was common cause, revealed that Mr. J of the E Group had discussed a book building exercise with Mr. Y at a coffee shop in San Francisco at a time when they were both involved with a similar exercise to raise capital for TSD, of which Mr. Y was the chief executive officer.

Some months later in March 2004, the E Group made a presentation concerning the process of a book building exercise, the aim of which was to dispose of the entire investment in the FG Group in a transaction to institutional investors without the risk of creating what was referred to as an ‘overhang’. Shortly thereafter, Mr. Z met Mr. J in Johannesburg on or about 25 March 2004, to discuss the concept of ‘book building’.

A meeting took place between Mr. Z and Mr. O, at which Mr. O raised no objection to the proposed sale. At that meeting Mr. Z sought to ascertain Mr. O’s attitude to a possible sale of the FG shares in the light of the fact that he, Mr. Z, had undertaken to ‘stay the course’ until ‘the M Ltd ship had turned around.’ This was described by Mr. Z as Mr. O ‘freeing’ him to sell the FG shares.

In terms of the agreement between the taxpayer and E Group, completion of the sale and purchase of 14 141 182 of the FG shares by E Group was to take place on 21 April 2004 and the payment was also made on that date by E Group to the taxpayer.

On 30 April 2004 D Ltd and KL concluded a further agreement to settle the loan agreement. At this time the taxpayer had sold the FG shares acquired in terms of the agreement and the parties therefore agreed to calculate the ‘equity kicker’ which was payable to D Ltd on the basis of the proceeds actually realised by the taxpayer upon its disposal of the FG shares.

On 12 July 2004 Mr. Z resigned as a director of the taxpayer, with effect from 30 April 2004 together with Mr. DD, Dr X and Mr. NN. Mr. Y was for the first time appointed to the board of the taxpayer on 12 July 2004. On 13 July 2004 an agreement between O et Cie and ABC was concluded in terms of which O et Cie assumed liability for the full indemnity agreed to by the taxpayer and ABC on 1 December 2003 and the taxpayer undertook to make a future payment of R55 million to O et Cie, on the basis that even if the amount payable by O et Cie to ABC in terms of the indemnity ultimately proved to be less than R55 million, the taxpayer would nevertheless pay the amount of R55 million to O et Cie.

The taxpayer declared and paid capital gains tax (CGT) on 28 February 2005 upon its disposal of the FG shares by way of a provisional tax payment of some R66 million on the basis that the taxable capital gain had been realised in terms of section 26A of the Income Tax Act read together with the Eighth Schedule thereto.

In an additional assessment SARS had included the proceeds of the disposal of the FG shares in the taxpayer’s gross income, on the basis that the proceeds were not of a capital nature.

The taxpayer objected to this assessment on the ground that the proceeds were indeed of a capital nature, and that its liabilities in respect of both the ‘equity kicker’ and the indemnity formed part of the base cost of the shares disposed of, for the purposes of CGT.

The taxpayer contended that, if its intention had to be determined with reference to that of Mr. Y, who unlike Mr. Z had a clear economic interest in the taxpayer, then at no material time did Mr. Y contemplate or intend the sale of the FG shares, but his wishes were subordinated to and overridden by those of Mr. Z. For all purposes concerning the sale of these shares, Mr. Z was the controlling director and mind of the company and Mr. Z said on numerous occasions during his evidence that he was the ‘captain of the ship’ and he had sole power to make the key decisions.

The taxpayer accordingly contended that the overwhelming inference to be drawn from an examination of this evidence was that the taxpayer had made a strategic long-term investment in the FG Group, that there was no discussion between Messrs Mr. O and Mr. Y as to whether and when they would exit the investment, whereas there had been earnest discussions about what would occur if Mr. O was unable to turn around the M Ltd business.

The taxpayer contended that there had not been a change of intention, whereby the shares initially held as capital assets had now changed character to stock-in-trade.

In regard to the deductibility of the equity kicker and indemnity settlement amount, SARS contended that the payments made in regard to the equity kicker were made in the absence of any unconditional legal obligation by the taxpayer requiring it to do so, with the result that the expenditure did not stand to have been incurred by the taxpayer.

Judge Davis held the following:

<u>As to the revenue or capital nature of the disposal of the FG shares</u>

(i) That whatever a taxpayer may tell the court has to be analysed through the prism of the objective facts presented to the court and when the evidence of the relevant persons testifying on behalf of the taxpayer are analysed through the prism of objective facts, then the intention of the taxpayer, both at the time of acquiring assets and at the time of the sale may well be of decisive importance and in this case the question arose as to how to ascertain the intention of the taxpayer.

(ii) That a true picture of the taxpayer appeared to be that Mr. Y was, for all purposes the organiser of the taxpayer, responsible for the financing of the taxpayer, and hence the brain of the company. Mr. Z confirmed that this submission was correct, save for Mr. Z's role to ensure that the shares would be sold as one block. In this connection, the evidence suggested that Mr. O's decision would prevail and bind the taxpayer in regard to the sale of the shares.

(iii) That the objective evidence, read as a whole, suggested that the investment in the FG shares was to last for a period of at least 3 years, arguably slightly longer, depending upon the success of the venture. While Mr. Z did seek to paint a gloss on the taxpayer's case by suggesting that there was a possibility that he might acquire more FG shares in the future and perhaps even take control of the company, this appeared to be a decision which he would have only taken as a means of salvaging something from an investment if it failed or had gone poorly.

(iv) That a constant theme running through Mr. Z's evidence was that he wanted to have the freedom to deal with his 'investment' as he saw fit. There were no significant restrictions which were imposed upon Mr. O and Mr. Y insofar as the FG shares were concerned, save that they would remain invested until the M Ltd transaction had 'been bedded down'.

(v) That a significant factor in the overall assessment was the fact that whatever Mr. Y's evidence with regard to his long-term intentions, he had attempted to raise money for the FG transaction for a maximum of a 3 to 5 year period.

(vi) That a further significant factor was the nature of the equity kicker, to which reference had been made in the introduction as part of the financing package, supported the argument that there was an intention to fund the loan repayments by way of a sale of the shares, because the equity kicker was clearly calculated to constitute a portion of the gain realised by the borrower on the assets acquired with the loan. The loan agreement made it clear that the envisaged source of funds to pay the equity kicker would be the proceeds of the FG shares, the cash from which had to come to KL through a declaration of a dividend by the taxpayer. However, even if there had been a refinancing of the taxpayer's debt, the equity kicker would have become immediately repayable.

(vii) That the evidence of Mr. J could not be easily discounted. It was common cause that at the meeting in San Francisco in November 2003, less than a month before the ultimate acquisition of the shares, Mr. Y initiated a discussion with Mr. J as to whether shares could be sold by way of a book building exercise, albeit that various versions of this meeting were presented and the witnesses were careful not to confirm that the only transaction on the agenda was that of FG shares.

(viii) That it appeared that Mr. Y had disclosed the name of the FG group, the size of the stake he had in mind as well as Mr. O's involvement. Not long thereafter, further discussions took place; that is in February 2004. Mr. Z testified further that, not only had he heard about this concept from Mr. Y at the Frankfurt Furniture Fair in January 2004, but that Mr. Y had informed Mr. Z that 'E Group was keen to make a book building'. Although there was some denial about who had taken the initiative, the letter which had been generated by the E Group to SARS clearly indicated that Mr. Y had raised the question of the applicability of a book building exercise.

(ix) That the question of the retention of shares in the capital versus revenue inquiry needed to be re-examined in the light of modern market conditions.

(x) That, significantly, if one examined the New York Stock Exchange in the year 2000, companies such as Compaq, EF Hutton, Paine Webber, MCI World Com, Eastern Airline, Enron, Woolworth's (the US company not the South African unrelated organisation), Panam, The Pullman Company, Arthur Andersen, General Foods Corporation, TWA were all part of many balanced share portfolios. By 2013, all have now disappeared. It could thus not be expected that holding shares 'for keeps' would thus have made investment sense nor, given the rapid rise of technological innovation, was it likely that companies will be successful for overly lengthy periods. The idea of 'shares for keeps' is thus reflective of an old, static economic order that no longer exists.

(xi) That, nevertheless, the question which arose in this case and which remained the key test was what was the intention of the taxpayer both at the point of acquisition and at the sale. The fact that the taxpayer did not have to show that shares are 'held for keeps' did not relieve it of the burden of proving that it was intended to be an investment for some significant duration. Further, in the present case, these shares were not part of an investment share portfolio which may have needed more rapid responses to protect the overall investment, but a once-off transaction.

(xii) That the evidence suggested that Mr. Z was not a reluctant seller. He and the taxpayer through Mr. Y realised that they could take advantage of a transaction which had turned significantly in their favour. The possibilities of a sale had always been in their mind from the commencement of the transaction as was evidenced by the nature of the financing, the equivocal approach by Mr. Z as to his exact intention, the discussions between Mr. J and Mr. Y about the book building exercise and the expedition in the actual sale of the shares.

(xiii) That the evidence did not discount the possibility of an early realisation and it could not be concluded on the strength of the available evidence that the probabilities were in favour of the shares being initially acquired as a capital asset.

(xiv) That it was significant that in correspondence with the Reserve Bank in October 2003, it was stated that the taxpayer's intention was to hold the shares for the long term, yet not more than a month later, consideration was already being given to the disposal of the shares which ultimately took place in April 2004. The evidence concerning the intention on acquisition was thus not definitively in the taxpayer's favour; it did no more than show that there was always an intention to realise the shares for a significant profit. The question was not if but when a sale would occur. Hence, a profit-making intention was always a dominant purpose within the mind of those who controlled the taxpayer; from Mr. Z's own evidence, it was clear that he was keeping his options open as to when to sell, possibly hold for longer than initially intended, acquire more shares or attempt to obtain a controlling interest in the FG Group and a variety of possibilities lay open at the time of acquisition.

(xv) That much was made of the evidence of Mr. Z to contend that he was the controlling mind of the taxpayer and that he was the captain of the boat. Further, it was contended that Mr. Y strove to hold the taxpayer's FG shares as was evident in the taxpayer's retention of a parcel thereof and, whatever the answer thereto, the taxpayer bore the *onus* and in this case the enquiry needed to focus on who was the 'mind of the company'.

(xvi) That in this case Mr. Y was clearly 'the mind' of the taxpayer. Whoever were the directors, it was in substance 'his' company. Assuming in the taxpayer's favour that in respect of this investment, Mr. Z was the controlling mind, to the extent that this concept applied specifically to the FG shares, the evidence did not provide an answer, on the probabilities, that this was to be a long-term investment. There may have been a purpose to so hold, but there is no clear proof of it being the dominant purpose. If the taxpayer was treated separately from Mr. Z, the duration of the D Ltd loans only adds to the picture of a mixed intention. Within a very short period however, the sale of the FG shares was on the agenda, initiated by Mr. Y and explored further by Mr. Z. When both the purpose at the time of acquisition and sale are considered, it cannot be concluded, on the probabilities, that a long-term investment was realised to best advantage. To the contrary, the mixed intention had converted into a clear purpose of selling to 'cash in' on the profit.

As to the deductibility of the equity kicker and the indemnity settlement

(xvii) That in terms of s 11(*a*) of the Income Tax Act 58 of 1962 the taxpayer may deduct expenditure and losses actually incurred in the production of income, provided that such expenditure and losses are not of a capital nature. This provision is qualified by s 23(*g*) of the Act which provides that no deduction shall be made in respect of any monies to the extent to which such monies were not laid out or expended for the purposes of trade.

(xviii) That if, as has been found, the gain from the disposal of the FG shares stands to be classified as a revenue gain in the hands of the taxpayer, the obligation, pursuant to the equity kicker, was, in substance, incurred by the taxpayer who was required to discharge that obligation. As Mr. Y testified, KL was nothing more than a SPV, a conduit which was required in the discharge of the equity kicker.

(xix) That the 'equity kicker' was expenditure incurred in order to implement the transaction which was of a revenue nature and this obligation fell ultimately to be discharged by the taxpayer. The court was fortified in this view by the meaning given to the phrase 'actually incurred' in *CIR* v *Golden Dumps* (*Pty*) *Ltd* 55 SATC 198 where Nicholas AJA employed the ordinary dictionary meaning for 'actually' as, 'in act or fact', in reality'. In substance, it was the taxpayer who 'really' incurred the obligation and who was thus entitled to the deduction as opposed to KL, because it 'actually', as employed in this context, incurred the liability.

(xx) That as far as the indemnity liability was concerned, the evidence served to indicate that, as at July 2004, the taxpayer had assumed an unconditional liability towards O et Cie in the amount of R55 million. This amount was then recorded as a loan in the taxpayer's books of account ending 28 February 2005. The evidence revealed that the taxpayer's liability to O et Cie in respect of this indemnity was subsequently settled by way of a set-off but that did not mean that the court was not entitled to conclude that R55 million was expenditure actually incurred during the 2005 year of assessment, because in that year of assessment an unconditional liability to pay that amount had been created.

(xxi) That an amount of R4 980 250 paid to G Co as a reward for work done in the transaction as a whole, could not be deducted because there was no evidence of an enforceable legal liability on the taxpayer to pay this amount and, accordingly, it was not expenditure actually incurred by the taxpayer in the production of income.

(xxii) That as far as the interest levied by the Commissioner was concerned, there was nothing to gainsay the taxpayer's contention that it had on reasonable grounds contended that the proceeds of the sale of the FG shares were of a capital nature and particularly in that the amounts were so disclosed and the taxpayer had duly discharged its obligation pursuant to this disclosure, by paying its CGT liability.

That, accordingly, the following order was made:

(*a*) the proceeds of the disposal by the taxpayer of 17 641 842 shares in FG Group Ltd, amounting to R498 434 500 constituted a receipt or an accrual of a revenue nature;

(*b*) the equity kicker of R45 123 050 and the indemnity liability of R55 million were allowed as deductions from the taxpayer's income; and

(*c*) the interest levied was remitted in terms of s 89*quat*(3) of the Income Tax Act 58 of 1962.

6.2 ITC 1868

The taxpayer company had been the subject of a VAT audit conducted by SARS in respect of its tax affairs and the audit had revealed that it had under-declared and, in consequence, had underpaid value-added tax to SARS.

The taxpayer was thus assessed to tax in the total sum of R4 040 377.28, consisting of a capital amount of R1 246 177.57 being under-declared output tax, additional tax of R2 492 355.06 levied on the capital amount in terms of section 60 of the VAT Act, a penalty of R124 617.55 levied on the capital amount in terms of section 39(1)(*a*)(i) of the VAT Act and interest of R177 226.90 levied on the capital amount in terms of section 39(1)(*a*)(ii) of the VAT Act.

The taxpayer, represented by its sole member, had filed a notice of objection on the regulation form ADR 1 in which it had ticked the boxes indicating that the objection covered the penalty, the additional tax, the interest and 'other'. However, the taxpayer's representative did not tick the box marked 'There is a miscalculation on the assessment in that an amount(s) was taken into account/not taken into account to determine the liability for tax'.

The taxpayer, in an *addendum* to ADR 1, described the grounds of objection as:

‘1. Unfair application of procedural matters by SARS Special Investigations.

2. Excessive add tax of 200% plus penalties and interest charges.

3. Interference of SARS Special Investigations officer into the affairs of the businesses including HR & Associates without any form of negotiations or consultations.

4. Reparations of damages caused by SARS interference and actions in the said businesses in order to put things right.

5. SARS contraventions of its own SARS CHARTER and SARS SSMO and Dispute Resolution processes.’

The taxpayer, in the letter attached to its objection, stated, *inter alia*:

‘Uncontested VAT Assessment value of R1 246 177.69 was presented to the said business on the 10th March 2004.

We did not contest this decision though the businesses have been denied adequate resources for re-establishing meaning operations.’

Nowhere in the objection on the prescribed ADR 1 form was it mentioned by the taxpayer’s representative that it had objected that there was a merger between the taxpayer’s two entities by SARS and hence the capital amount and the assessment itself were incorrectly calculated as the two entities were handled as one.

In both the taxpayer’s original objection and the resultant appeal the objection was directed against the additional tax, the interest and the penalties and the objections in issue were related to a reduction of these figures.

However, the taxpayer, in its Rule 11 Statement dated 15 March 2011, for the first time asserted that in calculating its VAT liability SARS had included the turnover figures of a related entity and hence the assessment in issue was null and void and should be cancelled and this was consequently a period of seven years after the confirmation of the assessment in relation to the turnover figures and four years after the Notice of Appeal (form ADR 2) had been filed on 22 January 2007.

SARS, as early as 28 July 2004, had confirmed to the taxpayer that according to him there had thus been no objection raised to the *quantum* of the additional output VAT.

The taxpayer's Notice of Appeal (ADR 2) had been filed by it on 22 January 2007 and had set out:

'1. Unfair imposition of 200% additional tax;

2. Unfair imposition and incorrect penalty;

3. Unfair imposition and incorrect interest charge;

4. Unfair tax procedure matters.'

Once again, there was no mention in the aforementioned document that the taxpayer was appealing against the method in which the capital amount had been determined by SARS or the amount of the capital on which the assessment was based.

SARS accordingly stated in its grounds of assessment in terms of Rule 10 of the tax rules:

'When the objection (Notice of Objection and the letter of the grounds of Objection) and appeal (Notice of Appeal and the letter of the grounds of Appeal) are considered, it is clear that the taxpayer does not dispute liability for the capital amount.'

The evidence had revealed that the taxpayer had agreed with the capital amount throughout as it had had no choice. It had agreed that the capital amount was correct so that SARS would unlock the taxpayer's bank accounts and that of another entity. This had, however, never been mentioned in the first objection, ADR 1, nor in the appeal, ADR 2.

The taxpayer had been quite clear that it was not requesting a remission of penalties or additional tax but that the whole assessment should be declared null and void and set aside.

Accordingly, as a result of an agreement between the parties, a preliminary point was argued in the Tax Court as to whether or not the taxpayer had objected to the capital portion in its Notice of Objection (ADR 1 form) read with the letter of its Grounds of Objection attached to the Notice of Objection.

The Tax Court had decided against the taxpayer and on appeal the Supreme Court of Appeal (see *Computek* (*Pty*) *Ltd* v *C: SARS* (SCA) 75 SATC 104.) confirmed the Tax Court's decision.

The question that had to be decided in the present matter was whether the taxpayer's objection to the assessment in issue was limited to its objections as set out in ADR 1 and ADR 2.

Judge Pretorius held the following:

(i) That the authorities make it quite clear that the provisions of the Value-Added Tax Act must be interpreted in such a manner that finality in a dispute must be reached and this should apply to the taxpayer as well and the taxpayer cannot shift the goalposts at each new hearing of the case but must adhere to the grounds of objection as set out in the original objection (ADR 1) and the appeal against the finding (ADR 2).

(ii) That in essence the taxpayer was contending that the Tax Court must revisit the question whether the capital amount in issue, which the assessment was based on, was correct but at the same time it was quite clear that the taxpayer had not appealed the capital amount as it seemed from all the information on the ADR 1 and ADR 2 as well as other correspondence, that the capital amount was never in dispute.

(iii) That the court found itself in the position that the taxpayer was not asking it to remit the penalties and interest but rather to find that the 'fusion' of two related entities had the effect of rendering the assessment, as regards the capital amount, to be incorrect and this flew in the face of the finding by the Supreme Court of Appeal in *Computek* (*Pty*) *Ltd* v *C: SARS* 75 SATC 104 at 111–12.

(iv) That it was clear from the decision in *Computek* (*Pty*) *Ltd* v *C: SARS*, *supra*, that the Tax Court in this instance cannot order SARS to revisit the assessment and this court cannot come to a decision which is contrary to what the Supreme Court of Appeal had already decided.

