# TAX UPDATE

**For period: January 2021 to March 2021**

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# 1. INTRODUCTION

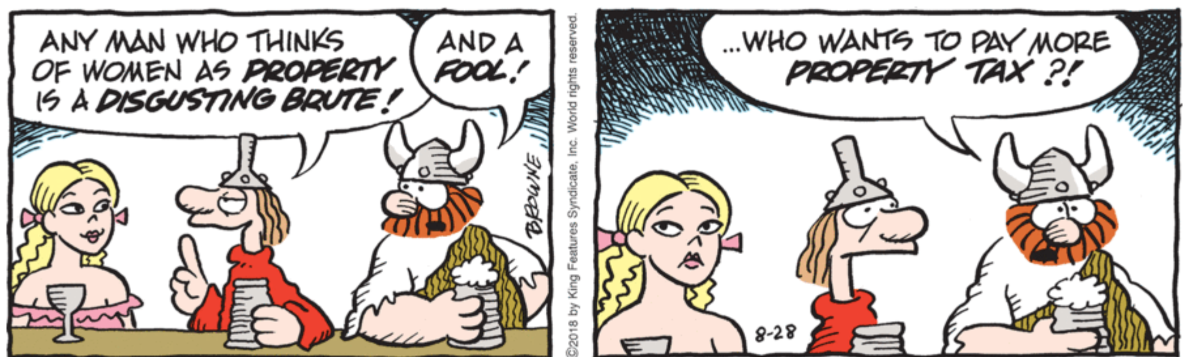
The purpose of this update is to summarise developments that occurred during the first quarter of 2021, specifically in relation to Income Tax and VAT. Johan Kotze, a Tax Executive at Shepstone & Wylie Attorneys, has compiled this summary.

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. ACTS PROMULGATED

The following Acts were promulgated in this quarter (20 January 2021):

- Rates and Monetary Amounts and Amendment of Revenue Laws Act, 2020 (20 January 2021)
- Taxation Laws Amendment Act, 2020
- Tax Administration Laws Amendment Act, 2020

# 3. BUDGET

## *3.1. Main tax proposals for 2021/20*

The main tax proposals are:

- An above-inflation increase of 5% in personal income tax brackets and rebates.
- Coroparte tax rates dropping from 28% to 27%..

## *3.2. Personal tax rates*

| 2021 year of assessment | | 2022 year of assessment | |
|---|---|---|---|
| **Taxable Income** | **Rates of tax** | **Taxable Income** | **Rates of tax** |
| R0 – R205 900 | 18% of each R1 | R0 – R216 200 | 18% of each R1 |
| R205 901 – R321 600 | R37 062 + 26% of the amount above R205 900 | R216 201– R337 800 | R38 916 + 26% of the amount above R216 200 |

| | | | |
|---|---|---|---|
| R321 601 – R445 100 | R67 144 + 31% of the amount above R321 600 | R337 801 – R467 500 | R70 532 + 31% of the amount above R337 800 |
| R445 101 – R584 200 | R105 429 + 36% of the amount above R445 100 | R467 501 – R613 600 | R110 739 + 36% of the amount above R467 500 |
| R584 201 – R744 800 | R155 505 + 39% of the amount above R584 200 | R613 601 – R782 200 | R163 335 + 39% of the amount above R613 600 |
| R744 801 – R1 577 300 | R218 139 + 41% of the amount above R744 800 | R782 201 – R1 656 600 | R229 089 + 41% of the amount above R782 200 |
| R1 577 301 and above | R559 464 + 45% of the amount above R1 577 300 | R1 656 601 and above | R587 589 + 45% of the amount above R1 656 600 |
| | | | |
| **Rebates** | | **Rebates** | |
| Primary | R14 958 | Primary | R15 714 |
| Secondary | R8 199 | Secondary | R8 613 |
| Third rebate | R2 736 | Third rebate | R2 871 |
| **Tax threshold** | | **Tax threshold** | |
| Below age 65 | R83 100 | Below age 65 | R87 300 |
| Age 65 and over | R128 650 | Age 65 and over | R135 150 |
| Age 75 and over | R143 850 | Age 75 and over | R151 100 |

The personal income tax brackets and the primary, secondary and tertiary rebates increased by 5.2% for 2020/21, which is above expected inflation of 4.4%. This

adjustment provides R2 billion in tax relief. The change in the primary rebate increases the taxfree threshold from R79 000 to R83 100.

### 3.3. Medical tax credits

An increase in medical tax credits from R319 to R332 per month for the first two beneficiaries, and from R215 to R224 per month for the remaining beneficiaries.

### 3.4. Paid-up retirement annuities

The minimum value for paid-up retirement annuities has not been adjusted since 2007/08. This value will increase from R7 000 to R15 000 from 1 March 2021

### 3.5. Corporate income tax & tax incentive reforms

Government is reducing the number of tax incentives, expenditure deductions and assessed loss offsets, with the aim of lowering the corporate income tax rate over the medium term. These changes are expected to enhance efficiency, transparency and fairness in the business tax system, while facilitating economic growth through improved investment and competitiveness.

Although corporate income tax is paid by the business, the burden of this tax is ultimately borne by three parties – the owners of capital, labour (through wages) and consumers (through prices). By implication, reducing the rate can have a positive effect on wages and employment, while promoting additional investment.

As discussed in the 2020 Budget Review, South Africa has a relatively high corporate tax rate in comparison with similar countries and trading partners. High tax rates reduce competitiveness and create an incentive for profit shifting to lower-tax jurisdictions.

Tax incentives are public subsidies to the private sector. They illustrate a persistent

trade-off in tax policy: the narrower the tax base, the higher the tax rate required to raise a given level of revenue. For example, many African countries have corporate income tax rates similar to or higher than South Africa, but raise lower levels of revenue because their tax bases are often narrower due to generous incentives, exemptions and tax holidays. Tax incentives often undermine the principles of a good tax system, which should be simple, efficient, equitable and easy to administer.

Reducing the extent of tax incentives for individuals and companies will provide the fiscal room to lower the corporate tax rate, which is aimed at benefiting all businesses, employees and consumers. Tax incentives and some expenditure deductions provide favourable tax treatment to certain taxpayers or groups of taxpayers, and inevitably result in the creation of vested interests and lobby groups. The 2021 Budget proposes to either limit or let lapse those tax incentives that erode the equity of the tax system or do not meet their intended objectives.

The 2020 Budget Review stated that government intends to restructure the corporate income tax system in a revenue-neutral manner. This requires broadening the tax base through limiting assessed losses and interest expense deductions to ensure the proposals are affordable. Since February 2020, many businesses have either closed down or are in financial distress as a result of pandemic-related restrictions on economic activity. Government has therefore postponed the introduction of these two measures until 2022.

In February 2020, a discussion document on limiting excessive interest deductions was released for public comment, followed by public consultation. After assessing the comments, government proposes to expand the scope of the current interest limitation rules to include some similar interest items; to adjust the fixed-ratio limitation for net interest expense to 30% of earnings; and to restrict only connected-party interest rather than total interest.

### 3.6. Tax incentices

The sunset date for the venture capital company (VCC) incentive, which was initiated in 2009 to encourage retail investments in smaller businesses, will not be extended beyond 30 June 2021. A National Treasury assessment determined that the incentive did not sufficiently achieve its objectives of developing small businesses, generating economic activity and creating jobs. Instead, it provided a significant tax deduction to wealthy taxpayers. The majority of investments supported by the incentive seem to be in low-risk or guaranteed return ventures that would have attracted funding without the incentive.

As announced in the 2020 Budget, a sunset date of 28 February 2022 has been introduced for tax incentives dealing with airport and port assets, rolling stock, and loans for residential units. Together with the incentive providing exemptions for films, these incentives will lapse once they reach their respective sunset dates. The National Treasury is accepting detailed submissions from affected stakeholders who wish to retain these provisions in the tax code. The submission deadline is 31 March 2021. The urban development zones and learnership tax incentives will be extended for two years while their reviews are completed.

### 3.7. Rebuilding the South African Revenue Service

The Commission of Inquiry into Tax Administration and Governance by SARS (the Nugent Commission) made 27 recommendations to address governance failures at the institution. To date, the Commissioner for SARS has implemented 14 of these recommendations, including re-establishing the Large Business Centre, and units focusing on litigation, compliance and integrity.

The performance of the previous executive committee was reviewed, and operational policies related to VAT refunds, settlements and debt collection contracts are being amended.

This year, SARS has started legal processes to recover unwarranted expenditure and handed over case files on persons identified in the Nugent report. The

inter-agency working group on criminal and illicit economic activities completed 117 investigations, yielding revenue of R2.7 billion. Customs and excise operations are reducing the illicit movement of goods across borders, assisted by specialised cargo scanners, resulting in 3 393 seizures valued at R1.5 billion for the fiscal year to January 2021.

Following the recommendations of the Davis Tax Committee, SARS will focus on consolidating wealth data for taxpayers through third-party information. This will assist in broadening the tax base, improving tax compliance and assessing the feasibility of a wealth tax.

As noted in the 2020 Budget Review, the Minister of Finance is responsible for implementing Nugent Commission policy recommendations. A National Treasury discussion document proposing legislative amendments to SARS governance, delayed by COVID-19, will soon be published. The document outlines processes to appoint and remove a commissioner, and the establishment of at least two deputy commissioners and an executive committee. It also considers measures to improve governance and integrity oversight processes, including the feasibility of a governance board, an inspector-general and mechanisms to account to the Minister of Finance.

An additional spending allocation of R3 billion will be provided to SARS to modernise its technology infrastructure and systems, expand and improve the use of data analytics and artificial intelligence capabilities, and participate meaningfully in global tax compliance initiatives. A digitalised SARS is intended to lower costs of compliance, simplify tax administration and improve collections.

## *3.8. UIF contributing ceiling*

The ceiling for contributions to the Unemployment Insurance Fund (UIF) has not been increased in the last four years, despite the increase in the benefit ceiling. The UIF's benefit provision in the last year has assisted 13.9 million workers. In these circumstances, the continued relief for employees who retain jobs and higher salaries is no longer appropriate.

The contribution ceiling will therefore return to be in line with the benefit ceiling and set at R17 711.58 per month from 1 March 2021.

### *3.9. Financial sector*

With the implementation of the Twin Peaks regulatory system since 1 April 2018, regulated companies in the financial sector will be expected to pay a levy towards the regulatory costs. A bill to impose levies on the financial sector is expected to be tabled in early 2021, and the resulting revenue will fund the Prudential Authority, the Financial Sector Conduct Authority and other entities and activities outlined in the Financial Sector Regulation Act (2017).

### *3.10. Tax research & reviews – Reviewing the research and development incentives*

The research and development tax incentive has evolved since it was introduced in 2006, and expires on 1 October 2022. The National Treasury and the Department of Science and Innovation will in 2021 publish a discussion paper inviting public comment on the future of the incentive.

### *3.11. Tax research & reviews – Reviewing tax provisions for travel and working from home*

In light of the large-scale migration to working at home over the past year, the National Treasury will review current travel and home office allowances to investigate their efficacy, equity in application, simplicity of use, certainty for taxpayers and compatibility with environmental objectives. In recognition of the potential effect on salary structuring, this will be a multi-year project, starting with consultations during 2021/22.

### 3.12. Reviewing the nature of long-service awards for fringe benefit purposes

The Income Tax Act permits an employer to grant a long-service award (in the form of an asset or a non-cash benefit) to an employee as a no value fringe benefit provided that the value of this award does not exceed R5 000. Currently, employers recognise long service through awards in a variety of forms that could be considered non-cash benefits in terms of the act. Therefore, it is proposed that the current provisions of the act be reviewed to consider other awards within the same limit granted to employees as long-service awards.

### 3.13. Curbing abuse in the employment tax incentive

The employment tax incentive (ETI) is aimed at reducing the cost of hiring youth between the ages of 18 and 29 years old. It allows employers to reduce their PAYE tax payments to the SARS for the first two years in which they employ qualifying employees with a monthly remuneration of less than R6 500, subject to certain limitations. Some taxpayers have devised certain schemes using training institutions to claim the ETI for students. To counter this abuse, it is proposed that the definition of an 'employee' be changed in the Employment Tax Incentive Act (2013) to specify that work must be performed in terms of an employment contract that adheres to record-keeping provisions in accordance with the Basic Conditions of Employment Act (1997). These amendments will take effect from 1 March 2021.

### 3.14. Clarifying the timing of disposal rules in respect of an asset acquired from a deceased estate

When a person dies, the Estate Duty Act (1955) provides for the assets of the person to be transferred to the estate of the deceased before the assets are distributed to their heirs. The act also provides for the executors to administer this estate, which includes preparing and submitting the liquidation and distribution

account to the Master of the High Court Office, and submitting the relevant tax returns – including payment of the estate duty – to SARS.

Legally, the liquidation and distribution account must remain open for inspection in the Master of the High Court Office for 21 business days. Once the liquidation and distribution account is finalised, the personal right of the heirs to claim delivery of the assets is triggered. At present, there is timing uncertainty around when the heirs are regarded as having acquired an asset from the estate of the deceased. To clarify the time of disposal of this personal right, government proposes that the legislation be changed so that the disposal by the estate occurs on the date when the liquidation and distribution account becomes final.

### *3.15. Tax treatment of the cession of a right to receive an asset*

The Income Tax Act specifies certain amounts to be included in 'gross income', which is defined in section 1, and certain disposals that are regarded as donations in terms of section 56. Some taxpayers have devised schemes to undermine both the abovementioned provisions. These schemes entail a service provider (for example, an employee or independent contractor) ceding the right to receive or use an asset to be received from the person to whom the services are rendered or are to be rendered.

The right is generally ceded to a family trust for no consideration. In these instances, the service provider will be able to circumvent the gross income provisions as the asset would have been ceded to the trust before a value can be attached to it. In addition, the service provider will not be liable for donations tax, as it appears as though they are disposing of a worthless asset and are therefore not liable for donations tax until the services have been rendered and the employer transfers the asset to the cessionary. Moreover, the service provider will not be entitled to the asset and therefore cannot be regarded as having disposed of it. In order to address these kinds of schemes, it is proposed that changes be made to the above-mentioned tax provisions.

### *3.16. Strenghtening anti-avoidance rules in respect of loan transfers between trusts*

Anti-avoidance measures were introduced in 2016 to curb the transfer of growth assets to trusts using low-interest or interest-free loans, which was done to avoid estate duty on the asset's subsequent growth in value. In 2017 and in 2020, further changes were made to the tax legislation to counter new attempts to undermine these rules. Some taxpayers may continue to undermine the current rules by transferring loans – which finance high-value assets – between trusts, where the founder of one trust is related to one or more beneficiaries of the other trust. To curb this abuse, it is proposed that further changes be made to these anti-avoidance rules.

### *3.17. Retirement provisions: Allowing members to use retirement interest to acquire annuities on retirement*

On retirement, a member of a retirement fund may receive an annuity. The annuity is to be provided with the balance of the member's retirement interest following commutation (where the member is allowed to take, or commute, a lump sum equal to a maximum of one-third of the retirement interest on retirement). The retirement fund can provide the annuity by paying it directly to the member, or purchasing it from a South African registered insurer in the name of the fund or purchasing it in the name of the retiring member. If a member opts to receive an annuity, the full value of their retirement interest following commutation must be used to provide either of the abovementioned annuities.

Therefore, a member is prohibited from using their retirement interest to acquire various annuities. To increase flexibility for a retiring member and maximise the retirement capital available to provide for an annuity, government proposes expanding the amount of retirement interest that may be used to acquire annuities.

### 3.18. *Retirement provisions: Applying tax on withdrawals of retirement interest when an individual ceases to be a tax resident*

When an individual ceases to be a South African tax resident, retirement funds are not always subject to withdrawal tax in terms of the act. At issue is the tax treatment of retirement interest when an individual ceases to be a South African tax resident, but retains his/her investment in a South African retirement fund, and only withdraws from the retirement fund when he/she dies or retires from employment. Section 9(2)(i) of the Income Tax Act deems such amounts to be from a South African source, thus remaining within South African tax jurisdiction despite the individual no longer being a South African tax resident.

