Issue 56 | 2023
MARCH

South African Institute of Taxation

Unstructured CPD 150mins

TAX CHRONICLES MONTHLY

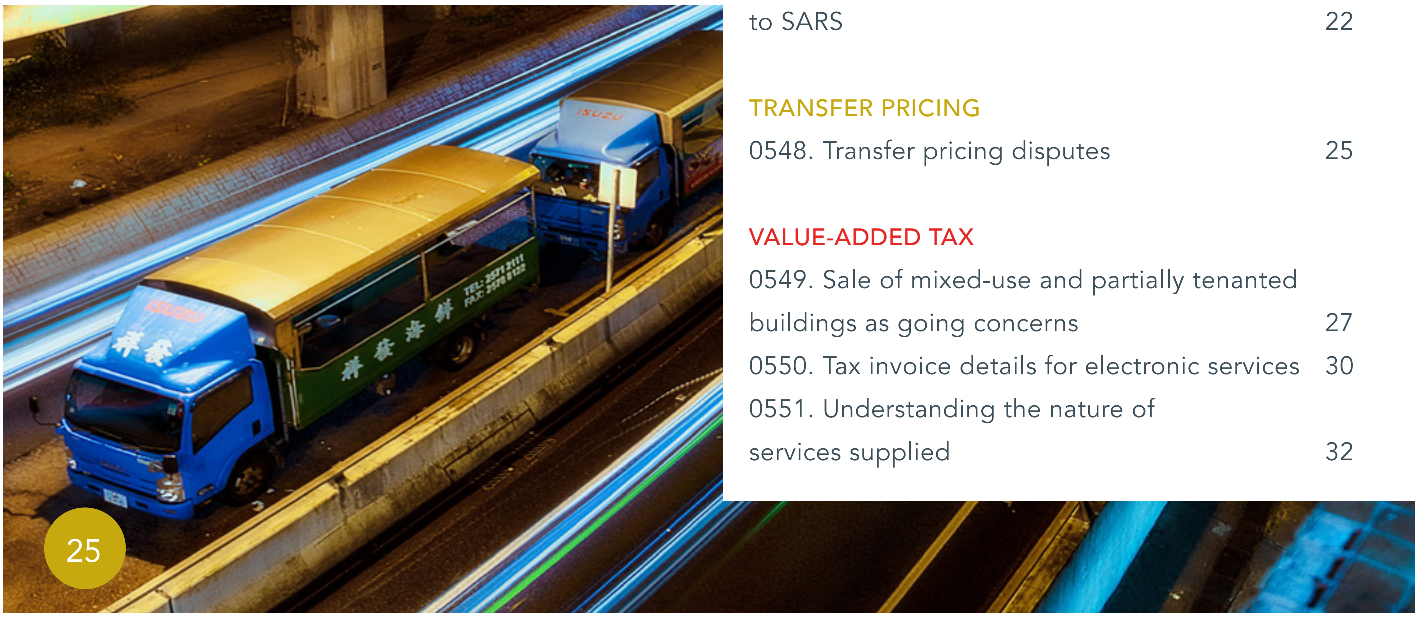
Official Journal for the South African Tax Professional

TRANSFER PRICING
TRANSFER PRICING DISPUTES

SECURITIES TRANSFER TAX
COLLATERAL ARRANGEMENTS

INTERNATIONAL TAX
SOUTH AFRICA RATIFIES THE MULTILATERAL INSTRUMENT

CONTENTS



Editorial panel:
Mr KG Karro (Chairman), Prof KI Mitchell, Prof JJ Roeleveld, Prof PG Surtees, Ms MC Foster, Prof DA Tickle, Ms D Hurworth.

Tax Chronicles Monthly is published as a service to members of the tax community and includes items selected from the newsletters of firms in public practice and commerce and industry, as well as other contributors. The information contained herein is for general guidance only and should not be used as a basis for action without further research or specialist advice. The views of the authors are not necessarily the views of the editorial panel or the South African Institute of Taxation.

EXCHANGE CONTROL, TAX AND FAIS PROPOSALS

In its 2020 and 2021 position papers, the Intergovernmental Fintech Working Group (IFWG) described the absence of financial regulation applicable to crypto assets as a regulatory void. In the same reports, and in attempting to address this void, the IFWG has made various proposals to amend and introduce legislation that will regulate the crypto assets industry.

On 19 October 2022, a notice (General Notice 1359 of 2022) by the Financial Sector Conduct Authority was published in *Government Gazette* 47334 declaring that crypto assets would constitute a "financial product" in terms of section 1(1) of the Financial Advisory and Intermediary Services Act, 2002 (FAIS). This means that, with effect from 19 October 2022, any provision in FAIS that applies to a "financial product" would equally apply to crypto assets, as defined in the notice. The notice defines "crypto assets" as "a digital representation of value that –

(a) is not issued by a central bank, but is capable of being traded, transferred or stored electronically by natural and legal persons for the purpose of payment, investment and other forms of utility;

(b) applies cryptographic techniques; and

(c) uses distributed ledger technology."

Pursuant to the FAIS notice, a question has arisen as to whether it has an impact on the tax and exchange control position in relation to crypto assets. In this article, these issues are briefly considered.

EXISTING EXCHANGE CONTROL REGULATION

Prior to 2022, the regulation of crypto assets was not expressly dealt with under the Exchange Control Regulations, 1961, or the Currency and Exchanges Manual for Authorised Dealers (AD Manual). The Financial Surveillance Department of the South African Reserve Bank (FinSurv) had issued guidance on its website (which was still published there at the time of writing) indicating that persons were not allowed to export capital through crypto assets, as this would constitute an unlawful export of capital under regulation 10(1)*(c)* of the Exchange Control Regulations.

However, pursuant to the 2022 Budget, FinSurv issued a number of circulars, which for the first time expressly gave permission for certain transactions in relation to crypto assets. The content of these circulars is included in the AD Manual. Most significantly, it was expressly stated that South African individuals could make use of their annual single discretionary allowance (R1 million) and their annual foreign capital allowance (R10 million) to acquire crypto assets abroad.

EXISTING TAX REGULATION

From a tax perspective, crypto assets are included in the definition of "financial instrument" in section 1(1) of the Income Tax Act, 1962 (the Act). Therefore, any provision in the Act that applies to "financial instruments" will also apply to crypto assets. Furthermore, in relation to specific types of transactions, including trading in cryptocurrency or crypto assets, the general income tax principles will apply to determine whether the amount that accrues to a person pursuant to a crypto asset transaction, is capital or revenue in nature. For example, the trading in crypto assets as part of a profit-making scheme will be taxed on revenue account. The tax consequences of other transactions, such as staking or pooling of crypto assets, will also be determined with reference to these capital/revenue and general income tax principles. There are also provisions in the Value-Added Tax Act, 1991, that apply to the supply of cryptocurrency. The supply is an exempt supply, unless the consideration is in the form of a fee.

"Prior to 2022, the regulation of crypto assets was not expressly dealt with under the Exchange Control Regulations, 1961, or the Currency and Exchanges Manual for Authorised Dealers (AD Manual)."

IMPACT OF THE FAIS REGULATION AND LOOKING AHEAD

While the FAIS regulation brings crypto assets within the remit of FAIS, it does not appear to impact the tax and exchange control rules currently applicable to crypto assets. The rules discussed above still apply and it therefore remains to be seen whether the tax and exchange control rules will be amended, pursuant to the FAIS notice.

From a tax perspective, it is possible that at some point providers of services in relation to crypto assets, such as crypto asset service providers (as they are referred to by the IFWG), will be required to submit third-party data to the South African Revenue Service (SARS), similar to the way in which banks and financial institutions are required to do. This would make it easier for SARS to enforce tax compliance in relation to the transactions concluded by taxpayers with crypto assets on the platforms administered by crypto asset service providers.

From an exchange control perspective, it is anticipated, as announced in the 2022 Budget Review, that the Exchange Control Regulations may be amended to specifically include "crypto assets" in the definition of "capital", similar to the inclusion of "intellectual property right" in the "capital" definition a few years ago.

Louis Botha

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Section 1(1) (definition of "financial instrument");
- Value-Added Tax Act 89 of 1991;
- Financial Advisory and Intermediary Services Act 37 of 2002 (FAIS): Section 1(1) (definition of "financial product").

Other documents

- 2020 and 2021 position papers (published by the Intergovernmental Fintech Working Group (IFWG));
- General Notice 1359 of 2022 (published by the Financial Sector Conduct Authority in *Government Gazette* 47334 on 19 October 2022 and declaring that crypto assets are included under the definition of "financial product" in section 1(1) of the FAIS);
- Exchange Control Regulations, 1961: Regulation 10(1)*(c)*;
- Currency and Exchanges Manual for Authorised Dealers (AD Manual);
- Circulars issued by FinSurv pursuant to the 2022 Budget (expressly giving permission for certain transactions in relation to crypto assets);
- 2022 Budget Review.

Tags: financial product; Exchange Control Regulations, 1961; financial instruments; profit-making scheme; crypto asset service providers.

FINANCE CHARGES AND SECTION 24J

In the tax court judgment of Taxpayer A v Commissioner for the South African Revenue Service IT 25042, *[2022], the taxpayer wanted a deduction for finance charges under section 24J of the Income Tax Act, 1962, in its income tax return for the 2016 year of assessment.*

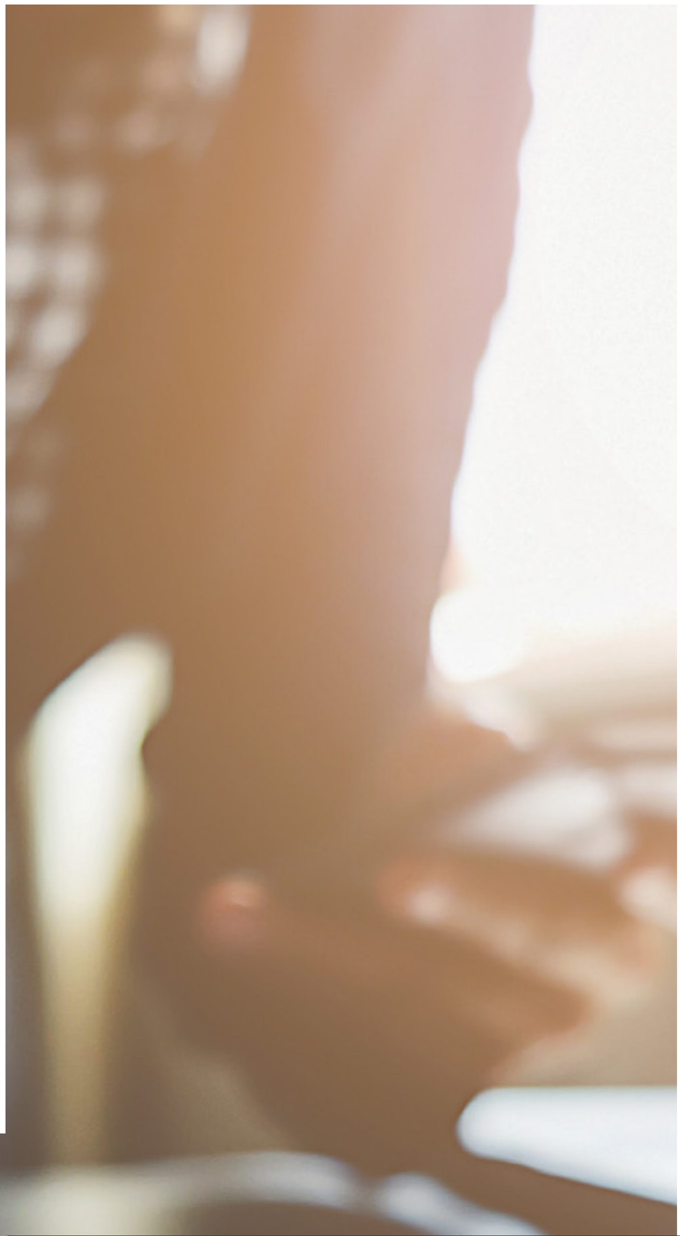
The finance charges were comprised of raising fees, debt origination fees and structuring fees (collectively the "upfront fees") which emanated from the taxpayer entering into loan agreements for the purposes of their property development and investment business.