(v) That the taxpayer's case was that the assessments in issue were invalid and therefore no penalties, interest or additional tax was owing to SARS and this was based on a reliance on section 33(3) of the Value-Added Tax Act which provides for the court to confirm or alter the assessment, or to refer the matter back to the Commissioner. However, in this instance, where a new ground of objection was raised in the Rule 11 declaration, which had no bearing on the objections in ADR 1 and ADR 2 and which the Supreme Court of Appeal had already ruled on, this court cannot refer the matter back to the Commissioner and the court accordingly finds in these circumstances that the provisions of s 33(3) of the Act do not apply.

(vi) That as the Tax Court is a creature of statute it did not have the same inherent powers that a High Court had and it was immaterial how the taxpayer's business was structured as it had admitted from the outset that the capital amount was correct and this was confirmed by the Supreme Court of Appeal.

(vii) That, therefore, this court cannot declare the assessment to be invalid as it had never been contested in the objections by the taxpayer and it had been mentioned for the first time in the Rule 11 statement and for the same reasons that the Supreme Court of Appeal had decided against the taxpayer, this court had no option but to do the same. It was conceded in the Computek judgment that even in the event that Respondent was wrong to include the turnover of the related entity it was too late to revisit the assessment as it became final and conclusive in April 2007.

Appeal dismissed with costs.

6.3 ITC 1869

The taxpayer had acquired a plantation business from D (Pty) Ltd and D Properties (Pty) Ltd in 2001 in terms of a 'sale of business agreement' of 3 October 2001.

In terms of the aforesaid agreement the purchase price of R11 956 121 was attributed to the standing timber.

The taxpayer thereafter disposed of the plantation to E (Pty) Ltd in terms of certain 'heads of agreement' for the sale of a business dated 21 February 2003 read with a 'settlement agreement' dated 29 July 2004 and the consideration for the plantation over and above the costs of the land was in the amount of R144 700 000.

SARS had, in an additional assessment, with a due date of 1 September 2010, taxed the net proceeds arising from the sale of the plantation as part of the taxpayer's gross income in terms of section 26(1) of the Income Tax Act 58 of 1962 read together with par. 14(1) of the First Schedule to the Act.

The taxpayer, however, contended that s 26(1) of the Act did not apply and hence the net proceeds should only have been taxed as a capital gain as had been the case in the original assessment.

Section 26(1) of the Act and the First Schedule thereto apply only when the taxpayer is carrying on farming operations and there is no definition of the expression 'farming operations' in the Act.

Paragraph 14(1) of the First Schedule provides that any amount received by or accrued to a farmer in respect of the disposal of a plantation, whether the plantation is disposed of separately or with the land on which it is growing, forms part of his gross income and will be deemed not to be a receipt or an accrual of a capital nature.

It was common cause that the taxpayer had not engaged in a scheme of profit-making.

The crisp issue before the court were whether the proceeds of a disposal of the plantation by the taxpayer had been correctly included in its gross income for the relevant year of assessment in terms of section 26(1) of the Act read with par. 14 of the First Schedule to the Act and in that endeavour the issue to be determined was whether the taxpayer had carried on 'pastoral, agricultural or other farming operations' as contemplated in section 26(1) of the Act between the relevant years of assessment and, if it did, then whether the proceeds of the disposal of the plantation were 'derived from such operations'.

Put in another way, the only question for determination by the court was whether the deeming provision in par. 14(1) of the Schedule applied to deem the proceeds of the disposal of the plantation to form part of the taxpayer's gross income.

The taxpayer's core submissions were that:

- It had acquired ownership of the plantation as an investment;
- It had contracted with E to carry on plantation and thus farming operations and for its/E's own benefit, on its/E's own behalf and for its/E's own account;
- It had disposed of the plantation to E in due course, which plantation was never part of its business operations as it did not farm.

The taxpayer submitted that it was a passive investor in farming land and after it had acquired the land it had granted a usufruct to E and had retained a *bare dominium* on which it had earned no income and had expended no income in any of the operations which were only and exclusively undertaken by E. In turn, E's only obligation towards the taxpayer was to safeguard its investment by maintaining the plantation rotation system in accordance with best practice and to return the same quantity of timber to the taxpayer in due course on termination of the agreement between them.

The taxpayer's contention was that the aforementioned agreements empowered E to farm actively on the plantation for its own account without acquiring ownership of the land and that the plantation was then to be ‘warehoused’ in the taxpayer. Thus the passive ownership of the land and of the plantation were to be and indeed were divorced from the farming operations which had been carried on by E which alone had the use of the land and of the plantation as well as the right to the yield of the plantation for the duration of the agreement between itself and the taxpayer.

In an explanation of the nature of the agreement between the parties it was evident that E had concluded written agreements with D Entity as sellers of the plantation in which E had agreed to acquire from D entity all of the assets and businesses of D entity as a going concern, including the land and the plantation for a total purchase price of R45 million. However, the main board of E’s holding company had then blocked the acquisition by E of the land and the plantation because, at that time, it was group policy not to acquire fixed property in South Africa which might negatively affect its consolidated balance sheet and thereby the share price of the listed holding company in the event that the value of fixed property was to decrease. As a result of this policy the agreements between D entity and E were cancelled and it was then agreed that the taxpayer would be the purchaser which would acquire the subject-matter of the cancelled agreement substantially on the terms and conditions as they later came to be documented in a written agreement.

In terms of the agreement between the taxpayer and E, E would, for its own account, conduct forestry and plantation operations on the land, the use of which was granted to it by the taxpayer who had no desire or interest in farming and E was to use the plantation acquired by the taxpayer for this purpose and for an indefinite period of time. Furthermore, the agreement provided that E would assume responsibility for all expenditure and risk and, in particular, the obligation to insure the plantation against the risk of fire.

The stipulated contractual period agreed to by the taxpayer and E was 29 years and it was anticipated at the time, both by the taxpayer and E, that their agreement would endure for a considerable period of time, given the long-term nature of investment in plantations.

Furthermore, the assets and equipment necessary to operate the plantation were sold directly to E by D entity and from that time E immediately commenced farming operations, *i.e.* the plantation, on the land owned by the taxpayer which E had acquired the right to so use.

Eventually, after the main board of E had changed its policy concerning the owning of land in South Africa, the taxpayer concluded an agreement on 21 February 2003 in terms of which the plantation was sold to E and E Africa and that the final purchase price would be R159 700 000 of which an amount of R144 700 000 would be allocated to the plantation and R15 million to immovable property. In terms of this agreement the taxpayer's business was described as meaning 'the immovable property and the plantation.' In turn, the plantation was defined as 'the standing timber on the immovable property and, for purposes of expressing the value thereof as part of the purchase price', it included the plantation business (the business of commercial forestry operations) including the plantation sale assets and machinery, equipment and plantation contracts, all as a going concern.

The taxpayer accordingly submitted that it had disposed, not of an income-earning activity and therefore not of a business as a going concern, but of land and a plantation thereon.

Moreover, the taxpayer had derived no income there from and did not have and could not have held the requisite profit motive or intention to qualify it as a farmer in terms of par. 14(1) of the First Schedule to the Act.

The taxpayer further contended that the only entity which should be regarded as 'the farmer' in terms of par. 14(1) of the First Schedule to the Act in relation to the plantation owned by the taxpayer was E because only E had the right to the yield of the plantation for the duration of the agreement and only E had the use of the land and plantation, which right had been granted to it by the taxpayer for the duration of the agreement between them. Furthermore, only E derived an income from the land on the plantation, the use of which had been granted by the taxpayer to it for its own benefit, on its own behalf, and for its own account.

SARS contended that the key question in the present dispute was to determine whether there was a sufficiently close or direct connection to the taxpayer as the owner of the plantation between the income generated and the farming activities conducted on the property and this determination would allow a court to ascertain whether section 26(1) of the Act read together with par. 14(1) of the First Schedule to the Act was applicable.

SARS contended further that the reason why an owner of land such as the taxpayer should be regarded as conducting farming operations was because it retained a direct interest in the farming operations, particularly the success or failure thereof and it could hold the agent or manager to a particular standard of management and it benefitted directly from the fruits of that management.

SARS submitted that the court should not consider what he referred to as 'litigation-focus semantics' but rather examine carefully the substantive evidence as to the continuous and close link between the taxpayer and the farming operations, supported by various unguarded statements made by the parties themselves describing the relationship accurately in terms of it being a plantation business and it was clear that the taxpayer was at all times, through E, carrying on farming operations in respect of the plantation.

SARS accordingly contended that, although the taxpayer had contracted with E to manage the plantation, this did not mean that the taxpayer had not carried on farming operations within the meaning of section 26(1) of the Act as, on the contrary, it retained a direct, real and commercial interest and involvement in its plantation business for the whole period under review and hence taxable income was derived directly from the farming operations.

Judge Davis held the following:

(i) That the key question in the present dispute was to determine whether there was a sufficiently close or direct connection to the taxpayer as owner between the income generated and the farming activities conducted on the property and this determination would allow a court to ascertain whether section 26(1) of the Act read together with par. 14(1) of the First Schedule to the Act was applicable; moreover, whether the taxpayer had retained a direct and substantial interest in the plantation and the plantation farming business such that it must be regarded as having conducted farming operations is a question of fact and it depended on an evaluation of the evidence presented during the case.

(ii) That the court was confronted with two diametrically opposed versions – the taxpayer's witnesses were insistent that the taxpayer had made an investment, to the effect that it had 'warehoused' the land and plantation thereon and had never engaged in farming operations which were done independently and separately by E for the latter's sole account. However, on the strength of documentary evidence in particular, SARS had insisted that the taxpayer stood to be classified as a farmer.

(iii) That without wanting to impugn the credibility of any of the taxpayer's witnesses, it would have been highly surprising if any other version would have been forthcoming from them and to this extent, therefore, the court was obliged to evaluate their evidence with a great degree of care through the prism of documentary evidence which was so presented and the outcome of this evaluation may more accurately determine whether the taxpayer had discharged the required *onus*.

(iv) That even if the witnesses' evidence was not rejected for lack of credibility, their evidence must be evaluated against documentary evidence, after which evaluation the requisite inferences could be drawn and probabilities assessed.

(iv) That even though the signed heads of agreement on 21 February 2003 provided that the business be sold as a going concern and this was reversed in the settlement agreement and VAT was later paid, the fact that the document containing this provision was signed by the relevant parties was itself instructive but, arguably on its own, might not be sufficient to draw an inference and thus the taxpayer's accounts become instructive.

(v) That in the financial accounts for the year ended June 30, 2002, the following note appears under the heading 'plantation sales' – 'In the current year no sales were recognised. Sales will be recognised when the plantation is sold'. A further note entitled 'inventory' provided as follows: 'The amounts attributable to the different categories are as follows: Plantation R11 956 121. The plantation is still growing and will be sold in the future. Growing of timber is one of the main objectives of the company'.

(vi) That, when the objective evidence, particularly the range of documents to which the court had made reference, including contracts and financial statements are considered, they all indicate in the direction that the taxpayer was conducting a business of plantation farming and even in the event that beneficial consideration is given to the taxpayer's case by virtue of amendments to various documents, it would appear that the thrust of contemporaneous documentation supports SARS' case, to the extent that the taxpayer has not discharged the *onus* of proving that its intention differed from that which was recorded in these financial documents, contracts, minutes and resolutions, namely that it had bought and sold the plantation businesses as a going concern and that it had employed E to manage its plantation business on its behalf.

(vii) That, expressed in the terms employed in *ITC 1185* 35 SATC 122, when the evidence of the witnesses is tested against the documentary evidence, the probabilities cannot be said to favour the taxpayer's version to justify a conclusion that it had discharged its *onus* of proof.

(ix) That, in the result, the proceeds of the sale of the plantation by the taxpayer were correctly included in the taxpayer's gross income in the 2004 year of assessment by virtue of section 26(1) of the Act read together with par. 14(1) of the First Schedule to the Act.

(x) That it appeared that SARS had erred in the additional assessment and that it had added back to taxable income the sum of

R97 932 321, being the proceeds of the sale less the costs of the acquisition and the management fee. However, the management fee had already been allowed as a deduction in the original assessment and, accordingly, there was a double deduction which had been taken into account and hence the amount to be added back to the taxpayer's taxable income should be R109 932 321 rather than R97 323 231 in terms of the additional assessment.

Appeal dismissed.

The initial assessment be amended by the addition of an amount of R12 000 000 by virtue of s 129(2)(*b*) of the Tax Administration Act 28 of 2011.

6.4 Stabilpave (Pty) Ltd v SARS

SARS had owed Stabilpave a tax refund of R724 494.29 and this amount was reflected as the amount due to Stabilpave on the tax assessment form (IB34) dated 16 October 2006 which had been issued to Stabilpave.

The core issue between the parties concerned the interpretation of a notice that was included in the tax assessment form which stated that the refund that reflected on Stabilpave's tax account would be paid shortly and that such amount would be paid either by way of a cheque which could be fetched from the nearest post office or by way of an electronic transfer to the Stabilpave's bank account on record with SARS if such bank details were available to it but the notice indicated that no bank account details of Stabilpave were known to SARS.

Accordingly, a cheque dated 12 November 2006, made payable to Stabilpave for the sum of R728 474.74, being the amount of the refund that was due to Stabilpave plus interest that had accrued thereon until 12 November 2006, was drawn by SARS on ABSA Bank Ltd, at its Vermeulen Street, Pretoria Branch. The cheque was crossed and marked 'not transferable'.

SARS handed the cheque in a sealed envelope (addressed to Stabilpave's post-box number at Menlyn Retail Post Office) to Securemail, a division of the South African Post Office and Securemail caused a delivery notification to be issued.

Neither Stabilpave nor anyone representing it had received the delivery notice and it got into the hands of a stranger to the parties who collected the envelope containing the cheque from the Menlyn Retail Post Office. The aforementioned person succeeded in stealing the cheque by presenting the delivery notice as well as a fake letter that professed to be from a firm of accountants, Prinsloo & Du Plessis, and authorising the collection.

The particulars of the directors of Stabilpave were fraudulently changed in the records kept by the Registrar of Companies to reflect one Petros Mandla Radebe as its sole director. Radebe, acting fraudulently and without the authority of Stabilpave, opened a bank account with First National Bank, Hatfield Branch, in the name of 'Stabilpave (Pty) Ltd'. The cheque was deposited at First National Bank, Menlyn Branch, and the account opened by Radebe was credited with the amount of R728 474.74. The cheque was presented for payment to ABSA Bank which duly paid that sum to First National Bank and the account of SARS was debited with the amount paid. The proceeds of the cheque were withdrawn by Radebe, ostensibly acting as a director of Stabilpave, over a relatively short period.

Stabilpave instituted action against SARS for payment of the tax refund which became due and payable to it on 16 October 2006 plus interest and costs.

SARS admitted the debt but raised the defence of payment and, in the alternative, it raised a defence '*... based on the wording of the assessment ...*', which was that by not providing any banking details to SARS in order for the payment to have been effected by electronic transfer, Stabilpave '*... elected, alternatively accepted that payment be effected by way of a cheque which would be collected at the nearest post office ...*' to Stabilpave.

Stabilpave's contention was that the obligation of SARS to pay the tax refund to it had not been fulfilled because in law there was no payment if a cheque was posted and lost before it reached the creditor.

SARS' contention, on the other hand, was that its obligation to pay the tax refund was legally deemed to be fulfilled even though the amount of the cheque was never credited to Stabilpave. It argued that the tax assessment form, on a proper construction, afforded Stabilpave the choice as to the mode of payment – by cheque through the post, or by providing its banking details, by means of electronic transfer. By not providing its banking details Stabilpave chose to be paid by cheque through the post and SARS relied for this on the trite legal principle '*... that if a creditor requests a debtor to settle his debt by sending a cheque through the post he agrees to run the risk in the transit*'.

The court of first instance had accepted SARS' contention and the Stabilpave's claim had been dismissed with costs and the majority of the Full Court, being the court *a quo*, had held that the Stabilpave had made a choice as to how the cheque was to be remitted *per* post and that the risk lay with the Stabilpave.

Judge Meyer held the following:

(i) That the principles to be applied in cases where cheques have been intercepted in the post and misappropriated by a thief have been concisely summarised by Nienaber J in *Mannesmann Demag* (*Pty*) *Ltd v Romatex* 1988(4)SA 383 (D) at 389F–390D and it was clear from the quoted passage that any agreement 'about the particular mode of performance' or 'as to the manner of payment' is reached only if the creditor stipulates (or requests or authorises) a particular mode of payment and the debtor accedes to the request.

(ii) That the decisive question in the present case is whether the notice contained in the tax assessment form gave the Stabilpave a choice as to a mode of payment, and, if it did, whether the choice was made by Stabilpave, expressly or by necessary implication, that SARS should effect payment by means of sending a cheque through the post and the parties were *ad idem* that only the tax assessment form must be looked at in order to determine the first question.

(iii) That a plain reading of the notice contained in the tax assessment form leads to the inevitable conclusion that it did not give a taxpayer, in this instance Stabilpave, a choice as to a mode of payment to be followed by SARS. The notice concerned the factual position as at 16 October 2006, which was the date of the tax assessment form. SARS informed Stabilpave that the credit amount reflected on its tax statement would be paid to the taxpayer shortly (‘eersdaags’) and the taxpayer was then informed of the manner of payment.

(iv) That there was no invitation, expressly or by implication, to Stabilpave to furnish banking particulars should it wish to be paid by means of electronic transfer and if there was such invitation one would have expected Stabilpave to be informed that payment would be effected by means of an electronic transfer, if valid banking particulars were available or furnished by Stabilpave. A further and clear indication that the notice did not afford a choice as to the manner of payment was the absence of a cut-off date on or before which Stabilpave might furnish its banking particulars to SARS but, instead, Stabilpave is informed that payment will be made soon and the notice was merely for the information of Stabilpave.

(v) That the clear implication of the notice was an advice from SARS that the tax record of Stabilpave reflected no banking particulars and that payment would therefore be effected by means of a cheque through the post. No choice was afforded to Stabilpave and the method of payment was dictated by SARS. The mere fact that a creditor knew or expected to be paid by cheque through the post or that it did not raise an objection did not in itself give rise to an implied request or election by the creditor to be paid in such manner.

(vi) That, accordingly, the risk of loss of the cheque was not assumed by Stabilpave and remained with SARS who thus had not discharged its indebtedness by posting a cheque for the amount of the refund that was due to Stabilpave.

Appeal upheld with costs.

6.5 Roshcon (Pty) Ltd v Anchor Auto Body Builders CC & others

Wallis JA (Maya, Shongwe, Petse and Saldulker JJA concurring)

[22] I have read the judgment of Shongwe JA with which I agree. I add something of my own merely because it appeared from the submissions made to us that there may be a misconception regarding the proper approach to simulated transactions. In Roshcon‟s heads of argument it was submitted that in *South African Revenue Services v NWK Limited*,1 this court developed or clarified the test laid down in previous judgments of this court and thereby took our law in that regard in a new direction.

[23] The foundation of our law in regard to simulated transactions is the classic statement by Innes J in *Zandberg v Van Zyl2* that:

> 'Now, as a general rule, the parties to a contract express themselves in language calculated without subterfuge or concealment to embody the agreement at which they have arrived. They intend the contract to be exactly what it purports; and the shape which it assumes is what they meant it should have. Not infrequently, however (either to secure some advantage which otherwise the law would not give, or to escape some disability which otherwise the law would impose), the parties to a transaction endeavour to conceal its real character. They call it by a name, or give it a shape, intended not to express but to disguise its true nature. And when a Court is asked to decide any rights under such an agreement, it can only do so by giving effect to what the transaction really is: not what in form it purports to be. The maxim then applies *plus valet quod agitur quam quod simulate concipitur*. But the words of the rule indicate its limitations. The Court must be satisfied that there is a real intention, definitely ascertainable, which differs from the simulated intention. For if the parties in fact mean

1 *South African Revenue Services v NWK Limited* 2011 (2) SA 67 (SCA)
2 *Zandberg v Van Zyl* 1910 AD 302 at 309

> that a contract shall have effect in accordance with its tenor, the circumstances that the same object might have been attained in another way will not necessarily make the arrangement other than it purports to be. The inquiry, therefore, is in each case one of fact, for the right solution of which no general rule can be laid down.'

