TAX UPDATE

For period: July 2022 to September 2022

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TABLE OF CONTENTS

1.	FOREWORD	4
2.	NOTICES / REGULATIONS	5
2.1.	Tables of interest	5
3.	TAX CASES	7
3.1.	Purveyors South Africa Mine Services (Pty) Ltd v C:SARS (84 SATC 215)	7
3.2.	ITC 1952 (Controlled Foreign Company)	14
3.3.	ITC 1953 (Manufacturing allowance)	22
3.4.	ITC 1954 (Public Benefit Organization)	30
3.5.	L'Avenir Wine Estate (Pty) Ltd v C:SARS (84 SATC 295)	33
3.6.	Mukuru Africa (Pty) Ltd v C:SARS (84 SATC 304)	37
3.7.	ITC 1955 (Unexplained receipts and deposits)	40
3.8.	ITC 1956 (Review application, procedural defective)	45
3.9.	ITC 1957 (VAT bad debts)	52
4.	INTERPRETATION NOTES	59
4.1.	Taxation of REITS and controlled companies – No. 97 (Issue 3)	59
4.2.	Concession or compromise of a debt – No. 91 (Issue 2)	62
4.3.	Public benefit activity: Bid to host or hosting of any international event – No. 122	68
4.4.	Exclusion of certain companies and shares from a 'group of companies' as defined in section 41(1) – No. 75 (Issue 4)	70
4.5.	Transfer Duty exemption: Public benefit organisations and institutions, boards or bodies – No. 75 (Issue 5)	71
4.6.	Effect on the date of issue of a share arising from a change in the redemption feature – No. 123	72
5.	DRAFT INTERPRETATION NOTES	73
5.1.	The VAT treatment of debt collection	73
5.2.	Section 18A: Audit certificate	76
6.	BINDING PRIVATE RULINGS	78
6.1.	BPR 375 – Unbundling of shares in a CFC	78
6.2.	BPR 376 – Corporate restructuring	79
6.3.	BPR 377 – Withholding of dividends tax at a reduced rate	84
6.4.	BPR 378 – Transfer of listed financial instruments to collective investment schemes in exchange for participatory interest	85
7.	BINDING CLASS RULINGS	88
7.1.	Tax implications for resident beneficiaries of a foreign pension trust – No. 80	88

7.2. Hybrid equity interest or third-party backed share – No. 81 93

8. GUIDES 95

8.1. VAT 404 – Guide fro Vendors (Issue 14) 95
8.2. Tax Exemption Guide for Public Benefit Organizations in South Africa (Issue 6) 102
8.3. Tax Exemption Guide for Companies Wholly Owned by Institutions, Boards or Bodies 103
8.4. Tax Exemption Guide for Institutions, Boards or Bodies 105
8.5. Tax Exemption Guide for Recreational Clubs (Issue 4) 106
8.6. Basic guide to Section 18A approval (Issue 4) 107
8.7. Foreign Donor Funded Projects – VAT reference guide (Issue 2) 108
8.8. Value-Added Tax levied on the importation of goods into South Africa – Customs & Excise 110

9. DRAFT GUIDES 112

9.1. Draft guide on the taxation of farming operations 112

10. INDEMNITY 113

1. FOREWORD

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

2. NOTICES / REGULATIONS

2.1. 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 November 2020	28 February 2022	7%
1 March 2022	30 April 2022	7,25%
1 May 2022	30 June 2022	7,50%
1 July 2022	31 August 2022	7,75%
1 September 2022	Until change in the Public Finance Management Act rate	8,25%

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	30 June 2022	3,50%

1 July 2022	31 August 2022	3,75%
1 September 2022	Until change in the Public Finance Management Act rate	4,25%

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

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

DATE FROM	DATE TO	RATE
1 August 2020	30 November 2021	4,50%
1 December 2021	31 January 2022	4,75%
1 February 2022	31 March 2022	5%
1 April 2022	31 May 2022	5,25%
1 June 2022	31 July 2022	5,75%
1 August 2022	30 September 2022	6,50%

1 October 2022	Until change in Repo rate	7,25%

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

3. TAX CASES

3.1. Purveyors South Africa Mine Services (Pty) Ltd v C:SARS (84 SATC 215)[1]

Purveyors South Africa Mine Services (Pty) Ltd (Purveyors), on 12 January 2015, had entered into a dry lease agreement with Freeport Minerals Corporation, a company incorporated and tax resident in the United States of America (Freeport) for the lease of an Embraer 135 LR Aircraft registered in the United States of America.

The dry lease agreement allowed Purveyors to operate air charter services for the benefit of Tenke Fungurume Mining SARL (Tenke), a non-resident company that owned and operated a mine located in the Democratic Republic of Congo (the DRC).

At the date of conclusion of the dry lease agreement, Freeport held 100% of the ordinary shares in Purveyors and 80% of the shares in Tenke.

Purveyors entered into an aircraft management agreement with Air Katanga, a company incorporated in the DRC, to provide air charter services for the benefit of Tenke. Based on the aircraft management agreement, Air Katanga served as manager of the aircraft and was engaged in the business of managing, operating and maintaining the aircraft.

1 Supreme Court of Appeal

Purveyors, on 19 January 2015, commenced with the provision of air charter services to Tenke under a usage agreement. The aircraft transported employees, sub-contractors, suppliers and business guests from Johannesburg to Lubumbashi and Kinshasa in the DRC generally three times a week. Whilst the aircraft was not in use, it was kept at a leased hangar at OR Tambo International Airport.

Purveyors, on 16 November 2016, had ceased to be a wholly owned subsidiary of Freeport by way of a disposal of its entire issued share capital by Freeport to CMOC DRC Limited, which was a company incorporated and tax registered in Hong Kong. A sister company of CMOC DRC subsequently assumed the initial dry lease agreement and a new dry lease agreement was concluded with Purveyors and all other agreements, including the usage agreement and the aircraft management remained in effect between Purveyors and Tenke and other service providers.

Purveyors, on 30 January 2017, requested, *via* e-mail, a meeting with SARS, 'to regularize the VAT that was supposed to be paid over.' In the e-mail Purveyors informed SARS that: 'We have just received a VAT technical opinion from PwC that we were supposed to pay the VAT over to SARS upon the import of the aircraft.' On 1 February 2017 SARS responded in an e-mail in which it was indicated that the aircraft was subject to penalty implications and SARS also requested to see documentation in terms of section 101 of the Customs and Excise Act.

On 29 March 2017 the SARS official concerned wrote to Purveyors explaining the reasons why VAT and penalties were payable and further indicated that Purveyors needed to appoint a clearing agent to assist it with an import permit to regularise its continued default.

Purveyors responded on the same day, indicating that it understood from the official's e-mail and from their telephone discussion that VAT output and customs duties were applicable, as well as fines and penalties.

On 30 March 2017 the SARS official responded in an email in which he sought to clear up any misunderstanding and indicated that there existed no waiver of

potential penalties and that if the tax payable to SARS was late, Purveyors would be liable to pay penalties and interest.

The SARS official, on 16 May 2017, sent a further e-mail to Purveyors indicating that it had to address the matter as he had allowed Purveyors sufficient time to regularise its tax affairs.

Purveyors then made a further request to PwC, its auditors, for an opinion as to whether it was liable to pay import VAT and this time PwC agreed with SARS that Purveyors was obliged to pay import VAT as well as penalties and interest and this was against the backdrop of PwC's earlier opinion, given in January 2017, advising Purveyors to honour its tax obligation in relation to its historical tax liability.

Purveyors took no further steps to regularise its liability for VAT and penalties for nearly a year, until 4 April 2018 when it applied for voluntary disclosure relief in terms of section 226 of the Tax Administration Act 28 of 2011.

SARS, relying on section 227 of the Act, rejected Purveyors's application on the grounds that it was not voluntary and did not contain the facts of which SARS was unaware as those facts had already been disclosed to it prior to the voluntary disclosure application.

Purveyors then appealed unsuccessfully to the High Court (see *Purveyors South Africa Mine Services (Pty) Ltd* v *C: SARS* 83 SATC 176 *per* Fabricius J) where it was found that if there was an element of compulsion underpinning a particular act, it was no longer done voluntarily and in the context of Part B of Chapter 16 of the Tax Administration Act, a disclosure is not made voluntarily where an application has been made after the taxpayer had been warned that it would be liable for penalties and interest owing from its mentioned default.

Purveyors then appealed to the Supreme Court of Appeal with the leave of the High Court.

The primary issue in this appeal was whether SARS was correct in rejecting Purveyors's voluntary disclosure application for non-compliance with section 227 of the Act, more specifically on the ground that it was not made voluntarily and the issue therefore resolved itself into this: did the exchange or discussions between

the representatives of SARS and the officials of Purveyors have any material bearing on the application?

Purveyors contended that the prior information disclosed to SARS in the process of ascertaining its tax liability was irrelevant and should not preclude it from making a valid voluntary disclosure application as the exchanges had no formal or binding effect on the views expressed by it.

Purveyors essentially contended that its application must not be considered at the historical point but crucially at the time when the application was made. In other words, prior knowledge disclosed by it was no bar to a valid voluntary disclosure application and did not affect the validity and voluntariness of the application.

Purveyors further contended, as regards the interpretation of the word 'disclosure' in the section of the Act, that there was no requirement that disclosure ought to be new or something of which SARS had not been previously aware.

SARS contended that Purveyors's application did not comply with the requirements of section 227 of the Act because, on a proper construction of section 227, Purveyors did not disclose information or facts of which SARS was unaware and it submitted that the application was not voluntary as Purveyors had been prompted by SARS and in essence the application had been brought because Purveyors had been warned that it would be liable for penalties and interest arising from its failure to have paid the relevant tax.

SARS further contended that the Customs officials had already gained knowledge of the default and had advised Purveyors on 1 February 2017 that the aircraft should be declared in South Africa and VAT paid thereon and hence Purveyors had been prompted by the actions of SARS to submit the application.

Judge Mathopo held the following:

(i) That what was implicated in this appeal was a proper interpretation of section 227 of the Act and the first and perhaps the most important question to consider was the approach to be adopted by the court in construing the section. There were *dicta* in many judgments which were open to the construction that, construing tax legislation should be regarded

as a respectable contest between the *fiscus* and the taxpayer concerned. At the same time, careful consideration should be given to the language of the section to ascertain its purpose and avoid a superficial assessment of the facts. One must read the words used in the section in their context, with regard to the apparent purpose of the section. We should bear in mind that there is no particular mystic about tax law and ordinary legal principles and terms are involved.

(ii) That the starting point to notice about the section is that it relates to 'voluntary disclosure.' Each of these words is of wide and general import. Cardinal among words to which meaning ought to be given is 'voluntary.' According to the *Shorter Oxford English Dictionary on Historical Principles* the word 'voluntary' means: 'performed or done of one's own free will, impulse or choice; not constrained, prompted, or suggested by another.' Disclosure means 'to open up to the knowledge of others, to reveal.'

(iii) That the words 'voluntary' and 'disclosure' in section 227 require that the voluntary disclosure application must measure up fully to the requirements of the section. This appears from the textual interpretation of the section and it was clear that the *onus* rested on the taxpayer to establish, on a balance of probabilities, that it had fully met the requirements of the section.

(iv) That the language used in the section clearly indicated the legislature's intention to arm SARS with extensive powers to prevent taxpayers from disclosures which are neither voluntary nor complete in all material respects. The fact that the section provides that the disclosure application must be made in the prescribed form or manner rather than obtaining *ad hoc* advice from SARS was a clear indication that the mischief sought to be prevented is one where a taxpayer discloses information to SARS and later on makes a voluntary disclosure application. The purpose of the application is designed to ensure that errant taxpayers who are not compliant must come clean, out of their own volition and without any prompting, to make amends in respect of their defaults by informing SARS.

(iv) That no purpose would be served if the Tax Administration Act enabled errant taxpayers to obtain informal advice and when it did not suit them, to then apply for voluntary disclosure relief. Whether a voluntary disclosure has been prompted by a compliance action is a question of fact to be determined by examining the circumstances in which it was made.

(v) That, applied to the present case, the facts show that from the outset – and well before the submission of its VDP application – Purveyors knew that it was liable for the import VAT on the aircraft and penalties, which were not going to be waived and that much was plain from the e-mail sent by Purveyors to SARS on 29 March 2017. This e-mail made three things clear: First, the VDP application by Purveyors was prompted by compliance action on the part of SARS which was aware of the default following interactions between the parties. Second, Purveyors itself appreciated that it was liable for fines and penalties which had to be paid before it would be tax-compliant. Third, the VDP application was not motivated by any desire to come clean, but rather to avoid the payment of fines and penalties.

(vi) That the disclosure of Purveyors to SARS was not in the context of a voluntary disclosure relief application. It is unconscionable to treat a disclosure by a taxpayer to SARS any different. This especially so where SARS had warned the taxpayer about the implications of its tax obligation and Purveyors wanted the court to disregard the discussions and interactions that it had with SARS officials.

(vii) That it was difficult to understand on what conceivable basis a taxpayer can obtain a voluntary disclosure relief in circumstances where SARS had prior knowledge of the default, regardless of the source of such prior knowledge, and had in addition, warned the taxpayer of the consequences of its default. To grant relief in these circumstances would be at odds with the purposes of the Voluntary Disclosure Programme – to enhance voluntary compliance with the tax system by enabling errant taxpayers to disclose defaults of which SARS is unaware, and to ensure the best use of SARS' resources.

(viii) That the court endorsed the opinion that the application must comply with the provisions of the section in all material respects. Moreover, the taxpayer

must take SARS into their confidence and voluntarily make a proper and frank disclosure which is neither prompted nor made as a result of any fear or compulsion. SARS must undoubtedly not be aware of the default. The architecture of the section is such that it is designed, by the use of wide and comprehensive language, to dispel any doubt as to what is required of a taxpayer. The section is not a penalty section.

(ix) That a sensible interpretation of the voluntary disclosure provisions, their context and purpose showed that the drafters of the provisions clearly had in mind that a taxpayer who elects to inform SARS of its default runs the risk that any subsequent disclosure might not be treated as being voluntary. Moreover, there was no room for Purveyors's submission that the section must be construed as excluding any prior knowledge on the part of SARS. Clearly it was not the intention of the legislature to reward involuntary conduct with exemptions conferred by the section.

(x) That, accordingly, upon a true analysis of the facts of the present case, Purveyors's application does not pass the test. The application was not voluntarily made. The Applicant, in its application, did not disclose information of which SARS was unaware. The submission that the application should be treated as if no exchanges, approaches or contact was made with SARS representatives was without merit. To construe section 227 in the way for which Purveyors contended would defeat the purpose of the section and produce an anomalous result.

(xi) That Purveyors had attempted one further argument, namely that SARS had not given notice of an audit or investigation as contemplated in section 226(2) of the Act and hence the decision by SARS fell to be reviewed and set aside but this contention was misconceived as it was under section 227, not section 226, that SARS had correctly rejected the application.

(xii) That the court agreed with the High Court that the application by Purveyors was not voluntary and did not meet the requirements of section 227 because SARS knew of its default and warned that it would be liable for VAT plus penalties and interest and nothing new was disclosed in the application and hence the appeal must fail.

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

3.2. *ITC 1952 (Controlled Foreign Company)*

The taxpayer was a company incorporated and registered in South Africa and was a South African taxpayer.

The taxpayer was one company in a large corporate structure and conducted business in the realm of financial investment.

The taxpayer, through ownership of the shares in an interlinked company, controlled AB with the prescribed participation rights and AB was a controlled foreign company ('CFC') in accordance with the Income Tax Act.

The taxpayer's business was that it had customers who gave it their money and which the taxpayer in turn used for the purpose of generating income for its clients. Its source of income for this service consisted primarily of fees which were based from time to time on the *quantum* of assets under management. In other words it acted as a vehicle or broker to identify opportunities where funds of its clients could be invested for profit.

The opportunities available to an investment company such as the taxpayer took various forms such as acquiring assets including immovable property, bank deposits, share or stock purchases, and a variety of other investment schemes and these were described as the assets under management and could be described as the company's investment products.

The taxpayer's controlling minds considered various options to provide more opportunities for its South African investors to invest abroad and the Republic of Ireland provided advantages for the creation of an infrastructure which the taxpayer could utilise to set up the opportunities it was seeking for its South African investors in both Europe and the United Kingdom and it identified Irish domiciled collective investment funds as an ideal opportunity for South African investors.

The taxpayer, to achieve this objective, arranged for a management company to be incorporated and licenced in Ireland in accordance with its laws and hence AB was

set up in Ireland in order to provide South African investors with the opportunity to invest in an ICIS, being an Irish collective investment scheme.

AB's offices were located outside of South Africa in Dublin in the Republic of Ireland and at all relevant times AB was registered with the Irish Financial Services Regulatory Authority for authorisation to manage and carry on collective investment schemes.

AB had employed four persons who worked on site to carry out the activities of the company at the offices in Dublin and these activities were directed at complying with the requirements to maintain the licence to operate. This was of a supervisory nature and the four employees were the managing director, two accountants and a compliance officer. There was also a Board of Directors who met quarterly and set the strategies and made policy decisions for the company. At the relevant times there were four directors, one of which was a member of the office staff.

AB had elected the choice of an outsource business model and it proceeded to outsource the investment management of the funds entrusted to it to an investment company registered in the United Kingdom and the administration was delegated to two companies registered in the Republic of Ireland and AB retained the function of management. The distribution function was delegated to the taxpayer in South Africa and the United Kingdom fund manager. The custody of records was delegated to a company registered in Ireland.

The taxpayer appealed to the Cape Town Tax Court against a decision of the SARS to include the net income of AB, a company incorporated and registered in the Republic of Ireland, in the determination of the tax payable by the taxpayer in South Africa.

When the taxpayer had submitted its income tax returns for the 2012 year of assessment, it had excluded the net income of AB from its taxable income and this was consistent with its returns for 2011 and subsequent returns for the 2013 year.

SARS, in April 2015, had conducted an audit of the taxpayer for the three years being 2011, 2012 and 2013 and the audit had been triggered by the 2012 tax return.

SARS thereafter had issued an automatic assessment and thereafter this assessment was manually reviewed and an audit and additional assessment was issued which imposed a very substantial additional sum of tax.

The taxpayer took issue with the aforesaid assessment which resulted in the present appeal to the Tax Court.

The taxpayer contended that it was entitled to exclude from its income the net income of AB on the ground that such income was subject to the foreign business establishment exemption granted in terms of section 9D(9)(*b*) of the Income Tax Act.

SARS, however, contended that in terms of section 9D of the Act the net income of AB had to be included in or attributed to the taxpayer's income for purposes of taxation and hence in its additional assessment had included such income as taxable income and thereby refuted the taxpayer's contention that it was exempt income on the ground that AB's business did not meet the requirements of the term 'foreign business establishment' in section 9D(1) of the Act.

SARS further contended that fund management was not the primary operation of AB's business and that the delegated activities, in particular investment management, which was not conducted in Dublin, comprised the primary activities of AB and therefore the AB office in Dublin did not satisfy the second, third and fourth requirements as envisaged in section 9D(1) of the Act.

At issue in the determination of this appeal was whether section 9D(9)(b) was applicable or not and to make that determination it was necessary for the court to decide whether the business conducted by AB satisfied the requirements of the definition of the term 'foreign business establishment' in section 9D(1) of the Income Tax Act.

Judge Hack held the following:

(i) That to determine whether the taxpayer was not liable to pay the additional tax, as it averred, it must prove that the net income of AB is excluded because AB is a foreign business establishment. To determine whether AB is a foreign business establishment the court must be satisfied that it

complied with all of five requirements set out in section 9D(1) of the Act. Not necessarily in this order, firstly, its fixed place of business is located outside the Republic of South Africa. Secondly, that the place of business is conducted in a physical structure. Thirdly, that the place of business is suitably staffed. Fourthly, that this place is suitably equipped to conduct the business. Similarly, and fourthly, that this place has suitable facilities to conduct the purpose. Fifthly and clearly the most important, that it is located outside the country not for the purpose of postponing or reducing tax imposed in South Africa. The fifth requirement is to a degree dependant on the proof of the second to fourth requirements, being factors the legislature has identified as relevant. The fifth requirement goes to the motive or intention and this requires an analysis and assessment of the other requirements.