The court found that the upfront fees constituted "related finance charges" and therefore "interest" as defined in section 24J as it read at the time. It follows that the taxpayer was entitled to a deduction for the upfront fees in terms of section 24J.

The definition of "interest" in section 24J had been amended with effect from 19 January 2017 to allow for a deduction of the "[...] gross amount of any interest or similar finance charges [...]" rather than the "[...] gross amount of any interest or related finance charges...".

The reason for the amendment which replaced the word "related" with the word "similar" was set out in the Explanatory Memorandum on the Taxation Laws Amendment Bill, 2016 (the Explanatory Memorandum) to clarify the policy position that this section applies to finance charges of the same kind or nature. The exact meaning of the term "same kind or nature" is unknown.

"The answer as to whether finance charges can be said to be 'similar' to interest and thus form part of the definition of interest in terms of section 24J will require a factual enquiry in each situation."



It follows that the finance charge must be similar to interest to fall within the scope of section 24J. The common law meaning of interest has been established as compensation for the use of money, ie, money paid for the use of money (credit). Interest as defined in section 24J is wider than the common law concept and the term "similar finance charges" broadens the definition of interest to include finance charges that do not conform to the common law definition of interest but are "similar" to it. The ordinary meaning of the word "similar" is having a resemblance in nature and essential characteristics without being identical.

If regard is to be had to the essential characteristics and nature of interest, it is arguable that it could mean any kind of charge levied irrespective of name or form, on the provision of credit which has the effect of raising the effective compensation for the use of money. The charge may arguably be required to be levied on a similar basis to interest and over the same time period for which interest will be paid. It therefore seems that the term "similar finance charges" has a more restrictive meaning than "related finance charges".

In the *IT 25042* case, the fact that the upfront fees were not linked to the duration of the loans and the fact that the taxpayer was liable to pay VAT on the upfront fees but not on the interest, did not constitute a basis for the court to find that the upfront fees were not "related finance charges". However, the court may have come to a different conclusion if the amended definition of interest in section 24J was applicable as the nature and essential characteristics of the upfront fees are arguably different from the interest.

The answer as to whether finance charges can be said to be "similar" to interest and thus form part of the definition of interest in terms of section 24J will require a factual enquiry in each situation.

Arnaaz Camay & Prishni Chetty

ENSafrica

Acts and Bills

- Income Tax Act 58 of 1962: Section 24J.

Other documents

- Explanatory Memorandum on the Taxation Laws Amendment Bill, 2016.

Cases

- *Taxpayer A v Commissioner for the South African Revenue Service IT 25042* [2022] ZATC 7 (14 July 2022).

Tags: finance charges; similar finance charges; upfront fees.

TAXATION OF FARMERS

Farming and agriculture form the lifeblood of any economy. It is no wonder that the Income Tax Act, 1962 (the Act), provides for a special set of beneficial rules applicable to farmers in South Africa. This special tax regime is by and large set out in the First Schedule to the Act.

Even though the South African Revenue Service (SARS) has already issued an interpretation note on "Game Farming", namely Interpretation Note 69, it had previously not provided an extensive explanatory note or guide on the First Schedule. Farmers would therefore have welcomed the publishing of the SARS Draft Guide on the Taxation of Farming Operations on 22 September 2022 (the Draft Guide). This article discusses some of the key guidance notes contained in the Draft Guide. [*Author's note*: Guides issued by SARS are neither "official publications" as defined in section 1 of the TAA (meaning they cannot be a "practice generally prevailing"), nor are they binding on SARS. They are merely intended to assist taxpayers in the practical interpretation and application of the requirements set by law.]

MEANING OF FARMING OPERATIONS

In order for the provisions in the First Schedule to apply, there are a number of requirements that need to be met. Arguably, the most important is the requirement that the person is "carrying on pastoral, agricultural or other farming operations". This is because only taxable income derived from the carrying on of farming operations will fall within the special tax regime. Even though, ultimately, it is a factual question whether a person is carrying on pastoral, agricultural or other farming operations, The Draft Guide indicates that the term "other farming activities" generally includes activities such as horse breeding, fish farming and bee keeping.

The Draft Guide discusses various cases giving rise to law on the meaning of "carrying on pastoral, agricultural or other farming operations", including *ITC 1324* [1980] 42 SATC 288, where a grower who merely intended to sell crops that were surplus to his needs was judged to not be carrying on farming operations. The Draft Guide thus confirms that one must be conducting a trade in farming and there must be an overall profit-making intention.

Another important issue that the Draft Guide considers is the position of two persons, where one person owns the land on which the farming operations are conducted, and another person physically conducts the farming operations. Ultimately, it is also a question of fact as to which person will be considered to be "farming" and thus benefit from the special tax regime. Example 1 on page 8 of the Draft Guide provides that if a person leases land from a second person entity where the first person physically conducts the farming operations (in this case wine farming), it is the first person that will generally be considered to be farming.

According to the Draft Guide, the owner of the land will not be involved in the farming operations as the rental income is derived from the ownership of the land and not from farming operations. Interestingly, the Draft Guide states that if the rental payments were not fixed amounts but determined as a percentage of the turnover from the activities conducted on the vineyard, the owner of the land might apply the First Schedule to determine its taxable income derived from farming.

As indicated, it is only income "derived from farming" that falls within the special tax regime in the First Schedule. This means that not all income from farming will necessarily fall within the First Schedule as there must be a connection between the income earned and the farming operations. Some examples the Draft Guide provides of "supplementary farming operations" include the sale of manure; the sale of firewood; the letting of grazing rights if the rental amount is derived from farming proceeds; the sale of plantation and forest produce; prize money received, for example, best wool or biggest pumpkin; or compensation received from the Government for the compulsory destruction of livestock due to disease.

Conversely, the Draft Guide states that, amongst other things, packing of fruit for other farmers; stakes won by a farmer as a result of racing horses which were bred by the farmer; and accommodation and catering activities for people spending holidays on the farm, do not constitute farming activities. In those circumstances, the normal tax principles apply to such income.

VALUATION OF CLOSING AND OPENING STOCK

Another important aspect which the Draft Guide discusses is the calculation of opening and closing trading stock of a farmer, including livestock and produce. Notably, the Draft Guide confirms that a farmer's consumable stores, for example fuel and spares used for farming equipment, and non-livestock or non-produce items do not have to be taken into account as closing stock for purposes of the First Schedule.

In addition, the Draft Guide discusses the use of standard values of livestock fixed by regulation, apart from game livestock. Farmers can also adopt a different value (other than the standard value) provided that it is not more than 20% higher or lower than the standard value fixed by the regulations. If a farmer adopts a different value, the farmer is bound by that value, and it cannot be altered or varied. Valuation of stock and produce is therefore an important taxation concept for farmers.

DEDUCTION OF CAPITAL EXPENDITURE

Generally, unless one of the special capital allowances in the Act applies, one is not permitted to deduct capital expenses from income. However, one of the most beneficial aspects of the First Schedule pertaining to farming operations is that paragraph 12 provides for a special dispensation for farmers which allows for a deduction in respect of specified capital expenses.

Paragraph 3.6.1(b) of the Draft Guide discusses some of the "capital development expenditure" that may be claimed under paragraph 12 of the First Schedule, including expenditure incurred in relation to the eradication of noxious plants and alien invasive vegetation; the prevention of soil erosion; dipping tanks; dams, irrigation schemes, boreholes and pumping plants; fences; and the erection of, or extensions, additions or improvements (other than repairs) to, buildings used in connection with farming operations, other than those used for domestic purposes.

Notably, the Draft Guide also discusses the deduction of costs incurred in relation to the building of roads and bridges as well as electrical infrastructure. Importantly, however, not all expenses incurred in respect of infrastructure will potentially fall under paragraph 12 of the First Schedule as one must be able to show that the relevant roads and bridges are used in connection with the farming operations (which the Draft Guide interprets to mean "in respect of" farming operations). In addition, electrical infrastructure costs must be wholly or mainly used for farming purposes, which SARS interprets to mean more than 50%. Electrical infrastructure that also services the farmer's domestic premises will therefore also need to be factored in when considering this provision.

DEDUCTION OF COSTS INCURRED IN RELATION TO RENEWABLE ENERGY

Given the ongoing electricity crisis in South Africa, farmers and their advisors would be well advised to study the provisions in the Act regarding the deduction of plant and machinery used in the course of providing renewable energy. Some key provisions mentioned in the Draft Guide include section 12B(1)*(h)*, which states that should a farmer use the plant or machinery in the production of renewable energy which is used in farming operations, then they will be entitled to an accelerated capital depreciation allowance on the plant and machinery.

EXPROPRIATION OF LAND

The Draft Guide also discusses aspects of taxation relevant to where a farmer's land is expropriated. It specifically refers to the reduced tax rate applicable to the "excess farming profits" derived on land that is expropriated as well as the capital gains tax consequences on the disposal of the land. Notably, the Draft Guide indicates that paragraph 65 of the Eighth Schedule to the Act may apply to defer the capital gain on the disposal of the land on the basis that it was disposed of involuntarily.

