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EXPENDITURE OF A CAPITAL NATURE

In the process of carrying on a business and creating value, taxpayers incur different kinds of expenditure and inadvertently often incur losses. From an income tax perspective, careful consideration must be given to the nature of such amounts and the purpose for which they have been incurred, to determine whether such amounts are deductible in the determination of taxable income.

Complexities often arise in practice as amounts that qualify for recognition as an expense in terms of the financial reporting framework applied in calculating the profit or loss from an accounting perspective do not necessarily qualify for an income tax deduction in terms of the Income Tax Act, 1962 (the Act). The opposite situation is often also true in that an amount may qualify for an income tax deduction, whereas it is capitalised for accounting purposes.

The deductibility of expenditure and losses is primarily governed by the "general deduction formula", which consists of section 11*(a)*, read with section 23*(g)* of the Act. Section 11*(a)* represents the so-called "positive test", which sets out the requirements for an amount to qualify for an income tax deduction. In terms of section 11*(a)*, a person must, in determining the taxable income derived during the year of assessment from carrying on a trade, deduct expenditure and losses actually incurred in the production of income, provided that such expenditure and losses are not of a capital nature. An amount that qualifies for a deduction under section 11*(a)* must, however, also pass the "negative test" contained in section 23*(g)*, which prohibits a deduction for amounts to the extent that such amounts were not laid out for purposes of trade. An amount that does not qualify for a deduction in terms of the general deduction formula, for example due to the amount being capital in nature, may still qualify for a special deduction or allowance in terms of other provisions of the Act.

The Act does not enumerate the types of expenditure that are of a capital nature, nor does it contain any definition of the term "capital nature". There is also no all-encompassing test that applies in distinguishing between expenditure of a capital nature and expenditure of a non-capital (ie, revenue) nature. The enquiry is often challenging and depends on the specific facts and circumstances surrounding the incurral of the expenditure and consideration of the relevant principles established by case law. The focus of this article is to highlight certain types of expenditure which sometimes cause confusion in practice.

A common example of expenditure of a capital nature is the cost of acquiring plant and machinery that forms part of the capital structure of a business. It is important to bear in mind that all expenditure relating to the acquisition of an asset, such as the cost of delivery and direct installation costs, would normally be capital in nature and form part of the cost of an asset on which a capital allowance may be claimable.

Expenditure incurred in moving business assets to new premises and in altering the new business premises is also considered to be capital in nature and not deductible under the general deduction formula, unless it relates to the cost of moving the taxpayer's trading stock. A specific capital allowance in terms of section 11*(e)* or 12C may, however, be available in respect of moving costs. The relocation of a business premises may also result in expenditure incurred in the transfer of a business licence, which would also be considered to be capital in nature. For example, a liquor trader may incur fees to transfer its liquor licence from one premises to another. These fees would usually not be deductible.

In the context of capital assets, it is also important to distinguish between expenditure incurred in respect of the repair of an asset, which may qualify for a specific deduction under section 11*(d)* of the Act and expenditure incurred in respect of the renewal or improvement of an asset, which is generally not deductible. Section 11*(d)* permits a deduction for expenditure actually incurred in respect of the repair of immovable property occupied for purposes of trade or any machinery, implements, utensils, and other articles used by the taxpayer for purposes of trade. To qualify as a repair, there must be damage or deterioration of a subsidiary part of the original asset and the repair should merely restore the asset to its original condition, with the use of different materials being permitted. If the whole or substantially the whole of the asset is reconstructed, it would constitute a "renewal" of an asset and the expenditure would not be deductible. Similarly, the creation of a new or enhanced asset with an improved income-earning capacity would constitute an improvement for which the expenditure is not deductible.

Where there is an alienation, loss or destruction of a capital asset, it would result in a capital loss and no deduction is claimable unless it involves a qualifying tax-depreciable asset and all the requirements to claim a scrapping allowance under section 11*(o)* of the Act are met. In this context, events that may result in a capital loss include the alienation of an asset through the transfer of ownership thereof, the loss of an asset due to theft and the destruction of an asset resulting in the item being extinguished or damaged beyond repair. The provisions of section 11*(o)* should be considered in these circumstances to determine if a deduction is allowable.

If a taxpayer incurs expenditure for travel, whether in South Africa or abroad, such expenditure is considered to be of a capital nature if the purpose of the underlying travel is to create or improve an income-producing asset of the taxpayer or to acquire a capital asset. This would, for example, be the case when travel is undertaken to acquire a capital asset to be used by the taxpayer in its business, to acquire a new agency that constitutes a capital asset for such a business or to establish a new branch or business in another location. The cost of travel undertaken to protect the capital assets or income-earning capacity of a business, would also be disallowed as it is capital in nature.

Taxpayers often enter into agreements to acquire shares in a company that are held as a long-term investment to generate returns, form joint ventures with other persons or take part in corporate reorganisation or restructuring transactions. Expenditure incurred by a taxpayer in respect of these types of transactions, such as professional and legal fees, is considered capital in nature as it is incurred to establish, improve or add to the income-earning structure of the business. From the perspective of a company issuing shares, no deduction is claimable in respect of the costs incurred in raising share capital on the basis that such expenditure is closely related to the company's capital structure and it is therefore capital in nature. Examples of such costs include underwriting commissions, legal fees and other professional fees. Expenditure related to the incorporation of a company and expenditure incurred to alter the memorandum of incorporation of a company are also closely related to the capital structure of the company and are not deductible. Where a taxpayer incurs a loss on the disposal of a business or shares, such a loss would be capital in nature unless the taxpayer is a trader or dealer in shares or business ventures.

"In the context of capital assets, it is also important to distinguish between expenditure incurred in respect of the repair of an asset, which may qualify for a specific deduction under section 11*(d)* of the Act and expenditure incurred in respect of the renewal or improvement of an asset, which is generally not deductible."

Even if an amount qualifies as a deduction in terms of the provisions of section 11*(a)*, among others, the taxpayer may be required to spread the deduction in terms of section 23H of the Act. Subject to certain exceptions, this would be required in respect of goods or services, all of which will not be supplied or rendered during the year of assessment in which the expenditure is incurred, and in respect of any other benefit where the period to which the expenditure relates extends beyond the year of assessment in which the expenditure is incurred.

Inappropriately claiming a deduction for expenditure that is of a capital nature may lead to the imposition of severe understatement and underestimation penalties. The taxpayer may also be exposed to interest on the late payment of normal tax resulting from the understatement. Taxpayers should therefore contact a tax advisor for assistance with any uncertainties.

Doria Cucciolillo & Associate Professor David Warneke

BDO

Acts and Bills

- Income Tax Act 58 of 1962: Sections 11*(a)*, *(d)*, *(e)* & *(o)*, 12C, 23*(g)* & 23H.

Tags: deductibility of expenditure; general deduction formula; qualifying tax-depreciable asset; underestimation penalties.

RENEWABLE ENERGY ASSETS

Section 12B of the Income Tax Act, 1962 (the Act), provides a 100% deduction for assets that a taxpayer uses in the generation of electricity from PV solar energy not exceeding 1 MW. It has allowed this since 2015.

In the 2023 Budget Review, the National Treasury announced a temporary expansion of the incentive. This aims to accelerate private investment to alleviate South Africa's energy crisis. Section 12BA, introduced by section 16 of the Taxation Laws Amendment Act, 2023, promulgated in the *Government Gazette* on 22 December 2023, contains this enhancement.

This article provides an overview of some critical aspects of the enhancement of the incentive.

SCOPE OF SECTION 12BA

The enhanced incentive applies to machinery, plant, implements, utensils, or articles, including foundations or supporting structures, that a taxpayer owns or purchases in terms of an instalment credit agreement. The taxpayer must use these assets in the generation of electricity from wind power, PV solar energy, concentrated solar energy, hydropower or biomass, compromising organic wastes, landfill gas or plant material.

There are some important differences between the assets that qualify for section 12BA and those that qualify for section 12B:

- Unlike section 12B, there is no restriction on the generation capacity under the enhanced incentive.
- The incentive only applies to assets used in the generation of electricity in South Africa.
- The taxpayer must bring the assets into use for the first time for purposes of its trade. The assets must be used by the taxpayer or the taxpayer's lessee in the generation of electricity. (If the taxpayer lets the asset, its deductions, as the lessor, could be limited in terms of section 23A of the Act.)
- The enhanced incentive applies to assets so brought into use between 1 March 2023 and before 1 March 2025.

Like section 12B, section 12BA describes eligible assets broadly as those used in the generation of electricity. This leaves the same uncertainty around storage and conversion assets as under section 12B. In the Draft Response Document (on the 2023 tax Bills), the National Treasury indicates that assets used in the generation of electricity imply that the incentive is not solely for assets that produce electricity. Assets that form part of the system of assets that produce electricity together are likely to qualify. The government intends to issue an FAQ document to provide clarity on the incentive.

THE 125% ALLOWANCE

The allowance is 125% of the cost of a qualifying asset(s). The determination of cost is subject to similar measurement rules to those found in many other asset allowances.