The challenge arises when the individual ceases to be a South African tax resident before he/she retires and becomes a tax resident of another country. When that individual withdraws from the retirement fund, due to the application of the tax treaty between South Africa and the other country, the retirement fund interest will be subject to tax in the other country as the individual will, in terms of the tax treaty, be regarded as a tax resident in that other country. The provisions of the tax treaty between South Africa and the new resident country will result in South Africa forfeiting its taxing rights. To address this anomaly, government proposes changing the legislation as follows.

When the individual ceases to be a South African tax resident, the retirement fund interest will form part of the assets that are subject to retirement withdrawal tax. The individual will be deemed to have withdrawn from the fund on the day before he/she ceases to be a South African tax resident.

If the individual ceases to be a South African tax resident but leaves his/her investment in a South African retirement fund and only withdraws from the retirement fund when he/she dies or retires from employment, then the retirement withdrawal tax (including associated interest) payment will be deferred until payments are received from the retirement fund or as a result of retirement. When the individual eventually receives payments from the fund, the tax will be calculated

based on the prevailing lump sum tables or in the form of an annuity. A tax credit will be provided for the deemed retirement withdrawal tax as calculated when the individual ceased to be a South African tax resident.

### *3.19. Retirement provisions: Transfers between retirement funds by members who are 55 years or older*

The Income Tax Act stipulates that any transfer by a member of a pension, provident or retirement annuity fund (who has opted to retire early) into a similar fund would be considered a taxable transfer. The policy in this regard is not intended to tax transfers from a less to a more restrictive fund, or between similar funds. To address this anomaly, government proposes allowing tax-free transfers into more or similarly restrictive funds by members who have already opted to retire.

### *3.20. Retirement provisions: Clarifying the calculation of the fringe benefit in relation to employer contributions to a retirement fund*

From 1 March 2016, all employer contributions to a retirement fund on behalf of employees were considered taxable fringe benefits for the employees. If the contribution contains a defined benefit component, the fringe benefit is to be calculated in accordance with the Seventh Schedule of the Act and the employer must provide the employee with a contribution certificate. An anomaly arises in instances where a retirement fund provides both a retirement benefit in relation to the defined contribution component and a self-insured risk benefit. The current interpretation of the legislation would result in the classification of the total contribution to the fund as a defined benefit component because self-insured risk benefits are not considered a defined contribution component.

It is proposed that self-insured risk benefits be classified as a defined contribution

component to ensure that retirement funds that provide both defined contribution component retirement benefits and self-insured risk benefits can provide the fringe benefit value based on the actual contribution.

### *3.21. Business (General): Clarifying the definition of contributed tax capital*

Contributed tax capital (CTC) is a notional and ring-fenced amount derived from contributions made as consideration for the issue of a class of shares by a company. It is reduced by any capital amount that the company subsequently transfers back to one or more shareholders of that class of shares (commonly known as a capital distribution) using the CTC received. No shareholder within a particular class of shares may receive CTC in excess of an amount per share that is derived by dividing the total CTC by the number of shares in that class immediately before the capital distribution. Some companies are allocating CTC on the basis of an alleged 'share premium' contributed by a particular shareholder but not by all shareholders within the same class of shares. To curb this abuse, it is proposed that changes be made to clarify the principle that shareholders within the same class of shares should share equally in the allocation of CTC as a result of a distribution.

### *3.22. Business (General): Limiting potential for double taxation under the hybrid debt anti-avoidance rules*

Hybrid debt anti-avoidance rules aim to curb the unfair use of hybrid debt instruments or hybrid interest to gain tax benefits. To ensure that instruments that exhibit equity features or returns that exhibit dividend features do not benefit from interest deduction, the Income Tax Act deems any returns to be in specie dividends paid by the issuer on which the issuer must pay dividends tax if no dividends tax exemption applies. The provision does not deem the return to be an in specie dividend for the recipient of the return. These anti-avoidance rules may

be overreaching as the return would be regarded as interest and thus also be taxable for the recipient, leading to economic double taxation. It is proposed that the tax legislation be amended to address this concern.

### *3.23. Business (General): Clarifying the meaning of 'interest' under the debt relief rules*

The Income Tax Act contains debt relief rules that trigger tax consequences for a waiver, cancellation, reduction or discharge of a debt owed by a taxpayer. In 2017, rules dealing with the tax treatment of converting debt into equity were introduced, along with changes to ensure that the debt relief rules apply in all instances where a debt is settled by a debtor and the creditor received inadequate consideration for the debt claim. However, amounts of interest that are waived, cancelled, extinguished or converted to shares are excluded from the application of the debt relief rules as it is anticipated that normal recoupment rules would apply to unpaid interest that was previously deducted. To clarify this exclusion, it is proposed that a definition of interest be included in these debt relief rules.

### *3.24. Refinements to the corporate reorganisation rules: Refining the interaction between anti-value shifting rules and corporate reorganisation rules*

The Income Tax Act curbs the use of structures that shift value between taxpayers free of tax. The anti-value shifting rules apply to transactions involving asset-for-share exchanges. Asset-for-shares base cost rules prescribe that a base cost for assets acquired by a company in exchange for its shares be equal to the sum of the market value of the shares it issued and the amount of the capital gain triggered by the application of the anti-value shifting rule to ensure that there is no double taxation on the future disposal of the assets.

Corporate reorganisation rules allow for the tax-neutral transfer of assets between

companies and qualifying persons. Qualifying asset-for-share transactions are subject to the anti-value shifting rules and such transfers are also subject to the rollover base cost rules within the corporate reorganisation rules. This raises an anomaly in the application of these rules as the capital gain triggered under the anti-value shifting rules is only added to the base cost outside of the corporate reorganisation rules. To address this anomaly, it is proposed that the tax legislation be changed to allow taxpayers to treat the capital gain as an additional base cost when applying the corporate reorganisation rules.

### *3.25. Refinements to the corporate reorganisation rules: Clarifying the rules that trigger additional consideration in asset-for-share transactions when a debt is assumed by a company*

The Income Tax Act allows for the tax-neutral transfer of assets that are disposed of to a company in return for shares in that company or the assumption of qualifying debt by that company. The asset-for-share transaction rules contain an anti-avoidance measure aimed at preventing a permanent loss to the fiscus (instead of a tax deferral) when a person disposes of an asset that was acquired using debt and the debt is assumed by the company acquiring that asset. For example, when a person disposes of a high-value asset and the company assumes the debt used to acquire the asset from that person, that person can only anticipate the receipt of shares up to the market value of the asset transferred net of the debt assumed. However, due to the application of the asset-for-share transaction rules, the person will have a base cost that is higher than the market value of the shares held after the transaction, thus creating a permanent loss position instead of a tax-neutral position.

To remedy this permanent loss, the anti-avoidance rule deems the person to have received additional consideration equal to the amount of the debt assumed by the company when the person subsequently disposes of the shares. However, the

rules that trigger additional consideration on disposal are undermined when the shares are subsequently transferred in terms of corporate reorganisation transactions because the applicable corporate reorganisation rules will enforce the rolled-over base cost of the previous asset-for-share transaction. To prevent the rule from being undermined, it is proposed that the additional consideration be taken into account during all corporate reorganisation transactions until the shares are disposed of in a transaction that falls outside the corporate reorganisation transactions.

### *3.26. Refinements to the corporate reorganisation rules: Clarifying the early disposal anti-avoidance rules in intra-group transactions*

The intra-group transaction rules in the Income Tax Act allow tax to be deferred when assets are disposed of between intra-group companies. Early disposal rules apply when an acquirer disposes of an asset it acquired through an intra-group transaction within 18 months of the acquisition. The early disposal anti-avoidance rules reverse the deferral benefit by ring-fencing the gain or loss arising from the early disposal of an asset to ensure that the gain or loss is not offset against other gains and losses.

In some instances, a capital gain may have been anticipated to arise from the disposal of an asset at the date of the intra-group transaction, but a capital loss arises when the asset is disposed of early. The difference in the resultant tax consequences (capital gain or loss) of these disposals creates ambiguity in the application of the early disposal anti-avoidance rules. To address this ambiguity, it is proposed that the resultant tax consequences of an early asset disposal be clarified.

### *3.27. Refinements to the corporate reorganisation rules: Clarifying the interaction between early disposal anti-avoidance rules and de-grouping anti-avoidance rules in intra-group transactions*

In addition to the early disposal anti-avoidance rules outlined above, the intra-group transaction rules contain de-grouping anti-avoidance rules, which apply when the acquirer and the party disposing of an asset in terms of an intra-group transaction cease to form part of the same group of companies within six years of the transaction. The de-grouping anti-avoidance rules apply to reverse the tax benefit that was obtained in terms of the intra-group transaction by triggering the greatest capital gain, gross income or taxable income that would have arisen between the date of the intra-group transaction and the date of de-grouping. Because both of these anti-avoidance rules apply to reverse the deferred tax benefit of an intra-group transaction, it is proposed that changes be made to the tax legislation so that if one of the anti-avoidance rules applies in respect of an asset, the other will not subsequently apply.

### *3.28. Refinements to the corporate reorganisation rules: Extending the reversal of the nil base cost rules to apply on the sixth anniversary of an intra-group transaction*

In 2020, the intra-group transaction rules were amended to remove the potential for double taxation due to the interaction between the nil base cost anti-avoidance rules, which aim to limit the ability of taxpayers to cash out on the sale consideration from a tax-deferred intra-group transaction, and the de-grouping anti-avoidance rules, which aim to curb the possibility of group companies de-grouping soon after a tax-deferred intra-group transaction. This was achieved by reversing the nil base cost rule if the de-grouping anti-avoidance rules have applied. Like the de-grouping anti-avoidance rules, the effect of nil base cost

anti-avoidance rules should not apply beyond the sixth year from the date of an intra-group transaction. It is proposed that the tax legislation be changed so that the nil base cost anti-avoidance rules only apply for six years after an intra-group transaction.

### *3.29. Refinements to the corporate reorganisation rules: Clarifying the interaction between the early disposal anti-avoidance rules and the nil base cost anti-avoidance rules*

Early disposal anti-avoidance rules apply when an acquirer under an intra-group transaction disposes of an asset it acquired in terms of that transaction within 18 months of acquiring it. The nil base cost anti-avoidance rules apply to limit the ability of taxpayers to cash out on the sale consideration from a tax-deferred intra-group transaction. Because the early disposal anti-avoidance rules reverse the deferral benefit of acquiring an asset through an intra-group transaction, it is proposed that the intra-group transaction rules be amended so that the nil base cost anti-avoidance rules are reversed when the early disposal anti-avoidance rules are triggered.

### *3.30. Refinements to the corporate reorganisation rules: Refining the provisions applicable to unbundling transactions*

The corporate reorganisation rules provide rollover relief where shares of a resident company (referred to as an unbundled company) that are held by another resident company (referred to as an unbundling company) are distributed to the shareholders of that unbundling company in accordance with their shareholding. However, these unbundling transactions are subject to anti-avoidance rules aimed at limiting tax avoidance by taxpayers when distributing shares on a tax-neutral basis. Following amendments to these rules in 2020, there is no tax deferral for an

unbundling transaction of an equity share that is distributed by an unbundling company to a shareholder that is a disqualified person and holds at least 5% of the equity shares in the unbundling company immediately before that unbundling transaction. Based on the 'pro-rata' application of the rules, it is proposed that the tax legislation makes provision for shareholders in an unbundling company that only qualifies for tax deferral to receive an increase in the base cost of the shares in the unbundled company (in accordance with their respective shareholding) to the extent that the unbundling company did not qualify for tax deferral.

In addition, it is proposed that the limitation of expenditure incurred by a taxpayer for shares held in an unbundling company should apply only to shares that are acquired through an unbundling transaction.

### *3.31. Refinements to the corporate reorganisation rules: Clarifying rehypothecation of collateral within collateral arrangement provisions*

The Income Tax Act contains tax relief rules that allow for the tax-neutral transfer of collateral (listed equity shares and listed South African and foreign government bonds) between the parties to a collateral arrangement, provided that certain requirements are met. At issue is the rehypothecation, where the bank or broker-dealer (collateral taker) reuses collateral received for trading or as security for its own borrowing through a tax-neutral collateral arrangement. It is proposed that changes be made to the legislation to clarify the policy intention that further rehypothecation of the collateral received by the collateral taker can only form part of subsequent collateral arrangement transactions.

### *3.32. Business (financial sector): Clarifying the transfer of a policy or insurance book of business between short-term insurers*

Section 28 of the Income Tax Act, which deals with the tax treatment of short-term insurers, does not specifically address all the tax consequences that arise from the sale of an insurance book of business, so the general provisions of the act apply. However, the interpretation of the general provisions, read with section 28, may result in inequitable tax treatments of the parties to the transaction. It is proposed that these provisions be changed to address the tax treatment of transfer of liabilities as part of a short-term insurance business.

### *3.33. Business (financial sector): Refining a deduction formula for taxable long-term insurer policyholder funds*

The act contains provisions in section 29A that deal with the tax treatment of long-term insurers. In 2012, changes were made to these provisions by inserting a wholly revised deduction formula for selling, administration and indirect expenses for long-term insurers. In general, this formula is based on taxable income divided by net economic income.

The concept of 'net economic income' for purposes of the denominator is intended to reflect total taxable income without a reduction of non-includible dividends, foreign dividends and capital gains. However, unrealised gains to be accounted for in the denominator do not specifically refer to aggregation of unrealised gains and losses and are inconsistent with dividends, foreign dividends and capital gains, which refer to an aggregation of amounts. To address this anomaly, it is proposed that these provisions be changed so that unrealised gains and losses explicitly are aggregated for all assets.

### 3.34. Business (financial sector): Tax treatment of deposit insurance scheme

In 2020, government committed to establishing a deposit insurance scheme to protect depositors in the event of a bank failure, which in turn will contribute to the stability of the South African financial system. It is also envisaged that each bank will make stipulated contributions to the scheme.

Parliament has yet to pass legislation making provision for the establishment of a deposit insurance scheme. It is proposed that as soon as that legislation is passed by Parliament, changes be made to the tax legislation relating to the tax implications of the deposit insurance scheme.

### 3.35. Business (incentives): Amending the timeframes of compliance requirements for industrial policy projects

Industrial policy projects approved in terms of section 12I of the Income Tax Act must comply with specific requirements within specified timeframes. The impact of the COVID-19 pandemic has hindered these projects from meeting the compliance criteria within the required time periods.

Government will, therefore, consider amending the time period within which assets must be brought into use, along with the section 12I compliance period. This is aimed at accommodating approved industrial policy projects that have bona fide reasons for non-compliance with section 12I requirements due to business-related disruptions caused by the COVID-19 pandemic.

### 3.36. International: Clarifying the controlled foreign company diversionary rules

In 2011, the diversionary rules governing the outbound sale of goods by a controlled foreign company (CFC) were abolished because the transfer pricing

rules could be applied instead. In 2016, government reinstated the diversionary rules for CFC outbound sale of goods due to their effectiveness in preventing base erosion and profit shifting.

The 2016 diversionary rules for CFC outbound sale of goods now provide for an exemption if similar goods are purchased by the CFC, from unconnected persons to that CFC, mainly within the country in which the CFC is resident. Certain taxpayers are circumventing these rules by merely entering into a contract of purchase and sale that implies that the purchase of goods took place in the country of residence of the CFC, when this is not the case. To curb this abuse, it is proposed that these diversionary rules be amended.

### *3.37. International: Clarifying the interaction between provisions dealing with a CFC ceasing to be a CFC and the participation exemption*

In 2020, changes were made to the Income Tax Act to reduce tax planning opportunities that may emerge from loop structures as a result of the relaxation of the approval requirement by the Reserve Bank. An amendment was made in relation to gains on the disposal of shares in a non-resident company to a non-resident that was not taxed because of the participation exemption in paragraph 64B of the eighth schedule.

This amendment has the effect that the participation exemption does not apply to the disposal of shares in a CFC to the extent that the value of the CFC's assets is derived from South African assets.