CONCLUDING REMARKS

The Draft Guide provides welcome clarity regarding several aspects of the special tax regime applicable to a vital industry of South Africa's economy. Farmers had the opportunity to submit comments to the SARS Legal & Policy Division until 25 November 2022. The final version of the Guide is expected to be published in the next few months.

"Another important issue that the Draft Guide considers is the position of two persons, where one person owns the land on which the farming operations are conducted, and another person physically conducts the farming operations."

Jerome Brink

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Section 12B(1)*(h)*; First Schedule: Paragraph 12; Eighth Schedule: Paragraph 65;
- Tax Administration Act 28 of 2011.

Other documents

- Interpretation Note 69 (Issue 3) ("Game farming") (6 August 2021);
- SARS Draft Guide on the Taxation of Farming Operations (published on 22 September 2022): Example 1 on page 8; Paragraph 3.6.1(b).

Cases

- *ITC 1324* [1980] 42 SATC 288.

Tags: farming operations; supplementary farming operations; trading stock; capital development expenditure.

SOUTH AFRICA RATIFIES THE MULTILATERAL INSTRUMENT

On 30 September 2022, South Africa deposited its instrument of ratification of the Multilateral Instrument (the MLI) – it entered into force for South Africa on 1 January 2023.

This has far-reaching implications for South Africa's bilateral tax treaties with other jurisdictions that have already ratified the MLI or will do so in future – these include the majority of South Africa's main trading partners. The MLI is one of the outcomes of the OECD/G20 Project to tackle Base Erosion and Profit Shifting (BEPS) – tax-planning strategies to exploit gaps and mismatches in tax rules that seek to shift profits to low-tax jurisdictions.

"The implementation of the Final BEPS Package will require changes to model tax conventions, as well as to the bilateral tax treaties based on the model conventions."

BACKGROUND

As outlined in the OECD's Explanatory Statement to the MLI, the BEPS Action Plan was developed by the OECD and was endorsed by the G20 leaders in September 2013. It identified 15 actions to tackle BEPS in a comprehensive manner and set out deadlines to implement those actions. Action 15 of the BEPS Action Plan provided for the possible development of a multilateral instrument to implement tax treaty-related BEPS measures to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties.

After two years the OECD produced the final BEPS Package, which was endorsed by the OECD Council and the G20 Leaders in November 2015. It was agreed that certain of the BEPS measures are minimum standards, meaning that the participating countries agreed that the particular standard must be implemented. The implementation of the Final BEPS Package will require changes to model tax conventions, as well as to the bilateral tax treaties based on the model conventions. Because there are more than 3 000 bilateral treaties in existence, in the absence of a method for swift implementation of the changes, negotiating changes to the treaties would be burdensome and time-consuming. The idea is therefore that if BEPS-related changes to multiple bilateral tax treaties are sought to be implemented, such implementation can be achieved by making amendments to the MLI, provided that the MLI has entered into force in the jurisdictions to which each bilateral treaty relates.

The Action 15 Report entitled "Developing a Multilateral Instrument to Modify Bilateral Tax Treaties" concluded that a multilateral instrument, providing an innovative approach to enable countries to swiftly modify their bilateral tax treaties to implement measures developed in the course of the work on BEPS, was desirable and feasible. An *ad hoc* Working Group was formed and endorsed by the G20 Finance Ministers and Central Bank Governors in February 2015. The *ad hoc* Group was open to all interested countries participating on an equal footing and 99 countries participated in the *ad hoc* Group on this basis, together with four non-State jurisdictions and seven international or regional organisations that participated as observers.

The MLI is the result of the work of the *ad hoc* Group and it entered into force for the first time on 1 July 2018. It presently covers 100 jurisdictions. Each jurisdiction was free to effectively choose its own date on which the MLI entered into force and thereby, when it entered into effect. For example, the MLI entered into effect in the UK on 1 January 2019 and in Germany on 1 January 2022. The USA is not a signatory to the MLI. The only African countries (of the 54), besides South Africa that are currently signatories to the MLI are Egypt and Mauritius (entry into effect 1 January 2021), Burkina Faso (entry into effect 1 January 2022), Cameroon, Lesotho, Senegal and Seychelles (entry into effect 1 January 2023).

IMPLEMENTATION APPROACH

The MLI modifies tax treaties between two or more Parties to the Convention. It, in effect, overlays existing tax treaties, and modifies their application to implement the BEPS measures. To determine whether the MLI applies to a bilateral tax treaty, one must first determine whether the MLI has entered into force in both jurisdictions. The MLI enters into force on the first day following three calendar months after a jurisdiction has finalised its ratification process. In the case of South Africa, the MLI came into force on 1 January 2023. If the MLI has entered into force for both jurisdictions, one should next determine whether both jurisdictions have notified the OECD that they wish to modify the specific bilateral treaty with regard to the MLI; in other words, whether the treaty is a "Covered Tax Agreement" as defined in the MLI. The extent to which the MLI will modify a Covered Tax Agreement with respect to a particular article in the bilateral treaty also depends on whether the relevant provision of the MLI has entered into effect for both jurisdictions and on the choices made by the respective jurisdictions from the various options that the MLI makes available. Broadly, the MLI makes the following choices available:

- Choices amongst alternatives in certain of the provisions of the MLI;
- Choices whether or not to apply optional provisions; and
- Choices to opt out, through reservation, with respect to all of their Covered Tax Agreements or certain Covered Tax Agreements.

However, jurisdictions may not choose to opt out of provisions of the MLI that are a BEPS minimum standard.

Assuming that a particular provision of the MLI has entered into effect for both Parties to a Covered Tax Agreement, to determine whether the provision applies to a Covered Tax Agreement, one therefore has to consider the choices made by both jurisdictions in relation to the provision and whether these choices result in a match or a mismatch. The consequences of a mismatch vary depending on the provision in question. In many cases, a mismatch results in the provision of the MLI not applying to the Covered Tax Agreement. This leaves the pre-existing clause in the double tax treaty (DTA) valid.

As mentioned above, once the MLI has entered into force in relation to a jurisdiction, one must determine the date on which its provisions enter into effect. A provision of the MLI may only apply to a Covered Tax Agreement if that provision has entered into effect for both Parties to a Covered Tax Agreement. The provisions (other than those relating to mutual agreement procedures) enter into effect as follows:

1. Withholding taxes: on the first day of the first calendar year following the entry into force – for South Africa this is for events that give rise to the withholding tax occurring from 1 January 2023 onwards; and

2. Other taxes: for taxable periods beginning on or after six calendar months after the entry into force date – for South Africa this is for taxable periods commencing from 1 July 2023 onwards.

IMPACT OF THE MLI

The following is a brief summary of some of the more important MLI provisions. Multinationals will need to carefully consider the treaty positions adopted by each of the jurisdictions in which they operate, with respect to each relevant bilateral treaty. In most cases, as indicated, the MLI provisions are subject to one or more of the choices described above, except where the provision is a BEPS minimum standard:

- Article 3 Transparent entities: Income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the law of either contracting jurisdiction shall be considered to be the income of a resident of a contracting jurisdiction, but only to the extent that the income is treated, for tax purposes by that contracting jurisdiction, as the income of a resident of that contracting jurisdiction.

- Article 4 Dual resident entities: The competent authorities of a dual resident entity shall endeavour to determine by mutual agreement the jurisdiction of which the entity shall be deemed to be a resident for purposes of the relevant bilateral tax treaty. In making this determination, the competent authorities are required to take into account the place of effective management, place of incorporation and any other relevant factors. In principle, treaty benefits will be denied in the absence of such agreement except to the extent and in such manner as may be agreed upon by the competent authorities.

- Article 7 Prevention of treaty abuse: Jurisdictions may choose between the principal purpose test on its own and the principal purpose test in combination with the simplified limitation on benefits rule. Parties that prefer to address treaty abuse by adopting a detailed limitation on benefits rule are permitted to opt out of the principal purpose test and agree to endeavour to reach a bilateral agreement that satisfies the minimum standard.

  South Africa has chosen the principal purpose test. This means that a benefit under the bilateral tax treaty will not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in the circumstances would be in accordance with the object and purpose of the relevant provisions of the bilateral tax treaty.

It is unclear how courts would interpret the phrase "one of the principal purposes" as applied to practical situations in this context.

- Article 8 Dividend transfer transactions: Provisions of a bilateral tax treaty that exempt or limit the rate of dividend withholding taxes paid by a company that is a resident of a contracting jurisdiction, provided that the beneficial owner or the recipient is a company which is a resident of the other contracting jurisdiction that owns, holds or controls more than a certain amount of the capital, voting rights or similar interests of the company paying the dividends, shall only apply if the ownership conditions are met throughout a 365-day period that includes the day of the payment of the dividends. For purposes of computing this holding period, no account shall be taken of changes of ownership resulting from corporate reorganisations such as mergers or divisive reorganisations.

- Article 9 Capital gains from alienation of shares deriving value principally from immovable property: South Africa has chosen the alternative whereby gains derived by a resident of a Contracting Jurisdiction from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting Jurisdiction if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting Jurisdiction.

- Article 13 Artificial avoidance of permanent establishments through specific activity exemptions: A permanent establishment shall be deemed not to include activities specifically listed in the bilateral tax treaty, the maintenance of a fixed place of business solely for the purpose of carrying on any activity for the enterprise, or a combination of these activities, if such specific activity or the combination of these activities of the fixed place of business is of a preparatory or auxiliary character. In addition, an anti-fragmentation rule applies for activities carried out by the same enterprise or closely related enterprises in the same jurisdiction.

"The extent to which the MLI will modify a Covered Tax Agreement with respect to a particular article in the bilateral treaty also depends on whether the relevant provision of the MLI has entered into effect for both jurisdictions and on the choices made by the respective jurisdictions from the various options that the MLI makes available."

- Article 16 Mutual agreement procedure: If a person considers that the actions of one or both of the contracting jurisdictions will result in taxation not in accordance with the provisions of the bilateral tax treaty, the taxpayer may present the case to either of the competent authorities. The case must be presented within three years as of the first notification of the action resulting in taxation not in accordance with the provisions of the bilateral tax treaty.

  South Africa has chosen to opt out of the above wording on the basis that it intends to implement element 1.1 of the BEPS Action 14 ("making dispute resolution mechanisms more effective") minimum standard through administrative measures.

- Article 19 Mandatory binding arbitration: Provides mandatory binding arbitration, upon request by the applicant, in case jurisdictions are unable to reach an agreement to resolve the dispute using the mutual agreement procedure.

CONCLUSION

The entry into force of the MLI on 1 January 2023 heralds a new era for South Africa in which international tax involving South Africa as a jurisdiction, including international tax planning, will become considerably more complex. Taxpayers will have to take account of the positions of other jurisdictions as well as those of South Africa in deciding whether the MLI should be applied to the relevant treaty and, if so, how it should be applied. In particular, the potential application of Articles 4, 7, 8 and 13 of the MLI will need to be carefully considered. It is also likely that changes will be made to the MLI over time, the effects of which will also have to be carefully monitored.