Whether the additional 25% allowance is recouped depends on when the asset is disposed of. For assets disposed of before 1 March 2026, the taxpayer must recoup an additional amount of 25% of the cost recouped on disposal. For disposals on or after 1 March 2026, there is no adjustment to the recoupment. This means that the additional 25% allowance becomes a permanent deduction at that point.

Pieter van der Zwan

Acts and Bills

- Income Tax Act 58 of 1962: Sections 12B, 12BA & 23A;
- Taxation Laws Amendment Act 17 of 2023: Section 16.

Other documents

- Draft Response Document (on the 2023 tax Bills) – published by National Treasury on 23 October 2023.

Tags: generation of electricity.

FOREIGN EMPLOYERS

The proposal by National Treasury to require all foreign employers to register for employees' tax (Pay-As-You-Earn) was significantly watered down in the Tax Administration Laws Amendment Act, 2023 (the TALA Act, 2023), but questions remain on the amendments, in section 13 of that Act, to paragraph 2(1) of the Fourth Schedule to the Income Tax Act, 1962.

In the first draft of the Tax Administration Laws Amendment Bill, 2023 (the draft TALAB), published on 31 July 2023, National Treasury proposed to require all non-residents who have employees working from South Africa to register for employees' tax (Pay-As-You-Earn (PAYE)).

Commentators pointed out that this requirement would be administratively cumbersome and potentially unenforceable.

Accordingly, National Treasury subsequently, in October 2023, advised Parliament's Standing Committee on Finance (SCoF), that it accepted this feedback and indicated that it would water down the earlier proposal made in the draft TALAB to only apply to non-resident employers conducting business through a permanent establishment (PE) in South Africa. The Tax Administration Laws Amendment Bill, 2023, introduced on 1 November 2023, therefore proposed to amend the said paragraph 2(1) of the Fourth Schedule in line with National Treasury's feedback. This led to the TALA Act, 2023, promulgated in the *Government Gazette* on 22 December 2023.

However, the amendment still raises a number of questions that were not addressed by National Treasury in response to the SCoF.

If a non-resident employs several individuals who are working remotely from their homes in South Africa, when will the non-resident employer have a PE in South Africa? To merely have an employee in South Africa who works from his or her own home does not necessarily create a PE for the non-resident employer.

The primary test for a PE is whether the non-resident employer has a fixed place of business through which the business of the employer is carried on.

The employee's home arguably cannot be a fixed place of business of the employer, as it is not free to use the employee's home for the purposes of the employer's business (put differently, the employee's home is not at the disposal of the employer). The OECD commentary regarding PEs states that whether a home office of an employee creates a PE for an employer depends on the facts and circumstances of each case. For example, the presence of a managerial level employee who works from home permanently because the employer does not have an office in South Africa could create a PE for the employer. Therefore, the amendment is unlikely to capture all foreign employers who employ remote workers in South Africa.

A further test for the existence of a PE is based on the activities of the employee. If an employee in South Africa habitually exercises authority on behalf of the foreign employer to conclude contracts in the name of such employer, the foreign employer is deemed to have a PE in South Africa based on the activities of the employee.

This is the case even though the employer may not have a fixed place of business in South Africa. Even if the non-resident employer has a PE based on the activities of the employee, it appears that SARS will face several difficulties in enforcing the withholding of PAYE.

One of the mechanisms for enforcement of PAYE obligations is to require the appointment of a representative employer (if the employee is a company, the public officer is the representative employer), who can then be penalised for the company's defaults (through the imposition of administrative non-compliance penalties or criminal liability).

However, a representative employer in relation to a company is normally a resident director, company secretary or officer of the company. If the company does not appoint a representative employer, SARS can designate a director or other officer of the company as such.

"Even if the non-resident employer has a PE based on the activities of the employee, it appears that SARS will face several difficulties in enforcing the withholding of PAYE."

However, if the employer has only low-level employees in South Africa, it is unlikely that SARS will be able to designate one of the employees as the representative employer.

Short of appointing a representative employer, SARS can only enforce the collection of PAYE by attaching the non-resident employer's South African assets or enforcing the collection of the PAYE from the non-resident employer's South African bank accounts.

If the non-resident employer does not have any significant assets or a bank account in South Africa, SARS cannot rely on one of the multilateral mutual administrative assistance treaties to request a foreign tax authority to collect PAYE from the non-resident employer, because these treaties do not mention PAYE as one of the covered taxes which are included in the treaty.

The final question to be answered relates to the application of the PAYE withholding requirement to specific employees.

The PAYE withholding requirement applies equally to resident and non-resident employees who are physically present in South Africa when performing their employment services.

However, unless the section 10(1)*(o)* exemption applies, the PAYE withholding requirement also applies to any expatriate employees who perform their employment outside of South Africa but have not emigrated from South Africa for tax purposes.

This could cause substantial hardship to these employees if they are subject to foreign PAYE withholding rules where they are resident or where they are physically rendering their services to the employer. This will have to be addressed through a request for a directive from SARS.

In conclusion, there is still significant uncertainty over how the requirement to withhold PAYE will be applied to, and enforced against, non-resident employers with a PE in South Africa, and whether these employers will actually comply with the new requirements of paragraph 2(1) of the Fourth Schedule.

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Acts and Bills

- Income Tax Act 58 of 1962: Fourth Schedule: Paragraph 2(1);
- Draft Tax Administration Laws Amendment Bill, 2023 (published on 31 July 2023);
- Tax Administration Laws Amendment Bill 37 of 2023 (introduced on 1 November 2023);
- Tax Administration Laws Amendment Act 18 of 2023 (promulgated on 22 December 2023): Section 13.

Tags: employees' tax (Pay-As-You-Earn (PAYE)); non-resident employer; representative employer.

ALLOWANCES FOR UNIFORMS

The inclusion of any part of an allowance paid or payable in an employee's taxable income is governed by section 8(1)(a) *of the Income Tax Act, 1962 (the Act).*

In terms of section 8(1)*(a)*(i), taxpayers are required to include, in their taxable income, an amount which is paid or granted by their principals as an allowance or advance, unless the allowance or advance is exempt from normal tax in terms of section 10(1) of the Act.

The types of allowances that may be paid by an employer to an employee include (but are not limited to) a travel allowance, a subsistence allowance and other allowances received by virtue of the employee's office or duties, for example a uniform allowance or a cell phone allowance.

In October 2023 it was reported that the Department of Health has agreed to pay a temporary allowance to nurses in the public sector to enable them to buy uniforms. According to a news article, the nurses had threatened to work in their own clothes if problems over uniforms were not resolved.

According to the article, nurses had been receiving a uniform allowance since 2005. However, this changed on 31 March 2023 when the Public Health and Social Development Sectoral Bargaining Council agreed to the provision of uniforms as opposed to the payment of an allowance. The uniforms were supposed to be handed out to the nurses on 1 October 2023; however, the department was unable to deliver them in time, which resulted in the stand-off with the nurses and the threat to wear their own clothes to work.

In an effort to resolve the issue, the Department of Health agreed to temporarily reinitiate the allowance until it was able to deliver the uniforms, which has been estimated to be from January 2023 to January 2025. Until then, the department undertook to pay the nurses an allowance of R3,153 by 20 November 2023.

From a tax perspective, this amount will potentially not be subject to tax. In terms of section 10(1)*(n*A*)* of the Act, where an employee is, as a condition of their employment, required while on duty to wear a special uniform which is clearly distinguishable from ordinary clothing, the value of such uniform, or any allowance provided in lieu of any such uniform, given to employees by their employers, will be exempt from normal tax and therefore not subject to tax.

However, the value of the allowance must still be reflected on an employee's IRP5/IT3(a) under source code 3714.

EXEMPTION CONDITIONS

In terms of section 10(1)*(n*A*)*, in order to qualify for the exemption:

1. The wearing of a uniform needs to be a condition of employment. In practice, the relevant employee's employment contract must incorporate this condition and may have to provide for disciplinary action in circumstances where the condition is not fulfilled.

2. The uniform must be a "special" uniform which is distinguishable from ordinary clothing. Therefore, requiring one's employees to wear black jeans and a black top while on duty will potentially not qualify for a uniform allowance exemption as these items of clothing are likely not readily distinguishable from ordinary clothing, notwithstanding that wearing them may be a condition of employment. Examples of the types of uniforms that could qualify for exemption include nurses' uniforms and firefighters' uniforms.

3. The value of the uniform given and the amount of the allowance paid by the employer must be reasonable. This is a question of fact having regard to the circumstances.

Allowances that are not exempt from taxable income as contemplated in section 10(1) will likely be subject to employees' tax as envisaged in the Fourth Schedule to the Act. The deduction of employees' tax from various types of allowances is governed by the definition of "remuneration" in paragraph 1 of the Fourth Schedule.

"Allowances that are not exempt from taxable income as contemplated in section 10(1) will likely be subject to employees' tax as envisaged in the Fourth Schedule to the Act."