[24] In *Zandberg v Van Zyl* a woman who owed £50 to her son-in-law purported, some 18 months after incurring the debt, to sell a wagon to him in exchange for her discharge from the debt. However, she retained the use and possession of the wagon at all times and it was agreed between her and her son-in-law that she could repurchase the wagon at any time for £50. When her son in-law wished to use the wagon for his own purposes he was permitted to do so, but always accompanied by one of Mrs. van Zyl's other sons, and on the basis that the wagon would be returned to her immediately he had finished his business with it. The court held, having regard to all the circumstances, that the parties intended to dress up what was in reality a pledge as a sale. The case is but one of a number in which our courts have held that the device of a sale has been used by a creditor, frequently one who is in a close personal relationship with the debtor, to seek to secure the benefits of a pledgee, without depriving the debtor of the use of the goods that are the subject of the transaction.3

[25] There is a common feature to many of these cases in that prior to the transaction in question the goods that were the subject matter of the purported sale were in the possession of the debtor and remained in their possession after the sale. In other words they were cases where it was contended that delivery had occurred by way of *constitutum possessorium*. That is a form of delivery that is always carefully scrutinised by courts because it affords scope for third parties dealing with the possessor of the goods to be deceived into thinking that the possessor is also the owner

3 See, for example, *Hofmeyr v Gous* (1893) 10 SC 115; *Goldinger's Trustee v Whitelaw & Son* 1917 AD 66; *McAdams v Fiander's Trustee & Bell NO* 1919 AD 207; *Vasco Dry Cleaners v Twycross* 1979 (1) SA 603 (A) and *Bank Windhoek Bpk v Rajie en 'n ander* 1994 (1) SA 115 (A). There are also cases in which money-lending transactions have been disguised as sales in order to avoid the application of statutes governing money-lending and rates of interest. *Lawson & Kirk v South African Discount and Acceptance Corporation (Pty) Ltd* 1938 CPD 273; *R v Port Shepstone Investments (Pty) Ltd and Another* 1950 (4) SA 629 (A) at 632; *S v Friedman Motors (Pty) Ltd and Another* 1972 (1) SA 76 (T) at 79D-E.

thereof.4 In each case the court was not satisfied that the debtor had truly intended after the purported sale to hold the goods on behalf of the purchaser. That was the foundation in all but one of these cases5 for the decision that the sale was a simulated transaction.

[26] On the other hand the law permits people to arrange their contractual or business affairs so as to obtain a benefit for themselves that a different arrangement would not permit or so as to avoid a prohibition that the law imposes. That principle was laid down in *Dadoo Ltd and others v Krugersdorp Municipal Council*,6 where Innes CJ said:

> '… parties may genuinely arrange their transactions so as to remain outside [a statutes] provisions. Such a procedure is, in the nature of things, perfectly legitimate.'

[27] These two principles are but two sides of the same coin, as is apparent from the fact that in both *Zandberg v Van Zyl* and *Dadoo* Innes CJ relied on the principle embodied in the maxim *plus valet quod agitur quam quod simulate concipitur* (the real intention carries more weight than a fraudulent pretence). Whether a particular transaction is a simulated transaction is therefore a question of its genuineness. If it is genuine the court will give effect to it and, if not, the court will give effect to the underlying transaction that it conceals. And whether it is genuine will depend on a consideration of all the facts and circumstances surrounding the transaction.

[28] These principles were considered and applied in *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd*.7. The difference of views between the majority and the minority in that case turned on a difference of opinion between the judges as to the genuineness of the disputed transactions. The respondent had previously imported cloth under rebate of duty and delivered it to cut, make and trim manufacturers to be made up into goods that it thereafter sold. Under amended regulations this could no longer be done without incurring a liability to pay customs duty, but

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4 *Goldinger's Trustee v Whitelaw & Son* at 74 and *Bank Windhoek Bpk v Rajie en 'n ander* at 145C-D.
5 The exception is *McAdams v Fiander's Trustee & Bell NO, supra,* fn 3 where the court held there was no intention to buy or sell.
6 *Dadoo Ltd and others v Krugersdorp Municipal Council* 1920 AD 530 at 548.
7 *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd.* 1941 AD 369.

it was legitimate for an importer to import cloth under rebate of duty and sell it directly from bond to a manufacturer. The respondent accordingly made arrangements with five manufacturers to import cloth and sell it to them at cost. The cloth would then be made into garments, which the respondent undertook to purchase from the manufacturers at cost plus the manufacturer's cut, make and trim charges. The Commissioner for Customs alleged that the transactions were not genuine and the respondent disputed this.

[29] The dispute came to this court after a lengthy trial at the end of which the trial judge held that the respondent's officials had honestly arranged the company's affairs in a way that fell within the amended regulations and so as to avoid payment of the duty. They had done so after careful discussion with the Commissioner's staff and after being advised that provided the transactions they concluded with the manufacturers were genuine they would have the desired effect of avoiding the imposition of duty. It was in the light of that advice that the respondent entered into the impugned agreements with the manufacturers. The majority held that ownership of the cloth passed from the respondent to the manufacturers when the cloth was delivered to the latter as reflected in the documents when they were released from bond. They were strongly impressed by the point that there was no purpose in the parties entering into a simulated transaction when only a genuine sale by the importer to the manufacturers would have the effect of avoiding the duty. A simulated transaction would not only attract liability for the duty, but also liability for penalties and criminal sanctions. There was accordingly no incentive for them to engage in deceit or simulation.

[30] It is against that background that the well-known passages in the judgment of Watermeyer JA must be read. Having cited both *Zandberg v Van Zyl* and *Dadoo* he said:[8]

> 'I wish to draw particular attention to the words 'a real intention, definitely ascertainable, which differs from the simulated intention', because they indicate clearly what the learned Judge meant by a

8 At 395-6.

> ‘disguised’ transaction. A transaction is not necessarily a disguised one because it is devised for the purpose of evading the prohibition in the Act or avoiding liability for the tax imposed by it. A transaction devised for that purpose, if the parties honestly intend it to have effect according to its tenor, is interpreted by the Courts according to its tenor, and then the only question is whether, so interpreted, it falls within or without the prohibition or tax.

A disguised transaction in the sense in which the words are used above is something different. In essence it is a dishonest transaction: dishonest, in as much as the parties to it do not really intend it to have, *inter partes*, the legal effect which its terms convey to the outside world. The purpose of the disguise is to deceive by concealing what is the real agreement or transaction between the parties. The parties wish to hide the fact that their real agreement or transaction falls within the prohibition or is subject to the tax, and so they dress it up in a guise which conveys the impression that it is outside of the prohibition or not subject to the tax. Such a transaction is said to be *in fraudem legis*, and is interpreted by the Courts in accordance with what is found to be the real agreement or transaction between the parties. Of course, before the Court can find that a transaction is *in fraudem legis* in the above sense, it must be satisfied that there is some unexpressed agreement or tacit understanding between the parties. If this were not so, it could not find that the ostensible, agreement is a pretence. The blurring of this distinction between an honest transaction devised to avoid the provisions of a statute and a transaction falling within the prohibitory or taxing provisions of a statute but disguised to make it appear as if it does not, gives rise to much of the confusion which sometimes appears to accompany attempts to apply the maxim quoted above.’

[31] The minority judgment of De Wet CJ does not in any way qualify these principles. Instead it focused on a number of features of the evidence and the underlying transactions that were unusual. For example, it was entirely up to the respondent to determine how much cloth was imported and what garments should be made. The manufacturers were not at any immediate financial risk because they did not have to pay for the cloth until they had

delivered and were entitled to be paid for the garments. Furthermore the evidence on behalf of the manufacturers was equivocal in regard to their intention to become owners of the cloth. De Wet Chas conclusion was that they had no genuine intention to purchase the cloth but simply fell in with the arrangements made by the respondent in order to obtain the cut, make and trim work, which was the staple of their businesses.

[32] Nothing said subsequently in any of the judgments of this court dealing with simulated transactions9 alters those original principles in any way or purports to do so. However, in a number of them dealing with income tax, the courts have been called upon to apply these principles in a different context. The earlier cases dealt with cases of agreements being dressed up in a particular form where the underlying intention of the parties was inconsistent with that form. In the income tax cases a different problem arises.

[33] In the income tax cases, the parties seek to take advantage of the complexities of income tax legislation in order to obtain a reduction in their overall liability for income tax. There are various mechanisms for doing this, but they all involve taking straightforward commercial transactions and adding complex additional elements designed solely for the purpose of claiming increased or additional deductions from taxable income, or allowances provided for in the legislation. The feature of those that have been treated as simulated transactions by the courts is that the additional elements add nothing of value to the underlying transaction and are very often self-cancelling. Thus in *Erf 1383/1* Hefer JA said that 'there is a distinct air of unreality about the agreements'10. In *Relier* Harms JA referred to the 'unusual and unreal aspects' of the transactions.11 The

9 *Du Plessis v Joubert* 1968 (1) SA 585 (A); *Vasco Dry Cleaners v Twycross* 1979 (1) SA 603 (A); *Skjelbreds Rederi A/S and Others v Hartless (Pty) Ltd* 1982 (2) SA 710 (A); *Hippo Quarries (Tvl) (Pty) Ltd v Eardley* 1992 (1) SA 867 (A); *Bank Windhoek Bpk v Rajie en 'n ander* 1994 (1) SA 115 (A); *Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue* 1996 (3) SA 942 (A); *Relier (Pty) Ltd v Commissioner for Inland Revenue* (1997) 60 SATC 1; *Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* 1999 (4) SA 1149 (SCA); *MacKay v Fey NO and Another* 2006 (3) SA 182 (SCA).

10 At 954D

11 At 123

analysis by Lewis JA of the transactions in *NWK12* clearly demonstrated that a range of unrealistic and self-cancelling features had been added to a straightforward loan. They served no commercial purpose, were based on no realistic valuation of the different elements of the transaction and were included solely to disguise the nature of the loan and inflate the deductions that NWK could make against its taxable income. In those circumstances the courts stripped away the unrealistic elements in order to disclose the true underlying transaction.13

[34] The problem dealt with in *NWK* was the contention that, irrespective of the unreality of most of the elements of the arrangement under scrutiny, provided the parties intended to take all the steps provided for in the contractual documents, in other words to jump through the contractual hoops as a matter of form, the court could not find that the transaction was simulated. That is what Lewis JA was dealing with, in par. 55 of her judgment, when she said:

> 'In my view the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. Invariably where parties structure a transaction to achieve an objective other than the one ostensibly achieved they will intend to give effect to the transaction on the terms agreed. The test should thus go further, and require an examination of the commercial sense of the transaction: of its real substance and purpose. If the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated. And the mere fact that parties do perform in terms of the contract does not show that it is not simulated: the charade of performance is generally meant to give credence to their simulation.'

[35] It appears that in some circles this, and particularly the statement that 'If the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as

12 Paras 56 to 90
13 *Kilburn v Estate Kilburn* 1931 AD 501 at 507

simulated', has been understood to condemn as simulated transactions any and all contractual arrangements that enable the parties to avoid tax or the operation of some law seen as adverse to their interests.14 But that fails to read this sentence in the context of both the particular paragraph in the judgment and the entire discussion of simulated transactions that precedes it. If it meant that whole categories of transactions were to be condemned without more, merely because they were motivated by a desire to avoid tax or the operation of some law, that would be contrary to what Innes J said in *Zandberg v Van Zyl* in the concluding sentence of the passage quoted above, namely that:

> 'The inquiry, therefore, is in each case one of fact, for the right solution of which no general rule can be laid down.'

That was manifestly not Lewis Jabs intention.

[36] The problem with general statements of this type is apparent from those by Cloete J in *Nedcor Bank Ltd v Absa Bank Ltd*,15 about floor plan agreements being simulated transactions. My colleague rightly holds those statements to be incorrect, based as they are, not on a consideration of a particular agreement in its own commercial context, but on generalisations about the nature of such agreements. For the avoidance of doubt, for so long as our law does not recognise a pledge of movables without delivery of the item pledged to the pledgee and its continued possession thereafter by the pledgee, commercial arrangements directed at finance houses securing their interests by taking ownership of the property that is the subject of a financing agreement, serve an entirely legitimate commercial purpose. Lewis JA recognised that in her acceptance that the transactions described in *S v Friedman Motors (Pty) Ltd16* and *Conhage*,17 served legitimate commercial purposes.18

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14 Trevor Emslie SC 'Simulated transactions – A new approach?' (2011) 60 *The Taxpayer* 2 at 5-6; Eddie Broomberg SC '*NWK* and *Finders Hall*' (2011) 60 *The Taxpayer i187 at 197-8;* C J Pretorius 'Simulated agreements and commercial purpose – Commissioner for the South African Revenue Service v NWK Ltd' (2012) 75 *THRHR* 688 at 696; Andrew Hutchinson and Dale Hutchinson 'Simulated transactions and the *fraus legis* doctrine' (2014) 131 *SALJ* 69.
15 *Nedcor Bank Ltd v Absa Bank Ltd* 1998 (2) SA 830 (W) at 836H-838G
16 Footnote 1 supra at 80G-H
17 Footnote 9 supra
18 *NWK* paras 53 and 54

[37] For those reasons the notion that *NWK* transforms our law in relation to simulated transactions, or requires more of a court faced with a contention that a transaction is simulated than a careful analysis of all matters surrounding the transaction, including its commercial purpose, if any, is incorrect. The position remains that the court examines the transaction as a whole, including all surrounding circumstances, any unusual features of the transaction and the manner in which the parties intend to implement it, before determining in any particular case whether a transaction is simulated.19

[38] In the present case, the reason for Wesbank and Nissan Diesel concluding the supplier agreement was to provide Wesbank with the security of being the owner of the vehicles, before providing finance to motor dealers. The agreement said so explicitly and had a clear commercial purpose namely the provision of appropriate security for a financial transaction, in the form of ownership of the *merx*. Obtaining security in that way is no different from any commercial seller stipulating that ownership of the goods sold will not pass until the full purchase price is paid (*pactum reservati domini*). That is the foundation for hire purchase contracts and financial leases. Similarly the floor plan agreement concluded with Toit's was designed to ensure that, until Toit‟s discharged its obligations to Wesbank in respect of a particular vehicle, Wesbank's security remained intact. The contention that these are simulated transactions ignores the commercial legitimacy of a finance house seeking security for the financing transactions that they conclude.

[39] For these further reasons I concur in the judgment of Shongwe JA.

19 This accords with the conclusion of Davis J in *Bosch and Another v Commissioner, South African Revenue Services* 2013 (5) SA 130 (WCC) paras 78 to 92.

7. INTERPRETATION NOTES

7.1 Income Tax – Trading stock: Assets not used as trading stock – No. 11 (Issue 2)

This Note provides guidance on the application and interpretation of paragraph (*j*A) and its interaction with other provisions of the Act.

Taxpayers sometimes manufacture capital assets for use in their businesses which are similar to the trading stock which they manufacture for resale. The treatment of the amount received or accrued on disposal of such manufactured capital assets was the subject of a dispute between SARS and the taxpayer in *C: SARS v Volkswagen of South Africa (Pty) Ltd.* The taxpayer in that case manufactured motor vehicles for sale to the public but also manufactured vehicles for its own use which it used for some time and then sold. SARS argued that the proceeds on disposal of the latter vehicles were of a revenue nature. However, the court disagreed, holding that the amount derived from the disposal of these vehicles was of a capital nature.

As a result of the decision in the *Volkswagen* case paragraph (*j*A) was inserted into the definition of the term 'gross income' in section 1.The effect of this deemed inclusion in gross income means that despite the amounts derived from the disposal of such assets being of a capital nature they are deemed to be gross income and the assets remain trading stock until disposed of.

Any amount received by or accrued to a taxpayer from the disposal of a paragraph (*j*A) asset used as a capital asset on or after 12 December 2001 must be included in the taxpayer's gross income. This inclusion in gross income means that a paragraph (*j*A) asset constitutes trading stock as defined in section 1 and section 22 will therefore apply.

In order to avoid double taxation, amounts included in paragraph (*j*A) are specifically excluded from inclusion in income under section 8(4)(*a*) and 22(8)(*b*)(iv).

The deductibility of costs associated with paragraph (*j*A) assets will be considered under section 11(*a*) read with section 23(*g*). No capital allowances can therefore be claimed for these assets

7.2 Income Tax – Trading stock: Inclusion in income when applied, distributed or disposed of otherwise than in the ordinary course of trade – No. 65 (Issue 2)

This Note provides guidance on the application and interpretation of section 22(8) which deems an amount to be included in income when trading stock is applied, distributed or disposed of in specified circumstances, otherwise than by sale at market value in the ordinary course of trade.

The cost of acquisition of trading stock should in principle not be deductible if it is:

- withdrawn for private consumption;
- donated;
- sold otherwise than in the ordinary course of the taxpayer's trade for less than its market value; or
- distributed *in specie* to a holder of shares.

A deduction results from these events because there would be no inclusion in income of closing stock while the cost price would have been allowed as a deduction.

The deduction could be under section 11(*a*) (trading stock disposed of in the same year of assessment in which it was acquired), section 22(1)(*a*) (write-down of closing stock) or section 22(2) (opening stock).

In these circumstances the purpose of the expenditure has changed to one that is not productive of income. Section 22(8) accordingly provides for a deemed inclusion in the taxpayer's income. The amount of the inclusion (for example, at cost, written-down value or market value) will depend on the manner in which the trading stock has been applied, distributed or disposed of.

7.3 Income Tax - Connected Person – No. 67 (Issue 2)

This Note provides guidance on the interpretation and application of the definition of a ‘connected person’ in section 1.

The Value-Added Tax Act contains a definition of the term ‘connected persons’ in section 1 of that Act. 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 only on the income tax definition and should not be relied on for purposes of interpreting the value-added tax definition.

Section 1 of the TA Act contains a definition of a ‘connected person’ which is cross-referenced to the income tax definition.

The Income Tax Act No. 113 of 1993 introduced the definition of a ‘connected person’ into section 1.[1] This definition is central to specific anti-avoidance provisions which 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 became effective as from 21 June 1993. It replaced the previous definition of a ‘connected person’ in section 12C(6) which was relevant only in the context of that section.

7.4 The tax treatment of tips for recipients, employers and patrons – No. 76

This Note discusses and clarifies the potential income tax, SDL and UIF implications for a recipient on the receipt of tips encountered in (but not limited to) the service industry. This Note will focus on a 'tripartite' tipping relationship between the following three parties:

- The patron
- The recipient
- The owner

For example, a customer (the patron) pays a waitron (the recipient) a tip for excellent service in a restaurant owned and operated by the owner. In some circumstances, the owner may also pay the recipient a tip in the owner's own capacity.

This Note considers an employee's potential obligation to include the receipt of tips in gross income and that employee's related provisional tax and UIF responsibilities. It also considers the owner and a patron's possible obligations to withhold employees' tax on such tips and to account for SDL and UIF.

Tips are generally awarded in money, for example, cash, cheque or by adding the tip to the total amount paid when making a credit or debit card payment. However, tips are not restricted solely to money and may take another form, for example, tickets to a sporting or entertainment event or, especially in the gambling industry, a casino chip or token.