(ii) That the taxpayer was required to prove its case on a balance of probabilities, as required by section 102(1) of the Tax Administration Act.

(iii) That it was not in dispute that AB's fixed place of business was located outside South Africa in Dublin in the Republic of Ireland.

(iv) That what was in dispute was whether the taxpayer had proven whether it was the primary operations of the business of AB which were conducted at its office in Dublin, Republic of Ireland. The words 'primary operations' are contained in each of requirements two, three and four in section 9D. In addition, the parties dispute whether there had been compliance with the fifth requirement regarding the purpose or motive for which AB was set up, as set out in the fifth requirement.

(iv) That the evidence was that the functions that were performed in the Dublin office were the conduct of maintaining the licence, making policy decisions and oversight of the entire operations of the company. The court would consider the question whether those activities consisted of the primary function of AB as required in the Act.

(v) That the second requirement that the fixed place of business was suitably staffed with on-site managerial and operational employees of that controlled

foreign company contained the further words in dispute, who conduct the primary operations of that business. The evidence was that for most of the relevant time four persons were employed by AB and worked on site to carry out the activities of the company at the offices in Dublin. In summary the activities were directed at complying with the requirements to maintain the licence. This was of a supervisory nature. In so far as the court found that the primary operations of the business were fund management it was satisfied that this office was suitably staffed.

(vi) That the third requirement that the fixed place of business was suitably equipped, contained the further words in dispute, for conducting the primary operations of that business. The court was satisfied that the uncontroverted evidence was that the premises were suitably equipped with office furniture, computers and accessories for the staff to perform their functions at the Dublin office.

(vii) That the fourth requirement that the fixed place of business had suitable facilities contained the further words in dispute, for conducting the primary operations of that business. Comprehensive and detailed evidence was led that the offices had all the normal facilities, power, water, internet and telephone connections for the staff to perform their functions at the Dublin office.

(ix) That the fifth requirement was that the fixed place of business was located outside South Africa solely or mainly for a purpose other than the postponement or reduction of any tax imposed by any sphere of government in South Africa. The taxpayer stated that no South African tax considerations had influenced the decision to set up AB in Ireland and the decision was taken purely on business considerations and tax was not a consideration. The court found it to be proven that there was no motive to gain any tax advantage by setting up AB.

(x) That, in regard to whether the primary business of AB was conducted at the premises in Dublin, it was common cause that when AB sought to obtain its licence, it had two options. It elected the choice of an outsource business

model. This has remained the position at all times. Having made the election, it was bound to it. Should it wish to change the model it needed to submit a new application for a licence and provide proof that it had acquired the necessary resources and manpower to perform the previously outsourced functions in Dublin. This did not occur at any stage and it proceeded to outsource four functions of its business.

(xi) That, according to the evidence, which the court accepted, investment management concerned the professional use of clients' (investors') money in terms of the specific schemes, mandates and limits. This was also referred to in the evidence as investment management trading activities. This is the day-to-day use of the money or what was called stock picking, selecting which stocks to buy or sell on a stock exchange. The taxpayer correctly submits that the actual discretionary decisions of investment managers play a relatively minor role in the overall picture of fund management.

(xii) That there was no dispute regarding the further outsourced functions of Administration, Custody and Distribution. They are all incidental or ancillary functions and nothing further needs to be said in that regard. As stated, AB retains the fund management function. According to the evidence this comprises the maintenance of its fund management licence, taking responsibility and doing or ensuring that all things necessary are done to comply with the regulations imposed by the Central Bank of Ireland. Furthermore, to ensure compliance with all the contractual obligations imposed on it as contained in the contracts with the investors. Finally, to supervise or oversee the work being performed by external service providers in terms of their contractual obligations to it and where necessary to take corrective measures in the event of failures or non-compliance.

(xiii) That in the court's view the correct terminology applicable was the distinction between fund management and investment management. While investment management is clearly an important function and should the important functions all be labelled as primary then investment management

was one of the primary functions. However, the Act clearly used the word 'primary' to refer to the single most important function which was supported by further ancillary functions.

(xiv) That the court was satisfied on the evidence before it that the numerous activities performed in Dublin were directed to maintaining the licence and managing the company's ability to offer the opportunity to invest in ICIS. Those activities are properly described as Fund Management. That is something completely different to the day-to-day process of managing the actual investments. Only as long as the licence is maintained can the taxpayer offer the investment opportunities in ICIS. The other functions are all dependent on this. This is the primary function of AB and this is carried out by the staff and infrastructure in Dublin, Republic of Ireland. The day-to-day decisions of where the money should be invested, in other words, for example, the decision to buy or sell stock, is the function of investment management, which is a subsidiary function and that can and is performed elsewhere.

(xv) That the fee income of AB was based on the *quantum* of assets under management. The evidence was that the fee was based on the capital contributed by the investors which occurred before any investment management took place. Fees are received as a result of the creation and managing of a fund. Investors' money comprised the assets under management and the fees were not based on the profitability of the investments carried out by each individual person playing a role in the process of investment managing. It was correct that investment performance did have some impact on the *quantum* of the fee but while investment performance is an important part of the overall fund management business, its relative contribution to the funds management fee was limited. It was the confidence that investors placed in the fund manager *per se* in placing their assets with the fund manager that gave rise to the fee, rather than the investment management activity and this was the correct conclusion to be drawn from the evidence.

(xvi) That in the court's view the determination of this matter was founded upon the distinction between the concepts of a fund management company – which described AB and the concept, investment management, which is one of the functions of a fund management company. AB is not an investment management company, it is a Fund Management company – it is a licenced fund management company and the licence states that it is licenced to conduct collective portfolio management. One of the functions that are carried out by a fund management company is investment management and in this instance that function is outsourced on contract to others.

(xvii) That in the court's view this matter did not require any detailed interpretation of the provisions of the Act. It required the application of the facts to the applicable legislation. While section 9 of the Act was lengthy with numerous subsections that required a thorough read to follow and understand. But the relevant portions applicable to this matter were clear, unambiguous and could be applied to the facts. The parties differ as to what is the primary operation of AB and so only those two words are at issue. They are not vague nor are there contradictory ways that they could be interpreted. The court must determine from the facts what constituted the primary function of AB and then it is a simple matter of fact if that was conducted in Dublin.

(xviii) That the court was therefore satisfied that management performed by AB was the primary operation of the business of AB.

(xix) That, in regard to the fifth requirement in the definition of 'foreign business establishment' in section 9D(1) of the Act, namely that the purpose of creating and operating AB was not for the purpose of avoiding tax, the court was satisfied that the reason why the taxpayer had acquired an interest in AB was to create opportunities (products/ICS) for its clients or investors which it could not provide in South Africa. To use the words of *Silke*, cited above, it was not conduct that amounted to housing the activities in the foreign company to avoid tax in the home country on the income they

produce. It cannot be said that AB was 'illusory or non-substantive business undertakings' as stated in Olivier and Honiball International Tax: A South African Perspective at p 581. The court was satisfied that AB 'has economic substance and does not merely exist on paper'; the terminology used by the authors at p 582. The court was also satisfied that the taxpayer had proven that it was not motivated by any desire to avoid paying tax in South Africa by the creation of AB.

(xx) That, accordingly, the court was satisfied that the taxpayer had successfully proven that it was entitled to the Foreign Business Establishment exemption provided for in section 9D(9)(*b*) of the Income Tax Act and that it complied with all the requirements set out in section 9(1) of the Act.

Appeal upheld.

The additional assessment for the 2012 year of assessment was set aside.

3.3. ITC 1953 (Manufacturing allowance)

The taxpayer was a waste management company that had claimed allowances in its 2015 and 2016 years of assessment in terms of section 12C(1)(*a*) of the Income Tax Act (ITA) for 'machinery or plant' in respect of the construction of its landfill cells, allegedly used directly in the process of manufacture (40% in the first year and 20% per year thereafter) and had also claimed section 24C allowances for future expenditure in respect of amounts included in its deduction calculations in terms of the above provisions of the ITA as 'unwinding effect charged to interest', namely R11 594 000 for 2015 and R12 661 000 for 2016.

Section 12C of the ITA provides for a deduction in respect of assets used by manufacturers 'in respect of any machinery or plant … owned by the taxpayer…and…used by the taxpayer directly in a process of manufacture carried on by the taxpayer or any other process carried on by the taxpayer which is of a similar nature;'

Section 12C(1)(*a*) thus applied to machinery or plant used directly in the process of manufacture or a process of a similar nature.

The dispute in this case was whether the taxpayer's landfill cells were used directly in a process of manufacture, or, as SARS contended, they were used in a process (the storage of waste) that was ancillary to a process that was similar to a process of manufacture, namely the treatment of leachate and the production of 'treated leachate.'

Only if it was found that, as the taxpayer submitted, its cells were used directly in a process of manufacture, was it necessary to consider the second leg of the enquiry, namely whether the cells constituted 'plant' or 'structures', since section 13 of the ITA dealt with allowances claimable in respect of buildings (or permanent structures) used in a process of manufacture.

The taxpayer had claimed section 12C allowances of R30 848 537.63 for 2015 and R29 733 577.36 for 2016 and the dispute between the parties pertained to these amounts.

SARS had undertaken an audit of the taxpayer in respect of its 2015 and 2016 years of assessment and, in additional assessments, had disallowed the taxpayer's claimed allowances in terms of section 12C(1)(*a*) i.e. 40–20%, and instead contended that it was limited to an allowance of 5% per year as contemplated in section 37B(2)(b) as read with section 13 of the ITA.

SARS contended that the 'treatment' of the waste once it had reached the cells (in which, it was common cause, the waste was stored in perpetuity) was not a process of manufacture. Put differently, it was SARS' case that the storage of the waste was ancillary to the treatment of the leachate process as the taxpayer did not manufacture leachate (which was an unwanted by-product) and the cells were, in fact, designed to minimise the forming of leachate.

The taxpayer contended that the process of waste treatment involved an end-product, namely material safe for the environment, that differed substantially from the material received by it from its customers, which was unsafe for the environment. This principal activity was the process of manufacture carried out by

the taxpayer and differed significantly from 'mere storage.' It was further contended that part of the leachate 'process' of its waste treatment also occurred in the cells constructed by it for use in its business.

The second issue for determination by the court was whether the taxpayer was entitled to the section 24C allowances claimed by the taxpayer for future expenditure in respect of the 2015 and 2016 years of assessment in respect of amounts included in its deduction calculations as 'unwinding effect charged to interest'. It was common cause that these were included in the total deduction claimed for future expenditure in respect of the treatment of leachate, rehabilitation capping costs and post-closure rehabilitation of the landfill cells in terms of section 24C of the ITA.

The third issue for determination by the court was whether SARS was entitled to levy certain understatement penalties (USPs) on the ground of 'reasonable care not taken in completing return' in a 'standard case' as provided for in sections 221–223 of the Tax Administration Act in respect of (*a*) the admitted understatement by the taxpayer of its interest income for the 2016 year of assessment by R25 910 000 and (*b*) the alleged understatement by the taxpayer of its taxable income for the 2015 and 2016 years by incorrectly claiming the section 24C allowances referred to above.

SARS imposed a USP of 25% on each of (*a*) and (*b*) above, but during closing argument SARS conceded that, in respect of (*a*), the appropriate penalty to have been levied was 15%, given that the taxpayer made voluntary disclosure after notification of commencement of the SARS audit.

The taxpayer contended that SARS should not have levied any penalty at all, maintaining that the 'understatements' were the result of a *bona fide* inadvertent error.

It was common cause that if the taxpayer succeeded on the section 24C issue, the USP levied in respect thereof had to be set aside as a consequence.

The USP imposed in respect of the section 24C allowances claimed was set aside by the court as it was common cause that if the taxpayer succeeded on the section 24C issue, the attendant USP must fall away.

The court thus only considered the revised USP of 15% levied in respect of the admitted understatement by the taxpayer of its interest income for the 2016 year of assessment and this in turn involved a consideration of whether it was a result of 'reasonable care not taken in completing return' or had occurred as a result of a '*bona fide* inadvertent error.'

SARS accepted that the taxpayer did not act intentionally or in a grossly negligent manner in making the understatement, but it contended that, given *inter alia* the materiality of the amount, that the taxpayer had failed to exercise reasonable care in doing so.

The taxpayer contended that the omission of the interest of R25 910 000 was due to an error which was subsequently identified during the audit of the 2017 financial year that occurred after the 2016 return had been submitted and it was not aware of the error when completing its tax return for the 2016 tax period.

Judge Cloete held the following:

As to whether the taxpayer was entitled to the section 12C allowance

(i) That the taxpayer bore the burden of proof in terms of section 102(1) of the Tax Administration Act, save for the issue in relation to the USP's where the burden of proof was on SARS in terms of section 102(2) of the Act.

(ii) That the taxpayer's evidence thus established that the principal activity of the constructed cells was the final disposal of the waste streams and by-products such as leachate. As far as the positioning of the bunkers above the cells was concerned, there was no evidence that this was a requirement of the taxpayer's licence to operate so as to ensure compliance with the host of environmental laws and the like which governed its operations.

(iii) That in the present case the evidence showed that the cells constructed by the taxpayer did not, on their own, cause the waste body and by-products

to become essentially different. Rather, they had become essentially different before they were finally disposed of in the cells.

(iv) That in the present case the evidence established that the cells were used by the taxpayer to store the already 'manufactured' products, as opposed, for example, to any deductions claimed in respect of its micro-encapsulation plant or bunkers. In the present case the evidence showed that the cells did not drastically change the waste body and by-products once they were stored, whether in terms of utility or value, but rather the contrary.

(iv) That the cells themselves were the result, as opposed to the process, of 'manufacture' and the subject matter of the present case was thus distinguishable from the facts in Formscaff Investments (Pty) Ltd v CIR 55 SATC 251.

(v) That the court accepted that the cells themselves were constructed through various processes, but that was not what this case was about. It is rather whether the constructed cells were used directly in the 'process of manufacture' of the taxpayer, namely the conversion of hazardous waste into waste that is safe for the environment. The court also accepted that the final product had to be stored somewhere. What the court did not accept was that the final destination of the treated waste body and leachate, i.e. the cells, equated to the cells being used directly in that process of manufacture.

(vi) That the court concluded that SARS was correct that the cells were used in a process (the storage of waste) that was ancillary to a process that was similar to a process of manufacture, namely, the treatment of leachate and the production of 'treated leachate.'

(vii) That decisions of the Tax Court have no value as precedent. However, given the amounts involved and the importance of the issue to the parties, there was every prospect that this judgment will be appealed. It was accordingly nonetheless necessary to deal briefly with the 'plant' versus 'structures' debate since it had been stated by the Constitutional Court

in Spilhaus Property Holdings (Pty) Ltd and Others v Mobile Telephone Networks (Pty) Ltd and Another 2019 (4) SA 406 (CC) at par. 44 that it was desirable, where possible, for a lower court to decide all issues raised in a matter before it and that litigants were entitled to a decision on all issues raised, especially where they have an option of appealing further and the court to which an appeal lies also benefits from the reasoning on all issues.

(ix) That there was no dispute that once a cell is filled it is capped, closed and exists in perpetuity. The dispute was whether the cells constituted plant qualifying as an 'environmental treatment and recycling asset' or structures qualifying as an 'environmental waste disposal asset.'

(x) That there could be little doubt that the taxpayer's cells were structures which were permanent in nature. Moreover, they were in reality no different to a combination of a dump and a reservoir. 'Plant', on the other hand, denoted something that had a measure of durability and was used in the carrying on, or promotion of, the taxpayer's trade, even if ancillary thereto.

(xi) That upon application of the 'functional test', applied by the Appellate Division in Blue Circle Cement Ltd v CIR 46 SATC 21, the cells were not used to 'carry on or promote the taxpayer's business'. Moreover, they could not be re-used once filled, capped, closed and rehabilitated. They did not constitute 'plant', but were 'structures' which met the characteristics of a 'dump' and/or 'reservoir' and, as such, qualified as 'environmental waste disposal assets' and hence SARS was correct on this score as well.

As to whether the section 24 C allowance was of application

(xii) That this dispute only pertained to amounts included in the taxpayer's deduction calculations as 'unwinding effect charged to interest.' It was common cause that these were included in the total deduction claimed for future expenditure in respect of the treatment of leachate, rehabilitation capping costs and post-closure rehabilitation of the landfill cells in terms of section 24C of the ITA.

(xiii) That SARS had requested a detailed analysis of the amounts claimed under 'unwinding effect charged to interest' and in its response the taxpayer had explained that it was required in terms of International Financial Reporting Standards (IFRS) to adjust all provisions, contingent liabilities and contingent assets to reflect their present day values so as to take into account the time value of money.

(xiv) That SARS had refused to allow the deductions on two grounds: (a) the adjustment of the face value of future expenses to present day values, cannot qualify as a deduction under section 24C as they were finance costs (b) the taxpayer had not discharged the onus of proving the quantification of the relevant amounts.

(xv) That, ultimately, there was no dispute that the allowances claimed were not finance costs, and that the taxpayer had discharged the onus of proving the section 24C requirements.

(xvi) That, taking all the considerations into account, the court concluded that it would be placing form over substance, and pandering to artificiality, to find that the taxpayer had failed to discharge its onus and it followed that the taxpayer's appeal succeeded on this issue.

<u>As to whether SARS was entitled to impose understatement penalties</u>

(xvii) That it was only necessary to consider the revised USP of 15% levied in respect of the admitted understatement by the taxpayer of its interest income for the 2016 year of assessment by R25 910 000 and this in turn involved a consideration of whether it was a result of 'reasonable care not taken in completing return' or had occurred as a result of 'a *bona fide* inadvertent error.'

(xviii) That SARS had accepted that the taxpayer did not act intentionally or in a grossly negligent manner in making the understatement, but it contended that, given *inter alia*, the materiality of the amount, the taxpayer had failed to exercise reasonable care in doing so. The taxpayer contended that where a taxpayer claims a deduction or allowance in the *bona fide* belief

that it was correctly deductible for income tax purposes, this was a classic example of an error that was inadvertent.

(xix) That the court was mindful that it exercised an original discretion in considering whether to confirm or reduce or increase a USP and in its view SARS was correct in reaching the conclusion that a USP penalty was payable by the taxpayer for four reasons:

(xx) That, first, it was the taxpayer's own management which took a decision to reduce the loan payable by reducing the interest that accrued on the loan and, accordingly, this decision was not based on outside professional advice. Second, the taxpayer was a large company which employed its own tax manager, being a chartered accountant, for the purpose *inter alia* of ensuring that its returns to SARS were accurate. Third, the tax manager should reasonably have realised that the sizeable sum of almost R26 million which came about as a consequence of that management decision needed to be treated with reasonable care and caution. Fourth, SARS picked up the error because, as was the undisputed testimony of its official, it was a glaring one.

(xxi) That in these circumstances it was not necessary to delve into those decisions of the Tax Court which have sought to grapple with the meaning of 'inadvertent.' The fact of the matter was that, on the evidence before the court, the taxpayer had failed to exercise reasonable care in completing its return. Moreover, it was open to the taxpayer to have adduced the evidence of the tax manager concerned in rebuttal of the SARS' official's testimony but it did not do so and it was not for the court to speculate on what had informed the tax manager's decision to treat the understated income in the tax return in the manner in which he or she did and it followed that SARS had discharged its onus on this aspect and had correctly imposed an understatement penalty of 15% in respect of the understatement of its interest income by the taxpayer in the 2016 year of assessment.