In this context, employees' tax must be deducted from an allowance paid or payable by an employer that falls within the definition of "remuneration", unless specifically excluded.

If one is uncertain about the tax treatment of a particular allowance or advance, one should obtain tax advice, as underdeclaring tax on an allowance or advance granted may result in the imposition of penalties and interest that could adversely impact the employer and employee.

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Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 8(1)*(a)* (also specifically subparagraph (i)), 10(1) (emphasis on paragraph *(n*A)); Fourth Schedule: Paragraph 1 (definition of "remuneration").

Other documents

- IRP5/IT3(a) (source code 3714).

Tags: taxable income; travel allowance; subsistence allowance; uniform allowance; cell phone allowance; condition of employment.

SHAREHOLDER REPORTING REQUIREMENTS

The correct completion of the annual income tax return remains an important obligation for all taxpayers, including companies. All South African resident companies and, in prescribed circumstances, non-resident companies, are legally obligated to file accurate income tax returns with the South African Revenue Service (SARS). As such, SARS relies on companies to accurately report their taxable income and pay their taxes on time. SARS depends on companies to fulfil their legal obligations, and it uses various mechanisms, such as verifications and audits, to enforce compliance.

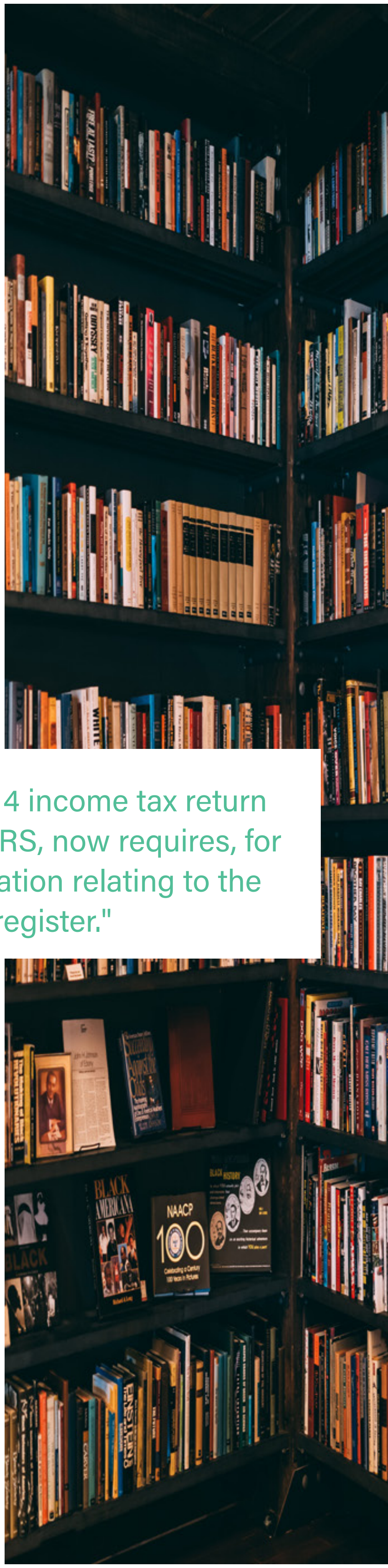
Incorrect or late submissions can result in penalties and interest charges. By completing tax returns accurately and on time, companies can avoid these additional costs. Incorrect tax returns can also lead to legal disputes with SARS, which can be time-consuming and costly. Accurate returns help companies avoid such legal issues. Companies that submit accurate tax returns that agree with their underlying records are also better prepared for tax audits. If SARS decides to audit a company, having accurate records and returns makes the process smoother and less stressful.

The timeous and correct submission of its income tax returns will also help to ensure that a company will be able to obtain a tax clearance certificate. Many government and private sector contracts in South Africa require companies to submit a tax clearance certificate as part of the tender process. This is to ensure that only tax-compliant businesses are considered for contracts. Investors, business partners, or financial institutions may also request a tax clearance certificate when considering investment, partnerships, or providing financial support. It is a way for them to assess the financial and legal standing of the company they are dealing with.

The information required by SARS to issue an income tax assessment is quite onerous and places a heavy duty of compliance on all companies. The volume of required information has, however, steadily increased over time and the reliance of SARS on corporate taxpayers to submit information that is already available to it through the Companies and Intellectual Property Commission (CIPC) and the various offices of the Master of the Supreme Court should be questioned.

The latest version of the ITR14 income tax return for companies, released by SARS, now requires, for the first time, detailed information relating to the company's share register. The following information is required for each class of shares issued by the company:

- A description of the class of shares;
- The total number of shares issued;
- The number of shareholders.



The above information must be provided for a maximum of three classes of shares. Where a particular class of shares is held by more than 20 shareholders (for example in the case of a listed company), details of each shareholder holding 5% or more of the shares must be provided.

Where a company has many shareholders, some of whom may be non-resident, or where shares are held by nominees, or where there are frequent changes in a company's shareholding, the resultant additional reporting requirements can be overwhelming and in practice impossible to comply with.

SARS is of the view that share register information will help to ensure transparency and accuracy in the reporting of ownership structures within companies. This could prevent potential tax evasion, money laundering, and other illicit activities by ensuring that the ownership details are consistent and verified. Detailed share register information could aid in detecting and preventing abusive tax practices or schemes designed to manipulate ownership structures to exploit tax loopholes.

Share register information could be used for data matching and verification purposes, allowing SARS to cross-reference the information provided in corporate tax returns with other sources of information to identify discrepancies or potential inaccuracies.

While all of the above reasons are valid, it is submitted that it is unacceptable that SARS now places a further burden of disclosure on companies for information to which it should be able to access through its on-line interfaces with the CIPC and the various Masters' offices. Some of the information requested below will, however, not be held by CIPC or the Masters' offices; although, in many of these cases, it will also not be held by the company.

If the shareholder is an individual, the following details must be provided:

- Surname
- First name
- Other name
- Initials
- Date of birth
- ID number
- Passport No, country and issue date – this is only required if the individual does not have a South African ID number
- Are you registered for tax in South Africa (Select Yes or No)
- Tax reference No
- Email address
- Number of shares owned

"The latest version of the ITR14 income tax return for companies, released by SARS, now requires, for the first time, detailed information relating to the company's share register."

Should the shareholder be another company, SARS requires the following details to be provided:

- Nature of business
- Registered name
- Trading name
- Country of registration

"Incorrect or late submissions can result in penalties and interest charges. By completing tax returns accurately and on time, companies can avoid these additional costs."

- Company /CC registration No
- ▪Financial year end
- Tax reference No
- Number of shares
- Contact details (initials, surname, cell number, email address)

Similar details as required where the shareholder is a company, need to be reported where the shareholder is a trust.

The share register section of the income tax return does not replace the contributed tax capital (CTC) section in the tax return and should reconcile with the CTC section of the tax return.

The ITR14 tax return cannot be submitted without disclosing the share register information.

The information is mandatory for all ITR14 returns for the 2022 and subsequent tax years that are submitted to SARS on or after 23 June 2023.

For example, if a company submits its 2021 return during the course of July 2023, the above share register information is not required. However, if the 2022 or 2023 return is submitted after 23 June 2023, the above disclosure is required.

In conclusion, the new requirements regarding companies' share registers are important and care should be taken that the correct information is submitted. However, there is a view that SARS' approach in shifting the burden of disclosure of information, much of which should already be accessible to it through the CIPC and the various offices of the Master of the High Court, to corporate taxpayers, is unacceptable. The gathering and recording of information which SARS should be able to access will result in additional unproductive costs for companies that they can ill afford, given our constrained economic environment.

Thereshnee Lamalettie & Johann Benadé

BDO

Other documents

- Tax clearance certificate;
- ITR14 income tax return for companies.

Tags: resident companies; non-resident companies; tax clearance certificate; tax-compliant businesses; share register information.

DISPUTE RESOLUTION

In Commissioner for the South African Revenue Services v Virgin Mobile South Africa (Pty) Ltd, *[2023], the High Court considered whether the South African Revenue Service (SARS) had failed to file its statement of grounds of assessment and opposing appeal (rule 31 statement) in time based on the rules promulgated under section 103 of the Tax Administration Act, 2011 (the TAA).*

In this matter, the taxpayer issued a notice under rule 56(1)(a) informing SARS of its intention to apply to the tax court for a final order under section 129(2) of the TAA in the event that SARS fails to remedy its default within 15 days. SARS filed its rule 31 statement shortly thereafter, but the taxpayer applied for default judgment in terms of rule 56(1)(b). The taxpayer averred that the rule 31 statement alone did not remedy SARS' default as SARS failed not only to address the reason for its delay but also to apply to the High Court for an order to condone its non-compliance with the rules.

The court considered whether the word "default" in rule 56(1)(a) refers to the failure by SARS to file a statement in terms of rule 31 or whether it refers to the failure by SARS to apply for condonation for the late filing of its rule 31 statement.

