TAX UPDATE

For period: January 2022 to March 2022

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1. INTRODUCTION

The purpose of this update is to summarise developments that occurred during the first quarter of 2022, specifically in relation to Income Tax and VAT. Johan Kotze, a Tax Executive at Shepstone & Wylie Attorneys, has compiled this summary.

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

Please take some time and consider the tax cases.

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

Enjoy reading on!

Trevor van Heerden, SARS' first commissioner, has died on 6 January 2022.

Mr Van Heerden played an instrumental role in the establishment of SARS when it was established in October 1997.

Mr Van Heerden started at the Inland Revenue Service on 20 August 1962. He was a skilled and dedicated civil servant who committed more than forty years of his life to SARS and one of its predecessors, Inland Revenue.

He was also deeply involved in the development of the taxation of fringe benefits and the Value-Added Tax Act.

2. AMENDMENT ACTS PROMULGATED

The following Amendment Acts were promulgated on 19 April 2022:

- Act No 19 of 2021 – Rates and Monetary Amounts and Amendment of Revenue Laws Act, 2021

  (GG 45786 – 19/01/2022) [was B21-2021, tabled on 11/11/2021; passed (unchanged) by NCOP on 15/12/2021]

- Act No 20 of 2021 – Taxation Laws Amendment Act, 2021

  (GG 45787 – 19/01/2022) [was B22-2021, tabled on 11/11/2021; amended B22B-2021 passed by NCOP on 15/12/2021]

- Act No 21 of 2021 – Tax Administration Laws Amendment Act, 2021

  (GG 45788 – 19/01/2022) [was B23-2021, tabled on 11/11/2021; passed (unchanged) by NCOP on 15/12/2021]

3. BUDGET

3.1. Personal tax rates

2022 year of assessment		2023 year of assessment	
Taxable Income	**Rates of tax**	**Taxable Income**	**Rates of tax**
R0 – R216 200	18% of each R1	R0 – R226 000	18% of each R1
R216 201 – R337 800	R38 916 + 26% of the amount above R216 200	R226 001 – R353 100	R40 680 + 26% of the amount above R226 000
R337 801 – R467 500	R70 532 + 31% of	R353 101 – R488	R73 726 + 31% of

	the amount above R337 800	700	the amount above R353 100
R467 501 – R613 600	R110 739 + 36% of the amount above R467 500	R488 701 – R641 400	R115 762 + 36% of the amount above R488 700
R613 601 – R782 200	R163 335 + 39% of the amount above R613 600	R641 401 – R817 600	R170 734 + 39% of the amount above R641 400
R782 201 – R1 656 600	R229 089 + 41% of the amount above R782 200	R817 601 – R1 731 600	R239 452 + 41% of the amount above R817 600
R1 656 601 and above	R587 589 + 45% of the amount above R1 656 600	R1 731 601 and above	R614 192 + 45% of the amount above R1 731 600
Rebates		**Rebates**	
Primary Secondary Third rebate	R14 958 R8 199 R2 736	Primary Secondary Third rebate	R16 425 R9 000 R2 997
Tax threshold		**Tax threshold**	
Below age 65 Age 65 and over Age 75 and over	R83 100 R128 650 R143 850	Below age 65 Age 65 and over Age 75 and over	R91 250 R141 250 R157 900

3.2. Medical tax credits

Medical tax credits will increase from R332 to R347 per month for the first two members, and from R224 to R234 per month for additional members.

3.3. Corporate income tax

As discussed in the 2020 Budget Review, government is restructuring the corporate income tax system in a manner that has no effect on net revenue collections. Effective for tax years ending on or after 31 March 2023, the corporate income tax rate is reduced by 1 percentage point to 27%. Changes to corporate income tax have the largest impact on investor behaviour – influencing jobs, wages and prices – and can support economic growth. Government's role is to find a balance between a reasonable tax burden that minimises the negative effect on investment and reduces incentives for base erosion and profit shifting, while ensuring that companies and their stakeholders contribute fairly to tax revenues.

South Africa's corporate income tax rate exceeds the Organisation for Economic Co-operation and Development average of 23%. Many countries have reduced their rates over the past 15 years. In contrast, South Africa's statutory rate has remained at 28%. Given that many countries with strong investment and trading ties to South Africa have significantly lower rates, this provides a strong incentive for tax avoidance.

3.4. Tax Incentives

Tax incentives create complexity and preferential treatment for certain taxpayers. In line with the recommendations of the Katz Commission and the Davis Tax Committee, expiring incentives that have not widened social or economic benefits will not be renewed. Government continues to assess existing incentives to enhance transparency and efficiency. Those found to be effective and which create

the intended benefits will be retained and, where necessary, redesigned to improve performance.

3.5. Cross-border tax treatment of retirement funds

Consultation on last year's proposal regarding the tax treatment of retirement interest when changing tax residence showed that multiple tax treaties need to be revised to ensure South Africa retains taxing rights on payments from local retirement funds. Government intends to initiate these negotiations this year.

3.6. Two-pot retirement system

The discussion paper entitled 'Encouraging South African Households to Save Morefor Retirement' was published in December 2021. It outlines a set of reforms to enable pre-retirement access to a portion of one's retirement assets – while ensuring that the remainder is preserved for retirement. Public comments on the tax treatment of contributions to the two pots are being reviewed in preparation for public workshops, to be followed by legislative amendments.

3.7. Disclosure of wealth

Provisional taxpayers with business interests are required to declare their assets (based on their cost) and liabilities in their tax returns each year. To assist with the detection of non-compliance or fraud through the existence of unexplained wealth, it is proposed that all provisional taxpayers with assets above R50 million be required to declare specified assets and liabilities at market values in their 2023 tax returns. The additional information will also help in determining the levels and structure of wealth holdings as recommended by the Davis Tax Committee.

3.8. Employment tax incentive

Youth unemployment remains stubbornly high at 56.2% for 20- to 29-year-olds in the third quarter of 2021. To encourage businesses to employ young people, government proposes an increase of 50% in the value of the employment tax incentive, effective from 1 March 2022. The incentive will increase from a maximum of R1 000 to a maximum of R1 500 per month in the first 12 months and from R500 to a maximum of R750 in the second 12 months of eligibility. Improved targeting of the incentive will be considered to support jobs for long-term unemployed work seekers, alongside an expansion of the eligibility criteria for qualifying employees to improve the incentive for small businesses.

3.9. Restructuring corporate income tax

The 2020 Budget announced government's intention to restructure the corporate income tax system by reducing avoidance opportunities and expanding the tax base, while lowering the headline tax rate. South Africa's interest limitation rules also need to be better aligned with OECD/G20 recommendations on base erosion and profit shifting.

Government proposed restricting the use of assessed losses. The offsetting of the balance of assessed losses brought forward will be limited to 80% of taxable income. This means that companies with an assessed loss balance that matches or exceeds their current-year taxable income will need to pay tax on 20% of their taxable income. The proposal does not increase companies' tax liability, but ensures tax payments from companies are smoothed over time. Smaller companies more likely to struggle with cash flow will be exempt from the proposed changes.

Restructuring the corporate income tax system is estimated to have no effect on corporate tax revenue over the medium term. While the reduction in the rate will result in a revenue loss, it will be offset by the additional revenue from the base protection and broadening measures. Due to the timing of companies' provisional

tax payments, only about 25% of the full effect of each measure will be felt in 2022/23.

It is proposed that these measures take effect for years of assessment ending on or after 31 March 2023.

3.10. Base erosion, profit shifting and digital service taxation

South Africa is a member of the Steering Group of the OECD/G20 Inclusive Framework tasked with finding consensus-based solutions to tax challenges associated with digitalisation of the economy. In October 2021, the Inclusive Framework agreed on a two-pillar solution, and will work on an implementation framework to take effect by 2023. South Africa will propose legislative amendments to implement these rules once the framework has been finalised and translated into a local context.

3.11. Tax incentives – Research and development tax incentive to be extended

A discussion document and an online survey reviewing the R&D tax incentive were published for public comment on 15 December 2021. Aworkshop will be held with interested parties during 2022. To allow for certainty and planning, the incentive will be extended in its current form until 31 December 2023. The extension and potential amendments will be included in the 2022 Taxation Laws Amendment Bill.

3.12. Tax incentives – Expiry of corporate tax incentives

Following reviews in 2021, including engagement with affected stakeholders, several corporate tax incentives in the Income Tax Act will not be renewed when they reach their sunset date. These include:

- Section 12DA (rolling stock) on 28 February 2022

- Section 12F (airport and port assets) on 28 February 2022
- Section 12O (films), which lapsed on 31 December 2021
- Section 13sept (sale of low-cost residential units through an interest-free loan) on 28 February 2022.

3.13. Tax research and reviews

- A discussion document will be published in 2022 on a personal income tax regime for remote work.
- A review of the exemption of foreign retirement benefits in domestic tax legislation will be conducted.
- A review of depreciation and investment allowances will take place during 2022/23, followed by the release of a discussion document.
- Government will review the approach to adjusting thresholds forinflation.

3.14. Individuals, employment and savings – Reviewing the timing of accrual and incurral of variable remuneration

Section 7B of the Income Tax Act (1962) allows for the taxation of variable remuneration to be deferred to the date when the amount is paid to the employee rather than when it accrues to the employee. The act provides that any amount of variable remuneration paid by the employer to the employee is deemed to accrue to the employee on the date during the tax year in which the amount is paid.

Under the Income Tax Act, variable remuneration includes: (i) overtime pay, bonuses or commission; (ii) an allowance or advance paid for transport expenses; (iii) an amount the employee becomes entitled to as a result of unused leave; (iv) any night shift or standby allowance; or (v) any amount paid or granted for a reimbursement as contemplated in the act.

Government is aware that this list may not fully cater for all types of variable remuneration. While the inclusion of commission caters for performance-based payments that form part of the employee's salary in the formal sector, it does not cater for the informal sector, where such payments may be calculated based on units produced (because the word 'commission' means a percentage-based payment and is not determined based on units produced). Government proposes that changes be made to section 7B to cater for these performance-based variable payments.

3.15. Individuals, employment and savings – Apportioning the interest exemption and capital gains tax annual exclusion when an individual ceases to be tax resident

In 2012, section 9H(2)(b) of the Income Tax Act was clarified to provide that, when an individual ceases to be a South African tax resident, their year of assessment is deemed to have ended on the date immediately before the day their tax residency ceased. The section further provides that the individual's next succeeding year of assessment will start on the day on which tax residency is ceased. As a result, the individual has two years of assessment during the 12-month period, which means the individual may be able to double-up on certain exemptions or exclusions that are allowed per year of assessment. This goes against the policy rationale of the provisions of the act. To address this anomaly, government proposes that the legislation be changed to apportion the interest exemption and capital gains annual exclusion in such instances.

3.16. Retirement provisions – Reviewing the transfer of total interest in a retirement annuity fund

The Income Tax Act allows members of retirement funds to transfer their retirement interest from one retirement fund to another. This provision is subject to

certain conditions, for example, if the individual is transferring to a similar type of retirement fund or from a less restrictive to a more restrictive retirement fund and – in the case of retirement annuity funds – if the total interest in the transferor fund is transferred. These conditions result in retirement annuity fund members with more than one contract in a particular fund being restricted from transferring one or more contracts from one retirement annuity fund to another. However, members of a preservation fund are not restricted on the proportion of their retirement interest that can be transferred into another fund. To address this anomaly, government proposes changing the legislation to allow fund members to transfer one or more contracts in a particular retirement annuity fund, subject to certain conditions to ensure that the current minimum thresholds are not contravened.

3.17. Retirement provisions – Clarifying the compulsory annuitisation and protection of vested rights when transferring to a public-sector fund

In 2013, retirement fund reform amendments were made to the Income Tax Act regarding the annuitisation requirements for provident funds and provident reservation funds. These amendments were intended to preserve retirement fund interests during retirement and to ensure uniform tax treatment across the various retirement funds. This would result in provident funds being treated similarly to pension and retirement annuity funds, and provident preservation funds being treated similarly to pension preservation funds, regarding the requirement to annuitise retirement benefits. These amendments came into effect on 1 March 2021, subject to the protection of vested rights. As a result, historical vested rights (those that arose before 1 March 2021) were segregated from new rights (those arising after 1 March 2021). The protection of vested rights therefore applies as follows:

- Any member of a provident or provident preservation fund as at 1 March 2021 will not be required to annuitise any historic vested rights.

- New vested rights in relation to members who are 55 years or older as at 1 March 2021 will remain protected provided the member remains in that same fund.
- Historical vested rights may be transferred into another retirement fund without forfeiting their vested rights protection (irrespective of the number of transfers effected).

It has come to government's attention that the current provisions would forfeit the protection of historical vested rights if a transfer is made into a public-sector fund. This is because the pension fund and provident fund definitions do not make any reference to the protection of vested rights for individuals who were members of a provident or provident preservation fund as at 1 March 2021. To address this anomaly, government proposes amending the pension and provident fund definitions to ensure that historical vested rights remain protected even if they are transferred to a public-sector fund.

3.18. Retirement provisions – Clarifying paragraph (eA) of gross income regarding public-sector funds

In 2021, the retirement reforms that require mandatory annuities for provident funds came into effect. These reforms included amendments that cater for public-sector pension funds that operate like provident funds. As such, with effect from 1 March 2021, members of provident funds (including public-sector pension funds that operate like provident funds) are required to receive their benefits as annuities on retirement. At issue is the fact that, despite the above-mentioned changes regarding the annuitisation of public-sector funds, paragraph (eA) of the definition of gross income in section 1 does not mention public-sector funds that fall within paragraph (a) of the definition of provident fund. Government proposes that paragraph (eA) be clarified to ensure that gross income includes all public-sector funds. These amendments will take effect from 1 March 2022.