(xxii) That in terms of section 130(1) of the Tax Administration Act a Tax Court may make an order for costs in favour of a party if (a) the SARS' grounds of

assessment or 'decision' or (b) the taxpayer's grounds of appeal, are held to be unreasonable. The court, in the exercise of its discretion, did not believe that any costs order was warranted in the particular circumstances of this matter as neither party could fairly be found to have acted unreasonably.

3.4. ITC 1954 (Public Benefit Organization)

The taxpayer, being a Trust, had applied on 11 September 2018 for approval as a PBO for exemption from income tax retrospectively from 1 February 2016 in terms of section 30(3B) of the Income Tax Act.

SARS had declined to grant retrospective status to the taxpayer from 1 February 2016 for the following reasons:

- the taxpayer did not conduct any public benefit activities (PBAs) since its establishment and accordingly did not qualify for tax exemption status prior to 26 June 2018;
- the taxpayer's trust deed did not comply with all the requirements set out in section 30 of the Income Tax Act;
- the taxpayer was not compliant as its compliance history showed that the 2017 to 2019 income tax returns were outstanding as at 1 March 2020.

The Tax Court invoked Rule 33(4) of the Uniform Rules of Court which provided that if, in any pending action, it appeared to the court that there was a question of law or fact which may conveniently be decided either before any evidence is led or separately from any other question, the court may make an order directing the disposal of such question in such manner as it may deem fit and may order that all further proceedings be stayed until such question has been disposed of.

The Tax Court then dealt firstly with the point of law concerning the interpretation of section 30(3B) as it was convenient and appropriate that the question of law concerning the interpretation of the impugned section be separated from the factual considerations.

Section 30(3B) provided at the relevant time:

> 'Where an organisation applies for approval, the Commissioner may approve that organisation for the purposes of this section with retrospective effect, to the extent that the Commissioner is satisfied that that organisation during the period prior to its application complied with the requirements of a 'public benefit organisation' as defined in subsection (1).'

SARS contended that section 30(3B) was unambiguous and its plain natural interpretation provided SARS with the discretion to approve an organisation as a public benefit organisation with retrospective effect and that it would be absurd to argue that SARS should not enquire whether there was compliance with the requirements set out in section 30(3B) of the Act and key thereto was whether the Trust Deed complied with the requirements and whether the taxpayer was tax compliant.

Judge Mali held the following:

(i) That, following the decision in Natal Joint Municipal Pension Fund v Endumeni Municipality 2012 (4) SA 593 (SCA), legislative interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence.

(ii) That in this matter one was grappling with two clear words, being 'restrospective' and 'approval'. Nevertheless, the context where the words appear need to be meticulously examined. The context needs to be approached as to the extent that SARS should be satisfied that the organisation, during the period prior to its application, complied with the requirements of a 'public benefit organisation' as defined in section 30(1) of the Act.

(iii) That, furthermore, the purpose of the provisions of section 30(3B) of the Act was to empower SARS to grant the qualifying PBO retrospective status and

the statute made it clear that SARS needs to be satisfied that the applicant met the requirements of section 30(1), nothing less and nothing more.

(iv) That the efforts to advance the aims of section 30(3B) were well expounded in the Explanatory Memorandum to the Taxation Laws Amendment Act 17 of 2009 where it was stated that many PBOs and clubs applying for exemption did so after several years of activity and failure to seek prompt approval then kept the relevant parties from subsequently seeking relief on a going forward basis because of concerns about the potential tax liability from pre-existing activities. It was then proposed that if a PBO or recreational club applied for tax exempt status, SARS should be given discretionary powers to retroactively approve tax exemption status and in order to obtain this relief, SARS must be satisfied that the relevant PBO or club was substantially within its given status in terms of existing law.

(iv) That SARS' contention that the taxpayer's Trust Deed did not comply with the requirements of section 30(1) of the Act and that it was not tax compliant were factors that could be taken into consideration when reviewing its application for retrospective approval was rejected by the court. It was not open for SARS to write its own desired sections within the setting of section 30(3B) of the Act. SARS' wide discretion could not be translated to him reading in sections or the law or what he thought the law could have said.

(v) That the subsequent amendment to section 30(3B), which came into effect on 15 January 2020, and which had the effect of obliging a PBO to meet the tax compliance requirement, only came into being long after the taxpayer had applied for PBO status in this case. In other words, at the time of the application by the taxpayer for PBO status in this case, the compliance history of the taxpayer had not been sanctioned by the provisions of section 30(3B) of the Act and the amended section 30(3B) could not be applied retrospectively. The general presumption is that legislation cannot apply retrospectively and hence the provisions of section 30(3B) were capable of being interpreted without any assistance.

(vi) That the taxpayer's point of law accordingly succeeded.

3.5. L'Avenir Wine Estate (Pty) Ltd v C:SARS (84 SATC 295)

L'Avenir, being a wine producer, had approached the High Court on an urgent basis for orders permitting it to submit an income tax return for the period 1 April 2009 to 31 December 2009 ('the disputed period') and for SARS to thereafter assess it for that period (the main relief).

It was common cause that L'Avenir's appeal against its 2018 assessment was then pending in the Tax Court and one of the central issues in that appeal was whether or not SARS had to take into account L'Avenir's alleged loss suffered in the disputed period.

L'Avenir had successfully applied to the Registrar of Companies to change the end of its 'current financial year' to March and thereafter on 8 March 2010 it had again applied to the Registrar of Companies to change the end of its 'current financial year' to December and this too was duly approved on 25 March 2010.

L'Avenir maintained that the latter approval took effect retrospectively for its 2009 tax year, but SARS maintained that the approval applied to L'Avenir's 2010 tax year.

This was the genesis of the dispute between the parties with L'Avenir adopting the position that SARS was obliged to assess the disputed period in the 2009 tax year, and SARS maintaining that the disputed period should have been included in the 2010 tax year.

What was common cause, however, was that, as a fact, a return had not been submitted for the disputed period and SARS had assessed L'Avenir for both these years without that period being included and SARS was not prepared to permit L'Avenir to either submit a separate return for the disputed period or agree to issuing reduced assessments for the 2009 and/or 2010 years.

SARS, in adopting this position, had rejected L'Avenir's contention that it was obliged to do so based on a 'readily apparent undisputed error in the assessment'

(by either SARS or L'Avenir) or a 'processing error' by SARS as envisaged in section 93(1)(*d*)(i) and section 93(1)(*a*)(ii) respectively of the Tax Administration Act.

The crux of L'Avenir's complaint in the dispute before the High Court was thus the 'refusal' by SARS to assess it for the disputed period and L'Avenir asked the court for what it described as a two-fold *mandamus*, i.e. orders permitting it to submit an income tax return for the period 1 April 2009 to 31 December 2009 and for SARS to thereafter assess it for that period.

SARS submitted that there were fatal defects in the procedure adopted by L'Avenir in approaching the High Court for a final, mandatory interdict.

SARS submitted, firstly, that the main relief sought by L'Avenir sidestepped the dispute resolution process contained in Chapter 9 of the Tax Administration Act in which L'Avenir was then engaged in the Tax Court. Secondly, section 105 of the Tax Administration Act provides that a taxpayer can only dispute an 'assessment' in terms of that process 'unless a High Court otherwise directs.' Thirdly, since the decision by SARS to decline the section 93 request(s) for reduced assessments was not subject to objection or appeal (as envisaged in section 104 as read with section 105 of the Tax Administration Act), and the dispute resolution process in Chapter 9 of the Act therefore did not apply, the appropriate avenue for the taxpayer to have followed was a review of an administrative decision under the Promotion of Administrative Justice Act 3 of 2000 (PAJA).

L'Avenir had agreed that the dispute resolution process in Chapter 9 could not be followed but had contended that 'it is not enough [for SARS] to simply point to the tax court procedure and claim that L'Avenir must be non-suited for its failure for not doing so…L'Avenir cannot be expected to endure the refusal of SARS to do something that would allow it to enter into the dispute resolution procedure.'

L'Avenir appeared to accept that it should indeed have approached the High Court for a review of SARS' administrative decision to decline its section 93 requests for reduced assessments.

The parties were then granted the opportunity to file supplementary notes dealing *inter alia* with whether or not the papers as they currently stood, duly supplemented if necessary, could form the basis for a review, i.e. conversion of the urgent application into a review.

L'Avenir, in its supplementary note, confirmed that it 'does not join issue with the view that a review is apposite', but submitted that such a conversion would be competent for the reasons advanced.

SARS argued against such a conversion and similarly advanced reasons therefor.

Judge Cloete held the following:

(i) That L'Avenir had overlooked the PAJA point which SARS had raised (i.e. that the appropriate avenue for L'Avenir to have followed was a review of an administrative decision under PAJA) and it had also overlooked the decision in *Absa Bank Ltd and Another* v *C:SARS* 83 SATC 401 where Sutherland ADJP had dealt with the interpretation of section 105 of the Tax Administration Act in the context of a taxpayer's direct approach to the High Court for a legality review prior to any appeal proceedings in the Tax Court. There was no suggestion that, given the absence of a Chapter 9 remedy in respect of the impugned decision, this would not qualify as 'exceptional circumstances.'

(ii) That, during argument before the court, the debate thus centred around whether or not L'Avenir had correctly approached the court for a *mandamus* instead of a review under PAJA. L'Avenir appeared to accept that it should indeed have approached this court for a review of SARS' administrative decision and the question then was whether or not the papers, as they currently stood, could form the basis for a review, i.e. a 'conversion'.

(iii) That SARS had argued against a conversion and its argument was compelling and the reasons it provided for opposing a conversion were supported by ample authority. In any event, as a starting point, if L'Avenir were permitted at this stage to make out a case under PAJA, it would have to overcome the hurdle of the 180 day period referred to in section 7(1) of PAJA or apply for condonation in terms of section 9 thereof. However,

irrespective of the course it chose to pursue, including that of a legality review, it would have to demonstrate that the review had been brought within a reasonable time, which would depend upon the circumstances, or it would have to ask for condonation.

(iv) That, however, irrespective of the course it chose to pursue, L'Avenir would have to make out a fresh case to explain its delay and SARS would require the opportunity to deal with it.

(iv) That, furthermore, L'Avenir would be required to set out the specific grounds upon which it relied for a review (whether under section 6(2) of PAJA or the common law if it chose to pursue a legality review) and SARS would similarly need to deal with those grounds before the matter could be considered ripe for hearing. Allied to this was the requirement that the record of the impugned decision should be placed before the court (Rule 53) so that it had all the relevant facts against which to consider the lawfulness of the decision.

(v) That it was settled law that even if SARS' decision was unlawful, it remained valid and binding, since it continued to have legally valid consequences until set aside.

(vi) That what in truth L'Avenir now sought to do, by way of a conversion, was to introduce fundamentally different relief (the review and setting aside of the impugned decision) when the case presently made out is effectively to compel SARS to change the decision it had (rightly or wrongly) already made. There is no reasonable possibility that the two can simultaneously co-exist on the same set of papers, whether or not they are supplemented.

(vii) That L'Avenir's reliance on Cloete J's finding when sitting as a Tax Court in *ITC 1956* 84 SATC 321 was misplaced. In that matter there was a pending appeal in the Tax Court and the taxpayer brought a 'stand alone' review application in that court in the sense that no relief was sought to have it heard *in limine* by the Tax Court ultimately seized with the appeal, nor that it be heard simultaneously therewith or dealt with as a separated issue. It was in response to this review application that SARS successfully launched

a Rule 30 application in the Tax Court to have it set aside as an irregular step.

Application dismissed with costs.

3.6. Mukuru Africa (Pty) Ltd v C:SARS (84 SATC 304)

Mukuru Africa (Pty) Ltd (Mukuru) was a registered vendor under the Value-Added Tax Act and had commenced business on 1 February 2014.

Mukuru provided money-transfer and bureau de change services, as well as mobile phone credit.

Mukuru made both taxable and exempt supplies for VAT purposes and also incurred expenditure in acquiring goods and services for the purpose of use, consumption or supply in the making of those supplies and the input VAT incurred by Mukuru accordingly fell to be apportioned in terms of section 17(1) of the Value-Added Tax Act.

Mukuru, on 20 February 2017, had applied to SARS for a ruling under section 41B of Act 89 of 1991 wherein it requested approval for the use of a so-called 'transaction count (TC)' ratio to apportion its mixed-purpose input VAT deductions for the tax periods commencing 1 February 2014.

SARS on 24 July 2018 had approved the TC method for use by Mukuru (the July 2018 ruling) and it did so for the period commencing 1 March 2016, but not in respect of the earlier period from 1 March 2014 to 29 February 2016.

SARS took the view that proviso (iii) to section 17(1) (which limited in certain circumstances the extent to which SARS may determine a ratio with retrospective effect) precluded it from approving the TC ratio for use in any period prior to 1 March 2016.

Mukuru objected and SARS had initially treated the objection as invalid and had refused to entertain or decide it.

Mukuru, on 12 June 2019, had launched an application with the Tax Court seeking, *inter alia*, an order compelling SARS to consider and decide the objection and that application succeeded. Following upon the order of that court SARS considered and disallowed Mukuru's objection and it then appealed to the Cape Town Tax Court (see *ITC 1930* (2019) 82 SATC 271 *per* Savage J).

The Tax Court dismissed Mukuru's appeal and the further appeal by Mukuru to the Supreme Court of Appeal was with the leave of the learned judge.

The Tax Court found in favour of SARS and stated that 'there is no reason why the legislature should not restrict the period of retrospective application of a private binding ruling having regard to the context and purpose of the provision and affording the provision a sensible and businesslike interpretation to it.'

Proviso (iii) to section 17(1) of the Act provided at the relevant time that 'where a method for determining the ratio referred to in this subsection has been approved by SARS, that method may only be changed with effect from a future tax period, or from such other date as SARS may consider equitable and such other date must fall…in the case of a vendor who is a taxpayer as defined in section 1 of the Income Tax Act, within the year of assessment as defined in the Act…during which the application for the aforementioned method was made by the vendor.'

The primary issue in the appeal was whether SARS (as it contended and the Tax Court held) was precluded by proviso (iii) from granting approval for use of the TC ratio by Mukuru in respect of the period 1 March 2014 to 29 February 2016.

Judge Ponnan held the following:

(i) That section 17(1) of the Value-Added Tax Act does not stipulate a ratio. That is to be determined by way of a ruling from SARS as contemplated in Chapter 7 of the Tax Administration Act (TAA) or section 41B of the Value-Added Tax Act. When SARS issued the July 2018 ruling in favour of Mukuru, there was already in existence a ruling as envisaged in Chapter 7 of the TAA, namely *Binding General Ruling* 16 (BGR 16). BGR 16, which determined a ratio for the purpose of section 17(1), was first issued by

SARS on 25 March 2013 (with effect from 1 April 2013) and re-issued on 30 March 2015 (with effect from 1 April 2015).

(ii) That the ratio fixed by BGR 16 is described as the standard turnover-based method (the STB method) of apportionment. The STB method, which is the default method of apportionment, applied to all vendors who had not obtained an alternative ruling from SARS.

(iii) That the ratio in BGR 16 thus applied to all vendors to whom section 17 found application and who had not applied for and been granted an alternative ruling by SARS. Mukuru fell within that category, until such time as SARS issued the July 2018 ruling in its favour (and at its request) permitting the use of the TC method.

(iv) That it was so that BGR 16 did indeed contain a section headed 'Conditions'. Those were however manifestly not conditions in the true sense. They do not relate to the ratio referred to in section 17, but rather to the requirement to apply to SARS for an alternative ruling in the event that the STB method operates unfairly and unreasonably or is inappropriate. The condition, such as it is, cannot qualify section 17(1). BGR 16 did no more than fix the ratio, left to SARS for determination by section 17(1).

(v) That, in any event, it was not open to a vendor to simply ignore a SARS ruling or to unilaterally apply its own method of apportionment. What is more, in terms of BGR 16, if the method prescribed is not fair and reasonable or appropriate, the vendor must apply to SARS for a fair, reasonable and appropriate ruling. It does not provide, as Mukuru appeared to suggest, that from the commencement of its operations, no approved apportionment method applied to it. Nor did it provide for Mukuru to simply unilaterally assume its own apportionment; one not sanctioned by SARS. The remedy for any unfairness and unreasonableness or inappropriateness is for a vendor to apply to the SARS for an alternative method of apportionment, not to regard BGR 16 as *pro non scripto.*

(vi) That the purpose served by the requirement that a vendor must make an application to SARS, is to enable the latter to evaluate whether there is indeed any unfairness, unreasonableness or inappropriateness and if so, to

approve an alternative method. Thus, even were it to be assumed in Mukuru's favour that the 'condition' is a condition in the true sense, Mukuru did not, at the level of fact, claim any unfairness, unreasonableness or inappropriateness.

(vii) That the legislature contemplated that the apportionment method for the purposes of section 17 of the Value-Added Tax Act must relate to a time in the future or, if it is to be retrospective, for a period not exceeding the income tax year during which the application is made for a change in the apportionment method. Properly understood therefore, Mukuru's application for the July 2018 ruling was an application to change from the STB method to the TC method. Accordingly, when SARS approved the change of method in response to Mukuru's application, it had no power to do so, retrospectively, to a date earlier than 1 March 2016 and it followed that the Tax Court was correct in its conclusion that '…The STB method set out in BGR 16 was the only ratio applicable to Mukuru until its private binding ruling had been issued in 2017 and proviso (iii) to section 17(1) expressly precluded SARS from issuing a ruling that had effect from a date earlier than 1 March 2016.'

Appeal dismissed with costs.

3.7. ITC 1955 (Unexplained receipts and deposits)

The taxpayer, Mr X, had launched an appeal in terms of section 107(1) of the Tax Administration Act against additional tax assessments raised by SARS, on 26 July 2010 and the subsequent refusal by SARS to uphold the main objection to the assessments for the financial years of 2005, 2006 and 2007.

The taxpayer was a businessman who earned his living from two parallel business ventures, one as a bookmaker and the other as a futures equity trader.

The taxpayer's bookmaking business entailed accepting and placing horseracing bets from private individuals and the public, as the punters. If the bets placed with the taxpayer win, he was obliged to pay out the winnings to the relevant punters

and to mitigate his exposure to risks from winning bets, he placed hedging bets with other bookmakers.

The taxpayer, in order to monitor the betting transactions, maintained a spreadsheet on a daily basis and he claimed that there were no directives in the industry to issue settling statements and statements of account during the relevant assessment period. The taxpayer claimed that during the 2005–2007 years of assessment in respect of hedging bets, he was never issued with any settling statements or statements of account by other bookmakers. Settling was done verbally on a mutually agreed figure on a weekly basis, and not on presentation of a statement as alleged and at no stage whatsoever did SARS raise the issue of 'settling'.

The taxpayer, in his Equity and Futures Trading Business, operated an account with Z Securities (Pty) Ltd for purposes of trading on the South African Futures Exchange (SAFEX) as Z Securities was a stock brokerage firm and a member of the SAFEX.

Following a tax audit and an analysis of deposits made to his bank account, SARS found that the taxpayer had under-declared income from his bookmaking business during the 2005–2007 years of assessment and the under-declared income during the 2005–2007 years of assessment ranged between R3.8 million and R4.8 million.

An analysis of the taxpayer's bank statements of the futures trading account, for the period 1 March 2004 to 28 February 2007, from Z Securities, revealed that the taxpayer did not declare the profits from his futures trading business which varied between R219 000 and R949 000 in each tax year.

The taxpayer had also not declared interest earned on his funds held by Z Securities and from the Y Bank call account.

SARS had accordingly raised the additional assessments for the years of assessment concerned and had imposed interest in terms of section 89*quat* of the Income Tax Act and additional tax in terms of section 76 of the Income Tax Act at the rate of 100% over and above the tax owing by the taxpayer in respect of the

income that was allegedly not declared correctly, i.e. interest, bookmaking income and equity futures trading income already referred to.