The court held that the word "default" relates to the words "failed to comply with a period or obligation described under the rules". The court then stated that SARS must file a rule 31 statement within the 45-day period. Where SARS files the statement outside of the required 45 days, it means that SARS has failed to comply with its obligations in terms of rule 31, and such failure must be remedied. The court found that to interpret rule 56(1)(a) as allowing SARS an opportunity to file a rule 31 statement which does not comply in form, substance or time to rule 31 and without availing itself of the remedies provided for to cure such default, would render the rules to do so superfluous and diminish SARS' accountability.

In a dissenting judgment, Judge Mabuse agreed with an earlier decision reached by the tax court in the matter between *P Taxpayer v Commissioner for the South African Revenue Service,* [2023]. In this matter, following the termination of alternative dispute resolution, the taxpayer afforded SARS a time extension to deliver its rule 31 statement, which SARS failed to do. The taxpayer delivered a rule 56(1)(a) notice. The rule 31 statement was subsequently delivered by SARS within the 15-day period. However, the taxpayer was of the view that the rule 31 statement needed to be accompanied by an application for condonation for the "late filing" of this statement.

The taxpayer argued that the plain language of rule 52(6) requires that a rule 31 statement must be accompanied by a condonation application if filed out of time, and since the tax court is a creature of statute, rule 52(6) must be read as requiring strict compliance. SARS argued that the purpose of a rule 56(1)(a) notice is to afford a defaulting party an automatic extension of 15 days within which to remedy its default, thereby absolving that party of the necessity to apply for condonation as contemplated by rule 52(6) if it complies with the 15-day period.

The court considered the relevant provisions and found that if SARS remedied the default within the 15-day period referred to in rule 56(1)(a), then the rule 31 statement is properly before the tax court. The court thus dismissed the taxpayer's rule 30 of the Uniform Rules of Court application with costs.

Given the Virgin Mobile case's High Court decision in favour of the taxpayer but with the dissenting judgment agreeing with the tax court, SARS may well be inclined to apply for leave to appeal to the Supreme Court of Appeal.

In the meantime, taxpayers ought to carefully consider their plan of action in litigation proceedings where SARS fails to deliver its rule 31 statement timeously.

Arnaaz Camay

ENSafrica

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 103 & 129(2).

Other documents

- Rules promulgated under section 103 of the Tax Administration Act 28 of 2011; Rules 31, 52(6) & 56(1)(a) & (b).
- Uniform Rules of Court: Rule 30;
- Rule 31 statement.

Cases

- *Commissioner for the South African Revenue Services v Virgin Mobile South Africa (Pty) Ltd* (A82/22 ; IT25117) [2023] ZAGPPHC 685 (17 August 2023);
- *P Taxpayer v Commissioner for the South African Revenue Service* (IT45935) [2023] ZAWCHC 29 (23 March 2023).

Tags: statement of grounds of assessment; alternative dispute resolution; rule 31 statement.

SUSPENSION OF PAYMENT OF TAX DEBT

In Tax Chronicles Monthly Issue 66 of January 2024 (article 0645), the judgment delivered by Judge Basson in Commissioner for the South African Revenue Services v Angelo Agrizzi and Another, *[2023], in relation to the repatriation application that was brought by the South African Revenue Service (SARS) was considered. In terms of the application, SARS was seeking an order to compel Angelo Agrizzi to repatriate his assets located in Italy to satisfy his outstanding tax debt.*

As a counter to the repatriation application, Agrizzi sought an order reviewing SARS' decision to refuse his request for the suspension of the outstanding tax liability in terms of section 164 of the Tax Administration Act, 2011 (the TAA) (the review application).

In this article, the court's judgment in relation to the review application is discussed.

The background and facts will not be discussed again in this article, save to state that SARS had raised and issued additional assessments in relation to Agrizzi's income for the 2006 to 2019 tax years. However, on 28 April 2021 (two days before the due date for payment of the assessed tax debt) Agrizzi delivered a request for the suspension of payment of debt as contemplated in section 164. SARS declined Agrizzi's request and directed that payment be made within 10 business days from the date of the refusal.

Agrizzi's counterapplication, therefore, sought to review SARS' decision to decline his request for the suspension of payment of his outstanding tax debt having regard to the provisions of section 164 and, from what can be gathered from the judgment, Agrizzi's poor health.

LEGAL CONSIDERATIONS: SECTION 164

Generally, the obligation to pay tax is not automatically suspended by an objection or appeal, or pending a decision of a court of law pursuant to an appeal (section 164(1)). This is the basis of the "pay now, argue later" principle.

However, section 164(2) allows a senior SARS official to suspend payment of tax or a portion thereof after considering certain factors that are noted in section 164(3).

These factors include –

- whether the recovery of the disputed tax will be in jeopardy or whether there will be a risk of dissipation of assets;
- the taxpayer's compliance history;
- whether fraud is *prima facie* involved in the origin of the dispute;
- whether payment will result in irreparable hardship to the taxpayer not justified by the prejudice to SARS or the fiscus if the disputed tax is not paid or recovered; or
- whether the taxpayer has tendered adequate security for the payment of the disputed tax and accepting it is in the interest of SARS or the fiscus.

The list above is not exhaustive, and any relevant factor that prevents taxpayers from paying their tax debt by the due date may be raised as a reason to request the suspension of the payment of the assessed tax debt.

Section 164(5), in turn, empowers a senior SARS official to deny a request for suspension or revoke a decision to suspend payment with immediate effect. In this context, the senior SARS official must be satisfied that –

- the objection or appeal lodged by the taxpayer is frivolous or vexatious;
- the taxpayer is employing dilatory tactics in conducting the objection or appeal;
- the suspension should not have been granted on further consideration of the factors noted in section 164(3); or
- there is a material change in any of the factors referred to in section 164(3) upon which the decision to suspend payment was based.

COURT'S FINDING

In support of his application, Agrizzi submitted that the request for suspension of payment should have been granted having regard to, amongst other things:

(i) Agrizzi's inability to pay the disputed tax;

(ii) Agrizzi being prohibited from selling his property in Italy to pay the disputed tax as he had already furnished the National Prosecuting Authority (NPA) with the title deed of the property; and

(iii) the fact that not suspending the payment of the disputed tax would cause him "irreparable hardship", especially considering his ill health, which left him with substantial medical expenses.

Notwithstanding the reasons provided by Agrizzi, SARS denied the request on the following basis:

- although SARS acknowledged that there was no risk of dissipation of assets as a result of the security held by the NPA, SARS was still of the view that the recovery of the debt was in jeopardy;
- the assets held in Italy could either satisfy the full payment of the debt or at least a portion thereof. This reasoning was provided by SARS notwithstanding the fact that it acknowledged that payment of the full debt would result in irreparable hardship for Agrizzi; and
- Agrizzi was not in a position to provide SARS with any security.

In considering the review application, the court confirmed that the decision being brought under review constituted administrative action capable of being reviewed in terms of the Promotion of Administrative Justice Act, 2000. The court noted that the basis of a judicial review is where administrative action is not lawful, reasonable or procedurally fair. In this context, the court noted that a decision will be unlawful if, for example, the decision-maker considered irrelevant considerations or failed to take into account relevant considerations. In relation to reasonableness, it was held that a decision will be unreasonable if it "is one that a reasonable decision-maker could not reach" having regard to the process used to reach such a decision.

In relation to the suspension of payment, the court noted that a request for a suspension of payment will not be granted if there is "some pressing need for SARS to collect the disputed tax immediately instead of waiting for the objection procedure to run its course".

In this context, the court held that there was no rational basis for SARS refusing to grant the suspension of payment of the disputed tax having regard to the fact that:

> "… there are no realisable assets to execute against; that the payment will result in irreparable hardship; that there is no risk of asset dissipation, that the respondent is fully tax compliant (except for the current dispute); that no fraud is involved in the origin of the dispute; that the objection is not frivolous or vexatious (although it was found that the respondent was employing dilatory tactics in conducting the objection or appeal); and the fact that the respondent is unable to provide any security as he has offered security to the NPA in terms of his bail conditions."

The court also found it contradictory for SARS to state that Agrizzi had no assets to execute against on the one hand, but also find that the recovery of the tax debt was in jeopardy. In the court's mind the two arguments were mutually exclusive.

The court also rejected SARS' reasoning that it would make no difference whether or not the suspension was granted as Agrizzi did not possess any assets against which SARS could execute. The court held that it would equally make no difference to SARS if the payments were suspended as Agrizzi lacked the means to pay the disputed tax.

It was further held that it was not rational to reject the suspension of payment based on the perceived subjective view held by the decision-maker that the irreparable harm that would be suffered by Agrizzi was self-inflicted based on the assets dissipated and repatriated to Italy. The court further noted that SARS seems to have ignored the fact that Agrizzi would suffer irreparable harm if he were forced to make payment of the disputed tax. The court was of the view that SARS seemed to only focus on Agrizzi's inability to pay the disputed tax and the perceived reasons for not being able to do so.

In this context, the court held that irrelevant factors were considered by SARS while relevant factors (such as Agrizzi's medical condition) were ignored.