[*Author's note*: Taxpayers may want to refer to a matrix on the OECD website [https://www.oecd.org/tax/treaties/mli-matching-database.htm] to assist anyone who wants to determine whether the contracting parties to any double tax treaty have triggered the MLI and, if so, which provisions apply to that particular treaty.]

Adjunct Associate Professor David Warneke

BDO

Other documents

- The Multilateral Instrument (MLI): Articles 3 (Transparent entities), 4 (Dual resident entities), 7 (Prevention of treaty abuse), 8 (Dividend transfer transactions), 9 (Capital gains from alienation of shares deriving value principally from immovable property), 13 (Artificial avoidance of permanent establishments through specific activity exemptions), 16 (Mutual agreement procedure), 19 (Mandatory binding arbitration);
- OECD's Explanatory Statement to the Multilateral Instrument (MLI);
- BEPS Action Plan: Actions 14 ("Making dispute resolution mechanisms more effective": more specifically element 1.1) & 15;
- Action 15 Report: "Developing a Multilateral Instrument to Modify Bilateral Tax Treaties".

Tags: Multilateral Instrument (the MLI); bilateral tax treaty; Covered Tax Agreement; withholding tax; contracting jurisdiction.

COLLATERAL ARRANGEMENTS

Any transfer of a share issued by a South African incorporated company or listed on a South African exchange is subject to securities transfer tax (STT), which is levied in terms of the Securities Transfer Tax Act, 2007 (the STT Act). In the context of providing shares as security by transferring ownership of the shares, the STT consequences are therefore an important consideration.

The STT Act contains various exemptions, including the so-called "collateral arrangement" exemption, which came into force on 1 January 2016. This exemption essentially provides relief in respect of collateral arrangements, ie, where an outright transfer of collateral of South African listed equities is executed in respect of an amount owed.

Before the introduction of the "collateral arrangement" exemption, the provision of security by transferring South African shares or shares listed on a South African exchange was subject to STT. The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2015 (which introduced the "collateral arrangement" exemption) (the 2015 EM), recognised that regulatory changes applying to the financial sector necessitated an urgent review of the tax treatment of collateral. It also referred to the benefits of an outright transfer of collateral as identified by the financial sector, including the "reduction of transaction costs and market pricing because of the ability to rehypothecate collateral and reduce tax costs; and making South Africa more attractive as an investment destination".

After the introduction of the "collateral arrangement" definition, certain amendments were effected to the definition with effect from January 2017 by –

- extending the 12-month limitation of a collateral arrangement to a 24-month limitation (ie, to extend the allowable period within which the identical shares are returned to the collateral provider by the collateral taker from the date on which the collateral arrangement was entered into);
- broadening the definitions of "identical share" and "identical security" to cater for other specified corporate actions; and
- including listed government bonds as allowable instruments on security lending and collateral arrangements.

Further changes were introduced with effect from January 2018 to extend the tax relief in terms of a collateral arrangement to include listed foreign government bonds to address concerns regarding the limited scope of tax relief in respect of the provision of collateral.

In the 2021 Budget Speech, which was delivered in February 2021, the matter of collateral arrangements was raised. The 2021 Budget Review stated that at issue was the rehypothecation of collateral (ie, where the collateral taker reuses collateral received for trading or as security for its own borrowing through a tax-neutral collateral arrangement).

It was 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.

These changes were promulgated in the 2021 Taxation Laws Amendment Act by introducing a proviso into the collateral

"Before the introduction of the 'collateral arrangement' exemption, the provision of security by transferring South African shares or shares listed on a South African exchange was subject to STT."

"The 2022 Budget Review stated that after reviewing the public comments on the Bill, government decided to postpone the effective date for these amendments to 1 January 2023 to give both National Treasury and affected stakeholders more time to consider the impact of the proposed amendments."

arrangement definition (the 2021 Proviso). In terms of the 2021 Proviso, a "collateral arrangement" will not include a transaction in terms of which the transferee (ie, the recipient of collateral) has subsequently transferred the listed share or bond contemplated in a manner other than a transfer contemplated in paragraphs *(a)* to *(e)* of the collateral arrangement definition (ie, a further "collateral arrangement") unless the listed share or bond is transferred for purposes of –

- a repurchase agreement entered into with the South African Reserve Bank as contemplated in section 10(1)*(j)* of the South African Reserve Bank Act, 1989;
- complying with Regulation 28 of the Pension Funds Act, 1956; or
- securing overnight cash placement to comply with the Basel III Supervisory Framework for measuring and controlling large exposures.

Of note is that the above proviso came into operation on 1 January 2023 and applies in respect of any collateral arrangements entered into on or after that date.

The 2022 Budget Review advised that the 2021 amendments were proposed to clarify that the use of collateral for purposes other than subsequent collateral arrangements or proposed limited regulated transactions is against the policy rationale for the introduction of these provisions, and could result in the avoidance of STT or capital gains tax. It did not provide details as to how the STT or capital gains tax is avoided because of the use of a collateral arrangement. The 2022 Budget Review stated that after reviewing the public comments on the Bill, government decided to postpone the effective date for these amendments to 1 January 2023 to give both National Treasury and affected stakeholders more time to consider the impact of the proposed amendments. Government proposed to review the impact of the 2021 amendments during the 2022 legislative cycle.

To the extent that changes were not made to the 2021 Proviso during the 2022 legislative cycle, from 1 January 2023, the collateral arrangement exemption only applies to the provision of collateral insofar as the recipient does not on-transfer the shares or on-transfers them in accordance with the exclusions in the 2021 Proviso. This means, *inter alia*, that where the collateral recipient is required to enforce the security by selling the shares, STT will be due and the recipient of the collateral will be on the line for the tax (and potential penalties and interest) in respect of the initial transfer of the shares as security to the collateral recipient. This will negate most of the benefits recognised in the 2015 EM as set out above.

Magda Snyckers

ENSafrica

Other documents

- Securities Transfer Tax Act 25 of 2007: Section 1 (definition of "collateral arrangement": paragraphs *(a)* to *(e)* & proviso);
- Taxation Laws Amendment Act 20 of 2021: Section 56;
- South African Reserve Bank Act 90 of 1989: Section 10(1)*(j)*.

Other documents

- Explanatory Memorandum on the Taxation Laws Amendment Bill, 2015;
- 2021 Budget Speech;
- Pension Funds Act 24 of 1956: Regulation 28;
- Basel III Supervisory Framework for measuring and controlling large exposures.

Tags: securities transfer tax (STT); collateral arrangement; tax-neutral collateral arrangement.

COLLECTION OF TAX DEBT FROM THIRD PARTIES

TAX ADMINISTRATION ACT

In a judgment of the High Court (*CSARS v Wiese and Others* (15065/17) [2022] ZAWCHC 188) on 9 September 2022, in a claim for declaratory relief against Dr Christo Wiese and the other parties, to declare them jointly and severally liable to pay an amount of R216.6 million, the court interpreted the meaning of the term "tax debt" when used in the context of the provisions for the recovery of tax debts from third parties in Part D of Chapter 11 of the Tax Administration Act, 2011 (the TAA).

The taxpayer, Energy Africa (Pty) Ltd (Energy Africa), was a company that was ultimately owned by Titan Premier Investments (Pty) Ltd (TPI).

Its only asset was a loan claim of R216.6 million owing by another company in the Titan group, Titan Share Dealers (Pty) Ltd (TSD), which Energy Africa distributed to its shareholder in anticipation of Energy Africa being assessed by SARS for capital gains tax and secondary tax on companies, which assessments were not disputed beyond the objection stage and became final. SARS alleged that Dr Wiese and the other parties each played a role (eg, as a director) in procuring the distribution by Energy Africa to its shareholder, in order to obstruct the collection of the capital gains tax and secondary tax on companies that were assessed by SARS.

The main issue in dispute between SARS and Dr Wiese and the other parties was that, at the time that Energy Africa distributed the loan claim of R216.6 million to its shareholder, no assessment had been made by SARS, and there was no "tax debt" in existence.

"The judgment has been appealed to the Supreme Court of Appeal, but it seems unlikely to succeed considering the compelling points made by the High Court."

TAX DEBT

A "tax debt" is defined in section 169(1) of the TAA as an amount which is due or payable to SARS in terms of a tax Act. Put differently, the taxpayer argued that a tax debt becomes due only once an assessment has been made by SARS.

The court rejected this argument, holding that the term "tax debt" carries a different meaning when considered in the context of section 183 of the TAA. When referred to in section 183 of the TAA, a tax debt could include an amount which the taxpayer anticipates will become due because of an assessment that will be issued by SARS.

Subsequent events (eg, the assessment – or a decision of the tax court, if there is a dispute) would establish that the taxpayer paid less than the full amount of tax that was due at the time when the return was filed.

SECTION 183 OF THE TAA

The court held that a contrary interpretation would also frustrate the intended purpose of section 183 of the TAA, which is to prevent taxpayers from dissipating their assets in order to obstruct the collection of tax by SARS, because taxpayers would then be free to rid themselves of their assets right up to the date that SARS makes an additional assessment for tax.

On the other hand, it could be argued that the proper approach, which is intended by the TAA, is for SARS to apply for a preservation order in terms of section 163 of the TAA in order to prevent the dissipation of assets on the grounds that such an order may be obtained if SARS has reasonable grounds to believe that a tax debt may be due.

The judgment has been appealed to the Supreme Court of Appeal, but it seems unlikely to succeed considering the compelling points made by the High Court.

Kyle Fyfe

Werksmans Attorneys

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 163, 169(1) (definition of "tax debt") & 183; Chapter 11: Part D (sections 179—184 ("Collection of tax debt from third parties")).

Cases

- *CSARS v Wiese and Others* (15065/17) [2022] ZAWCHC 188 (9 September 2022)).

Tags: secondary tax; additional assessment.

REDUCED ASSESSMENTS

As SARS is under ever-increasing pressure to optimise revenue collection from taxpayers, it can reasonably be anticipated that there will be a corresponding increase in disputes between SARS and taxpayers. Whilst many of the dispute resolution rules appear to be in favour of SARS, there are a few noteworthy taxpayer-friendly rules.

One such rule is that of section 93 of the Tax Administration Act, 2011 (the TAA), which allows the taxpayer, under certain circumstances, to request a reduced assessment from SARS.

This article explores the provisions of section 93, the provisions of prescription under section 99 of the TAA, the question as to why section 93 is a unique remedy in favour of the taxpayer and also the obstacles in applying it in practice.