3.19. Retirement provisions – Retirement of a provident fund member on grounds other than ill health

In 2021, the retirement reforms that require mandatory annuities for provident funds came into effect. As a result, it is no longer necessary to differentiate between a pension and provident fund for retirement purposes, as these funds now operate in the same way. Paragraph 4(3) of the Second Schedule to the Income Tax Act treats pension and provident funds differently. According to this paragraph, if a member of a provident fund who is younger than 55 retires from that fund for reasons other than ill health, any lump sum received shall be taxed as a withdrawal benefit rather than a retirement benefit. This does not apply to members of pension or retirement annuity funds. To address this anomaly, government proposes to delete paragraph 4(3) of the Second Schedule to the act.

3.20. Retirement provisions – Clarifying the applicability of tax-neutral transfers from a pension to a provident fund

Before the mandatory annuitisation of provident funds came into effect in 2021, transfers to a provident or provident preservation fund would be taxable if the transfer was made from a fund that had mandatory annuitisation requirements. From 1 March 2021, and in accordance with paragraph 6(1)(a) of the Second Schedule to the Income Tax Act, transfers to a provident or provident preservation fund would be tax-neutral irrespective of the type of retirement fund from which the retirement interests were transferred. Both before and after 1 March 2021, the policy intent is for these transfers to be tax-neutral. It has come to government's attention that the current provisions of paragraph 6(1)(a) create an anomaly: transfers from a pension fund to a provident fund related to contributions made before 1 March 2021 are not tax neutral. Government proposes that contributions to a pension fund before 1 March 2021 also receive tax-neutral transfer status.

3.21. *Business (general) – Clarifying the tax treatment of collateral arrangement provisions*

In 2021, amendments were proposed in the Taxation Laws Amendment Bill to clarify that the use of collateral for purposes other than subsequent collateral arrangements or proposed limited regulated transactions is against the policy rationale for the introduction of these provisions, and could result in the avoidance of securities transfer tax or capital gains tax. The effective date for the proposed amendments was 1 January 2022. After reviewing the public comments on the bill, government decided to postpone the effective date for these amendments to 1 January 2023 to give both the National Treasury and affected stakeholders more time to consider the impact of the proposed amendments. Government proposes to review the impact of the 2021 amendments during the 2022 legislative cycle.

3.22. *Business (general) – Clarifying the definition of contributed tax capital*

In 2021, amendments were proposed in the Taxation Laws Amendment Bill to address tax avoidance concerns and clarify the definition of contributed tax capital. The effective date for the proposed amendments was 1 January 2022. After reviewing the public comments on the bill, government decided to postpone the effective date for these amendments to 1 January 2023 to give oth the National Treasury and affected stakeholders more time to consider the impact of the proposed amendments. Government proposes to review the impact of the 2021 amendments during the 2022 legislative cycle.

3.23. *Business (general) – Refining the reversal of the nil base cost rules applicable to intra-group transactions*

The intra-group transaction rules in the Income Tax Act allow tax to be deferred when assets are disposed of between companies within the same group. The nil

base cost rule aims to limit the ability of taxpayers to cash out on the sale consideration from a tax-deferred intra-group transaction.

In 2021, amendments were made to these rules in the corporate reorganisation provisions, clarifying the application of the reversal of the nil base cost rules in instances where a group company acquires an asset in terms of a tax-deferred intra-group transaction and disposes of it within 18 months, triggering the reversal of the tax deferral benefit. Amendments were also made to allow for a reversal of the nil base cost rules when a transferee company is no longer part of the same group of companies as a transferor company. It has come to government's attention that there are further instances that should result in the reversal of the nil base cost rules that have not been taken into account in the 2021 amendments.

For example, when an asset is disposed of beyond an 18-month period outside of the corporate reorganisation rules and a transferee company is no longer part of the same group of companies as a controlling company in relation to a transferor company. Government proposes that further refinements be made to the intra-group transactions rules in the corporate reorganisation provisions to account for these instances.

3.24. Business (general) – Clarifying the rule that triggers recoupment under the debt forgiveness rules

According to the debt forgiveness rules, an additional recoupment is triggered if an asset is disposed of during a year of assessment and the debt that was used to fund the acquisition of that asset is forgiven in a subsequent year of assessment. Government proposes clarifying that this provision is also intended to apply in a subsequent year of assessment if the disposal of the asset in a prior year of assessment resulted in a scrapping allowance or capital loss.

3.25. Business (general) – Reviewing the debtors' allowance provisions to limit the impact on lay-by arrangements

Section 24 of the Income Tax Act makes provision for the debtors allowance to be claimed as a deduction against a taxpayer's income if the taxpayer has entered into an agreement with any other person in which the taxpayer transfers property ownership to that person after the taxpayer has received the whole or a certain portion of the amount payable in terms of the agreement. This is provided that the agreement is at least 12 months long and at least 25% of the amount due to the taxpayer is only payable in a subsequent year of assessment. In terms of this provision, the whole of the amount due is deemed to have accrued to the taxpayer on the day on which the agreement was entered into and included in the taxpayer's income upfront. It has come to government's attention that lay-by arrangements do not benefit from the above-mentioned debtors allowance rules because such arrangements are for periods shorter than 12 months. To remedy this, government proposes that the current debtors allowance rules be reviewed to limit the adverse effect on lay-by arrangements.

3.26. Business (financial sector) – Impact of IFRS17 insurance contracts on the taxation of insurers

The International Accounting Standards Board issued International Financial Reporting Standard (IFRS) 17 insurance contracts on 18 May 2017 to replace IFRS4 insurance contracts, which were issued in March 2004 on an interim basis.

IFRS17 insurance contracts aim to provide a global uniform and comprehensive standard on insurance accounting for insurers. They will be effective for reporting periods starting on or after 1 January 2023. The implementation of IFRS17 insurance contracts may have a material impact on the valuation method for insurance contract liabilities and insurers' cash-flow and profit profiles. To mitigate this impact, government proposes that changes be made to the income tax provisions dealing with the taxation of insurers.

3.27. Business (financial sector) – Study on the tax treatment of amounts received by or accrued to portfolios of collective investment schemes

In 2018, amendments in the Taxation Laws Amendment Bill were proposed to clarify and provide certainty on the tax treatment for trading profits of collective investment schemes. Government proposed that profits arising from frequent trading by collective investment schemes be treated as income rather than capital. After reviewing the public comments, government decided to withdraw the proposed amendments to allow more time to find solutions with the industry. Over the past two years, further concerns have been raised. Government proposes that a discussion document dealing with the tax treatment of amounts received by or accrued to portfolios of collective investment schemes be published for public comment before any amendments are proposed to the tax legislation.

3.28. Business (incentives) – Tax treatment of mining operations

Interaction between the application of the assessed loss restriction rules and capital expenditure regime for mining operations In 2021, changes were made to section 20 of the Income Tax Act to restrict the use of assessed losses carried forward as part of the corporate income tax restructuring to broaden the tax base and reduce the corporate tax rate.

It has come to government's attention that there is an anomaly in the interaction between the new assessed loss restriction rules in section 20 and the current capital expenditure regime applicable to mining operations in terms of section 36 of the act. Government proposes that the legislation be clarified to ensure that the assessed loss restriction in terms of section 20 of the act is calculated before taking into account the capital expenditure deduction for mining operations in terms of section 36 of the act.

3.29. Business (incentives) – Interaction between the application of the interest limitation rules and capital expenditure regime for mining operations

In 2021, changes were made in section 23M of the Income Tax Act to strengthen the rules dealing with the limitation of interest deductions on debts owed to persons not subject to tax.

Concerns have been raised regarding the interaction between the application of the interest limitation rules in section 23M and the current capital expenditure regime applicable to mining operations in terms of section 36 of the act.

At issue is the application of the provisions of section 23M to the interest expense of non-producing mining operations that forms part of capital expenditure of such mining operations. Government proposes clarifying in the legislation that the interest limitation rules in section 23M will not be applied to the interest expense of non-producing mining operations that forms part of capital expenditure of such mining operations in terms of section 36 of the act.

3.30. Business (incentives) – Tax treatment of an asset acquired as government grant in kind

The Income Tax Act provides a tax exemption for any government grant received or accrued under a programme or scheme listed in terms of the Eleventh Schedule or approved under the national annual budget process and gazetted by the Minister of Finance. Furthermore, any expenditure funded by a government grant that has been received or accrued, other than a government grant in kind, must be reduced for the purpose of claiming allowances for trading stock and allowance assets. This reduction is required because a taxpayer receiving a government grant does not incur the expenditure – it is settled by the government grant.

It has come to government's attention that when a government grant in kind is acquired, the provisions for wear and tear allowance in section 11(e) are applicable

because they apply to the value of the asset and not the expenditure or cost incurred by the taxpayer. This creates an anomaly in the system as, similar to a cash government grant, the receipt of a government grant in kind is exempt from tax but the assets received should not qualify for wear and tear allowances. To address this anomaly, government proposes that changes be made in the legislation to align the tax treatment of an asset acquired as a government grant in kind with the tax treatment of assets acquired using a cash government grant.

3.31. International – Updating the definitions and terms relating to the Insurance Act in the determination of net income of controlled foreign companies

In general, where a resident shareholder has an interest in the participation rights of a controlled foreign company (CFC), an amount of the CFC's net income will be imputed into the resident shareholder's taxable income.

However, there are certain exclusions that result in no imputation to the resident shareholder's taxable income.

One of the exclusions relates to the participation rights that are held in a policyholder fund of an insurer. The participation rights can be directly attributable to a linked policy or they are directly attributed to a policy where the amount of the policy benefit is not guaranteed by the insurer and is to be determined solely by reference to the value of the particular assets or categories of assets. With the Insurance Act coming into effect on 1 July 2018, the definitions in the Long-term Insurance Act (1998), such as the 'linked policy' definition, have been deleted and new definitions have been inserted in the Insurance Act. It is proposed that this exclusion be amended to refer to the appropriate provisions of the Insurance Act.

3.32. International – Clarifying the deeming provisions in respect of royalties derived by CFCs

The most important rule contained in the CFC provisions is that the net income of the CFC must be calculated as if the CFC is a taxpayer for South African tax purposes and as if the CFC is a resident when applying certain provisions of the act.

For example, a CFC is deemed to be a resident in relation to interest derived from a South African source. However, section 9D(2A) does not mention royalties derived by the CFC. Government proposes that the deeming provision be extended to cater for royalties.

3.33. International – Clarifying the treatment of amounts from hybrid equity instruments deemed to be income under CFC rules

The CFC rules contain an exclusion applicable to a payor and payee for intra-CFC interest, royalties, rental income, insurance premium or income of a similar nature, provided both the payor and payee are part of the same group of companies. In terms of hybrid equity instrument rules, certain dividends in relation to the recipient are deemed to be income. To ensure neutral tax treatment, it is proposed that specific reference be made to the exclusion of the payee company's deemed income for hybrid equity instruments between CFCs.

3.34. International – Clarifying the exclusion of participatory interests in foreign collective investment schemes from the definition of foreign dividend

The Income Tax Act defines a foreign dividend as an amount paid by a foreign company in respect of a share in that company. Specifically excluded as a foreign

dividend are any amounts that constitute the redemption of a participatory interest in a foreign portfolio of collective investment scheme. It has come to government's attention that, in certain instances, foreign law does not only deal with redemptions but also the sale of units, shares or interest to the foreign management company of the scheme. It is therefore proposed that the term 'or other disposal' be included to cater for any amounts that constitute the sale of a participatory interest in a foreign collective investment scheme's portfolio.

3.35. VAT – Reviewing section 72 arrangements and decisions

In 2019, changes were made to section 72 of the VAT Act, which deals with the SARS discretion to make arrangements or decisions regarding the application of the act to specific situations where the manner in which a vendor or class of vendors conducts their business leads to difficulties, anomalies or incongruities.

These changes affected the arrangements or decisions made on or before 21 July 2019. In the past two years, government reviewed the impact of these decisions to ascertain whether they should be discontinued or extended in accordance with the new provisions of section 72. As a result, changes were made to the VAT legislation in this regard. It is proposed that further changes be made to account for further reviews of some of the section 72 decisions.

3.36. VAT – Updating the regulations prescribing electronic services

With effect from 1 April 2019, the regulations prescribing electronic services were amended to broaden the scope of electronic services that are subject to South African VAT, in line with the Organisation for Economic Co-operation and Development/Group of 20 Base Erosion and Profit Shifting Action 1 Report. Government proposes to review the current regulations to account for further developments in this area.

3.37. Tax administration – Refunds of dividends tax by SARS to regulated intermediaries

It is proposed that the Income Tax Act be amended to allow a regulated intermediary to recover refundable dividends tax from SARS in instances where the refundable amount exceeds the dividends tax withheld by the regulated intermediary at least one year after the amount became refundable.

3.38. Tax administration – Review of provisional tax system

Government proposes a review of the provisional tax system given changing circumstances and international developments, with the intention of publishing a discussion paper on this subject.

3.39. Tax administration – Once-off electronic services supplies by non-resident suppliers to a recipient in South Africa

It is proposed that a specific exception to the rule that a non-resident supplier register as a vendor when electronic supplies exceed R1 million a year – an exception that already applies to resident suppliers – be considered. This will prevent unnecessary registrations, costs and administrative burden for both non-resident suppliers and SARS.

3.40. Tax administration – Review of domestic legal framework to effect joint audits

Government proposes that the South African domestic legal framework, particularly the Tax Administration Act, be amended to make provision for the full use of joint audits with other tax administrations in order to improve the effective exchange of information under international tax agreements.

