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COMPANIES
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INTERNATIONAL TAX
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CONTRIBUTED TAX CAPITAL

This article deals with the amendment of the concept of "contributed tax capital" (CTC) as defined in section 1(1) of the Income Tax Act, 1962 (the Act).

The following are some of the characteristics of CTC:

- CTC is a notional concept under the Act that might or might not arithmetically correspond to share capital;
- a distribution by a company to a shareholder is, under the Act, by default a dividend unless the directors specifically determine that the distribution is a reduction of CTC; and
- the maximum amount of CTC that can be reduced per share is the amount of CTC per share attributable to that class of shares.

As a reduction of CTC is not a dividend and is treated in the shareholder's hands as a reduction of the latter's base cost of the shares, a distribution out of CTC could be preferable as it avoids dividends tax where it would otherwise be payable. But if the distribution of CTC exceeds the base cost, the excess will be treated as a capital gain in the shareholder's hands. Accordingly it can be seen that different shareholders have different preferences, and under the law as it applied prior to amendment in 2022, it was possible to treat the distribution to some shareholders as a dividend and to others as a reduction of CTC.

As a consequence, the Act was amended in 2021 by section 4(1)*(c)* of the Taxation Laws Amendment Act, 2021 (only effective 1 January 2023), to eliminate this practice because of its tax avoidance potential. The amendment caused considerable consternation and in July 2022 a draft amended version of the amendment was published for comment.

THE 2021 AMENDMENT

The 2021 amendment effectively stated that no CTC could be returned unless all shareholders of that class received the same return of CTC. This was not such a problem when it came to a general distribution to shareholders, but serious problems could arise if shares were repurchased. In such case it would not be possible to treat the purchase price as a reduction of CTC because the non-selling shareholders were not getting anything, and therefore the requirement could not be met.

THE 2022 AMENDMENT

The July 2022 draft amendment sought to correct this problem by replacing these provisions with a new proposal that effectively stated that there could only be a payment out of CTC if all holders of the shares in that class to which transfers were made within a period of 91 days before or after the date of payment, were actually allocated an amount of CTC based on their proportional shareholding within that class. This was certainly an improvement, but obviously there could still be difficulties arising given the 182-day period during which all distributions had to be treated in the same way.

> "The 2021 amendment effectively stated that no CTC could be returned unless all shareholders of that class received the same return of CTC."

The Taxation Laws Amendment Bill, 2022, which was tabled in Parliament on 22 October 2022, included an amended version of the further proviso to the definition of CTC which was contained in the July 2022 draft amendment. This Bill was passed by Parliament, and the Taxation Laws Amendment Act, 2022, in section 41(1), now includes the new rules effective from 1 January 2023. The restriction is now that there can only be a transfer of CTC where, in relation to a particular class of shares –

- There is a distribution; or
- there is a share repurchase,

and each share receives the same amount of CTC per share and, in addition, the amount of CTC transferred per share cannot exceed the total amount of CTC for that class divided by the number of issued shares in that class.

The effect of this is that whenever there is a single event whereby amounts are distributed to shareholders, whether as a general distribution or by way of share repurchases, all shareholders participating in that event must receive an equal amount per share of CTC, failing which the entire amount will not be considered to be a reduction of CTC. So if, for example, there are several shareholders selling their shares to the company in terms of a single or indivisible transaction, all the shareholders must receive the same amount of CTC per share.

But, by way of example, if there is a specific share repurchase in relation to one shareholder and two months later there is another specific repurchase in relation to another shareholder, each could have different amounts of CTC received by them. Similarly, if the amount of CTC per share is R5 and a general distribution is made where all shareholders receive R2 per share and two months later there is a further general distribution, in the latter case the distribution of CTC could be R2.50 per share, or zero for that matter.

This would appear to deal with Treasury's and SARS' concerns without restricting too much the freedom of companies and their shareholders in their dealings with each other.

Ernest Mazansky

Werksmans Attorneys

Acts and Bills

- Income Tax Act 58 of 1962: Section 1(1) (definition of "contributed tax capital");
- Taxation Laws Amendment Act 20 of 2021: Section 4(1)*(c)*;
- Draft Taxation Laws Amendment Bill, 2022 (published on 28 July 2022): Clause 41(1);
- Taxation Laws Amendment Bill 26 of 2022: Clause 41(1);
- Taxation Laws Amendment Act 20 of 2022: Section 41(1).

Tags: contributed tax capital; reduction of CTC share repurchase.

RETURNS OF CAPITAL

The National Treasury published the Taxation Laws Amendment Bill, 2022, on 26 October 2022. Amongst others, clause 41(1) of this Bill includes an amendment that affects returns of capital.

This is the outcome of a process that started in 2021. The Bill was passed by Parliament without any amendment in December 2022, resulting in the promulgation of the Taxation Laws Amendment Act, 2022, in January 2023.

PRINCIPLES OF RETURNS OF CAPITAL

When a company makes a distribution to its shareholders, that distribution is either classified as a dividend or a return of capital for tax purposes. A return of capital is a distribution made from a company's contributed tax capital (CTC). CTC essentially consists of the amounts contributed to the company when it issued shares.

A shareholder reduces the base cost of shares held on capital account with any returns of capital received without disposing of the shares. If the return of capital exceeds the base cost, this results in a capital gain. Any returns of capital upon the disposal of shares form part of proceeds from the disposal.