Tips may be paid directly by a patron to a recipient. For example, a patron gives a waitron a R50 note as a tip in recognition of the service rendered.

Alternatively, the patron may pay the tip to the owner. It is important to determine what role the owner is playing when receiving a tip from a patron, that is, whether the tip has been received by or accrued to the owner for the owner's own benefit (or potentially for the owner's own benefit) or, alternatively, whether the owner is purely acting as a conduit between the patron and the recipient of the tip.1 In the role of a conduit, the owner is merely a channel which the patron is using, sometimes unknowingly, to transmit the tip to the recipient. The owner could either immediately distribute the tip to the employee in the form of cash, or the owner could distribute the tip later in, for example, cash or by depositing the amount into the recipient's bank account.

Although not part of the subject matter of this Note, it is noted that in the conduit situation the tip is not received by the owner for his or her own benefit and does not form part of the owner's gross income. However, when the tip is received by the owner for the owner's own benefit it must be included in the owner's gross income.

The facts and circumstances of each situation must be considered in determining the role the owner is playing. A unique feature to tips is that, although the patron's intentions are not disregarded, it is critically important to look at the arrangement for tips. The reason for this is because the arrangement will determine who is beneficially entitled to the tips and therefore whether the owner is acting as a conduit or as a receiver in his or her own right. For example, a patron may assume that the tip is being paid to the recipient, however, the recipient and the owner may have agreed that the owner will be entitled to all tips earned and that the employee will receive a higher hourly wage rate in view of this arrangement.

An owner plays the role of a conduit if, for example:

- all tips (cash and non-cash) for a specific recipient are accumulated and subsequently paid by the owner to that recipient (for example, a patron adds 10% to his or her restaurant bill which is settled by credit card, and the owner subsequently pays that 10% to the waitron who served the patron); or
- all tips (cash and non-cash) for all recipients are collected (in what is often referred to as a 'tipping pool') and are subsequently distributed according to a pre-agreed formula to all recipients and possibly other employees who are part of the chain of service (for example, all tips are collected and subsequently distributed according to the following

formula: 70% of the tips are distributed to waitrons based on the number of hours each waitron worked and 30% of the tips are distributed to the hostess, bartender and kitchen team based on the number of hours worked).

Examples of an owner not playing the role of a conduit and the tip being received by or accruing to the owner for the owner's own benefit, include –

- all tips (cash and non-cash) are collected (in a tipping pool) and the owner has full authority to decide on the portion of the tipping pool which will be distributed to employees and the amount that a particular employee will receive; or
- the recipient and the owner agree in advance that the employee will receive a higher hourly wage rate and that the owner will be entitled to all tips earned.

The Note does not deal with compulsory service charges (for example, adding a 10% service fee to a restaurant bill for tables exceeding eight guests), however for completeness it is noted that the facts and circumstances applicable to a compulsory service charge will determine whether the owner receives the service charge for the owner's own benefit (often but not necessarily the case) or as a conduit on behalf the owner's employees.

In summary:

- The recipient may therefore receive a tip from a patron, from the owner acting as a conduit for the patron or from the owner in the owner's own capacity (which may be funded out of tips which were previously received by or accrued to the owner or from other sources). The income tax consequences for the recipient are discussed.
- The owner may receive the tip as a conduit and on-pay it to the recipient, or the owner may receive the tip for the owner's own benefit.

- The patron's potential employees' tax, SDL and UIF obligations are discussed.

7.5 Application of the VAT Act to the gambling industry – No. 41 (Issue 3)

This Note provides clarity on the value-added tax (VAT) implications of specific transactions undertaken in the gambling industry.

This Note sets out the VAT implications of the various supplies made by and to a vendor in the gambling industry. It contains, for ease of reference, an extract from Binding General Ruling No. 13, which allows VAT to be calculated using the net drop method, subject to certain conditions being met.16 or facsimile on 086 540 9390. The application should be headed 'Application for a VAT Class Ruling' or 'Application for a VAT Ruling' and it must meet all the requirements as set out in section 79 of the TA Act.

7.6 Recipient-created tax invoices, credit and debit notes – No 56 (Issue 2)

This Note serves to:

- set out the legal framework for recipient-created tax invoices, credit and debit notes (also known as self-invoicing); and
- discuss paragraph 2 of BGR (VAT) No. 15 (Issue 2) which provides the necessary approval to issue recipient-created tax invoices, credit and debit notes.

Generally, a supplier of goods or services is required to issue a tax invoice for taxable supplies made to a recipient within 21 days of the supply being made. The supplier is required to retain a copy of the tax invoice which forms part of the supplier's records and serves to verify the output tax declared. The tax invoice issued by the supplier, in the hands of the recipient of the supply, becomes the document that is retained for purposes of substantiating the recipient's input tax deduction.

The amount of value-added tax (VAT) shown on a tax invoice may in certain circumstances be incorrect, for example, where goods supplied have been returned. A credit note must, in this instance be issued to rectify the amount of VAT incorrectly charged. Tax invoices, credit and debit notes are, therefore, a very important part of how the VAT system operates as such documents are used to create a paper trail for audit purposes.

It is acknowledged that a supplier may in certain circumstances be unable to issue a tax invoice. Provision is therefore made for the Commissioner to allow the recipient of a supply to issue a tax invoice, credit and debit note for a supply made by a supplier.

This Note sets out the criteria that have to be met in order for the Commissioner to approve the issuing of recipient-created tax invoices, credit and debit notes.

Vendors failing to comply, may apply in writing for approval to issue recipient-created tax invoices, credit and debit notes. In this regard a clearly motivated application complying with the provisions of section 79 of the TA Act, 2011 excluding section 79(4)(*f*), (*k*) and (6), accompanied by the prescribed VAT301 form must be submitted.

7.7 Resident: Definition in relation to a natural person. – Application of the physical presence test in the year of death or insolvency – No. 25 (Issue 3)

This Note explains the application of the physical presence test in the year of assessment that a natural person, who is not ordinarily resident on the Republic, dies or becomes insolvent. The implications of a double taxation agreement have not been taken into account in this Note.

Issue 2 of this Note, dated 8 February 2006, is hereby replaced.

Persons who are residents of the Republic of South Africa are subject to tax on their worldwide taxable income. A person is a 'resident' as defined in section 1 if that person is:

- **ordinarily resident** in the Republic; or
- **physically present** in the Republic for a specified number of days during the relevant (current) year of assessment as well as during each of the five years of assessment immediately preceding the current year of assessment (the **physical presence test**).

This Note must also be read in conjunction with Interpretation Note No. 4 (Issue 4) dated 12 March 2014 'Resident: Definition in Relation to a Natural Person – Physical Presence Test' as well as Interpretation Note No. 8 (Issue 3) dated 28 August 2013 'Insolvent Estates of Natural Persons'.

In the event of death or sequestration, the first requirement of the physical presence test (namely, physical presence exceeding 91 days in total for the current year of assessment) is applied in the normal way, notwithstanding that the year of assessment is for a period covering less than a full calendar year. The first requirement is therefore not scaled down to account for the fact that the 'year of assessment' is less than a full year.

An insolvent person will be assessed as a natural person for the period before insolvency, as well as for the period subsequent to insolvency, should any income accrue to that person in his or her personal capacity. The physical presence test must be applied to each of these two periods of assessment. The first period will be regarded as an immediately preceding year of assessment in relation to the second period.

7.8 Resident: Definition in relation to a natural person. – Physical presence test – No.4 (Issue 4)

This Note explains the requirements of the physical presence test, with which a natural person, who is not at any time ordinarily resident in the

Republic of South Africa during the relevant year of assessment, must comply before that person will be a 'resident' as defined in section 1.

South Africa's tax system has been residence-based since years of assessment commencing on or after 1 January 2001. For a natural person, this was the commencement of the 2002 year of assessment, that is, 1 March 2001. Persons who are 'resident' in the Republic are taxed on their worldwide income, subject to certain exclusions. Persons who are not resident are only taxed on their income from a source within the Republic.

A natural person can become a resident for income tax purposes by:

- being ordinarily resident in the Republic; or
- complying with all the requirements of the physical presence test.

7.9 Taxable benefit – use of employer-provided telephone or computer equipment or employer-funded telecommunication services – No. 77

This Note provides clarity regarding:

- the determination of the value of the taxable benefit arising from the private or domestic use by an employee of employer-provided or employer-owned telephone or computer equipment (including cellular telephones, laptops, tablets, modems, removable storage devices, printers and software) or telecommunication services; and
- the taxability of any allowance or reimbursement granted by the employer to the employee for the employee's privately-owned equipment or service contract which is used by the employee for purposes of the employer's business.

For the purposes of this Note, software is regarded to be computer equipment and should be evaluated on the same basis as any other telephone or computer equipment provided to an employee. The facts and circumstances of the particular case will determine whether the software should be treated as a separate asset for purposes of paragraph 2(*b*) or whether it should be treated as part of the asset on which the software is installed. For example, operating system software which is acquired as part of the acquisition of an item of equipment, such as a laptop, and the use of which is limited to the equipment acquired, should not be treated as a separate asset. However, software which is acquired separately, even if at the same time as the item of equipment on which it will be installed, or software which is acquired as part of an item of equipment but its use is not restricted to that item of equipment, must be treated as a separate asset. 2

The Note does not consider paragraph 2(*a*). Paragraph 2(*a*) deals with the fringe benefit tax consequences when an employee acquires an asset, which the employee may or may not previously have had the use of, from an employer or associated institution as a benefit of employment.

Employers often provide employees with telephones or computer equipment. The intention is that the employee will use the assets for work purposes. However, given that the assets are often used outside of the office, some private or domestic use is inevitable.

Previously, the Seventh Schedule to the Act treated almost all private or domestic use by employees of employer-owned telephones and computer equipment and employer-provided telecommunication services as a taxable benefit under paragraphs 2(*b*) or 2(*e*).

The associated compliance and enforcement costs were potentially prohibitive and in 2008 the legislation was amended to provide that in certain circumstances an employee's private or domestic use will not be taxed. This Note discusses the circumstances when an employee's private or domestic use of these benefits will not be subject to taxation.

This Note focuses primarily on the following scenarios:

<u>Employer-owned (or leased) equipment and related services</u>

> In this scenario the employer provides the employee with equipment or related services and incurs the associated cost. Two potentially taxable benefits arise, namely:

- the private or domestic use of an employer-owned or provided asset [paragraph 2(*b*)]; and
- access to and use of a telecommunication network (for example, line rental, call charges, data downloads) for private or domestic purposes at the employer's cost [which constitutes the provision of free or cheap services under paragraph 2(*e*)].

<u>Employee-owned (or leased) equipment and related services</u>

In this scenario the employee would typically have entered into a contract with a service provider for which the employee (and not the employer) has acquired the right to, for example, a cellular telephone (cell phone) or laptop and access to a telecommunication network. The contract with the service provider could take the form of a standard 24-month (or similar) contract between the employee and the service provider or a 'prepaid' (or similar) contract.

The employer may require the employee to use his or her private contract or equipment during the course of the employee's employment for work purposes. Typically the employer would grant the employee an allowance or a reimbursement in order to defray the expenditure incurred for business purposes.

The facts and circumstances of a particular employee's case will determine whether the use of an employer-provided telephone, computer equipment or employer-funded telecommunication service gives rise to a taxable fringe benefit.

A taxable fringe benefit will not arise if the facts and circumstances indicate that the employee uses the asset or telecommunication service mainly for the purposes of the employer's business. 'Mainly' in this context means that more than 50% of the total use of the asset or service is for business purposes.

The employer will have to calculate the value of the taxable fringe benefit if the asset or service is not used mainly for business purposes. In the case of:

- the use of an asset, the value of the taxable fringe benefit is, depending on the facts, equal to either the rental cost or the 15% calculated amount or the cost to the employer, less any consideration payable by the employee for such use; or
- the use of a telecommunication service, the value of the taxable fringe benefit is the cost to the employer of rendering or having the service rendered but only to the extent it is used for private or domestic purposes less any consideration payable by the employee for such service.

Allowances received in anticipation of an employee incurring business-related expenditure for telephone and computer equipment or telecommunication services must be included in taxable income and generally do not qualify for any reductions or deductions in determining the amount of the allowance which must be included in taxable income.

Reimbursements of expenditure, which was incurred on the instruction of the employer and where the employee is required to provide the employer with proof of the expenditure, are excluded from taxable income. 'Predetermined reimbursements' based on expected business usage are treated as allowances and not as reimbursements. 'Reimbursements' are taxable to the extent they exceed the cost incurred by the employee for business purposes.

In context, 'advances' are not used as frequently as allowances or reimbursements. Depending on the detail, the treatment may be the same as that for reimbursements.

8. DRAFT INTERPRETATION NOTES

8.1 Valuation of stock held by nursery operators

This Note provides guidance on the valuation of trading stock held and not disposed of by nursery operators at the beginning and at the end of each year of assessment.

It replaces Practice Note No. 32 dated 7 October 1994.

Section 26(1) stipulates that the taxable income of any person carrying on pastoral, agricultural or other farming operations shall, in so far as the income is derived from such operations, be determined in accordance with the Act but subject to the First Schedule. The First Schedule deals with the computation of taxable income derived from pastoral, agricultural or other farming operations.

The taxable income from farming operations is combined with the taxable income from other sources to arrive at the taxpayer's taxable income for the year of assessment.

The First Schedule applies regardless of whether a taxpayer derives an assessed loss or a taxable income from farming operations. The Schedule may further apply even after farming operations have been discontinued [section 26(2)].

Both section 26 and the First Schedule apply to farming operations conducted by a nursery operator. Some nursery operators have in the past, however, failed to comply with paragraph 2 of the First Schedule to the Act. Paragraph 2 requires a nursery operator carrying on farming operations to include in that operator's return of income the value of all livestock or produce held and not disposed of at the beginning and at the end of each year of assessment.

Persons conducting the business of a nursery in the course of which plants or trees are grown for sale are regarded as carrying on farming operations. Persons in this category are taxed in accordance with section 26 subject to the First Schedule. The same tests used to determine whether a person carries on farming operations apply to these nursery operators.

The produce held at the beginning and at the end of the year of assessment of a nursery operator carrying on farming operations is specifically excluded from section 22 and must be dealt with under the First Schedule. The value of the produce held and not disposed of must be brought into account at the beginning and end of the year of assessment. The value to be placed upon the produce on hand is the fair and reasonable value as the Commissioner may fix in accordance with paragraph 9. The plants or trees grown by a nursery, which are not ready for sale, will fall into the category of growing crops and must not be brought into account when the taxable income from farming operations is determined.

Any trading stock purchased from outside sources and offered for sale is not attributable to farming operations and must be dealt with under section 22.

8.2 Allowance of future expenditure on contracts

This Note provides guidance on the interpretation and application of section 24C when income is received in advance while the expenditure under the contract will only be incurred in a subsequent year of assessment.

The nature of a taxpayer's business may be such that the taxpayer receives amounts under a contract that will be used to finance expenditure to be incurred in the future in performing under that contract. An anomaly arises when the income is received in one year and the expenditure is incurred in a subsequent year of assessment.

In the absence of section 24C the income would be fully taxable in the year received without any deduction for future expenditure. The non-deductibility of the expenditure is attributable to most sections requiring that the expenditure be actually incurred before a deduction can be allowed [for example, section 11(*a*)] and, in addition, section 23(*e*) which specifically prohibits the deduction of income carried to any reserve fund or capitalised in any way.

Section 24C was inserted in the Act1 as a relief measure to taxpayers that, because of the nature and special circumstances of their businesses, receive advance income during a year of assessment but only incur related expenditure in a subsequent year of assessment. The explanatory memorandum explains the reason for the insertion of section 24C as follows:

> 'The new section caters for the situation which often arises in the construction industry and sometimes in manufacturing concerns, where a large advance payment is made to a contractor before the commencement of the contract work, to enable the contractor to purchase materials, equipment etc. In a number of instances such advance payments are not matched by deductible expenditure, resulting in the full amounts of the advance payments being subject to tax.'

Although Section 24C was originally intended for taxpayers entering into building and manufacturing contracts, it does not mean that the section cannot be applied to taxpayers entering into other types of contracts. In ITC 16973 *Galgut J* stated the following:

> 'The fact that the allowance might have been intended for building contractors does not mean, however, that it is not available to others. On the contrary, by the particular wording of s 24C the types of trades that the individual taxpayer might carry on, and the types of contracts concerned, are in no way limited. The sole question is whether the provisions of s 24C otherwise apply. . . .'

Section 24C has been and can be applied to businesses in industries other than building and manufacturing provided the detailed requirements of the section are met. For example, the section has been applied to the motor industry, the financial services industry, publishers and share block schemes.

An assessment of whether section 24C applies must be performed annually taking up-to-date information into account.

A decision made by the Commissioner under section 24C is subject to objection and appeal in accordance with Chapter 9 of the Tax Administration Act, 2011.4

In summary:

- Section 24C provides temporary relief, in the form of an allowance which reverses in the following year of assessment, to taxpayers that receive income in advance of incurring the expenditure related to the earning of that income.
- The Commissioner must be satisfied that:
  - the taxpayer's income in a particular year of assessment includes an amount of income received or accrued under a contract;
  - all or part of the advance income will be used to finance future expenditure which *will be incurred* by the taxpayer in performing the taxpayer's obligations under that contract; and
  - the future expenditure when incurred will qualify for a deduction or, in the case of the acquisition of an asset, will qualify for any deduction under the Act.
- The contract may be a written contract or a verbal contract; however, in the latter case it may be more difficult to prove the existence of a contract and the rights and obligations flowing from it.
- The words *'will be incurred'* indicate that the Commissioner must be satisfied that there is a high degree of probability and inevitability that the expenditure will be incurred by the taxpayer. A taxpayer must therefore be able to demonstrate that, although the expenditure is contingent at the end of the year of assessment in question, there is a high degree of certainty that the expense will in fact be incurred in a subsequent year. The facts of each case are critical. The degree of certainty required is unlikely to be met if performance under the contract is *not* contractually obligatory but is only *potentially*

contractually obligatory because of an act or event other than just the taxpayer’s client or customer taking action.

- Assets already acquired do not represent future expenditure.
- Assets falling within the ambit of section 24C are those assets which will be acquired in order to perform under the specific contract giving rise to the advance income. The replacement of assets generally used in the taxpayer’s trade fall outside the ambit of section 24C.
- The amount of the section 24C allowance is equal to the amount of advance income which the Commissioner is satisfied will be used to finance future expenditure.
- The section 24C allowance may not exceed the amount of income received or accrued under the contract in a particular year of assessment. The amount of income received or accrued in a current year includes the reversal of the previous year’s section 24C allowance.
- The section 24C allowance is based on how much of the advance income will be used to finance future expenditure and may, therefore, never exceed the amount of income even if the contract is running at a commercial loss.
- It is not possible to be prescriptive on the methods used to calculate the amount of the section 24C allowance. However, in a number of cases the ‘gross cost method’ will be appropriate.
- Generally, the calculation of the section 24C allowance must be performed on a detailed contract-by-contract basis. However, there are limited circumstances in which it may be appropriate to perform the analysis at a higher level by taking a number of contracts into consideration.
- An assessment of whether section 24C is applicable must be performed annually taking into account up-to-date information.

- A decision made by the Commissioner under section 24C is subject to objection and appeal in accordance with Chapter 9 of the Tax Administration Act, 2011.

8.3 Income Tax: Public Benefit Organisations: Written undertaking furnished to the Commissioner confirming compliance with the prescribed requirements

This Note provides guidance on the interpretation and application of section 30(4), which provides for a written undertaking to be submitted under certain circumstances before an organisation can be approved as a PBO by the TEU.

Section 30(3)(*b*) prescribes specific requirements that have to be included in a founding document before an organisation can be approved as a PBO.