The taxpayer contended that the income tax audit findings were inconsistent with the documents and therefore the findings were unfounded and unsubstantiated. He contended further that irrational and inconsistent conduct by SARS was reflected in its correspondence.

At the hearing Ms M, a SARS official, had contended that SARS had conceded part of the taxpayer's complaint as it had altered the assessment by adjusting the interest income and futures trading profit realised from the taxable income, which thus covered the period unaccounted for. SARS had also conceded with the taxpayer that the proceeds in the futures and trading account were capital in nature and raised capital gains tax throughout the relevant period. In addition, SARS had allowed as deductions those expenses proved by the taxpayer, and had invited the taxpayer to explain the unexplained deposits and it had also considered extenuating circumstances and had imposed an additional tax at 50%, rather than 100% that it was entitled to impose.

The taxpayer was, however, still aggrieved by the partial disallowance of the objections and the additional assessments raised by SARS on 26 July 2010 and appealed to the Johannesburg Tax Court.

It was common cause between the parties that SARS had issued assessments in terms of which it had included the deposits made into the taxpayer's bank account statement as part of his gross income. An analysis of the taxpayer's bank statements revealed that the taxpayer had not disclosed all the deposits in his bank accounts.

This matter had been on the court roll numerous times previously but had been removed at the instance of the taxpayer on each occasion on the basis that the matter be removed from the roll by agreement for settlement negotiations which had been rejected by SARS.

At the eventual hearing of the matter on 4–5 February 2021, and after the Tax Court had indicated that no further postponements would be granted, the

proceedings took place in the taxpayer's absence and, in addition, the taxpayer's attorneys of record withdrew legal representation on the day of the hearing of the appeal, and, accordingly, Ms M, acting for SARS, sought an order in terms of Rule 44(7) of the Tax Court Rules read with section 129 of the Tax Administration Act, that the appeal should be dismissed and that the court should make an order confirming SARS' revised assessments in terms of section 129(2)(*a*) and (*b*) of Act.

The issues for determination before the court were whether:

- The unexplained receipts and deposits in the taxpayer's bank account, together with the unaccounted expenses, formed part of the taxpayer's gross income of his bookmaking business and equity futures trading business as defined in section 1 of the Income Tax Act for the relevant years of assessment, and entitled SARS to levy the additional assessments;
- The interest income earned by the taxpayer on the funds deposited with the financial institutions formed part of his 'gross income' as defined in section 1 of the Act, for the relevant years of assessment;
- The taxpayer had produced sufficient evidence to satisfy SARS that the failure to declare, or the under-declaration of income, was not done with intent to evade taxation or of any extenuating circumstances as contemplated in section 76(2) of the Act and was therefore entitled to a remittal of the additional tax imposed;
- The taxpayer has, on reasonable grounds, contended that the amounts in dispute should not have been declared in its income tax returns to justify the waiver and remittal of the interest in terms of section 89*quat*(3) of the Act.

Judge Siwendu held the following:

(i) That the taxpayer bore the burden of proof to show that the assessment was incorrect and it was not for SARS to prove that the assessment was correct but rather to defend the assessment.

(ii) That, based on the history of the appeal as well as the submissions made, and the late notification to the court of the withdrawal of the taxpayer's attorney of record, the case for the determination of the appeal in the absence of the taxpayer was well grounded. The taxpayer had been aware of the looming appeal since November 2020. Submissions made before the court were that he had failed to provide instructions to his attorneys in preparation for the appeal.

(iii) That in terms of section 11(*a*) of the Income Tax Act the taxpayer was obliged to provide proof that such expenses were actually incurred and that they met the requirements of section 11(*a*). In addition, in terms of the old section 76 of the Income Tax Act, the taxpayer must prove that exceptional circumstances existed to warrant a further remission of the additional tax.

(iv) That in terms of the old section 76(2) of the Income Tax Act, which was applicable in this case, SARS may remit the additional tax imposed under section 76(1), but only if SARS is of the opinion that there were extenuating circumstances and that the taxpayer had not done any act or omission with intent to evade taxation.

(iv) That in terms of section 89*quat*(3) of the Income Tax Act interest imposed may be remitted if the taxpayer had on reasonable grounds contended that an amount should not have been included in taxable income or should have been allowed as a deduction.

(v) That the court, after enquiring from SARS as to how it had arrived at its calculations, was satisfied that the unexplained deposits fully appeared in the documentation before the court and the reconciliation of the expenses claimed by the taxpayer had been presented for consideration by the court. The court was also satisfied that the taxpayer had declared R174 644 as income while after the SARS audit his income was found to be R4 294 125.

(vi) That the court was satisfied that SARS had levied the appropriate tax as well as the additional tax and had thereafter reduced the taxpayer's tax assessment following his objection and had issued a further assessment.

(vii) That, having regard to all the facts, the appeal failed and the court granted judgment in default against the taxpayer as provided for in Rule 44(7) of the Tax Court Rules.

Appeal dismissed.

SARS' revised assessments for the 2005–2007 years of assessment were confirmed.

The additional tax levied in terms of section 76 of the Income Tax Act was confirmed.

The interest imposed in terms of section 89quat of the Income Tax Act was confirmed.

The taxpayer was ordered to pay the costs of the appeal which costs were to include the employment of counsel.

3.8. ITC 1956 (Review application, procedural defective)

SARS who had applied in terms of Rule 30 of the Uniform Rules of Court read with Rule 42 of the Tax Court Rules for an order setting aside, as an irregular step, a legality review brought by the taxpayer in appeal proceedings already pending in the Tax Court.

SARS did not challenge the taxpayer's election to proceed by way of a legality review as opposed to one under the Promotion of Administrative Justice Act ('PAJA'), but at the same time did not concede that the administrative action complained of was unlawful, unreasonable or procedurally unfair.

SARS contended that the review itself was both procedurally defective and irregular, since it could not be brought in terms of the Tax Administration Act ('TAA') and the Rules promulgated thereunder.

The taxpayer opposed SARS' application in the Tax Court on the grounds that:

(*a*) SARS had improperly relied on Uniform Rule 30, which was directed at procedural irregularities and should instead have raised a point of law in terms of Uniform Rule 6(*d*)(iii);

(*b*) the Tax Court was not precluded from entertaining a legality review by the TAA and its Rules;

(*c*) there was nothing improper or irregular for a review to be launched on motion in an appeal pending before the Tax Court.

SARS, on 31 January 2018, had notified the taxpayer that it would be conducting an audit into its tax affairs in respect of its 2014, 2015 and 2016 years of assessment and the taxpayer had mandated its accountants, who were also its tax advisors, to liaise with SARS on its behalf and subsequent engagements were facilitated in this manner.

The taxpayer stated that it had co-operated fully with the audit procedures including the provision of all additional information requested by SARS.

Thereafter, on 8 August 2018, SARS issued notices of assessment for the years in question, and these reflected that additional assessments had been raised in relation to each year and understatement penalties had been levied at 25% on each.

The taxpayer had filed objections in respect of all the additional assessments, both in relation to the capital amounts as well as the understatement penalties.

The taxpayer's objections related not only to alleged procedural unfairness, but also the merits of the assessments themselves, as far as the taxpayer could understand them.

Insofar as procedural unfairness was concerned, it was the taxpayer's contention that SARS had raised the additional assessments <u>out of the blue without warning</u>, without issuing it with a letter of audit findings, and without providing it with 21 business days within which to respond thereto, as required by section 42(2) of the TAA.

Related complaints by the taxpayer were that the Notice of Adjustment to Assessment itself did not comply with section 96(2)(*a*) of the TAA since it had failed to include a statement of the grounds of assessment, alternatively insufficient grounds were provided in respect of expense or loss categorisation and, insofar as the understatement penalties were concerned, no explanation was given as to how the facts at hand justified their imposition.

It was common cause that the taxpayer did not avail itself of Rule 6(1) which provided that a taxpayer '…who is aggrieved by an assessment may, prior to lodging an objection, request SARS to provide the reasons for the assessment required to enable the taxpayer to formulate an objection in the form and manner referred to in Rule 7.

SARS thereafter issued notices disallowing all three objections and the taxpayer proceeded to file its appeals to the Tax Court which included the same objections to the procedural fairness already referred to and also dealt with the merits as the taxpayer understood them.

The parties thereafter attempted alternative dispute resolution, but to no avail, and the matter was referred to the Tax Court.

SARS, on 9 December 2020, delivered its Rule 31 statement and it was only then that legal advice was obtained and the taxpayer became aware of the possibility of bringing a review application and therefore elected to proceed on this basis in an attempt to avoid a protracted Tax Court appeal and the significant legal expenses associated therewith and, as a result, the taxpayer had not delivered its Rule 32 statement.

The review application was launched on 16 April 2021 and it was a 'stand alone' review application in the sense that no relief was sought to have it heard *in limine* by the Tax Court ultimately seized with the appeal, nor that it be heard simultaneously therewith, nor that it be dealt with as a separated issue.

The taxpayer's rationale for this approach was that determination of the review in its favour would dispense of the appeal as a whole and it was in response to the

legality review application that SARS launched its Rule 30 application which was before the court in order to set aside the application as an irregular step.

SARS contended firstly that the taxpayer's attempt to challenge and set aside assessments on the basis of alleged administrative non-compliance on application to the Tax Court, instead of following the pleading process, was irregular, since the Tax Court was a creature of statute with its jurisdiction, ambit and operation confined to the TAA and its Rules which did not permit such a procedure.

SARS contended secondly that in terms of section 104 of the TAA, a taxpayer may only dispute an assessment or 'decision' as described therein by way of appeal in the Tax Court, unless a High Court directs otherwise in accordance with section 105 thereof.

Administrative actions in terms of section 42 and section 106 of the TAA did not constitute 'decisions' as contemplated in section 104.

SARS thus contended that the taxpayer's attempt to circumvent the TAA and its Rules by leapfrogging the relief it sought under the guise of a legality review in the Tax Court was an irregular step which fell to be set aside.

The taxpayer contended that in terms of section 117(1) of the TAA the Tax Court, for purposes of Chapter 9 of the TAA (i.e. dispute resolution), had jurisdiction over tax appeals lodged under section 107 of the Act and relied on the case of *South Atlantic Jazz Festival (Pty) Ltd* v *C:SARS* 77 SATC 254 where it was held that 'the fact that the determination of the appeal might entail the Tax Court in considering the legality of an administrative decision, that was integral to the making of the assessment, does not deprive the court of its jurisdiction to decide the appeal. To interpret and apply the legislation, as requiring the dichotomous procedures enjoined in the argument advanced on behalf of SARS, would in many cases defeat the very purpose of the establishment of the specialist tax court. The jurisdiction of the Tax Court to determine tax appeals is conferred without any limitation in section 117(1) of the TAA. The court must be taken to have been invested with all the powers that are inherently necessary for it to fulfil its expressly provided functions.'

Section 117(1) of the TAA provided:

> '117. Jurisdiction of the Tax Court.–
>
> The tax court for purposes of this Chapter has jurisdiction over tax appeals lodged under section 107.'

The taxpayer further contended that it would be patently unfair, oppressive and irrational to force it to incur the expense of preparing for an appeal, only to be given the opportunity for the first time to deal with a legality review that is potentially dispositive of the whole dispute on the first day of that appeal hearing and the interpretation for which SARS contended would moreover lead to an undesirable dichotomy between the High Court on the one hand and the Tax Court on the other.

Judge Cloete held the following:

(i) That to the court's mind, the taxpayer had misconstrued the true nature of SARS' complaint, namely that to proceed on motion for review in the Tax Court in pending appeal proceedings is a procedural step not permitted by the TAA and its Rules, and was therefore irregular. While the objection involved a consideration of jurisdiction, this did not detract from, and should not be conflated with, what SARS contended was a procedural irregularity.

(ii) That, put differently, the complaint is directed at non-observance of the Rules promulgated under the TAA. These rules do not exist independently of the TAA but instead are intended to give procedural effect to its provisions. To the extent that the procedural irregularity complained of necessarily requires a determination on jurisdiction, a matter of law, then so be it.

(iii) That in the present context it is the 'hindrance' of the review on motion which will be removed from the future conduct of the pending tax appeal should the review be set aside as an irregular step. The court was accordingly persuaded that SARS could not be criticised for invoking Uniform Rule 30 rather than Uniform Rule 6(*d*)(iii) and the court turned to consider the merits of its application on that basis.

(iv) That, as correctly submitted by the taxpayer, the debate about whether or not section 117(3) of the TAA must be interpreted in such a manner as to give meaningful content to the Tax Court's powers under section 117(1) only had relevance if it is found that section 117(1) conferred on a Tax Court the authority to entertain a legality review on motion in pending tax appeal proceedings.

(v) That although the taxpayer, at least in argument, seemingly drew no distinction between a review on motion where no appeal is pending and one in pending appeal proceedings, as a matter of fact the actual issue before the court was the latter and not the former and the court intended confining itself to the actual issue, particularly given that a Tax Court is not a court of precedent.

(vi) That the first distinguishing feature in the *South Atlantic Jazz Festival* case, *supra*, was that there the taxpayer was exercising a right of appeal before the Tax Court and not, as pointed out by Binns-Ward J, the review and setting aside of an administrative decision. In the present matter the taxpayer had brought a 'stand alone' review application albeit under the same case numbers as those in the appeal, for the specific purpose of avoiding having to exercise its right of appeal.

(vii) That the second distinguishing feature was that it was never contended by SARS in *South Atlantic Jazz Festival* that the administrative decision it made, which was integral to the issuing of the assessments, was not susceptible to objection and appeal but in the present matter SARS had specifically raised this as part of its objection.

(viii) That it was accordingly the court's view that the taxpayer's reliance on *South Atlantic Jazz Festival* as authority for its proposition stretched it too far.

(ix) That it should also be borne in mind that section 105 of the TAA, as it read at the time, gave the taxpayer two options. The first was to dispute an assessment or 'decision' described in section 104 in accordance with

Chapter 9 of the TAA and the Tax Court Rules. The other was to apply to the High Court for review.

(ix) That, however, as presently worded, section 105 makes clear that a taxpayer may only dispute an assessment or 'decision' as described in section 104 of the Act in accordance with Chapter 9 of the TAA and its Rules in the Tax Court unless a High Court otherwise directs and in the court's view the current wording of section 105 militates against the interpretation proffered by the taxpayer, rather than bolstering it.

(x) That the taxpayer had also relied on *Absa Bank Ltd and Another* v *C:SARS* 83 SATC 401 where the court dealt with the interpretation of section 105 of the TAA as presently worded in the context of the taxpayer's direct approach to the High Court for a legality review prior to any appeal proceedings in the Tax Court.

(xi) That in the court's view the decision in *Absa* in fact reinforced SARS' argument that the taxpayer's review application to the Tax Court, when there was already an appeal pending before it, constituted an irregular step. Even if one assumes that the taxpayer had no procedural control over the referral of the appeal to the Tax Court, it remained open to it to approach the High Court for leave to institute a review application in that court, while simultaneously seeking a stay of the appeal proceedings pending the determination of the review.

(xii) That the other decision to which the taxpayer referred, *ITC 1921* 81 SATC 373, found *inter alia* that SARS' non-compliance with section 42 of the TAA, was a breach of the taxpayer's section 33 rights in the Constitution, rendering the subsequent assessment made invalid. In that matter the issue was raised *in limine* by the taxpayer in the context of a tax appeal and it seemed that no reliance had been placed by either party on section 105 of the TAA as currently worded, and the judgment itself made no mention of it either.

(xiii) That, accordingly, for all of the above reasons, the court was persuaded that the launching of a review application in appeal proceedings already

pending before the Tax Court was an irregular step as envisaged in Uniform Rule 30 and was set aside and the appeal proceedings in the Tax Court were stayed pending the determination of a review application to be launched in the High Court.

3.9. ITC 1957 (VAT bad debts)

The taxpayer was ZZZ Venture ('the Venture').

Prior to 2011 AB (Pty) Ltd (AB) and CD (Pty) Ltd (CD) carried on the business of civil contracting. They agreed to form a joint venture to tender for the construction of an overhead bridge interchange at the intersection of the N2 Highway, the M19 Highway and Umgeni Road ('the project'). To this end the Venture was established, it tendered for the project and was awarded it. The employer on the project was the South African National Roads Agency Limited (SANRAL).

At the outset of the project there were three partners in the Venture, being AB, CD and an entity that was referred to as a BEE partner, XY Trading CC, trading as ED Civil and Building Contractors (ED). They concluded a written joint venture agreement ('the agreement') on 12 April 2011, setting out, inter alia, their respective rights and obligations.

Their shares in the Venture were 52%, 36% and 12% respectively.

From the outset of the project matters went poorly. Labour unrest and difficulties plagued the project. Communities residing near the project demanded inclusion as part of the labour force. The local residents, apparently as a result of pressure by SANRAL, were then hired. It quickly became apparent that they did not have the necessary skills for the project and violence was used to attempt to gain the upper hand, there were assaults on the project staff and security, and damage to project assets. The entire workforce was eventually dismissed and other, more competent workers, were hired to complete the project. The consequence of all of this was that the project got behind schedule, and the Venture incurred extensive penalties from SANRAL and this resulted in substantial losses for the Venture.

Originally, the partners contributed the necessary capital, as the Venture possessed no assets. In addition, the partners (only AB and CD being relevant here) supplied goods and services to the Venture, for which they rendered monthly invoices to the Venture. Those invoices included output tax which was paid to SARS, and is not in dispute in this appeal. To shore-up the failing finances of the Venture, the partners were required to make further substantial capital contributions. ED realised that it was simply unable to do so, and on 28 February 2013, and with the consent of the other partners and SANRAL, it was permitted to withdraw as a partner in the Venture.

On 24 August 2011 a meeting was held of the Venture which was attended by the partners and what was referred to as 'the first addendum' to the agreement was concluded as follows:

> 'The Venture participants agree that in order to protect the integrity of the project the Venture Participants agree to payment of services rendered and goods supplied will only be made as and when and to the extent that the Venture cashflow permits it.'(sic)

In accordance with the agreement and the first addendum, goods and services continued to be supplied to the Venture by the two partners. Those invoices were not paid by the Venture. At the end of the various accounting periods those amounts were converted from short-term debts to long-term liabilities in the books of the Venture. To achieve this, the simple expedient of crediting them to the loan accounts of the partners in the Venture was used. Although this appeared to be the factual position, the appeal was argued by both parties on the basis that it was not.

What gave rise to the dispute before the Tax Court was that the Venture claimed the VAT charged on the invoices from the partners, as input tax.

Eventually, pursuant to a SARS audit, it was established that the debts were not being paid by the Venture to the partners and SARS then, in terms of section 92 of the Tax Administration Act, read with section 22(3) of the Value-Added Tax Act, imposed an output tax assessment on the Venture in a sum equivalent to those

input taxes claimed by the Venture and this was contained in a 'Finalisation of Audit' notice, dated 15 December 2017.

The Venture delivered a Notice of Objection to SARS' additional assessment on 12 April 2018 which related to the imposition by SARS of output tax in terms of section 92 of the Tax Administration Act and section 22(3) of the Value-Added Tax Act for the tax periods 2012/12–2016/08 and 2016/10–2017/01.

SARS disallowed the objections of the Venture and a Notice of Appeal was then issued by the Venture on 27 May 2019 in which it submitted that proviso (i) to section 22(3) of the Value-Added Tax Act applied to the input tax amounts claimed in respect of the debt owing to AB and CD Construction, and it was further submitted that the minutes (i.e. the first addendum) constituted a 'contract in writing' as required by the proviso.