However, section 9H provides that where a CFC ceases to be a CFC as a direct or indirect result of the disposal of all or some of the equity shares in that CFC, the capital gain or loss realised in respect of such disposal is disregarded if the participation exemption under paragraph 64B of the Eighth Schedule applies.

To address the interaction between section 9H and paragraph 64B, it is proposed that section 9H be amended so that a partial participation exemption in terms of

paragraph 64B(6) of the Eighth Schedule would not affect the exclusion under section 9H(5).

## *3.38. International: Clarifying the rules dealing with withholding tax exemption declaration*

The Act contains provisions in Part IV A and Part IV B for withholding tax on royalties and interest respectively.

According to the rules dealing with withholding tax on interest, no withholding tax on interest applies if the foreign person submits a declaration that he/she is – in terms of an agreement for the avoidance of double taxation – exempt from the tax. A similar declaration does not exist for withholding tax on royalties. To address the anomaly, it is proposed that the tax legislation be amended.

## *3.39. VAT: Zero-rating of super fine maize meal*

Schedule 2 of Part B of the VAT Act provides for a list of zero-rated items, which include the following grades of maize meal: super maize meal, special maize meal, sifted maize meal or unsifted maize meal.

The grading of maize products is regulated by Agricultural Products Standards Act (1990), which allows for 18 grades of maize products, including those mentioned above to be zero rated.

In 2016, another grade of maize meal, super fine maize meal, was added to the list regulated by the Agricultural Products Standards Act.

To align the VAT Act with the Agricultural Products Standards Act, it is proposed that Schedule 2 of Part B of the VAT Act be amended to include super fine maize meal in the list of grades of maize meal that qualify for zero rating.

## 3.40. VAT: Introducing measures to address undue VAT refunds on gold

The 2020 Budget Review noted that schemes and malpractice to claim undue VAT refunds have been detected in the value chain relating to gold exports.

It is proposed that regulations providing for a domestic reverse charge mechanism for industry, under section 74(2) of the VAT Act, be issued.

It is also proposed that the mechanism be included in the VAT Act to deal with such malpractice. Under the mechanism, a vendor that acquires gold from another vendor would declare and pay to SARS the VAT charged on the acquisition.

## 3.41. VAT: Aligning the provisions of the VAT Act with the New Insurance Act

The New Insurance Act (2017) categorises insurance policies into life and non-life policies, and makes provision for micro-insurance.

The VAT Act currently provides for the VAT treatment of both life (referred to as 'long-term insurance policy' in the VAT Act) and non-life (referred to as 'insurance' in the VAT Act) policies.

However, the VAT Act does not make provision for micro-insurer conducting a micro-insurance business. It is proposed that the VAT Act be amended to make provision for the VAT treatment of micro-insurance.

## 3.42. VAT: VAT treatment of temporary letting of residential immovable property

Property developers are entitled to deduct input tax on the VAT costs incurred to build residential property for sale. However, where the developer is unable to sell the residential property and temporarily leases it out until a buyer is found, the developer is required to make an output tax adjustment based on the open market

value of the property when the property is let for the first time.

An announcement was made in the 2010 Budget Review to investigate and determine an equitable value and rate of claw-back for developers as the current treatment is disproportionate to the exempt temporary rental income.

However, no subsequent changes were made to the VAT Act.

It is proposed that the VAT Act be amended to resolve this matter.

## *3.43. Tax Administration: Tax-deductible donations*

The information required by law in the receipts issued for tax-deductible donations is limited and entities issuing the receipts are not required to provide third-party data on the donations to SARS on a systematic basis.

SARS has detected that receipts are being issued by entities that are not approved to do so.

To ensure that only valid donations are claimed and to enhance SARS' ability to pre-populate individuals' returns, it is proposed that the information required in the receipts be extended and third-party reporting be extended in future to cover the receipts issued.

## *3.44. Tax Administration: Aligning periods for refunds of dividends tax for cash and in-kind dividends*

SARS will only pay a valid refund of dividends tax if the claim is submitted within three years from the date of payment of a cash dividend.

However, the corresponding period for a dividend in kind ends three years from the date of payment of the tax.

It is proposed that the period within which a taxpayer may claim a dividends tax refund for in-kind dividends also be determined with reference to the date of payment of the dividend.

### *3.45. Tax Administration: Aligning the period allowed for farmers to replace livestock sold and tax administration rules*

Farmers are allowed to deduct the cost of livestock purchased, within a fixed period, to replace livestock sold in a previous year of assessment on account of drought, fire or other specified reasons, by reopening the assessment for the previous year of assessment.

It is proposed that the period during which assessments may be reopened and document retention requirements be aligned.

### *3.46. Tax Administration: Administrative non-compliance penalties for non-submission of six-monthly employees' tax returns*

SARS may impose a penalty for the non-submission of the six-monthly employees' tax returns by employers. The penalty is calculated as a percentage of the employees' tax for the period covered by the return.

Where the employees' tax for the period is not known to SARS, due to the non-submission of monthly or six-monthly returns, the penalty can only be imposed retrospectively.

This undermines the purpose and deterrent effect of the non-compliance penalty.

It is proposed that SARS be enabled to raise the penalty on an alternative basis in such cases, for example through an estimate of the employees' tax with an adjustment once the actual employees' tax is known.

### *3.47. Tax Administration: Provisional taxpayers with years of assessment of six months or shorter*

Provisional taxpayers are required to make provisional tax payments within six months after the commencement of a year of assessment and then again by the end of the year of assessment.

Currently, no provision is made for instances where a taxpayer has a short year of assessment, whether by reason of death, ceasing to be a tax resident, a company being incorporated during a year or a change of a company's financial year.

It is proposed that a first provisional tax payment and return not be required when the duration of a year of assessment does not exceed six months.

### *3.48. Tax Administration: Review of advance tax ruling system*

Taxpayers may approach SARS to obtain advance rulings on proposed transactions, which are binding on SARS, to enhance taxpayer certainty.

In line with its strategic objectives, SARS has invited public comment on the advance tax ruling process for binding rulings to assess whether it can be improved.

Legislative amendments may be required to give effect to improvements identified during the consultation process.

### *3.49. Tax Administration: Review of voluntary disclosure programme*

Taxpayers may approach SARS to regularise their tax affairs to avoid criminal prosecution, understatement penalties and certain administrative non-compliance penalties.

The voluntary disclosure provisions will be reviewed in 2021 to ensure that they align with SARS' strategic objectives and the policy objectives of the programme.

# 4. TAX CASES

## *4.1. Agricultural and Industrial Mechanisation (Pty) Ltd v C:SARS (83 SATC 1)*

Agricultural and Industrial Mechanisation (Pty) Ltd (AIM) was a private company which conducted business in the industrial and mining sector and supplied agricultural equipment and delivered waste management services to local farmers, municipalities and mines.

AIM, in February 2013, had commenced voluntary business rescue in terms of the provisions of section 129 of the Companies Act 71 of 2008 with the intention of settling its debts due to SARS and other creditors.

The acting business rescue practitioner had convened a meeting of creditors where AIM's business rescue plan was presented and accepted by the majority of AIM's creditors.

SARS had not attended that meeting, but it was resolved there that SARS be paid 10 cents in the Rand on the outstanding debt of approximately R5.3 million and it had to be paid by 31 August 2013.

AIM had needed a tax clearance certificate to continue as a going concern and it was important that SARS accepted the rescue plan so as to enable AIM to continue trading with a tax clearance certificate.

Proper notice of the meeting was given to SARS and of the majority decision taken by AIM's creditors.

SARS, however, had failed to submit a claim against AIM despite the business rescue practitioner's repeated attempts to do so in order for AIM to obtain the tax clearance certificate.

It was only after a further two years that, on 13 July 2015, SARS finally accepted the business rescue plan and completed the necessary claim form.

However, SARS refused to accept a payment on its system made by the business rescue practitioner to settle AIM's indebtedness in terms of the business rescue plan.

It was only on 19 January 2016, almost three years after the launch of the business rescue plan, that SARS notified AIM's business rescue practitioner of the debt and that it would accept the sum of R341 188.60 in payment of the settlement amount.

As a result of SARS not issuing the tax compliance certificate AIM was forced to obtain a debt loan from the bank so as to enable it to operate and the bank had taken a notarial bond over AIM's stock.

AIM, on 3 October 2016, had made a motivated application to SARS for a compromise of its post-business rescue debt in terms of section 201 of the Tax Administration Act.

SARS, after an exchange of correspondence, declined AIM's proposal and provided the following two reasons: that it had demonstrated a history of non-compliance and that a compromise had already been granted in terms of the business rescue plan.

AIM submitted that the business rescue plan was not a compromise in terms of the Tax Administration Act as a compromise is a contract and, consequently, its offer and acceptance must be proved as a compromise contract and the parties to the compromise must reach agreement on the terms of the compromise.

AIM contended that the compromise agreement was one in terms of the common law and when a senior SARS official authorised to compromise in terms of section 200 of the Tax Administration Act, the senior SARS official and the debtor must sign an agreement setting out the terms of the compromise provided for in section 204 of the Act.

AIM submitted that there was no signed compromise between it and SARS, and a senior SARS official may not compromise any amount of the tax debt where the

debtor was a party to the agreement within the three years immediately before such a request.

The issue for determination before the court was whether the adoption of a business rescue plan was the same form of compromise as the compromise referred to in the Tax Administration Act.

Judge Victor held the following:

(i) That the adoption of a business rescue plan in the view of the court was not the same compromise as the compromise referred to in the Tax Administration Act. The Act was clear in its terms in that a contractual compromise can never amount to the statutory compromise which SARS relied upon to justify its decision not to grant the compromise requested by AIM.

(ii) That the compromise between a company and its creditors as provided for in section 155 of the Companies Act and compared with section 152(4) of the Companies Act was not the same as the compromise referred to in terms of the Tax Administration Act.

(iii) That these two forms of compromise were clearly distinguishable, in particular SARS did not attend the meeting of creditors on 19 June 2013 and did not vote on the business rescue plan provided for in terms of section 152(4) of the Companies Act and its acquiescence some two years later was an acceptance in terms of the business plan.

(iv) That, therefore, the submission by SARS that it had accepted the business rescue plan and that this was a compromise in accordance with the Tax Administration Act was fatally flawed and its argument that it had already accepted a compromise and could not accept a second compromise conflated two separate acts.

(iv) That AIM submitted that section 197 of the Tax Administration Act clearly sets out a procedure as to how a senior SARS official may write off its debts and this did not occur when the statutory business rescue compromise was reached.

(v) That in this case the procedure for the statutory compromise was not followed and therefore the decision of SARS based on an already accepted compromise in terms of the Companies Act by SARS was reviewable as the decision did not take into account the difference between the two sets of compromise.

(vi) That AIM had placed all the relevant information before the SARS committee when it considered the compromise and it was quite clear that based on the cursory manner in which the voluminous information was placed before the SARS committee, it could not in those few hours have considered the question.

(vii) That a further factor which justified the setting aside of SARS' decision was that SARS had failed to take into account that AIM was a Category B VAT vendor and accordingly did not have to submit its VAT returns every month but only every second month. When SARS found that AIM was not tax compliant in this regard, it was clearly wrong and did not investigate whether AIM was a Category B or Category C VAT vendor.

(ix) That the court therefore accepted that it was reasonable for AIM to continue in the belief that it was a Category B VAT vendor and that SARS incorrectly drew an adverse inference in this regard. In the court's view, based on the precipitous decision taken by SARS without considering all the information before it, this was a decision which should be set aside in terms of PAJA and AIM had asked the court to extend the 180-day period because it was 15 days late and this extension was granted.

(x) That, accordingly, SARS' decision was set aside and the matter was referred back to SARS for reconsideration, with the specific directive that SARS take into account that the business rescue plan dated 19 June 2013 was not a compromise agreement under ss 197 and 200 of the Tax Administration Act.

## 4.2. ITC 1935 – Loss or expenditure arising from a trade debt

The taxpayer and D Exporters (Pty) Ltd (D) were subsidiaries of XYZ Holdings (Pty) Ltd, and both conducted the business of purchasing fruit locally and selling it to the export market.

The taxpayer was the principal trading entity, with D used on occasion for strategic purposes such as to avoid conflicts with customers in competition with one another and for a year or two before 2014 D had not been actively trading.

In 2014 one of the taxpayer's major suppliers of fruit for the export trade, E (Pty) Ltd (E), was in financial difficulty. The taxpayer contracted with it to acquire its business pertaining to F Fruit with the aim of ensuring that the supply of F Fruit for the export business was retained. The major asset purchased was the F Fruit, which fruit was at various stages in the production process, some on trees and others in the process of picking or packing and none of this fruit had yet been sold or marketed for export purposes and the purchase price for the fruit made up the bulk of the purchase price paid for the E business.

As the taxparyer's normal finance facility was not available to assist it to finance the E purchase, an alternative financier, V Exchange, therefore provided finance against the production of *pro forma* invoices issued to purchasers for fruit sales based on purchase commitments made. Because the taxpayer was not able to deal directly with V Exchange it was agreed orally between the taxpayer and D that the taxpayer would sell the E fruit to D on a consignment basis and that D would then sell the fruit to the export market.

D issued the *pro forma* invoices required by V Exchange to provide finance to assist the taxpayer in paying the purchase price to E.

The terms of the consignment sale were that the sale price to D was not fixed upfront, but that the taxpayer would receive whatever D was able to sell the fruit in the market for, after deduction of its costs. D would first repay V Exchange for its provision of finance with any remainder then paid to the taxpayer.

Since D lacked the infrastructure to enable it to market the fruit and to make logistical arrangements in relation to the sale of the goods, it was orally agreed between the taxpayer and D that the taxpayer would provide the necessary resources, would incur the expenditure for items such as shipping and logistics, and would charge D an equivalent amount for so doing. This was required in that otherwise the taxpayer would have received nothing from D for the sale of the fruit, since its sale price was dependent, under the consignment arrangement, on D selling the fruit in the market.

The taxpayer's evidence in the Tax Court was that the trading operation involving the E fruit was not as successful as had been hoped, with lower volumes being available and quality issues arising. This led to credit notes having to be issued, with a net loss realised on this set of transactions, which reflected in the net amount owed by D to the taxpayer.

At the end of the 2014 D was indebted to the taxpayer in the amount of R18 273 271.26 and the taxpayer recognised that D had no resources to settle its indebtedness to it and the amount was written off.

This, it was common cause, gave rise to a loss in the hands of the taxpayer, which the taxpayer claimed as a deduction and which is in issue in this matter.

SARS took the view that the amount was of a capital rather than a revenue nature, because the net debt of D to the taxpayer, at the end of the year of trading between them, was accounted for as a loan between the taxpayer and D.

When the debt was written off in favour of D, D accounted for this as additional income and for tax purposes declared this amount as part of its taxable income, therefore as revenue rather than as a capital gain and SARS agreed that this was the proper tax treatment in D's books.

In issue in this matter was whether expenditure or loss of R18 273 271.26 incurred by the taxpayer was of a capital or revenue nature and, if of a revenue nature, should have been allowed as a deduction from the income of the taxpayer in the 2014 year of assessment in terms of section 11(*a*) of the Income Tax Act.

*Judge Savage held the following:*

(i) That a loss suffered by a taxpayer as a result of writing off an indebtedness of another party can be categorised as either capital or revenue in nature and there is no single definitive yardstick for distinguishing between capital and revenue expenditure. Each case falls to be decided on its own facts, having regard to the substance and reality, or the 'true nature' of the transaction, with the *onus* on the taxpayer to prove that an amount or item is deductible or may be set off from taxable income in a year of assessment in terms of section 102(1)(*b*) of the Tax Administration Act.

(ii) That whether an amount lost or written off was advanced or treated as a loan is not in itself determinative of the capital or revenue nature of the loss or expenditure, since the accounting treatment applied by a party is not to be regarded as determinative of either the legal position or the correct tax position and the question is always one of substance rather than form, and is to be decided on all the facts of the case.