Distributions that are not returns of capital are dividends. They are generally exempt from normal tax but subject to dividends tax. Some beneficial owners qualify for an exemption or a reduced rate of dividends tax.

SHAREHOLDER PREFERENCES

Depending on the shareholder, a dividend or return of capital may be more favourable. A resident company in whose hands a dividend is exempt from normal tax and dividends tax may prefer a dividend. A foreign person not subject to capital gains tax on the disposal of shares may prefer a return of capital. This escapes tax in South Africa. Persons subject to dividends tax could similarly prefer a return of capital. This reduces the base cost of their shares and does not have any immediate tax implications, unlike dividends.

Due to these preferences, companies elected to make distributions to some shareholders as returns of capital (from CTC) and others as dividends. The rules for returns of capital determine that a transfer of CTC to a specific shareholder may not exceed that shareholder's proportionate share of the company's overall CTC. This rule applies to each transfer. It did not prevent the company's CTC from disproportionate allocation to some shareholders as returns of capital and others as dividends over multiple transfers.

AMENDMENT

Two further restrictions on transfers from CTC aim to curb the above practice.

The first rule requires that a transfer may only be made from CTC if an equal amount is transferred to each share in respect of which the distribution is made. In the case of a distribution in the form of consideration paid for the acquisition, cancellation or redemption of a share, the same amount of CTC must be transferred to all shares in respect of which such consideration is paid.

The second restricts the amount of CTC transferred per share. This amount may not exceed the total CTC for the class divided by the total shares issued. It is unclear whether this second restriction will practically have any effect that the existing rule did not already achieve. It does not seem to.

The revised rules apply from 1 January 2023.

"The rules for returns of capital determine that a transfer of CTC to a specific shareholder may not exceed that shareholder's proportionate share of the company's overall CTC."

Pieter van der Zwan

Acts and Bills

- Taxation Laws Amendment Bill 26 of 2022: Clause 41(1);
- Taxation Laws Amendment Act 20 of 2022: Section 41(1).

Tags: return of capital; beneficial owners.

BUSINESS TRAVEL DEDUCTIONS

"Without a logbook, you will not be able to claim a travel deduction." (SARS Travel Logbook 2022/23)

Even while recovering from the economic impact of COVID and facing the challenges of power blackouts, businesses and their employees are also contending with the costs of travel that have reached historic highs. Fuel prices have more than doubled over the last five years and continue to set new records. In addition, Wesbank recently reported that the monthly cost of vehicle ownership for an average entry-level vehicle is 33% higher than five years ago and has increased 32% between November 2021 and November 2022.

Thankfully, expenses related to business travel can be deducted from taxable income – reducing the tax liability for taxpayers, including businesses, employees, commission-earners and independent contractors. All these taxpayers should prioritise maximising the available tax deductions by ensuring they can claim for every actual business travel-related expense. This is increasingly important given the rapidly rising costs referred to above.

To claim any business travel expenses, it is compulsory to keep an accurate and up-to-date SARS-compliant logbook for each vehicle. In addition, there are other tax implications related to travel expenses, travel allowances and travel reimbursements, some of which are briefly highlighted below.

Claiming the business travel deduction – fast facts

- Businesses can claim business travel expenses incurred in the production of income.
- Employees who receive a travel allowance can claim a deduction for the use of their private vehicles for business purposes.
- Employees may also be entitled to claim a reduction on the fringe benefit in respect of business kilometres travelled in a company car.
- To claim any travel deduction, an accurate, up-to-date logbook detailing all business kilometres travelled is required. SARS accepts electronic logbooks.
- There is no deduction allowed for private travel, which is any travel not for business purposes, including travelling between home and work.
- In addition to a logbook, taxpayers who want to claim actual travel expenses should keep accurate records and proof of all travel expenses, such as fuel and maintenance, incurred during the year.
- A separate logbook and records must be kept for each vehicle used for business purposes.
- SARS reserves the right to query and audit the content or information recorded in any logbook by the taxpayer.
- Logbooks and other records must be kept for at least five years as taxpayers may be required to submit them to SARS for verification of travel claims.

How to claim a business travel tax deduction

1. Record the vehicle's odometer reading on the first day of a tax year (1 March for individuals and also for companies).
2. Maintain the logbook all year – SARS requires the following minimum information for every single business trip: date of travel; kilometres travelled; and travel details including where the trip started, the destination and the reason for the trip. It is not necessary to record details of private travel.

3. Keep records of all related travel expenses such as fuel, oil, repairs and maintenance, car licence, insurance, vehicle tracking costs, wear-and-tear, toll road fees, parking fees at airports, and finance charges or lease costs to claim the actual travel costs incurred.

4. Record your motor vehicle's closing odometer reading on the last day of the applicable tax year (end of February for individuals and also for many companies). The difference between the opening odometer reading and the closing odometer reading equals the total kilometres (business and private) travelled for the full year.

5. Calculate the total business kilometres for the year using the detailed logbook.

6. The travel deduction can then be calculated in one of two ways:

   - Use the cost scale table supplied and updated annually by SARS, if an accurate record of all travel expenses has not been maintained – the table simply provides a rate per kilometre based on the value of the vehicle; or
   - Calculate the claim based on actual costs incurred, determined by the accurate records and proof of all business travel expenses during the year, in addition to the logbook.

"To claim any travel deduction, an accurate, up-to-date logbook detailing all business kilometres travelled is required. SARS accepts electronic logbooks."