Section 93 of the TAA empowers SARS to issue a reduced assessment to a taxpayer if –

- the taxpayer is successful in an objection or appeal;
- it is necessary to give effect to a settlement reached between SARS and the taxpayer;
- it is necessary to give effect to a judgment issued pursuant to an appeal;
- SARS is satisfied that there is a readily apparent undisputed error in the assessment by either SARS or by the taxpayer in a return;
- a senior SARS official is satisfied that the assessment was based on –
  - the failure to submit a return or submission of an incorrect return by a third party or by an employer;
  - a processing error by SARS; or
  - a return fraudulently submitted by a person not authorised by the taxpayer; or
- the taxpayer in respect of whom an estimated assessment has been issued requests SARS to make a reduced or additional assessment by submitting a true and full return or the relevant material within 40 business days from the date of assessment.

In October 2021 SARS issued a Draft Interpretation Note setting out its interpretation of the meaning of "readily apparent undisputed error" as referred to in section 93(1)*(d)* of the TAA.

Of critical importance is that SARS may issue a reduced assessment under section 93 even where no formal objection has been lodged against the assessment or appeal noted by the taxpayer.

A fundamental rule of tax law is that of prescription. In broad terms, prescription is a process which ends a right or a duty after a certain period of time has elapsed. Generally, once prescription applies, SARS is unable to reopen assessments that have prescribed and, similarly, taxpayers are unable to object against assessments that have prescribed. The purpose of prescription is to bring finality to assessments issued by SARS.

In terms of section 99 of the TAA, prescription generally applies to original and self-assessments as follows:

- Three years after the date of assessment of an original assessment by SARS;
- In the case of self-assessment for which a return is required, five years after the date of the assessment of an original assessment –
    - by way of self-assessment by the taxpayer; or
    - if no return is received, by SARS;

"Whilst the spirit and intention of section 93 is clear, the practical application of this section is fraught with the difficulties and obstacles outlined above. The legislation and practical application are not congruent and can often leave the taxpayer frustrated with red tape and procedure."

- In the case of a self-assessment for which no return is required, after the expiration of five years from the –
    - date of the last payment of the tax for the tax period; or
    - effective date, if no payment was made in respect of the tax for the tax period.

Taxes such as PAYE and VAT are classified as self-assessment taxes.

Section 99(2)*(d)* and *(e)* of the TAA provide that prescription will not apply where it is necessary to give effect to –

- the resolution of a dispute under objection or appeal;
- an assessment referred to in section 93(1)*(d)*, provided SARS became aware of the error referred to in that subsection before the expiry period for that assessment; or
- where SARS receives a request for a reduced assessment under the circumstances set out in section 93(1)*(e)* (failure to submit a return or incorrect return by a third party, processing error by SARS or a return fraudulently submitted by an unauthorised person).

Generally, prescription will not apply where the full amount of tax chargeable was not assessed due to fraud, misrepresentation or non-disclosure of a material fact.

Where prescription does not apply, the taxpayer may still request SARS to issue a reduced assessment in terms of section 93 of the TAA.

What this means in practice is that where assessments are older than three or five years, as the case may be, the taxpayer has no remedy to object or appeal against that assessment. At first glance, one might think that the dispute resolution process ends there, but this is not always the case where section 93 applies.

This is of considerable value to a taxpayer as an error in an assessment may only be identified in later tax years (for example, the taxpayer discovers a SARS processing error on its 2016 assessment whilst completing its 2022 income tax return). Under normal dispute resolution rules, the taxpayer will not be able to object against the 2016 assessment as that assessment has prescribed (as three years or more have elapsed since the date of the 2016 assessment). However, the taxpayer can still apply for a reduced assessment in terms of section 93 as one of the circumstances of paragraph (e) above applies (in this example, a SARS processing error).

THE PRACTICAL APPLICATION OF SECTION 93

On a practical level, SARS eFiling has a "dispute" work page where aggrieved taxpayers can submit their objection or appeal against the assessment or certain decisions made by SARS. The advantage of having this platform available on SARS eFiling is that comfort can be found that once the objection or appeal has been electronically submitted via the "dispute" work page, it will be automatically diverted to the correct division within SARS which will then consider the technical or substantive merits of the objection or appeal lodged.

However, there is no equivalent platform on SARS eFiling to submit a section 93 application. For example, should the section 93 application be submitted via the "dispute" work page on eFiling, the application is automatically rejected by SARS with the error message "Dispute more than 3 years after assessment or decision not allowed". In other words, the section 93 application is automatically rejected in terms of the rules of prescription notwithstanding the fact that in certain circumstances, as explained above, prescription does not apply.

The aggrieved taxpayer is then forced to consider other possible routes to submit its request for a reduced assessment. One option which may be considered is to email the section 93 request to SARS, or to submit it via the On-Line Query System on the SARS website. However, with both these options, the request is unlikely to be channelled to the correct division within SARS to effectively assess the validity of the section 93 application. There is a risk that the application simply gets lost in the SARS system. Even physical delivery of the application at a SARS branch office will also be rejected as dispute-related matters are usually not manually accepted by SARS branch offices.

Assuming the taxpayer does find a way to submit the application to SARS, a further obstacle arises. As section 93 applications are not governed by the rules that apply to objections or appeals, which are subject to very strict time limitations on both SARS and the taxpayer, the taxpayer cannot compel SARS to respond to the section 93 application within a certain period of time. This leaves the taxpayer at the mercy of SARS with numerous follow-up requests invariably required for SARS to process the application.

The taxpayer may also approach the SARS Complaints Management Office and, if there is no satisfactory outcome at that office, the taxpayer's last resort is to engage with the office of the Tax Ombud.

However, the Tax Ombud can only issue a non-binding recommendation to SARS regarding a service matter or a procedural or administrative matter arising from the application of a tax Act by SARS. The Tax Ombud has no mandate to address technical matters and is therefore precluded from addressing the technical substantive merits on which the request for the reduced assessment is based.

A POSSIBLE SOLUTION

Whilst the spirit and intention of section 93 is clear, the practical application of this section is fraught with the difficulties and obstacles outlined above. The legislation and practical application are not congruent and can often leave the taxpayer frustrated with red tape and procedure.

A simple remedy to address some of the obstacles discussed above is simply for the SARS eFiling system to be updated to include a platform which will allow section 93 applications to be electronically submitted. The taxpayer would then be in a position to know that the application has been successfully received by SARS and that it will be channelled to the correct division within SARS to deal with the substantive merits of the application.

Introducing this platform would ensure that the intention of the legislation and the rights of the taxpayer are equally balanced. It will also allow for easy administration and excellent service delivery as promised in the SARS Service Charter.

It is hoped that the submission of this recommendation to SARS will lead to the updating of the current system to help simplify the life of the taxpayer.

"Taxes such as PAYE and VAT are classified as self-assessment taxes."

Brigitte Zegwaard

BDO

Acts and Bills

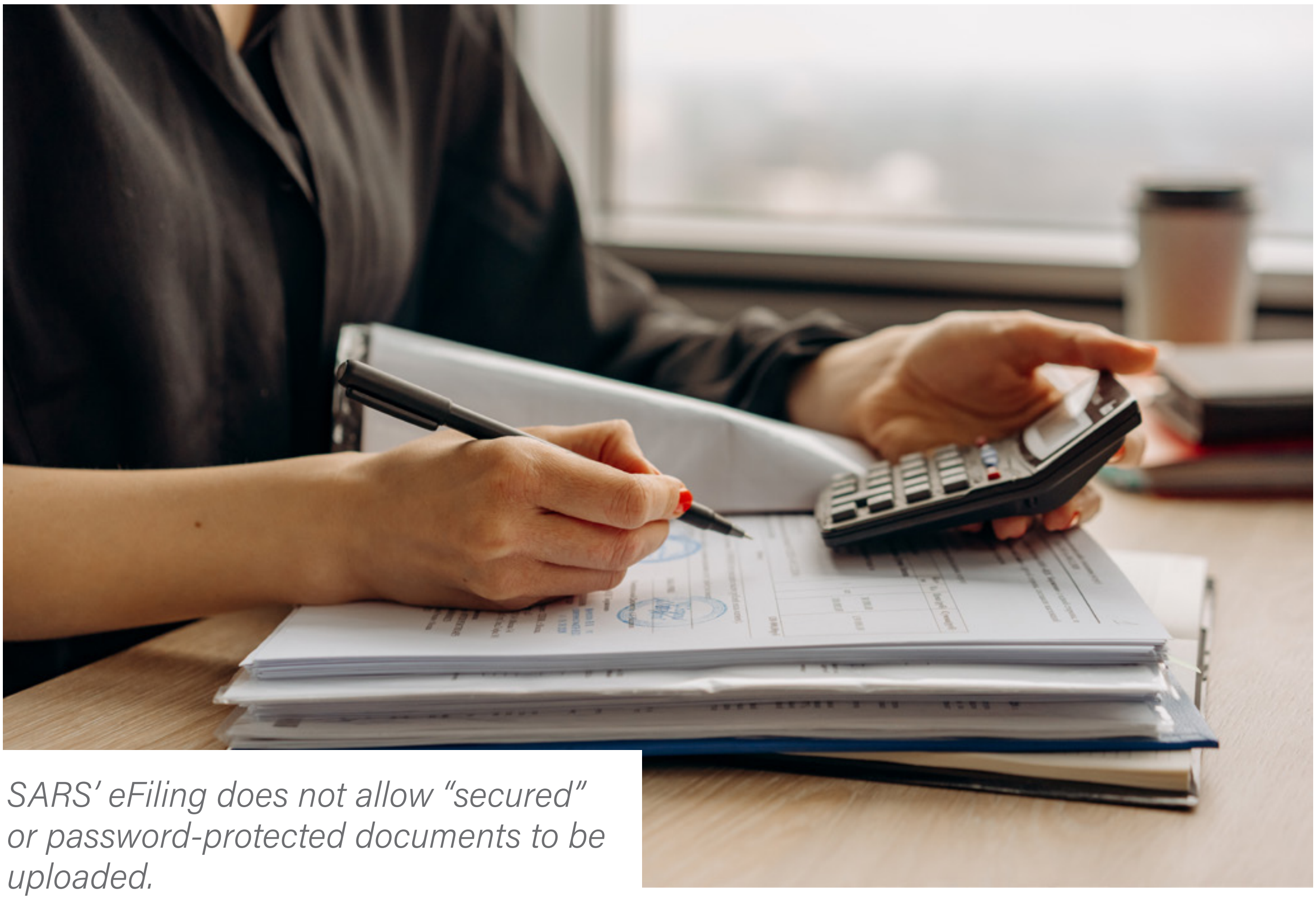
- Tax Administration Act 28 of 2011: Sections 93 (specifically subsection (1)*(d)* & *(e)*), 99 (specifically subsection (2)*(d)* and *(e)*).