(iii) That what was important were the circumstances giving rise to the indebtedness, and more particularly whether the expenditure equips the taxpayer's income-earning machine or structure as capital, or forms part of the costs of actually performing the income-earning operations as revenue. This may involve an analysis of the nature of the capital to which the expenditure relates, with a distinction drawn between fixed capital, which is deployed by the taxpayer, so as to equip the business on a non-recurring basis and is treated as capital in nature, as opposed to floating capital, which frequently changes form from money to goods and *vice-versa* for purposes of making a profit and is regarded as revenue.

(iv) That it was clear that it was not the treatment of an amount as a loan which is determinative, but whether the loss was incurred in the conduct of the taxpayer's own revenue-earning trade or not. The expenditure was incurred by the taxpayer for purposes of providing logistical support to D to ensure the success of the taxpayer's own business involving the sale of fruit to D on consignment. As much was apparent from the treatment of such expenditure, which was accepted as correct by SARS, in the books of D.

(iv) That what was apparent was that the true nature of the expenditure was that related directly to the taxpayer's own taxable business of selling fruit and was concerned with its revenue stream *via* the sale of fruit to D. As much is evident from the fact that the taxpayer could have made a trading profit on the fruit but did not, with the result that it incurred a trading loss after the writing off of D's indebtedness. This was not an investment concerned with supporting an extraneous business of D and the expenditure or loss incurred did not amount to the deployment of the taxpayer's fixed capital to equip its income-earning machine. It was rather an indebtedness that arose from its trading activities with D and as such is a clear example of the deployment of floating capital, insofar as it was not intended to remain outstanding but intended to be converted back into cash in the ordinary conduct of the taxpayer's trade.

(v) That the nature of the expenditure or loss in question therefore clearly relates to a trade debt arising on the sale of fruit and is not a loan. D's treatment of the corresponding benefit to it as a taxable revenue receipt makes as much patently clear. In the circumstances, the facts of this matter are plainly analogous to those in *ITC 167* 5 SATC 87, *ITC 434* 10 SATC 447 and *ITC 807* 20 SATC 338 referred to above.

(vi) That, accordingly, the loss or expenditure in this case was of a revenue nature and should have been permitted as a deduction.

Appeal upheld.

## *4.3. ITC 1936 – Tax Adminitration, Estimated assessments*

The taxpayer had appealed against certain additional estimated assessments raised by SARS in respect of income tax for the 2005 to 2011 years of assessment ('the relevant period') pursuant to following the relevant objection procedures prescribed by the Tax Administration Act ('the TAA').

SARS, in an extended period commencing in 2002, had conducted an income tax audit into the affairs of the taxpayer and several other entities in respect of which the taxpayer had a direct or indirect interest. Its investigations pertaining to the relevant period commenced in June 2009 when a letter of engagement was issued by SARS pertaining to the years 2005 to 2007 requesting certain information and the taxpayer responded and provided SARS with the requested information and documentation.

SARS, in 2011, expanded the scope of the audit which ultimately covered the period 2005 to 2011 and issued a further letter of engagement in 2012 for the relevant period and requested a wide-ranging scope of information and documentation comprising some thirteen different categories.

SARS was of the view that documentation provided by the taxpayer was insufficient and had identified the taxpayer and all the entities in which he was involved as a risk.

SARS, pursuant to a final demand for documentation and information on 3 May 2012, issued a letter of audit findings on 31 August 2012 in respect of the years of assessment 2005 to 2011.

SARS thereafter, on 15 February 2013, issued the finalisation of audit letter in which it accepted certain of the adjustments proposed by the taxpayer which resulted in a reduction of the taxpayer's taxable income as per the audit findings from R88 104 941 to an amount of R73 469 366.

The taxpayer had made a request to SARS for a reduced assessment in terms of section 93 of the TAA and, pursuant thereto, SARS issued further estimated assessments in terms of section 95 of the TAA reducing the taxpayer's taxable income to R70 062 028.

The taxpayer objected to the latter assessments and this formed the basis of the present appeal.

SARS was of the view that the taxpayer had submitted incomplete, misleading, inadequate supporting documentation and irrelevant material both in his annual returns of income and in reply to SARS' subsequent request for relevant

information for the period under audit and had thus not discharged the burden of proof required in terms of section 102(1) of the TAA explaining why the amounts included should be excluded.

SARS, as a result of the alleged misconduct, had levied understatement penalties of 125% based on its characterisation of the taxpayer's conduct as gross negligence and obstructive under the relevant columns of the understatement penalty table in section 223(1) of the TAA.

During the course of the proceedings the parties each appointed an expert and the respective experts reconsidered the documentation made available to SARS and conducted various meetings and as a result a joint minute was produced.

During the course of the hearing the respective experts reached agreement on the taxpayer's taxable income in respect of the 2005 to 2011 years of assessment, utilising the documentation provided.

It was common cause that the agreed taxable income differed substantially from the taxable income reflected by SARS in its assessments forming the basis of this appeal.

The issues that were to be determined in the appeal were:

- Whether the estimated assessments issued by SARS were reasonable;
- Whether the facts on which SARS relied to impose understatement penalties at a rate of 125% were reasonable and whether SARS was justified in imposing understatement penalties of 125% on the basis that the taxpayer's conduct constituted 'gross negligence' and was 'obstructive' in accordance with the understatement penalty table in section 223(1) of the TAA;
- Whether the interest imposed by SARS in terms of section 89*quat* of the Income Tax Act should be remitted;
- Whether any costs order should be granted.

It was undisputed that in terms of section 102(2) of the TAA the *onus* to prove that the estimated assessments under section 95 of the TAA were reasonable and to prove the facts on which it based the understatement penalties levied, rested on SARS.

SARS contended that, in the light of the fact that the respective experts by agreement had determined the taxpayer's taxable income for the aforesaid years of assessment, the issue pertaining to the reasonableness of the assessments had become moot and that an order should rather be granted in terms of section 129(2)(*b*) of the TAA altering the assessments to accord with the experts' agreed determination and the question arose as to whether the Tax Court had the jurisdiction to do so.

In terms of the relevant provisions of sections 129(2) and (3) of the TAA the tax court can exercise a discretion to make the following orders in the case of an assessment on appeal:

> '(2)(a) confirm the assessment or 'decision';
>
> (b) order the assessment or 'decision' to be altered; or
>
> (c) refer the assessment back to SARS for further examination and assessment;
>
> (3) In the case of an appeal against an understatement penalty imposed by SARS under a tax Act, the tax court must decide the matter on the basis that the burden of proof is upon SARS and may reduce, confirm or increase the understatement penalty.'

SARS had issued the estimated assessments and levied the understatement penalties on the basis that the taxpayer had not provided necessary information and had provided returns which substantially under-declared his taxable income.

SARS' case was based on the averment that the estimated additional assessments were raised as a result of the taxpayer's failure to provide 'corroborating and supporting documentation and relevant material.'

SARS' version was that the documentation provided by the taxpayer throughout the course of the audit and even after the assessments were raised was insufficient and incomplete, and SARS had levied a penalty of 125% based on 'gross negligence' under item 1(iv) and 'obstructive conduct' under column 4 of the understatement penalty table in section 223(1) of the TAA.

Judge Dippenaar held the following:

As to the tax court's power to alter an assessment in terms of section 129(2)(b) of the Act

(i) That a tax court is not a court of inherent jurisdiction and, as a creature of statute, enjoys only the statutory powers granted to it. It may, as a court of revision, take into account all evidence presented at the hearing, exercise its own discretion and make its own decision in exercising the powers afforded under section 129 of the Tax Administration Act.

(ii) That in Africa Cash & Carry (Pty) Ltd v C:SARS 82 SATC 73 the Supreme Court of Appeal accepted the principle that section 129(2)(b) was an appropriate tool where a portion of the original assessment can be set aside with clarity, where the taxpayer has not been taken unaware and proper notice has been given of the proposed alteration, where the provenance of the alteration is known to all and has been carefully examined by both SARS and the taxpayer and the court.

(iii) That it was common cause that the estimated assessments raised by SARS differed materially from the figures agreed upon by the experts pertaining to the taxpayer's taxable income and the evidence did not support the amounts determined in the estimated assessments.

(iv) That in Africa Cash & Carry, supra, it was held that if the evidence before the tax court does not sustain the amount determined in an estimated assessment of a taxpayer's liability, or it determines that the amount in the estimated assessment is unreasonable then, subject to constitutional principles and compliance with the audi alteram partem principle, and fairness, provided that the basis for taxation is not now entirely different,

and provided the court has all the information it requires to decide the matter before it, a tax court can alter an assessment, rather than 'refer the assessment back to SARS' and such an alteration, if in compliance with the aforesaid principles and justified on the facts as reasonable, will fall within the powers conferred in section 129(2)(b) of the Act, accordingly be competent, not offend against the separation of powers doctrine, amount to a proper discharge of the obligation imposed upon a tax court, and be entirely consistent with the tax court's function in the greater constitutional framework as a court of revision and the tax court will simply be discharging one of its core functions.

(iv) That in the present instance there was no further evidence requiring further investigation and assessment and both parties employed experts who conducted various investigations and meetings and had determined the figures by agreement. In so doing, they utilised the same documentation presented to SARS and the parties were in agreement regarding the taxable income for the relevant period.

(v) That although no evidence was presented on the methodology adopted by the experts, it did not appear from the joint minutes that a substantially different methodology was used than that adopted by SARS during the audit process. The same schedules used during the audit process, based on the methodology adopted by SARS were utilised to motivate adjustments thereto.

(vi) That in argument the taxpayer did not challenge the approach adopted by SARS and it was not contended that the agreed findings pertaining to the taxpayer's taxable income should not be taken into account or were flawed and he also did not contend that such an approach would be procedurally unfair. From the available evidence it was not apparent that the methodology used and the assumptions on the strength of which the estimated assessments were made were materially different.

(vii) That there was thus merit in the approach adopted by SARS to alter the assessments in order to bring finality to the matter, rather than remitting the

matter back to SARS for reconsideration. To simply set aside the assessments as sought by the taxpayer, would not bring any finality to the matter and would by necessity involve incurring substantial additional time and costs and this court had the jurisdiction to do so.

As to the understatement penalties levied by the Commissioner

(ix) That it was necessary to consider the reasonableness of the conduct of the respective parties in relation to the audit process in order to consider the understatement penalties levied by SARS. It is in this context that the conduct of both the taxpayer and that of SARS in raising the assessments remains relevant, as it informed the basis on which SARS exercised its discretion in finding that the taxpayer's conduct was grossly negligent and obstructive.

(x) That understatement penalties are regulated by sections 221 to 223 of the TAA and, in terms of section 222, an understatement penalty, in addition to the tax liability due, must be paid in specified circumstances. Section 223(1) contains a percentage table in respect of understatement penalties and in terms of section 223(2)(a) an understatement penalty is chargeable in cases where an assessment based on an estimation under section 95 is made.

(xi) That this court is required to consider the issue de novo and to exercise its own original discretion based on the facts placed before it, rather than to review the decision of SARS. In terms of section 129 of the TAA, this court has an unfettered discretion to reduce, confirm or increase the understatement penalty and in terms of section 102(2) of the TAA, SARS bore the burden of proving the facts on which it based the imposition of the understatement penalty.

(xii) That our courts have held that the imposition of a penalty is by definition punishment although it may also be compensatory in effect and the levying of a penalty depends on the level of blameworthiness attributed to the conduct of the taxpayer.

(xiii) That the starting point of this enquiry was to establish whether SARS was entitled to raise an understatement penalty at all and, to do so, it was necessary to consider the returns submitted by the taxpayer and the taxable income ultimately determined by the experts.

(xiv) That, pursuant to agreement being reached between the parties' respective experts, it was common cause that the taxpayer had under declared his taxable income by the specified amounts in the relevant period.

(xv) That in section 221 of the TAA the concept 'understatement' is defined to mean any prejudice to SARS or the fiscus as a result of, inter alia, an incorrect statement in a return. A 'substantial understatement' is defined as 'a case where the prejudice to SARS or the fiscus exceeds the greater of five per cent of the amount of 'tax' properly chargeable or refundable under a tax Act for the relevant tax period, or R1 000 000.'

(xvi) That on these undisputed facts the taxpayer had substantially understated his taxable income for the relevant period as envisaged by the TAA and SARS was thus justified in believing that there was under declared income resulting in it raising the assessments under section 95 of the TAA, albeit that the assessments were substantially overstated.

(xvii) That it was also necessary to consider the methodology adopted by SARS in relation to the audit and this was to 'follow the cash' and consider each and every deposit into the bank accounts of the taxpayer as gross income and then required the taxpayer to show to the contrary.

(xviii) That the approach adopted by the taxpayer pertaining to the provision of documentation was unreasonable and in the light of the taxpayer's refusal to provide certain documentation, SARS utilised reliable information readily available to it as a starting point for the audit and it could not be concluded that the methodology chosen was in the circumstances per se unreasonable.

(xix) That central to the taxpayer's case was that SARS had adopted an unorthodox methodology and had misconstrued the onus that SARS bore in

relation to an estimated assessment which had rendered the assessments and the penalties unreasonable. It was clear that SARS had misconstrued its onus and there was merit in the taxpayer's contention that this was unreasonable. However, this too did not per se render the methodology adopted by SARS unreasonable or unorthodox.

(xx) That the disputes between the parties primarily centered around broken undertakings, errors, inter account transfers and the taxpayer's trading activities in contracts for difference and it had to be considered whether their respective conduct in relation thereto was reasonable. The evidence established that the taxpayer did not make all the necessary documentation requested by SARS available to it when requested to do so and, ultimately, the final documentation required to determine the taxpayer's tax liability was only provided some seven years after it was requested.

(xxi) That, as with the raising of an assessment, the discretion afforded to SARS is not unfettered but must be based on reasonable grounds.

(xxii) That SARS had sought a negative inference to be drawn from the taxpayer's failure to testify as he was present at court and was afforded an opportunity to present rebutting evidence. It was argued that absent any evidence being led, there were no facts before this court explaining the substantial under declaration of the taxpayer's income, nor the source or reason for the inflow of some R202 million into his accounts and there was merit in these contentions.

(xxiii) That no evidence was led to justify the conclusion that the methodology adopted by SARS was flawed as contended by the taxpayer. That contention also disregards the taxpayer's conduct in materially understating his taxable income in the returns submitted, as established by the experts. Considering how flawed the returns were as illustrated by the findings of the experts and the failure by the taxpayer's auditors to substantiate his approach, it cannot be said that the methodology adopted by SARS was unreasonable or that the differences could be attributed to the methodology

adopted and no explanation was tendered by the taxpayer for this state of affairs.

(xxiv) That, in considering whether the methodology adopted by SARS struck a reasonable equilibrium between the applicable principles and objectives sought to be achieved in the context of the facts, it must be concluded that the methodology adopted by SARS was reasonable.

(xxv) That on a conspectus of all the facts, it can be concluded that it was not unreasonable for SARS to levy an understatement penalty, although in certain instances, the approach adopted by SARS was unreasonable in insisting on the production of documents which were not available or did not exist. The conduct of the taxpayer in relation to the substantial under declaration of his taxable income and the audit overrode any perceived unreasonableness on the part of SARS.

(xxvi) That what was ultimately agreed upon by the experts was that the taxpayer had indeed substantially under declared his income, the reasons for which remained unexplained. SARS argued that the imposition of a 125% penalty was justified in the circumstances and that the conduct of the taxpayer was obstructive and grossly negligent, thus justifying confirmation of the penalties levied in the assessments.

(xxvii) That, from the facts, it was clear that the taxpayer's conduct fell short of the standard of a reasonable man and that he was negligent. Whether his conduct could be classified as grossly negligent and involved a conscious risk taking or a total failure to take care, was the true question. The evidence did establish that the taxpayer did not take reasonable or any care in completing his returns and, on a conspectus of the facts, the reasonable conclusion could be drawn that the taxpayer was grossly negligent and that there was a total failure on the part of the taxpayer to take care in the completion of his returns. As such, the applicable item on the understatement penalty table to be applied was item (iv).

(xxviii) That on a conspectus of the facts it could reasonably be concluded that the taxpayer's conduct was obstructive. Ultimately, if the conduct under column 4 of the table in section 223(1) was considered, other than for the first year of assessment, it mattered not whether the taxpayer's conduct was 'obstructive' or 'a repeat case' as the impact would be the same.