The founding document of an organisation may not comply with the requirements of section 30(3)(*b*) at the time the application is submitted to the TEU for approval. In these circumstances section 30(4) makes provision for the founding document to be deemed to comply with the requirements of section 30(3)(*b*), if the person responsible in a fiduciary capacity for the funds and assets of the organisation furnishes the Commissioner with a written undertaking that the organisation will be administered in compliance with the prescribed requirements.

In those circumstances in which it is possible to amend the founding document, the written undertaking is an interim measure, and the relevant requirements must subsequently be formally incorporated into the founding document within a specific timeframe.

The TEU may grant an organisation approval as a PBO under section 30(3) if its founding document does not meet the prescribed requirements of section 30(3)(*b*) provided a written undertaking that the organisation will be administered in compliance with section 30(3)(*b*) is submitted by the person responsible in a fiduciary capacity for the funds and assets of the organisation.

8.4 Rebates and deduction for foreign taxes on income

This Note explains the scope, interpretation and application of sections 6*quat*, 6*quin* and 64N.

Residents of South Africa are subject to income tax on their worldwide taxable income regardless of the source of the income. Foreign-sourced amounts derived by a resident of South Africa may sometimes be taxed by the country of source and by South Africa, resulting in international juridical double taxation. International juridical double taxation is the imposition of similar taxes by two or more sovereign countries on the same item of income (including capital gains) of the same person.

Relief from double taxation resulting from the imposition of tax by a residence country and a source country on the same amount is normally granted by the residence country. Thus, the source country's right to tax generally has priority over the residence country's right to tax. In many instances, countries provide for relief from international juridical double taxation by way of a tax treaty, although many countries (including South Africa) also provide unilateral tax relief in their domestic law.

One of the main purposes of a tax treaty is to protect taxpayers against double taxation by allocating the right to tax the amount of income (or capital) to one of the contracting states. However, in some instances both states have the right to tax such income or capital thus requiring relief from double taxation to be provided for by the state of residence of the taxpayer.3 A tax treaty provides, amongst other things, a framework for resolving cross-border tax disputes and assists in curtailing tax evasion.

Countries seek to resolve double taxation under their domestic tax laws by applying one of the following methods of relief:

- The credit method (also referred to as the rebate method)

- The exemption method
- The deduction method
- A combination of the above-mentioned methods

8.5 Tax deduction for amount refunded to employers

This Note provides guidance and clarity on the tax implications of amounts that were included in a person's taxable income, and subsequently refunded or repaid.

A person may receive remuneration and other similar amounts (for services rendered or to be rendered, or by virtue of employment or the holding of any office) which subsequently have to be repaid, often because of contractual obligations not having been fulfilled or a previous overpayment. These amounts can include, for example, paid maternity or sick leave benefits, or retention bonuses. These amounts are often recovered by an employer, but sometimes in a subsequent year of assessment. There is uncertainty regarding the amount (which has been subject to the withholding or deduction of employees' tax (PAYE)) that has to be refunded, and the related tax implications.

Amounts which have been received by or accrued to an employee may subsequently be recovered by the employer in another year of assessment. Whilst the Act does not permit the employer to refund taxes paid retrospectively, the Act does permit a deduction of the amount repaid by the employee in the year that the amount became repayable. This has the effect of reducing the employee's taxable income (on assessment) in the

8.6 Provisional tax estimates

This Note provides guidance on provisional tax and considers:

- who is a provisional taxpayer;
- the calculation of provisional tax including how estimates of taxable income must be made;
- the consequences of an incorrect or late submission of estimates; and
- the consequences of a late payment of provisional tax.

Employees who earn remuneration generally pay tax in the form of employees' tax (PAYE) on a monthly basis. This results in the collection of an employee's normal tax liability being spread throughout the year with a potential additional payment or a refund at the end of the year of assessment. However, for people who do not earn 'remuneration' as defined in the Fourth Schedule to the Act, for example, a self-employed person earning business income, in the absence of a provisional tax system the full amount of tax would only be payable on assessment at the end of the year of assessment, without the option or obligation of making interim payments like those paying PAYE monthly.

Provisional tax is not a separate tax payable by certain persons. It is merely a method used to collect normal tax, that will ultimately be payable for the year of assessment concerned, during the year. Otherwise stated, provisional tax is an advance payment of a taxpayer's normal tax liability. A provisional taxpayer is generally required to make two provisional tax payments, one six months into the year of assessment and one at the end of the year of assessment, but has the option to make a third top-up payment after the end of the year of assessment.

Provisional tax is a method used to collect normal tax which will ultimately be payable for a particular year of assessment during the year. There are potentially three payments, two of which are compulsory. The first compulsory payment must be made within the first period which ends six months after the start of the year of assessment. The second compulsory payment must be made on or before the end of the second period which ends on the last day of the year of assessment. A third payment, which is voluntary, must (in most cases) be made within seven months of the end of the year of assessment.

The calculation of the amount of a provisional tax payment involves estimating taxable income for the year concerned. Depending on which payment (first, second or third) and on the facts and circumstances of the case, certain penalties may be imposed and interest levied if the estimates are not accurate.

8.7 Application of section 20(7) and 21(5) of the VAT Act

This Note serves to set out:

- the conditions that must be met in order for the Commissioner to apply the provisions of sections 20(7) or 21(5); and
- the person who may submit the request to the Commissioner.

This Note sets out the criteria that have to be met in order for the Commissioner's discretion to be exercised under section 20(7) or 21(5) to the effect that :

- certain information need not be contained on a tax invoice, credit or debit note,
- certain information may be furnished in another manner (in the case of tax invoices), or
- a tax invoice, credit or debit note is not required to be issued.

A vendor that complies with all the requirements contained in this Note may apply to the Commissioner for approval contemplated in section 20(7) or 21(5) by submitting an application. The application must clearly demonstrate that the vendor complies with all the requirements contained in this Note.

8.8 Input tax on motor cars

This Note sets out the:

- interpretation of the definition of a 'motor car';
- general principle that value-added tax (VAT) incurred on the acquisition of a motor car is not permissible as an input tax deduction;
- exceptions to the general principle, that is, when an input tax deduction is allowed on the acquisition of a motor car;
- instances when input tax may be deducted on the acquisition of accessories, modifications and conversions to motor cars;
- application of change in use adjustments to motor cars; and
- VAT treatment of motor cars supplied as a fringe benefit.

This Note provides an analysis of the definition of a 'motor car' and the process to be followed in determining whether a particular vehicle constitutes a 'motor car'.

A vendor is generally not entitled to deduct input tax on the acquisition of a motor car irrespective of whether it is applied for taxable purposes or not. An exception to this rule includes motor dealers who supply motor cars in the ordinary course of their business.

Input tax incurred on expenses relating to the repair, maintenance and insurance of a motor car may be deducted, subject to the provisions of sections 16, 17 and 20.

To the extent that this Note does not deal with a specific scenario, vendors may apply for a VAT ruling or VAT class ruling.

8.9 The VAT treatment of supplies of transport services and ancillary transport services

This Note serves to:

- set out the value-added tax (VAT) treatment of the transport of passengers and goods as well as ancillary transport services; and
- withdraw VAT Practice Notes No. 7 dated 10 February 1992 and No. 10 dated 1 October 1991.

The transport of passengers by road or rail within the RSA is exempt whereas the transport of goods is taxable. The international transport of both passengers and goods as well as the ancillary transport services associated thereto may be zero rated under the various provisions contained in section 11(2) provided that the requirements for the zero rating are met. In this regard, it is important to note that should the vendor not obtain and retain the documentary evidence within the time periods stated in Interpretation Note No. 31, the supply will not qualify to be zero rated.

8.10 The Master Currency case and the zero-rating of supplies made to non-residents

This Note discusses the impact of the judgment of the SCA in the *Master Currency* case on the interpretation and the application of section 11(2)(*ℓ*), with particular reference to the principles highlighted by the SCA.

The *Master Currency* case concerned an appeal by Master Currency (Pty) Ltd (the appellant) against the dismissal of its appeal by the Johannesburg Tax Court about revised value added tax (VAT) assessments relating to the October 2003 to January 2005 tax periods.

The appellant operated two *bureau de change* in the duty free area at O.R. Tambo International Airport (previously Johannesburg International Airport) in the Republic. Shops located in the duty free area are able to supply goods free of certain taxes and duties to departing passengers. The VAT refund administrator, also located in the duty free area, refunds the VAT paid on goods purchased in the Republic to departing non-residents exporting those goods.

The appellant rendered services to non-resident passengers whereby they presented their South African rand to the appellant, who would convert the rand into foreign currency. In doing so, the appellant would calculate the exchange rate margin, and charge a commission and transaction fee. The relevant amounts would all be indicated on an invoice presented to the passenger when the services were rendered.

The dispute between the parties related to whether the appellant was, (on the currency exchange services rendered), obliged to levy and pay VAT at the standard rate of 14%, as per section 7(1)(*a*), or at the rate of zero% by virtue of section 11(2)(*ℓ*) (as the appellant contended).

The SCA found that the services supplied by the appellant were disqualified from the zero-rating provided by section 11(2)(ℓ), since they were supplied directly in connection with money, and that money did not constitute movable property that was subsequently exported.

8.11 VAT treatment of vouchers

This Note provides clarity on what constitutes a voucher and the concomitant value-added tax (VAT) treatment. It does not cover the VAT treatment of telecommunication vouchers.

Vouchers have become a widely used commodity for the payment or acquisition of goods and services. A wide variety of vouchers are currently available and they differ in form, value as well as the goods or services to which the holder may be entitled upon redemption.

These different variations result in different accounting and VAT treatment. The interpretation and application of the terms ‘supply’ and ‘consideration’ are of utmost importance when considering the VAT implications of the various types of vouchers.

This Note sets out the VAT treatment of the sale and redemption of the various types of vouchers. In this regard, the sale of a monetary voucher is disregarded for VAT purposes at the point of sale as opposed to the sale of a product-specific voucher where VAT is accounted for at the point of sale. In addition, an output tax liability only arises when the consideration charged for a monetary voucher exceeds the face value of the voucher. Output tax in this instance is however limited to the extent of the amount paid in excess of the face value of the voucher.

Vouchers envisaged under section 10(20) do not reduce the value of the supply of goods or services made by a supplier when the voucher is redeemed. The issuer of the voucher is entitled to a deduction under section 16(3)(*i*) by applying the tax fraction (14/114) to any payments made to the supplier who honoured the voucher in respect of a standard supply.

The payment of any commission or fees to an agent or operator for facilitating the supply of the vouchers is consideration for a separate supply of services made by the agent or operator and subject to VAT if supplied by a vendor.

Cash-back vouchers that fall within the ambit of section 21 must be evidenced by a credit note in order to qualify for an input tax deduction.

8.12 VAT Bodies of persons

This Note explains the bodies of persons that fall within the ambit of section 51.

A business can be carried on in various legal forms including a company, a sole proprietor and a partnership. A company, for example, has a separate legal personality, exists separately from its members and can therefore register for value-added tax (VAT) in its own right. On the other hand, unincorporated bodies of persons (for example, partnerships, joint ventures or associations) are not regarded as legal persons in terms of common law and the rights acquired and obligations incurred by these entities vest in the members of these entities rather than in the entities themselves. Certain bodies of persons may, however, be established by law and be given separate legal personality in terms of that law (that is, a corporate body of persons, for example, the Government Employees Pension Fund). Although for common law purposes, a body of persons is not regarded as a legal person, for VAT purposes it is included in the definition of a ‘person’ in section 1.

8.13 VAT treatment of bets

This Note provides clarity on what constitutes a bet and the concomitant value-added tax (VAT) treatment of bets.

Vendors operate various competitions that provide participants (subject to competition rules) with the opportunity to win prizes or awards. Entry to these competitions may be in the form of a purchased entry, free entry or free entry subject to the purchase of specified goods or services.

The issue at hand is whether or not the free entry to these competitions constitute a ‘bet’ on the outcome of an event for purposes of section 8(13). Should the provisions of section 8(13) apply, vendors are entitled to a deduction determined in accordance with section 16(3)(*d*) for the prizes or awards given to competition winners.

Betting transactions falling within the National Lotteries and Gambling Acts will be regarded as a bet for purposes of section 8(13). As a result the vendor would be required to account for output tax as the supply would be subject to VAT under section 7(1)(*a*).

Consideration charged (that is, charges to cover the cost of posting or otherwise transmitting an entry form) for entrance into promotional competitions falling within section 36 of the CPA, is not a bet as envisaged by section 8(13). The consideration charged will be payment received for the supply of the administration services supplied by the operator of these promotional competitions which services are taxable under section 7(1)(*a*).

Competitions that do not qualify as promotional competitions (including competitions charging costs which are in excess of the reasonable costs contemplated in the CPA) may fall within the ambit of the Lotteries Act. Should the competition fall within the Lotteries Act, the person is supplying a betting service contemplated in section 8(13).

9. BINDING PRIVATE RULINGS

9.1 BPR 158 – Income Tax – Transport services provided by an employer for employees

This ruling deals with transport services provided by an employer to convey employees between their homes in a foreign country and construction project sites in South Africa.

In this ruling references to paragraphs are to paragraphs of the Seventh Schedule to the Act applicable as at 4 October 2013 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of paragraph 10(2)(*b*) of the Seventh Schedule.

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

The Applicant: A branch of a foreign company.

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

The Applicant is registered in South Africa as an external company and in the process of being registered as an employer with the South African Revenue Service.

The foreign company is engaged in the rendering of services required for the implementation and completion of construction projects in various countries.

Employees of the foreign company (the Employees) will be seconded to the Applicant to render services on an ongoing basis at the site of a specific construction project in South Africa (the Project).

All the Employees working on the Project will work in South Africa on a rotational basis and will, for the duration of the Project, periodically travel home at the cost of the employer.

The Employees are nationals of the foreign country and will retain their homes in the foreign country for the duration of the Project. If the Employees have families, their families will remain in the foreign country while the Employees are working in South Africa.

The Employees will not be entitled to any annual leave while they are in South Africa. Due to the nature of the Project, they will be required to work over weekends and to supervise the Project site.

The Employees are permanently employed by the foreign company and will remain in the permanent employ of the foreign company after the period of their secondment to South Africa.

The activities and type of work that the Employees would be involved in after their secondment to South Africa would be similar to their activities and services rendered prior to and during their secondment to South Africa.

Conditions and assumptions

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

- The ruling applies to the transport services made available to the Employees on or after the date of this ruling.
- The transport services are made available to all the Employees working on the Project on a rotational basis.

Ruling

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

- No value shall be placed on the provision of transport services by the Applicant to convey the Employees (who will work in South Africa on the Project on a rotational basis) between the foreign country and the construction project sites in South Africa.

General Note

This ruling was issued based on specific facts and circumstances relating to the Applicant and should not be interpreted to mean that a nil value may be placed on home leave benefits provided to expatriate and/or seconded employees.

9.2 BPR 159 – Income Tax – Asset-for-share and amalgamation transactions

This ruling deals with shares acquired in terms of an 'asset-for-share transaction' as defined in section 42(1) of the Act and whether the merger of involved parties will be an 'amalgamation transaction' as defined in section 44(1) of the Act.

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

- section 1, definition of 'trading stock';
- section 41, definition of 'asset' and 'allowance asset';
- section 42(1), (5), and (8); and
- section 44(1), definition of 'amalgamation transaction'.

Parties to the proposed transaction

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

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

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

Description of the proposed transaction

The controlling interest in both the Applicant and the Co-Applicant is held by individuals and family trusts (the shareholders).

The Applicant and Co-Applicant do not form a ‘group of companies’ as defined in section 1, read together with section 41.

The shareholders are in many cases a ‘connected person’ as defined in section 1 and hold their shares in the Applicant and the Co-Applicant in exactly the same ratio.

The aforementioned shareholders wish to hold their investments in the Applicant and the Co-Applicant through a single company and propose to consolidate the businesses held under the two companies to enhance the group's cash flow management, credit rating, attractiveness to outside investors and future public listing potential.

In order to achieve this the Co-Applicant will incorporate a new wholly owned subsidiary (NewCo) and will dispose of its business to NewCo in return for equity shares in NewCo under an ‘asset-for-share transaction’ as defined in section 42(1).

The tangible assets will be transferred to NewCo at their fair market value.

The sale of business agreement will ascribe the surplus of the fair value consideration, paid in excess of the net asset value of the tangible assets, to goodwill.

NewCo will recognise the aforementioned goodwill in its accounting records on acquisition of the business from the Co-Applicant.

The agreement between the Co-Applicant and NewCo will identify certain assets in relation to which NewCo will assume certain debts. The assumption of these debts by the Co-Applicant will serve as compensation for the selected and specified assets.

The Co-Applicant and NewCo will agree in writing that section 42 will not apply to the aforegoing debt assumption, as contemplated in section 42(8A).

The only assets that the Co-Applicant will hold after the aforementioned asset-for-share transaction will be the NewCo shares.

These newly acquired shares will be disposed of by the Co-Applicant to the Applicant in exchange for the issue of shares in the Applicant, this being the first step in the amalgamation transaction.

The Co-Applicant will distribute the newly acquired shares in the Applicant to its shareholders in anticipation of winding up its existence, as contemplated in section 44(1).

The directors of the Co-Applicant will take the necessary steps to liquidate the company.

<u>Ruling</u>

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

- Based on the specific facts of this application, the NewCo shares will be regarded as having been acquired and held by the Co-Applicant on capital account even though the equity shares in NewCo will be disposed of to the Applicant shortly after acquisition. The facts and circumstances of this matter, taking into account the proposed steps before and after the acquisition of the NewCo shares by the Co-Applicant, are very specific and, in the context of the corporate rules contained in Part III of Chapter II of the Act, indicate that the Co-Applicant and the group as a whole will not deal with the asset as trading stock.
- The Co-Applicant must take goodwill into consideration when calculating the ratio contemplated in section 42(5)*(b).* No ruling is issued on the value of the goodwill, or any asset for that matter.
- Section 42(6) will not find application to the proposed transaction.
- Section 42(8) will not find application to the proposed transaction to the extent that the Co-Applicant and NewCo agree in writing that section 42 will not apply to the assumption of the Co-Applicants debt, by NewCo, in return for certain assets of the Co-Applicant.

- The disposal of the shares in NewCo by the Co-Applicant to the Applicant will constitute an amalgamation or merger, as contemplated in paragraph (*a*)(i) of the definition of an 'amalgamation transaction'' in section 44(1).

9.3 BPR 160 – Income tax & VAT – Incentive payments

This ruling deals with incentive payments to be made in accordance with an incentive programme to be implemented for purposes of increasing trade.

In this ruling references to sections are to sections of the relevant Acts applicable as at 23 August 2014 and 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 provisions of:

- section 11(*a*) of the Act; and
- sections 1, definition of 'consideration' and 20 of the VAT Act.

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

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

The Farmers: Farmers who trade with the Applicant

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

The Applicant proposes to implement a programme that will incentivise farmers to trade with it. The Farmers will buy their agricultural goods and equipment from the Applicant's trade division, make use of the Applicants financing options and store their grain and produce in the Applicant's silos.

In return for transacting with the Applicant, the Farmers will receive an incentive payment from the Applicant. The incentive payments will be made in proportion to the value of transactions with the Applicant, specifically in relation to the business areas of the Applicant and their contribution to the fees and gross profits of the Applicant. These payments will, however, only be made at the discretion of the board of directors of the Applicant and be subject to solvency and liquidity tests.

The Applicant will consider the foregoing fees and gross profits and exercise its discretion on the amount payable to the Farmers.

The Applicant will accrue for the total incentive amount to be paid in their books of account before year-end by establishing an unconditional obligation at year-end to pay the incentives and issuing an acknowledgement of the amount due to the Farmers.