3.41. Tax administration – Imposition of understatement penalty for employment tax incentives improperly claimed

Given the abuse of employment tax incentives, government proposes that the Employment Tax Incentive Act be amended to impose understatement penalties on reimbursements that are improperly claimed.

3.42. Tax administration – Removal of statutory recognised controlling body

A statutory recognised controlling body has indicated that it is no longer appropriate for it to be listed as a recognised controlling body in terms of the Tax Administration Act. It is proposed that this body be removed from the list.

3.43. Tax administration – Tax compliance status for taxpayers under business rescue

SARS cannot reflect a taxpayer as being tax compliant if it has outstanding tax debts unless the taxpayer has entered into an instalment payment agreement or compromise agreement with SARS or, where the tax debt is disputed, a suspension of payment has been granted.

This may not be possible in the earliest stages of a business rescue, which may negatively affect the prospects of the rescue being successful. It is proposed that empowering SARS to assist in these cases, under certain conditions, be investigated.

3.44. Tax administration – Tax compliance status system abuse

SARS has noted increased abuse of the tax compliance status system. Taxpayers that are economically active may file a nil (zero-income) or otherwise inaccurate

returns to meet the requirement that there are no outstanding returns, among other abuses. It is proposed that approaches to ensuring that the system provides a more accurate reflection o the actual tax compliance status of taxpayers be investigated.

4. NOTICES / REGULATIONS

4.1. New Employment Tax Incentive values effective from 1 March 2022

The Minister of Finance announced an increase in the ETI values which will become effective from 1 March 2022.

This information was published in the draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill of 23 February 2022.

The ETI Calculation Formulae that are in Operation up to 28 February 2022:

Monthly Remuneration	**Formula – First 12 Months**	**Formula – Second 12 Months**
R0 to R1 999,99	50% of Monthly Remuneration	25% of Monthly Remuneration
R2 000 to R4 499,99	R1 000	R500
R4 500 to R6 499,99	R1 000 – (50% x (monthly remuneration – R4500))	R500 – (25% x (monthly remuneration – R4 500))

The ETI Calculation Formulae that are Effective from 1 March 2022:

Monthly Remuneration	Formula – First 12 Months	Formula – Second 12 Months
R0 to R1 999,99	75% of Monthly Remuneration	37,5% of Monthly Remuneration
R2 000 to R4 499,99	R1 500	R750
R4 500 to R6 499,99	R1 500 – (75% x (monthly remuneration – R4500))	R750 – (37.5% x (monthly remuneration – R4 500))

The Taxation Laws Amendment Act of 19 January 2022 has amended the calculation of ETI monthly remuneration from 1 March 2022.

4.2. Tables of interest

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

DATE FROM	DATE TO	RATE
1 September 2020	31 October 2020	7,25%
1 November 2020	28 February 2022	7%
1 March 2022	30 April 2022	7,25%
1 May 2022	Until change in the Public Finance Management Act rate	7,50%

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

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

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

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

DATE FROM	DATE TO	RATE
1 August 2020	30 November 2021	4,50%
1 December 2021	31 January 2022	4,75%
1 February 2022	Until change in Repo rate	5%

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

4.3. Average exchange rates

The Income Tax Act provides specifically that certain amounts expressed in a foreign currency must be translated into rand by the application of an applicable average exchange rate.

The term "average exchange rate" is defined in section 1(1) of the Act and means, in relation to a year of assessment, the average exchange rate determined by using the closing spot rates at the end of daily or monthly intervals during a year of assessment. This rate must be applied consistently within that year of assessment.

The South African Reserve Bank determines weighted average exchange rates, based on the foreign exchange transactions of commercial banks. SARS publishes

these rates on a quarterly basis, which may be used by stakeholders (taxpayers) in the determination of the average exchange rate when required in the Act.

The use of these average exchange rates is not compulsory. Stakeholders using average exchange rates which differ from those published by SARS must, however, keep record of all calculations for audit purposes.

A list of the average exchange rates of selected currencies for a year of assessment as from December 2003 has been published by SARS on 8 March 2022.

A list of the monthly average exchange rates to assist a person whose year of assessment is shorter or longer than 12 months has also been published by SARS on 8 March 2022.

5. TAX CASES

5.1. C:SARS v Tourvest Financial Services (Pty) Ltd (84 SATC 62)

Tourvest Financial Services (Pty) Ltd (TFS), a licensed dealer in foreign exchange, traded under the name American Express Foreign Exchange. The business of TFS consisted of 52 branches countrywide and a head office, with a centralised treasury division that procured stock of foreign currency and set the exchange (buy and sell) rate at which the branches may transact with customers. A margin was built into the quoted rates in favour of TFS. The rate was set by taking the market exchange at any given time and adding a percentage mark-up thereto. The branches bought from – or sell to – customers at the exchange rate set by the treasury division, which was continually subject to change as the currency markets fluctuated.

In essence TFS offered to sell foreign currency to the public at a rate in excess of the rate at which it acquired that currency and offered to buy foreign currency at a rate that was lower than the price at which it expected to sell that currency. In

addition, TFS charged a commission, based on a percentage of the transaction value. VAT was levied on the commission. A client purchasing foreign currency will therefore pay TFS an amount made up of the quoted Rand value of the foreign currency, plus the commission and VAT. A client selling foreign currency will receive the quoted Rand value of the currency, less the commission and VAT.

The difference between the sale or purchase price and the value constituted TFS' margin or notional margin. To enable it to trade, TFS purchased a stock of foreign currency at the supplier's rate. It hedged its foreign currency exposure by maintaining an overdraft, also denominated in foreign currency, to the same value. From time to time, TFS closed out its net foreign exchange position and this meant equalising the position between its foreign currency overdraft and the foreign currency held by it at the time.

TFS' margin or notional margin was the gross profit made out of trading the stock and the final margin was, however, 'only truly known when the position is closed out.'

TFS, prior to September 2013, completed its VAT returns on the basis that not all the VAT paid by it on acquiring goods and services for its branches constituted deductible input tax. It, instead, applied an apportionment in terms of section 17(1) of the VAT Act. The apportionment was based on an acceptance that the relevant goods and services were acquired by TFS partly for consumption or use in the course of making taxable supplies and partly for use in the course of making exempt supplies.

However, after receiving tax advice, TFS changed its stance in the September 2013 tax period as it took the view that the goods and services obtained for the branches were in fact used by it wholly in the course of making taxable supplies and not at all in the course of making exempt supplies and, accordingly, so it concluded, no apportionment was required.

TFS, on the view that it had overpaid VAT in each tax period over the prior five years, claimed an input tax deduction of R24 389 036.58 in the September 2013 tax period, which was paid by SARS to TFS on 19 November 2013.

After a further audit on 5 April 2016, SARS issued an additional assessment adding back the amount of R24 389 036,58, on the basis that the goods and services had been acquired by TFS for use in the course of making both taxable and exempt supplies and accordingly an apportionment of input tax was necessary.

TFS' objection failed and its subsequent appeal to the Tax Court of South Africa, Johannesburg, succeeded with costs and the additional assessment was set aside by Maluleke AJ, sitting with assessors. (see ITC 1933 (2020) 82 SATC 388)

SARS, with the leave of the Tax Court, appealed directly to the Supreme Court of Appeal.

The issue for determination on appeal was thus whether TFS, in conducting its enterprise of the exchange of currency through its branch network, made both taxable and exempt supplies as SARS contended or whether it only made taxable supplies, as TFS contended.

Judge Ponnan held the following:

(i) That VAT incurred by a vendor: (a) wholly for the purpose of consumption, use or supply, in the course of making taxable supplies may be deducted in full as input tax; (b) wholly for the purpose of consumption, use or supply in the course of making exempt supplies, or for some other non-taxable purpose, may not be deducted as input tax at all; and (c) on goods or services acquired partly for the purpose of making taxable supplies and partly for the making of exempt supplies or some other non-taxable purpose (i.e. mixed supplies) must be apportioned in accordance with section 17(1) of VAT Act and is only input tax (and hence deductible) to the extent that it pertains to a taxable supply.

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

the VAT Act, which lay at the heart of the present appeal, provided that the exchange of currency (whether effected by the exchange of bank notes or coin, by crediting or debiting accounts, or otherwise) was deemed to be a financial service. The proviso to section 2(1) provided further that the activity contemplated in para 2(1)(a) was not to be deemed to be a financial service to the extent that the consideration payable in respect thereof was any fee, commission, merchant's discount or similar charge, excluding any discount cost.

(iii) That the term 'consideration' was defined in section 1 of VAT Act (in relevant part) in relation to the supply of goods or services to any person, to include any payment made or to be made, whether in money or otherwise, or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods or services, whether by that person or by any other person.

(iv) That with the introduction of VAT in 1991, the legislative policy was to treat the supply of identified financial services as exempt from VAT. This was because of perceived difficulties in establishing the value added by financial services on a transaction-by-transaction basis. The exchange of currency was, from the outset, identified in the VAT Act as an exempt financial service. That activity therefore did not attract VAT, even to the extent that a commission or fee was charged for performing the exchange. That changed in 1996 following the report of the Katz Commission, which set up a VAT Sub-Committee into the Taxation of Financial Services and in a report issued on 22 September 1995, it was recommended that fee-based financial services, which were exempt when VAT was introduced, should become subject to VAT and the result was the introduction of the proviso to section 2(1) of the VAT Act.

(iv) That the Explanatory Memorandum on the Taxation Laws Amendment Bill, 1996, which introduced the proviso, stated, inter alia, that there was no reason why value added in respect of financial transactions should be treated differently from value added in other sectors of the economy.

Financial services were furthermore consumed mainly by businesses and the more affluent section of the population and this principle was recognised by the Tax Commission and it was therefore recommended by them that all fee based financial services…should be brought into the VAT net.

(v) That TFS had carried on the activity of the exchange of currency as envisaged in section 2(1), which was, on the face of it, a defined financial service under section 2(1)(a) and was accordingly an exempt supply by virtue thereof. If no fee or commission were charged by TFS as a consideration for that supply, the entire activity would be exempt, and no input tax could therefore be deducted. The proviso to section 2(1) states however that the activity of the exchange of currency shall not be deemed to be financial services 'to the extent that the consideration payable in respect thereof is any fee, commission…or similar charge.' The effect of the proviso is thus limited to ensuring (in keeping with the intention, as expressed in the VAT Sub-Committee report, of bringing financial services into the VAT net) that any commission or fee charged in respect of the activity of the exchange of currency will attract VAT. To achieve this, it was necessary to carve out the activity from the definition of financial services for the limited purpose of making the provision of the goods or services taxable to that extent.

(vii) That the fact that, by virtue of the proviso, what would otherwise have been an exempt financial service is to an extent treated as a taxable supply (so that the commission carries VAT) did not mean that the activity loses its exempt nature entirely. It remained an exempt supply for all other purposes, while the taxable component carried VAT.

(viii) That it followed that the proviso created a mixed supply out of an identified activity, rather than causing the activity to lose its exempt status in its entirety. Accordingly, the effect of the proviso in the present context was merely to add a taxable element to what was, and at its core remained, an exempt financial service. It turned the activity into a partly exempt and a

partly taxable supply. That being so, any tax paid on goods and services acquired by TFS must be apportioned and only the part attributable to the taxable supply may be deducted as input tax. TFS' attempt to claim the entire VAT charge as deductible input tax must therefore fail.

(ix) That it followed that TFS' deduction in the September 2013 VAT return of the full unclaimed VAT expense over the previous five years was therefore impermissible as the inputs ought to have been apportioned. On this basis, the appeal must be upheld.

(x) That SARS had initially contended, in the event of the appeal succeeding, that a further issue fell to be decided, namely whether the interest imposed on TFS in the additional assessment ought to be remitted. In that regard, SARS had contended that the failure to make payment of the tax within the period for payment was not due to circumstances beyond the control of TFS as envisaged in section 39(7)(a) of the VAT Act. However, from the bar, counsel for SARS eschewed section 39(7)(a). Instead, reliance was sought to be placed on section 190(5) of the Tax Administration Act 28 of 2011 (the TAA). But, the latter provision had not been invoked by SARS when assessing TFS to tax. In the circumstances, counsel rightly conceded that, for the present, section 190(5) of the TAA did not find application. It was nonetheless suggested that it was still open to SARS to invoke section 190(5). Whether that be so, remained for another day.

(xi) That, in regard to costs, it went without saying that before this court, costs, including those of two counsel, should follow the result. As to the costs in the court below: Having upheld the appeal, the Tax Court ordered SARS to pay the costs of TFS. In the light of the contrary conclusion to which this court arrived, the costs order of the Tax Court cannot stand. It was suggested on behalf of SARS that it should be substituted with one directing TFS to pay SARS's costs. In the court's view, no warrant existed for such an order. It could not be said that TFS' grounds of appeal were unreasonable, particularly as TFS' change in stance was as a consequence

of legal advice obtained. In all the circumstances there should be no order as to costs in the court below.

Appeal upheld with costs including those of two counsel.

5.2. C:SARS v Van der Merwe & others (83 SATC 49)

SARS had sought an order in terms of section 2(1)(b) of the Vexatious Proceedings Act that no legal proceedings may be instituted by the First Respondent, Mr Gary Walter van der Merwe ('GVDM'), in his personal capacity, or in his capacity as a director, member or trustee of any company, close corporation or trust, or by the Second, Third and Fourth Respondents, in their capacities as trustees of the Eagles Trust, against any person in any court without the leave of the court and only if the court was satisfied that the proceedings were not an abuse of the process of the court and that there were prima facie grounds for the proceedings.

Respondents, GVDM in his personal capacity and the trustees of the Eagles Trust, being GVDM, his mother, Ms Fern Cameron ('FC'), and Mr Dave Nkhoma in their representative capacities, opposed the application and all were represented by GVDM in doing so.