Tax implications to beware of

- If an employee receives a travel allowance as part of his/her remuneration, 80% of the travel allowance must be included when calculating PAYE. This percentage is reduced to 20%, where the employer is satisfied that at least 80% of the motor vehicle use during the tax year will be for business purposes.

- However, if there is any underpayment of PAYE on the travel allowance due to incomplete or incorrect information, the employer is liable for any PAYE shortfall, so employers should obtain professional advice before providing travel allowances and ensure employees with travel allowances keep detailed logbooks.

- Fuel costs can only be claimed by an employee if the employee pays the full cost of fuel used in the vehicle, and similarly, maintenance costs can only be claimed if the employee carries the full cost of maintaining the vehicle, for example, if the vehicle is covered by a maintenance plan.

- Where a travel allowance or advance is based on the actual distance travelled by the employee for business purposes (reimbursive travel allowance), it is non-taxable (ie, no employees' tax must be deducted) provided that two criteria are met: the rate per kilometre is not higher than the rate published by SARS (464 cents per kilometre from 1 March 2023), and no other compensation in the form of an allowance or reimbursement (except parking or toll fees) is received in respect of the vehicle.

- If the two criteria mentioned above are not met, the reimbursive travel allowance is taxable and employees' tax must be deducted from any amount that exceeds the prescribed rate per kilometre.

To maximise the tax deductions related to business travel, it is important that taxpayers maintain an accurate and up-to-date SARS-compliant logbook that is kept current for each vehicle and each employee with a travel allowance, and that the many tax implications for all concerned before making decisions regarding business travel are clearly understood.

Crowe

Other documents (not legislation or cases)

- *SARS Travel Logbook 2022/23.*

Tags: business travel-related expense; travel allowance; rate per kilometer; reimbursive travel allowance.

INTRA-GROUP LOANS

In January 2023, the South African Revenue Service (SARS) provided taxpayers with a long-awaited final version of Interpretation Note 127 (IN 127): "Determination of the taxable income of certain persons from international transactions: intra-group loans".

IN 127 provides guidance as to how SARS will apply the amended provisions of section 31 of the Income Tax Act, 1962 (the Act), to intra-group loans. This has been highly anticipated as, since the withdrawal of Practice Note 2 (withdrawn for years of assessment commencing on or after 1 April 2012), there has only been a draft interpretation note in place since 2013. This resulted in uncertainty for taxpayers as to how SARS would interpret some aspects of section 31 of the Act.

The finalised IN 127 provides guidance on the application of the arm's length principle in the context of the pricing of intra-group loans and covers several aspects, including transactions that qualify as affected transactions, the question as to who qualifies as connected persons and associated enterprises as well as the factors which SARS will consider to determine whether the arm's length principle has been complied with.

SARS emphasises in the Media Statement relating to IN 127 that it will act sternly to protect the fiscus if the parties are found to have acted at variance with the arm's length principle.

Some of the key issues covered in IN 127 are briefly summarised as follows:

Arm's length

Paragraph 5 of IN 127 states that SARS will consider a taxpayer's debt to be non-arm's length if, amongst other factors, some or all of the following circumstances exist:

- The taxpayer is carrying a greater quantity of debt than it could sustain on its own (that is, it is thinly capitalised).
- The duration of the lending is greater than would be the case at arm's length.
- The repayment, interest rate, or other terms are not what would have been entered into or agreed to at arm's length.

No "safe harbour" rules have, however, been introduced.

IN 127 indicates that both direct and indirect funding is included in the ambit of section 31 and includes guarantees provided by a party to support a borrower's credit.

Thin capitalisation

In applying the arm's length principle, SARS requires taxpayers to consider a transaction from the perspective of the borrower and the lender.

"IN 127 indicates that both direct and indirect funding is included in the ambit of section 31 and includes guarantees provided by a party to support a borrower's credit."

Accordingly, an arm's length amount of debt for a borrower with a healthy balance sheet and excess cash reserves may be nil and such a loan will fall within section 31 if the borrower cannot show a business need or reason or commercial benefit for obtaining the relevant loan.

Advanced pricing agreement

In terms of IN 127, although no advanced pricing agreement process is in place as yet, SARS is considering the introduction of an APA process.

The newly released IN will provide taxpayers with some comfort and certainty going forward.

Vanessa Turnbull-Kemp

Regan van Rooy

Acts and Bills

- Income Tax Act 58 of 1962: Section 31.

Other documents

- Interpretation Note 127 *("Determination of the taxable income of certain persons from international transactions: intra-group loans")*: Paragraph 5;
- Practice Note 2 *("Income Tax: Transactions in credit instruments which are issued at a discount")* – withdrawn for years of assessment commencing on or after 1 April 2012.

Tags: intra-group loans; arm's length principle; thin capitalisation.

REQUIREMENTS FOR SECTION 18A RECEIPTS

In a world buffeted by extreme weather events and social upheaval, assessing the performance of corporates has undergone a paradigm shift.

No longer are financial ratios the only measure of success, as both customers and investors test the impact of companies on stakeholders beyond the shareholder. Customers and investors now also assess what have become known as a company's environmental, social and governance (ESG) credentials.

Companies, as organisations designed for profit maximisation, do not necessarily have the mandate or capacity to actively engage in ESG initiatives in an effective manner. A valuable tool available to corporates to address their selected ESG priorities, is the ability to fund organisations that undertake specific or general activities for the public good.