(xxix) That the determination of a reasonable understatement penalty primarily centres around the behaviour classifications in column 2 of the penalty understatement table in section 223(1) of the TAA and SARS sought to classify, in the alternative, the taxpayer's conduct as a 'substantial understatement' as envisaged in item (i).

(xxx) That it was thus concluded that a reasonable understatement penalty would be 125% for the 2005 to 2011 years of assessment and that the understatement penalties imposed by SARS should be confirmed.

<u>As to whether interest levied under section 89quat of the Income Tax Act 58 of 1962 should be waived</u>

(xxxi) That on a consideration of all the facts no proper case had been made out for interest to be remitted or that the relevant criteria of section 89quat(3) were met and it followed that the interest should not be remitted.

<u>As to whether an order for costs should be granted</u>

(xxxii) That the Tax Court has a discretion to award costs in terms of section 130 of the TAA if one of the parties was unreasonable as envisaged in section 130. Both parties had on this basis sought costs against the other, including the costs of two counsel, SARS on a punitive scale.

(xxxiii) That in considering all the imperatives relevant to balancing the competing interests of the parties in the exercise of the discretion afforded, and in considering their respective conduct, it was concluded that no award of costs should be granted.

## 4.4. *ITC 1937 – VAT, Input tax*

The taxpayer was a registered micro refinery with the Diamond and Precious Metal Regulator of the Republic of South Africa and was a registered VAT vendor.

The nature of the taxpayer's business was the smelting, assaying and trading of gold and other precious metals.

The taxpayer bought gold products from suppliers who were also VAT vendors and to whom it paid input VAT as required by the Value-Added Tax Act ('the VAT Act').

The taxpayer then smelted the gold product, poured the molten liquid into moulds to ultimately produce gold bars and the taxpayer then sold the gold bars to its customers.

During the VAT period August 2014 to March 2015 (hereinafter referred to as 'the VAT period') the taxpayer regularly bought gold jewellery from, amongst others, two suppliers, X Gold Trading CC and Z Gold Trading CC (hereinafter referred to as 'X Gold' and 'Z Gold').

These two entities were, at all relevant times, VAT vendors and tax invoices were provided in respect of each batch of gold jewellery provided by Z Gold and X Gold to the taxpayer during the VAT period.

It was common cause that the taxpayer was permitted to issue 'recipient-generated tax invoices' in accordance with the provisions of *Interpretation Note 56* (dated 30 March 2014) read with *General Binding Ruling* VAT No 15 (dated 31 March 2014) issued by SARS.

The taxpayer, during the VAT period, submitted eight VAT returns to SARS in respect of which it claimed VAT refunds in terms of section 1 and section 16(2) of the VAT Act. The VAT 210 returns reflected that the taxpayer was in a VAT refund situation for each of the returns that it rendered during this period.

SARS at first verified the VAT returns in issue and had allowed the input tax deductions that the taxpayer had claimed and had issued assessments reflecting a refund position in the aggregate amount of R25 966 161.83 but in May 2016 SARS referred the returns in question to a post-verification audit and an auditor was

appointed in August 2016 to conduct an investigative audit into the affairs of the taxpayer.

The investigative audit was finalised on 16 November 2016 and SARS issued a letter of 'Audit Findings' informing the taxpayer of the outcome of the audit and proposed adjustments which would be made to the assessments.

The result of the audit investigation was that, although all the requested invoices were supplied by the taxpayer together with proof of payment, SARS could not satisfy itself that the tax invoices were valid and that supplies actually took place between the taxpayer as vendor and the suppliers X Gold and Z Gold as provided for in sections 1 and 16(2) of the VAT Act.

SARS accordingly notified the taxpayer that it intended to disallow the input tax claimed as it was not satisfied that the entities existed and had conducted an enterprise and that supplies actually took place between the taxpayer and these two suppliers.

SARS then raised additional assessments in respect of the relevant VAT period in terms whereof input tax was disallowed.

SARS was requested to furnish reasons for the assessments raised and it did then give written reasons for, *inter alia*, disallowing the invoices pertaining to X Gold and Z Gold.

The taxpayer thereafter filed an objection against the additional assessments raised and SARS then notified the taxpayer that the objection had been fully disallowed whereupon the taxpayer filed a notice of appeal against SARS' decision to disallow the input tax deductions for the VAT period under review.

The factual issue that needed to be determined by the court was the 'supply dispute' :did X Gold and Z Gold make supplies to the taxpayer during the relevant VAT period?

The taxpayer had the *onus* to prove that the supplies in question were delivered by X Gold and Z Gold during the VAT period and that it had traded with these two entities.

The evidence revealed that during the VAT periods, and in accordance with its business practice, the taxpayer had purchased gold jewellery from, *inter alia*, X Gold and Z Gold, who were both trading at the time. Both Z Gold and X Gold requested payment in cash. Z Gold and X Gold were at all relevant times duly registered for VAT that it paid to its suppliers and if they made supplies to the taxpayer, the taxpayer was obliged to pay for the supplies plus VAT. Seen from the taxpayer's perspective, the VAT that it paid to its suppliers was the 'input VAT' contemplated in section 16(3) of the VAT Act and the taxpayer could then set-off the paid input VAT against the output VAT that it received from its customers.

SARS' disallowance of the taxpayer's input tax deductions for the VAT period relating to supplies that had been made by Z Gold and X Gold was motivated by the factual basis that these two entities did not make any supplies to the taxpayer during the periods in question.

SARS had adopted the formal wording of the VAT Act by stating that SARS was not 'satisfied' that the supplies, such as they may have been, had complied with the requirements of 'Input Tax' and it gave three grounds for its dissatisfaction: (1) The tax invoices issued were not valid; (ii) Z Gold and X Gold did not exist or conduct enterprises; and (iii) No supplies were made to the taxpayer.

SARS' statement of grounds of assessment dated 9 April 2018 listed the following:

- Whether the taxpayer was entitled to claim input tax in terms of section 1 read with section 16(2) of the VAT Act in respect of the supplies made by Z Gold and X Gold ('the alleged suppliers') in instances where the supply of goods or services has not been made;
- Alternatively, whether the invoices issued to the taxpayer by the alleged suppliers, alternatively, whether the invoices issued by the taxpayer to the alleged suppliers in respect of the alleged supplies were valid in terms of section 20 of the VAT Act.

Judge Windell held the following:

(i) That the taxpayer had the *onus* to prove that the supplies were delivered by X Gold and Z Gold to the taxpayer during the VAT period and that it had

traded with these two entities and the subject of this judgment and the factual issue that needed to be determined was the 'supply dispute.'

(ii) That for the sake of fairness and proper court procedure, SARS must clearly state the grounds on which it based its assessments and make it clear to the taxpayer as to what it disputed. This must be done so that the taxpayer, as the taxpayer, can know what was required from it in order to discharge the *onus* of proof. In terms of Rule 34 of the Rules under the Tax Administration Act 28 of 2011 ('the TAA') the issues in an appeal to the Tax Court will be those contained in the statement of the grounds of assessment and opposing the appeal (Rule 31), read with the statement of the grounds of appeal (Rule 32) and, if any, the reply to the grounds of appeal (Rule 33). Together these pleadings delineate the issues in dispute between the parties.

(iii) That the Supreme Court of Appeal, in the matter of *C:SARS* v *Pretoria East Motors (Pty) Ltd* 76 SATC 293 stressed the importance of the taxpayer knowing what disputes were truly in issue and what needed to be produced in order for it to discharge the burden of proof that rested upon it and also held that as the taxpayer was not alerted to any other issue it was certainly not called upon to produce every underlying voucher or invoice or to reconstruct its accounts from scratch for the Tax Court.

(iv) That on a proper reading of the pleadings, *in casu*, it was clear that the only issue that the taxpayer needed to prove was that X Gold and Z Gold had supplied jewellery to the taxpayer during the VAT period.

(iv) That the Tax Court was not a court of appeal in the ordinary sense, it was a court of revision and it was the Legislature's intention that there should be a re-hearing of the whole matter by the Tax Court and that the court could substitute its own decision for that of SARS. (see *Rand Ropes (Pty) Ltd* v *CIR* 13 SATC 1.) With these principles in mind it was this court's task to evaluate the evidence produced by the taxpayer and to establish whether it had discharged the *onus*.

(v) That the majority of the taxpayer's suppliers were paid in cash and the reason why the suppliers were paid in cash had to be discerned in the context of the second-hand goods industry. The suppliers were 'pawn shop' and 'gold shop' owners and their clients were people that sold gold jewellery to access cash. Both X Gold and Z Gold wanted to be paid in cash for their supplies by the taxpayer.

(vi) That SARS' main contention, and the high watermark of their case, was that the taxpayer failed to produce any documentary evidence showing that the money transferred into the bank account of the cash-in-transit companies, was paid to X Gold and Z Gold. It was submitted that the taxpayer and its witnesses had opted not to disclose such material evidence for fear that such disclosure would reveal foul-play. It was SARS' contention that because there was no proof of payment to X Gold and Z Gold, there was no proof that any supplies were made to the taxpayer.

(vii) That the Z Gold and X Gold payments were nothing out of the ordinary, seen from an administrative perspective. The Z Gold and X Gold transactions were about 13% of the overall transactions. SARS had accepted that 87% of the transactions took place, *ie* that there were supplies for which payment was made.

(ix) That one of the reasons why SARS performed an audit was the fact that the taxpayer had issued recipient-generated invoices but the issue was, however, deprecated by SARS as the reason for the disallowance of the input tax deduction in its Statement of Grounds of Assessment pursuant to Rule 31. However, the fact that invoices were generated by the taxpayer was of no consequence for present purposes.

(x) That SARS' case, as contained in the pleadings, was that X Gold and Z Gold did not at all operate businesses during the VAT period in question and that they could therefore not make supplies and did not make supplies. A SARS official came to this conclusion based on two site inspections during October 2016. The official concerned could therefore not have

reasonably come to a conclusion based on this information obtained from site inspections and he had to investigate further but had failed to do so.

(xi) That the court agreed with the taxpayer's submission that for SARS' auditor to ignore the taxpayer's version, and the mass of information in its possession, was a compound methodological error. The raising of an assessment must be based on a proper, objectively reasonable, factual basis and if competing evidence is presented to SARS, SARS must deal with it rationally. The auditor could therefore not have come to a conclusion that there were no supplies made by Z Gold based on the information available to him.

(xii) That once again, SARS had selectively discarded evidence that supplies were made and had raised assessments based on insufficient information. Moreover, SARS had brought a witness to court but had failed to lead his evidence. The only conclusion that could be drawn from this failure was that the witness did not support SARS' case when push came to shove and accordingly that supplies had been made by Z Gold.

(xiii) That when an audit against a taxpayer is conducted in terms of the Tax Administration Act, it comes with massive power. It allows the auditor to investigate and interrogate, making full use of the machinery of the Act. However, the power to investigate comes with a huge responsibility. It must be done in a proper, reasonable and responsible manner.

(xiv) That SARS' finding was that the two entities, X Gold and Z Gold, did not trade at the time supplies were made to the taxpayer. It was an extremely serious allegation as it amounted to fraud. The question was: did the SARS auditor conduct a proper investigation or did he just scratch the surface. Was his investigation not too superficial to make a finding? SARS contended that the auditor did his best to accumulate the information but what was the extent of his investigation?

(xv) That the approach adopted by SARS in this appeal was not fair towards the taxpayer. Fairness demanded that the taxpayer must be informed, in no

uncertain terms, what underlying facts are placed in dispute so that the taxpayer knows what should be proved and which witnesses to call to discharge its *onus*. This was not done. Instead general allegations were made regarding recipient generated invoices, entities that did not exist or conducted enterprises, and that there was no supply. Fairness also demanded that there must be a proper investigation into the affairs of the taxpayer.

(xvi) That the judgments in which the concept of 'satisfaction' had been considered, all signified one thing: if there is reasonable doubt about something or the other, there cannot be satisfaction that it occurred. The test whether an official can be satisfied about something or not is objective. It is based on reason and reasonableness. It invokes the concept of rationality and thus, legality under the Constitution.

(xvii) That it was clear that SARS' auditor had already made up his mind about the taxpayer even before he had his second meeting with the representatives of the taxpayer on 15 November 2016. The purpose of this meeting was to discuss the status of the investigation and the minutes of the meeting seemed to indicate that there was still time for the taxpayer to provide and assist with the obtaining of further evidence, before the auditor made his finding. However, at that point, the auditor was already busy finalising his letter of audit findings. The letter was sent to the taxpayer the next day, 16 November 2016. In the letter the auditor concluded that there was fraud. Not a word was spoken on 15 November 2016 about the fact that the horse had bolted and that it mattered not what the taxpayer's representatives would say or do after the meeting. The auditor was clearly not interested in receiving any information from the taxpayer and the meeting on 15 November 2016 was a ruse.

(xviii) That it was regrettable that the auditor's audit file was not disclosed to the court. He had testified without any of his investigation documents before him and the audit file should have been disclosed. It would have given the court insight into the auditor's investigations and would have been a

valuable tool against which his evidence could have been tested. The auditing of vendors and taxpayers is a serious business. The absence of the audit file left many aspects of this case unanswered.

(xix) That the SARS auditor clearly had a one-sided approach to the matter. He only took into consideration facts that were prejudicial to the taxpayer's relationships with X Gold and Z Gold and nothing in their favour. He ignored the mass of evidence that the taxpayer produced to him and he clearly did not familiarise himself with the second-hand goods industry and the process followed to transform jewellery into gold bars. He completely ignored the evidence and failed to properly analyse and investigate the documentation provided to him. The auditor had conducted an imperfect audit and his suspicions did not meet the high yardstick of reasonableness that is set in law.

(xx) That the taxpayer's witnesses, Mr H and Ms S, gave compelling evidence. Their evidence was supported by transaction documents that paint a complete picture from the time that the gold jewellery was brought to Mr H, to the time that the second payment was made to the suppliers. The taxpayer's case literally begins and ends with Mr H. Mr H was consistent in his evidence and the material aspects of his testimony were not contested. His evidence, undoubtedly, proved that supplies were made. If supplies were made, suppliers had to be paid and if the suppliers were VAT registered entities, they had to charge VAT on the supplies. Both X Gold and Z Gold were VAT registered entities, and they had to charge VAT on the supplies.

(xxi) That the taxpayer bore the *onus*, to show on a preponderance of probability, that the decision of SARS against which it appealed was wrong. In *CIR* v *Middelman* 52 SATC 323 the court held that the *onus* was discharged where the court has no reason to disbelieve the taxpayer and his evidence is not contradicted by the objective facts. The taxpayer has met the *onus* required to establish that supplies were made by X Gold and Z Gold during the VAT period and that it traded with these two entities.

(xxii) That SARS' statement of grounds of assessment were unreasonable for the following reasons: SARS contended in the Letters of Assessment that the tax invoices were not valid; that the suppliers of Z Gold and X Gold did not exist or conduct enterprises; and that no supplies were made. These grounds were carried through to the Statement of Grounds of Appeal. It was not put to any of the taxpayer's witnesses that no supplies were made and no positive evidence was led by SARS that there were no supplies. The reasons provided by the SARS auditor for rejecting all the information provided to him were unreasonable and SARS' conduct, both in raising the assessment and its reliance on statements of grounds of assessment which were not sustained in the course of evidence, fell within the parameters of section 130(1)(*a*) of the Tax Administration Act, rendering the statement of grounds of assessment unreasonable.

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

# 5. INTERPRETATION NOTES

## *5.1. Wear-and-tear or depreciation allowance – No. 47 (Issue 5)*

This Note provides guidance on the circumstances in which the wear-and-tear or depreciation allowance in section 11(e) may be claimed as a deduction.

This Note also provides guidance on the application and interpretation of section 11(e) in relation to the determination of:

- the 'value' of a qualifying asset on which the allowance is based; and
- the acceptable write-off period of a qualifying asset.

The Annexure contains a schedule of write-off periods for various qualifying assets which are acceptable to SARS.