Two striking out applications were also before the court: one brought by SARS in relation to certain allegations contained in the answering affidavit filed by GVDM in this matter and the other brought by GVDM in relation to certain allegations and annexures to SARS's founding affidavit.

In this matter a long history of litigation existed between the parties and which was relevant.

GVDM had been investigated by the SARS and had been arrested in 2004 following which he was charged criminally with various fraud and tax-related offences. Litigation related to the validity of search and seizure warrants issued persisted until 2010 when the Constitutional Court found against the Minister of Safety and Security.

Following an unsuccessful application for legal aid and an unsuccessful application to the High Court in 2012 for an order that the Legal Aid Board fund his representation in the criminal trial, GVDM represented himself at the trial which continued for 15 years. In June 2016 GVDM was convicted of certain charges but was acquitted on eight tax-related counts and the appeal in that matter remained ongoing.

In a second criminal trial, GVDM obtained a discharge in terms of section 174 of the Criminal Procedure Act on alleged exchange control violations and this followed his arrest after foreign currency was found in his possession and seized on 13 July 2004 as he was attempting to leave the country. In an urgent application in July 2004 GVDM and Zonnekus Mansion (Pty) Ltd ('Zonnekus') of which GVDM was a director and which was owned by the Eagles Trust, sought the return of the foreign currency seized and many years later after the seizure of the currency, despite the dismissal of the urgent application as well as subsequent appeals, the foreign currency was returned.

In 2008 GVDM was unsuccessful in an urgent application for a declaratory order in terms of section 172(1) of the Constitution to the effect that the Directorate of Special Operations, known as the Scorpions, in relation to his alleged exchange control violations had acted outside of its mandate and in a manner which was unlawful, invalid and unconstitutional in investigating him. The refusal by the High Court to make such an order was upheld on appeal by the Supreme Court of Appeal.

SARS had made various unsuccessful attempts to recover GVDM's assessed tax liability for the years 2002 and 2003 and it was thereafter reported to SARS that US$15 million had been received by GVDM's daughter, Candice van der Merwe ('CVDM') paid from a foreign source into her local savings account.

SARS, on 30 August 2013, obtained an ex parte preservation order in terms of section 163 of the Tax Administration Act ('the TAA') against the assets of Zonnekus, GVDM, CVDM and other related entities and that order was made final in February 2014 and in May 2015 the Supreme Court of Appeal confirmed such order, finding that GVDM 'controls Zonnekus Mansions and that he does so

through his mother to escape judgment creditors' and, in addition, appeared to control the affairs of CVDM and in September 2015 CVDM's application for leave to appeal to the Constitutional Court failed.

SARS, in December 2013, obtained an order appointing a presiding officer for purposes of an inquiry to be held in terms of section 50 of the TAA into the tax affairs of GVDM, CVDM, Zonnekus and various related entities. In February 2014 GVDM, CVDM and twelve other applicants failed in an application to interdict the tax inquiry, alternatively to have certain provisions of the TAA declared unconstitutional and invalid and were refused an order allowing them access to the court file. Leave to appeal was refused with costs and in March 2014 the Supreme Court of Appeal dismissed an application for special leave to appeal and in June 2014 the Constitutional Court dismissed an application for leave to appeal.

As a result, the tax inquiry proceeded and resulted in letters of audit findings being issued in respect of inter alia GVDM, CVDM and Zonnekus, culminating in assessments being raised against them by SARS.

SARS, in May 2014, in accordance with the terms of the preservation order, instituted an action inter alia against GVDM, CVDM, Zonnekus and Pearl Island Trading 712 (Pty) Ltd but later withdrew its claims against CVDM but SARS nevertheless persisted with its claims inter alia against GVDM and Zonnekus and sought an order that GVDM be held personally liable for the tax debts of certain of the defendants cited in the matter.

SARS, in 2015, had issued a letter of audit findings in respect of Zonnekus in which it advised that it intended to raise assessments which would result in additional normal tax liability in the amount of R12 million, excluding interest on the underpayment of provisional tax and the assessments became final and conclusive in terms of section 100 of the TAA, with the total tax indebtedness of Zonnekus exceeding R42 million.

GVDM, in response to the proceedings against him and other entities linked to him outlined above, embarked on a series of actions and applications against SARS and other parties that included:

- An application challenging the authority of attorneys MacRobert Inc ('MacRobert') to act on behalf of SARS. During these proceedings GVDM brought a Rule 35 application to allow a handwriting expert to determine the validity of a signature and subsequently the Rule 35 application was dismissed with costs with the court finding that the application was an abuse of process, 'doomed, frivolous and spurious' and an attempt to delay the hearing of the rule 30A application.
- Proceedings had been instituted for the winding up of Zonnekus on the basis that it was commercially insolvent and it was placed into provisional liquidation in September 2014 and thereafter made final. Thereafter GVDM and other applicants launched four separate business rescue applications in relation to Zonnekus and the various applications were found to be an abuse of process and brought in bad faith. In the fourth such application the court found that GVDM was an experienced litigator 'on a mission to discredit SARS' and that his explanation as to why he had delayed nine months in launching the first business rescue application indicated that the application had been launched 'to frustrate the liquidators from discharging their obligations' and GVDM's conduct was found to have 'precluded the liquidators from taking any steps in relation to the company for more than two years' and a 'clearer example of abuse of process…could not be found.'
- The Eagles Trust, represented by GVDM, launched an urgent application requesting that the liquidators' attorneys, the liquidators and SARS be declared in contempt of the preservation order granted in March 2014. The court found that the application was 'brought without sufficient ground' and was 'vexatious and an abuse of the court process'.
- GVDM in his personal capacity and as a trustee of the Eagles Trust applied for the removal of the liquidators of Zonnekus and that the liquidation proceedings be stayed.

- In January 2019 GVDM in his personal capacity and as a trustee of the Eagles Trust applied, inter alia, for the re-opening and setting aside of the first confirmed liquidation and distribution account of Zonnekus and the institution of an enquiry into the conduct of the liquidators under section 381 of the Companies Act 1973. Subsequent applications were dismissed with costs on an attorney and client scale. The court took issue with the 'excessive claims' made by GVDM and he was cautioned by the judge in his judgment to 'exercise restraint lest he go beyond the reasonable bounds of litigation privilege' and the applications in issue were found to be an abuse of process 'carefully planned and designed to interrupt the winding-up process and to cause as much collateral damage to the liquidators and creditors as possible.'
- In 2019 GVDM instituted an action against the Minister of Finance and SARS seeking R1 billion in constitutional damages on the basis inter alia that SARS had obtained the preservation order after misrepresenting the facts to the court and that he had been the subject of malicious prosecution. CVDM instituted a similar application also seeking R1 billion in damages. In addition, GVDM instituted a R5.6 billion claim for damages against SARS in June 2019 consequent to investigations instituted by SARS between April 2002 and September 2003 against a number of companies in which GVDM was a majority shareholder as a result of which the companies were irreparably prejudiced and ceased business operations.
- GVDM had launched other unsuccessful applications and court proceedings which had resulted in punitive costs orders.

SARS launched the current application in the High Court on 30 April 2019.

Both SARS and the Respondents also sought orders striking out certain material contained in the founding and answering affidavits filed in this matter.

Respondents' application to strike out certain portions of SARS' founding affidavit was based on the allegation that the contents were inadmissible in that their disclosure was unlawful as it constituted a breach of the provisions of section

69(1), read with sections 67, 68 and 236 of the TAA and, alternatively, that they were irrelevant, vexatious, scandalous and defamatory. GVDM claimed that he would be prejudiced if the averments in these paragraphs and annexures were allowed to remain in the founding affidavit as this would allow SARS to use illegally obtained information in the presentation of its case against him and unfairly paint him as a tax defaulter and tax evader when such tax claims were the subject of other proceedings. He further submitted that since the TAA required taxpayer information to be protected as confidential, the information contained in the affected portions should be struck out in that it detailed his tax number, the amounts claimed from him by SARS and the steps taken by him to challenge these amounts and correspondence relating to his tax affairs.

SARS opposed the Respondents' strike out application on the basis that the evidence contained in the founding papers was not inadmissible, nor irrelevant or in breach of the confidentiality provisions of the TAA. Moreover, SARS submitted that the Respondents' strike out application constituted an abuse of the court process and a continuance of strategy to delay and frustrate SARS's attempts to recover the taxes due.

SARS sought in its application to strike out certain portions of the Respondents' answering affidavit on the basis that such material was irrelevant, vexatious, scandalous or inadmissible and to the prejudice of SARS.

Judge Savage held the following:

As to the strike out applications

(i) That Rule 6(15) of the Uniform Rules of Court provided that a court may on application order to be struck out from any affidavit any matter which is scandalous, vexatious or irrelevant, with an appropriate order as to costs including costs as between attorney and client and the court will not grant the application unless it is satisfied that the applicant will be prejudiced in his case if it be not granted.

(ii) That an order striking out any matter from an affidavit will succeed where an applicant has shown that the matter to be struck out is scandalous,

vexatious or irrelevant and that he or she will be prejudiced if the matter is not struck out. Scandalous matter consists of 'allegations which may or may not be relevant but which are so worded as to be abusive or defamatory'. Vexatious matter consists of 'allegations which may or may not be relevant but are so worded as to convey an intention to harass or annoy'. Irrelevant matter consists of 'allegations which do not apply to the matter in hand and do not contribute one way or the other to a decision of such matter.' In relation to prejudice it was said that this 'does not mean that, if the offending allegations remain, the innocent party's chances of success will be reduced. It is substantially less than that. How much less depends on all the circumstances.'

(iii) That, in regard to the Respondents' application to strike out, there was nothing before the court to suggest that the material sought to be struck out was inadmissible, nor that it had been put up in breach of the confidentiality provisions of the TAA when the tax affairs of GVDM, Zonnekus and CVDM were directly relevant to the issues raised in the main application. Section 5 of the South African Revenue Service Act expressly permits SARS to institute legal action such as the current. Section 68(3) of the TAA permits a SARS official to disclose confidential SARS information where the information is public or the disclosure is authorised by SARS and section 69(2) allows a SARS official to disclose taxpayer information when it is in the course of the performance of duties under a tax act or the information is public. There was no basis on which to find that the information disclosed in the founding affidavit was not disclosed in the execution of the duties of a SARS official in terms of prevailing tax laws, or that by putting up such information GVDM's privacy rights had been breached when much of such information had been the subject of previous litigation between the parties and for the above reasons the Respondents' application to strike out could not succeed and the application was dismissed.

(iv) That, in regard to SARS's application to strike out, the paragraphs in issue in the Respondent's answering affidavit contained allegations which were

worded in a manner which was abusive or defamatory and vexatious in the sense that they were intended to harass or annoy. As much was evident from the serious and repeated allegations of fraud, corruption and harassment raised against SARS and its attorneys, without evidence put up to support such serious allegations, as well as the unwarranted and unduly emotive language used repeatedly throughout such paragraphs.

(iv) That, similarly, Annexure GVDM1 should be struck out given the extensive details it contained relating to matter which was irrelevant to the current application. It followed that given the irrelevant matter contained in this Annexure and the allegations raised in it, which were largely unrelated to the current application, if they applied at all, SARS would be prejudiced in the current matter were this document not to be struck out.

(v) That, accordingly, it followed that SARS' application to strike out the paragraphs and Annexure in issue succeeded and the offending paragraphs and Annexure were to be struck out. There was no reason why costs should not follow the result, and the Respondents must therefore pay SARS' costs in respect of its application to strike out, jointly and severally, the one paying the other to be absolved, including the costs of two counsel.

As to the application for declaration of the Respondents as vexatious litigants

(vi) That it was acknowledged that while section 2(1)(b) of the Vexatious Proceedings Act (‘the VPA’) limited the right of access to courts, such limitation was reasonable and justifiable having regard to section 36 of the Constitution of South Africa, 1996.

(viii) That the purpose of section 2(1)(b) of the VPA was to impose a procedural barrier to litigation on persons who are found to be vexatious litigants so as to restrict their access to courts to stop ‘persistent and ungrounded institution of legal proceedings’ and ‘the making of unjustified claims against another or others, to be judged or decided by the Courts’. The VPA does not afford protection against vexatious proceedings, or an abuse of process in respect of legal proceedings, which have already been instituted.

(ix) That the jurisdictional requirements for an order in terms of section 2(1)(b) of the VPA were that legal proceedings must in the past have been instituted, or there was reason to believe that proceedings will in the future be instituted, against SARS and that the court was satisfied that the respondent had persistently instituted legal proceedings without any reasonable ground in a court, or inferior court, whether against the same person or against different persons.

(x) That there was no dispute that legal proceedings had in the past been instituted both by GVDM in his personal capacity, and by GVDM and the other trustees of the Eagles Trust, directly against SARS and against a range of other parties. The thread that runs through all of this litigation is that its relationship to the tax affairs or determined tax liabilities of GVDM, CVDM, the trustees of the Eagles Trust or other entities to which GVDM was related. From this litigation it was apparent that GVDM had acted both on his own behalf and on behalf of the trustees of the Eagles Trust, in whom ownership in Zonnekus was vested, or other entities in which GVDM held an interest.

(xi) That what was in issue for purposes of the current application was whether the Respondents had been shown to have 'persistently and without any reasonable ground instituted legal proceedings in any court or in any inferior court, whether against the same person or against different persons' in a manner which warranted an order to be made against them in terms of section 2(1)(b) and this required a careful consideration of the legal proceedings which had been instituted by the Respondents.