The settlement of the 'incurred obligation' will only occur after year-end, by way of a cash payment (cheque) to the Farmers, representing a minimum of 20% of the incentive. This cash payment will be made to enable the Farmers to pay their tax liability resulting from the incentive payments.

The remaining 80% of the incentive amount will be utilised to buy ordinary shares and redeemable preference shares in the ultimate holding company of the Applicant on behalf of the Farmers. The Applicant will facilitate the acquisition of these shares.

The only existing current limitation on these shares will be that they may only be disposed of to other farmers. The Farmers will be entitled to immediately dispose of the shares at their discretion and will not be required to hold them for any period of time. Furthermore, it is not a condition of the proposed programme that the Farmers commit to supplying their produce to the Applicant. In addition the Farmers will not be bound to:

- buy the agricultural goods or equipment from the Applicant; or
- utilise the finance awarded to them to pay for the agricultural goods or equipment bought from the Applicant or for services of the Applicant.

The acquisition of shares will occur as follows:

- The Applicant will facilitate the process and issue a cheque to its ultimate holding company to settle its liability to the Farmer and to settle the Farmer's liability for the subscription price.

- The Farmer will be required to firstly acquire 40 000 shares in the ultimate holding company of the Applicant pro rata from existing shareholders at 66% of the net asset value.
- If the Farmer already owns a minimum of 40 000 shares, the incentive, or balance thereof, will be used to buy 15 year redeemable preference shares in the ultimate holding company of the Applicant.

The Farmers are not shareholders of the Applicant, but may be shareholders of the ultimate holding company of the Applicant. It is not a requirement that the Farmers be shareholders of the Applicant or the ultimate holding company of the Applicant in order to qualify for an incentive payment. Any Farmer may participate and will be rewarded based on transactions and interactions with the Applicant during a specific financial year, subject to the Farmer being a registered vendor as defined in section 1 of the VAT Act.

The incentive programme will be evaluated by the Applicant on an annual basis in order to determine whether it is adding value to its business.

The directors of the Applicant will have the right to alter or cancel the incentive programme at any time.

Ruling

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

- The incentives payable by the Applicant will be deductible under section 11(*a*) of the Act.
- The incentives payable to the member suppliers are not regarded as 'consideration' as defined in section 1 of the VAT Act in respect of a supply of goods or services made by such member to the Applicant. Such payments are, therefore, not subject to VAT. It follows that a tax invoice contemplated in section 20 of the VAT Act cannot be issued and the Applicant cannot deduct any 'input tax' in respect of the incentives paid.

9.4 BPR 161 – Income Tax – Employee share ownership plan

This ruling deals with the income tax and employees' tax consequences for an employer and a trust through which an employee share scheme will be implemented.

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Fourth Schedule to the Act applicable as at 8 October 2013 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

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

- section 11(*a*) read with section 23(*g*);
- section 54 read with section 58; and
- paragraphs 2(1) and 11A(4) of the Fourth Schedule.

Parties to the proposed transaction

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

The Trust: A share ownership trust to be formed and registered in South Africa

The Beneficiaries: Beneficiaries of the Trust who will be qualifying employees of the Applicant

Description of the proposed transaction

The Applicant intends implementing an employee share ownership plan (ESOP), by offering its qualifying employees the right to participate in the benefits attributable to the shares of the Applicant's JSE listed holding company.

The Trust will be used as a special purpose vehicle for carrying on the ESOP and qualifying employees will be allocated notional units (trust units) which will determine their participation in the dividends and net capital proceeds attributable to the shares. Each trust unit will restrict the employee to whom it is allocated from disposing of the shares for a specified ‘lock-in’ period.

The Applicant will make annual cash contributions to the Trust during the first six years. The ESOP will commence with the first trust unit allocation following the Applicant’s first annual cash contribution. The ESOP will terminate upon the expiry of the last lock-in period.

The contribution amounts will be used by the Trust to purchase shares in the Applicant’s holding company.

The main objectives of the Trust will be to:

- enter into a Contribution Agreement with the Applicant;
- acquire the shares and any other assets from time to time;
- administer the assets for the benefit of the Beneficiaries;
- receive any dividends and net capital proceeds;
- distribute any dividends, net capital proceeds and other amounts due to the Beneficiaries in accordance with the terms of the Trust Deed; and
- vest the shares in and distribute them to the Beneficiaries in accordance with the terms of the Trust Deed.

The Trust will create the trust units as soon as the shares have been acquired. The number of trust units at the time will be equal to the number of shares acquired. Thereafter the trustees will confirm with the founder that the trust units are available for allocation to qualifying employees.

All trust units that are taken up by qualifying employees will form part of the allocated trust units, and all other trust units will form part of the unallocated trust units.

The rights attached to the trust units which are allocated to a Beneficiary will entitle the Beneficiary to:

- an immediate vested right to the dividends received by the Trust;

- an immediate vested right to the net capital proceeds realised by the Trust upon the disposal of the shares; and
- a vested right to the shares held by the Trust when the trustees exercise their discretion to vest the shares in the Beneficiaries.

The trustees will, from time to time, send to each Beneficiary a written notice notifying the Beneficiary of:

- the number and net value of the shares;
- the number of the Beneficiary's allocated trust units which are still subject to the lock-in period; and
- the number of those allocated trusts units which are no longer subject to the lock-in period (matured units).

In respect of the Beneficiary's matured units, the Beneficiary shall be required to indicate by way of an annual election notice whether the trustees must:

- dispose of the related shares and distribute the net capital proceeds to him/her; or
- vest the shares in and transfer them to him/her.

After receipt of the election notice from a Beneficiary the trustees will exercise their discretion and pass a resolution on whether the shares should be sold or vested in the Beneficiary. In exercising this discretion the trustees are obliged to act in the best interests of the Beneficiary, taking into account the wish per the election notice and relevant commercial considerations at the time. The trustees shall, as soon as reasonably possible, notify each Beneficiary of their decision.

Should the trustees decide to vest the shares in and transfer them to the Beneficiary, the Beneficiary shall be obliged to pay employees tax and expenses before such transfer can take place.

The trustees may, notwithstanding the lock-in period, exercise their discretion at any time and dispose of the shares and distribute the net capital proceeds realised to a Beneficiary, or vest the shares in and transfer them to the Beneficiary as indicated in the relevant annual election notice.

Qualifying employees who leave the employ of the Applicant in certain circumstances will forfeit any allocated trust units that are still subject to the lock-in period. Such trust units shall then form part of the unallocated trust units.

Unallocated trust units are then allocated to qualifying employees upon the next allocation date. In view of the fact that it is intended that upon the next allocation date that all unallocated trust units be allocated and that one trust unit is created per share purchased, there should, in the absence of any forfeiture during the year, be no unallocated trust units.

Any amount of the contribution remaining after the purchase of the shares by the Trust will, in the first instance, be used to settle any liabilities of the Trust and any amount remaining thereafter will be rolled over to augment the contribution amounts received by the Trust each year.

<u>Ruling</u>

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

- The contributions made by the Applicant to the Trust for purposes of the ESOP will be deductible under section 11*(a),* read with section 23*(g)*. No ruling is made, and no opinion is expressed, on the application of section 23H.
- The contributions made by the Applicant to the Trust will not be subject to donations tax under section 54.
- The contributions received by the Trust will be of a capital nature and will not be included in the Trust's 'gross income', as defined in section 1.
- The Applicant will be liable to withhold employees' tax on each section 8C gain made by qualifying employees (Beneficiaries) to the extent that shares vested in the Beneficiaries and the Trust does not have any funds from which to withhold employees' tax. However, the Trust will be liable to register as an employer and withhold employees'

tax, to the extent that the shares are disposed of and the Trust has funds available.

- The aforegoing ruling will not alter or affect the obligation of the employer, whether it is the Applicant or the Trust, to ascertain from the Commissioner the amount of employees' tax to be deducted or withheld, as contemplated in paragraph 11A(4) of the Fourth Schedule.

9.5 BPR 162 – Income Tax & VAT – Sale of an oil and gas right

This ruling deals with the consequences on the sale of an oil and gas right and the timing of when value-added tax (VAT) will be payable in respect of the consideration accruing on the disposal of the exploration right (ER).

In this ruling references to sections and paragraphs are to sections of the relevant Acts and paragraphs of the Schedules to the Act applicable as at 26 November 2013 and 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 provisions of:

- paragraph 2 of the Eighth Schedule;
- paragraphs 1, definition of 'oil and gas company' and 'oil and gas right' and 7(1) and (2) of the Tenth Schedule.
- sections 1, definition of 'consideration' and 'fixed property', 9(3)(*d*) and (4); and 16(4)(*a*)(ii) of the VAT Act.

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

The Applicant: An oil and gas company incorporated in and a resident of South Africa

The Co-Applicant: A newly formed company incorporated in and a resident of South Africa

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

The Applicant currently owns an ER acquired by it in terms of the Mineral and Petroleum Resources Development Act, No. 28 of 2002 (the MPRD Act). The ER constitutes an 'oil and gas right', as defined in paragraph 1 of the Tenth Schedule, and is held by the Applicant as a capital asset.

The Applicant wishes to develop the ER, and in order to do so, wishes to conclude a contract (the agreement) with the Co-Applicant in which the Applicant will sell a participating interest in the ER. The agreement is subject to certain suspensive conditions.

In return for the participating interest in the ER, the Co-Applicant will undertake to pay certain agreed amounts to the Applicant when the suspensive conditions of the agreement are met.

<u>Conditions and assumptions</u>

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

- The Applicant and the Co-Applicant are not connected persons as envisaged in the definition of 'connected person' in section 1 of the VAT Act.
- The ER is held by the Applicant as a capital asset.

<u>Ruling</u>

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

Income tax

- The Applicant will qualify for rollover relief, as referred to in paragraph 7(1) and (2) of the Tenth Schedule.
- A letter by the Applicant submitted to the Legal and Policy Division, stating that both parties are in agreement that the rollover provisions as set out in paragraph 7(2) of the Tenth Schedule must apply, will constitute the Applicant's election for rollover relief as required in paragraph 7(1).
- In terms of paragraph 7(2) of the Tenth Schedule, the Applicant will be deemed to have disposed of the participating interest in

the ER for an amount equal to the base cost. Thus, no capital gain will be realised and no amount of tax will be payable by the Applicant on the disposal.

VAT

- The disposal of the participating interest in the ER will be a disposal of 'fixed property' as defined in section 1 of the VAT Act (that is, the ER acquired by virtue of a conversion contemplated in the MPRD Act is a real right in land). The time of supply in respect of such supply will be determined in accordance with section 9(3)(*d*) of the VAT Act. The Applicant will, under section 16(4)(*a*)(ii) of the VAT Act, be required to account for output tax to the extent that payment of any consideration relating to the purchase price of the ER is made during a tax period.

Exclusions

This ruling only addresses the VAT implications in respect of the supply of the ER and does not deal with any other supplies emanating from that supply.

9.6 BPR 163 – Income Tax – Interest on replacement loans and proceeds arising from a share repurchase

This ruling deals with interest incurred on replacement loans and whether the loans will retain their initial business purpose for the interest on those loans to qualify for a deduction under section 24J(2). The ruling also deals with a share repurchase consideration received by a selling company and whether such consideration constitutes a dividend and consequently exempt from dividends tax and income tax.

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 11

February 2014 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

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

- section 1 definition of 'dividend' and 'contributed tax capital';
- section 10(1)(*k*)(i);
- section 22B;
- section 24J(2);
- section 64F(1)(*a*); and
- paragraphs 35 and 43A of the Eighth Schedule.

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

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

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

The Subsidiaries: Private companies incorporated in and residents of South Africa and directly held subsidiaries of the Applicant

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

The Co-Applicant owns 49.3% of the shares in the Applicant. Various professional individuals own 50.57% of the shares in the Applicant, either individually or through trusts, companies or the executors of their deceased estates. The employees of the Applicant own the remaining 0.13% of the shares.

The Applicant proposes to repurchase the entire shareholding which the Co-Applicant holds in the Applicant.

The steps comprising the proposed transaction are as follows:

- The Applicant will acquire all the shares in a company (NewCo) for a nominal value.

- NewCo will acquire all the shares in the Subsidiaries from the Applicant in exchange for issuing new shares in itself to the Applicant.
- The Subsidiaries will refinance four existing interest-free intra-group loans (group loans) through interest-bearing third party bank loans (replacement loans). The cash arising from the replacement loans will be applied in repaying the group loans. The group loans arose from time to time as a consequence of companies, with available surplus cash (creditor companies), advancing interest-free loans to fellow group companies which had certain funding requirements (debtor companies).
- The Subsidiaries will distribute their refinanced cash and excess cash to NewCo as a dividend.
- NewCo will source loan funding from a third party bank in order to partly raise funding for the share repurchase consideration payable by the Applicant to the Co-Applicant. The loan will represent a large portion of the share repurchase consideration payable by the Applicant to the Co-Applicant.
- NewCo will distribute the cash arising from the aforementioned third party bank loan together with the cash distributions it will receive from the Subsidiaries to the Applicant as a dividend. The Applicant will apply these funds towards the settlement of the repurchase consideration.
- The professionals will purchase specified numbers of the Applicant's shares directly from the Co-Applicant.
- The Applicant will repurchase all of the remaining shares held by the Co-Applicant in accordance with section 48(2)(*a*) of the Companies Act, No. 71 of 2008, subsequent to the professionals acquiring the shares from the Co-Applicant.

The first three group loans were applied by the respective debtor companies to finance working capital, various building projects or for the purchase of capital equipment necessary to continue to conduct their businesses. Since the replacement loans will be interest bearing funding, the debtor companies will incur interest and will seek to deduct such interest for income tax purposes.

The original purpose of a fourth loan was that it would be applied by the debtor company for a future capital expenditure programme. Projects were budgeted for but the implementation of these projects was dependent on approval of the necessary licenses. Had the applications for the licenses been granted, surplus cash resources would have been utilised to fund such an expansion project. Prior to this happening and in anticipation of the forthcoming capital expenditure, the group loan was advanced by the creditor company and the proceeds of the group loan were placed by the debtor company in a fixed interest-earning deposit. The result is that the debtor company will retain only an interest bearing bank loan and have no funds available for the initially intended project. The debtor company will have to borrow these funds again when the group decides to proceed with the initially intended project.

Ruling

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

- Interest incurred on the first three replacement loans will be deductible by the respective Subsidiaries under the provisions of section 24J(2).
- Interest incurred on the fourth loan will not be deductible by the relevant Subsidiary under the provisions of section 24J(2).
- The repurchase consideration to be paid by the Applicant to the Co-Applicant will constitute a 'dividend', as defined in section 1, and will be exempt from dividends tax under the provisions of section 64F(1)(*a*). In addition, it will also be exempt from income tax in the hands of the Co-Applicant under the provisions of section 10(1)(*k*)(i).

9.7 BPR 164 – Income Tax – Buyback of shares at a purchase price in excess of their market value

This ruling deals with the buy-back of ordinary shares by a company at an amount that is in excess of the market value of the shares.

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 13 September 2013 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

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

- section 55(1), definition of 'donation';
- section 58(1); and
- paragraph 38 of the Eighth Schedule.

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

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

Company A: A company incorporated in and a resident of South Africa whose shareholders are a broad based black economic empowerment (BBBEE) consortium

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

Company A concluded a BBBEE transaction in terms of which it acquired 40 percent of the ordinary shares of the Applicant (the shares). Company A financed the acquisition through the issue of different classes of cumulative redeemable preference shares to various investors, the majority of which were subscribed for by a financing house. The shares were used as security for the issue of the preference shares. In terms of the security arrangement, should Company A fail to redeem the preference shares when due, the preference shareholders may take cession of the shares in the Applicant held by Company A in satisfaction of the redemption obligations.

The first of the preference share funding periods is coming to a close and the Applicant wishes to ensure that Company A does not default on its redemption obligations which could lead to the possible loss of the Applicant's favourable BBBEE status.

To avoid such a loss of status the Applicant proposes to buy-back a portion of the shares held by Company A, representing approximately 20% of the entire issued share capital of the Applicant, at an amount in excess of the market value thereof. The purpose of the share buy-back is to enable Company A to pay outstanding dividends accumulated over the period and to enable Company A to redeem all of the preference shares. Company A will then hold 25.1 percent of the Applicant's ordinary shares after the proposed share buy-back.

Ruling

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

- The proposed buy-back of the shares by the Applicant at an amount in excess of the market value thereof will not constitute a 'donation' as defined in section 55(1), nor a deemed donation as envisaged in section 58(1).
- Paragraph 38 of the Eighth Schedule will not be applicable to the proposed buy-back of the shares.

9.8 BPR 165 – Income Tax Act – Letting of accommodation where the provision of meals is outsourced

This ruling deals with the letting of accommodation to students on the basis that the owner of the building outsources the provision of meals in the on-site cafeteria to a third party caterer and whether this trade falls within the definition of 'hotel keeper' as defined in section 1 of the Act.

In this ruling references to sections are to sections of the Act applicable as at 22 January 2014 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

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

- section 1, definition of 'hotel keeper'; and
- section 13*bis*.

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

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

Service Providers: Companies incorporated in and residents of South Africa whose trade is the preparation and provision of meals at their clients' on-site cafeterias (the caterers)

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

The Applicant currently provides apartment style off-campus residential accommodation for students in buildings (residences) close to educational institutions. These residences typically provide fully furnished accommodation which includes a kitchenette, recreational facilities, computer centres, internet, gyms, and tutoring and mentorship programmes. Furthermore, the residences have on-site provision of food either in the style of a cafeteria or café.

The accommodation is either let directly to the students or the building is let to the educational institution which in turn lets it to the students on the basis that the Applicant is still responsible for the provision of meals.

The Applicant proposes to establish on-site cafeterias at all the facilities and outsource the supply of meals at these cafeterias to a Service Provider.

The Applicant also proposes to erect another building for the purpose of providing additional student accommodation to be operated on the same basis as the existing residential buildings.

The provision of meals will take place as follows:

- The Applicant will supply the kitchen equipment and incur the capital expenditure in respect of the kitchen fit out.

- The Service Provider will in turn prepare and sell meals and 'call order items' (cafeteria items) to students.
- The Service Provider will supply drinks and further convenience grocery items to students.
- The meals will be sold on an eat-in or take-away basis.

Conditions and assumptions

This ruling is subject to the additional condition and assumption that meals are supplied to students at the on-site cafeteria with the option of eating in.

Ruling

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

- The Applicant's trade of providing residential accommodation to students, or letting a building to an educational institution for the provision of student accommodation, and outsourcing of the provision of meals to be supplied to the students in on-site cafeterias to a Service Provider, will qualify as carrying on the trade of 'hotel keeper' as defined in section 1.
- The Applicant or its lessee will qualify as a hotel keeper in respect of the existing buildings and the new building to be erected, effective from the date that the provision of meals is outsourced.
- The Applicant will be entitled to claim the allowance provided for under section 13*bis*(1) in respect of:
    - the cost of qualifying improvements (other than repairs) to be made to existing buildings that will be used by the Applicant or rented out to a lessee for purposes of student accommodation, effective from the date of outsourcing the provision of meals; and
    - the cost of the new building to be erected and qualifying future improvements (other than repairs) to the building that will be used by the Applicant or rented out to a lessee for purposes of student accommodation, where the provision of meals is

outsourced to a third party caterer, provided that meals are supplied to the students from the onset and at all relevant times thereafter.

9.9 BPR 166 – Income Tax – Change of place of incorporation (domicile) of a controlled foreign company

This ruling deals with a change of domicile of a controlled foreign company and whether this change will be regarded as a 'disposal' as defined in paragraph 1 and envisaged in paragraph 11 of the Eighth Schedule.