The court concluded by saying that the decision by SARS to refuse the suspension lacked a rational connection to the underlying purpose of section 162 of the TAA, which is to ensure prompt payment of the assessed tax without first having to consider any objections raised against the assessments. The court found that there was no pressing need for SARS to collect the disputed tax, especially considering that Agrizzi would suffer irreparable hardship as he lacked the necessary funds to pay the disputed tax, and there was no risk of dissipation of assets. The court therefore set aside SARS' decision and remitted the matter back to SARS for a reconsideration of the suspension application.

"PAY NOW, ARGUE LATER"

As the phrase notes, the "pay now, argue later" principle requires taxpayers to settle their assessed tax debts as soon as they arise, notwithstanding the fact that they intend to dispute the assessment raised by SARS that gave rise to the tax debt.

Depending on the value of the tax debt, this principle has the potential to create real hardship for a taxpayer who may not have the necessary funds to settle the tax debt immediately. This is especially so if the taxpayer is of the view that they have good prospects of success on objection or appeal. Therefore, the relief contained in section 164 is critical for alleviating any hardship that may be caused by strictly implementing the principle.

From a review of the court's judgment, it is clear that the decision to (or not to) suspend payment involves a balancing of the considerations relevant to a specific set of facts. It is important to note that the considerations contained in section 164(3) are not exhaustive. Put differently, a taxpayer can rely on almost any relevant and reasonable factor to support an application for the suspension of payment, including ill health.

The court in this case highlighted the fact that not enough weight was afforded by SARS to Agrizzi's medical state and too much weight was placed on their subjective views of why Agrizzi was unable to pay the disputed tax debt. Although ill health is not specifically noted in section 164(3), this factor was used by Agrizzi to demonstrate the irreparable hardship that could be caused to him if he were required to immediately settle the tax debt as opposed to waiting until the appeal is decided.

It is therefore clear that the decision to grant a request for the suspension of payment is highly dependent on the particular facts of the matter, and for any taxpayer that is disputing an assessment raised by SARS, the suspension of payment application is generally the first "fight" in which the taxpayer will engage with SARS, aside from the objection.

The potential benefit of not having to immediately pay the disputed tax, arises upon submission of the application. This is because in terms of section 164(6)*(a)*, SARS cannot take any recovery steps against the taxpayer from the date that SARS receives a request for the suspension of payment until 10 business days after it has issued a decision on the application.

One should appreciate that even if an application to suspend payment of tax is granted, late payment interest will generally still be imposed, to the extent that the dispute is resolved in SARS' favour. Such late payment interest is generally calculated from the date that the tax in dispute initially became due to the date of payment. Any decision to apply for suspension of payment should therefore also take this into account. Depending on the outcome of a dispute, it is possible that the amount payable pursuant to finalisation of the dispute (including interest) is higher when the dispute is resolved compared to when the dispute arose.

"Section 164(5), in turn, empowers a senior SARS official to deny a request for suspension or revoke a decision to suspend payment with immediate effect."

Puleng Mothabeng

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 162 & 164;
- Promotion of Administrative Justice Act 3 of 2000.

Cases

- *Commissioner for the South African Revenue Service v Angelo Agrizzi and Another* (45008/2021) [2023] ZAGPPHC 604; [2023] JDR 2844 (GP).

Tags: additional assessments; outstanding tax debt; "pay now, argue later" principle; irreparable hardship.

ARM’S LENGTH PRICING

Normally, a sales agent and a buy-sell distributor would not be regarded as comparable owing to the differences in functions, assets and risks relevant to each party.

However, in a French court case, *France vs SAS Sames Kremlin*, March 2023, it was determined that the independent agents and distributors were comparable based on the relevant facts. The court ruled that the commission paid to independent agents served as a comparable uncontrolled price (CUP), and therefore, the commission payable to distributors should be determined in a similar manner as that of independent agents.

As surprising as the court’s decision may at first appear, upon further consideration, it becomes apparent that the court’s finding seems to be correct. Taxpayers who do not adhere to the basic principles and processes of transfer pricing to arrive at a correct application of the arm's length principle do so at their own peril.

BACKGROUND

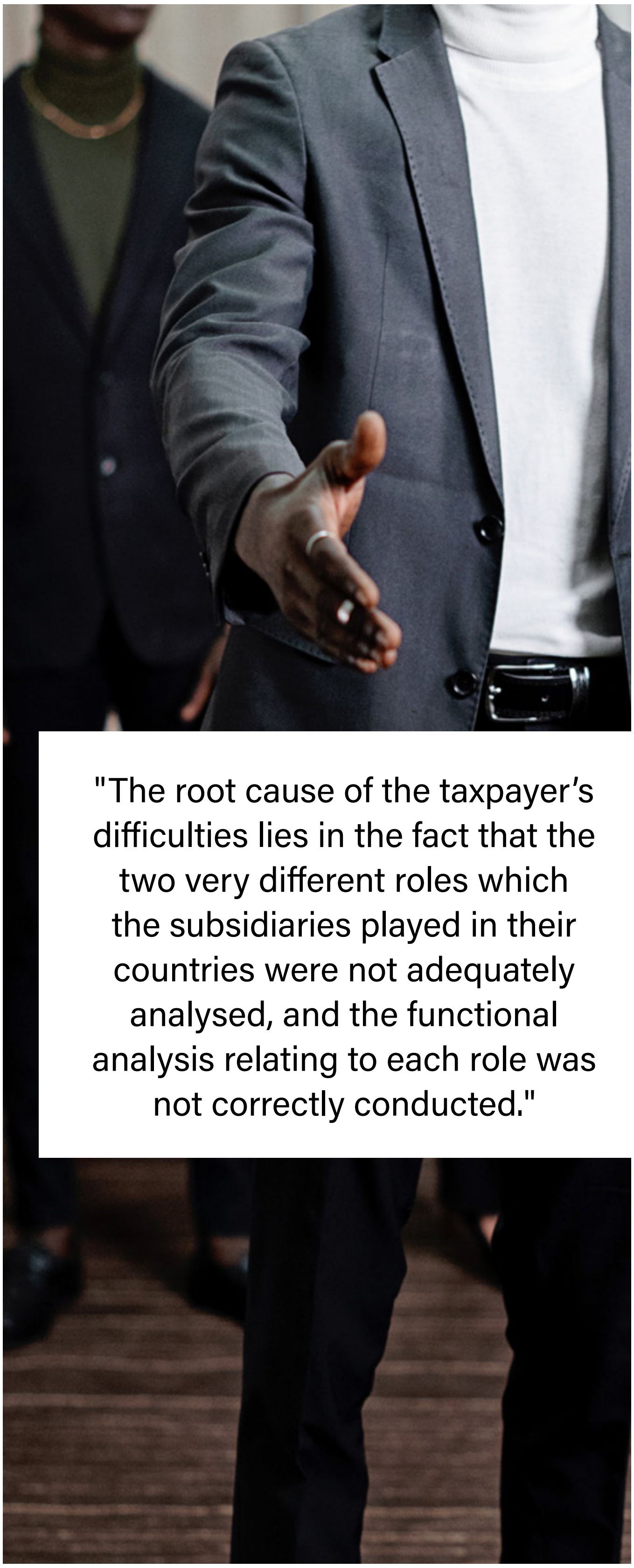
The taxpayer marketed its products either through its subsidiaries or independent agents. In certain countries, it sold its products through its subsidiaries in those countries under either a buy-sell distributor agreement or a commissionaire agreement. In other countries, it sold its products through independent agents to whom it paid a commission.

The remuneration of the independent sales agents was set at 20% of turnover, irrespective of the nature of the products and equipment sold. Subsidiaries, however, were remunerated based on the amount of the discount they would have received if they had acted as a buy-reseller, and this remuneration was payable irrespective of the nature of the products and equipment sold.

THE ARGUMENTS

The Revenue authorities argued that there was no justification for the remuneration paid to the subsidiaries for the intermediation commission to be higher than the 20% rate granted to the independent representatives.

The taxpayer argued that the geographical markets in which the subsidiaries operated were fundamentally different from those in which the third-party sales agents operated. This was because they were highly strategic for the business as key customers were located there, while the other markets where the agents operated were of lesser importance.



"The root cause of the taxpayer’s difficulties lies in the fact that the two very different roles which the subsidiaries played in their countries were not adequately analysed, and the functional analysis relating to each role was not correctly conducted."

The subsidiaries responded to major requests to tender, while the local sales agents were only involved in the supply of spare parts and small equipment. Additionally, the subsidiaries played a crucial role by providing –

- marketing support;
- after-sales service;
- on-site assembly and equipment testing;
- assistance with debt collection.

These activities demanded a substantial workforce dedicated to the subsidiaries' operations.

The taxpayer further argued that the commissions paid to independent sales agents could not constitute a relevant comparable for assessing the nature of the remuneration paid to foreign subsidiaries. The commissions paid to the subsidiaries took into account the margin they would have made on a purchase-sale of the product.

THE COURT'S FINDING

The court found that the difference in the remuneration between the independent agents and the subsidiaries (economic agents belonging to the group) could not be justified since both were involved in the same intermediary activity, which must be distinguished from the purchase-resale activity.