(xii) That the persistent and vexatious approach taken by GVDM and the other Respondents in the unreasonable institution of legal proceedings was most clearly apparent in relation to the liquidation of Zonnekus and applications ancillary to it. The unsuccessful business rescue applications were patently unwarranted, instituted without any commercial justification and were doomed to failure and set out to achieve an extraneous objective, namely to frustrate and delay the liquidation. The single-minded persistence with

which these applications were pursued was unreasonable, patently vexatious and constituted an abuse of court process. The further applications concerned with Zonnekus were each instituted in the persistent and relentless manner in which they were, were equally unmeritorious and unreasonable, patently vexatious and constituted an abuse of court process.

(xiii) That what constituted an abuse of court process was a matter to be determined from the circumstances of each case and, in general, such abuse arises where procedures permitted by the rules of court to facilitate the pursuit of the truth are used for a purpose extraneous to that objective. Moreover, the persistent manner in which the applications had been instituted, together with their content, had been unreasonable and the litigation had been pursued in so vexatious a manner as to point squarely to its intent to harass and delay in circumstances in which this was plainly unwarranted. As such, there could be little doubt that all such litigation had been vexatious, unreasonable and an abuse of court process.

(xiv) That the Respondents had been shown to have persistently and without any reasonable ground repeatedly instituted legal proceedings, whether against SARS, its attorneys or others, in so unreasonable and persistent a manner as to warrant an order being made to restrict such litigation into the future. Since such litigation poses the very real risk of not only negatively impacting on the court system and the administration of justice, but has in the past patently amounted to an abuse of court process, it followed that in the exercise by this court of its discretion, an order in terms of section 2(1)(b) should, for the reasons stated, be made against GVDM in his personal capacity, as well as each of the Respondents as trustees of the Eagles Trust.

(xv) That the Respondents were to bear the costs of this application, including the costs occasioned by the previous postponement of the matter, jointly and severally, the one paying the other to be absolved, inclusive of the costs of two counsel.

5.3. C:SARS v Spur Group (Pty) Ltd (84 SATC 1)

Respondent was the main operating entity in the Spur Group of companies. It was a wholly owned subsidiary of Spur Corporation Limited (Spur HoldCo).

In 2004 the Spur Group including the Respondent and Spur HoldCo, resolved to implement a new share incentive scheme (the scheme), in terms of which eligible employees of the Respondent (the participants) were afforded the opportunity of participating in that scheme.

The purpose of the scheme was to promote the continued growth and profitability of the Respondent. It was common cause that the scheme came into being after 18 months of planning which included the Respondent obtaining advice in respect of the tax implications of the scheme.

On 30 November 2004, in order to implement and regulate the scheme, Spur HoldCo established the Spur Management Share Trust (the trust), a discretionary trust of which Spur HoldCo was the sole capital and income beneficiary. The Trust Deed was amended on 13 December 2010 to permit the participants to benefit from dividends received by the trust, however Spur HoldCo remained the sole capital beneficiary.

The trust, in furtherance of the scheme, incorporated Maxshell 72 Investments (Pty) Ltd (NewCo). The participants were offered the opportunity to acquire ordinary shares in NewCo (the NewCo shares) at par value (i.e. 1 cent each) in proportions determined by Spur HoldCo.

The purchase price of the NewCo shares was settled in cash by each participant upon the issue of the NewCo shares on 15 December 2004. The participants were not entitled to deal freely with the NewCo shares for a period of at least seven years and those participants who left the Respondent's employment during this period forfeited their shares, which were then re-allocated to other participants.

Respondent, on 7 December 2004, concluded a contribution agreement with the trust in terms of which an amount of R48 471 714 (R48 million) was contributed to the trust.

On 20 December 2004, after NewCo's share capital had been altered to create NewCo preference shares, the trust subscribed for 1000 NewCo preference shares for an amount equal to the aggregate of the market price of Spur HoldCo shares, amounting to approximately R48 471 714 in aggregate, to be acquired by NewCo.

The 'dividend rate' of the NewCo preference shares was set at 75% per annum of the prime interest rate and this was a market-related preference dividend rate. The 'redemption date' for the NewCo preference shares was set at five years following their issue.

On 10 January 2005 the share incentive scheme was formally adopted by Spur HoldCo, Spur, the trust, NewCo and Shares Buy-Back (Pty)Ltd (SBBco). NewCo applied the aggregate of the preference share subscription price, i.e. the R48 million from the trust, to purchase 8 274 043 ordinary Spur HoldCo shares from SBBco and another seller. NewCo then ceded in security and pledged the ordinary Spur HoldCo shares to the trust until NewCo had complied with all its obligations to the trust in terms of clause 11 of the Preference Share Subscription Agreement concluded between the trustees and NewCo (the preference share agreement).

After the scheme had commenced operating, NewCo received dividends from time to time through its holding of the SpurHoldCo shares. NewCo retained the dividends to assist in meeting its cumulative preference share obligations towards the trust.

On 18 December 2009 the directors of NewCo passed a resolution in terms of which the 1 000 NewCo preference shares, issued five years previously on 18 December 2004, were redeemed in accordance with the preference share agreement for a total consideration of R48 471 714. In addition, the dividends that had accrued on the preference shares from the date of issue, or as calculated in accordance with the preference share agreement and amounting to R22 562 254, were to be distributed to the trust.

The redemption of the preference shares and the payment of the dividends, as described above, were settled by way of NewCo distributing to the trust a total of 6 688 698 Spur HoldCo ordinary shares. The shares had a total agreed value equal to the redemption and preference dividends amounts of R48 471 714 and R22 562 254 respectively.

In terms of the resolution the directors of NewCo declared a dividend of R286.27 per ordinary share totalling R28 627 000, payable on 22 December 2009 to the ordinary shareholders listed on NewCo's share register on 22 December 2009. These were the participants to the scheme. In order to pay the aforesaid amount, NewCo disposed of 1 585 345 Spur HoldCo shares to SBBco at the ten-day volume weighted average share price calculated as at close of trade on 17 December 2009. In April 2011 a further dividend of approximately R635 000 was declared and paid to the participants in the scheme.

The share incentive scheme has since been terminated and NewCo was deregistered on 10 December 2012. The trust remained extant and continues to hold Spur HoldCo shares that were distributed to it by NewCo.

The actual cause of the dispute in this matter occurred when the Respondent claimed the contribution of R48 million it made to the trust as a deduction against its income in terms of section 11(a) of the Act. The claimed deduction was spread over the period of the anticipated benefit to be derived from the payment, from and including 2005 to 2012, in terms of section 23H of the Act.

SARS had originally issued assessments allowing the claimed deduction. However, following an audit, SARS issued additional assessments and disallowed the deductions claimed in terms of the provisions of section 11(a) of the Act, and brought the deductions back into account as additional taxable income. The basis of the disallowance was that the expenditure (i.e. R48 million contribution) was not incurred in the production of the Respondent' income as required by section 11(a) of the Act, in that '…there is no direct, causal link between the contribution and the production of [Respondent's] income.'

SARS, in disallowing the deductions, reasoned as follows: Respondent made the contribution to the trust, of which Spur HoldCo was the sole beneficiary; Spur HoldCo was the only party to have benefited directly from the contribution to the trust in that it would receive the investment in the NewCo preference shares, i.e. the contribution of R48 million and the preference share dividends at the time when NewCo redeemed the NewCo preference shares; and the trust distributed the preference share capital and the preference share dividends to its beneficiary, Spur HoldCo. The participants, SARS concluded, were thus not the beneficiaries of the contribution. The causal link referred to was thus lacking.

Respondent had appealed successfully to the Tax Court (see ITC 1919 (2018) 81 SATC 308 per Cloete J) and SARS had thereafter appealed unsuccessfully to a Full Bench of the High Court, Western Cape Division which found in favour of the Respondent.

The majority of the court a quo (see C: SARS v Spur Group (Pty) Ltd 82 SATC 181) was satisfied that the Respondent had established a sufficiently close connection between the contribution and its income earning operations. The majority found that the purpose of the expenditure, i.e. the contribution of R48 million, directly served to incentivise the participants, key managerial staff, and to promote the continued growth of the Respondent and, as such, it was expenditure incurred in the production of the income of the Respondent and was thus deductible.

On appeal in the Supreme Court of Appeal, SARS submitted that the contribution in issue was not expenditure incurred in the production of the Respondent's income as required by section 11(a) of the Act, and that there was only an indirect and insufficient link between the expenditure and any benefit arising from the incentivisation of the Respondent's key staff and thus it would not be proper, natural and reasonable to regard the expense as a justifiable deduction.

Respondent on appeal submitted that, on the evidence, the dominant purpose in the establishment and implementation of the scheme was to protect and enhance Respondent's business and its income by motivating its management employees to be efficient, productive and remain in Respondent's employ. That the incentive

offered to and in fact received by such employees was the financial benefits, which would flow from the success of Respondent's business and the growth in the value of the shares in Spur HoldCo, could not detract from the fact that the expenditure in question was incurred by the Respondent for the purpose of earning income.

Respondent's case was that the expenditure made in order to establish and implement the scheme was so closely linked to the acts required to be performed to produce its income, that it constituted part of the cost of performing those income-producing acts.

In view of the court's finding that the Respondent's contribution did not qualify as expenditure in the production of income for purposes of the Act the court had to deal with the prescription issue and consider whether SARS was precluded from issuing the additional assessments in respect of the 2005–2009 years of assessment by virtue of the provisions of section 99(1) of the Tax Administration Act.

Respondent's complaint was that the additional assessments were raised after the period of three years from the date of the original assessments and the court had to consider whether there had been misrepresentation and non-disclosure of material facts by the Respondent as provided for in section 99(2)(a) of Act.

The prescription issue related to additional assessments that SARS made on 28 July 2015 in respect of the Respondent's 2005–2009 years of assessment. The original assessments were raised on 31 May 2007 (2005), 7 August 2007 (2006), 12 May 2009 (2007), 24 February 2010 (2008) and 16 January 2010 (2009).

Judge Mbha held the following:

<u>As to the 'in the production of the income' aspect</u>

(i) That it was common cause that expenditure was actually incurred and that it was not of a capital nature. The sole issue for determination by the court was accordingly whether the court a quo had correctly held that there was a sufficiently close causal link that existed between the Respondent's expenditure of the contribution and its income producing operations.

(ii) That the law governing the approach to be adopted when determining whether an expense was incurred in the production of income, as contemplated in section 11(a) of the Act was clear. In Port Elizabeth Electric Tramway Co Ltd v CIR 8 SATC 13 at 16 Watermeyer J explained the position and, clearly, there must be a sufficiently close connection or link between the expenditure and the income earning operations of a taxpayer. The determination of whether the necessary link exists will require an examination of all the facts of a particular case. In this regard Corbett JA's dictum in CIR v Nemojim (Pty) Ltd 45 SATC 241 at 254 was apposite and Corbett JA then quoted with approval Schreiner JA's dictum in CIR v Genn and Co (Pty) Ltd 20 SATC 113 at 121.

(iii) That what could be gleaned from the authorities referred to was that the deductibility of expenditure in terms of section 11(a) of the Act was dependent upon two criteria that had to be considered on the particular facts of the case. First, the purpose of the taxpayer in incurring the expenditure in question, and whether the purpose was to produce an income. Second, whether a sufficiently close nexus or link existed between the expenditure and the ultimate production of income. These criteria clearly established that a mere existence of a nexus or link between the expenditure and the earning of income was not, on its own, sufficient to justify a deduction under section 11(a) of the Act. A taxpayer must show an adequate closeness between the expenditure and the production of income.

(iv) That clearly the contribution of R48 million by the Respondent to the trust was central to the share incentive scheme. However, the participants did not benefit directly, and even indirectly for that matter, from the making of the contribution.

(iv) That the contribution of R48 million was used, wholly, to subscribe for preference shares in NewCo. Only the trust held the NewCo preference shares, and only it was entitled to the return of the R48 million contribution, plus the preference dividend on those shares. The participants had no right

to any part of the contribution, nor to the preference dividends that flowed from the investment thereof.

(v) That, importantly, in terms of the Trust Deed, only Spur HoldCo would, as capital beneficiary, have any right to the ultimate delivery of the R48 million contribution and any yield therefrom. The participants were neither capital nor income beneficiaries of the trust at that stage as the concern must obviously be in relation to what was done when the contribution of R48 million was made in 2004.

(vi) That the indisputable factual position therefore was that the participants benefitted directly from their separate investment, at par value in ordinary shares in NewCo. The evidence confirmed that '…the participants benefited through NewCo. There was no ways they could directly benefit from the trust. There had to be funding that flowed through to NewCo, and they would then benefit in their participation in NewCo.'

(vii) That there was a potential benefit to the participants which lay in the possibility of growth in the value of the NewCo ordinary shares. That would in turn arise to the extent that the value of NewCo's assets, namely, the SpurHoldCo shares in which NewCo invested, increased above what was required by NewCo to meet its redemption and preference dividend obligations to the trust.

(ix) That, however, as was confirmed by the evidence, the contribution by the Respondent was in effect a funding mechanism for the scheme, which was to remain in place for most of the duration of the scheme. The purpose was always for the R48 million to remain within the Spur Group and not to transfer it to the benefit of the participants. As shown, that was ultimately what the contribution achieved, i.e. the R48 million was returned to the trust where it still resided, in the form of shares, with SpurHoldCo as the sole capital beneficiary.

(x) That, in the court's view, the majority in the court a quo had erred in finding that the expenditure in issue had directly served the purpose of

incentivising the participants, and that a sufficiently close nexus had existed between the expenditure and the production of income by the Respondent. As demonstrated earlier, the R48 million contribution did not itself serve to incentivise the participants as it was an amount that would never accrue to the participants. Instead, it ultimately became available for the benefit of Spur Hold Co as the capital beneficiaries of the trust.