Other documents

- Draft Interpretation Note issued by SARS in October 2021 ("Reduced assessments: meaning of 'readily apparent undisputed error'").

Tags: reduced assessment; readily apparent undisputed error; prescription; self-assessment taxes.

SUBMITTING SUPPORTING DOCUMENTS TO SARS



SARS' eFiling does not allow "secured" or password-protected documents to be uploaded.

Following SARS Commissioner Edward Kieswetter's announcement that he intends to rebuild SARS' enforcement capabilities, as part of SARS' quest to become the scourge of recalcitrant taxpayers, there has been a noticeable increase in requests from SARS for the submission of supporting documents.

However, thanks to eFiling, the days are long gone of having to photocopy reams of documents and pop them in the post, fervently praying that they will arrive at SARS' offices, reach the right department, and be received and logged within the 21 working-day window. For the past few years, any required documents can quickly be uploaded using eFiling.

"SARS' eFiling places no constraints on the number of pages contained within a single PDF, as long as the overall file size does not exceed 5MB."

Except, it is not always quite as simple as it might appear.

Whenever a tax return is submitted, one holds one's breath after clicking "Submit to SARS", while waiting for the assessment to be issued, hoping and praying that the box next to "Selected for Verification" contains an "N". If this is the case – once the assessment has been checked, the process is completed.

However, if the box contains a "Y", then it is a case of waiting for the verification request letter from SARS.

Of course, it would be helpful if SARS were to indicate on the letter which document(s) are required, but one often gets the equivalent of "we have got documents that you have not submitted, but we will not tell you what those documents are". [*Editorial comment*: Recent requests from SARS specify exactly the documents they require.]

In short, they simply say something along the lines of "send us all the documents you used in completing this return, as we want to verify these".

Now that is simple enough if one only has an IRP5 and certificates showing interest from one's bank, contributions towards one's retirement annuity, and membership of one's medical scheme. Not so simple if a taxpayer's tax affairs are a bit more complex.

There are also a number of constraints that the eFiling system imposes when it comes to uploading and submitting documents, namely:

- Documents must be in one of the following formats: pdf, doc, docx, xls, xlsx, gif, jpg, jpeg, bmp and png.
- Documents should not be empty, password-protected, or encrypted;
- Documents may not be more than 5MB per upload, and a maximum of 10 documents may accompany a single submission;
- Document names should not include the characters ' or &; and
- No more than 10 submissions are permitted against a given case number.

Nowadays, virtually all documents are sent electronically, usually in a PDF format. However, following the coming into operation in 2020 of the Protection of Personal Information Act, 2013 (POPI), most institutions are paranoid about electronic documents being intercepted in transit, with most of them being encrypted and/or password-protected.

Say, for instance, a taxpayer is required by SARS to submit many supporting documents (including the entire year's bank statements), most of which have some form of encryption or password protection. Passwords that are required to open documents are usually readily available, but to get the passwords to remove the encryption from documents from financial institutions is not that easy – different passwords are required for that exercise.

One solution may be to print out all the documents, then scan them. However, this is a huge waste of both time and paper. Furthermore, since scanned paper documents tend to create far larger file sizes than the original PDF that have to be printed out, there is a good chance of breaching SARS' 5MB limit.

To overcome this hurdle, one can scan the documents in smaller batches, but this means that one could end up with more than the 10 documents that are allowed by SARS to be uploaded. One would then have to submit as many documents as allowed, and wait for SARS to request the missing ones – this could be as many as 21 working days later!

There is, however, a far better solution, requiring just two pieces of software – one that is included as part of Windows, and the other one that is a free download.

REMOVING ENCRYPTION AND PASSWORDS FROM PDFS

To remove all encryption and passwords from any PDF, one does not need any specialised software. For Windows users, the functionality is built in as standard.

These are the steps to follow:

1. Open up the PDF by double-clicking it. For most Windows users, the PDF will open up either with Adobe Reader or Microsoft PDF Viewer.
2. If the PDF is password-protected, enter the password.
3. Once the document is opened, you will see the word SECURED to the right of the file name.
4. Click on the "print" icon or press Ctrl-P on the keyboard, and when the printer selection box appears, select "Microsoft Print to PDF" as the printer to use.
5. Click "print", and a box will open to make it possible to save the document. Choose an appropriate file location and enter a unique file name (an example of the format that can be used for "taxpayer Smith" is "*Smith, KLM – 2023 – Document (IT3B Bank Z*)"), and click "Save".
6. If the newly saved PDF is then opened up, one will notice that a password is no longer needed, and that any references to "SECURED" have been removed.
7. This new PDF can then be uploaded to SARS via eFiling.

COMBINING MULTIPLE PDFS INTO A SINGLE FILE

If one has multiple documents of a similar type to upload (for example, 12 months of bank statements or a number of IRP5 / IT3B / IT3C certificates), one might decide to combine the documents into a single file. SARS' eFiling places no constraints on the number of pages contained within a single PDF, as long as the overall file size does not exceed 5MB.

To do this, one needs to download a free piece of software called "PDFBinder" from https://pdfbinder.en.softonic.com/.

Once the site's URL has been entered into one's browser and the ubiquitous cookies have been accepted, one should click on the box marked "*Free Download for Windows*". An ad for other software will usually pop up, so be careful not to click on the big green "Download Now" button – instead, click on the link that states "*No thanks, continue to download PDFBinder*".

One will then need to click on the button marked "*Free Download for PC*", and one will then be taken to the page where the files are listed for download. The current version is "PDFBinder-v1.2.msi". Click on the file name, click "Save as", and select the location in which you want to save the file. The desktop is normally fine as it's a tiny file (about 1.7 MB).

Although the Softonic website is considered to be safe, for one's own peace of mind, it is advisable to scan the downloaded file with one's anti-virus software before installing the program. When installing, simply follow the prompts until complete – the software will now be ready for use.

One only needs to do this once, but if anyone is not comfortable loading software on a PC, virtually all computer shops will gladly do this at a relatively low cost.

Actually binding one's PDFs into a single document could not be easier.

1. Launch the software by clicking the shortcut icon (usually found on a desktop or by clicking the "start" icon).

2. Then click "Add file..." on the following screen. Navigate to the folder where the PDFs that one wants to upload are stored.

3. Select the files in the order in which one wants them to appear in the combined PDF. Each time a file is selected, one will return to the initial screen, and a list of the files that have been selected will be visible.

4. To add another file, click "Add file...'" and repeat the process until all the files needed have been selected.

5. If the files have been selected in an incorrect order, the up and down arrows will allow the order to be changed.

6. Once all the necessary files have been selected to be combined into a single PDF, click "Bind", navigate to the folder where the new PDF is to be saved, give it a new file name, and click "Save".

7. It will then be possible to upload the new combined PDF to SARS via eFiling.

PDFBinder will not allow users to bind PDFs that are secured and/or contain passwords (eFiling will in any case not allow the uploading of these). If one gets an error indicating that one of the files that are being selected is secured / contains a password, cancel out and remove the security from the file using "Microsoft Print to PDF" as described above.

Note: These two processes have been found to work fine on both Windows 10 and Windows 11. Unfortunately, for Apple users it is necessary to enlist some assistance from other Apple users.

"To remove all encryption and passwords from any PDF, one does not need any specialised software. For Windows users, the functionality is built in as standard."

Steven Jones

Acts and Bills

- Protection of Personal Information Act 4 of 2013.

Tags: verification request letter.

TRANSFER PRICING DISPUTES

*Tackling base erosion and profit shifting (BEPS) remains a priority for the National Treasury and the South African Revenue Service (SARS). It was reported on 22 September 2022 **(https://www.businesslive.co.za/fm/features/cover-story/2022-09-22-exclusive-the-truth-about-our-taxes/)** that in the 2021 fiscal year, SARS dealt with 345 cases of transfer pricing, base erosion and profit shifting to the value of almost ZAR12 billion.*

Yet, there have only been three transfer pricing matters which have been dealt with by the South African courts. In none of these cases, however, was it necessary for witnesses to testify about the impugned transaction. It follows that this limited transfer pricing jurisprudence does not deal with the evidentiary aspects that may necessarily arise in such a dispute.

A case in point is the evidentiary value of comparable transactions. A comparability analysis typically involves a comparison between the taxpayer's transaction and third-party transactions which are comparable. Taxpayers usually rely on such a comparison to show that they transacted at arm's length.

But in transfer pricing matters, SARS often rejects the taxpayer's benchmarking study (advanced in support of the arm's length nature of its transaction) and then issues an additional assessment based on its own analysis.

This raises a few interesting questions.

In *Africa Cash & Carry (Pty) Ltd v The Commissioner for the South African Revenue Service*, [2019], the taxpayer argued that the gross margin reconstructed by SARS (which formed the basis of SARS' estimated assessments) was too high when compared with that of Massmart, a similar type of business. The SCA noted *obiter* that evidence of Massmart's earnings was in the nature of similar fact evidence. Thus, it was incumbent on the taxpayer to prove (factually) that its comparison was valid. Although this dispute did not relate to transfer pricing, would the same considerations not apply in a transfer pricing dispute? If so, it is submitted that SARS must present factual evidence to show that its benchmark is valid.

Foreign case law has shown difficulties with this proposition. For example, in *Commissioner of Taxation v Glencore Investment Pty Ltd,* [2020], the Federal Court of Australia (the FCA) ruled that the process of examining agreements concluded by other parties, although necessary in a transfer pricing dispute, is an "unsatisfactory task". This is because, according to the court, a witness can only say so much about a contract with which he had nothing to do; so, their observations may amount to inadmissible "speculation" or "severe hearsay".

Similarly, in the *SNF (Australia) (Pty) Ltd v Commissioner of Taxation,* [2010], transfer pricing dispute, the FCA ruled that the testimony of some of the taxpayer's witnesses, who lead evidence about the comparable companies, was inadmissible hearsay.

"Tax Court Rule 44(2)*(a)* explicitly states that the normal rules of evidence, which include the rules about similar fact evidence, must be observed in the tax court."

Because of these difficulties, the FCA in the *Glencore* matter found that comparable contracts were no more than "reference points" or "illustrations of arm's length terms". But could South African courts also adopt such a practical approach?

Tax Court Rule 44(2)*(a)* explicitly states that the normal rules of evidence, which include the rules about similar fact evidence, must be observed in the tax court. In that instance, it would be incumbent on the party (whether SARS or the taxpayer) that relies on a benchmark to prove (factually) that its comparison is valid.