Based on the evidence, it was not clear that the services provided by the independent intermediaries were significantly less substantial than the services provided by the subsidiaries in their intermediation activity alone. When acting as intermediaries, the subsidiaries should be remunerated as such and not for their buy-sell activities, which were separate from the intermediation activities.

The turnover achieved in the countries where the independent agents operated was generally lower than that achieved by the subsidiaries, but the turnover of the subsidiaries was not systematically higher than the turnover achieved by the independent agents. It was found that the characteristics of these markets did not justify the differences in the remuneration paid to the subsidiaries and independent agents. Furthermore, there was no evidence that services provided by the independent agents were significantly less substantial than the services provided by the subsidiaries in their role as intermediaries. The mere fact that the subsidiaries had greater material and human resources was not sufficient to presume, in the absence of any evidence to the contrary, that those resources were used for the intermediation activity.

WHERE DID THINGS GO WRONG FOR THE TAXPAYER?

To ensure that a transaction between related parties is at arm's length, a two-step approach is required: a functional analysis followed by a comparative analysis. The terms and conditions of the transaction to be tested must be similar to those that would have been entered into by unrelated parties in similar circumstances.

To accurately identify or delineate the actual transaction between related parties, the commercial and financial relations between them must be carefully examined. Consideration should be given to the economic sector in which the parties operate and any factors which would affect the performance of businesses operating in that sector.

The role which each party plays in the transaction must be defined, and a number of "economically relevant" or "comparability factors" should be determined. These include the contractual terms between the parties, a detailed analysis of important functions, assets employed and the assumption of risks. A group value chain analysis should be performed. Other factors to be considered would be the characteristics of the property transferred or services rendered and whether these are tangible or intangible, etc. Market-related factors and business strategies should also be taken into account. If this analysis is correctly performed, then the relevant transaction between connected parties will be correctly delineated.

The root cause of the taxpayer's difficulties lies in the fact that the two very different roles which the subsidiaries played in their countries were not adequately analysed, and the functional analysis relating to each role was not correctly conducted. By correctly following the steps required to delineate the actual transaction that the subsidiary was concluding when acting in its capacity as an intermediary rather than as a purchaser-reseller, the differences in the two roles would have been clearly identified. The consequence of not making these distinctions was that the incorrect transfer pricing method was applied, and the subsidiaries were inappropriately remunerated when transacting in their capacity as intermediaries.

After correctly delineating the transaction, the correct transfer pricing method must be selected. The court confirmed that, in this case, the CUP method was appropriate for determining the remuneration to be paid to the subsidiaries. An internal CUP was available in the form of the commissions paid to independent agents, and this was then applied to the remuneration paid to the subsidiaries when acting in their capacity as intermediaries.

CONCLUSION

This case illustrates the importance of applying the basic rules and processes correctly to arrive at the appropriate arm's length arrangements between the parties.

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Cases

- *France vs SAS Sames Kremlin*, March 2023.

Tags: comparable uncontrolled price (CUP); buy-sell distributor agreement; commissionaire agreement; unrelated parties.

CROSS-BORDER SECONDMENTS

Secondment arrangements are frequently and increasingly utilised by organisations operating in a global market, and with South Africa's current skills shortage, they are an attractive option for local businesses. They can be equally attractive for employees who want to explore a new country and develop their experience.

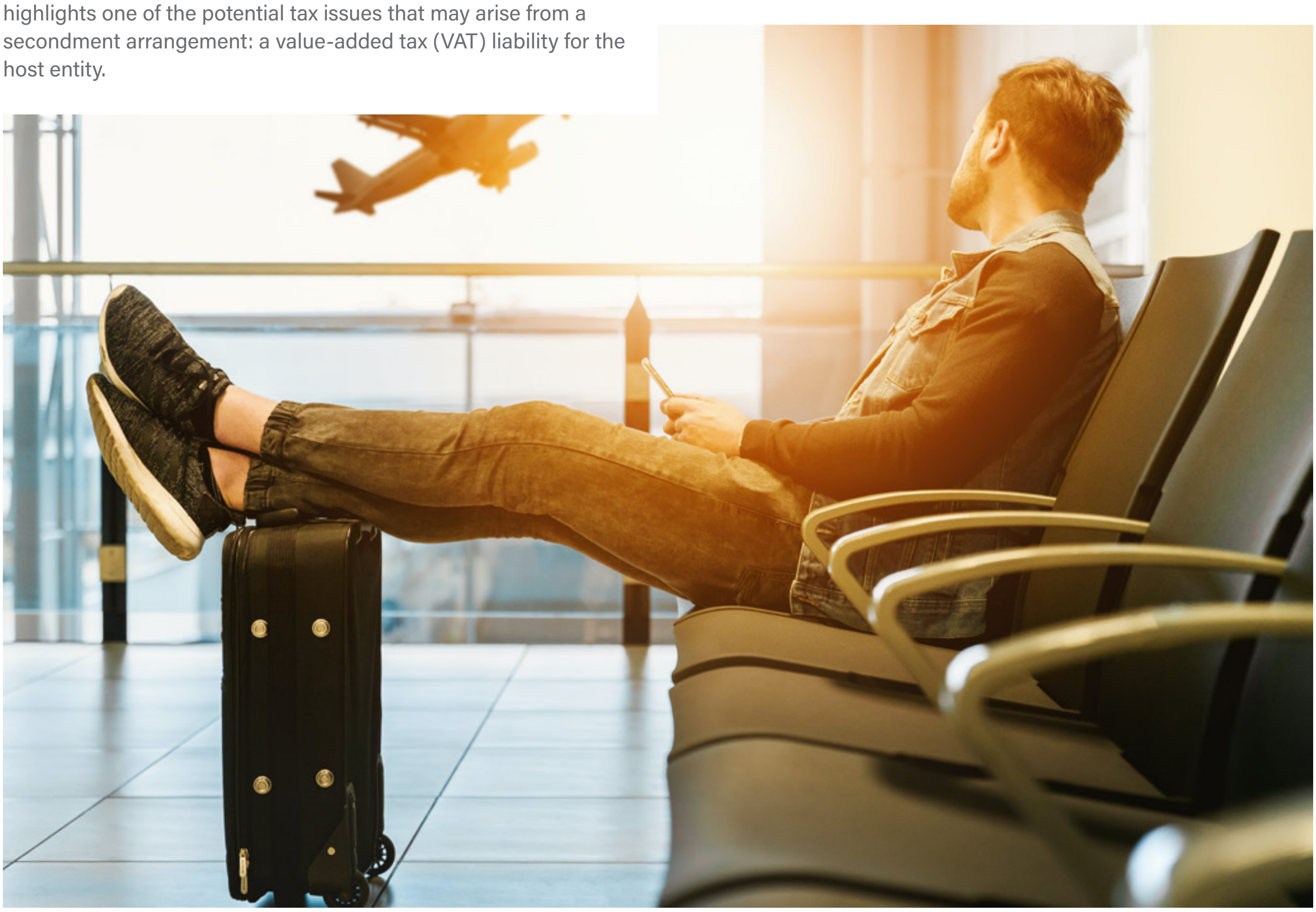
Secondments are particularly prevalent in group company structures, where secondees are sent between "home" and "host" offices/legal entities in different jurisdictions. These cross-border secondments are not without risk and, when considering the details of the arrangements such as which entity will pay the secondee's salary and how expenses will be apportioned, there are several employment and tax considerations to bear in mind.

TAX CONSIDERATIONS

The decision in the matter of *Citibank, NA South African Branch and Another v Commissioner for the South African Revenue Service,* [2023], decided by the Gauteng High Court on 20 September 2023, highlights one of the potential tax issues that may arise from a secondment arrangement: a value-added tax (VAT) liability for the host entity.

The case involved the secondment of employees by one or more foreign employers in the global Citigroup group of companies (referred to in the judgment as "Sending Home Entities") to Citigroup Global Markets (Pty) Ltd and to the South African branch of Citibank US (Applicants, referred to in the judgment as the "Receiving Home Entities"). While the judgment used the concepts "Sending Home Entity" and "Receiving Home Entity", in this article, the more commonly used terms, "Home Entity" and "Host Entity", respectively, are used.

The judgment also refers to a "further" Citigroup company that is involved in the secondment, by administering the expatriate salary and benefits of the secondees (the Agent).



"Despite possible reservations about certain aspects of the judgment, it is recommended that existing secondment arrangements with South African Host Entities are reviewed to assess whether such arrangements may be vulnerable to attack by SARS."

The crux of the dispute is whether the secondment of the employees to the Applicants resulted in:

- The supply of imported services which would oblige the Applicants to self-charge VAT at a rate of 15% on the amount paid to the Home Entities; *or*

- the employment of the secondees by the Applicants, which would not trigger a VAT liability.