The following facts became common cause between the parties:

(a) all the invoices in question were sent by the partners to the Venture after the first addendum was concluded;

(b) each partner co-signed the invoices of the other;

(c) those invoices had never been paid in money, but transferred to the loan accounts of the partners to the Venture;

(d) the first addendum did constitute a valid agreement;

(e) the debts had never become payable in terms of the first addendum, and it was unlikely (but not impossible, or yet determined) that they ever would be paid;

(f) the Venture is deemed, in terms of section 51 of the Value-Added Tax Act 89 of 1991, to be a separate and distinct entity from its partners;

(g) the Venture did not, and does not seek relief pursuant to the provisions of section 22(3A) of the Act;

(h) the project eventually accrued a loss of R177 million.

The taxpayer contended that its main argument was in relation to proviso (i) to section 22(3) of the Value-Added Tax Act which applied to the input tax amounts claimed in respect of the debt owing to AB and CD Construction and that the first addendum, referred to as 'the minutes' constituted a 'contract in writing' as required by the proviso. As the cash flow of the Venture had not yet permitted the payment of the outstanding debts, those debts had not yet become payable. Until the suspensive condition had been fulfilled, the end of the month during which the deemed output tax becomes payable, had not yet arrived. The simple question then arose – had the Venture complied with the proviso to section 22(3)(b) to enable it to avoid the liability for those deemed taxes?

Section 22(3) of the Act provided:

> 'Subject to subsection (3A), where a vendor who is required to account for tax payable on an invoice basis in terms of section 15–
>
> (a) has made a deduction of input tax in terms of section 16(3) in respect of a taxable supply of goods or services made to him; and
>
> (b) has, within a period of 12 months after the expiry of the tax period within which such deduction was made, not paid the full consideration in respect of such supply,
>
> an amount equal to the tax fraction, as applicable at the time of such deduction, of that portion of the consideration which has not been paid shall be deemed to be tax charged in respect of a taxable supply made in the tax period following the expiry of the period of 12 months:
>
> Provided that–
>
> (i) the period of 12 months shall, if any contract in writing in terms of which such supply was made provides for the payment of consideration or any portion thereof to take place after the expiry of the tax period within which such deduction was made, in respect of such consideration or portion be calculated as from the end of the month within which such consideration or portion was payable in terms of that contract.'

Judge Lopes held the following:

(i) That the fact that SARS had submitted its 'Finalisation of Audit' relying on section 92 of the Tax Administration Act, and that it was not dealt with by the Venture in its objections or grounds of appeal, did not mean that it was precluded from raising it in argument. It was simply the basis upon which SARS had issued the additional assessment. Had SARS not believed that it was financially prejudiced, it would surely not have raised the additional assessment.

(ii) That in its reference to section 92 of the Act, SARS had actually recited that prejudice was part of its complaint, and regarded itself as bound in this regard. Even though section 92 was not referred to in the Venture's objections and grounds of appeal, the section was part of the structure of the Tax Administration Act relied upon by SARS. The Venture had made it clear why it believed that the additional assessment should not have been levied and that inevitably involved a debate on whether SARS or the fiscus was left in a financially neutral position.

(iii) That the next aspect was whether there had been an agreement concluded between the Venture and AB and CD, which satisfied the proviso to section 22(3)(b). The Venture, represented by its partners AB and CD, had concluded the first addendum with AB and CD, in terms of which the repayment of the debts owed by the Venture to AB and CD would be delayed until the Venture had the necessary cash flow to do so. On the basis that, for the purposes of the Act, the Venture was deemed to be an entity, separate and distinct from its partners in terms of section 51 of the Value-Added Tax Act, it was appropriate to find that the agreement was a legally binding contract between them.

(iv) That the question which then arose was whether the agreement fulfilled the requirements of the proviso to section 22(3)(b). If an input deduction has been made on the basis of a supply of goods or services to the Venture in this matter, and the supplier has not been paid within a period of 12 months, then SARS may deem a tax to be charged in respect of that

supply. The tax will be payable in the tax period following the expiry of the 12 months and the proviso allows an exemption to that deeming provision. The exemption occurs in circumstances where:

- A contract in writing is concluded between the supplier and the vendor (AB and CD on the one hand, and the Venture on the other);
- Providing for the payment of the consideration (or any portion thereof), to take place after the tax period during which the contract (the first addendum here) was concluded; and
- The tax will be payable in the month after the end of the tax period during which payment was to have been made.

(v) That the parties were agreed that the agreement and the first addendum provided that the payment of the goods or services would only be made 'as and when and to the extent that the Venture cashflow [sic] permits it'; that the cash flow has never permitted it; and that a period of 12 months has elapsed after the end of the tax period during which the output tax on the original invoices was payable.

(vi) That there seemed no doubt that the Venture, which, it was common cause, was a registered vendor in terms of the definition of that word in section 1 of the Value-Added Tax Act, qualified as a 'person' as defined in that section, being a 'body of persons (corporate or unincorporated).'

(vii) That SARS had maintained that no payment would ever be made, because the Venture ran at a loss, and sufficient cash flow would never become available. That statement did not deal with the matter entirely, because the Venture had sued SANRAL, apparently for an amount of R100 million, arising out of the principal contract. The court had no knowledge of the basis upon which the partners may conclude that sufficient cash flow is or is not available to pay the debts of the Venture and in those circumstances it cannot validly be asserted that the Venture will never pay the output taxes (or part thereof), nor that the suspensive condition is so vague as to be unenforceable.

(viii) That with regard to the possible vagueness of the addendum because of the uncertainty of the payment date, it was not an undertaking to pay when

the Venture chooses to do so, but rather when it was able to do so. The happening of that event will be a matter of fact, not solely within the Venture's discretion. That the cash flow of the Venture enabled it to pay its suppliers may be objectively established. It may be evidentially difficult for SARS to establish that, but that is a separate issue, and not an insurmountable problem, because SARS need do no more than follow the legal proceedings between SANRAL and the Venture in order to establish the financial well-being of the Venture.

(ix) The fact that the venture is deemed to be a separate and distinct entity for VAT purposes, was important in establishing the independence of the partners from the Venture and this was what may be viewed as a mixed potestative condition, depending as it did on future events outside the powers of the Venture, i.e. the result of the litigation with SANRAL.

(ix) That there had been no hint of a deliberate manipulation in this matter (see ITC 889 79 SATC 39 where Savage J dealt with a matter, the facts of which were very similar to the facts in this case and at para [25] analysed the purpose of section 22(3)). A suggestion by SARS that an invoice provided by one of the partners to the Venture was 'false' was not followed-up, pursued or established by SARS. The Venture and its partners had concluded an agreement to postpone payment of the Venture's debts. The first addendum was concluded to regulate the payment of the debts owed by the Venture to its partners and it provided for the payment of the debts to take place when the cash flow was sufficient to allow the Venture to do so and that cannot be said to be an event which would, or could, never happen as the pending action between the Venture and SANRAL was yet to be decided.

(x) That the court had interpreted section 22(3) and the wording of the addendum in the same manner, i.e. to give a commercial and purposive meaning to the agreement expressed by the parties, taking into account their understandable desire to protect the integrity of the project. It seemed certain that had they not concluded the addendum, the project would have

collapsed, jobs would have been lost and the finalisation of a much-needed public facility inevitably delayed.

(xi) That SARS had been left with a financially neutral position – a factor that a court would, almost always consider in weighing-up the merits of any tax case, particularly when the facts clearly established the true position.

(xii) That in all the circumstances it was inappropriate for SARS to have delivered an additional assessment of tax based on section 22(3) and the Venture's defence that its conduct fell within the provisions of section 22(3)(b) and its proviso succeeded.

Appeal upheld.

The additional assessment made by SARS, contained in its 'Finalisation of Audit' notice, dated 15 December 2017 was set aside.

4. INTERPRETATION NOTES

4.1. Taxation of REITS and controlled companies – No. 97 (Issue 3)

This Note:

- provides guidance on the interpretation and application of section 25BB, which deals with the taxation of REITs and controlled companies;
- considers other selected provisions of the Act that are particularly relevant to REITs, controlled companies and the holders of shares or linked units in these companies;
- does not consider all the sections which apply to REITs and controlled companies which, while not specifically referring to REITs and controlled companies, are nevertheless applicable to REITs and controlled companies; and

- reflects the amendments introduced up to the Taxation Laws Amendment Act 20 of 2021.

South African REITs own several kinds of commercial property such as shopping centres, office buildings, factories, warehouses, hotels, hospitals and residential property in South Africa. REITs may also invest in property in other countries. The objective of a REIT is to provide investors with steady rental income and capital growth in the underlying properties.

A REIT may be a company as commonly understood or may be deemed to be a company for taxation purposes. A portfolio of a collective investment scheme in property that qualifies as a 'REIT' as defined in the listing requirements is deemed to be a 'company'.

Both corporate and trust (collective investment schemes in property) REITs that comply with the listing requirements are listed and publicly trade on an exchange. Once the shares in a company or a trust which is deemed to be a company for tax purposes are listed as shares in a 'REIT' as defined in the listing requirements, the company or trust will qualify as a REIT for income tax and CGT purposes.

A REIT, and a 'controlled company' as defined, are subject to a specific tax regime under section 25BB. In essence, a REIT and a controlled company are granted a deduction, subject to various limitations, for distributions made by it. A resident investor is subject to normal tax on distributions derived from a REIT or controlled company.

By contrast, a non-resident investor is liable for dividends tax (as opposed to normal tax) on such distributions.

A REIT and a controlled company must also consider other taxes that may be applicable and which may or may not be mentioned in this Note.

Section 25BB introduced a uniform set of rules for the taxation of REITs and their controlled companies as well as the holders of shares or linked units in such REITs and controlled companies with effect from years of assessment commencing on or after 1 April 2013. In order to qualify as a REIT, a company or a portfolio of a collective investment scheme in property must be a resident, be listed on an

exchange as a REIT and meet the listing requirements. A REIT can be a trust if it takes the form of a portfolio of a collective investment scheme in property, but for income tax purposes it is deemed to be a company.

The effect of section 25BB is to treat a REIT or a controlled company as tax neutral on profits from rental and other income that are distributed to holders of shares. This treatment is achieved by allowing a deduction of a 'qualifying distribution' made by a REIT or a resident controlled company. The deductible amount of the qualifying distribution is limited to the taxable income of the REIT or controlled company before taking into account:

- the qualifying distribution;
- any assessed loss brought forward from the previous year of assessment; and
- any taxable capital gain.

A distribution by a REIT or a controlled company that was in existence at the end of the preceding year of assessment will constitute a deductible qualifying distribution only if at least 75% of any gross income derived by the REIT or controlled company for the preceding year of assessment consists of 'rental income'. A similar rule applies during the first year of assessment in which a company qualifies as a REIT or controlled company, but in such event the gross income derived by the REIT or controlled company for that year of assessment is used.

Rental income equals PI + EG. PI means the aggregate of income from the use of immovable property, dividends from another REIT, a qualifying distribution from a controlled company, dividends or foreign dividends from a property company, and the recoupment of capital allowances claimed under specified sections. EG means the total of foreign exchange gains contemplated in the definition of 'exchange difference' in section 24I(1), determined under that section in respect of the amounts referred to under PI that constitute exchange items or any exchange item serving as a hedge in respect of amounts referred to in PI.

A REIT and a controlled company must disregard any capital gain or capital loss on disposal of shares or linked units in another REIT or a property company as well as any capital gain or capital loss on disposal of immovable property. However, a REIT or a controlled company must account for other capital gains and capital losses, while amounts received or accrued of a revenue nature on the disposal of assets are included in gross income.

Interest received by or accrued to a person during a year of assessment on a debenture forming part of a linked unit in a REIT or a resident controlled company is deemed to be a dividend. Dividends from a REIT or resident controlled company that are received by or accrued to resident holders of shares are taxable for normal tax purposes but are exempt from dividends tax. Non-residents are exempt from normal tax on such dividends but are instead subject to dividends tax.

Interest received by or accrued to a person during a year of assessment on a debenture forming part of a linked unit in a controlled company that is not a resident is deemed to be a foreign dividend.

The other provisions of the Act and other legislation dealing with REITs, controlled companies and the holders of shares or linked units, as dealt with in this Note, should also be considered.

4.2. Concession or compromise of a debt – No. 91 (Issue 2)

This Note provides guidance on the interpretation and application of section 19 and paragraph 12A which deal with the concession or compromise of debt in respect of years of assessment commencing on or after 1 January 2018.

The information in this Note is based on the income tax and tax administration legislation (as amended) as at the time of publishing and includes the following:

- The Taxation Laws Amendment Act 20 of 2021 which was promulgated on 19 January 2022 (as per Government Gazette 45787).
- The Tax Administration Laws Amendment Act 21 of 2021 which was promulgated on 19 January 2022 (as per Government Gazette 45786).

- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 19 of 2021 which was promulgated on 19 January 2022 (as per Government Gazette 45788).

Issue 1 of this Note should be consulted for comprehensive commentary on the debt reduction provisions applicable for years of assessment commencing before 1 January 2018.

The Note does not address section 22 of the VAT Act dealing with irrecoverable debt.

Debt relief occurs in, for example, insolvency, business rescue, similar statutory proceedings or informal workouts, and can occur within and outside a group of companies.

Before 1 January 2013 various taxes were imposed upon persons receiving the benefit of debt relief that may have effectively undermined the economic benefit of the relief. A uniform system that provides relief to persons under financial distress in specified circumstances was introduced in the form of section 19 and paragraph 12A with effect from years of assessment commencing on or after 1 January 2013.

The revised rules aim to subject debt relief to only one of the following taxes:

- Estate duty
- Donations tax
- Income tax on a fringe benefit received by an employee
- Income tax on income

CGT Section 19 and paragraph 12A were subsequently amended by the 2017, 2018, 2019, 2020 and 2021 Taxation Laws Amendment Acts.

Section 19 and paragraph 12A were substituted by sections 32 and 70 of the Taxation Laws Amendment Act 17 of 2017. Further amendments were made by sections 36 and 77 of the Taxation Laws Amendment Act 23 of 2018, most of which, barring two mentioned below, were backdated to 1 January 2018. These backdated amendments were largely aimed at lessening the impact of the debt

relief rules which could have had harsh consequences, for example, as a result of the terms of a loan being changed.

Further amendments to section 19(8)(b) and paragraph 12A(4) and (6)(b) and the introduction of section 19(6A) by the Taxation Laws Amendment Act 23 of 2018 came into effect for years of assessment commencing on or after 1 January 2019. The introduction of section 19(6A) and the amendments to paragraph 12A(4) deal with a debt benefit that arises in a year of assessment subsequent to that in which the asset was disposed of. Previously, the only consequence for a debtor under the latter circumstances was a reduction in an assessed capital loss. However, with effect from years of assessment commencing on or after 1 January 2019, a recoupment or capital gain may occur in the year of assessment in which the debt benefit arises. The amendments to section 19(8)(b) and paragraph 12A(6)(b) deal with the exclusion of a debt benefit arising by donation which now applies only in respect of the portion of the donation on which donations tax is payable. Section 19 or paragraph 12A will therefore apply to the extent that the debt benefit arises by means of a donation which qualifies for exemption from donations tax under, for example, the annual donations tax exemption of R100 000.

Further amendments were included in the 2019, 2020 and 2021 Taxation Laws Amendment Acts.

Section 19 and paragraph 12A deal with the concession or compromise of a debt. These provisions apply to trading stock, deductible expenditure, allowance assets and capital assets financed by debt that is subsequently cancelled, waived, extinguished or settled, in the case of a company, by being converted to or exchanged for shares in that company or applying the proceeds from shares issued by the company.

The application of section 19 and paragraph 12A depends on the nature of the expenditure that was funded by the debt. Specific ordering rules apply to a debt benefit in respect of debt owed in respect of or that was used to fund expenditure incurred in respect of the following assets:

- Trading stock that is held and not disposed of at the time the debt benefit arises

  Any deduction under section 11(a) or the value of opening stock or closing stock is reduced by the debt benefit under section 19(3). Any excess amount is deemed under section 19(4) to be an amount recovered or recouped for purposes of section 8(4)(a)

- Trading stock disposed of and other deductible expenditure excluding allowance assets

  The debt benefit is deemed under section 19(5) to be an amount recovered or recouped for purposes of section 8(4)(a)].

- Assets not disposed of in a year of assessment before that in which the debt benefit arises

  The base cost of the asset is reduced under paragraph 12A(3) by the debt benefit. After the base cost of an allowance asset has been reduced to RNil, any excess amount is deemed under section 19(6) to be an amount recovered or recouped for purposes of section 8(4)(a). Future capital allowances are limited under section 19(7) to the cost of the asset less the debt benefit and any previous allowances claimed on the asset.

- Assets disposed of in a year of assessment before that in which the debt benefit arises

  Under section 19(6A) and paragraph 12A(4) respectively, the debt benefit triggers a re-determination of the recoupment of allowances or the capital gain or loss recognised in that earlier year of assessment. The difference between the re-determined recoupment and the amount of recoupment in the earlier year of assessment is treated as an amount recovered or recouped for purposes of section 8(4)(a) in the year of assessment in which the debt benefit arises. The absolute difference between the re-determined capital gain or loss and the capital gain or loss determined in the earlier

year of assessment is treated as a capital gain in the year of assessment in which the debt benefit arises.

A special rule applies to debt that financed the acquisition of a pre-valuation date asset. The effect of the rule in paragraph 12A(5) is to treat the asset as a post-valuation date asset by re-establishing its base cost as expenditure which can be reduced by the amount of a debt benefit.

Special rules apply to a debt benefit in respect of a debt that funded expenditure incurred by persons carrying on mining.

Section 19 and paragraph 12A do not apply to a debt benefit in respect of any debt owed by a person:

- that is an heir or legatee of a deceased estate to the extent that the debt is owed to, and reduced by, the deceased estate and the amount by which the debt is reduced forms part of the property of the deceased estate for purposes of estate duty under the Estate Duty Act [section 19(8)(a) and paragraph 12A(6)(a)];
- to the extent that the debt is reduced by way of a 'donation', as defined in section 55(1) or any transaction to which section 58 applies, in respect of which donations tax is payable [section 19(8)(b) and paragraph 12A(6)(b)];
- to an employer to the extent that the debt is reduced in the circumstances contemplated in paragraph 2(h) of the Seventh Schedule, the so-called fringe benefits tax provisions [section 19(8)(c) and paragraph 12A(6)(c)];
- to another company forming part of the same domestic group of companies and the debtor company did not carry on a trade during the year of assessment in which the debt benefit arises and during the immediately preceding year of assessment, unless certain provisions apply [section 19(8)(d) and paragraph 12A(6)(d)];
- to another company forming part of the same domestic group of companies and the debtor company reduces or settles the debt directly or indirectly by

means of issuing shares, unless certain provisions apply [section 19(8)(e) and paragraph 12A(6)(f)]; or

- to the extent that the debt so owed is settled, directly or indirectly, by being converted to or exchanged for shares in the debtor company or by applying the proceeds from shares issued by that company and does not consist of or represent an amount owed in respect of interest incurred by that person during any year of assessment [section 18(8)(f) and paragraph 12A(6)(g)].

In addition, paragraph 12A does not apply to any debt owed by a company to a connected person if the debt is reduced in the course, or in anticipation, of the liquidation, winding up, deregistration or final termination of the existence of that company under specified circumstances [paragraph 12A(6)(e) and (7)].

Consequential amendments to prevent double taxation have been made to sections 8(4)(a), 9C(5), 24J(4A)(b) and paragraphs 3(b)(ii), 20(3)(b)(i) and (iii) and 56(2)(a).

The amount of a debt benefit in respect of a debt that is denominated in a currency other than the currency of the Republic must be translated to the currency of the Republic (the rand) on the date on which the debt benefit arises by applying the applicable exchange rate under section 25D.