There is another aspect to consider. If SARS makes a transfer pricing adjustment to a taxpayer's taxable income by way of issuing an additional assessment, and such additional assessment is based on SARS' own benchmarking study, is the additional assessment an estimated assessment under section 95 of the Tax Administration Act, 2011 (as amended) (the TAA)? Section 95(1)*(b)* allows SARS to issue an assessment, based in whole or in part on an "estimate" if the taxpayer submitted a return or information that is, according to SARS, incorrect or inadequate.

Thus (or so SARS argues), it uses its study as a benchmark to estimate what it considers an arm's length consideration.

Interestingly, the OECD Transfer Pricing Guidelines and SARS' Practice Note 7 both state that transfer pricing methods are used to determine an "estimate" of an arm's length outcome.

If an assessment is an estimated assessment for purposes of section 95 of the TAA, the outcome is that the burden is on SARS, and not the taxpayer, to prove that the estimate is reasonable. But, if the onus is on SARS, does it have the duty to give evidence first? If coupled with the rules that apply to similar fact evidence, it may be difficult for SARS to prove, in the tax court, the basis of its additional assessment adjusting the taxpayer's taxable income.

More anomalies may be revealed as transfer pricing enforcement increases. These will supplement our existing case law and potentially compel the legislature to allow for carve-outs.

Dealing with tax disputes requires a multi-layered approach. This cannot be overemphasised in the context of transfer pricing. Engaging with SARS on these matters requires an in-depth knowledge of not only the legislative provisions but also the law of evidence.

These aspects must be considered from the beginning when SARS commences a transfer pricing audit. So, taxpayers should, from the commencement of a transfer pricing audit, consult and involve tax practitioners with knowledge of not only transfer pricing but also tax procedural law and the law of evidence.

Andries Myburgh & Simon Weber

ENSafrica

Acts and Bills

- Tax Administration Act 28 of 2011: Section 95(1)*(b).*

Other documents

- Tax Court Rule 44(2)*(a)*;
- OECD Transfer Pricing Guidelines;
- SARS' Practice Note 7.

Cases

- *Africa Cash & Carry (Pty) Ltd v The Commissioner for the South African Revenue Service* (783/18) [2019] ZASCA 148; [2020] (2) SA 19 (SCA) (21 November 2019);
- *Commissioner of Taxation v Glencore Investment Pty Ltd* [2020] FCAFC 187;
- *SNF (Australia) (Pty) Ltd v Commissioner of Taxation,* [2010] FCA 635.

Tags: comparable transactions; estimated assessments; normal rules of evidence; OECD Transfer Pricing Guidelines.

SALE OF MIXED-USE AND PARTIALLY TENANTED BUILDINGS AS GOING CONCERNS

Subject to certain exemptions and exceptions, value-added tax (VAT) is levied at the standard rate of 15% on the supply of goods or services by a vendor in the course or furtherance of the vendor's enterprise.

However, the supply of an enterprise or part of an enterprise as a going concern may be subject to VAT at the zero rate provided that certain requirements, as stipulated in section 11(1)*(e)* of the Value-Added Tax Act, 1991 (the VAT Act), are complied with.

In terms of section 11(1)*(e)*, the supply of an enterprise or part thereof which is capable of separate operation may be subject to VAT at the zero rate, provided that the seller and purchaser are both registered vendors; the supply consists of an enterprise or part of an enterprise capable of separate operation; the parties agree in writing that the supply is a going concern; the parties, at the conclusion of the agreement, agree in writing that the enterprise will be an income-earning activity on the date of transfer; the assets necessary for carrying on the enterprise are disposed of to the purchaser; and the parties agree in writing that the consideration for the supply includes VAT at the zero rate.

It follows that vendors selling mixed-use fixed property or partially tenanted fixed property need to properly consider their entitlement to apply VAT at the zero rate to the sale of such properties.

Mixed-use properties are properties used partly for making taxable supplies and partly for making non-taxable or exempt supplies, such as a building that has commercial or retail space on the ground floor and residential accommodation on the top floors. A partially tenanted property is a fully commercial property, but which is only partially tenanted, meaning that part of the property is vacant.

MIXED-USE PROPERTY

Where a building or property comprises taxable retail areas and exempt residential accommodation, notwithstanding that part of the property is used for exempt purposes, the supply of the entire property is deemed to be a taxable supply in terms of section 8(16) of the VAT Act. The proviso to section 11(1)*(e)* provides that, where goods are applied mainly for purposes of an enterprise, and partly for other purposes, the supply is deemed to form part of the enterprise, notwithstanding the proviso to the definition of "enterprise" in section 1(1) of the VAT Act, which excludes VAT-exempt activities. It must therefore be determined whether the vendor can show that the property is used "mainly" for the commercial enterprise, to determine whether the zero rate may be applied to the whole transaction in accordance with the proviso to section 11(1)*(e)*.

"In determining the application of the zero rate to partially tenanted properties, it is necessary to consider the 'income-earning' requirement applicable to the supply of a going concern as provided by section 11(1)*(e)*."

Section 11(1)*(e)* does not prescribe the basis upon which the use of the goods for making taxable supplies is to be determined. However, in VAT Interpretation Note 57 (IN57) ("Sale of an enterprise as part of a going concern" – 31 March 2010) of the South African Revenue Service (SARS), which provides some guidance on each of the "going concern" requirements, SARS indicates that "mainly", in this context, means more than 50%. IN57 provides an example which refers to "the area" of a property. From IN57, SARS seems to be of the view that where more than 50% of the floor space is used for commercial purposes, this indicates that a property is used mainly for taxable purposes.

Notwithstanding what appears to be SARS' view regarding the applicability of floor space when determining the use of fixed property, it is noted that SARS' interpretation notes are not law (see *Commissioner for the South African Revenue Service v Marshall NO and Others* [2017] (1) SA 114 (SCA)). The fact remains that the legislation in this instance does not prescribe the basis upon which the application of the goods disposed of should be determined, for the purpose of establishing whether the goods are used mainly for the purposes of the enterprise. It follows that any reasonable alternate method of measurement, for example, a measurement based on the extent of taxable versus exempt revenue derived from a property, is not excluded. In this regard it is noted, however, that in practice, SARS simply applies the principles as set forth in IN57 and, as such, generally only considers the floor space or area of a property and not the income derived from it, for purposes of determining its use or application. It seems that SARS will simply continue to apply this method of determination until such time as it is formally disputed or until IN57 is updated in this regard.

In order to achieve a middle ground, vendors in this instance could consider applying section 8(15) of the VAT Act. Section 8(15) provides for a supply to be apportioned between zero-rated and standard-rated components, where, if separate considerations had been payable, part of the supply would be subject to VAT at the standard rate and part at the zero rate.

A vendor could accordingly seek to apportion the selling price between the taxable retail space and exempt residential space, so as to enable VAT to be levied at the zero rate on the portion of the selling price attributable to the retail area of the property being sold. This is in line with IN57, which provides that if the goods are not used mainly for the purpose of the enterprise, then the portion of the consideration payable for the property which is used for carrying on the enterprise, qualifies for the zero rate in accordance with section 8(15), and VAT at the standard rate is therefore only payable on the consideration for the remaining part of the property.

PARTIALLY TENANTED PROPERTIES

In determining the application of the zero rate to partially tenanted properties, it is necessary to consider the "income-earning" requirement applicable to the supply of a going concern as provided by section 11(1)*(e)*.

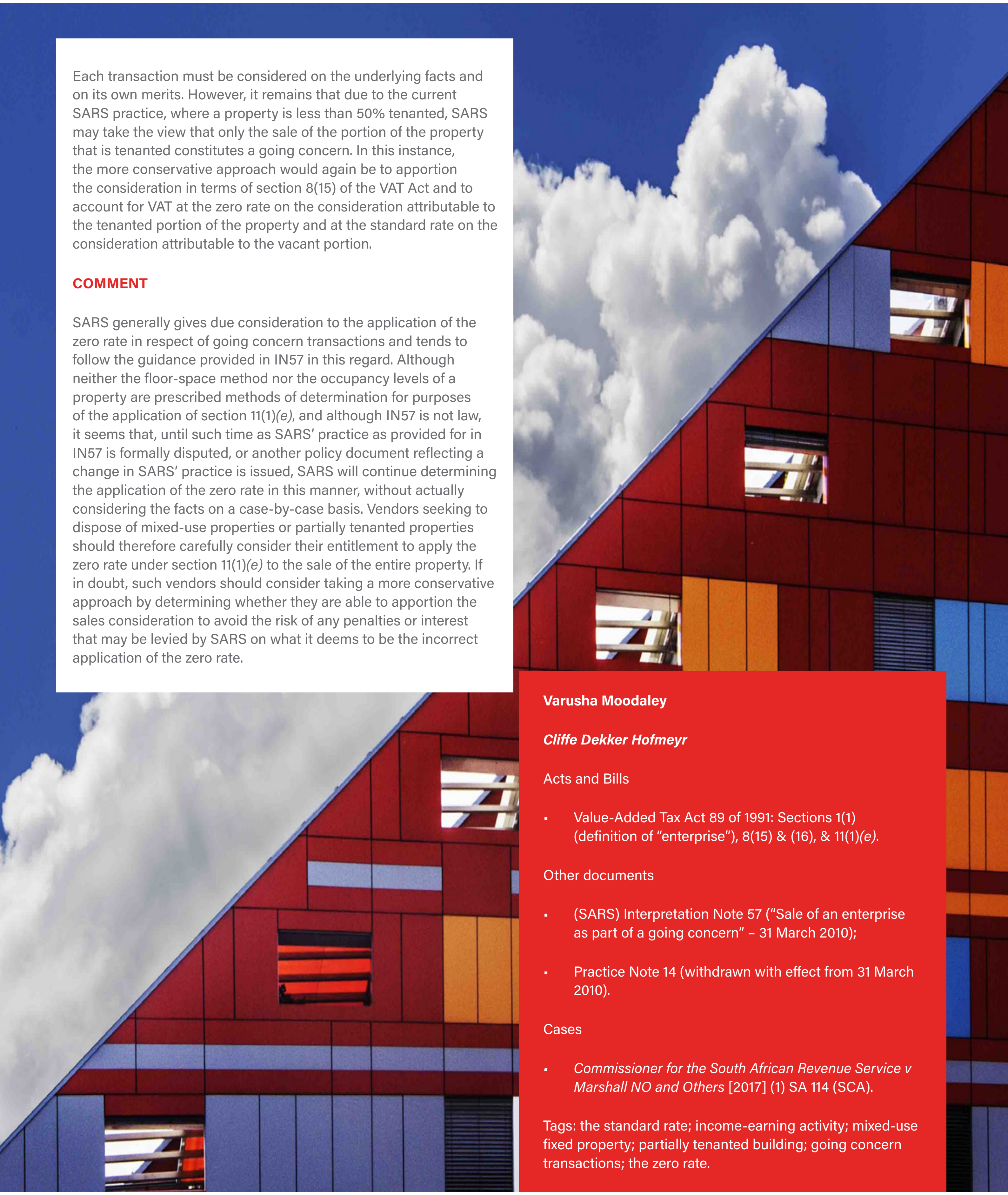
With regard to the income-earning requirement, and specifically leasing activities, IN57 stipulates that the supply of a leasing activity must consist of an underlying asset that is the subject of a lease, together with the contract of lease.