This Note is a binding general ruling made under section 89 of the Tax Administration Act on section 11(e) in so far as it relates to the determination:

- of the value of an asset for purposes of section 11(e); and
- the amount that will qualify as an allowance.

This ruling applies to any qualifying asset brought into use on or after 24 March 2020 Section 11(a) allows a deduction for expenditure and losses actually incurred in the production of income, provided such expenditure and losses are not of a capital nature.

Over many years South African courts have developed or adopted a number of principles for determining whether expenditure is of a capital or revenue nature. Although capital expenditure may be incurred in the production of income and in carrying on a trade, it is nevertheless excluded from deduction under the general deduction formula in section 11(a).

The Act addresses this issue by granting a deduction for specific types of capital expenditure incurred in carrying on a trade, usually in the form of an allowance spread over a number of years based on the cost or value of an asset.

Section 11(e) is one such specific provision and provides for an allowance on the value of any machinery, plant, implements, utensils and articles used by the taxpayer as owner in the carrying on of a trade.

## *5.2. Interaction between section 25B(1) and section 7(8) in case of conflict, inconsistency or compatibility – No. 114*

This Note provides clarity on only the interpretation and application of the words 'subject to the provisions of section 7' in section 25B(1) and, more specifically, whether section 7(8) or section 25B(1) applies if there is a conflict, inconsistency or incompatibility between the sections. This may occur when an amount received by or accrued to a non-resident discretionary trust by reason of or in consequence of a donation, settlement or other disposition by a resident, which would have constituted income if the non-resident were a resident, is vested in a resident beneficiary by the trustees of the non-resident discretionary trust.

Consideration of other sections in the Act that may apply to the vesting of an

amount in a resident beneficiary by the trustees of the non-resident discretionary trust is beyond the scope of this Note.

Sections 25B and 7(8) are applied inconsistently by taxpayers. The interaction of these two sections therefore needs to be considered and analysed.

Under section 25B(1) if any amount is received by or accrues to a trust during a year of assessment, and during the same year of assessment the amount:

- does not vest in a beneficiary, it is deemed to accrue to the trust; and
- vests in a beneficiary, it is deemed to accrue to that beneficiary.

Generally, once an amount has been received by or accrued to a person, that receipt or accrual is not undone by giving the right to that amount to someone else.

If applicable, however, section 25B(1) and 25B(2) will result in a different outcome because the amount is deemed to have been received by or accrued to the second person and not the first. For example, if an amount, which constitutes income, accrues to a discretionary trust on 1 July of year 1, and the trustees vest the amount in a beneficiary on 30 November of year 1, under normal receipt and accrual principles, taking into account that the trust is a separate person for income tax purposes, the amount would prima facie have accrued to the trust on 1 July of year 1, but under section 25B(1) and 25B(2) it is deemed to accrue to the beneficiary, not the trust.

Both the outcomes described in the above bullet points are 'subject to the provisions of section 7'. This Note considers the implications of this 'subject to' clause in relation to section 7(8).

The Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004 states the following on the rationale for the introduction of section 7(8):

> 'Foreign trusts have been a focus of concern for quite some time. South African taxpayers continue to artificially shift assets offshore via foreign trusts, thereby excluding income from the South African tax net. In 2001 and 2002 (as part of the shift to worldwide taxation), Government enacted further anti-avoidance measures to prevent this form of artificial exclusion

> from the South African tax net. Section 7(8) is a key anti-avoidance measure in this regard.'

In applying section 7(8), the words 'subject to the provisions of section 7' in section 25B(1) must be interpreted to mean that to the extent that both section 7(8) and section 25B(1) potentially apply, only section 7(8) must be applied. Section 25B(1) will apply to the balance of any income not derived in consequence of a donation, settlement or other disposition.

# 6. DRAFT INTERPRETATION NOTES

## *6.1. Tax Treatment of the receipt or accrual of government grants – No. 59 (Issue 2)*

This Note deals with:

- the tax consequences of the receipt or accrual of government grants;
- the exemptions from normal tax applicable to government grants; and
- anti-double-dipping rules applicable to expenditure funded by such grants

Government grants are generally intended to stimulate various aspects of the economy. Allocation of funding can occur in a variety of ways. A grant may:

- be received in advance by a taxpayer for anticipated purchases of goods and services;
- be made directly for goods and services purchased for the benefit of a taxpayer;
- be intended to reimburse the taxpayer after the goods or services have been purchased; or
- be in the nature of a reward for achieving a milestone, such as creating a specified number of jobs.

The income tax rules relating to government grants were spread over a number of

sections in the Act which resulted in inconsistent treatment, with some grants being exempted and others not. In order to address this problem, a unified system for exempting or taxing government grants was introduced. Specific exemptions in section 10(1)(zA), (zG), (zH) and (zI) were deleted, while section 12P and the Eleventh Schedule were inserted with effect from years of assessment commencing on or after 1 January 2013.6 Section 12P exempts specified government grants paid by government in the national, provincial and local spheres, while the previous system exempted only selected grants paid by national authorities.

On or after 1 January 2016 government grants paid to PPPs to effect improvements on land or to buildings owned by any sphere of government or over which any sphere of government holds a servitude are exempt under section 12P(2A).

These grants were previously exempt under section 10(1)(zI) which was deleted with effect from1 January 2016.

With effect from 19 January 2017, all government grants received by or accrued to a taxpayer must be included in gross income under paragraph (lC) of the definition of 'gross income' in section 1(1), regardless of whether they are of a capital nature.

A government grant received by or accrued to a taxpayer before this date would have to be analysed to determine whether it was of a capital or revenue nature in order to determine whether it should be included in gross income In determining whether a government grant is subject to normal tax regard must be had to:

- specific inclusions in gross income (for example, farming subsidies and government grants, and recoupments);
- any exemption under section 10;
- any exemption under section 12P and the Eleventh Schedule; and
- the facts and circumstances of the particular case.

In addition, it is important to consider the impact on deductions, allowances and base cost. For example, the specific anti-double dipping rules under section 12P(3)

to (6) which are applicable to government grants as contemplated in section 12P(2) and (2A).

## *6.2. Deduction in respect of improvements to land or buildings not owned by a taxpayer*

This Note provides guidance on the interpretation and application of:

- section 12N, which facilitates allowances under specified sections of the Act for improvements made to land or buildings not owned by a taxpayer but over which the taxpayer holds a right of use or occupation. The improvement must be effected under a PPP, a lease agreement with the state or certain other taxexempt statutory bodies and the state or that body owns the land or building, or under the Independent Power Producer Procurement Programme.
- section 12NA, which deals with deductions for improvements effected under a PPP by a person to land or to a building over which the state holds the right of use or occupation.

Other sections in the Act, which potentially provide an allowance on improvements to land or buildings not owned by the taxpayer, include section 11(g) and section 13bis.

These sections are not dealt with in this Note. See Interpretation Note 110 'Leasehold Improvements' and Interpretation Note 105 'Deductions in respect of Buildings used by Hotelkeepers'.

The Act provides for a variety of depreciation allowances for the creation or acquisition of qualifying movable or immovable assets. In order to qualify for these allowances, the taxpayer must generally be the owner of the assets. Under the common law principle of superficies solo cedit (owner by accession), buildings or other structures affixed or attached to land become the property of the owner of the land.

Often lease agreements of immovable property require the lessee to effect improvements on land or to buildings as part of the obligations under the agreement.

The problem with such an arrangement is that the land belongs to the lessor and the improvements become the property of the lessor when effected. The lessor is not entitled to use the improvements until the lease expires and as the lessee is not the owner, many allowances are not applicable. In order to address these issues the Act contains specific provisions relating to leasehold improvements.

In relation to the lessee, section 11(g) provides for a deduction of expenditure actually incurred by a lessee in pursuance of an obligation to effect improvements on land or to buildings under an agreement under which the right of use or occupation of the land or buildings is granted by the lessor.

The allowance under section 11(g) does not, however, apply if the value of the improvements effected by the lessee does not constitute income of the lessor. A taxpayer effecting leasehold improvements to land owned by the state would not be able to secure a deduction under section 11(g), since the state is exempt from tax under section 10(1)(a). In order to encourage private sector participation in government projects it was therefore necessary to introduce specific legislation to enable taxpayers to secure deductions for leasehold improvements effected to stateowned land or buildings.

Section 12N does not provide for a deduction, however it was introduced to facilitate allowances available under other sections on improvements not owned by a taxpayer.

With effect from 4 July 2013, section 12N was amended to facilitate allowances on expenditure incurred under an obligation or voluntarily by a lessee to effect improvements on leased land or buildings.

With effect from 1 January 2013, section 12NA was introduced to provide for a deduction when a person is under an obligation under a PPP to effect an improvement to land or a building over which the state holds the right of use or occupation.

### *6.3. Deduction of medical lump sum payments*

This Note provides guidance on the interpretation and application of section 12M which relates to the deductibility of a lump sum amount paid by a taxpayer to or in respect of a former employee or dependants of that former employee for purposes of covering post-retirement medical benefits. The income tax implications of this benefit to the former employee are not considered in this Note.

Employers often provide various incentives to attract and retain employees with scarce skills. One form of benefit is to cover the medical aid contributions of former employees in retirement. This could be an expensive and risky exercise for a taxpayer as medical inflation may exceed general inflation, or a chronic illness of a former employee can be protracted. In order to counter such a risk, taxpayers may seek to settle this liability upfront. Two common approaches to settling the liability upfront are to make a lumpsum payment to an insurer for a policy of insurance or to make a direct lump-sum payment to the former employee or dependant. Depending on the facts, the taxpayer may shift their contractual responsibility to provide post-retirement medical benefits to the insurer, former employee or dependant.

Previously the tax treatment of a lump sum paid by a taxpayer to cancel the obligation to provide for the post-retirement medical benefits of a former employee was uncertain and arguably not deductible. Since the introduction of section 12M, a taxpayer can claim an immediate deduction of a lump sum payment made for purposes of covering the post-retirement medical aid contributions of a specified former employee or dependant if it meets certain requirements.

A taxpayer may be entitled to claim a deduction in the year of assessment a lump sum amount is paid for the purposes of covering post-retirement medical benefits of former employees or dependants of former employees under specified circumstances. A deduction under section 12M will be available if the lump sum is paid by the taxpayer during the taxpayer's year of assessment in the course of taxpayer's trade:

- to:
  - any former employee who retired from the taxpayer's employment on the grounds of old age, ill-health or infirmity or any dependant of such former employee, or
  - to an insurer under a policy of insurance taken out solely in respect of one or more of the above-mentioned former employees or their dependants; and
- the purpose of making the lump sum payment is to enable the former employee or his or her dependants to make a contribution to a specified medical scheme or a specified medical scheme fund. The deduction is limited to the extent that the lump sum payment is for the purpose of making a contribution to a specified medical scheme or medical scheme fund in respect of the above-mentioned former employee or dependant.

No deduction is allowed if the taxpayer or any connected person to the taxpayer retains or has any further obligation, whether actual or contingent, related to the mortality risk of the above-mentioned former employee or a dependant of the former employee.

# 7. ADVANCE TAX RULINGS SYSTEM – INVITATION FOR COMMENT

The legislature created the legal framework for ATRs in 2006, in order to enhance the level of tax certainty, clarity and consistency regarding the interpretation and application of a tax Act.

The ATR process is based on international best practice and has been operational for 14 years.

In keeping with SARS' 2024 strategic objectives, SARS is currently reviewing the existing ATR process for binding private and binding class rulings to assess whether it can be improved and in so doing enhance taxpayer service levels and

satisfaction.

The purpose of this document is to extend an invitation to all taxpayers, tax practitioners and professional associations to submit comments on the current ATR process and make recommendations for improvement that SARS can consider in conducting its review.

Process

Details on the ATR process can be found in section 75 to 90 of the TA Act and the Comprehensive Guide to Advance Tax Rulings, which can be accessed on the SARS website (www.sars.gov.za).

A brief summary of some of the important features are provided below.

- Filing the application form.

  The ATR process begins with the filing of the application forms and the payment of the application fee. The application forms must be submitted electronically and the payment of the application fee must also be made through the SARS eFiling system. An e-Application that is filed without payment of the application fee will expire within 10 business days. If there is uncertainty as to whether a rejection may apply, applicants are welcome to lodge the online application and upload the application documentation for evaluation before payment of the application fee.

- Pre-screening checklist.

  The first form that must be completed is the pre-screening checklist, which helps to ensure that the application is eligible for the ATR process and that it is not subject to a rejection.

- Confirmation and reference number.

  An electronic confirmation will be issued to the applicant once the applicant has successfully submitted the pre-screening checklist and the application forms. The confirmation will also include a reference number, which must be used in further communication with SARS on the application.

- Supporting information and other required items.

  Applicants are required, under section 79 of the TA Act, to provide detailed supporting information and other required items in connection with the application. The supporting information and required items must be submitted within five business days, unless an extension is granted in writing.

- Review of application.

  Once the supporting information and required items have been received, the application will be assigned to a specialist. The specialist will review the application more comprehensively to ensure that none of the rejection criteria apply. Upon completion of this review, the specialist will notify the applicant within five business days whether or not the application has been accepted.

- Estimated cost recovery fee.

  The specialist will provide the applicant with an online estimate of the cost recovery fee. Work in connection with the application cannot begin until the applicant has electronically accepted the estimated cost recovery fee and made the advance payment. The advance payment is calculated as a percentage of the highest estimated cost recovery fee (normally 20%).

- Letter of Engagement.

  Upon acceptance of the estimated cost, the applicant must indicate that he or she has read and accepted the Letter of Engagement by ticking the relevant box. The engagement letter is a binding contract between the applicant and SARS that sets forth the basic terms and conditions that govern the ruling process, including acceptance of the estimated cost recovery fee and agreement to make the advance and final payments.

- Substantive review.

  During the substantive review process, the specialist may request additional information from the applicant. A ruling application may still be

rejected during the review process if it becomes apparent that an exclusion or rejection criterion is applicable.

- Status checks.

  The applicant will be able to check the status of the application on the eFiling system throughout the review process. Alternatively, the applicant can contact the specialist or email ATRInfo@sars.gov.za.

- Notice of proposed ruling.

  The applicant will be notified by the specialist upon completion of the review process. The proposed ruling may be positive or negative. The applicant will be provided with a draft ruling if the proposed ruling is positive. The applicant must review the draft ruling carefully for accuracy and inform SARS of any errors or omissions. The applicant will be notified and given an opportunity to discuss the matter with the specialist if SARS intends to issue a negative ruling.

- If a final decision is taken that the ruling, if issued, will be a negative ruling, the applicant will be given the option to:

  - request that the ruling not be issued and to withdraw the application; or

  - in certain limited cases, to amend the application to address those aspects of the proposed transaction that have given rise to the problem.

- Issuance of the ruling.

  Once all of the foregoing steps have been completed, the ruling will be issued to the applicant through eFiling. A request for a hard copy of the ruling may be made at the time the final ruling is issued.

- Validity period of the ruling.

  The ruling will be valid for a specific period. A reconfirmation can be requested, provided the facts have remained the same. In a number cases

it is unnecessary to request an extension even if the period over which the ruling is applied exceeds the validity period. For example, if a ruling has been issued on section 12D of the Income Tax Act 58 of 1962 and the write-down of the value of the asset is limited to 5% per year, the ruling may be valid for five years, but the cost will be written off over 20 years. SARS will not change the write-down period after the ruling has expired unless circumstances would justify a withdrawal of the ruling. In that event, SARS will communicate the circumstances and its conclusions to the applicant as if the ruling were in force. Notwithstanding the stated period of validity, a ruling will cease to be valid if a provision of the tax Act that materially affects the ruling is amended or a court overturns or modifies the interpretation in the ruling. SARS may also withdraw or modify a ruling.

- Publication of the ruling in a sanitised form.

  The final step involves the publication of the ruling in a sanitised form (published ruling).

- Reconfirmations.

  The following steps must be taken to apply for a reconfirmation:

  - Access the SARS eFiling system and apply online again following the normal application process.
  - Pay the application fee.
  - Within five business days, submit a reconfirmation request together with a motivation as to the reason why the reconfirmation should be granted. This motivation must address both the question of whether or not the background circumstances have changed and the reason why, in this instance, an extension is necessary from the applicant's perspective.