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 9 October 2013 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of paragraphs 1, definition of 'disposal' and 11 of the Eighth Schedule.

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

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

Company A: A limited liability company, incorporated in a foreign country that is a tax haven (Country X) which is a wholly owned subsidiary of the Applicant and a 'controlled foreign company' (CFC) in relation to the Applicant as defined in section 9D

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

Company A is the intermediate holding company of the Applicant's offshore investments. The Applicant proposes to change the domicile of Company A from Country X to Country Y, another foreign country that is also a tax haven, in order to avail itself of the benefits of agreements for the avoidance of double taxation that Country Y has with other countries in which Company A holds investments.

The re-domiciliation of Company A from Country X to Country Y will be effected in terms of the laws governing the re-domiciliation of companies of Country X and of Country Y respectively.

The place of effective management of Company A will change from Country X to Country Y after the implementation of the proposed transaction.

Conditions and assumptions

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

- The change of domicile of Company A from Country X to Country Y will be effected in terms of the laws governing the re-domiciliation of companies of Country X and of Country Y respectively with the following consequences:
- The effect of the re-domiciliation of Company A to Country Y shall not:
  - create a new legal entity;
  - prejudice or affect the identity of the body corporate constituted by Company A or its continuity as a legal entity;
  - affect the property, rights or obligations of Company A; or
  - affect proceedings by or against Company A.
- Proceedings that could have been commenced or continued by or against Company A in Country X before its re-domiciliation to Country Y may be commenced or continued after its incorporation in Country Y.
- The place of effective management of Company A is located outside of South Africa at all relevant times before and after the implementation of the proposed transaction.

Ruling

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

- The change of domicile of Company A from Country X to Country Y will not constitute a 'disposal' by the Applicant as defined in paragraph 1 and envisaged in paragraph 11 of the Eighth Schedule.

9.10 BPR 167 – Income Tax – Debentures tracking the value of a reference asset

This ruling deals with the income tax consequences for a company that issues debentures to investors, the value of which tracks the price of specified quantities of a precious metal as reference assets.

In this ruling references to sections are to sections of the Act applicable as at 2 December 2013 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

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

- section 1, definition of 'gross income' and paragraph (*a*) of the definition of 'trading stock';
- section 11(*a*) read with section 23(*g*); and
- section 22(1)(*a*).

Parties to the proposed transaction

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

Debenture Holders: Holders of debentures to be issued by the Applicant

Description of the proposed transaction

The Applicant is 'ring-fenced' and 'insolvency remote' in that its Memorandum of Incorporation limits its legal capacity to conduct any business or to incur any liability other than that permitted without the prior consent of the JSE and that of its Debenture Holders by special resolution.

The Applicant conducts the business of establishing and operating exchange traded funds (ETFs) listed on the JSE and by way of one or more secondary or dual listings on such other exchanges as the Applicant may select from time to time, in relation to the debt instruments issued by it, the values of which track the prices of specified quantities of given reference assets.

The Applicant has no employees and is managed in terms of a management agreement by a manager appointed by it from time to time. The manager manages and administers the business and affairs of the Applicant and advises the Applicant in relation to the conduct of its business. The Applicant is a wholly-owned subsidiary of a trust which was established with the sole purpose of beneficially holding its entire issued share capital.

In a JSE approved 'Offering Circular and Pre-Listing Statement' the Applicant proposes to notify the terms under which it will issue and redeem the debentures by listing them on the main board of the JSE on the JSE's ETF sub-sector in the expectation that investors will buy and sell them primarily in the secondary market.

The debenture based method of investment is used to enable the Debenture Holders to invest in the reference asset concerned without acquiring the ownership of a quantity of the asset itself, because doing so is extensively regulated.

The subscription price for a debenture may be settled in cash or *in specie* and will be the price of a specified initial quantity of the reference asset on the issue date.

The Applicant will use any cash proceeds from the issuing of the debentures to buy quantities of the reference asset. The reference asset will be kept on deposit and in a segregated account with a custodian.

Each debenture entitles its holder to receive a cash amount on redemption equal to the value of the specified quantity of the reference asset at the redemption date. The specified quantity is to be determined by a formula which reduces it over time because the Applicant must from time to time sell appropriate quantities of the reference asset to defray its monthly costs.

A Debenture Holder may on notice redeem the debenture at any time. The Applicant has no right of voluntary redemption except in certain narrowly defined circumstances relating, in the main, to performance being or becoming impossible. A Debenture Holder will have the right, upon redemption, to require the Applicant to sell to the Debenture Holder the specified quantity of the reference asset associated with the debentures as at the redemption date, provided that the Debenture Holder must have opened a nominated account with the custodian into which the Applicant can transfer the acquired reference asset on the delivery date.

In that event the obligation of the Applicant to pay the redemption value of the debentures to the Debenture Holder on the redemption date will be off-set against the obligation of the Debenture Holder to pay the purchase price of the reference asset on the redemption date to the Applicant. Although the specified quantity reduces over time, the unit price of the reference asset may rise. This entails that the Applicant may be obliged, on redemption, to pay either less or more than the subscription price as at the date of issue, depending on the prevailing price of the reference asset (in the ruling referred to as the 'shortfall' or the 'excess', respectively). 3

The debentures are unsecured senior obligations of the Applicant and rank equally with one another. They evidence the final indebtedness of the Applicant to the Debenture Holders.

<u>Conditions and assumptions</u>

This ruling is subject to the additional condition and assumption that it is based on the terms of the 'Offering Circular and Pre-Listing Statement', together with the documents it incorporates by reference.

<u>Ruling</u>

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

- Amounts received by the Applicant in respect of debenture subscriptions do not form part of the Applicant's 'gross income' as defined in section 1.
- On the redemption of a debenture:
    - the Applicant must include the shortfall that results from a decline in the reference asset's price between the debenture's issue date and redemption date in its gross income; and

- the Applicant may deduct the excess that results from a rise in the reference asset's price between the debenture's issue date and redemption date from its income.

- Expenditure incurred to acquire appropriate quantities of the reference asset will be expenditure contemplated in section 11(*a*) read with section 23(*g*).
- The proceeds from the sale of quantities of the reference asset for purposes of the redemption of debentures will form part of the Applicant's gross income in the year of sale.

10. BINDING GENERAL RULING

10.1 BGR 19 (Issue 2) – VAT – Approval to end a tax period on a day other than the last day of a month

This BGR relates to the approval to end tax periods on a day other than the last day of the month.

Ruling

The following three categories of cut-off dates of a vendor's tax periods are approved by the Commissioner for purposes of proviso (ii) to section 27(6):

(i) A fixed day, being a specific day of the week.

(ii) A fixed date, being a specific date in a calendar month.

(iii) A fixed day determined in accordance and consistent with the 'commercial accounting periods' applied by the vendor.

This approval is conditional upon the following:

(a) In respect of the cut-off dates set out in the last-mentioned category, the vendor is required to retain the necessary proof that the cut-off dates required are in accordance and consistent with its commercial accounting periods (for example, the minutes of a board meeting in which a decision was made regarding the entity's commercial accounting period or proof of cut-off dates for management reporting purposes);

(b) In all instances where a change in cut-off dates is allowed, the first day of the next tax period is the day following the last day of the previous tax period, or the fixed day as approved by the Commissioner;

(c) Any cut-off date that is changed in accordance with this ruling must be for a future tax period and remain unchanged for a minimum period of 12 months under proviso (ii) to section 27(6);

(d) Notwithstanding any of the above, the cut-off date must fall within 10 days before or after the end of the tax period; and

(e) Failure to comply with the above will result in the imposition of interest under section 39 of the VAT Act and penalties under sections 210 and 213 of the TA Act, where applicable.

This ruling constitutes a BGR issued under section 89 of the TA Act.

General

A vendor who intends changing the date on which its tax period ends, and the date does not fall within one of the categories listed above, may apply for a VAT ruling or VAT class ruling.

10.2 BGR 21 – VAT – Address to be reflected on a tax invoice, credit and debit note

This BGR sets out the various options available to vendors regarding the address that must be reflected on a tax invoice or a credit or debit note issued to a recipient, being a vendor or a non-resident.

Ruling

The address of the recipient and the supplier that must be reflected on a tax invoice, credit or debit note is either:

- the physical address from where the enterprise is being conducted;
- the postal address of the enterprise; or
- both the physical and the postal address of the enterprise.

With regard to branches or divisions that are separately registered for VAT under section 50(1), the tax invoice, credit or debit note must reflect the address of the branch or division as listed above.

A tax invoice, credit or debit note issued for a zero-rated supply of goods or services made to a non-resident must reflect:

- the physical address of the non-resident in the foreign country;
- the postal address of the non-resident; or
- both the physical and the postal address of the non-resident.

10.3 BGR 22 - Income Tax – Subsistence allowance: Amounts deemed to be expended for business purposes

To formalise through a BGR an established practice contained in paragraph 5.3.3 of Interpretation Note No. 14 (Issue 3) dated 20 March 2013 'Allowances, Advances and Reimbursements', under the heading 'Deemed method'.

<u>Background</u>

In order for a recipient to deduct subsistence-related expenses from a subsistence allowance granted by a principal, that recipient must, by reason of the duties of his or her office or employment, be obliged to spend at least one night away from his or her usual place of residence in the Republic. A recipient who meets these requirements may deduct the amount deemed to be expended on accommodation, meals and other incidental costs during that period. Section 8(1)(*c*) sets out the methods that a recipient may use to calculate the amounts deemed to have been expended.

Under the deemed method set out in section 8(1)(*c*)(ii), the amount the recipient is deemed to have actually expended is equal to:

- an amount determined by the Commissioner for the relevant year of assessment by way of notice in the *Government Gazette*;
- for meals and other incidental costs, or incidental costs only;
- for each day or part of a day in the period during which the recipient is absent from his or her usual place of residence;
- excluding any amount of expenditure borne by the employer (otherwise than by way of the allowance or advance) for which the allowance was paid or granted for that day or part of that day;
- excluding any amount proven by the recipient to SARS as actual expenditure and claimed as a deduction for meals or incidental costs equal to the actual costs for that day or part of that day; and
- limited to the amount of the allowance or advance granted to meet these expenses.

The amount stipulated in the *Government Gazette* is a daily amount. Accordingly, in calculating the amount of deemed expenditure based on the points listed above, the recipient must multiply the daily amount by the number of days or part of a day that the recipient is away on business. Taxpayers must review the effective date of the particular notice to ensure they apply the correct amounts to the correct year of assessment.

The *Gazetted* amounts are for meals and other incidentals for local and foreign travel, or incidentals only for local travel, and do not cover accommodation for either local or foreign travel. As a result, when a recipient receives an allowance or an advance for accommodation, the recipient must apply the actual method to determine the amount that will be allowed to be deducted from that allowance, or relevant portion of the allowance, for accommodation. There is no 'meals only' deemed expenditure amount. Accordingly a recipient, who receives such an allowance, would also have to apply the actual method to calculate the allowable deduction.

In practice, accommodation service providers often levy a single charge for bed and breakfast, whether or not the guest eats breakfast.

Ruling

The cost of breakfast may be regarded as part of the cost of accommodation if an accommodation service provider charges a single rate for 'bed and breakfast'. The *Gazetted* amount determined by the Commissioner for the relevant year of assessment does not need to be reduced to make provision for the cost of breakfast.

10.4 BGR 23 – Income Tax – Travel allowance: Fuel cost to an employee who receives a petrol or garage card

To formalise through a BGR an established practice contained in the second bullet of paragraph 5.4.4 of Interpretation Note 14 (Issue 3) dated 20 March 2013 'Allowances, Advances and Reimbursements', under the heading 'Expenditure per kilometer – deemed rate per kilometer'.

Background

The recipient of an allowance or advance granted in respect of the use of a private motor vehicle for business purposes may claim a deduction against that allowance, on assessment for normal tax. The allowable deduction is determined by applying the actual cost, the deemed rate per kilometer method or the specified rate per kilometer.

Recipients who use the deemed rate per kilometer method must calculate the deduction in the manner prescribed by the Minister of Finance by notice in the *Government Gazette* (the Notice).

Paragraph 2(*b*) of the Notice sets out the circumstances under which a recipient may claim the 'fuel cost' element of the rate per kilometer. Under this requirement, in order to claim the fuel cost, the recipient of the allowance must have –

'…borne the full cost of the fuel used in the vehicle…'

Recipients who use their private vehicles for business purposes may in certain instances be provided with petrol or garage cards by their principals. The amount expended on these cards is included in the recipient's travel allowance, and the appropriate portion thereof (80% or 20%, as the case may be) is subject to the deduction of employees' tax.

There is uncertainty as to whether the recipients in these circumstances have '*borne the full cost of the fuel*' within the meaning in the Notice.

Ruling

Recipients who are provided with principal-owned petrol or garage cards are regarded as having 'borne the full cost of the fuel'[4] if the full amount expended on that card during the year of assessment is included in the recipient's travel allowance and is taxed as remuneration.

In these circumstances, a recipient will be entitled to claim the 'fuel cost' element as a deduction against the travel allowance.

11. BINDING CLASS RULING

11.1 BCR 42 – Income Tax – Preferred securities issued by a company registered in a foreign country

This ruling deals with the applicability of the definition of 'listed share' in section 1 to preferred securities issued to South African investors by a company registered in a foreign country and with issues concerning distributions to the class members.

In this ruling references to sections are to sections of the Act applicable as at 2 December 2013 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

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

- section 1, definition of 'listed share'; and

- section 10B(2)(*d*).

Class

The class members to whom this ruling applies are described in point 4 below.

Parties to the proposed transaction

The Applicant: A joint stock company with limited liability, incorporated in and a resident of a foreign country (Country X)

The Class Members: South African investors who are beneficial owners of dividends associated from time to time with the preferred securities issued by the Applicant

Description of the proposed transaction

The Applicant is wholly-owned by a company limited by shares that is incorporated in and a resident of another foreign country (Country Y). The Applicant will be listed on the JSE Limited. The Applicant will invest in non-South African debt instruments (the debt instruments) and will receive an interest return thereon. There will be no direct or indirect reinvestment into South African assets.

The Applicant will raise the funds for investing in the debt instruments by way of its branch in Country Y issuing preferred securities. The preferred securities will:

- be redeemable upon the maturity date, which will be five years or more after date of issue, at the same amount paid for the preferred securities;
- confer preferred rights to dividends and such dividends will be –
    - calculated with reference to a rate derived from the underlying debt instruments;
    - limited to the net revenue derived from these debt instruments; and
    - paid in cash;

- be non-voting except in certain circumstances that are mandatory under the laws of Country X; and
- rank pari passu with all other preferred securities and all preferred securities will rank in preference to ordinary shares.

Ruling

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

- The preferred securities will constitute listed shares as defined in section 1.
- The distributions to the Class Members will:
  - constitute 'amounts payable' as envisaged in the definition of 'foreign dividend' in section 1; and
  - not constitute a distribution of an asset *in specie* as envisaged in section 10B(2)(*d*).
- No ruling is made on the provisions of sections 8E and 8EA.

11.2 BCR 43 – Income Tax – Antecedent cession of rights to future production rebate credit certificates

This ruling deals with the antecedent cession of rights to future Production Rebate Credit Certificates (PRCCs) issued in terms of the Automotive Production and Development Programme (APDP).

In this ruling references to sections are to sections of the Act applicable as at 8 October 2013 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the definition of 'gross income' in section 1.

Class

The class members to whom this ruling applies are described in point 4 below.

Parties to the proposed transaction

Cessionary: An Original Equipment Manufacturer (OEM) that qualifies as a recipient in terms of certain requirements

Class Members (cedents): Component Manufacturers in the automotive industry as identified in the ruling application

Description of the proposed transaction

The Automotive Production Development Programme

The Customs and Excise Act No. 91 of 1964, in item 317.03 of Schedule 3 thereto, creates the legislative framework for the APDP. Amongst others, the APDP includes a Production Incentive (PI), which is administrated through the use of PRCCs issued by the International Trade Administration Commission of South Africa. The PI is basically a percentage of the difference in value between the 2 selling price of, and material used (value-added) in, an eligible product, and is indicated on the PRCC.

A PRCC will be issued for the qualifying amount, in terms of the PI, applicable to the eligible product. The value of the PRCC is used to reduce the customs duty value of specified automotive products to be imported into the South African Customs Union. It thus follows that the actual monetary benefit to be derived by the holder of the PRCC depends on the percentage duties payable on the particular imported products to which the PRCC is applied.

The regulatory system allows[2] for a Component Manufacturer to cede the right to obtain a PRCC, prior to its initial issue. In terms of such an arrangement, the OEM is the original holder of a freshly issued PRCC, for which another entity (e.g. the component manufacturer) successfully qualified and applied.

Proposed transaction

The Class Members propose to cede to an OEM their rights to future PRCCs that they may qualify for as a result of the supply of components to such OEMs, each under a separate transaction (antecedent cession). The antecedent cession may form part of the upfront negotiation process relating to the supply of components that takes place between a Class Member and an OEM. The following methods of providing consideration for the rights to future PRCCs are contemplated:

- a pre-determined amount of, say, 10% of the face value of the PRCC to be payable by the OEM for the transfer to it of the right to a future PRCC. (In this regard it should be noted that the amount determined may not necessarily be the open market value which could be fetched for the PRCC, but rather an agreed nominal amount. In most cases, the pre-determined amount agreed to is intended to only cover the administrative costs associated with the PRCC.); or
- reimbursement of the component manufacturer in relation to the costs[3] payable by the component manufacturer to apply for the PRCC; or
- a combination of the above; or
- none of the above, but the component manufacturer acknowledges that, given the mere fact that it has been awarded the tender and hence its improved business capacity, it is prepared to cede the PRCCs.

Conditions and assumptions

This ruling is subject to the following additional conditions and assumptions being true and accurate:

- The Class Members manufacture eligible products and, therefore, fully qualify to apply for the PRCCs in question.

- The Class Members will submit draft agreements to the Advance Tax Rulings Unit in relation to every future antecedent cession for confirmation that each such transaction falls within the ambit of this ruling.

Ruling

The ruling made in connection with the proposed transaction, in the context of the specific background facts, is as follows:

- Only such amounts, as are agreed between the parties to an antecedent cession to constitute monetary consideration, would constitute 'gross income' for purposes of income tax, as defined in section 1.

12. DRAFT – DISCUSSION PAPER ON CONTINGENT LIABILITIES

This discussion paper sets out SARS' views on the income tax implications for the seller and purchaser when the transaction is structured so that the purchase price of assets acquired as part of a going concern is settled or partly settled by the assumption of free-standing contingent liabilities.

The outcome will be the same regardless of whether the sale agreement reflects the purchase price as comprising a lump sum net amount or as an itemised list of assets less liabilities and contingent liabilities.

This discussion paper does not consider the effect, if any, of the application of the corporate rules contained in sections 41-47.

The views set out in this document are not final and once comments have been received, SARS will consider publishing Interpretation Notes on appropriate aspects of the discussion paper.

13. DRAFT – GUIDE ON BUILDING ALLOWANCE

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 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*bis* – Buildings used by hotel keepers
- Section 13*quin* – Commercial buildings
- Section 13*quat* – Buildings in urban development zones
- Section 13*sex* – Residential units
- Section 13*sept* – Deduction for loans to employees to acquire low-cost housing from employers
- Paragraph 12(1)(*f*) of the First Schedule – Buildings used in farming operations

A number of other building allowances discussed in this guide have been discontinued but will be relevant to taxpayers still claiming such allowances on buildings acquired before the relevant provisions were discontinued.

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 cases unless excluded, as in the case of farm buildings.

Since building allowances tend to be claimed over extended periods of up to 50 years taxpayers must retain proper records of the cost of buildings and the allowances claimed.