A foreign exchange loss may have been claimed as a deduction under section 24I(3)(a)and a foreign exchange gain included in income in one or more earlier years of assessment upon annual translation of the outstanding debt to rand or upon realisation of the debt in the current year of assessment. Foreign exchange losses must be included in income under section 8(4)(a) when a debt benefit arises. Foreign exchange gains included in the income of a debtor before a concession or compromise or as a result thereof remain taxable.

The amount of expenditure contemplated in section 19(2) or paragraph 12A(2) that was funded by a debt that is cancelled, waived, extinguished or settled must be determined:

- exclusive of VAT for a debtor that is a vendor and that is or was entitled to a deduction of input tax under section 16(3) of the VAT Act; and

- inclusive of VAT for a debtor that is not a vendor.

4.3. Public benefit activity: Bid to host or hosting of any international event – No. 122

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.

The approval of an international event for purposes of PBA 11(b) is at the discretion of the Minister. The Minister may approve an international event for purposes of PBA 11(b) having regard to the foreign participation in that event and the economic impact that event may have on the country as a whole. An organisation must submit comprehensive reasons why the Minister should approve the event as an international event for purposes of PBA 11(b).

The application for approval by SARS of the organisation bidding to host or hosting an international event as a PBO is therefore dependent on the approval of the international event by the Minister for purposes of PBA 11(b). An organization bears the onus of proving that it complies with the requirements relative to the approval as a PBO carrying on PBA 11(b) as discussed in this Note and must retain the necessary evidence to support the view taken. The burden may be

discharged by way of supporting evidence submitted by the organisation. Whether an organisation complies with the requirements of PBA 11(b) will be a factual enquiry and since, the facts and circumstances, pertaining to each organisation may differ, each case will be considered on its own merits.

4.4. Exclusion of certain companies and shares from a 'group of companies' as defined in section 41(1) – No. 75 (Issue 4)

This Note provides guidance on the application of the proviso to the definition of 'group of companies' in section 41(1).

The information in this Note is based on the income tax and tax administration legislation (as amended) as at the time of publishing and includes the following:

- The Taxation Laws Amendment Act 20 of 2021 which was promulgated on 19 January 2022 (as per Government Gazette 45787).
- The Tax Administration Laws Amendment Act 21 of 2021 which was promulgated on 19 January 2022 (as per Government Gazette 45788).
- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 19 of 2021 which was promulgated on 19 January 2022 (as per Government Gazette 45786)

Under specified circumstances the corporate rules provide relief from income tax when assets are disposed of between companies forming part of the same 'group of companies' as defined in section 41(1). Generally these relief measures defer the income tax on income and capital gains until the asset is disposed of to a third party or until a degrouping occurs.

The Act contains a global definition of 'group of companies' in section 1(1) and a narrower definition of the same term in section 41(1). The narrower definition generally applies for the purposes of the corporate rules but is also used elsewhere in the Act.

The definition in section 41(1) starts with the definition in section 1(1) and then proceeds to exclude specified companies and shares by way of a proviso. At issue is whether, after excluding the companies and shares listed in the proviso, the remaining companies meet the requirements of the definition of 'group of companies' in section 1(1) and comprise a group of companies under the definition of 'group of companies' in section 41(1). If not, the corporate rules may not apply to a transaction conducted between those remaining companies.

This Note is concerned with the application and effect of that proviso.

It is impermissible to interpret the proviso as an independent enacting clause and its provisions must be read having regard to the opening words of the definition of 'group of companies' in section 41(1). The exclusion by the proviso of, for example, a controlling company from a group of companies will accordingly impact on whether its controlled companies remain part of a group of companies under the corporate rules.

The exclusion of non-resident companies by the proviso does not constitute discrimination under South Africa's tax treaties.

4.5. Transfer Duty exemption: Public benefit organisations and institutions, boards or bodies – No. 75 (Issue 5)

This Note provides guidance on the interpretation and application of the following sections of the Transfer Duty Act:

- Section 9(1)(c), which exempts from the payment of transfer duty a PBO or any institution, board or body provided the whole or substantially the whole of the property acquired is used for carrying on one or more PBAs.
- Section 9(1A), which exempts from transfer duty the transfer of property by a PBO to any other entity controlled by that PBO.

For purposes of this Note, the transactions do not constitute taxable supplies of fixed property.

Transfer duty is levied on a sliding scale on the value of any property acquired by any person under a transaction or in any other manner. The person acquiring the property (the transferee) is normally the person who is liable for the payment of transfer duty.

All the exemptions from transfer duty are contained in section 9 of the Transfer Duty Act. The exemptions in section 9(1)(c) and section 9(1A) of the Transfer Duty Act apply only to PBOs and institutions, boards or bodies meeting requirements.

This Note provides general guidelines and considers the broad principles of the legislation. The particular circumstances of each case must be considered before an exemption from transfer duty can be approved.

4.6. Effect on the date of issue of a share arising from a change in the redemption feature – No. 123

This Note considers whether adding redemption features or making a change to the existing redemption features of a share constitutes a new date of issue for purposes of section 8E.

The Act has a number of anti-avoidance provisions aimed at preventing the use of an instrument with a legal form different from its substance with the aim of achieving a favourable tax position, for example, where shares are used to facilitate what is in substance a loan. Section 8E is one such provision that targets shares and equity instruments with substantial debt features. The treatment of these shares as hybrid financial instruments ensures that debt is not disguised as short-term redeemable preference shares or any other redeemable share containing certain dividend preferences.

Section 8E deems a dividend or foreign dividend on a hybrid equity instrument to be an amount of income accrued to the recipient and will not be exempt from normal tax. The payer is also not offered a deduction for the payment of affected dividends or foreign dividends.

The date of issue is important to determine whether a share qualifies as a hybrid equity instrument because that is the date from which the three-year period within which the presence of certain redemption rights or obligations for purposes of section 8E must be assessed.

Section 8E covers not only the date of original issue of a share, but also where redemption features are added or changed after the original issue of the share. The potential classification of a share as a hybrid equity instrument must be reassessed whenever an event occurs that falls within the definition of "date of issue".

The critical question as to when a variation of the redemption features of a share will result in a new date of issue under section 8E is considered in this Note.

Section 8E is an anti-avoidance provision preventing the use of shares to facilitate what is in substance a loan. The section applies to hybrid equity instruments as defined.

Section 8E also covers shares where redemption features are added or changed after the original date of issue of the share. A share which does not originally qualify as a hybrid equity instrument on date of issue will qualify as such when a change in the redemption feature is effected which brings it into the ambit of the definition. The "date of issue" of a share in a company is important in determining whether it qualifies as a hybrid equity instrument.

Not all additions or changes to the redemption features of a share will result in it becoming a hybrid equity instrument. The date and terms of the agreement and date of redemption are critical in this regard.

5. DRAFT INTERPRETATION NOTES

5.1. The VAT treatment of debt collection

This Note provides clarity on the VAT treatment of debt collection activities, whether undertaken by credit providers, in-house or outsourced to external debt

collectors. In particular, this Note examines the VAT treatment of the prescribed amounts recovered by the debt collector from the debtor under the DCA. This Note does not address debt collection activities outsourced to attorneys.

Credit providers incur substantial debt collection costs when debtors default on payment. Typically, the debtors are contractually liable under the credit agreement governing their relationship with the credit providers for the payment of the debt collection costs. The NCA regulates the legal relationship between the credit provider and the debtor.

The debt collection process may either be undertaken in-house by credit providers or outsourced to debt collectors for an agreed remuneration. The latter arrangement is formalised under a service level agreement (SLA) between the credit provider and the debt collector. The debt collector's remuneration will vary depending on the contractual terms agreed upon between the parties. Generally, the agreed remuneration includes a commission paid by the credit provider, calculated as a percentage of the amount collected from the debtor, as well as the recovery of the prescribed amounts under the DCA. The debt collector therefore acts on the mandate of the credit provider to collect the outstanding amounts owed by the debtor to the credit provider.

Debt collectors are regulated by, amongst others, the DCA. The recovery of the prescribed amounts is stipulated in the DCA. Examples of these prescribed amounts include fees for writing and sending letters, making telephone calls, and sending emails and short message services (SMSs). In practice, the prescribed amounts recovered from the debtor are usually retained by the debt collector, although the debt collector is normally obliged to first collect the actual debt from the debtor before proceeding to collect the prescribed amounts.

The issue at hand is whether the remuneration referred to under the SLA, including the commission and the prescribed amounts recovered by the debt collector from the debtor under the DCA, constitutes 'consideration', as defined in section 1(1) of the VAT Act, for the supply of debt collection services. Should these amounts be regarded as consideration for such supply, the question that follows is whether the credit provider or the debtor, being a vendor, is entitled to deduct the VAT paid on

these amounts as input tax

This Note provides clarity on the VAT consequences of debt collection services for various parties involved, namely, the debt collector, the credit provider and the debtor. In particular, it deals with the effect for the various parties regarding the recovery of certain costs and expenses as provided for in the NCA and DCA.

The conclusions may be summarised as follows:

- The supply of debt collection services by the debt collector to the credit provider is taxable at the standard rate, therefore, the commission paid for such services is subject to VAT at 15%.
- In the event that the agreed remuneration for debt collection services includes the recovery of the prescribed amounts under the DCA, such amounts retained by the debt collector are regarded as also being for the taxable supply of debt collection services. Accordingly, the prescribed amounts received for these services is also subject to VAT at 15%.
- Debt collection costs incurred by the creditor and recovered by the debt collector on behalf of the credit provider is not regarded as consideration received by the credit provider for any supply that it makes to the defaulting debtor. Since the recovery of such costs by the credit provider is not for any supply made, VAT is not required to be levied by the credit provider.
- The costs of outsourced debt collection services (that is, the commission paid by the credit provider and the prescribed amounts under the DCA retained by the debt collector) relate in its entirety to the collection of the debt that is not for purposes of consumption, use or supply in the course of making taxable supplies. Therefore, the credit provider is not entitled to deduct the VAT on the outsourced debt collection service as input tax.
- The costs of in-house debt collection also relate in its entirety to the collection of the debt that is not acquired for purposes of consumption, use or supply in the course of making taxable supplies. Thus, no input tax may be deducted by the credit provider in respect of acquisitions relating to such

costs.

- The debt collector on the other hand is entitled to deduct the VAT incurred on their own goods or services acquired as input tax, to the extent that they relate to the taxable supply of debt collection services.
- The debtor does not acquire debt collection services and as such is not entitled to deduct any VAT relating to the prescribed amounts or any other debt collection costs paid.

5.2. Section 18A: Audit certificate

This Note provides guidance on the interpretation and application of sections 18A(2B) and (2C) in relation to the audit certificate that must be obtained and retained in specified circumstances for section 18A receipts issued by an approved organisation or department.

Sections 18A(1) and (2) potentially provide a taxpayer with a deduction for bona fide donations paid or transferred to any approved organisation, agency, programme, fund, High Commissioner, office, entity, organisation or department, if the donation is supported by a section 18A receipt issued by that approved organisation, agency, programme, fund, High Commissioner, office, entity, organisation or department.

Generally speaking, under section 18A(2A) a PBO, an institution, board or body or a department may issue section 18A receipts only to the extent that the donation will be used to carry on PBAs in Part II in South Africa or, in the case of a conduit PBO, that 50% of the donations will be distributed within 12 months and that the funds will be used to fund PBOs, or institutions, boards or bodies, which carry on PBAs in Part II in South Africa.

A section 18A receipt issued by an approved organisation, agency, programme, fund, High Commissioner, office, entity, organisation or department is required to include a certification to the effect that the receipt is issued for the purposes of section 18A and that the donation has been or will be used exclusively for the

object of that organisation, agency, programme, fund, High Commissioner, office, entity or organisation or, in the case of a department, in carrying on the relevant PBA.

Part I of the Ninth Schedule lists a variety of activities that are recognised as PBAs for purposes of section 30(1). Part II of the Ninth Schedule lists some, but not all, of the activities listed in Part I for the purposes of section 18A. An organisation may conduct a combination of PBAs in Part I and PBAs in Part II. In this situation section 18A receipts can be issued only for donations that will be used for purposes of carrying on PBAs in Part II. Concerns arose regarding whether approved organisations and departments in these situations would restrict the issuing of section 18A receipts to donations that would be used for PBAs in Part II in South Africa.

As a result, the requirement for an approved organisation or department to obtain an audit certificate was introduced as a control measure to ensure that section 18A receipts were issued only for donations received or accrued during the year of assessment that would be and ultimately are used for purposes of PBAs in Part II. It is not unreasonable to require control over donations for which an approved organisation or department issues a section 18A receipt, since this potentially entitles the donor to claim a tax deduction that has a real cost to the fiscus given that the donee is normally not subject to tax on the donation received.

Section 18A(2B) and (2C) merely refer to an audit certificate. No detailed requirements are prescribed with regards to the information that must be contained on the audit certificate, or from whom the audit certificate should be obtained, with the exception of who must issue it in the case of a department. Thus uncertainty exists on how to comply with the audit certificate requirement.

This Note therefore provides guidance on what would be regarded as acceptable information on an audit certificate referred to in section 18A(2B) and (2C) and from whom such a certificate may be obtained.

Strict control measures must be applied to donations received by or accrued to approved organisations, agencies, programmes, funds, High Commissioners,

offices, entities, organisations and departments for which section 18A receipts are issued, since such donations may qualify for a tax deduction from the taxable income of taxpayers and as such represent a cost to the fiscus. Approved organisations, agencies, programmes, funds, High Commissioners, offices, entities, organisations and departments are therefore required to maintain proper control over the application and spending of such donations.

Approved organisations and departments must obtain and retain, or submit as appropriate, an audit certificate confirming that such donations were used in conducting PBAs in Part II and, in the case of conduit PBOs, also confirm that donations were distributed in accordance with section 18A(2A)(b)(i).

6. BINDING PRIVATE RULINGS

6.1. BPR 375 – Unbundling of shares in a CFC

This ruling determines the tax consequences of an unbundling transaction of the shares in a controlled foreign company.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 28 March 2022. 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 46(1) – paragraph (b) of the definition of ‘unbundling transaction’;
- section 46(2); and
- section 46(5).

Parties to the proposed transaction

The applicant: A resident company

Company A: A controlled foreign company that is a resident of country X and a wholly owned subsidiary of the applicant

Company B: A controlled foreign company that is a resident of country Y and 70%

held by Company A

Description of the proposed transaction

The applicant and its subsidiaries would like to restructure the group as there is no economic benefit for the applicant holding Company B via Company A. The applicant prefers to exercise direct control over its investment in Company B and the revised structure will place all the applicant's subsidiaries at the same level without administrative hurdles. The proposed transaction entails Company A unbundling all its shares in Company B to the applicant.

Conditions and assumptions

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

Ruling

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

- The proposed distribution by Company A of the shares held in Company B to the applicant will constitute an 'unbundling transaction' as defined in paragraph (b) of the definition of that term in section 46(1).
- In terms of section 46(2) Company A must disregard the distribution of the shares in Company B for purposes of determining its taxable income or assessed loss or its net income as contemplated in section 9D.
- The distribution of the shares by Company A must be disregarded in determining any liability for dividends tax in terms of section 46(5).

6.2. BPR 376 – Corporate restructuring

This ruling determines the capital gains tax, donations tax and securities transfer tax consequences of the applicants restructuring.

In this ruling references to sections and paragraphs are to sections of the relevant Act and paragraphs of the Eighth Schedule to the Act applicable as at 7 April 2022.

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

This is a ruling on the interpretation and application of:

- the Income Tax Act:
  - section 9C(6);
  - section 45;
  - section 54;
  - section 58(1);
  - paragraph 4;
  - paragraph 12A;
  - paragraph 13(1);
  - paragraph 20(1);
  - paragraph 32(3);
  - paragraph 35(1);
  - paragraph 38; and
  - paragraph 39.
- the STT Act:
  - section 8(1)(a)(iii); and
  - section 8(1)(a)(iv)(C).

Parties to the proposed transaction

The applicant: A resident company that is a wholly-owned subsidiary of co-applicant 1

Co-applicant 1: A listed resident company

Co-applicant 2: A resident company that is a wholly-owned subsidiary of the applicant

Description of the proposed transaction

The applicant is the main trading entity of the group.

Co-applicant 2 is a dormant company. The book value of its shares is R1.00 and the base cost of the shares exceeds that amount. Co-applicant 2 is not in an assessed loss position.

The applicant holds investments in South African subsidiaries, associates and cell captives and loan account claims (the investments). The market values of the investments exceed their book values and the base costs of some of the investments are less than their market values. Some of the investments have been impaired from an accounting perspective. The investments are held by the applicant as capital assets.

It is proposed that the shares in co-applicant 2 be transferred to co-applicant 1 and that all the investments be transferred from the applicant to co-applicant 2 so that the applicant will carry on trading entities only and co-applicant 2 will hold all the investments.

The proposed steps for implementing the restructuring are as follows:

- The applicant will sell all its shares in co-applicant 2 to co-applicant 1 for R1.00 with the result that the applicant and co-applicant 2 will both be wholly-owned subsidiaries of co-applicant 1.
- The applicant will transfer the investments to co-applicant 2 in accordance with section 45 for consideration equal to the book value of the investments.

The purchase price will be left outstanding on loan account on an interestfree basis and the loan will be repaid over time. The agreements to be concluded for the restructuring will contain suspensive conditions.

Conditions and assumptions

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

Ruling

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

- The applicant will receive proceeds of R1.00 from co-applicant 1 for the disposal of the shares in co-applicant 2 in terms of paragraph 35(1).
- The applicant will realise a capital loss in respect of the disposal of the shares in co-applicant 2 to co-applicant 1 in terms of paragraph 4(a).
- Paragraph 13(1)(a)(i) will apply to determine the date of disposal of co-applicant 2's shares by the applicant.
- Paragraph 38 will not apply to the disposal by the applicant of the shares in co-applicant 2 to co-applicant 1.
- Paragraph 39 will apply to the applicant's resulting capital loss.
- Sections 54 and 58 of the Act will not apply to the disposal of the shares, by the applicant, in co-applicant 2 to co-applicant 1.
- In terms of paragraph 20(1)(a), co-applicant 1 will acquire a base cost of R1.00 in the shares of co-applicant 2. It may apply paragraph 32(3)(a) electing which method to use to determine the base cost of the shares and section 9C(6) will not apply.
- The transfer of the shares in co-applicant 2 will be exempt from securities transfer tax in terms of section 8(1)(a)(iv)(C) of the STT Act.
- The disposal, by the applicant, of the investments to co-applicant 2 will meet the requirements of paragraph (a) of the definition of 'intra-group transaction' in section 45(1) of the Act.
- Section 45(2) of the Act will apply so that:
    - the applicant will be deemed to have disposed of the investments for an amount equal to the base costs of the investments on the date of disposal;
    - the applicant and co-applicant 2 must, for purposes of determining

any capital gain or capital loss in respect of the disposal of the investments by co-applicant 2, be deemed to be one and the same person with respect to:

- the date of acquisition of the investments by the applicant and the amount and date of incurral by the applicant of any expenditure in respect of the shares allowable in terms of paragraph 20;
- any valuation of the investments effected by the applicant as contemplated in paragraph 29(4).

- The applicant will be deemed to have acquired the purchase price loan account for expenditure of Rnil in terms of section 45(3A)(b)(i) of the Act.
- The applicant may apply paragraph 32(3)(a) electing which method to use to determine the base cost of the shares and section 9C(6) will not apply.
- The aggregate base costs of the investments will constitute proceeds in the hands of the applicant in terms of section 45(2) of the Act read with paragraph 35(1).
- Paragraph 13(1)(a)(i) will apply to determine the date of disposal of the investments by the applicant.
- Paragraph 12A will not apply in respect of the transfer of debt claims which have been impaired by the applicant.
- Paragraph 38 will not apply on the disposal of the investments by the applicant to co-applicant 2.
- Sections 54 and 58 of the Act will not apply in respect of the disposal by the applicant of the investments to co-applicant 2.
- The transfer of investments that constitute shares will be exempt from securities transfer tax in terms of section 8(1)(a)(iii) of the STT Act.