(xi) That in Solaglass Finance Co (Pty) Ltd v CIR 53 SATC 1 this court made it clear that the deduction of expenditure in relation to monies spent for the purposes of advancing the interests of the group of companies to which the taxpayer belonged was precluded.

(xii) That, applying PE Tramway, the court found that the purpose of the Respondent in incurring the expenditure was not to produce income, as required by section 11(a) of the Act, but to provide funding for the scheme, for the ultimate benefit of Spur HoldCo. There was only an indirect and insufficient link between the expenditure and any benefit arising from the incentivisation of the participants. The contribution was therefore not sufficiently closely connected to the business operations of the Respondent such that it would be proper, natural and reasonable to regard the expense as part of the Respondent's costs in performing such operations.

<u>As to the prescription of assessments</u>

(xiii) That SARS had averred that the amount of tax chargeable in terms of the additional assessments were not so assessed by SARS in the 2005–2009 years of assessment due to misrepresentation and non-disclosure of material facts by the Respondent. Section 99(2)(a) of the Tax Administration Act provided that SARS was not bound by the three-year period of limitation where 'in the case of assessment by SARS, the fact that the full amount of tax chargeable was not assessed was due to (i) fraud; (ii) misrepresentation; or (iii) non-disclosure of material facts.'

(xiv) That the Respondent's defence to the allegation of misrepresentation and non-disclosure of material facts was that the contested statements in its

income tax returns were negligently and inadvertently made. Respondent also asserted that SARS had failed to establish the requisite causal nexus, in that it was unclear how its inadvertent and incorrect disclosures would have altered the basis of SARS' assessment in the affected years. Respondent submitted that as the onus to establish a causal nexus to displace the statutory immunity conferred by the Tax Administration Act had not been met, the additional assessments issued in respect of its 2005–2009 years of assessment were unlawful, invalid and could not be confirmed.

(xv) That the Respondent's assertion that the wrong entries in the tax returns were negligent and inadvertent was patently false. Central to this entire dispute was the contribution of R48 million that the Respondent had made to the trust in 2005. The answer 'no' to the question whether any contribution was made to a trust or whether the company was party to the formation of a trust, was, in my view, plainly false and a misrepresentation. These were questions pertinently, and for tax purposes, seriously raised. It required specific attention and an honest answer. Strikingly, the answers were repeated.

(xvi) That in each of the 2005 to 2009 years of assessment, deductions claimed by the Respondent were in fact limited in terms of section 23H of the Act. It simply boggled the mind that the Respondent answered 'no' to the relevant question for each and every subsequent year from 2005 to 2009. Moreover, the Respondent's failure to include the said amounts in a separate line item which specifically required a disclosure of deductions limited by section 23H, and their inclusion in a general line item, amounted in the court's view, to a deliberate misrepresentation and a non-disclosure of material facts. It simply could not, by any stretch of imagination, be ascribed to any inadvertent error.

(xvii) That, similarly, the Respondent's answer 'no' to the question whether a trust had been formed, was also plainly false and a misrepresentation. Respondent was intimately involved in the conceptualisation of the share

incentive scheme. It followed that it cannot be said that Respondent was not involved in the formation of the trust.

(xviii) That the Respondent's attempt to put the blame for the so-called errors in the entries on a new accountant on the basis that she was not fully appraised of the details of the scheme, could not succeed. Firstly, she was never called to testify in the court a quo on this aspect and, second, Respondent's public officer had signed off the relevant tax returns as being correct.

(xix) Respondent's further argument that SARS had all the relevant and correct facts at his or her disposal because its annual financial statements were submitted together with the tax returns, and that the correct information could be distilled from them, was unhelpful. The mere fact that an astute auditor or assessor could have been able to ascertain from supporting documentation the fact that the return contained a misrepresentation, cannot mean that there was no misrepresentation in the first place.

(xx) That it was trite that SARS bore the onus to show that the non-asssessment within the requisite three-year period was the result of the aforesaid misrepresentation and non-disclosure referred to earlier: In addressing this issue it was apposite to consider SARS' relevant internal processes in the years in question pertaining to the making of original and additional assessments.

(xxi) Respondent had accepted that false statements were contained in its returns but against that it contended that scrutiny of the financial statements and a more alert auditing process would and should have ensured a proper assessment within the prescribed period. However it overlooked the face value assessment process understandably undertaken by SARS. Audits are implemented because of triggers caused by specific answers in tax returns. If the questions that would give rise to the triggers are wrongly answered, as happened in this case, the matter may not come before an auditor within the three-year period, and the clarification questions will therefore never be asked.

(xxii) That the court also added that as a matter of policy, a court would be loath to come to the assistance of a taxpayer that has made improper or untruthful disclosures in a return. Clearly, this would offend against the statutory imperative of having to make a full and proper disclosure in a tax return.

(xxiii) That, accordingly, the court found that the misrepresentations and non-disclosures by the Respondent caused SARS not to assess the Respondent correctly within the three-year period after the original statements.

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

Additional income tax assessments raised by SARS in respect of the Respondent's 2005 to 2012 years of assessment were confirmed.

6. INTERPRETATION NOTES

6.1. Deductions of home office expenses incurred by persons in employment or persons holding an office – No. 28 (Issue 3)

This Note provides clarity on the deductibility of home office expenses incurred by persons in employment or persons holding an office.

This Note incorporates the changes made to section 23(m) by section 56(1) of Taxation Laws Amendment Act 31 of 2013 and section 35(1) of Taxation Laws Amendment Act 17 of 2017.

The changes effected in this Note are applicable from the 2023 year of assessment.

It has become common in recent times for employers to require or permit employees to work from home. The reasons for this include supporting flexibility, increasing productivity, health reasons or as a cost-saving measure for employers to minimize work space and related costs. Such arrangements could be temporary in nature or may have a degree of permanency. Persons in employment or persons

holding an office may therefore wish to claim a deduction for certain expenses incurred in relation to a home office.

Expenses in maintaining a home office have been a controversial issue since the judgment handed down in KBI v Van der Walt. The legislation relating to home office expenditure that a taxpayer may claim, section 23(b), has therefore been periodically amended since 1990. The most recent amendment to have an effect on the deduction of home office expenditure was the amendment to section 23(m) which, subject to specific exceptions, prohibits the deduction of certain expenditure, losses and allowances that relate to employment or the holding of an office.

The effect of section 23(b) and 23(m) on the deductibility of home office expenditure for employees and holders of an office is the main focus of this Note.

Recent global developments have resulted in a number employees working from home for varying periods of time. In some instances employees may have directed existing expenditure towards a work purpose or may have incurred additional expenditure for work purposes. It is important to note that the interpretations reflected in this note are based on the provisions of section 23(b) and section 23(m) which have not been amended since the onset of these developments. Some people may consider the provisions to be overly strict, inequitable and unaccommodating of the modern work environment, however, absent legislative amendment they are the provisions which must be applied. Dependent on the facts of a particular employee-employer relationship, an employee who has incurred business expenditure may be able to claim a reimbursement from their employer to offset a financial hardship experienced as a result of incurring expenditure for work purposes.

In the event that section 23(m) and section 23(b) apply, but the specific exclusions in those sections are met, the deductible home office expenses are limited to rental, repairs and expenses incurred in relation to premises under section 11(a) and (d), and wear-and-tear allowances under section 11(e) on, for example, office equipment used by the taxpayer for the purpose of his or her trade (employment or office).

7. DRAFT INTERPRETATION NOTES

7.1. Determination of the taxable income of certain persons from international transactions: intra-group loans

This Note provides taxpayers with guidance on the application of the arm's length principle in the context of the pricing of intra-group loans. The pricing of intra-group loans includes a consideration of both the amount of debt and the cost of the debt.

An intra-group loan would be incorrectly priced if the amount of debt funding, the cost of the debt or both are excessive compared to what is arm's length. The Note also provides guidance on the consequences for a taxpayer if the amount of debt, the cost of debt or both are not arm's length.

The guidance and examples provided are not an exhaustive consideration of every issue that might arise. Each case will be decided on its own merits taking into account its specific facts and circumstances.

The application of the arm's length principle is inherently of a detailed factual nature and takes into account a wide range of factors particular to the specific taxpayer concerned.

Section 31 was substituted by the Taxation Laws Amendment Act, 2011 with effect from years of assessment commencing on or after 1 April 2012. Practice Note 2 of 14 May 1996 and its Addendum of 17 May 2002, which gave guidance on section 31(3), were withdrawn for years of assessment commencing on or after 1 April 2012, since they were no longer applicable from the date the legislation changed.
Taxpayers are broadly financed in two ways, namely using equity and debt. The returns on equity capital and debt capital are treated differently for tax purposes.

Interest payments incurred in the production of income by a person carrying on a trade are, subject to certain conditions, exceptions and restrictions, deductible in determining taxable income while dividends and returns of capital are not deductible.

The way in which a taxpayer is financed has an impact on the calculation of the

taxpayer's taxable income. This raises tax concerns regarding the balance between the amount of equity capital and debt capital. A taxpayer that is considered to have too much debt when considered against the amount of its equity is said to be thinly capitalised for tax purposes.

Thin capitalisation becomes a potential issue where a South African taxpayer is directly or indirectly funded by a non-resident relevant party. The funding of a South African taxpayer with excessive intra-group, back-to-back or intra-group-guaranteed debt may result in excessive interest deductions thereby depleting the South African tax base when there is a mismatch with the taxability of the interest income because of interest exemptions and reduced rates of withholding tax on interest.

South Africa introduced thin capitalisation rules in 1995. Under these rules, which were contained in section 31(3), SARS was empowered to have regard to the international financial assistance rendered and if it was considered excessive in proportion to the particular lender's fixed capital in the borrower, the interest, finance charges or other consideration relating to the excessive financial assistance were disallowed. SARS's views on what constituted excessive international financial assistance were documented in Practice Note 2 of 14 May 1996. These rules and Practice Note 2 have been repealed and are only applicable to years of assessment commencing before 1 April 2012.

For years of assessment commencing on or after 1 April 2012, thin capitalisation is no longer dealt with by a separate subsection of section 31 and is instead governed by the general transfer pricing provisions of section 31(2). Section 31(2) applies to, for example, the amount of the intra-group loan and the rate of interest incurred during years of assessment commencing on or after 1 April 2012 irrespective of whether the underlying loan was initially granted before, on or after that date.

One of the most significant changes is that taxpayers must determine the acceptable amount of debt applying arm's length principles. The application of the arm's length principle to intra-group loans will be considered further in this Note.

The pricing of intra-group loans includes a consideration of both the amount of debt and the cost of the debt.

This Note deals with the provisions of section 31 which, as noted above, are applicable for years of assessment commencing on or after 1 April 2012. For example, in the case of a year of assessment ending on 31 December, the first year of assessment to which the new legislation applies is the year of assessment commencing on 1 January 2013 and ending on 31 December 2013.

In summary:

- Section 31 applies to affected transactions which are broadly cross border transactions between relevant parties that have been concluded on terms and conditions that would not have existed if the parties had been independent persons dealing at arm's length and those terms and conditions result or will result in a tax benefit.
- For years of assessment commencing on or after 1 April 2012, taxpayers must determine the acceptable amount of debt from affected transactions applying arm's length principles.
- Taxpayers are required to calculate taxable income based on the arm's length terms and conditions that should have applied to the affected transaction. This means that the interest and other charges relating to the non-arm's length amount of affected transaction debt and the amount of interest which is nonarm's length must be disallowed as deductions in computing taxable income.
- In addition to a disallowed deduction for the interest and other charges, the amount of the disallowed deduction will in certain cases be deemed to be a dividend which is subject to dividends tax or a donation subject to donations tax.
- Taxpayers must be able to substantiate their view of the extent to which the relevant party debt is considered to be arm's length and accordingly must retain appropriate documentation.

- The transfer pricing provisions have been relaxed in relation to certain transactions involving financial assistance and headquarter companies, with a corresponding limitation on the amount of the related interest deductions.
- South Africa does not currently have advance pricing agreements.
- Section 31 applies prior to considering the impact, if any, of section 23M and section 23N.
- Section 31(2), if applicable, does not deem the underlying transaction to have been conducted at an adjusted amount for purposes of the Act as a whole and accordingly any 'adjustment' to taxable income or tax payable under section 31(2) will not impact on the calculation of withholding tax on interest under Part IVB of Chapter II of the Act.

7.2. Mining rehabilitation company or trust: Deductibility of amounts paid and compliance with section 37A

This Note provides guidance on the interpretation and application of section 37A which deals with payments made by persons to a mining rehabilitation company or trust where that company or trust has been established for the purposes of conducting rehabilitation upon the closure of a mine and the cessation of mining activities. This rehabilitation is to also cover any latent and residual environmental impacts of the mining activities.

The Note also discusses the special tax relief provided for persons contributing cash to a mining rehabilitation company or trust, as well as specific anti-avoidance rules designed to prevent misuse or abuse of those provisions.

Financial provision for environmental rehabilitation is regulated by NEMA and administered by the DMR. NEMA provides that in the event that a mining right holder fails to rehabilitate or to manage any impact on the environment, or is unable to undertake such rehabilitation, the Minister may use all or part of the financial provision (funds and assets) of a mining rehabilitation company or trust to

rehabilitate the affected areas.

The aim of section 37A is to align tax policy with environmental regulation. Section 37A regulates mining rehabilitation companies or trusts for income tax by requiring that the funds or assets of the rehabilitation company or trust be applied solely for a purpose stated in section 37A(1)(a) before a deduction of contributions made to the mining rehabilitation company or trust during a year of assessment may be considered. Section 37A contains strict rules for the distribution of the assets and funds of a mining rehabilitation company or trust and imposes harsh penalties under circumstances where such funds are used for purposes other than those provided for under section 37A(1)(a).