South Africa's tax system includes a special dispensation for organisations which do not have a profit motive and instead are solely or mainly aimed at undertaking activities for the public good. Public benefit organisations (PBOs) approved by the South African Revenue Service (SARS) are exempt from income tax in recognition of the fact that the income of such entities is being applied to fund activities for the public good, in a manner akin to the government's use of tax revenues.

An important feature of the PBO regime when considering ESG, is that it enables companies to provide donor funding for their selected ESG priorities and receive a tax deduction for this expenditure. This is the case where the PBO to which the company donates has been approved by SARS in terms of section 18A of the Income Tax Act, 1962 (the Act), and issues the donor with a valid section 18A receipt for the donation.

On 18 November 2022, SARS, in a draft notice, proposed that additional information be included on section 18A receipts for them to constitute valid receipts entitling the relevant donors to a deduction. Members of the public had until 5 December 2022 to provide SARS with comments on the proposed augmentation of the section 18A receipt requirements. The final notice (Notice 3082) was issued by SARS on 24 February 2023 in *Government Gazette* 48104.

SOUTH AFRICA'S DEDUCTIBLE DONATION REGIME

It is noteworthy that not only SARS approved PBOs are capable of issuing section 18A receipts. Other institutions that may do so include amongst others the Government of the Republic of South Africa, a SARS approved institution, board or body, and certain specified United Nations entities. However, PBOs are the most prevalent issuers of section 18A receipts and present the most utility for the pursuit of ESG targets by companies.

To be approved as a PBO under section 30 of the Act, the applicant must satisfy, inter alia, the following requirements:

- The entity must be a non-profit organisation, trust or non-profit company, or a branch of a similar entity established in another jurisdiction where it benefits from an income tax exemption;
- the sole or main object of the entity is the carrying on of one or more public benefit activities (PBAs), as listed under the Ninth Schedule to the Income Tax Act;
- all PBAs are carried on in a non-profit manner and with altruistic or philanthropic intent;
- no activity of the entity is intended to promote the economic self-interest of any fiduciary or employee of the entity directly or indirectly, otherwise than by way of reasonable remuneration payable to that fiduciary or employee; and
- each PBA is carried on by that entity for the benefit of, or is widely accessible by, the general public.

An organisation that meets the above requirements and makes an application to SARS for approval as a PBO may be granted tax-exempt status regarding its income. However, this does not enable the PBO to receive donations that are deductible by the donor. To be able to do so, the PBO must additionally be approved for the purposes of section 18A.

Section 18A enables PBOs and other selected entities to issue receipts to donors entitling such donors to a deduction of the amount of their donation. The core requirement for approval under section 18A is that the PBO carries on PBAs noted in Part II of the Ninth Schedule or otherwise approved by the Minister of Finance by notice.

The broad categories of the PBAs listed in Part II of the Ninth Schedule are:

- Welfare and humanitarian;
- healthcare;
- education and development;
- conservation, environment and animal welfare; and
- land and housing.

Where a donor has made a donation to an organisation entitled to issue a section 18A receipt, that donor is entitled to a deduction of the amount donated (subject to prescribed limits) upon submission of a valid section 18A receipt issued by the organisation.

AMENDMENTS TO SECTION 18A RECEIPTS REQUIREMENTS

The requirements for a valid section 18A receipt are contained in section 18A(2) and are as follows:

- The reference number of the PBO or other approved entity issued by SARS for the purposes of section 18A;
- the date of the receipt of the donation;
- the name of the PBO or other approved entity which received the donation, together with an address to which enquiries may be directed in connection with the donation;
- the name and address of the donor;
- the amount of the donation or the nature of the donation (if not made in cash);
- a certification to the effect that the receipt is issued for the purposes of section 18A, and that the donation has been or will be used exclusively for the object of the PBO or other approved entity in carrying on the relevant PBA; and
- such further information as the Commissioner for SARS may prescribe by public notice.

In its notice of 24 February 2023, SARS indicated that the following information would be added to the requirements for a valid section 18A receipt:

- Donor nature of person (natural person, company, trust, etc.);
- Donor identification type and country of issue (in case of a natural person);
- Identification or registration number of the donor;
- Income tax reference number of the donor (if available);
- Contact number of the donor;
- Email address of the donor;
- A unique receipt number; and
- Trading name of the donor (if different from the registered name).

COMMENT

The ability for companies to select or even create an independent organisation with a specified mandate targeting that company's ESG priorities is a useful mechanism that allows corporates to directly link the utilisation of funds or assets donated by them, with positive public outcomes. The availability of a tax deduction for this expenditure (which may not have otherwise constituted deductible expenditure) is a strong incentive to utilise this avenue to attain a company's ESG goals.

The amendments proposed to the information to be contained in section 18A receipts may be aimed at augmenting the administration of the section 18A regime, as greater information regarding the donor noted on a section 18A receipt would increase the ease with which SARS administers the regime.

Greater transparency in this instance can also be in the donor's interest, as it provides corporates with a verifiable means to highlight their ESG spend. The proposed changes would provide a third-party document, which the donating company could choose to use to fly its ESG flag high.

Tsanga Mukumba & Louis Botha

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 18A (with emphasis on subsection (2)) & 30; Ninth Schedule: Part II.

Other documents

- Section 18A receipts (receipts issued for donations to qualify for deduction of donations tax);
- Draft Notice issued by SARS on 18 November 2022;
- Notice 3082 issued by SARS on 24 February 2023 in *Government Gazette* 48104 ("Further information required in terms of section 18A(2)*(a)*(vii) for purposes of a receipt issued under section 18A(2)*(a)* of the Income Tax Act 58 of 1962").