6.3. BPR 377 – Withholding of dividends tax at a reduced rate

This ruling determines the dividends withholding tax consequences resulting from the declaration of a dividend by a company to a trust where certain non-resident beneficiaries of that trust are the beneficial owners of these dividends.

In this ruling references to sections are to sections of the Act applicable as at 5 May 2022. 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 64D; and
- section 64G(3).

Parties to the proposed transaction

The applicant: A resident company

The co-applicant: A resident trust

Beneficiaries: Non-resident beneficiaries of the co-applicant

Description of the proposed transaction

The applicant intends to pay dividends in the 2023 tax year. The co-applicant is the shareholder of the applicant. The co-applicant's trust deed confers a discretion on the trustees to award income and capital to its beneficiaries. No limitation is placed on when such discretion may be exercised.

On a date preceding the actual declaration of such dividend, the trustees of the co-applicant will take a resolution to vest any dividend declared by the applicant in that year, in the beneficiaries.

The beneficiaries are residents of another tax jurisdiction. This jurisdiction has entered into a treaty with the Republic of South Africa for the avoidance of double taxation and the prevention of fiscal evasion, which provides for a reduced dividend withholding tax rate.

The co-applicant will obtain the required declarations as required by section 64G(3)

and submit these to the applicant before the date of payment.

Conditions and assumptions

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

Ruling

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

- The applicant will be required to withhold dividends tax at a reduced rate as contemplated in section 64G(3), provided that the declarations and written undertakings contemplated in section 64G(3)(a) and (b) will be submitted before payment of the dividend.

6.4. BPR 378 – Transfer of listed financial instruments to collective investment schemes in exchange for participatory interest

This ruling determines tax consequences of a transfer of listed shares to a portfolio of a collective investment scheme (CIS) in securities in exchange for participatory interests in those schemes.

In this ruling references to sections and paragraphs are to sections of the relevant Act and paragraphs of the Eighth Schedule to the Act applicable as at 10 May 2022.

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

This is a ruling on the interpretation and application of:

- the Income Tax Act:
  - section 9C(2);
  - section 42(1) – paragraph (a) of the definition of 'asset-for-share

transaction';

  - section 42(2)(a);
  - section 42(7)(a) and
  - Paragraph 61(3) of the Eighth Schedule.
- the STT Act:
  - section 8(1)(a)(i).

Parties to the proposed transaction

The applicant: A resident, acting as 'manager' as defined in section 1 of the Collective Investment Schemes Control Act, 45 of 2002 on behalf of portfolios of collective investment schemes in securities (the funds).

Description of the proposed transaction

The applicant acts as the fund manager for the funds on whose behalf it manages a segregated portfolio of investments comprising JSE listed financial instruments, foreign mutual funds and collective investment schemes in securities (the investments) with the aim of building long-term wealth for each investor. The investors are the beneficial owners of listed shares and have held the shares on capital account. The shares constitute 'equity shares' as defined in section 1(1) of the Act. The shares do not constitute hybrid equity instruments as envisaged in section 8E of the Act.

The proposed steps for implementing the envisaged 'asset-for-share transaction' are as follows:

- The investor intends to transfer the shares to the relevant fund in exchange for the issuance of participatory interests in the fund under section 42 of the Act; and
- Subsequently, the fund may be required to rebalance its portfolio by disposing of certain shares obtained in terms of the proposed transaction within 18 months of their acquisition in line with the fund's objective and investment mandate.

<u>Conditions and assumptions</u>

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

- The market value of each share transferred is equal to or exceeds its base cost.
- The shares are held as capital assets by the investors and will be acquired by the fund with the intention to hold them as capital assets.
- The ruling is not applicable to shares acquired by the fund which does not fit the fund's investment strategy and which the fund will acquire with the intention to immediately or shortly after dispose of, after entering into the 'asset-for-shares transaction'.
- The fund will not hold more than 25% of the equity shares in the listed companies that issued the shares.

<u>Ruling</u>

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

- Section 9C(2) will apply on disposal of the shares by the fund provided the shares have been held by the fund and the investors for three years in aggregate.
- The proposed transaction, being the transfer of the shares to the fund in exchange for the issuance of participatory interests in the fund to the investor, constitutes an 'asset-for-share transaction', as defined in paragraph (a) of the definition of that term in section 42(1).
- The investor and the fund will be deemed under section 42(2)(b) to be one and the same person with respect to:
  - the shares that will be acquired by the fund as capital assets from that investor who disposes of it as a capital asset;
  - the date of acquisition of that share by that investor; and

- the amount and date of incurral by the investor of any expenditure in respect of that share allowable in terms of paragraph 20 of the Eighth Schedule.

- Section 42(7)(a) will apply to the disposal of the shares by the fund, which were acquired as capital assets in terms of the 'asset-for-share transaction' and disposed of within 18 months after the transaction. However, the effect will be nil, due to the application of paragraph 61(3) of the Eighth Schedule.
- The transfer of the listed shares to the fund will qualify for an exemption from STT in terms of section 8(1)(a)(i) of the STT Act. It requires that the public officer of the relevant company provides a sworn affidavit or solemn declaration that the acquisition of the relevant security complied with the provisions of section 8(1)(a). This requirement would be met if the public officer of the fund (being the acquirer of the shares) provides a sworn affidavit or solemn declaration that the acquisition of the shares has complied with the provisions of section 8(1)(a) of the STT Act.

7. BINDING CLASS RULINGS

7.1. Tax implications for resident beneficiaries of a foreign pension trust – No. 80

This ruling determines the income tax, capital gains tax and estate duty implications for resident beneficiaries of a foreign pension trust.

In this ruling references to sections and paragraphs are to sections of the relevant Act and paragraphs of the Eighth Schedule to the Act applicable as at 11 July 2022. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of:

- the Act:

- section 1(1): definitions of 'gross income', 'pension fund', 'provident fund', 'retirement annuity fund' and 'trust';
- section 7(1);
- section 9HA;
- section 11F;
- section 25B;
- section 54;
- section 55: definitions of 'donation' and 'property';
- section 58;
- paragraph 1: definition of 'asset';
- paragraph 20(1);
- paragraph 35(1);
- paragraph 54;
- paragraph 80; and
- paragraph 81.

- the Estate Duty Act:
    - section 3.

Class

The class members to whom this ruling will apply are the resident investors who will become beneficiaries of the foreign pension trust (FPT).

Parties to the proposed transaction

The applicant: A resident company

The class: Resident investors who will make contributions to and become beneficiaries of the FPT

Description of the proposed transaction

The applicant is the founder of the FPT. The FPT is a non-resident pension scheme established under trust and constituted by way of trust deed. The FPT has scheme rules. Its proper law is not South African (SA).

The FPT was established in a foreign jurisdiction where its beneficiaries are potentially exempt from income tax on any annuities or lump sums paid pursuant to its pension scheme, provided that the individual to whom the annuity or lump sum is payable is not resident for income tax purposes in that jurisdiction.

The applicant intends to offer a financial product which will be housed in the FPT which is intended to be a pension scheme which will offer SA resident investors access to offshore hard currency retirement investment options with estate and succession planning benefits.

The applicant proposes that the scheme will operate as follows:

- An SA resident person (Investor) will make a contribution of cash or assets to the FPT. The contribution may be once-off or on an ad hoc basis.
- The Investor will make the contribution with the expectation of becoming a beneficiary/member of the FPT and receiving certain retirement benefits such as lump sums and/or annuities from the FPT, subject to the trustees of the FPT exercising their discretion in accordance with the scheme rules.
- The Investor will serve as a single member to the offshore retirement arrangement.
- Each Investor's retirement benefits will be determined with reference to the Investor's contribution.
- An Investor will be eligible to receive retirement benefits upon reaching the 'normal retirement date'.
- Prior to the normal retirement date, an Investor will be eligible to receive –
- 'discretionary distributions' of income or capital in the event of incapacity; and

- retirement benefits from the age of fifty years, subject to approval from the trustees of the FPT.
- The retirement benefits will be funded firstly from the capital contributed by the Investor to the FPT, the growth on that contribution, and then from any income earned because of the contribution. Any income earned prior to the Investor reaching the normal retirement date will, according to the applicant, vest in the Investor on the exercise of the trustees' discretion only and will be subject to the scheme rules.
- If an Investor dies prior to reaching the normal retirement date, the designated dependants of the deceased may become beneficiaries of the FPT. These beneficiaries may receive annuity payments or lump sum payments from the FPT subject to the trustees exercising their discretion in terms of the scheme rules.
- The FPT will not become obsolete if an Investor changes his or her country of tax residence.
- The applicant states that Investors will not have beneficial control of the contributions made to the FPT and any growth thereon.
- The FPT will provide protection from creditors and will not form part of the Investor's personal assets.
- The contributions and growth thereon will not at any time be encumbered by existing or potential liabilities of other Investor's.
- With respect to investment choices, most assets will be allowed including cash, quoted and unquoted shares, fixed interest securities, commercial and residential property, offshore insurance bonds and discretionary active managed or passive strategies.
- There will be no requirement for an Investor to purchase an annuity and there will be no prescribed drawdown limit.
- Investors may take a loan of up to 50% of the fund value before normal retirement date.

- With respect to beneficiary nominations, an Investor's assets may be passed to any nominated beneficiary or into a trust on the death of an Investor. Assets will not go through probate.

Conditions and assumptions

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

Ruling

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

- The FPT is not a 'pension fund', 'provident fund' or 'retirement annuity fund' as defined in section 1(1).
- Section 11F will not apply in respect of contributions made by Investors to the FPT.
- A contribution made by an Investor will not constitute a 'donation' as defined in section 55. Sections 54 and 58(1) will not apply to Investors in respect of contributions made to the FPT.
- An Investor will, upon becoming a beneficiary/member of the FPT, acquire a personal right against the trustees of the FPT to administer the trust appropriately, and a vested personal right to the income and capital of the FPT, subject to the time-based restrictions stipulated in the scheme rules.
- An Investor's personal right to the income and capital of the FPT will have a base cost in accordance with paragraph 20(1) of the Eighth Schedule equal to the contribution made by the Investor. Paragraph 81 of the Eighth Schedule will not apply in respect of the personal right of an Investor mentioned in this paragraph as the right is not a contingent right but a vested right.
- Section 7(1) will apply to the Investors of the FPT.

- When an Investor dies prior to normal retirement date, the vested personal right will constitute 'property' in terms of section 3 of the Estate Duty Act. The right will form part of the deceased Investor's dutiable estate.
- When an Investor dies prior to normal retirement date, he or she will be deemed to have disposed of his or her vested personal right before his or her death for market value in terms of section 9HA(1). Where the requirements of paragraph 54(b) of the Eighth Schedule are not satisfied, the market value of the right will be treated as proceeds for purposes of paragraph 35(1) of the Eighth Schedule.
- When an Investor reaches normal retirement date as stipulated in the scheme rules, any annuity paid by the FPT to the Investor will constitute an annuity for purposes of the Act which must be included in the gross income of the Investor in terms of paragraph (a) of the definition of 'gross income' in section 1(1).
- On the death of an Investor after normal retirement date, the right to an annuity will constitute 'property' as defined in paragraph (b) of the definition of 'property' in section 3 of the Estate Duty Act. The right to an annuity will fall within the dutiable estate of the deceased Investor.
- On the death of an Investor after normal retirement date, the Investor will be deemed to have disposed of the right to an annuity for market value in terms of section 9HA(1). The Investor will also be deemed to have disposed of his or her right to lump sum benefits for market value where the requirements of paragraph 54(b) of the Eighth Schedule are not satisfied.
- No ruling is made on the application of section 25B of the Act and paragraph 80 of the Eighth Schedule to the Investors.

7.2. Hybrid equity interest or third-party backed share – No. 81

This ruling determines whether a participatory interest held by a class member in a collective investment scheme (CIS) in securities constitutes a 'hybrid equity

instrument' as defined in section 8E or a 'third-party backed share' as defined in section 8EA.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 4 May 2022. 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 8E; and
- section 8EA.

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

The applicant: A resident management company of the CIS

The CIS: A portfolio of a collective investment scheme in securities in accordance with the provisions of Part IV of the Collective Investment Schemes Control Act 45 of 2002 (CISCA)

The class members: Resident natural persons, trusts, companies and pension funds

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

The CIS is open to the public and generally invests in dividend yielding instruments in accordance with the provisions of Board Notice 90 issued by the Financial Sector Conduct Authority and the provisions of the CISCA.

The CIS proposes to amend its investment portfolio and will, in future, invest in rated preference shares, bank preference shares, unit trust funds and interest-bearing investments which provide an appropriate return. The precise instruments in which the applicant proposes to invest, as well as the terms of those instruments, were furnished to SARS and were duly examined. The proposed transaction relates to the returns which will be received and distributed by the CIS in future.

The value of the participatory interest which the class members hold in the CIS will be determined partly with reference to the money market fund investments and

partly with reference to preference share investments. The participatory interests held by the class members are not subject to any arrangement in terms of which the issuer of that equity instrument is obliged to redeem that equity instrument or to distribute an amount constituting a return of the issue price in whole or in part.

The CIS will not invest in any instrument contemplated in paragraphs (a), (b) and (c) of the definition of a 'hybrid equity instrument' as defined.

The terms of the participatory interest do not entitle the class members to any of the rights contemplated in the definition of an 'enforceable right'.

Condition and assumption

This binding class ruling is subject to the following additional condition and assumption:

- The ruling is applicable solely to the investments made by the CIS as set out in the facts and which were examined by SARS.

Ruling

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

- The participatory interest in the CIS, held by a class member will not constitute a 'hybrid equity instrument' as defined in section 8E nor a 'third-party backed share' as defined in section 8EA.

8. GUIDES

8.1. VAT 404 – Guide fro Vendors (Issue 14)

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

The information in this guide is based on the VAT Act and the TA Act as at the time of publishing and includes the amendments contained in the Taxation Laws Amendment Act 20 of 2021, the Tax Administration Laws Amendment Act 21 of

2021 and the Rates and Monetary Amounts and Amendment of Revenue Laws Act 19 of 2021. These Acts were all promulgated on 19 January 2022 as per Government Gazettes (GGs) 45787, 45786 and 45788 respectively.

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

The following amendments came into effect from 1 April 2020 unless otherwise stated:

- Decisions to overcome difficulties, anomalies or incongruities – Section 72 was amended with effect from 21 July 2019 to align the wording with the construct and policy intent of the other provisions of the VAT Act. See 15.4.4 for more details and explanation.
- Foreign Donor Funded Projects (FDFPs) – The provisions relating to the tax treatment of FDFPs have been changed significantly by the introduction of the definition of 'implementing agency' as well as amending certain definitions in section 1(1) and section 50. See 2.1.4 and the VAT Reference Guide for Foreign Donor Funded Projects for more information.
- Transfer of ownership of reinsurance policies – The provision of reinsurance in respect of a life insurance policy is exempt from VAT under section 12(a) read with section 2(1)(i). The scope of the exemption was extended with an inclusion of the transfer of ownership of any life reinsurance policy to another reinsurer.
- Refining the VAT corporate reorganisation rules – A new proviso to section 8(25) was introduced to afford the roll-over relief in respect of the transfer of fixed property, only in instances where the supplier and the recipient have agreed in writing that, immediately after the sale, the supplier will lease the fixed property back after it has been transferred, to the recipient. (Section 8(25) was also amended by the addition of a further proviso with effect from 1 April 2021 – see the summary on the 2021 amendments below).

- Zero-rating of sanitary towels (pads) – The zero-rating of sanitary towels (pads) was introduced with effect from 1 April 2019, under section 11(1)(w) read with Part C of Schedule 2. The importation of sanitary towels (pads) is exempt from VAT under section 13(3) read with paragraph 7(d) of Schedule 1.
- Deregistration of certain foreign electronic services suppliers – With effect from 1 April 2019, the registration threshold for which a foreign electronic services supplier is obliged to register for VAT, was increased from R50 000 to R1 million. Binding General Ruling (VAT) 51 'Cancellation of Registration of a Foreign Electronic Services Supplier' (BGR 51) was issued clarifying that those foreign electronic services suppliers that fell below the new threshold could have their VAT registrations cancelled. Section 24(1) was subsequently amended and BGR 51 was withdrawn.
- Tax invoices issued by foreign suppliers of electronic services – Section 20(5B) was introduced in 2014 to give the Minister of Finance powers to issue a regulation that prescribed the particulars that must be contained in a tax invoice issued by foreign suppliers of electronic services. In the absence of such Regulation, SARS issued Binding General Ruling (VAT) 28 'Electronic services' (BGR 28) to provide clarity at the time. The Notice has since been published. See GN 1594 in GG 45324 dated 10 December 2021.

The following amendments came into effect from 1 April 2021:

- Cross border leases of foreign-owned ships, aircraft and rolling stock – proviso (xiii) to the definition of 'enterprise' was inserted to clarify that a foreign lessor is not regarded as carrying on an enterprise in the Republic where foreign-owned ships, aircraft or rolling stock are leased for use in the Republic, subject to certain conditions being met.
- Refining the VAT corporate reorganisation rules – A further proviso to section 8(25) was introduced to address the situation where under the Income Tax Act certain assets may not qualify for the roll-over relief even

though the asset form part of the entire transaction. The amendment allows for the parties to agree that the entire transaction be treated under the going concern provisions of section 11(1)(e), thereby qualifying for VAT relief.

- Zero-rating of telecommunication services – The zero-rating of international roaming services between resident telecommunication services suppliers and non-resident telecommunication services suppliers was introduced, under section 11(2)(y). To qualify for the zero-rating, the service must be as contemplated in the International Telecommunication Regulations that were concluded at the World Conference on International Telecommunications held in Dubai in 2012.
- Accounting basis for an intermediary – Section 15(2)(a)(vii) has been amended to allow an 'intermediary' involved in the supply of electronic services to account for VAT on the payments basis.
- Irrecoverable debts – Proviso (ii) to section 22(3) deals with the VAT adjustment to be made in respect of irrecoverable debts by a vendor that is sequestrated, declared insolvent, enters into a comprise arrangement or ceases to be a vendor. Proviso (ii) to section 22(3) has been amended to clarify that the output tax must be calculated by applying the tax fraction (at the rate applicable when the input tax deduction was made) to the unpaid amount.
- Management of superannuation schemes – The application of the special valuation rule in section 10(22A) has proved to be challenging. This has ultimately resulted in the provision being deleted.
- Imported services – Section 14(1)(a) has been amended to require the recipient of imported services to obtain, complete and retain VAT215 form. The effect of this amendment is that the recipient no longer has to furnish the physical VAT215 form to SARS, as it is completed online. The VAT215 record and the invoices issued by the foreign supplier must be retained as

relevant material by the recipient and must not be submitted to SARS for filing purposes.

- Second-hand goods – Section 20(8) prescribes information and documentation that must be retained by a vendor in respect of the acquisition of second-hand goods. The proviso to section 20(8)(a) has been amended to refer to identity card instead of identity document. This is to align with the terminology contained in the Identification Act, 1997.
- Special shops for diplomats – Paragraph 8 of Schedule 1 and Item 406.00 of that Schedule, were amended as a consequence of the substitution of the notes to rebate item 406.00 in Schedule 4 to the Customs and Excise Act. The amendment was as a result of concerns raised about the risk of abuse in the tax treatment of duty-free shops. In line with the amendments to the Customs and Excise Act, the VAT Act was also amended with effect from 1 August 2021, to regulate purchases made by diplomats at 'special shops for diplomats' as defined in the rules to the Customs and Excise Act. (See VAT Notices R. 369 in GG 44473 dated 23 April 2021 and R. 526 in GG 44705 dated 14 June 2021 for more details.) See also VAT Notice R2185 as published in GG 46589 dated 24 June 2022 regarding the inclusion of licensed customs and excise storage warehouses as places where diplomats may be able to obtain new motor vehicles.