Mining companies in South Africa are required to make financial provision under the MPRDA read with NEMA for the rehabilitation of mining areas covered by its mining permit. Persons making a cash contribution to a mining rehabilitation company or trust as contemplated in section 37A may qualify for a deduction in determining taxable income for any year of assessment commencing on or after 2 November 2006. The deduction is subject to a mining rehabilitation company or trust complying with the following requirements:

- The sole object of the mining rehabilitation company or trust must be to apply its property solely for rehabilitation purposes provided for under section 37A(1)(a).
- The mining rehabilitation company or trust holds assets solely for purposes of rehabilitation as contemplated in section 37A(1)(a).
- Under section 37A(2) mining rehabilitation company or trust may only invest in financial instruments issued by certain qualifying entities or any sphere of government in the Republic. Investments held before 18 November 2003 are not subject to this requirement.

Where the mining rehabilitation company or trust contravenes any of the above requirements a penalty is imposed.

Section 37A deals with the treatment of excess property or funds of a mining

rehabilitation company or trust arising either before or after the issue of a closure certificate.

A mining rehabilitation company or trust must comply with the reporting requirements contained in section 37A(10).

7.3. Recoupment of amounts deducted or set off when an asset commences to be held as trading stock which was previously not so held

This Note provides guidance on the interpretation and application of section 8(4)(k)(iv) that applies when any asset on which an allowance or deduction under a provision referred to in section 8(4)(a) has been granted, commencesto be held as trading stock.

The Comprehensive Guide to Capital Gains Tax may be referred to for a comprehensive discussion of the capital gains tax implications when an allowance asset commences to be held as trading stock.

The Act provides for various deductions and allowances which reduce the tax value of certain assets. The subsequent disposal of such an asset for an amount in excess of the tax value will normally result in a taxable recoupment of the difference. Section 8(4)(a) is a general recoupment provision and provides that an amount that previously has been allowed as a deduction or set off under sections 11 to 20, 24D, 24F, 24G, 24I, 24J, 27(2)(b) and 37B(2) must be included in a taxpayer's gross income if it has been recovered or recouped during the year of assessment. The effect of section 8(4)(a) is that whenever a taxpayer has claimed a deduction or allowance under the specified sections and the amount is subsequently recovered or recouped it must be included in the taxpayer's gross income.

Section 8(4)(a) is limited in its application to amounts that have been recovered or recouped when an asset is disposed of or where an expense is otherwise recovered. There are, however, events which do not constitute a disposal and

therefore do not result in the recovery or recoupment of an amount despite a deduction or an allowance being previously granted. Section 8(4)(k) provides for a deemed disposal under certain circumstances that are not considered to be a disposal. Before its amendment, the deemed disposal under section 8(4)(k) only applied where during any year of assessment any person has:

- donated any asset;
- in the case of a company, transferred in whatever manner or form any assets to another holder of a share in that company; or
- disposed of any asset to a person who is a connected person in relation to that person.

An asset on which an allowance or deduction was allowed and that asset subsequently commenced to be held as trading stock, for example, where a taxpayer changed its intention with regard to the use or the purpose of the asset, was therefore not included under section 8(4)(k), meaning that the allowance or deduction allowed was not recouped in that year of assessment or any subsequent year of assessment.

Paragraph 12(2)(c) provides for a deemed disposal for CGT purposes when an asset, whether an allowance or non-allowance asset, held otherwise than as trading stock commences to be held as trading stock. In order to provide for a similar deemed disposal rule for income tax purposes, section 8(4)(k) was amended by the insertion of subparagraph (iv) that provides for the deemed disposal and reacquisition when a taxpayer commenced to hold any allowance asset as trading stock.

Section 8(4)(a) provides for the recoupment of all amounts granted as deduction or set off under certain provisions of the Act when an asset is disposed of or where an expense is otherwise recovered. There is, however, no disposal of an asset when a taxpayer changes its intention from holding an asset on capital account to trading stock. Section 8(4)(k)(i)-(iii), however, provide for a deemed disposal of the asset under certain circumstances.

With effect from 15 January 2020 section 8(4)(k) was amended by the insertion of subparagraph (iv) to make provision for the recoupment of amounts previously granted as a deduction where any person commenced to hold an allowance asset as trading stock which was previously not held as trading stock. The purpose of the amendment is to recoup the allowances in the year of assessment when the asset is commenced to be held as trading stock. Section 8(4)(k)(iv) only applies to the amounts stipulated under section 8(4)(a).

Amounts under any of the sections listed in section 8(4)(a) that have subsequently been recovered or recouped shall not be included in the taxpayer's income and includes any such amount so recovered or recouped which has been:

- included in gross income under paragraph (jA) of the definition of 'gross income';
- applied to reduce any cost or expenditure incurred by such taxpayer under a concession or compromise in respect of a debt; or
- previously taken into account as an amount that is deemed to have been recovered recouped under section 19(4), (5) or (6).

7.4. Understatement Penalty: Meaning of 'maximum tax rate applicable to the taxpayer'

This Note provides clarity on the interpretation and application of the phrase 'maximum tax rate applicable to the taxpayer' used in section 222(5) when the tax rate applicable to the shortfall determined under subsections (3) and (4) is applied.

The TA Act provides for an understatement penalty to be imposed where a taxpayer has made an understatement. The main purpose of the understatement penalty regime is to deter behaviours that result in non-compliant reporting, and the understatement penalty framework aims at ensuring consistent and equal treatment of taxpayers in comparable circumstances.

Section 222(2) stipulates that the highest understatement penalty percentage must

be applied to each shortfall determined under subsections (3) and (4). Section 222(5) provides that the tax rate applicable to the shortfall determined under these subsections is the 'maximum tax rate applicable to the taxpayer, ignoring an assessed loss or any other benefit brought forward from a preceding tax period to the tax period'.

There is uncertainty as to how the 'maximum tax rate applicable to the taxpayer' may be applied to a taxpayer that has made an understatement and is in an assessed loss position. This Note provides clarity on the rate to be applied in circumstances where the taxpayer is in an assessed loss position after the understatement is corrected.

Section 222 imposes an understatement penalty in the event of an understatement by a taxpayer, except if the understatement is as a result of a bona fide inadvertent error.

The understatement penalty is determined by applying the highest applicable understatement penalty percentage in accordance with the table in section 223 to each shortfall. Each 'shortfall' is determined under section 222(3) as the sum of paragraph (a), (b) and (c) depending on the specific facts of the taxpayer for the respective tax period to determine the shortfall in tax.

Section 222(3)(c) provides for the determination of the portion of the shortfall in tax where a taxpayer is in an assessed loss position afterthe understatement is corrected. Since an assessed loss is not a tax liability section 222(5) provides that under these instances, the 'maximum tax rate applicable to the taxpayer', determined by ignoring an assessed loss or any other benefit brought forward from a preceding tax period to the tax period in which the understatement occurred, must be applied to determine the shortfall in tax.

Certain taxpayers are taxed either at a flat rate or a progressive rate of tax. The tax rate applicable to taxpayers subject to a flat rate of tax represents the 'maximum rate applicable to that taxpayer' for purposes of section 222(5).

For taxpayers that are taxed at a progressive rate of tax, the maximum tax rate applicable to the shortfall envisaged under section 222(3)(c) is the marginal tax

rate applicable to the taxable income or taxable turnover that is established by, ignoring the assessed losses or any other benefit brought forward from a preceding tax period to the tax period in question.

The facts and circumstances of each taxpayer must be considered to determine what tax rate will apply when determining the 'maximum tax rate' for purposes of determining the shortfall in tax under section 222(3)(c).

7.5. Public Benefit Activity: Bid to Host or Hosting an International Event

This Note provides guidance on the interpretation and application of PBA 11(b) relating to the bid to host or hosting of any international event approved by the Minister having regard to specified prescribed criteria.

The bid to host or hosting of any international event exposes South Africa on an international level by providing public pride in hosting such an event, attracting overseas visitors, changing perceptions about South Africa as a business and leisure destination and providing an inflow of funds. These benefits can be realised on a tax beneficial basis when the Minister approves an international event for purposes of PBA 11(b) and SARS approves the organisation bidding to host or hosting that international event as a PBO under section 30(3).

This Note does not consider any other taxes or duties the bid to host or hosting of any international event may attract, or for which exemption may be required.

An international event is normally an event of a limited duration having a global reach in terms of participation, audience and media coverage.

A document published by the Organisation for Economic Co-operation and Development (OECD) called the Recommendation on Global Events and Local Development provides the following on the hosting of global events:

> 'The hosting of global events such as the Olympic Games, Expos, World Cups, Cultural Festivals, and many more have long been seen as

> opportunities to stimulate growth and development in the countries, and particularly the cities, that host them. Hosts increasingly seek to ensure that such events act as catalysts for local development, are used to leverage long-term infrastructure investments, boost tourism and trade, create jobs and promote community development. To deliver on these promises, events must be deliberately designed and executed to generate long-term benefits. They need to clearly demonstrate how they impact upon communities to contribute to economic growth and development. Tax incentives, investment and sponsorship deals must be thoroughly assessed and managed to ensure that each event benefits host cities and the awarding body. Global events can leverage investment, urban, rural and infrastructure development towards progressive opportunities for further job creation, community development, business development, environmental protection, social cohesion and post-event uses.'

Local development benefits generally occur through the bidding process or before hosting an event, which may include improved environment, infrastructure and amenities, global exposure, increased visitor economy and tourism, trade and investment promotion, employment and social or business development, national pride and public engagement. The local development benefits are an important justification for the event itself, for the investment and an incentive to ensure the event is a success. An event should also create a lasting legacy and not leave a host country or city in a worse position, with expensive facilities that have no post-event use, with huge debt and impoverished.

7.6. Public Benefit Organisations: Provision of Residential Care for Retired Persons

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

Institutional care of older persons was in the past prioritised by government and nongovernmental organisations resulting in the establishment of old age homes

and care centres. Government policy, however, shifted the emphasis to – • encourage older people to live active, healthy and independent lives within the community to retain their independence for as long as possible; • encourage family and home care of older persons; and • restrict institutional care to the frail elderly who require 24-hour care and who do not have the financial resources to meet their own needs. The care for older persons has therefore become the responsibility of every citizen. Retired persons who can afford to do so therefore may choose to live in housing schemes built to meet their particular needs, to maintain relative independence and to secure a comfortable quality of life. These housing schemes typically comprise housing units that range from freestanding houses with private gardens to multi-storey apartments, or flats, or a combination of these. The housing schemes are also normally walled or fenced off to form a separate village or complex and may offer communal facilities such as gyms, tennis courts, swimming pools, bowling greens, community centres as well as laundry services.

Section 10(1)(cF), which was repealed on 15 July 2001, provided an exemption from income tax for organisations providing residential accommodation under a sale or a lease or otherwise to aged or retired persons in a building, housing complex or village. An organisation had to provide at least one meal per day as well as nursing services in addition to residential accommodation in order to qualify for exemption under section 10(1)(cF). Organisations exempted under the repealed section 10(1)(cF) were thus mainly organisations selling accommodation by operating Life-Right Schemes contemplated in the Housing Schemes for Retired Persons Act 65 of 1988.

Section 10(1)(cN) and section 30 were introduced into the Act to deal with exempt organisations. The concept of a 'PBO' carrying on a 'PBA' was introduced. Specific PBAs were included in the Ninth Schedule to be carried on by a qualifying PBO. One such PBA is the provision of residential care for retired persons as contemplated in PBA 3(c). Section 10(1)(cF) was repealed simultaneously with the introduction of these sections.

Organisations previously exempted under section 10(1)(cF) were required to re-

apply to SARS for approval as a PBO carrying on PBA 3(c) on or before a prescribed date. An organisation that did not submit a re-application to SARS before the prescribed date lost its exempt status and became a normal taxpayer.

Approval of the previously exempt organisations by SARS as a PBO was not automatic. Many organisations exempted under the repealed section 10(1)(cF), especially those operating only Life-Right Schemes, did not qualify as carrying on PBA 3(c).

8. DRAFT BINDING GENERAL RULINGS

8.1. Disqualification as a qualifying company under section 12R(4)(b)

For the purposes of this ruling:

- 'Government Gazette' means Government Gazette 39930 issued on 15 April 2016;
- 'qualifying company' means a 'qualifying company' as defined in section 12R(1);
- 'SEZ' means a 'special economic zone', as defined in the Special Economic Zones Act 16 of 2014, that is approved for the purposes of section 12R by the Minister of Finance under section 12R(3);
- 'SIC Code' means version 7 of the Standard Industrial Classification Code as issued by the Statistics South Africa

Purpose

This BGR provides guidance on the interpretation and application of the excluded activities under section 12R(4)(b) conducted by a qualifying company located within an SEZ. It does not address any aspect of the accelerated building allowance available under section 12S. This ruling sets out SARS's view.

Background

The South African government introduced the SEZ's regime as a means of promoting foreign direct investment, growth and especially job creation in the South African manufacturing and industrial sector, and to encourage the exportation of value-added commodities by specific industries situated within a designated SEZ. An income tax incentive in the form of a reduced corporate income tax rate is available to qualifying companies located within an SEZ. Although a company may be classified a 'qualifying company' as defined in section 12R(1), it may be disqualified from participating in the income tax incentive if it conducts an activity listed in either section 12R(4)(a) or an activity listed in the SIC Code as gazetted by the Minister of Finance under section 12R(4)(b). In this regard the Minister of Finance issued a Government Gazette listing the activities from the SIC Code that constitute a disqualifying activity by a qualifying company. The problem arises in that some of the activities listed in the Government Gazette may constitute ancilliary activities to the main business of the qualifying company. Because the qualifying company may conduct any of these activities, it could be disqualified from participating in the income tax incentive.