Tags: environmental, social and governance (ESG) credentials; public benefit organisations (PBOs); public benefit activities (PBAs); tax-exempt status.

BONA FIDE INADVERTENT ERROR

Tax law is often difficult to interpret and frequently the South African Revenue Service (SARS) and the courts hold a different view from that of a taxpayer and its advisers.

A consequence for taxpayers in South Africa is the understatement penalty (USP), which may be imposed by SARS based on certain criteria set out in the Tax Administration Act, 2011 (the TAA). USPs are based on a matrix of possible taxpayer behaviours. However, before enquiring into the matrix, there are two preliminary possibilities of relief.

The first is that in respect of a USP levied for a "substantial understatement", the USP must be remitted where, at the relevant time, the taxpayer had an opinion by an independent registered tax practitioner which confirmed the correctness of that taxpayer's tax treatment of the tax position (albeit later proven wrong), in compliance with the requirements of section 223 of the TAA.

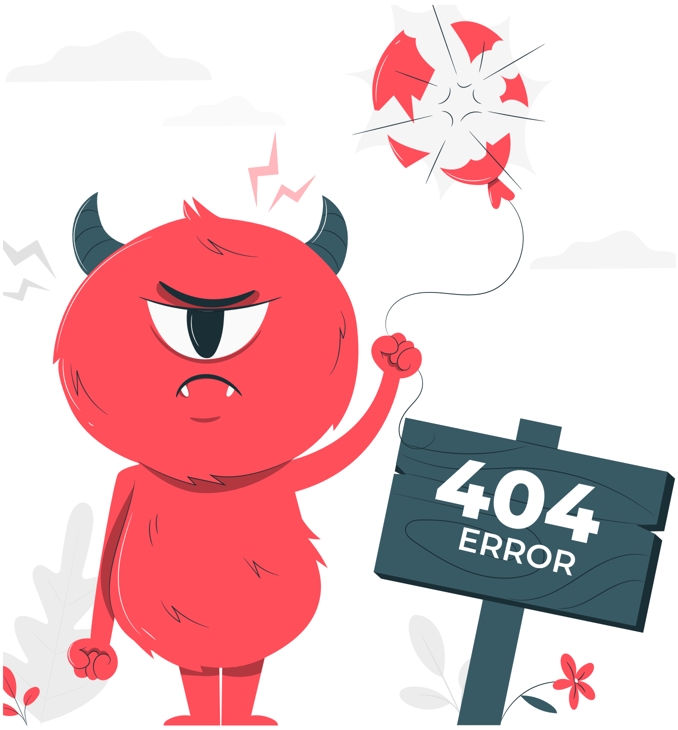
"The ruling significantly widens the ambit of the defence of *bona fide* inadvertent error and may serve as support for future taxpayer arguments against the levying of USPs in appropriate circumstances."

The second is where the understatement results from a "*bona fide* inadvertent error", in which case a USP cannot be imposed. So far, in practice, this has been interpreted extremely narrowly, for example, in instances of computation error and an escape from understatement penalties based on the "*bona fide* inadvertent error" defence that appears to only be accepted by SARS in very limited circumstances.

THE THISTLE TRUST CASE

In the case of *Commissioner, South African Revenue Service v The Thistle Trust,* [2022] (the *Thistle Trust* case), which dealt with the tax treatment of amounts distributed by a trust (the Taxpayer) to its beneficiaries, there were two pertinent questions before the Supreme Court of Appeal (SCA), one of which is relevant to USPs.

The first question was whether the capital gains which arose as a result of disposals by various South African trusts were taxable in the hands of the Taxpayer being a trust itself (because such amounts were distributed by those trusts to the Taxpayer) or taxable in the hands of the Taxpayer's beneficiaries (because those amounts received by the Taxpayer were distributed thereafter by the Taxpayer to its beneficiaries). In this regard, the SCA held in favour of SARS, namely that the amounts were taxable in the hands of the Taxpayer and not in the hands of its beneficiaries.



The second question, the Taxpayer having lost on the merits, dealt with the USP. In this regard, SARS had imposed a 50% USP on the Taxpayer for understating its taxable capital gains in light of the Taxpayer's treatment of the amounts it received. The USP was imposed on the basis that, in terms of section 223, the Taxpayer had "no reasonable grounds for the tax position taken".

It should be noted that it was common cause that the Taxpayer had obtained a legal opinion which had been sought by another entity within the group of entities in which the Taxpayer found itself.

In respect of the USP, SARS initially adopted the position that, in the light of the legal opinion, it should be concluded that the Taxpayer had consciously and deliberately adopted the position it took when it elected to distribute the amounts of the capital gains as it did. SARS was accordingly of the view that the Taxpayer's actions (and the understatement) were not as a result of a *bona fide* inadvertent error. (It is unclear from the judgment whether the legal opinion to which the Taxpayer had access was an opinion in terms of section 223.)

Although SARS adopted the initial view that the Taxpayer's actions were deliberate, and imposed the USP based on this view, during the argument SARS conceded that the understatement by the Taxpayer resulted from a *bona fide* inadvertent error and that the Taxpayer's actions in understating its taxable capital gains were unintentional. In this regard, the SCA, in expressly commenting that the SARS concession was indeed correct, stated as follows:

> "... during the argument before us, counsel for SARS conceded, correctly, that the understatement by the Thistle Trust was a *bona fide* and inadvertent error as it had believed that s 25B was applicable to its case. Though the Thistle Trust erred, it did so in good faith and acted unintentionally. In the circumstances, it was conceded that SARS was not entitled to levy the understatement penalty."