SARS has previously stated that a vendor that conducts a commercial leasing activity cannot sell the rental income-earning enterprise as a zero-rated going concern if the leases are terminated before the transfer takes place. This is because the vendor will only be selling a property and the income-earning activity is not supplied together with the property. It follows that where a vendor has a partially tenanted building with lease agreements in place in respect of only part of the property, it will have to be determined if the sale of the whole property constitutes an income-earning activity.

SARS initially indicated in its Practice Note 14 (withdrawn with effect from 31 March 2010), that a property could only be regarded as income-earning if tenanted 80% or more. SARS then subsequently stated that an occupancy level of more than 50% is accepted. The level of occupancy required for a leasing activity to be regarded as a going concern has, however, not been incorporated into IN57. Despite this, SARS still seems to apply the 50% occupancy level test in practice. It follows that where a property is more than 50% tenanted, SARS will generally accept this as being an income-earning letting enterprise which may be disposed of as a going concern at the zero rate.

In the case of *ITC 1622* [1996] 59 SATC 334 (N) the tax court was required to determine whether the sale of a property comprised the transfer of an enterprise as a going concern in terms of the provisions of section 11(1)*(e)*. Galgut, J stated that the question of whether the disposition in use was a going concern was a question of hard fact and depended on exactly what was sold. It follows that, notwithstanding what seems to be SARS practice regarding the occupancy levels, whether a letting enterprise is disposed of is a question of fact, and the occupancy level should merely be considered a guideline.

Consequently, it is arguable that a lower occupancy level at the time of transfer could also qualify as a letting enterprise if it can be substantiated that the occupancy level dropped due to exceptional or temporary circumstances, and the intention of the parties at the time of the conclusion of the agreement was to dispose of and acquire a letting enterprise, as opposed to disposing only of an asset. So, for example, even if a property is less than 50% tenanted at the time of transfer, where the property is commercial in nature, and the property is available for letting and actively marketed at the time of transfer, then, on the basis that it is the intention of the parties to dispose of and acquire a letting enterprise, and if the requirements of section 11(1)*(e)* are met, the zero rate should still apply.



Each transaction must be considered on the underlying facts and on its own merits. However, it remains that due to the current SARS practice, where a property is less than 50% tenanted, SARS may take the view that only the sale of the portion of the property that is tenanted constitutes a going concern. In this instance, the more conservative approach would again be to apportion the consideration in terms of section 8(15) of the VAT Act and to account for VAT at the zero rate on the consideration attributable to the tenanted portion of the property and at the standard rate on the consideration attributable to the vacant portion.

COMMENT

SARS generally gives due consideration to the application of the zero rate in respect of going concern transactions and tends to follow the guidance provided in IN57 in this regard. Although neither the floor-space method nor the occupancy levels of a property are prescribed methods of determination for purposes of the application of section 11(1)*(e)*, and although IN57 is not law, it seems that, until such time as SARS' practice as provided for in IN57 is formally disputed, or another policy document reflecting a change in SARS' practice is issued, SARS will continue determining the application of the zero rate in this manner, without actually considering the facts on a case-by-case basis. Vendors seeking to dispose of mixed-use properties or partially tenanted properties should therefore carefully consider their entitlement to apply the zero rate under section 11(1)*(e)* to the sale of the entire property. If in doubt, such vendors should consider taking a more conservative approach by determining whether they are able to apportion the sales consideration to avoid the risk of any penalties or interest that may be levied by SARS on what it deems to be the incorrect application of the zero rate.

Varusha Moodaley

Cliffe Dekker Hofmeyr

Acts and Bills

- Value-Added Tax Act 89 of 1991: Sections 1(1) (definition of "enterprise"), 8(15) & (16), & 11(1)*(e)*.

Other documents

- (SARS) Interpretation Note 57 ("Sale of an enterprise as part of a going concern" – 31 March 2010);
- Practice Note 14 (withdrawn with effect from 31 March 2010).

Cases

- *Commissioner for the South African Revenue Service v Marshall NO and Others* [2017] (1) SA 114 (SCA).

Tags: the standard rate; income-earning activity; mixed-use fixed property; partially tenanted building; going concern transactions; the zero rate.

TAX INVOICE DETAILS FOR ELECTRONIC SERVICES

A Public Notice was issued under section 20(5B) of the Value-Added Tax Act, 1991 (the VAT Act), prescribing the particulars that a tax invoice must contain for supplies made by electronic service providers.

Notice 1583 was issued in *Government Gazette* 45616 dated 10 December 2021 (Notice 1583) with the purpose of detailing the particulars that a tax invoice must contain if the supply by a vendor is in relation to electronic services as contemplated in paragraph *(b)*(vi) and (b)(vii) of the definition of "enterprise" in section 1(1) of the VAT Act.

Prior to the release of Notice 1583, the requirements of a tax invoice for an electronic services provider were contained in Binding General Ruling 28 (BGR 28). Per Notice 1583, the tax invoice will now need to reflect the VAT number of the recipient if the recipient is a registered VAT vendor. In addition, previously in terms of BGR 28, the recipient's address could also be an email address. Notice 1583 now limits the recipient's address to either a postal or physical address.

In terms of Notice 1583, the supplier of electronic services is required to issue a tax invoice in terms of section 20(5B); the invoice must contain, as a minimum, the following:

1. The name and VAT registration number of the electronic services supplier;
2. The name, address (physical or postal) and where the electronic services recipient is a vendor, the VAT registration number of the electronic services recipient;
3. An individual serialised number;
4. The date on which the tax invoice is issued;
5. A full and proper description of the electronic services supplied; and
6. The consideration in money for the supply in the currency of any country and if the consideration is reflected in the currency of—
    - the Republic —
        - the value of the supply; and
        - the amount of tax charged or a statement that the consideration includes a charge in respect of the tax and the rate at which the tax was charged; or
    - any country other than the Republic —
        - the amount of the tax charged in the currency of the Republic and the exchange rate used; or
        - a separate document issued by the electronic services supplier reflecting the amount of tax charged in the currency of the Republic and the exchange rate used.

"Prior to the release of Notice 1583, the requirements of a tax invoice for an electronic services provider were contained in Binding General Ruling 28 (BGR 28)."

The exchange rate to be used is required to be the —

- daily exchange rate on the date on which the time of supply occurs;
- daily exchange rate on the last day of the month preceding the time of supply; or
- monthly average rate for the month preceding the month during which the time of supply occurs.

The exchange rate must be the rate as published by —

- the South African Reserve Bank (www.resbank.co.za);
- Bloomberg (www.bloomberg.com); or
- the European Central Bank (www.ecb.europa.eu).

Charl Hall & Malan du Toit

Mazars

Acts and Bills

- Value-Added Tax Act 89 of 1989: Sections 1(1) (definition of "enterprise": Paragraph *(b)*(vi) and (vii)) & 20(5B).

Other documents

- Public Notice 1583 (issued in *GG* 45616 on 10 December 2021 in terms of section 20(5B) of the VAT Act, 1991);
- *Government Gazette* 45616 (dated 10 December 2021);
- Binding General Ruling 28.

Tags: VAT registration number; electronic services supplier; electronic services recipient.

UNDERSTANDING THE NATURE OF SERVICES SUPPLIED

In Rennies Travel Pty Ltd v Commissioner for the South African Revenue Service (20/2021) *[2022] ZASCA 83 (6 June 2022), the Supreme Court of Appeal (the SCA) was required to consider whether a certain commission derived by Rennies Travel, an entity conducting a travel agency enterprise, was subject to VAT at the standard rate or, alternatively, at the zero rate.*

The SCA considered the matter and noted that VAT is levied in respect of the supply of a service or a good. The meeting of a target is not a supply of services, and it must therefore be considered what was "supplied" by Rennies Travel in exchange for the Supplementary Commission. The SCA held that the Supplementary Commission was paid for the sale of a particular volume of international airline tickets by Rennies Travel and furthermore held that the fact that the same services gave rise to more than one type of consideration did not alter the nature of the services. The Appeal was therefore allowed.

In terms of the facts of the case, a part of the business of Rennies Travel is to make arrangements for international travel for its clients, including the sales of airline tickets for international flights. Rennies Travel derived the following sources of contractual income in this regard:

- A service fee charged to the client;
- A flat rate standard commission charged to an airline for the sale of an international airline ticket ("the Standard Commission"); and
- Additional or increased commission charged to an airline if a certain target is reached ("the Supplementary Commission").

Section 11(2)*(d)* of the Value-Added Tax Act, 1991, provides for the zero-rating of VAT in respect of a supply of services comprising the arranging of international transport of passengers.

SARS argued that the Supplementary Commission is subject to VAT at the standard rate and accordingly that VAT of approximately R8.6 million plus interest and penalties was due by Rennies Travel.

The tax court agreed with SARS and held that the Supplementary Commission had been paid for the supply of marketing services and promoting the sale of airline tickets – as distinguished from the zero-rated supply of services relating to the arranging of international transport. The tax court therefore held that the Supplementary Commission was subject to VAT at the standard rate.

On appeal, Rennies Travel maintained that it was providing only one service – which is the arrangement of international transport for individuals and, accordingly, that this should be zero-rated.

SARS, however, argued that the Supplementary Commission is a commission earned for reaching a target – not for arranging international transport.

This case illustrates the importance of understanding the nature of services supplied by an enterprise and distinguishing between a single contract with two supplies of services, as opposed to a contract relating to a single supply of services with two forms of consideration payable in respect of such supply of services. As is evident from the decision of the SCA, the VAT considerations in respect of these two scenarios may be vastly different.

"On appeal, Rennies Travel maintained that it was providing only one service – which is the arrangement of international transport for individuals and, accordingly, that this should be zero-rated."

Alexa Muller

PKF Cape Town

Acts and Bills

- Value-Added Tax Act 89 of 1991: Section 11(2)*(d)*.

Cases

- *Rennies Travel Pty Ltd v Commissioner for the South African Revenue Service* (20/2021) [2022] ZASCA 83 (6 June 2022).

Tags: VAT at the standard rate; zero-rating of VAT; supply of services.

sait South African Institute of Taxation