This BGR provides clarity on the interpretation and application of the excluded activities under section 12R(4)(b).

Discussion

The disqualified activities under section 12R(4)(a) relate to certain specific manufacturing activities that are not targeted as part of the income tax incentive. Section 12R(4)(b) allows for the Minister to proclaim through the issuing of a gazette certain further non-manufacturing activities to constitute a disqualifying activity. The list of non-manufacturing activities in the gazette relate mainly to ancilliary activities that support the main trade of a qualifying company.

Both, subsections 12R(4)(a) and (b) refer to 'a company that conducts any activity' and 'is not a qualifying company'. Applying the same strict interpretation under both paragraphs, as is required following the judgement in Western Platinum Ltd v C: SARS, would result in a qualifying company being disqualified to participate in the income tax incentive as it is conducting a disqualified activity under section 12R(4)(b), which may only be an ancillary activity to the main trade of the qualifying

company.

Such an interpretation creates an absurdity as some of the activities listed in the Government Gazette are required to be undertaken as part of most business processes. The proper approach to the interpretation of statues was decided in the case of Natal Joint Municipal Pension Fund v Endumeni Municipality in which the judgment confirmed that it is incorrect to simply apply a purposive interpretation if the ordinary meaning does not give rise to an absurd or ambiguous result. In the case of an absurd or ambiguous result, a sensible and businesslike interpretation taking into account the purpose of the legislation should be adopted.

The courts also noted that it is important when giving words and expressions their ordinary meaning, to consider the context in which such words or expressions is contained. Since the purpose of the SEZ regime is to promote investment in certain under-capitalised manufacturing and industrial sectors and thereby create jobs, a businesslike interpretation must be adopted. This interpretation would mean that, if an activity listed in the said Government Gazette is ancillary to the manufacturing or industrial process undertaken by the qualifying company, then the qualifying company would not be disqualified from the income tax incentive under section 12R(4)(b). However, if any activity under section 12R(4)(b) is a separate income-earning activity that is conducted on a continuous basis, then that activity would result in the disqualification of that company as a qualifying company.

Example 1: An excluded ancillary activity conducted by a qualifying company

Facts:

Company M, a qualifying company, carries on the trade of manufacturing electronic appliances in a designated SEZ. Company M packages the final manufactured product for its safe and secure transport. Customers are invoiced for the final product and not separately for the cost of packaging.

Result:

The activity of packaging is listed as an excluded activity in Government Gazette 39930. The packaging activity is a necessary activity in support of the manufacturing trade of Company M and is not conducted as a separate

incomeearning activity. As the packaging activity is ancilliary to the income-earning activity, Company M will not be disqualified from participating in the income tax incentive by virtue of the application of section 12R(4)(b).

Example 2: Excluded activity conducted by a qualifying company as a separate income-earning activity

Facts:

Company D, a qualifying company, carries on the trade of manufacturing motor vehicles in a designated SEZ. Company D owns and operates a fleet of customised vehicles to transport the vehicles it manufactures to the harbour which is several hundred kilometres away, for export. On the return trip Company D, on behalf of other motor vehicle manufacturers situated in the SEZ, transports vehicles imported by such other companies for a fee.

Result:

The activity of land transport is listed as an excluded activity in Government Gazette 39930. The activity by Company D of transporting the vehicles it manufactures to the harbour will be considered a necessary activity in support of its manufacturing activity and will not be disqualified from participating in the income tax incentive under section 12R. However, the activity of transporting vehicles imported by other vehicle manufacturers is not a necessary activity in support of its manufacturing activity and will be considered as one of the dual-trades of Company D. Company D will be disqualified as a quailifying company under section 12R, as it conducts an excluded activity as envisaged under section 12R(4)(b), and is therefore not entitled to the income tax incentive for that year of assessment.

Ruling

A qualifying company will be disqualified from the income tax incentive under section 12R for that year of assessment if it conducts any activity listed in the Government Gazette. However, where that activity is an integral part of the manufactured product to protect or transport the final product, it is accepted that it is not disqualified, provided the secondary product is not sold separately.

9. BINDING CLASS RULINGS

9.1. Employee share incentive scheme – Shares in foreign company – No. 78

This ruling determines the income tax consequences of an employee share incentive scheme that holds shares in a foreign company.

In this ruling references to sections are to sections of the Income Tax Act and paragraphs are paragraphs of the Eighth Schedule to the Act applicable as at 20 September 2021.

Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1), – definitions of 'gross income' and 'trade';
- section 6quat(1) and (1A)(a)(i);
- section 10B;
- section 11(a) read with section 23(g);
- section 23H;
- paragraph 1, – definitions of 'asset' and 'proceeds';
- paragraph 3, – definition of 'capital gain'; and
- paragraph 11, – definition of 'disposal'.

Class

The class members to whom this ruling will apply are the applicants and the employees.

Parties to the proposed transaction

The applicants: Resident companies forming part of the same group of companies

as defined in section 1(1)

The co-applicant: A trust to be created by the applicants in order to administer the share incentive scheme

Employees: Employees of the applicants participating in the share incentive scheme

Description of the proposed transaction

The applicants became a group of companies in terms of a merger agreement which was approved by the Competition Tribunal. The ultimate holding company of the applicants is Holdco, a public company incorporated and tax resident in a foreign jurisdiction (Country X), whose shares are listed on an exchange in Country X. The applicants propose to establish an employee share incentive scheme.

The purpose of the employee share incentive scheme will be to incentivise all the participating employees by affording them the opportunity to participate in the economic benefits and appreciation in value in the shares held by the co-applicant that will be driven by their endeavours. This will be achieved by the participating employees being entitled to on-going dividends and indirectly the capital appreciation of the scheme shares by virtue of being entitled to so-called milestone distributions and leaver distributions as defined in the scheme rules and trust deed.

A participating employee will be entitled to the following benefits in terms of the trust deed of the co-applicant:

- A proportionate share of 50% of any dividends received in respect of the scheme shares;
- Milestone distributions after an initial period of four years participation in the scheme and thereafter every five years of completed participation in the scheme. The milestone distributions will be determined in accordance with a formula that considers any appreciation in the value of the scheme shares held by the co-applicant at the relevant 'Assessment Dates'.
- Leaver distributions, being equivalent to milestone payments (and essentially determined on the same basis) payable to a participating

employee that ceases employment with an applicant.

The applicants will make contributions to the co-applicant to enable it to purchase and acquire listed shares in Holdco.

The following proposed salient features of the trust deed of the co-applicant are relevant:

- Once the co-applicant acquires the shares in the ultimate holding company, with the approval of the South African Reserve Bank, the participating employees will be allocated notional units in the co-applicant for no consideration.
- The participating employees employed by the applicants on the Closing Date, or who join within a period of 12 months of the Closing Date, will be allocated one unit each by the trustees. An employee who joins an applicant after the first anniversary of the Closing Date (i.e. after a period of 12 months after Closing Date) will similarly be entitled to one unit once the employee has been employed for 12 consecutive months by an applicant. The unit will entitle a participating employee to a portion of the dividend distributions and to so-called milestone distributions and leaver distributions via the co-applicant.
- In all instances, a participant, on ceasing employment with an applicant, will forfeit the unit awarded to him or her for no value. Any such unit may be reallocated to a future participant or cancelled by the trustees in their sole discretion. The benefits to be derived by an employee are dependent on the employee remaining in employment, with the result that the workforce is incentivised to not only render exemplary services so as to positively impact the value of the trust shares for their benefit, but also to stay in the employ of an applicant to continue to render those services so as to maximise the benefits that may be derived by workers over time.

The proposed transaction will be achieved by way of the following transaction steps:

- The applicants will make cash contributions to the co-applicant. The value of the contributions will be determined with reference to the number of participating employees on the Closing Date employed by each applicant and who remained participating employees on that date.
- The co-applicant will use the proceeds of the contributions to acquire shares in Holdco.
- The trustees of the co-applicant will allocate units in the co-applicant to the participating employees.
- The co-applicant will seek appointment as a Foreign Withholding Trust (FWT) by the Revenue Service of Country X with the result that it will be liable to deduct and account for the applicable Dividends Withholding Tax (DWT) on dividends received by the co-applicant from Holdco for the benefit of participating employees.
- The co-applicant will assume the withholding and reporting obligations under Country X's tax laws for dividends paid to its beneficiaries. Such an arrangement would avoid all the participating employees from having to individually apply for the DWT relief. Instead, the co-applicant would undertake to withhold the applicable DWT and remit same to Country X's Revenue Service. In addition, the participating employees will not be required to submit any tax returns to Country X's Revenue Service.
- The co-applicant will receive the gross foreign dividends that vest in the participating employees and would pass on the net amount (foreign dividend less the DWT at the applicable reduced rate that will be withheld by the co-applicant and paid to Country X's Revenue Service) to the participating employees. The co-applicant will annually issue a certificate to participating employees certifying the amount of Holdco dividends derived by them and the amount of DWT accounted for by the trust on their behalf.

Conditions and assumptions

This binding class ruling is subject to the additional condition and assumption that the co-applicant be duly approved as a FWT by Country X's Revenue Service and successfully enter into a withholding tax agreement with the revenue service in respect of the DWT obligations.

Ruling

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

- The contributions to be made by the applicants to the co-applicant will constitute expenditure deductible under section 11(a) read with section 23(g), subject to the application of section 23H.
- The contributions to be received by the co-applicant will not constitute its gross income.
- The receipt of the contributions will not result in a gain or a loss under paragraph 3 for the co-applicant.
- The certificate to be issued by the co-applicant evidencing the DWT paid to Country X's Revenue Service on behalf of participating employees will suffice as evidence of the payment of the dividend withholding tax proved to be payable for purposes of section 6quat(1A)(1)(a).

10. GUIDES

10.1. Frequently Asked Questions – Insolvent Estates of Individuals (Income Tax)

The Frequently Asked Questions (FAQs) in this document have been compiled on the basis of questions that executors, trustees and the public at large have about the tax treatment of insolvent estates of individuals.

The FAQs are drafted purely to assist executors, trustees and the public at large to obtain clarity and to ensure consistency on certain practical and technical aspects relating to the insolvent estate of an individual. The FAQs are therefore not

intended to be used as legal reference. More information about some of the aspects discussed in this document are available in the Guide to the Individual Income Tax Return for Deceased and Insolvent Estates – External Guide and the Comprehensive Guide to Capital Gains Tax (Issue 9).

The FAQs are also intended to solicit further questions regarding the practical aspects and tax treatment of insolvent estates of individuals. The FAQs will therefore be updated periodically to address these questions, as well as any changes to the legislation.

10.2. Guide for Employers in respect of employees' tax (2023 tax year)

The purpose of this document is to assist employers in understanding their obligations relating to Employees' Tax, Skills Development Levy (SDL) and Unemployment Insurance Fund (UIF) contributions.

This basic guide is issued in terms of Paragraph 9(2) of the Fourth Schedule to the Income Tax Act.

This guide prescribes:

- the employees' tax deduction tables as contemplated in Paragraph 9(1) of the Fourth Schedule to the Income Tax Act; and
- the manner in which the tables must be applied by the employer

What is employees' tax?

- Where an employer pays or becomes liable to pay remuneration to an employee, the employer has an obligation to deduct or withhold employees' tax from the remuneration and pay the tax deducted or withheld to the South African Revenue Service (SARS) on a monthly basis. In most instances, the employer is obliged to issue each employee with an employees' tax certificate [IRP5/IT3 (a)] at the end of each tax period which reflects, amongst other details, the employees' tax deducted.

- These subjects are fully dealt with later in this guide. In addition thereto, the employer is obliged to submit an Employer Reconciliation Declaration (EMP501) to SARS.
- In terms of Paragraph 3 of the Fourth Schedule, employees' tax receives preference over any other deduction from the employee's remuneration which the employer has a right or is obliged to deduct otherwise than in terms of any law.
- Any reference to the start date and end date of a tax period is 1 March and 28/29 February. This guide will include the start and end dates of 2nd alternate period. An alternate period is normally determined at the option of the employer which may be exercised in relation to all employees or any class of employee. Where an employer adopts the so-called alternate period, any remuneration paid to an employee during such alternate period is regarded as having been paid to him/her during the corresponding tax year.

What is SDL?

This is a compulsory levy scheme for the purposes of funding education and training as envisaged in the Skills Development Act, 1998. This levy came into operation on 1 April 2000 and is payable by employers on a monthly basis.

What are UIF contributions?

This is a compulsory contribution to fund unemployment benefits. Since 1 April 2002, the contributions deducted and payable by employers on a monthly basis have been collected by SARS and are paid over to the UIF which is managed by the UI Commissioner.

Liability of representative employer?

The representative employer is not relieved from any liability, responsibility or duty of the employer and is therefore subject to the same duties, responsibilities and liabilities as the employer.

References to the Act?

Paragraphs of the Fourth and Seventh Schedules and Sections referred to in this publication are governed by the Income Tax Act. References to the Skills Development Levies Act (the SDL Act), Unemployment Insurance Contributions Act (the UIC Act) and Tax Administrative Act (the TA Act) are specifically indicated.

10.3. Guide for Employers in respect of fringe benefits

The purpose of this document is to assist employers in understanding their obligations relating to determining the cash equivalent of the value of a taxable fringe benefit as provided for in the Seventh Schedule to the Income Tax Act.

This basic guide explains the methods to be applied by employers in determining the taxable fringe benefit and includes the legislative requirements as well as examples.

10.4. Guide for Employers in respect of allowances (2023 tax year)

The purpose of this document is to assist employers in understanding their obligations relating to allowances paid or payable to their employees.

This basic guide explains the methods to be applied by the employers in respect of allowances paid or payable to employees and includes the legislation requirements as well as examples.

11. INDEMNITY

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