Although the court found that SARS correctly raised the additional assessments and the relevant amounts were taxable in the Taxpayer's hands, the court held that SARS was not entitled to levy a USP because the Taxpayer's understatement arose as a result of a *bona fide* inadvertent error.

CONCLUDING THOUGHTS

This judgment constitutes a significant confirmation by the SCA that reliance on legal advice (even if proven incorrect) can justify the finding of a *bona fide* inadvertent error. Within the USP regime, this is a first line of defence for a taxpayer, before any analysis of whether the behaviour of that taxpayer falls into one or the other of the penalty categories in section 223, and regardless of whether the opinion it obtained complied with section 223.

The ruling significantly widens the ambit of the defence of *bona fide* inadvertent error and may serve as support for future taxpayer arguments against the levying of USPs in appropriate circumstances.

"Although SARS adopted the initial view that the Taxpayer's actions were deliberate, and imposed the USP based on this view, during the argument SARS conceded that the understatement by the Taxpayer resulted from a *bona fide* inadvertent error and that the Taxpayer's actions in understating its taxable capital gains were unintentional."

Robert Gad & Taryn Solomon

ENSafrica

Acts and Bills

- Income Tax Act 58 of 1962: Section 25B;
- Tax Administration Act 28 of 2011: Section 223.

Cases

- *Commissioner, South African Revenue Service v the Thistle Trust* [2022] ZASCA 153; 2023 (2) SA 120 (SCA) (7 November 2022).

Tags: understatement penalty (USP); substantial understatement; bona fide inadvertent error; additional assessments.

SARS' DEBT RECOVERY OPTIONS

In terms of section 169(1) of the Tax Administration Act, 2011 (the TAA), any amount of tax due or payable under a tax Act is a tax debt due to the South African Revenue Service (SARS).

The court in *Commissioner, South African Revenue Service v Wiese and Others*, [2022], held that in circumstances where the objective and purpose of the TAA is to hold a third party liable, a section 80J(1) notice is sufficient to give rise to a tax debt recoverable by SARS as contemplated in section 183 of the TAA.

Has the court in *Wiese* extended the scope of what constitutes a "tax debt"? Or is the judgment a warning to taxpayers and advisors alike that the courts have little sympathy for tax advisors who provide "aggressive" tax advice that frustrates SARS' ability to collect taxes?

THE FACTS

Energy Africa Proprietary Limited, the taxpayer in the matter, sold its shares and claims in Energy Africa Holdings (Pty) Ltd (EAH) to Tullow Overseas Holdings BV on 25 January 2007, pursuant to a restructure that was undertaken by the Tullow Group during January 2007 (the transaction).

On 16 November 2012, SARS issued a notice in terms of section 80J(1) of the Income Tax Act, 1962 (the Act) to the taxpayer notifying it of SARS' intention to apply the general anti-avoidance rules (GAAR) and adjust its 2007 assessment. This was pursuant to an audit that was conducted into the taxpayer's tax affairs.

According to SARS, the taxpayer was liable for capital gains tax (CGT) and secondary tax on companies (STC) of R453 million and R487 million, respectively, on the basis that the transaction amounted to, amongst other things, an impermissible tax avoidance arrangement as defined in section 80L of the Act.

On 15 April 2013, the taxpayer addressed a letter to SARS, disputing any tax liability under the "substance over form" doctrine, alternatively under the GAAR provisions contained in the Act.

According to the taxpayer, the main purpose of the transaction was not to obtain a "tax benefit", as contemplated in section 80A of the Act. As such, the taxpayer was of the view that the Commissioner was not entitled to invoke the provisions of section 80B of the Act.

Notwithstanding this, on 21 August 2013, SARS addressed a finalisation of audit letter to the taxpayer in terms of which the taxpayer's additional income tax liability for the 2007 year of assessment was fully described (finalisation letter).

In terms of the finalisation letter, an additional assessment was raised by SARS for CGT of R453 126 518 on the disposal of the EAH shares, and an understatement penalty of R679 689 777 was imposed.

The only asset that the taxpayer had during all relevant times was a loan claim against Titan Share Dealers Proprietary Limited for R216,6 million (loan claim).

On 19 April 2013, prior to the issuing of the finalisation letter, the taxpayer disposed of its only asset by making a distribution to its sole shareholder, Elandspad Investments Proprietary Limited (Elandspad). Elandspad, in turn, immediately distributed the asset to Titan Premier Investments (Pty) Ltd (TPI), its holding company. It was SARS' view that this was done by the individual defendants cited and that they also arranged for the sale of the shares in the taxpayer to Friedshelf 1395 (Pty) Ltd.

In September 2013, the taxpayer replied to the finalisation letter and advised SARS, *inter alia*, that it did not have any cash or assets and could not pay the disputed tax.

On 24 October 2014, SARS was informed that the taxpayer was dormant and in April 2016 the taxpayer was finally wound up by an order of the High Court.

Accordingly, SARS sought an order from the court declaring the defendants liable, jointly and severally, to pay to SARS the amount of R216,6 million in terms of sections 183 and 184 of the TAA. This was on the basis that the defendants knowingly caused, or assisted in causing, the taxpayer to dissipate the loan claim by declaring and transferring it as a dividend *in specie* to its holding company, Elandspad, which in turn declared and transferred the loan claim as a dividend *in specie* to its own holding company, TPI.