# 8. BINDING PRIVATE RULINGS

## *8.1. BPR 357 – Donations to a foreign trust of property situated outside the Republic*

This ruling determines the tax consequences of the donation by resident natural persons to a foreign trust of property situated outside the Republic originally acquired by donation from a foreign person.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 25 November 2020. 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 56(1)(g)(iii).

Parties to the proposed transaction

The applicant: A resident natural person married in community of property to the co-applicant

The co-applicant: A resident natural person married in community of property to the applicant

Trust A: A foreign discretionary trust settled by the applicant of which

the applicants, amongst others, are beneficiaries

Trust B: A foreign discretionary trust settled by the applicant of which the applicants and their three children are the beneficiaries

Description of the proposed transaction

The applicant and co-applicant together with some of the applicant's siblings, who have never been residents of South Africa, entered into an agreement with a foreign seller for the purchase of all the shares of two foreign companies each holding a number of shares in a third foreign company.

The purchase was finalised in November 2009, with the price payable in

instalments from December 2013. Over the years the applicants received distributions from Trust A that were used to partially settle the applicants' share of the purchase price.

Trust A was funded by shares donated by the applicant. The shares were a gift from the applicant's parents who have never been residents of South Africa.

Disputes arose between the siblings who had been part of the share purchase transaction and those who were not. The disputes resulted in legal proceedings, but following extensive negotiations a settlement was reached between the parties that will be made an order of the relevant foreign court. The settlement includes what is termed a 'partial liquidation' of the two foreign companies acquired in November 2009. As a result, the applicants will receive cash as well as shares in the third foreign company. The cash will be deposited into the foreign bank account(s) of the applicants.

The applicants will dispose of the cash as well as the shares in the third foreign company to a fourth foreign company on loan account, and then donate their loan accounts to Trust B.

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 donation by the applicant and the co-applicant, jointly, to Trust B will be exempt from donations tax under section 56(1)(g)(iii).

## *8.2. BPR 358 – Amalgamation of short or long-term insurers*

This ruling determines the tax consequences of an amalgamation of life and nonlife reinsurers.

In this ruling references to sections are to sections of the Income Tax Act

applicable as at 29 January 2021. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

Parties to the proposed transaction

The applicant: A South African resident company providing short-term reinsurance services

Co-applicant 1: A South African resident company holding all the shares in the applicant and co-applicant 2

Co-applicant 2: A South African resident company providing long-term reinsurance services

Description of the proposed transaction

The applicant and co-applicant 2 carry on business under separate insurance licences. They wish to reorganise their corporate structure to combine their short-term and long-term reinsurance businesses from 1 January 2021.

The proposed transaction steps are as follows:

- The applicant will transfer all its assets to co-applicant 2 in anticipation of its liquidation or deregistration (as the case may be) in terms of section 44. The assets that will be transferred include investments in subsidiaries, other invested assets, fixed income securities, funds withheld, property and equipment, other balance receivables and accounts receivable. In addition, all the employees in the employ of the applicant will be transferred to coapplicant 2.
- As consideration for the assets transferred, the applicant will transfer and delegate its liabilities to co-applicant 2. The liabilities that will be transferred include insurance liabilities relating to premiums; insurance assets relating to reinsurance premiums; insurance liabilities relating to claims; insurance assets relating to reinsurance claims; deferred acquisition costs conditionally incurred by the applicant; reinsurance deferred acquisition costs to which the applicant is conditionally entitled; retrocession recoverables on provision for profit commissions; provisions for

recoverables; contingent commissions and provision for contingentcommissions.

- For the balance of the purchase consideration not discharged by the liabilities assumed, co-applicant 2 will issue the applicant with equity shares equal to the net asset value of the business.
- In anticipation of its liquidation or deregistration, the applicant will distribute the shares it obtained in co-applicant 2 to co-applicant 1.
- The applicant will commence with the steps to deregister or liquidate within 36 months.

Conditions and assumptions

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

- Nothing contained in this ruling may be construed as an opinion with regards to the matching of any future deductions that co-applicant 2 may seek with the particular assets of which the purchase price is or was settled by the assumption of that specific liability.
- The applicant will within a period of 36 months after the date of the proposed transaction, or such further period as the Commissioner may allow, take the steps contemplated in section 41(4) to liquidate, wind up or deregister.
- The applicant will not at any stage withdraw any step taken to liquidate, wind up or deregister or do anything to invalidate any step so taken with the result that it will not be liquidated, wound up or deregistered.
- None of the exclusions listed in section 44(14) apply to the proposed transaction.

Ruling

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

- The proposed transaction will constitute an 'amalgamation transaction' as

defined in paragraph (a) of that definition in section 44(1).

- The applicant and co-applicant 2 will qualify for the relief contemplated in sections 44(2) and 44(3).
- Sections 44(2) and 44(3) will not be precluded from applying to the proposed transaction since the liabilities assumed by co-applicant 2 qualify as debt envisaged in section 44(4)(b).
- The tax consequences of the assumed contingent liabilities will be determined in accordance with the provisions of section 11(a) read with section 23(g) and any other relevant provisions when they materialise. Coapplicant 2 will have to ensure that the requirements of the relevant provision are satisfied before claiming any deductions when the assumed contingent liabilities materialise.
- Subject to the rulings contained in f) and g) below, no tax adjustments as contemplated in section 28 will be required at implementation date of the proposed transaction.
- Sections 28(2) and 28(3) will apply in determining the tax treatment of the short-term insurance business in the hands of co-applicant 2 from 1 January 2021.
- The applicant will be required to add back the provisions and estimated amounts previously deducted under section 28(3) for the year of assessment to 31 December 2020 in the 2021 year of assessment, as contemplated in section 28(4).

## *8.3. BPR 359 – Transfer of reinsurance business from a resident company to a local branch of a foreign company*

This ruling determines the tax consequences, for a resident company that conducted reinsurance business, of the transfer of its business as a going concern to a local branch of the foreign holding company of the Applicant.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 25 February 2021. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definition of 'gross income';
- section 11(a) read with 23(g); and
- section 28.

Parties to the proposed transaction

The Applicant: A resident public company that is a wholly-owned subsidiary of a foreign company

The Co-applicant: A foreign company acting through a permanent establishment registered as an external company in South Africa

Description of the proposed transaction

It recently became lawful for a non-resident reinsurer to operate via a branch in South Africa.

The Applicant proposes to transfer its reinsurance businesses to the Co-applicant once a branch license has been granted to the Co-applicant by the Prudential Authority. After the transfer of the reinsurance businesses the activities of the Co-applicant will be identical to the former activities of the Applicant.

The proposed steps to implement the transfer are as follows:

- The Applicant will, as step 1a, transfer its existing short-term reinsurance business to the Co-applicant. This will comprise the payment of a cash amount by the Applicant in exchange for the assumption by the Co-applicant of the net underlying liabilities owing to short-term reinsurance policyholders. The consideration is viewed by the Applicant as the arm's length market value of the short-term reinsurance business. Any residual value of the short-term business will then be distributed in cash by the Applicant to its non-resident shareholder as a liquidation dividend, subject

to any obligation to withhold dividends tax.

- The Applicant will, as step 1b, transfer its existing long-term reinsurance business to the Co-applicant. The Applicant will pay a cash amount in exchange for the assumption by the Co-applicant of the Applicant's liabilities owing to its long-term reinsurance policyholders. The consideration is viewed by the Applicant as the arm's length market value of the long-term reinsurance business. Any remaining policyholder assets will be transferred to the Corporate Fund under section 29A and taxed there. Any residual value that remains of the long-term business will be distributed in cash as a liquidation dividend to the Applicant's non-resident shareholder, subject to any obligation to withhold dividends tax.

- The Applicant will, as step 1c, transfer its reinsurance goodwill (comprising, amongst others, goodwill, renewal rights and customer lists) to the Co-applicant for a market-related cash consideration. The Applicant may decide to set off its obligation to pay the cash amount under Step 1b against the Co-applicant's obligation to pay the cash consideration under Step 1c.

- As step 2, the Co-applicant will be required to transfer cash to a South African trust, formed to provide and maintain local security for policyholders. The Co-applicant will be the vested income beneficiary of the trust. Policyholders will have rights against the trustees in respect of the trust assets. The trustees will settle qualifying claims directly with policyholders. Quarterly, the assets of the trust will be reconciled with the value of the liabilities covered by the trust assets. Whenever a surplus arises, this amount will vest in the Co-applicant. Similarly, upon termination of the trust, any surplus assets will vest in the Co-applicant.

- In step 3, in a separate but simultaneous transaction from the transfer of the insurance liabilities in steps 1a and b, the Applicant will transfer office equipment and other property it has the right to use, as well as accounts receivable from assumed reinsurance transactions and other assets, the

liability under a lease, as well as accounts payable under assumed and ceded reinsurance transactions, provisions and other liabilities, to the Co-applicant. In consideration for the sale of the assets in step 3, the Co-applicant will assume liabilities (other than the policyholder liabilities) and pay a cash consideration.

- Subsequent to the proposed transaction the Applicant will be liquidated and deregistered.

Conditions and assumptions

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

- The pricing of the delegation payments under step 1a and step 1b is marketrelated.
- The Co-applicant will constitute a permanent establishment in South Africa.

Ruling

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

- The delegation payment in step 1a in relation to the transfer of the net shortterm policyholder liabilities to the Co-applicant is not deductible by the Applicant.
- The receipt of the delegation payment in step 1a by the Co-applicant will not constitute 'gross income' as defined in section 1(1).
- The receipt of the delegation payment in step 1b by the Co-applicant will not constitute 'gross income' as defined in section 1(1).
- The Co-applicant may apply section 28(3) and (4) in relation to its short-term insurance business and section 28(3A) in relation to the long-term insurance business.
- The Co-applicant may not deduct the contribution to the South African trust in step 2.

- The receipts from the South African trust (excluding any investment income thereon) will not constitute 'gross income' as defined in section 1(1) for the Co-applicant.

## 8.4. BPR 360 – Internal restructure followed by a dispoal of shares to a BBBEE investor

This ruling determines the tax consequences of an internal restructure aimed at consolidating the operating entities involved in a particular type of business (the target business) under a single intermediate holding company (company G) (the internal restructuring), as well as the sale of a 25% interest in company G by the ultimate holding company (the applicant) to a third party B-BBEE investor (the investor) (the BEE transaction).

In this ruling references to sections and paragraphs are to sections of the relevant Income Tax Act and the STT Act, and paragraphs of the Eighth Schedule to the IT Act applicable as at 27 November 2020. 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 'contributed tax capital', 'gross income' and the definition of 'group of companies' together with the definition of the same term in section 41(1);
    - section 24BA;
    - section 40CA; 2
    - section 42;
    - section 45;
    - section 55;

  - section 58;
  - paragraph 12A;
  - paragraph 13(1)(a)(i);
  - paragraph 20(1)(a);
  - paragraph 32(3)(a);
  - paragraph 35(1); and
  - paragraph 39.
- the STT Act:
  - section 8(1)(a)(i) read with section 8(1)(a)(iv)(B) and 8(1)(a)(iii).

Parties to the proposed transaction

The applicant: A listed resident company

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

Company B: A resident company that is a wholly-owned subsidiary of Company A

Company C: A resident company that is a wholly-owned subsidiary of the applicant before the proposed transaction

Company D: A resident company that is a wholly-owned subsidiary of the applicant

Company E: A resident company that is a wholly-owned subsidiary of the applicant

Company F: A resident company that is a wholly-owned subsidiary of Company E

Company G: A resident company that is a wholly-owned subsidiary of the applicant, formed to be the new intermediate holding company of the target business

Description of the proposed transaction

The applicant and all the co-applicants are South African resident companies. The applicant is listed on, amongst others, the JSE Limited and is the ultimate holding company of, amongst others, the co-applicants (collectively the group). The applicant directly holds the entire issued share capital of company A, company C,

company D, company E and company G. Company A holds the entire issued share capital of company B, and company E holds the entire issued share capital of company F.

As part of its B-BBEE initiative, and to contribute to the realisation of its strategy to protect and enhance its commercial position, the applicant will sell a 25% interest in company G to the investor under the BEE transaction.

As a precursor to the BEE transaction the group will implement an internal restructuring (internal restructuring) to consolidate its target business under company C, an intermediate holding company, and under an ultimate intermediate holding company (company G).

Unrelated to the internal restructuring, the applicant will subscribe for additional shares in company C to enable the repayment of outstanding funding used for strategic acquisitions by company C (the C subscription). The C subscription will take place prior to the asset-for-share transaction (AFS transaction).

The internal restructuring is implemented in two phases. Phase I comprised various intra-group transactions, as envisaged in paragraph (a) of that definition in section 45(1), in terms of which wholly-owned subsidiaries (directly or indirectly) of the applicant sold and transferred equity shares held in subsidiary companies to wholly-owned subsidiaries (directly or indirectly) of the applicant at their market values.

Phase II will comprise an AFS transaction and an intra-group transaction (the B sale) at market value, with the consideration for the B sale remaining outstanding on loan account.

In terms of the AFS transaction the applicant will transfer its entire holding of shares in company C (the C disposal shares) to company G, in exchange for shares issued by company G, on a 1:1 basis, as envisaged in section 42. The C disposal shares will comprise existing shares in issue (C existing Shares) and new shares issued in consequence of the C subscription (new C shares). The effective date of the AFS transaction will occur after all approvals are obtained for the internal restructuring (the AFS effective date).

The market value of all but 1 of the C existing shares will be equal to or exceed their base costs on the AFS effective date. It is assumed for purposes of this ruling that the market values of the new C shares will be equal to or exceed their base costs on the AFS effective date. These shares are referred to as the qualifying C disposal shares.

The remaining C existing shares has a base cost which is expected to exceed the market value of this share on the AFS effective date. This share is referred to as the disqualified C existing share.

The shares to be issued by company G in exchange for the receipt of the qualifying C disposal shares are referred to as the qualifying G consideration shares. The single share to be issued by company G in exchange for the receipt of the disqualified C existing share is referred to as the disqualified G consideration share.

Following the implementation of the AFS transaction company A will sell all the issued shares in company B to company C at market value (the B sale). The purchase consideration will remain outstanding on loan account in favour of company A (the B consideration loan).

Under a set-off agreement to be entered into between company A and company C (set-off agreement), the B consideration loan in favour of company A will be set off against an existing loan owing by company C to company A in part settlement of the B consideration loan.

Following the implementation of the internal restructuring the applicant will sell 25% of the issued shares (the G disposal shares) in company G on a specific identification basis as envisaged in paragraph 32(3) to the investor. For purposes of the BEE transaction and the determination of the purchase price payable by the investor, a minority and liquidity discount was applied to the value of the target business. The BEE transaction will be subject to a number of conditions precedent, including the obtaining of regulatory approvals.

Conditions and assumptions

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

assumptions:

- The intra-group transactions under phase I meet the requirements for the application of section 45.
- The transaction steps occur in the order they were stated above.
- On the AFS effective date the market value of each of the qualifying C disposal shares equals or exceeds its base cost.
- On the AFS effective date the market value of the disqualified C existing share does not exceed its base cost.

Ruling

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

- The applicant and the co-applicants form part of the same group of companies as defined in section 1(1) and section 41(1).
- The applicant's subscription for the new C shares will not have any immediate tax consequences for the applicant or company C. These shares will have contributed tax capital as defined in section 1(1) attributable to them equal to the subscription price. The subscription price paid by the applicant for these shares will constitute expenditure actually incurred by the applicant for purposes of paragraph 20(1)(a).
- The disposal of the qualifying C disposal shares in exchange for the issue of the qualifying G consideration shares on a 1:1 basis will constitute an AFS transaction as defined in paragraph (a) of that definition in section 42(1).
- Under section 42(2) the applicant;
    - will be deemed to have disposed of the qualifying C disposal shares for an amount equal to the base cost of these shares on the AFS effective date in accordance with section 42(2)(a)(i)(aa);
    - will be deemed to have acquired the qualifying G consideration shares for a cost equal to the expenditure in respect of the

qualifying C disposal shares actually incurred by the applicant that is allowable 5 under paragraph 20 and on the date on which the expenditure will be incurred. These costs must be treated as expenditure actually incurred and paid by the applicant in respect of the qualifying G consideration shares for purposes of paragraph 20, in accordance with sections 42(2)(a)(ii)(aa) and 42(2)(a)(ii)(A); and

 - the applicant and company G, in accordance with section 42(2)(b)(ii), must for the purposes of determining any capital gain or capital loss in respect of the disposal of the qualifying C disposal shares be deemed to be one and the same person with respect to:
   - the date of acquisition of the qualifying C disposal shares by the applicant and the amount and date of incurral by the applicant of any expenditure in respect of these shares allowable under paragraph 20; and
   - the market value determined by the applicant in respect of the qualifying C disposal shares as contemplated in paragraph 29(4).