Unfortunately, the judgment's description of the background facts is not too clear, but it appears that the secondments were effected in terms of –

- an **assignment agreement** with the secondee, which expressly stated that the secondee would not be an employee of the Host Entity, nor of the Agent; and

- an "**Intra-Citi Agreement**" between the Home Entity (the "Service Provider") and the Host Entity (the "Service Recipient") for "the supply of employee services". The Host Entity was obliged to pay the Home Entity for the supply of the secondees' services. While there is reference to such amount being equal to the cost of the employees' remuneration plus a mark-up, it appears that no mark-up was in fact charged or paid.

The Applicants sought an order declaring that the payments made by them fell outside the scope of VAT. In terms of the Value-Added Tax Act, 1991, VAT is not payable in respect of imported services if the supply is in respect of services rendered by "an employee to his employer in the course of his employment" to the extent that any "remuneration", as defined in paragraph 1 of the Fourth Schedule to the Income Tax Act, 1962, is paid or is payable to such employee. To succeed with this argument, the Applicants had to be the employers of the secondees.

The Applicants argued that the secondees became their employees for the duration of the secondment, as –

- the secondees placed their productive capacity at the disposal of the Applicants and furthered the enterprise of the Applicants in the course of their employment; and

- the Applicants had the right of supervision and control over the secondees for the duration of their secondment. Accordingly, they argued, the payment to the Home Entities did not constitute consideration for the supply of services but comprised the reimbursement of salary costs paid to the secondees.

While the Applicants argued that the court should consider "the substance, not labels" to determine whether there is an employment relationship, the court held that the Applicants failed to discharge their onus that the secondees constituted their employees for tax purposes. The Applicants placed substantial emphasis on the fact that the secondees were treated as its employees for purposes of employees' tax withholding. Although the judgment refers to the Applicants deducting and withholding employees' tax from the secondees' remuneration, it is not clear whether the Applicants included this in their monthly employees' tax returns to SARS. If so, one would have expected the Applicants to place substantial emphasis on the fact that the secondees were treated as their employees for purposes of employees' tax compliance.

Instead, the Applicants argued that that the secondees placed their productive capacity at the disposal of the Applicants, who had the right to supervise and control the secondees. However, the Applicants did not adduce any evidence regarding the substance of the relationship, including whether or not they actually exercised supervision and control over the secondees. The reason for this may have been the fact that the application was for a declarator and did not form part of the normal tax dispute resolution process. However, the court held that the Applicants failed to prove that it was an "employer" of the secondees and further failed to prove that the payments to the Home Entities constituted "remuneration". Accordingly, the court refused to issue the declarator.

While the judgment dealt only with VAT, a secondment arrangement could also give rise to a permanent establishment risk and thus a South African income tax liability for the Home Entity, if it is not clear that the secondees are carrying on the business of the Host Entity for the duration of the secondment.

Despite possible reservations about certain aspects of the judgment, it is recommended that existing secondment arrangements with South African Host Entities are reviewed to assess whether such arrangements may be vulnerable to attack by SARS.

EMPLOYMENT CONSIDERATIONS

Depending on the factual circumstances of the actual relationship between the parties, where employees are seconded/assigned from a Home Entity (whether local or cross-border) to a Host Entity in South Africa, the Host Entity in South Africa may be considered a co-employer under South African law.

If the secondees can establish that, in addition to being employed by the Home Entity, they were also employed by the Host Entity in South Africa, then regardless of the terms and conditions of the secondment agreement, both the Host Entity and Home Entity may be found to be employers of the employee in South Africa. In relation to cross-border secondments, this means that the secondees will be entitled to the protections provided by our Labour Relations Act, 1995, including those in relation to unfair dismissals and unfair labour practices. This is because our courts generally adopt a substance over form approach, which means they will look beyond the terms of an agreement to determine who the true employer(s) of the employee is (are).

> "While the Applicants argued that the court should consider 'the substance, not labels' to determine whether there is an employment relationship, the court held that the Applicants failed to discharge their onus that the secondees constituted their employees for tax purposes."

Our courts have held that, in determining who the employee's employer(s) is (are), it will take into account various factors, including, amongst others:

- any paper trail (for example any employment contract) which links the employee back to a particular entity;
- by whom the employee is paid;
- any representations that the parties make to a third party (such as the public) which give rise to the impression that a co-employment relationship exists; and
- any other conduct towards the employee that is inconsistent with the stated employer (ie, the Home Entity).

Finally, and perhaps most importantly, is the control element. This refers not only to which entity exerts control over the day-to-day activities of the employee, but which entity ultimately determines the employee's fate within the organisation in so far as it has the ultimate say over the decision to hire and more vitally, dismiss, the employee.

Further, in respect of cross-border secondment arrangements, even though foreign employees working for a South African Host Entity would be subject to the terms of their foreign employment contracts, there may be risks for the Host Entity if the provisions of the Basic Conditions of Employment Act, 1997 (for example, in relation to minimum annual leave, sick leave, notice period, etc), are not complied with while the employees are working in South Africa.

From a different angle, South African companies looking to second/assign employees to foreign companies should be aware of the laws applicable in the relevant jurisdiction. Specialist legal advice on tax and employment law should therefore be sought in those foreign jurisdictions, including a careful consideration as to the possibility of creating a co-employment relationship.

Parties should not only obtain advice on immigration laws, employment laws and tax law consequences; it would also be advisable for the Home Entity to consult with its fund managers/administrators about the impact that an employee's absence from the home country may have on the employee's participation in any medical aid scheme, retirement fund, share incentive scheme or voluntary or compulsory group risk insurance policies in their home country.

While cross-border secondments to South Africa can be attractive both for employees wanting to see the world, and for companies looking to access the necessary skills, it is recommended that these arrangements be reviewed carefully to determine, among others, whether they may be vulnerable to attack by SARS, create co-employment risks, or result in practical difficulties for the secondee from a benefits perspective.

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Acts and Bills

- Income Tax Act 58 of 1962: Fourth Schedule: Paragraph 1 (definition of "remuneration");
- Value-Added Tax Act 89 of 1991;
- Labour Relations Act 66 of 1995;
- Basic Conditions of Employment Act 75 of 1997.

Cases

- *Citibank, NA South African Branch and Another v Commissioner for the South African Revenue Service* (2022/043103) [2023] ZAGPPHC 1209 (20 September 2023).

Tags: cross-border secondments; imported services; co-employment risks.

SALE OF PROPERTY

An item that is often overlooked when buying or selling property is the issue of value-added tax (VAT) and whether it is payable and by whom. Property sale agreements generally stipulate how this should be dealt with, but in some cases agreements can be silent on the issue of VAT. What then is the correct position?

In terms of section 2(1) of the Alienation of Land Act, 1981, an agreement for the sale of any immovable property has to be in writing. In such an agreement, the seller and buyer have to, amongst other things, agree on the property to be sold as well as the purchase price to be paid. It is usually also here that the agreement stipulates whether VAT will be payable on the agreed purchase price or not. This is important, as an agreement for the sale of immovable property can attract tax in the form of either VAT or transfer duty and this must be clearly established to avoid undesired financial complications for the seller and buyer.

VAT is a tax levied on the price of goods or services that are supplied by a VAT vendor in the scope and furtherance of its enterprise. Immovable property is included in the definition of "goods" in terms of section 1(1) of the Value-Added Tax Act, 1991 (the VAT Act), and the supply of immovable property can therefore attract VAT. In contrast to transfer duty, VAT is payable by the seller. Therefore, if the seller is a VAT vendor and sells the property in the course of an enterprise, for example, it is in the business of buying and selling properties, it will be obliged to pay VAT on the sales price charged for such property. If the seller does not meet the aforementioned requirements for charging VAT, the default position will be that transfer duty is payable by the buyer. For purposes of this article, it is assumed that the seller is a VAT vendor and sells the property in the course of an enterprise.

Where the sale of property is therefore subject to the payment of VAT, a well-drafted agreement should expressly state whether the VAT amount is included in or excluded from the purchase price. Where VAT is included, the purchase price will include VAT at the standard rate of 15% (assuming the sale does not qualify to be zero-rated). For example, if the purchase price is R800 000.00 and is VAT inclusive, the seller will be obliged to pay the VAT out of the R800 000.00. This will effectively mean that the purchase price is less than R800 000.00, namely R695,652.17 and the VAT payable is R104,347.83. In such a case, the buyer will not have to pay the VAT on top of the purchase price as it is included.

In turn, where the purchase price excludes VAT, the buyer will have to pay VAT in addition to the purchase price to the seller. Clearly, express reference as to how VAT must be dealt with is important as it may hold serious consequences for buyer and seller if there is uncertainty.

But what happens if the agreement makes no mention of VAT at all?

In such an instance, section 64(1) of the VAT Act finds application. Section 64(1) provides that any price charged by any vendor in respect of any taxable supply of goods or services shall for the purposes of the Act be deemed to include any tax payable in terms of section 7(1)*(a)* of the VAT Act in respect of such supply; whether or not the vendor has included tax in such price. Where an agreement of sale is silent on the issue of VAT, it will therefore be assumed that VAT is included in the purchase price where the provisions of section 64 apply. Our courts have confirmed the aforementioned position and have held that section 64(1) creates a presumption that any purchase price for the sale of immovable property charged by a VAT vendor is deemed to include VAT. This means that where a seller is a VAT vendor, and the sale is a taxable supply, the purchase price shall be deemed to be VAT inclusive and VAT will not be collectable from the buyer in addition to the purchase price unless the agreement specifically states that the purchase price excludes VAT.