QUESTION OF LAW

The question before the court was the meaning of the term "tax debt", as contemplated in sections 183 and 169 of the TAA, and specifically whether SARS is required to issue an assessment to create a tax debt before invoking section 183. This issue (along with another) was considered as a separate point of law and the question was thus not whether the defendants were liable in terms of section 183.

KEY ARGUMENTS RAISED BY SARS AND THE DEFENDANTS

SARS argued that section 183 finds application in circumstances where an assessment is anticipated, and adopting a contrary interpretation would negate or seriously undermine the purpose of the section and could lead to "absurd consequences".

The defendants, on the other hand, argued that a "tax debt", properly construed, requires SARS to issue an assessment to the taxpayer before it can invoke the provisions of section 183.

The defendants submitted that a distinction needs to be drawn between when a debt is owing, due, or payable (in the context of the phrase "due and payable") and enforceable by SARS. It was contended that a contingent liability is not a debt and as such a contingent tax liability cannot qualify as a "tax debt" under section 183.

JUDGMENT

In determining this question, the court noted that the point of departure must be the language of the provision itself, read as a whole, and its context and purpose.

In terms of section 183:

> "If a person knowingly assists in dissipating a taxpayer's assets in order to obstruct the collection of a tax debt of the taxpayer, the person is jointly and severally liable with the taxpayer for the tax debt to the extent that the person's assistance reduces the assets available to pay the taxpayer's tax debt."

The court noted that the object of section 183 was to hold person(s) jointly and severally liable if they knowingly assisted in dissipating a taxpayer's assets in order to obstruct the collection of a tax debt. The provision, therefore, applies to parties other than the taxpayer.

Section 183 falls under Chapter 11 of the TAA, which covers Part A to F under the main heading "*Recovery of Tax*".

The court held that on a purposive reading, section 169(1) of the TAA informs the meaning of the phrase "tax debt" within the provisions of Chapter 11. Accordingly, the term "tax debt" in section 183 of the TAA must be read through the prism of section 169 of the TAA. The phrase, "debt due to SARS" is used in the heading of section 169 and, section 169(1) refers to an amount that is "due or payable".

The court further held that it would be "unbusinesslike but will also emasculate the very purpose of the TAA as a whole" to require an assessment to first be issued before there is a "tax debt" for purposes of section 183. This would mean that a third party could knowingly assist a taxpayer to dissipate their assets until the day before an assessment is issued by SARS.

The court also confirmed that, reading section 183 with section 169, a tax debt that is "due and payable", will not lead to two irreconcilable constructions. In this regard, the court relied on the judgment handed down in *Singh v Commissioner, South African Revenue Service,* [2003], in order to conclude that the assessing of a taxpayer to tax is to retrospectively render the tax due and payable when it ought to have been paid, ie, a tax debt exists irrespective of whether the taxpayer or SARS has made an assessment.

The court quoted a passage from the Singh judgment to elucidate this point:

> "… an amount is due when the correctness of the amount has been ascertained either because it is reflected as due in the taxpayer's return or because the circumstances set out in section 32(5) had been applicable (in both of which cases it is both due and payable) or if there is a dispute after the procedures relating to objection and appeal have been exhausted (in which case the amount so ascertained was due and payable with the return)."

The court, therefore, held that the amounts for CGT and STC that were subsequently assessed by SARS were already owing by the taxpayer at the time of the dissipation. SARS did not have to issue an assessment to establish the tax debt. The court noted that the debt existed irrespective of whether the taxpayer or SARS made an assessment.

COMMENT

It is no secret that the *Wiese* case has a unique set of facts. The court's interpretation of what constitutes a "tax debt" seems to widen the net for liability to ensure that SARS' efforts at recovering tax that is "due and payable" are not frustrated by clever timing, so to speak. It clearly seeks to ensure that a person who knowingly assists a taxpayer to dissipate assets before an additional assessment is raised is treated the same as a person who does so after the assessment is raised. However, how far in the future will tax advisors have to look when restructuring the tax affairs of their clients to ensure that there is no reduction of assets that could have been used for the settlement of a potential liability in the future, somewhere?

In *Top Watch (Pty) Ltd v Commissioner for SARS,* [2018], the court also relied on *Singh* and found that tax is due or payable when it has been assessed, in the context where SARS wanted to set off VAT refunds against an alleged outstanding tax debt. What is interesting is how contradicting these judgments appear to be, notwithstanding the fact that both cases relied on *Singh* to come to their conclusions.

It will be interesting to see how in the main hearing, the court will dissect the remaining requirements contained in section 183. In this regard, for a person to be held liable, jointly and severally with the taxpayer for its tax debt, that person must –

- knowingly assist;
- in the dissipation of the taxpayer's assets;
- in order to obstruct the collection;
- of the tax debt; and

- the person's assistance must reduce the assets available to pay the taxpayer's tax debt.

Although the court's interpretation of what constitutes a "tax debt" in section 183 of the TAA may cause some whiplash, taxpayers should not lose too much sleep, as the remaining requirements are a question of fact and are likely more difficult for SARS to prove. Seeing that SARS is the *dominus litis* in the matter, it might have an uphill battle trying to prove liability on the part of the defendants. The matter, therefore, merely may assist SARS in using section 183, but still requires them to prove a number of things before the section can be applied.