The impact of the Covid-19 pandemic on the economy necessitated that certain tax relief measures be put in place. See the Disaster Management Relief Administration Act 13 of 2020, VAT Connect – Issue 11 (September 2020) and The International Trade Administration Commission of South Africa (ITAC) website for more information on exemptions and certificates relating to certain goods imported under item 412.11 that applied at the time.

The following amendments came into effect from 1 April 2022 unless otherwise stated:

- Life insurance / financial services – textual amendments have been made in section 2 to align the terminology used with reference to the Insurance

Act, 2017. As a result, the VAT Act now refers to 'life' insurance and not 'long-term' insurance. The amendments take effect from 19 January 2022.

- Temporary letting of dwellings by developers – New provisions in the form of sections 9(13), 10(29), 16(3)(o) and 18D have been introduced to deal with dwelling units that have been developed for sale by a developer and such dwellings are temporarily let for exempt residential use whilst the developer continues to pursue a taxable intention of selling the units. Section 18D applies from the date that any newly developed property held for taxable supplies is temporarily let for the first time on or after 1 April 2022. See 9.5.2 for more details.
- International telecommunications services – section 11(2)(y) was further amended to align the zero-rating of international telecommunications services with the International Telecommunication Regulations. The amendments confirm that the zero-rating will not apply if the telecommunications service is provided to any branch, main business or customer of an International Telecommunications Service Provider situated in the Republic. The only exception in this regard is the supply of international roaming services.
- Zero-rated foodstuffs – Item 2 of Part B to Schedule 2 to the VAT Act has been extended to include super fine maize meal in the list of zero-rated foodstuffs contemplated in section 11(1)(j).
- Estimated assessments – significant amendments were made to section 95 of the TA Act regarding certain aspects of estimated assessments with effect from 20 January 2021 and then again with effect from 19 January 2022. Section 95 of the TA Act previously allowed SARS to make an estimated assessment if a taxpayer does not submit a return or submits a return or relevant material that is incorrect or inadequate. These circumstances have now been expanded to include a situation where the taxpayer does not submit a response to a request for relevant material after delivery of more than one request for such material to the taxpayer. SARS

bears the burden of proving that the estimated assessment is valid and reasonable.

An estimated assessment does not detract from the obligation by a taxpayer to submit a return or the relevant material for the tax period concerned. A taxpayer may, however, within 40 business days from the date of the estimated assessment, request SARS to issue a reduced assessment or additional assessment by submitting a true and full return or the relevant material. If the taxpayer fails to do this, the assessment becomes final and will not be subject to objection or appeal. In that case, the burden of proof relating to the validity or reasonableness of the estimated assessment will move from SARS to the taxpayer. The period of 40 business days cannot be extended beyond the prescription period for VAT in section 99 of the TA Act except in a case where the estimated assessment is raised within 40 days of the prescription date. A consequential amendment was made to section 99 of the TA Act in this regard to provide that the prescription periods do not apply in a case where it is necessary to give effect to a reduced or additional assessment requested within the period of 40 business days.

For a further, more detailed explanation in regard to these amendments, see the Memorandum on the Objects of the Tax Administration Laws Amendment Bill, 2021.

Lastly, the Domestic Reverse Charge Regulations relating to certain transactions involving gold and other 'valuable metals' was published as Notice 2140 in GG 46512 dated 8 June 2022. The Explanatory Memorandum and Media Statement in relation to the Regulations were published on 13 June 2022. The Regulations come into effect from 1 July 2022 and will require certain vendors that supply 'valuable metal' (as defined in the Regulations) to re-validate their VAT registration with SARS. See Public Notice 2200 as published in GG 46598 dated 24 June 2022 for more details in this regard. The SARS website will be updated with further information, including a dedicated e-mail address that must be used to request validation. The Regulations essentially provide that the recipient of the supply of

valuable metal must account for the VAT on the supply instead of the supplier and that certain additional information to this effect must appear on any tax invoice issued in respect of a supply falling within the ambit of the Regulations. The duties and responsibilities of the affected suppliers and recipients are prescribed in the Regulations and further explained in the associated Explanatory Memorandum. More information in this regard will be made available in the next issue of VAT Connect.

8.2. Tax Exemption Guide for Public Benefit Organizations in South Africa (Issue 6)

This guide provides general guidance on:

- the approval as a public benefit organisation under section 30;
- the partial taxation of public benefit organisations under section 10(1)(cN); and
- approval of public benefit organisations under section 18A to issue section 18A receipts for donations, which potentially entitles the donor to an income tax deduction for bona fide donations made.

The guide deals with the following taxes and duties that may affect organisations approved as public benefit organisations:

- Capital gains tax
- Dividends tax
- Donations tax
- Employees' tax
- Estate duty
- Income tax
- Securities transfer tax

- Skills development levy
- Transfer duty
- Unemployment insurance contributions
- Value-added tax

This guide does not consider the following:

- The tax relief provided for COVID-19 disaster relief organisations under section 7 of the Disaster Management Tax Relief Act 13 of 2020 during the COVID-19 pandemic.
- The deduction of donations to COVID-19 disaster relief organisations under section 8 of the Disaster Management Tax Relief Act, 2020.
- The deduction of donations to the Solidarity Fund under section 5 of the Disaster Management Tax Relief Administration Act 14 of 2020 and the increase in the annual deduction limit for donations to that Fund under section 8 of the Disaster Management Tax Relief Act, 2020.

The principles and requirements of sections 30 and 18A to the extent that it relates to COVID19 disaster relief organisations and the Solidarity Fund must be applied in accordance with those Acts.

8.3. Tax Exemption Guide for Companies Wholly Owned by Institutions, Boards or Bodies

This guide provides general guidance on the exemption from income tax of qualifying wholly owned associations, corporations or companies of institutions, boards or bodies under section 10(1)(cA)(ii). These wholly owned associations, corporations or companies of institutions, boards or bodies enjoy preferential tax treatment only after SARS has granted them approval and if they continue to comply with the relevant requirements and conditions as set out in the Act and discussed in the guide.

Section 10(1)(cA)(i) and (ii) respectively provide an absolute exemption from income tax of the receipts and accruals of any:

- institution, board or body established by or under any law; and
- company all the shares of which are held by any institution, board or body provided the operations of such company are ancillary or complementary to the object of the institution, board or body.

An institution, board or body envisaged in section 10(1)(cA)(i) may for various reasons establish a company whose operations are ancillary or complementary to the object of the institution, board or body. If that institution, board or body holds all the shares in such company, the receipts and accruals of that company will also be exempt from income tax if the requirements of section 10(1)(cA)(ii) are met.

Section 10(1)(cA) does not contain provisions restricting or prohibiting business or trading activities. All the operations of the wholly owned company, however, must be ancillary or complementary to the object of the institution, board or body. If the company is merely a trading entity operating, say, a hotel, holiday resort, service station, cinema, or carries on business as a debt collector for the sole financial benefit of the institution, board, or body, it will not qualify for the exemption under section 10(1)(cA)(ii). Examples of qualifying operations may include the development and maintenance of the South African national road system, the provision of development finance to small, micro and medium enterprises to stimulate growth and development of the economy, mining, housing finance or investments. This guide considers only section 10(1)(cA)(ii).

Nonprofit organisantions play a significant role in society by undertaking shared responsibility for the social and developmental needs of the country, thus relieving the financial burden that would otherwise fall on the state.

Internationally, NPOs are granted some degree of preferential tax treatment including donor incentives, although the eligibility criteria and available benefits vary from country to country.

Tax benefits are designed to assist NPOs by augmenting their financial resources and providing them with an enabling environment in, which to achieve their

objectives. An organisation having a non-profit motive, or established or registered as an NPO under the NPO Act, or incorporated as an NPC does not automatically qualify for preferential tax treatment or approval as a PBO. Registration as an NPO is not a condition for approval as a PBO, since it is a voluntary registration lodged with the Director of NPOs. The Director of NPOs may, however, request SARS to withdraw the approval of any PBO convicted of an offence under the NPO Act.

The terms 'public benefit activity' and 'public benefit organisation' are defined in section 30(1) and form the basis for the preferential tax treatment of a PBO. An organisation will enjoy preferential tax treatment only after it has been granted approval as a PBO by SARS and continues to comply with the relevant prescribed requirements set out in the Act. Preferential tax treatment includes the benefit of being exempt from the payment of income tax on certain receipts and accruals and the benefit of being exempt from certain other taxes and duties.

Government has recognised that organisations are dependent on the generosity of the public, and, to encourage that generosity, has provided a tax deduction for certain donations made by taxpayers. The eligibility to issue section 18A receipts is, however, restricted to PBOs approved by SARS that use the donations for which they issue section 18A receipts to carry on or fund specific PBAs listed in Part II in South Africa.

The Basic Guide to Income Tax Exemption for Public Benefit Organisations provides a basic understanding of the requirements to obtain and retain approval as a PBO and the Basic Guide to Section 18A Approval provides a basic understanding of the requirements to obtain and retain approval under section 18A.

8.4. Tax Exemption Guide for Institutions, Boards or Bodies

This guide provides general guidance on the exemption from income tax of qualifying institutions, boards or bodies under section 10(1)(cA)(i). These institutions, boards or bodies enjoy preferential tax treatment after they have been granted approval by SARS and continue to comply with the relevant requirements and conditions as set out in the Act. Any institution, board or body approved by

SARS under section 10(1)(cA)(i) carrying on PBAs in Part II in South Africa may also qualify for approval under section 18A.

Section 10(1)(cA)(i) and (ii) respectively provide an absolute exemption from income tax of the receipts and accruals of any:

- institution, board or body established by or under any law (see 2) engaged in specified prescribed activities; and
- association, corporation or company all the shares of which are held by any such institution, board or body. The approval of this exemption will not be discussed in this guide.

The exemption under section 10(1)(cA)(i) will, however, apply only to the extent that such institution, board or body:

- has been approved by SARS subject to any conditions deemed necessary to ensure that the activities of that institution, board or body are wholly or mainly directed to the furtherance of its sole or principal object; and
- complies by law or under its constitution with the prescribed requirements.

Any institution, board or body approved by SARS under section 10(1)(cA)(i) carrying on PBAs in Part II in South Africa may potentially qualify for approval under section 18A subject to the requirements of that section being met. An institution, board or body bears the onus of proving that it complies with the requirements relative to the exemption and approval under section 18A and must retain the necessary supporting evidence.

8.5. Tax Exemption Guide for Recreational Clubs (Issue 4)

This guide provides general guidance on the approval of qualifying recreational clubs under section 30A and the partial taxation of the receipts and accruals under section 10(1)(cO).

A recreational club will enjoy preferential tax treatment only after it has been granted approval by SARS and continues to comply with the relevant requirements

and conditions set out in section 30A. The qualifying receipts and accruals of an approved recreational club are exempt from income tax under section 10(1)(cO), however, non-qualifying receipts and accruals are subject to partial taxation to the extent that they exceed the basic exemption. The underlying principle in establishing a recreational club is that members provide money by way of membership fees or subscriptions that in turn are used by the club to finance amenities or facilities for their collective enjoyment. Members therefore contribute to share the cost of providing a collective benefit, namely, the social or recreational amenity or facility. Essentially no business or trade is carried on and there is no personal financial gain for the individual members. Under this principle, the sharing of expenses by various members joining based on mutuality does not generate additional taxable income for a recreational club.

Recreational clubs fall outside the scope and tax rules for PBOs. The main difference between a recreational club and a PBO is that a PBO operates for the benefit of the general public at large, while a recreational club operates for the benefit of its members. A PBO predominantly relies on donations, grants or bequests to fund its objects, while a club receives its income from its members who contribute by way of membership fees or subscriptions. Any bona fide donations made to a recreational club are not tax-deductible under section 18A in determining the taxable income of a donor.

8.6. Basic guide to Section 18A approval (Issue 4)

This guide has been prepared to assist organisations in understanding the basic requirements for obtaining and retaining approval under section 18A. It does not deal comprehensively with the technical and legal detail and should not be used as a legal reference. The previous archived issue of this guide is titled the Basic Guide to Tax-Deductible Donations.

The Tax Exemption Guide for Public Benefit Organisations in South Africa can be consulted for comprehensive information on both the approval of public benefit organisations as well as the approval under section 18A.

The Basic Guide to Income Tax Exemption for Public Benefit Organisations can also be consulted for a basic understanding of the requirements to obtain and retain approval as a public benefit organisation under section 30.

This guide is based on the legislation as at time of issue.

This guide does not consider the tax relief provided under section 8 of the Disaster Management Tax Relief Act 13 of 2020 during the COVID-19 pandemic. The principles and requirements relating to the deduction of donations to COVID-19 disaster relief organisations under section 18A apply only to donations made in accordance with that Act. This guide also does not consider the deductions of donations made by employers on behalf of their employees to the Solidarity Fund under section 5 of the Disaster Management Tax Relief Administration Act 14 of 2020.

Government has recognised that certain organisations are dependent on the generosity of the public and to encourage that generosity has provided a tax deduction for certain donations made by taxpayers. The eligibility to issue section 18A receipts is restricted to specific organisations approved by SARS that use the donations to carry on or fund specific PBAs in South Africa.

The aforementioned specific organisations must apply to SARS for approval under section 18A to issue section 18A receipts for donations received. A section 18A receipt may be issued by a section 18A-approved organisation only from the date SARS has confirmed section 18A approval. SARS issues a reference number for purposes of section 18A which must appear on the section 18A receipts.

8.7. Foreign Donor Funded Projects – VAT reference guide (Issue 2)

This reference guide provides information and guidelines regarding the value-added tax (VAT) treatment of foreign donor funded projects (FDFPs).

The South African government may enter into international donor funding agreements with foreign governments or other international entities in terms of

which goods or services must be supplied for the benefit of people in South Africa (SA). The international donor funding agreements, also commonly referred to as Official Development Assistance Agreements (ODAAs), are pursuant to section 231(3) of the Constitution of the Republic of South Africa Act 108 of 1996 (the Constitution) and the ODAA stipulate that such funding cannot be used to pay for any taxes imposed under South African Law. The project under which this agreement is facilitated is known as an FDFP.

In order to give effect to the requirement stipulating that such funding cannot be used to pay for any taxes imposed under South African Law, the South African VAT legislation was designed in such a way that:

- no VAT is levied on the international funding received; and
- South AfricanVAT charged to the FDFP on the acquisition of goods or services or VAT paid by the FDFP on the importation of goods, for purposes of the project, may be deducted as input tax.

Recent legislative changes resulted in a significant change in the administration of FDFPs for VAT purposes. The main difference between the old and new legislation is with reference to the 'person' who is required to register for South African VAT.

The purpose of this reference guide is to provide certainty to taxpayers on the VAT treatment of FDFPs implemented by an implementing agency. The guide is divided into five parts:

- Part I sets out the development of the South AfricanVAT system with regard to FDFPs and introduces the concept of an FDFP together with the different persons involved.
- Part II provides guidance on the VAT registration requirements and procedures of FDFPs registered by SARS as vendors on or after 1 April 2020.
- Part III sets out the VAT consequences of any transactions entered into by an implementing agency for the purpose of an FDFP.

- Part IV deals with the various documentary and record-keeping requirements set out in the VAT Act.
- Part V contains comprehensive examples illustrating the various VAT principles discussed in this guide.

8.8. Value-Added Tax levied on the importation of goods into South Africa – Customs & Excise

The guide enhances the understanding of the payment of value-added tax (VAT) on goods imported into the Republic.

VAT is an indirect tax charged on the consumption of goods and services in South Africa. Import VAT and customs duty may be leviable on goods that are imported into South Africa. This has to be paid or secured before the goods will be released from SARS Customs' control. VAT paid on the importation of goods by a vendor may be deducted as input tax, subject to the following.

From 1 April 2015, VAT may only be deducted during the tax period when the goods are released under the Customs and Excise Act

For purposes of deducting the VAT paid on the importation of goods, the vendor making the deduction must be in possession of the following documentation:

- An 'EDI Customs Status 1 Release Message'
- A valid bill of entry or other document prescribed by the Customs and Excise Act (for example, form SAD 500 and any additional SAD document that might be required)
- The receipt number for the payment of such tax, that is, the receipt issued on eFiling

From 1 April 2015 where the goods are imported by an agent acting on behalf of the vendor (being the principal), and the bill of entry or such other document prescribed by the Customs and Excise Act is held by the agent, the agent must

furnish the vendor with a statement within 21 days at the end of the calendar month during which the goods were imported, containing the following particulars:

- The full and proper description of the goods
- The quantity or volume of the goods
- The value of the goods
- The amount of tax paid and the receipt relating to the payment of such tax, that is, the receipt number issued on eFiling for such payment

The vendor must be in possession of the aforementioned statement at the time the VAT return containing the deduction is submitted to SARS. Furthermore, in addition to furnishing the statement, the agent must maintain sufficient records to enable the name, the address and VAT registration number of the vendor to be ascertained.

Further:

- the goods that are imported must be acquired by the vendor wholly or partly for consumption, use or supply in the course of making taxable supplies;
- VAT at the standard rate must have been charged on the importation of the goods; and
- the appropriate documentation must be held by the vendor, in this case, a bill of entry or other prescribed customs documentation86 which may be required in the circumstances, including the receipt for the payment of the VAT to Customs, that is, the receipt number on eFiling. Should such bill of entry or other prescribed documentation be held by the vendor's agent, the vendor must be in possession of a statement received from such agent containing, amongst other particulars, the receipt number for the payment of the VAT on importation issued on eFiling.

9. DRAFT GUIDES

9.1. Draft guide on the taxation of farming operations

This guide is a general guide regarding the taxation of farming operations in South Africa.

This guide is based on the legislation as at date of issue.

Farming contributes largely to job creation and is a major contributor to the gross domestic product. Just as there are many different types of farming operations, for example pastoral farming, crop farming, plantation farming, aquaculture and game farming, there are also a variety of different methods of conducting farming operations, such as free-range farming, organic farming and conventional farming.

Various factors such as the climate, demand for products as well as the high costs associated with farming have an impact on successful farming. These factors can potentially negatively impact a farmer's income and expenditure on a regular basis.

To assist farmers, a beneficial set of tax rules applies to farming operations and the income and expenses emanating from such operations. Section 26(1) provides that the taxable income of any person carrying on farming operations shall, in so far as the income is derived from such operations, be determined in accordance with the Act but subject to the First Schedule.

The First Schedule details the computation of taxable income derived from farming operations. The taxable income from farming operations is combined with the taxable income from other sources to arrive at the taxpayer's taxable income for the year of assessment. The First Schedule applies regardless of whether a taxpayer derives an assessed loss or a taxable income from farming operations. The First Schedule may also apply even after farming operations have been discontinued.

The main aim of this guide is to highlight the tax consequences for persons conducting farming operations in South Africa.

Farming can be a very lucrative business in South Africa. It is, however, very dependent on various factors such as the climate, demand for a product and the

weather, amongst others. This may result in fluctuations in taxable income with farmers not producing any yield in one year but exceeding expectations in the next.

To assist farmers, a beneficial set of tax rules applies to farming operations and the income and expenses emanating from such operations. Section 26 stipulates the persons and circumstances that this section will find application while the First Schedule sets out how to compute the taxable income of the persons engaged in farming operations.

Generally, the farmer will be required to bring to account the value of livestock and produce in opening and closing stock. In the event that standard values have been prescribed by regulation, these must be used, unless the farmer has entered into an agreement with the Commissioner that other values may be used. Livestock and produce which are acquired by donation or through inheritance must also be included in opening stock in the year of acquisition at market value under paragraph 4.

The deduction under section 11(a) for the cost of livestock and produce is ring-fenced under paragraph 8, while an assessed loss or balance of assessed loss from farming is subject to potential ring-fencing under section 20A.

10. 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.