Given the impact that VAT can have if not properly dealt with in a purchase agreement, it is advisable to pay careful attention to one's purchase agreement and the wording thereof or the absence of wording in regard to VAT to ensure there are no unexpected consequences.

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PH Attorneys

Acts and Bills

- Alienation of Land Act 68 of 1981: Section 2(1);
- Value-Added Tax Act 89 of 1991: Sections 1(1) (definition of "goods"), 7(1)*(a)* & 64(1).

Tags: immovable property; taxable supply of goods or services.

REGISTRATION REQUIREMENTS

There is a compulsory threshold for registering for value-added tax (VAT), but there may be advantages to voluntary registration.

VAT registration is a crucial obligation for businesses operating in South Africa. Knowing when to register for VAT is essential to comply with tax laws and avoid penalties. This article discusses the circumstances under which businesses must register for VAT, the registration process, and the benefits and responsibilities that come with VAT registration.

WHEN IS ONE REQUIRED TO REGISTER FOR VAT?

Businesses are required to register with SARS as VAT vendors if they conduct an "enterprise" and their taxable supplies, which include supplies of both goods and services, exceed (or will, in terms of a contractual obligation in writing, exceed) the prescribed threshold within a consecutive 12-month period. This prescribed threshold for compulsory registration is currently set at R1 million.

It is essential to monitor the value of taxable supplies regularly to ensure timely VAT registration —particularly if one's taxable supplies are getting close to the prescribed threshold. If a business surpasses the threshold during a 12-month period, it is required to apply to register for VAT within 21 days from the end of that month.

However, if its taxable supplies will exceed the threshold in the next 12 months in terms of a written contractual obligation which has been entered into, it must apply to register for VAT within 21 days from the commencement of the month in which the obligation arises.

Non-resident suppliers of certain electronic services are also liable for compulsory VAT registration at the end of the month in which the total value of taxable supplies exceeds R1 million in any consecutive 12-month period. An intermediary is also allowed to register and account for VAT on behalf of supplies made by the non-resident supplier of electronic services.

VOLUNTARY VAT REGISTRATION

Even if a business's taxable supplies do not exceed the threshold, it has the option to voluntarily register for VAT. This decision might be advantageous for businesses that want to claim VAT input credits on their purchases or to appear more credible to potential clients. SARS will entertain an application for voluntary registration if an enterprise is conducted and the value of taxable supplies made is less than R1 million but has exceeded R50 000 in the most recent consecutive 12-month period.

Furthermore, persons carrying out the following business activities are eligible to submit a voluntary registration application even if the total of their taxable supplies for the past consecutive 12 months has not exceeded R50 000:

- Municipalities;
- Welfare organisations (ie, charities);
- A purchaser who acquires an existing business as a going concern, where the seller has made taxable supplies from carrying on that enterprise which have exceeded R50 000 in the past 12 months;
- Activities listed in General Notice R446 (as published in the *Government Gazette* 38836 of 29 May 2015). This includes agriculture, farming, forestry, fisheries, mining, ship and aircraft building, the manufacturing or assembly of a plant, machinery, motor vehicles, or locomotives, property development, infrastructure development, or beneficiation.

For business activities not listed above, persons meeting the requirements and conditions listed in General Notice R447 (as published in the *Government Gazette* 38836 of 29 May 2015) may voluntarily register for VAT. These requirements and conditions include the following:

Taxable supplies made for one month: Where taxable supplies have been made for only one month preceding the date of application, the value for that month must have exceeded R4 200.

Taxable supplies made for two months or more: Where the taxable supplies have been made for two months or more preceding the date of application, the average value of taxable supplies made in the months preceding the date of application, must have exceeded R4 200 per month. The average is calculated using a minimum of two months and a maximum of 11 months before the date of application.

Written contracts: Where taxable supplies exceeding R50 000 in the 12 months following the date of registration will be made in terms of a contractual obligation in writing.

Expenditure: Where expenses are incurred or are to be incurred for commencing or continuing an enterprise in terms of an agreement; or capital goods are acquired in connection with the commencement of the enterprise; and where payment has been made or any extended payment agreement entered into where –

- as at the registration application date, payment has exceeded R50 000; or
- in any consecutive 12-month period commencing before and ending after the registration application date, payment will exceed R50 000; or
- in the 12 months following the registration application date, payment will exceed R50 000.

Finance agreement: This would include –

- a financial agreement with a registered bank;
- a credit agreement with a credit provider as per the National Credit Act, 2005;
- an agreement with a designated entity, public authority, or other person who continuously or regularly provides finance; or
- a financial agreement with a non-resident.

The total repayment in the 12 months following the registration application date must exceed R50 000.

Voluntarily registered businesses must adhere to the same VAT rules and obligations as businesses that are mandated to register.

BENEFITS OF VAT REGISTRATION

One of the primary advantages of being VAT-registered is the ability to claim VAT input credits. Registered businesses can offset the VAT paid on their purchases against the VAT collected on their sales, thereby reducing their overall VAT liability. This can result in significant cost savings for businesses, especially those that have substantial input VAT costs. Additionally, VAT registration can enhance a business's image and credibility, as it signals that the business is established and operating above a certain turnover level. This can be particularly valuable when dealing with other businesses or tendering for contracts.

HOW TO REGISTER FOR VAT

VAT registration is done via the SARS eFiling platform (www.sarsefiling.co.za), where the following steps are set out:

- Create or log on to one's eFiling profile.
- Navigate to the "SARS Registered Details" screen.
- On the "Individual" portfolio, select "Home" to find "SARS Registered Details" on the left menu. On the "Tax Practitioner" and "Organisations" portfolio, the "SARS Registered Details" functionality is under the "Organisations" menu tab.
- Select "Maintain SARS Registered Details" on the left menu. Once the screen has loaded, select "I Agree" to confirm that one is authorised to perform maintenance functions of the registered details of the vendor.
- Select VAT under "My tax products > Revenue" on the left menu.
- Select "Add new product registration" to register a new or additional VAT branch registration.
- Complete the following in the VAT container: Registered particulars (if not pre-populated), "Trading As" name (where applicable), and "Liability Date".
- Select the "Business Activity" code. The codes may be obtained in the VAT 403 Vendors and Employers Trade Classification Guide.
- Select Farming Activity Code, if applicable. (Note: If one selects a different business activity code after one has received the containers for Diesel concession, the following error message will appear: "Mark here if you derive farming income in addition to your main business activity income". If one selects this indicator, the "Farming Activity Code" field will be mandatory).
- Select the relevant registration option.
- Enter the following information: Value of taxable supplies, accounting basis ("invoice" or "payments" basis), and tax period.
- Complete the following fields if not pre-populated: Contact details, physical address, postal address, and banking details.

EFFECTIVE DATE OF REGISTRATION

Voluntary VAT registrations

The VAT liability date will be set according to the date of application. The backdating of a voluntary registration is not allowed. If one wants to backdate one's voluntary registration application, one must provide SARS with the necessary supporting documents to justify the backdating request.

Compulsory VAT registrations

The SARS eFiling (RAV01) system only allows backdating up to six months from the date on which the compulsory registration threshold of R1 million was exceeded. If the backdating is more than six months from the date on which the compulsory registration threshold was exceeded, one will need to make an appointment to visit a SARS branch with the necessary supporting documents such as financial statements, signed contracts, invoices issued, etc.

RESPONSIBILITIES OF VAT-REGISTERED BUSINESSES

Once registered for VAT, businesses assume several responsibilities. They must charge the appropriate VAT rate on their taxable supplies, issue VAT invoices to their customers, and file regular VAT returns with SARS.

VAT returns must be submitted on time, and any VAT owed to SARS must be paid promptly. The due date for the submission of the return and payment of any VAT due is the 25th of the month following the end of each tax period. If the 25th falls on a weekend or public holiday, the due date is the previous business day. If the vendor is registered for eFiling and payment is made via either SARS eFiling or Electronic Funds Transfers (internet banking), the return and payment may be submitted by the last business day of the month.

Businesses also have an obligation to keep accurate VAT records, including invoices, receipts, and relevant financial documents. These records are subject to review by SARS during tax audits.

Failure to fulfil these responsibilities or comply with VAT regulations can lead to penalties and interest charges. It is therefore essential for VAT-registered businesses to stay updated on VAT rules and regulations, to avoid potential pitfalls and ensure compliance.

Steven Jones

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Acts and Bills

- National Credit Act 34 of 2005.

Other documents

- *Government Gazette* 38836 of 29 May 2015;
- General Notices R446 & R447 (as published in the *Government Gazette* 38836 of 29 May 2015).

Tags: non-resident supplier; taxable supplies; VAT input credits.

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