"The court in *Commissioner, South African Revenue Service v Wiese and Others*, [2022], held that in circumstances where the objective and purpose of the TAA is to hold a third party liable, a section 80J(1) notice is sufficient to give rise to a tax debt recoverable by SARS as contemplated in section 183 of the TAA."

Puleng Mothabeng

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 32(5), 80A, 80B & 80J(1);
- Tax Administration Act 28 of 2011: Chapter 11 (Recovery of tax (Parts A to F) – sections 169 to 186); more specifically sections 169(1), 183 & 184.

Other documents

- Section 80J(1) notice.

Cases

- *Commissioner, South African Revenue Service v Wiese and Others* 2023 (1) SA 119 (WCC); (15065/17);
- *Singh v Commissioner, South African Revenue Service* 2003 (4) SA 520 (SCA); 65 SATC 203;
- *Top Watch (Pty) Ltd v Commissioner for SARS* 80 SATC 448; [2018] ZAGPJHC 466 (11 June 2018).

Tags: tax debt; general anti-avoidance rules (GAAR); secondary tax on companies (STC); debt due to SARS.

SARS RISK-SPECIFIC LETTERS TO COMPANIES

On 16 September 2022, SARS announced that the supplementary (IT14SD) declaration for companies and close corporations was to be removed.

In its place, SARS has introduced a new risk-specific letter for corporate taxpayers requesting relevant information and documentation, based on the reason the taxpayer was selected for verification.

The IT14SD required a detailed reconciliation between income tax, VAT, PAYE and customs declarations (if applicable). The new risk-specific letters do not require such reconciliation.

Since the discontinuation of the IT14SD, numerous risk-specific letters have been issued by SARS demonstrating a trend of the typical information that is requested by it. Below is a summary of the most commonly encountered queries.

In all cases, SARS requires the signed annual financial statements, which must include a detailed income statement, as well as the detailed tax computation and the underlying supporting documentation/tax schedules (for example, a "taxpack"). This is a standard request and applies to all taxpayers that are selected for verification.

SARS requires the following:

- For taxpayers in a loss situation, detailed reasons for the loss that was incurred.
- For taxpayers in a refund situation:
    - Reasons for the overpayment of provisional tax; and
    - If a 3rd provisional tax payment was made, reasons why there is a discrepancy between the estimated taxable income and the actual final taxable income.

"The IT14SD required a detailed reconciliation between income tax, VAT, PAYE and customs declarations (if applicable). The new risk-specific letters do not require such reconciliation."

- In relation to the total expenses incurred by the taxpayer:
  - A detailed income statement together with comparative figures; and
  - In respect of the three largest expenses in the income statement, or where expenses exceed income by 50% or more, SARS requires an explanation for the incurral of the expense and reason/s why the expense is considered to be tax deductible.
- Where the taxpayer has submitted a claim in relation to future expenditure (ie, a section 24C allowance):
  - Confirmation that the income received in advance was included in taxable income;
  - The actual section 24C calculation; and
  - Copies of the applicable contracts in respect of which the section 24C allowance was claimed.
- Where a taxpayer has submitted a foreign tax rebate or foreign tax deduction claim:
  - All supporting foreign tax certificates; and
  - A breakdown between local and foreign taxable income together with associated tax computation adjustments.
- Where the taxpayer has an interest in a controlled foreign company (CFC):
  - A calculation of the imputed taxable income;
  - A list of all CFCs;
  - Where there is no imputation of foreign income, proof that the CFC did not realise income for the current year; and
  - A completed IT10B for each CFC of the taxpayer.
- If any donations were claimed as a tax deduction, all supporting section 18A tax certificates for each donation claimed.
- Where the tax computation includes any recoupment of wear and tear:
  - A detailed asset register;
  - An historical schedule since the date of acquisition of the asset to the date of disposal of the asset reflecting both the depreciation and wear and tear claimed on the asset; and
  - A detailed calculation of the recoupment.
- Where the taxpayer has submitted a claim for wear and tear:
  - A detailed asset register; and
  - A detailed calculation of the wear and tear claimed.

SARS allows 30 days for the response to the letter to be submitted. A further extension can be applied for, subject to a maximum of 90 days (ie, 120 days in total).

If the response is not submitted timeously, SARS has been known to raise additional assessments simply disallowing expenses claimed. The additional assessments, in most cases, also include a penalty for under-estimation of provisional tax, as well as interest on the underpayment of provisional tax.

Should this occur, the taxpayer will be required to object against the additional assessment and in most cases, also submit a request for the suspension of the payment of tax, pending the outcome of the objection lodged.

Taxpayers are therefore well advised to ensure that, as a minimum, they have the standard information on hand at the time of submitting their annual income tax return in the event that they are selected for verification by SARS. Taxpayers are also well advised to ensure that the response to the SARS verification letter is submitted timeously in order to prevent entering into the dispute resolution process with SARS.

In some instances, risk-specific letters are issued by SARS with questions. Some of these cannot be correctly answered, based on the trade carried on by the taxpayer or because the questions appear to be nonsensical and almost unrelated to the taxpayer selected for verification.

Brigitte Zegwaard

BDO

Acts and Bills

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

Other documents

- Supplementary (IT14SD) declaration for companies and close corporations;
- Section 18A tax certificate;
- New risk-specific letter for corporate taxpayers requesting relevant information and documentation;
- IT10B document.

Tags: risk-specific letters; foreign tax rebate; foreign tax deduction; foreign tax certificates; depreciation and wear and tear.

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