14. DRAFT – DISCUSSION PAPER ON THE VAT TREATMENT OF LOYALTY PROGRAMMES

Loyalty programmes are incentive schemes used by businesses such as retailers or banks to encourage sales by offering rewards with the intention of attracting new customers, as well as retaining their respective customer bases.

Businesses also use the information gathered throughout this process to identify trends in customer spending and maximise efficiency in their stock management systems.

There is a range of different loyalty programmes currently available in the South African market. It recently came to SARS' attention that stakeholders operating loyalty programmes interpret and apply the relevant provisions in the VAT Act differently from each other.

This document contains proposals intended to promote discussion between SARS and stakeholders with a view to:

- identify and understand the current difficulties experienced, if any, in applying the provisions of the VAT Act;
- identify areas in the VAT Act which may require amendments to address the difficulties identified, if any; and
- adopt a policy which will result in the consistent application of VAT principles for all loyalty programmes

15. DRAFT – RULES OF ELECTRONIC COMMUNICATION

Explanatory Note:

1. This draft notice proposes the promulgation of the rules in terms of section 255 of the Tax Administration Act, 2011, prescribing the rules for electronic communication.

SCHEDULE

1. Definitions

In these rules, unless the context indicates otherwise, a term which is assigned a meaning in the Act, has the meaning so assigned, and the following terms, if in single quotation marks, have the following meanings—

'access code' means a series of numeric characters, alphabetic characters, symbols or a combination of the aforementioned, associated with an individual 'user ID';

'addressee' means a person who is intended by the 'originator' to receive an 'e-mail', but not a person acting as an 'intermediary' in respect of that 'e-mail';

'automated transaction' means an electronic transaction conducted or performed, in whole or in part, by means of 'data messages', in which the conduct or message of one or both parties is not reviewed by a natural person in the ordinary course of such natural person's business or employment;

'data' means electronic representations of information in any form;

'data message' means 'data' generated, sent, received or stored by electronic means and includes a stored record;

'destructive element' means a back door, Trojan horse, worm, virus or other software function, method, routine, sub-routine or code intended or designed to—

(a) permit access to or the use of an 'information system' of SARS by an unauthorised person; or

(b) disable, damage, erase, disrupt, corrupt, impair or otherwise interfere in the operation of an 'information system' or 'data' of SARS;

'digital signature' has the meaning assigned to an 'electronic signature';

'domain name' means a series of numeric characters, alphabetic characters or a

combination of the aforementioned, which designates a registered or assigned 'website' on the 'Internet';

'electronic address' means a series of numeric characters, alphabetic characters, symbols or a combination of the aforementioned, which identifies a destination for an 'electronic communication';

‘electronic communication’ means a communication by means of ‘data messages’;

‘Electronic Communications and Transactions Act’ means the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002);

‘electronic communicator’ means a person who—

(a) as part of the particulars provided under Chapter 3 of the Act, provided an ‘electronic address’;

(b) is obliged or has elected an ‘electronic address’ under the rules for dispute resolution issued under section 103 of the Act; or

(c) elects to communicate with SARS in electronic format;

‘electronic filing page’ means a secure ‘data message’ which—

(a) is created by a ‘SARS electronic filing service’ within the ‘information systems’ of SARS;

(b) is accessible from the ‘SARS web site’, through the use of a ‘registered user’s’ ‘user ID’ and ‘access code’; and

(c) contains the ‘electronic filing transactions’ of that ‘registered user’;

‘electronic filing transaction’ means an ‘electronic communication’, generated through the use of a ‘SARS electronic filing service’ by—

(a) a ‘registered user’, including by means of—

(i) electronically completing and submitting to SARS a return, the completion and submission of which is supported by a ‘SARS electronic filing service’;

(ii) submitting to SARS documents in support of the aforementioned return; or

(iii) making payments to SARS;

(b) SARS, including by means of issuing to the ‘registered user’ a notice of assessment made by SARS;

(c) a registered tax practitioner who is a ‘registered user’ duly authorised by a taxpayer and on behalf of that taxpayer, including by means of—

(i) completing and submitting a return;

(ii) submitting documents in support of a return;

(iii) receiving a notice of assessment made by SARS; or

(iv) making payments to SARS; or

(d) any of the aforementioned persons by means of receiving or submitting any other **'electronic communications'** available on a 'SARS electronic filing service';

'electronic signature' means 'data' attached to, incorporated in, or logically associated with other data and which is intended by the **'registered user'** or **'electronic communicator'** to serve as a signature and must, for purposes of a **'SARS electronic filing service'**, include—

(a) the 'user ID' and 'access code' of the user; and

(b) the date and time that the 'electronic filing transaction' was received by the 'information system' of SARS;

'e-mail' means electronic mail, a 'data message' used or intended to be used as a mail message between the 'originator' and 'addressee' in an 'electronic communication';

'home page' means the primary entry point 'web page' or 'web site';

'information system' means a system for generating, sending, receiving, storing, displaying or otherwise processing 'data messages';

'intermediary' means a person who, on behalf of another person sends, receives or stores a particular 'data message' or provides other services in respect to that message;

'Internet' means the interconnected system of networks that connects computers around the world using the 'TCP/IP' and includes future versions thereof;

'originator' means a person by whom, or on whose behalf, an 'e-mail' purports to have been sent or generated prior to storage, if any, but does not include a person acting as an 'intermediary' with respect to that 'e-mail';

'registered user' means a person registered under rule 4;

‘SARS electronic filing service’ means secure ‘Internet’ based software applications where SARS and ‘registered users’ can generate and exchange ‘electronic filing transactions’;

‘SARS web site’ means the secure location in the ‘information system’ of SARS which contains and from which a ‘SARS electronic filing service’ is accessible;

‘TCP/IP’ means the Transmission Control Protocol/Internet Protocol used by an ‘information system’ to connect to the ‘Internet’;

‘the Act’ means the Tax Administration Act, 2011 (Act No. 28 of 2011);

‘user ID’ means the unique identification—

(a) created under rule 3(1) and 3(2); and

(b) used by a ‘registered user’ in order to access the user’s ‘electronic filing page’;

‘web page’ means a ‘data message’ on the ‘World Wide Web’;

‘web site’ means a location on the ‘Internet’ containing a ‘home page’ or ‘web page’; and

‘World Wide Web’ means an information browsing framework that allows a user tolocate and access information stored on a remote computer and to follow references from one computer to related information on another computer.

2. Provision of ‘SARS electronic filing service’

(1) A person who is required or enabled to submit a return in electronic format must do so in the manner prescribed in these rules.

(2) SARS must provide a secure and reliable ‘SARS electronic filing service’ for purposes of enabling a person to submit a return in electronic form.

(3) A ‘SARS electronic filing service’ must—

(a) provide the ‘registered user’ *(a)* with the ability to—

(i) create a ‘user ID’ and ‘access code’;

(ii) use the user ID and access code to access, conclude, receive and read ‘electronic filing transactions’ on the user’s ‘electronic filing page’; and

(iii) cancel the user’s ‘SARS electronic filing service’; and

(b) ensure that all ‘electronic filing transactions’ on a user’s ‘electronic filing page’ remain complete and unaltered except for the addition of endorsements and changes which arise in the normal course of communication, storage and display, for the period required by the Act.

(4) A ‘SARS electronic filing service’ may—

(a) provide a person the ability to—

(i) authorise a registered tax practitioner, who is a ‘registered user’, to perform a ‘electronic filing transaction’ on behalf of the taxpayer; or

(ii) terminate the tax practitioner’s authority over the tax affairs of that ‘registered user’;

(b) provide a tax practitioner, who is a ‘registered user’, the ability to terminate the authority provided by the taxpayer; and

(c) limit the amount of ‘data’ that can be submitted by the ‘*(c)* registered user’ on the ‘electronic filing page’.

3. ‘User ID’ and ‘access code’

(1) A ‘user ID’ and ‘access code’ must be—

(a) uniquely linked to the ‘registered user’;

(b) capable of identifying only that user; and

(c) based on the relevant material provided by the user under rule 4(1)*(a)*.

(2) The ‘registered user’ must—

(a) only gain ‘access’ to a ‘SARS electronic filing service’ by using the user’s own ‘user ID’ and ‘access code’;

(b) ensure that adequate measures have been introduced and exercise reasonable care to retain control over and confidentiality of the user ID and access code;

(c) prevent disclosure of the user ID and access code to an unauthorised person and may not under any circumstances—

(i) share an access code with anyone, verbally or otherwise, including a SARS official; or

(ii) store an access code as a 'data message'.

(3) If the 'user ID' or 'access code' have been compromised or is suspected of being compromised in any manner, the 'registered user' must inform SARS accordingly and must reset the 'access code' without delay.

(4) The applicant for a 'SARS electronic filing service' or a 'registered user' who is required to change the user's 'access code', must create an 'access code' that cannot be easily surmised.

4. 'SARS Electronic filing service' registration

(1) For purposes of utilising a 'SARS electronic filing service', a person must—

(a) apply for registration on the 'SARS web site' and provide SARS with the particulars and documents as SARS may require for the registration;

(b) create and secure the person's own 'user ID' and 'access code' in compliance with the security requirements of rule 3; and

(c) accept and abide by the general conditions of use set out in these rules.

(2) SARS must—

(a) confirm the 'SARS electronic filing service' activation if the particulars supplied are complete and valid; or

(b) notify the person to re-submit correct particulars if any of the particulars supplied are incomplete or invalid.

(3) Subject to subrule (4), SARS may refuse an application for registration or, cancel or suspend a registration for a specified period if the person applying for registration—

(a) contravenes or fails to comply with the requirements for registration contained in these rules or with the conditions or obligations imposed by SARS;

(b) misuses or abuses the ‘SARS web site’ or a ‘SARS electronic filing service’ in the manner referred to in these rules; or

(c) has, during the preceding five years, been convicted for an offence under Chapter XIII of the Electronic Communications and Transactions Act.

(4) Upon cancelation or suspension, a SARS official must provide reasonable—

(a) grounds for the cancellation or suspension; and

(b) opportunity for the ‘registered user’ to respond and make representations as to why the registration should be reinstated.

(5) When SARS cancels or suspends the registration, the cancellation or suspension will take effect from the day on which the notice is delivered to the ‘registered user’.

(6) Upon registration and while using a ‘SARS electronic filing service’, a ‘registered user’—

(a) may not leave an ‘electronic filing page’ unattended once accessed;

(b) will be held accountable for all activities and ‘electronic filing transactions’ performed using the ‘user ID’ and ‘access code’; and

(c) must take all reasonable steps to ensure that the content *(c)* of all documents submitted electronically to SARS are true and correct and comply in all respects with the provisions of these rules or a tax Act.

(7) Where an ‘electronic communication’ is received by SARS from the ‘registered user’ authenticated by the ‘user ID’ and ‘access code’, the communication must be taken by SARS to have been communicated by the user.

5. ‘SARS web site’

(1) A ‘SARS electronic filing service’ is available on the ‘SARS web site’.

(2) A person who accesses the ‘SARS web site’ must, prior to registering for a ‘SARS electronic filing service’, be satisfied that the content available from and through the web site meets the person’s individual requirements.

(3) The ‘SARS web site’ may contain links to third party ‘web sites’—

(a) for which SARS receives no financial benefit;

(b) which are outside of the control of SARS with regards to content, updates, links or changes to the 'web sites'; and

(c) the content of which is neither attributable to nor endorsed by SARS.

(4) A person who accesses and uses the 'SARS web site' must report untrue, inaccurate, defamatory, illegal, infringing or harmful content available on the web site to SARS and SARS must correct or remove the content or part thereof where SARS determines that the content is untrue, inaccurate, defamatory, illegal, infringing or harmful.

6. Intellectual Property

(1) All intellectual property in the 'SARS web site' and a 'SARS electronic filing service' is either the property of or licenced to SARS and is therefore protected by both the laws of the Republic of South Africa and international laws pertaining to intellectual property rights.

(2) A person who accesses and uses the 'SARS web site' or a 'SARS electronic filing service' may—

(a) not do anything that infringes or may infringe intellectual property rights and must comply with all laws applicable to intellectual property;

(b) view, download and print the content of the web site for the exclusive purposes of accessing and using the web site and filing service; or

(c) quote from the content available on the web site only if the content is correctly quoted, placed in inverted commas and attributed to SARS.

(3) No person may use the trade name 'SARS' as an element of a domain name or sub-domain name.

7. Other 'electronic communications' between SARS and other persons

(1) A 'electronic communicator' must issue, give, send or serve notices, documents or other communication in an electronic format as provided in these rules.

(2) A document in electronic format, required to be completed and delivered under the rules for dispute resolution issued under section 103 of the Act

must be capable of—

(a) delivery in the form prescribed under section 103 of the Act;

(b) being signed by means of an 'electronic signature' in compliance with these rules and the rules for dispute resolution; and

(c) being accepted by the computers or equipment forming part of the 'information system' of SARS.

8. Formation of an 'electronic communication'

(1) Where an 'electronic communicator' and a SARS official have not agreed that an acknowledgment of receipt for a communication be given in a particular form or by a particular method, an acknowledgement may be given through a—

(a) communication from a SARS official pertaining to that communication excluding an 'automated transaction';

(b) communication from the communicator pertaining to that communication, whether an 'automated transaction' or otherwise; or

(c) conduct by SARS or the communicator to indicate that *(c)* the communication has been received.

(2) The time of receipt of an 'electronic communication' must be when—

(a) the communication referred to in subrule (1)*(a)* and (1)*(b)* enters the 'information system' of SARS or the 'electronic communicator'; or

(b) the conduct referred to in subrule (1)*(c)* is reasonably regarded as coming to the attention of SARS or the communicator.

(3) Unless an acknowledgement of receipt for an 'electronic communication' has been received, the communication must be deemed not to have been sent.

(4) An 'electronic communication' is regarded as sent from and received at SARS or the 'electronic communicator's' usual place of business or residence.

9. Consequences of ‘electronic communications’

(1) Where an ‘electronic communication’ is received by SARS from the ‘electronic address’ provided by an ‘electronic communicator’—

(a) the communication must be taken by SARS to have been sent by the communicator or the duly authorised representative of the communicator personally; and

(b) the communicator is liable for all liabilities and obligations emanating from the communication, whether or not it is evidenced by an ‘electronic signature’.

(2) An ‘electronic communicator’ must take all steps reasonably necessary to ensure that all ‘electronic communications’ are complete, accurate and secure against alteration during the course of transmission.

(3) Where an ‘electronic communication’ is identified or capable of being identified as compromised it must be re-transmitted by the ‘electronic communicator’ as soon as reasonably possible.

(4) Whenever an ‘electronic communicator’ uses the services of an ‘intermediary’ in order to transmit, log or process ‘electronic communications’, the communicator is liable towards SARS in respect of every act or omission by the intermediary as if the act or omission was the act or omission of the communicator.

10. ‘Electronic signature’

(1) A person who uses an ‘electronic signature’ in compliance with these rules agrees that the signature must have the same force and effect as if it was affixed to a document required under a tax Act.

(2) A ‘registered user’ who submits a return or other document by way of a ‘SARS electronic filing service’ under these rules is regarded as having attached a valid ‘electronic signature’ to that return.

(3) In addition to the use of a ‘user ID’ and ‘access code’ for the signing of ‘electronic filing transactions’, if a provision of a tax Act requires a document to be signed by or on behalf of an ‘electronic communicator’, that signing may be effected if the ‘electronic signature’ is—

(a) uniquely linked to the signatory;

(b) capable of identifying the signatory and indicating the signatory's approval of the information communicated;

(c) created using means that the signatory can maintain under the signatory's sole control;

(d) linked to the 'data' to which it relates in such a manner that a subsequent change of the data is detectable;

(e) capable of being accepted by the computers or equipment forming part of the 'information system' of SARS; and

(f) reliable and appropriate for the purpose for which the information was communicated having regard to all the relevant circumstances at the time the signature was used.

(4) When considering the use of an 'electronic signature' an 'electronic communicator' must specifically consider the level of confidentiality, authenticity, evidentiary weight and 'data' integrity afforded by the signature.

(5) Where, in any civil or criminal proceedings involving the Commissioner or SARS, the question arises whether an 'electronic signature' affixed to an 'electronic communication' to SARS, the clerk of the tax board or the registrar of the tax court was used in the communication with or without the consent and authority of the 'registered user' or 'electronic communicator', it must, in the absence of proof to the contrary, be assumed that the signature was used with the consent and authority of the user or communicator.

11. Security

(1) No person may interfere with 'data', services (including a 'SARS electronic filing service') or the 'information systems' of SARS in a manner which causes the data, services or information system to be modified, destroyed or otherwise rendered ineffective, including by—

(a) delivering or attempt to deliver, whether intentionally or negligently, a 'destructive element' to the 'SARS web site', a 'SARS electronic filing service' or the 'information systems' of SARS; or *(b)* developing, distributing or using any device to breach or overcome the security system on the 'SARS web site' or the 'information systems' of SARS.

(2) An 'electronic communicator' may not use an 'electronic communication'—

(a) to distribute unnecessary 'data messages' or offensive material;

(b) to actually or potentially overload the 'information systems' of SARS including sending 'e-mail' to all or substantially all personnel of SARS;

(c) to impersonate another communicator or SARS;

(d) to send large volumes of non-business related attachments; or

(e) that includes active animated programs or graphics.

(3) A person who accesses and uses the 'SARS web site' may not, apart from the use of *bona fide* search engine operators and the search facility provided on the web site, use or attempt to use software to search or copy content on the web site for any purposes, without the prior written consent of SARS.

(4) SARS may take whatever action necessary to preserve the security of its 'data', as well as the security and reliable operation of its 'information system', the 'SARS web site' and a 'SARS electronic filing service'.

(5) A person who obtains information regarding another person or information that they reasonably believe is not intended for that person must—

(a) notify SARS accordingly without delay and disclose the circumstances under which the information was obtained;

(b) follow the processes that SARS prescribes to remove or *(b)* destroy the information from the 'information system' of the person;

(c) not disclose to another person nor retain in any manner or form the information so obtained; and

(d) retain the record of the receipt of the information.

12. Record retention by 'registered users' and 'electronic communicators'

(1) A 'registered user' or 'electronic communicator' must keep records of all 'electronic communications' in compliance with section 16 of the 'Electronic

Communications and Transactions Act' and the electronic form of record keeping prescribed in the public notice issued under section 30(1)*(b)* of the Act for the period and for the purpose required by a tax Act.

(2) SARS may at any time require from a 'registered user' or an 'electronic communicator' the production of an original document required to be produced under the provisions of a tax Act.

(3) A 'registered user' must, by means of a 'SARS electronic filing service', in compliance with section 23 of the Act, communicate to SARS within 21 business days any changes in the particulars provided during registration under rule 4(1)*(a)*.

(4) An 'electronic communication' is on its production in proceedings under a tax Act, admissible in evidence against a person and rebuttable proof of the facts contained in that record, copy, printout or extract if—

(a) made by a 'registered user' or 'electronic communicator' in the ordinary course of business; or

(b) it is a copy or printout of or an extract from the communication certified to be correct by the representative taxpayer of the user or communicator, which certification must include the particulars specified in the public notice issued under section 30(1)*(b)* of the Act.

13. Electronic record retention by SARS

(1) A 'SARS electronic filing service' must retain a history of the 'electronic filing transactions' of the 'registered user' for periods required by a tax Act.

(2) SARS must secure information in a method and in a format that ensures the integrity and reliability of the 'data' and ensures that the information can be reproduced when required as permissible evidence in a court of law.

16. INDEMNITY

Whilst every reasonable care has been taken in the production of this update we cannot accept responsibility for the consequences of any inaccuracies contained herein or for any action undertaken or refrained from taken as a consequence of this update.