- Section 24BA would not find application in the context of the AFS transaction.
- Under section 40CA company G will be deemed to have acquired the disqualified C existing share for expenditure equal to the market value of the disqualified G consideration share immediately after the implementation of the AFS transaction. The applicant will be treated as having:
  - disposed of the disqualified C existing share for proceeds equal to the value of the consideration received by the applicant, being the market value of the disqualified G consideration share received by the applicant, which will result in a ring-fenced capital loss for the applicant in accordance with paragraph 39; and
  - acquired the disqualified G consideration share for expenditure equal to the market value of the disqualified C existing share, being

the value by which the applicant's assets diminished. That value will be expenditure incurred by the applicant for purposes of paragraph 20(1)(a).

- The transfer of the C disposal shares (which includes the disqualified C existing share) pursuant to the AFS transaction will be exempt from securities transfer tax in accordance with section 8(1)(a)(i) read with section 8(1)(a)(iv)(B) of the STT Act and provided that the required sworn affidavit or solemn declaration is made by the public officer of company G.
- The B sale will constitute an intra-group transaction as envisaged in section 45(1)(a) and section 45(2) will apply, so that:
  - company A will be deemed to have disposed of the shares in company B (B sale shares) for an amount equal to the base cost thereof as at the B sale date; and
  - for purposes of the determination of any capital gain or capital loss resulting from the disposal of the B sale shares by company C, 6 company A and company C must be deemed to be one and the same person with respect to:
    - the date of acquisition of the B sale shares, the amount and date of incurral of any expenditure allowable under paragraph 20 by company A; and
    - any valuation of the B sale shares effected by company A as contemplated in paragraph 29(4). i) Company A will be deemed to have acquired the B consideration loan for expenditure of nil pursuant to section 45(3A)(b)(i).
- Section 45(6) will not apply to the B sale.
- The transfer of the B sale shares pursuant to the B sale will be exempt from securities transfer tax by virtue of the provisions of section 8(1)(a)(iii) of the STT Act, provided that the required sworn affidavit or solemn declaration is made by the public officer of company C.

- Paragraph 12A will not find application pursuant to the implementation of the set-off agreement.
- Section 45(3A)(c) will find application and the amounts accrued to company A and company C pursuant to the set-off agreement will be disregarded and will not result in any capital gain or other taxable income in the hands of company A or company C.
- The proceeds from the sale of the G disposal shares by the applicant to the investor will not be of a revenue nature and will not fall within the applicant's 'gross income'.
- The base cost of the G disposal shares will be determined in accordance with the specific identification method as envisaged in paragraph 32(3)(a) and will comprise the expenditure actually incurred by the applicant for the acquisition of these specific shares. The first-in-first-out mandatory method as envisaged in section 9C(6) is merely for the purpose of applying section 9C and does not affect the identification method adopted by the applicant for determining the base cost of the G disposal shares.
- The purchase price payable by the investor will constitute 'proceeds' in the hands of the applicant, as envisaged in paragraph 35(1).
- The applicant will be treated as having disposed of the G disposal shares on the date on which all the suspensive conditions for the disposal transaction are fulfilled as per the provisions of paragraph 13(1)(a)(i).
- The discount applied for purposes of the determination of the pricing of the BEE transaction will not constitute a 'donation' as envisaged in section 55.
- It would not be an appropriate case for the Commissioner to exercise the discretion under section 58 to conclude that the pricing of the BEE transaction does not constitute adequate consideration under the circumstances. 7
- Section 45(4)(b) will not find application pursuant to the BEE transaction, the AFS transaction or the B sale.

### *8.5. BPR 361 – Asset-for-share transaction followed by an unbundling transaction, the issue of capitalization redeemable preference shares and the sale of shares to a third party*

This ruling determines the tax consequences of an internal restructuring involving corporate rules. Cumulative redeemable preference shares are also issued as a capitalisation issue which is followed by the sale of shares to a third party. In particular, the tax relief under corporate rules for the parties involved are examined and whether the dividend stripping rules will apply.

In this ruling references to sections and paragraphs are to sections of Income Tax Act (IT Act), STT Act, Transfer Duty Act and the VAT Act, and paragraphs of the Eighth Schedule to the IT Act as at 11 February 2021. 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) definition of 'dividend' and 'trading stock';
  - section 24BA;
  - section 41(1) definition of 'group of companies';
  - section 42;
  - section 46; and
  - paragraph 43A.
- the STT Act:
  - section 1 – definition of 'transfer'; and
  - section 8(1)(a).

- the TD Act:
  - section 9(1)(l).
- the VAT Act:
  - section 8(25).

Parties to the proposed transaction

The applicant: A resident company

Company A: A resident company that is the holding company of the applicant

Company B: A resident company that will become as subsidiary of company A

Third party buyer: A resident natural person who is currently the managing director of the applicant

Description of the proposed transaction

Company B wishes to reduce its involvement in the applicant to that of a passive limited shareholder, whose interest will be phased out over time, whilst the third party buyer wishes to obtain an equity interest in the applicant. The third party buyer will acquire the ordinary shares of the applicant for purposes of holding them as a long-term investment.

The steps for implementing the proposed transaction are as follows:

Step 1

The applicant owns the property (the Property) from which the applicant carries on its operating activities. The applicant has claimed section 13 allowances on the Property. This Property will be transferred to company B in exchange for the issue of ordinary shares by company B. This transaction will be implemented under section 42 of the Act. The value of the property contributed to company B by the applicant will represent 60% of the overall value of properties held by company B after the acquisition.

The applicant will simultaneously enter into a five year lease with company B in respect of the Property. The lease payments will be at an arm's length

consideration.

Step 2

The applicant will distribute the company B shares it acquired in step 1 to company A in terms of an unbundling transaction as defined in section 46 of the Act.

Step 3

The applicant will issue class A cumulative redeemable preference shares to company A as a capitalisation share issue. The proposed terms of the class A preference shares will be as follows:

- Each preference share will have a specified capital value.
- Each preference share can be redeemed at the discretion of the applicant's board of directors, but a proposed redemption schedule has been prepared and it is envisaged that all the preference shares will be redeemed over the next 12 years.
- The preference shares will bear cumulative preference dividends determined with reference to the published inflation rate. • If the applicant redeems a specified number of preference shares during each of the first three years after they have been issued, the remaining preference shares will not bear cumulative preference dividends during the next three years (the Dividend Holiday). If it fails to redeem the specified shares, the remaining issued preference shares bear cumulative preference dividends during the Dividend Holiday Period.
- The preference shares can only be redeemed if there are no outstanding cumulative preference dividends.
- The applicant may not make distributions to the ordinary shareholders of the applicant while there are any class A preference shares in issue.
- The preference shares do not have any voting rights, except in respect of protected matters that require the consent of the class A preference Shareholder.

The capitalisation issue will be implemented under section 47 of the Companies Act 71 of 2008 (the Companies Act).

Step 4

Company A will dispose of all the ordinary shares in the applicant to the third party buyer for a nominal amount which will be the market value of the ordinary shares at that time.

Post step 4

The third party buyer will subscribe for additional ordinary shares in the applicant through which he will provide the company with a cash injection to fund its operations.

The applicant will declare and pay cumulative preference dividends in respect of the class A preference shares. Over time, the applicant will redeem the preference shares.

Conditions and assumptions

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

- the Property will be sold at market value;
- the Property does not secure any debt;
- the parties to the proposed transaction will not elect that the provisions of section 42 of the Act do not apply;
- the public officer of company B will make a sworn affidavit or solemn declaration, as required by the STT Act, that the acquisition of the Property is by way of an asset-for-share transaction under section 42 of the Act;
- the applicant and company B will not jointly elect that the provisions of section 46 of the Act do not apply; and
- the requirements of section 47 of the Companies Act will be complied with

when the applicant makes any payment in respect of the class A preference shares.

Ruling

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

Step 1

- The applicant will be deemed to have disposed of the Property to company B for an amount equal to its base cost in terms of section 42(2)(a)(i)(aa) of the Act.
- The building allowance, previously allowed in respect of the Property, must not be recovered or recouped by the applicant or included in its income in the year of that transfer, as contemplated in section 42(3)(a)(i) of the Act.
- The applicant and company B will be deemed to be one and the same person for purposes of determining the amount of any allowance previously deducted, as contemplated in section 42(3)(a)(ii) of the Act.
- Company B will not be entitled to any allowances as the Property has been fully claimed for income tax purposes and has a zero tax value. The amount of any allowance or deduction previously claimed by the applicant must be recovered or recouped by company B in the event that company B disposes of the Property in the future.
- The transfer of the Property will be deemed not to be a supply made by the applicant for value-added tax purposes under section 8(25)(iii) of the VAT Act.
- The transfer of the Property will not be subject to transfer duty under section 9(1)(l)(i) of the TD Act.

Step 2

- The applicant must disregard any income tax implication of the distribution of the company B shares to company A under sections 46(2), 46(5) and 46(5A) of the Act.

- Company A must allocate a portion of the base cost of the ordinary shares of the applicant to the ordinary shares of company B which the applicant will distribute to it, under section 46(3) of the Act.
- The distribution of the ordinary shares of company B by the applicant will be exempt from Securities Transfer Tax in terms of section 8(1)(a)(iv) of the STT Act.

Step 3

- The issuing of the class A preference shares of the applicant as capitalisation shares to company A is not a 'dividend' or 'gross income' as defined in section 1(1) of the Act.
- The class A preference shares have a zero base cost for company A, under section 40C of the Act. The contributed tax capital of these shares amounts to Rnil.
- No contributed tax capital will be created by the issuing of the class A preference shares.

Step 4

- On the disposal of the ordinary shares by company A to the third party buyer, the difference between the proceeds and the base cost of the ordinary shares, after the adjustments have been made in terms of section 46(3) of the Act, will be subject to CGT.
- STT will be levied under section 2 of the STT Act on the market value of the ordinary shares of the applicant transferred to the third party buyer. The applicant is liable for the payment of STT under section 6 of the STT Act which may be recovered under section 7(2) from the third party buyer.

Post-Step 4

- Paragraph 43A will not apply to the distribution of the company B shares to company A by the applicant, under section 46 of the Act;
- The issue of the class A preference shares will not be regarded as a

'dividend', as defined in section 1(1) of the Act and as a result paragraph 43A will not apply;

- The class A preference shares are not hybrid equity instruments as defined in section 8E(1) of the Act and the dividends are not deemed to be income under section 8E(2) of the Act; and
- To the extent that the class A preference share dividends and redemption amounts are received by or accrued to company A, these amounts will be 'dividends', as defined in section 1(1) of the Act. In the context of the specific facts and circumstances of the transaction, these 'dividends' that arise on 6 the dividend declaration dates and on the redemption dates will be 'extraordinary dividends' as defined in paragraph 43A(1) and paragraph 43A(2) of the Eighth Schedule to the Act will apply to these 'dividends'.

# 9. GUIDES

## *9.1. VAT 409 – Guide for Fixed Property and Construction*

This guide is a general guide concerning the application of the VAT Act in connection with fixed property and construction transactions in South Africa

The fixed property industry consists of many role-players, including architects, builders, developers, property speculators, quantity surveyors, engineers, plumbers, electricians, municipalities, public entities, financial institutions, estate agents etc. Although these role-players are mentioned in this guide, the content deals primarily with vendors that are involved in transactions concerning the development, construction and selling of fixed property.

VAT is an indirect tax which is levied on the supply of any 'goods' or 'services' supplied by a 'vendor' in the course or furtherance of any enterprise carried on by that vendor. 'Goods' is defined to include 'fixed property' and any real right in any such fixed property, but excluding any right under a mortgage bond or pledge of any fixed property. The scope of transactions with which this guide is concerned

with is therefore those described in the definition of 'fixed property', which means:

- land (together with improvements affixed thereto);
- any unit as defined in section 1 of the Sectional Titles Act 95 of 1986;
- any share in a share block company which confers a right to or interest in the use of immovable property under the Share Blocks Control Act 59 of 1980;
- in relation to a property time-sharing scheme, any time-sharing interest as defined in section 1 of the Property Time-sharing Control Act 75 of 1983; and
- any real right in any such land, unit, share or time-sharing interest.

It will therefore be found that most transactions which have some connection with the acquisition of rights to fixed property (excluding rights under a mortgage bond or pledge of fixed property) will fall within the ambit of the definition and will be subject to VAT if the supplier is a vendor.

Other examples of rights falling within the definition include:

- Certain rights of use such as usufructs, usus or habitatio
- Bare dominium rights of ownership
- Servitudes, encroachments and other encumbrances
- Exclusive use areas in sectional title developments
- Rights to minerals or rights to mine for minerals
- Leases or sub-leases of rights to minerals, or to mine for minerals

Although most supplies of fixed property by a vendor will be subject to VAT, there are certain instances when such supplies will not be. In these cases, the transactions will be subject to transfer duty. It is therefore important that vendors are able to distinguish between the different types of supplies to establish whether VAT or transfer duty applies. The VAT Act and the Transfer Duty Act 40 of 1949 (the Transfer Duty Act) therefore both contain special rules to deal with these

situations. (See The Transfer Duty Guide.)

The approach of this guide is as follows:

Chapter 1 – This chapter sets out the scope of the most common transactions falling within the definition of 'fixed property'.

Chapter 2 – Introduces the reader to the most important concepts, terms and definitions mentioned in the guide so that the VAT treatment of supplies which are explained in later chapters can be understood. A key point addressed in this chapter is the concept of an 'enterprise' and the different circumstances under which certain activities conducted will render a person liable to register for VAT.

Chapter 3 – Deals with the interaction between VAT, transfer duty and securities transfer tax. This chapter explains which types of transactions are subject to VAT and when the other taxes will apply.

Chapter 4 – Explains the VAT treatment of the different types of supplies and the VAT accounting in respect thereof. The chapter includes a discussion on the application of the special time and value of supply rules with regard to the declaration of output tax and input tax. It also explains the rules which apply for deducting notional input tax on the acquisition of second-hand goods constituting fixed property.

Chapter 5 – Deals with a number of adjustments which apply in connection with fixed property based on the extent of taxable use. These include annual adjustments in regard to the use of capital goods and services as well as situations which give rise to a change in use or application, or change of intention with regard to the taxable use of the fixed property after the initial acquisition.

Chapter 6 – Explains the specific application of the VAT law which has been set out in previous chapters to transactions in the construction industry. The focus is specifically on those vendors that supply construction services only and deals mainly with quoting of prices, costing of projects, invoicing, agent and principal relationships, and certain other aspects such as penalties and retentions which are unique to the construction industry.

Chapter 7 – Deals mainly with the issues faced by developers and property speculators. The focus is therefore on supplies of newly constructed properties and second-hand properties that have been renovated before being sold, or properties that are bought and sold on a speculative basis. Included is a discussion on the consequences of temporarily applying properties for exempt supplies (residential purposes). Other topics dealt with include temporary letting of dwellings by developers, sale of shares and members' interests in fixed property, fractional ownership-type developments and land restitution transactions.

Chapter 8 – Deals with the VAT treatment of rental pools. The chapter contains a detailed explanation of the special rules set out in section 52 and how these apply in practice to override what would otherwise be viewed as supplies made by an agent.

Chapter 9 – Discusses some other aspects regarding the supply of fixed property which are not dealt with in the other chapters.

## 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.