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COMPANIES
SHARE BUYBACKS

TAX ADMINISTRATION
LIMITS TO RIGHT OF DISCOVERY

VALUE-ADDED TAX
INPUT TAX: HOLDING COMPANIES

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SHARE BUYBACKS

The tax implications of share buybacks by companies are complex for both the company and its shareholders, and harsh penalties may be levied for non-compliance.

Companies frequently buy back their own shares for a variety of reasons, such as to return surplus funds to shareholders or to enable shareholders to exit the company. The tax implications can be complex, both for the company and the shareholder.

OVERVIEW OF THE COMPANIES ACT PROVISIONS DEALING WITH SHARE BUYBACKS

The definition of "distribution" in section 1 of the Companies Act, 2008, includes a share buyback. Under section 46, before a company can make a distribution, the directors must authorise it and be satisfied that the company will reasonably meet the solvency and liquidity test in section 4 immediately after completing the proposed distribution. Section 48 provides that the board of a company may determine that it will acquire a number of its own shares. A subsidiary may acquire its holding company's shares, but all such subsidiaries, taken together, may not hold more than 10% of any class of the holding company's shares. The subsidiary may not exercise any voting rights in respect of the shares in question. Once shares of a company have been bought back, they are restored to the status of shares that have been authorised but not issued under section 35(5).

IMPACT ON THE COMPANY

While the Companies Act defines a distribution to include a share buyback, the Income Tax Act, 1962 (the Act), does not contain a definition of "distribution". This was not always the case. Before the introduction of dividends tax, paragraph 74 of the Eighth Schedule to the Act contained a definition of "distribution" which included a share buyback. However, it was deleted by the Taxation Laws Amendment Act, 2011. The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2011, noted that the term "distribution" would be clarified "as to whether the term includes both dividends and return of capital or simply one kind of distribution". Sadly, to date no such clarification has been forthcoming, let alone a clarification as to whether a share buyback was intended to be included in paragraph 75. Given that the definition of "dividend" clearly distinguishes between a distribution (paragraph *(a)*) and a share buyback (paragraph *(b)*), it is doubtful whether the word "distribution" in paragraph 75 includes a buyback. In statutory interpretation there is a presumption that, unless the context otherwise indicates, words in a statute are used consistently. (See *ITC 1420* (1986) 49 SATC 69 (T) at 74.) A distribution is thus more likely to refer to a transfer of cash or an asset for which there is no *quid pro quo*. For CGT purposes, a buyback is simply a sale, with the proceeds being equal to the value of the shares acquired. When the company and the shareholder are connected persons, paragraph 38 requires that the proceeds be equal to the market value of the asset being disposed of.

Upon acquisition, the company's shares will comprise an asset for an instant before being extinguished through merger, since it cannot hold shares in itself (see *Grootchwaing Salt Works Ltd v Van Tonder* [1920]). This extinction is treated as a non-disposal under paragraph 11(2)*(b)* of the Eighth Schedule to prevent the creation of an artificial capital loss.

A holding company can acquire its own shares by way of a distribution from a subsidiary, but in this instance paragraph 75 will trigger a disposal at market value on the date of distribution with attendant CGT consequences for the subsidiary. If the subsidiary can be liquidated or deregistered, it could distribute the shares through a "liquidation distribution" under section 47 of the Act (see Binding Private Ruling (BPR) 336). In this way, the subsidiary will not have to account for a capital gain or loss on disposal of the shares under paragraph 75 and the holding company will simply acquire them at the base cost to the subsidiary for an instant before they are restored to the status of authorised capital. Securities transfer tax will not be payable by virtue of the exemption in section 8(1)*(a)*(v) of the Securities Transfer Tax Act, 2007 (the STT Act), on either the distribution, or, it is submitted, on the immediate extinction of the shares, since there would be no change of beneficial ownership. (See definition of "transfer" in section 1 of the STT Act.)

IMPACT ON THE HOLDER OF SHARES

From the perspective of the holder of shares, a share buyback is a sale and hence a disposal under paragraph 11(1)*(a)*. The amount received or accrued will consist of a dividend or a return of capital or both, depending on whether the company uses any part of its contributed tax capital (CTC) to buy back its shares. Any dividend element is first included in gross income before being exempt under section 10(1)*(k)*(i) and hence excluded from proceeds under paragraph 35(3)*(a)*. The return of capital paid out of the company's CTC will thus comprise the proceeds, unless the shares were held as trading stock and the amount received or accrued on their disposal is of a revenue nature, in which case paragraph 35(3)*(a)* will reduce the proceeds for CGT purposes to nil. Section 9C will render the amount received or accrued on the disposal of qualifying shares held as trading stock to be of a capital nature if they have been held for at least three years.

Importantly, the directors must pass a resolution confirming any payment out of CTC before the buyback, otherwise the payment will be a dividend (see paragraphs *(a)(bb)* and *(b)(bb)* of the definition of "contributed tax capital" in section 1(1) of the Act). Under the proviso to the definition of "contributed tax capital" , a shareholder may not participate in the CTC beyond that holder's pro rata share. For example, if there are 100 shares in issue and R1 000 of CTC, each share may not be allocated more than R10.

In the context of listed shares, the definition of "dividend" in section 1(1) contains an exception to the requirement to split the consideration for the buyback between its dividend and CTC elements. It provides that a share buyback will not comprise a dividend when the company buys back its shares on the open market, referred to as a "general repurchase" under the JSE Limited Listings Requirements or equivalent rules under another exchange. This rule was inserted because the shareholder would be unaware that it was the company buying back the shares and so would not be in a position to split the consideration between its dividend and return of capital elements. However, when a listed company conducts a "specific repurchase" from all its shareholders, the consideration will have to be split into its component parts.

For non-resident companies, the split of the buyback consideration is based on the definitions of "foreign dividend" and "foreign return of capital" in section 1(1) of the Act, and not on the definition of "contributed tax capital".

The definition of "foreign dividend" excludes an amount paid or payable that constitutes a redemption of a participatory interest in a collective investment scheme referred to in paragraph *(e)*(ii) of the definition of "company" in section 1(1). The effect of this exclusion is to treat the full redemption consideration as proceeds, unless the amount is of a revenue nature.

ANTI-AVOIDANCE RULES

When a share buyback consists primarily of a dividend, the result will usually be a capital loss as a result of the reduction in proceeds under paragraph 35(3)*(a)*, which requires proceeds to be reduced when the amount in question is included in gross income (paragraph *(k)* of the definition of "gross income" includes a dividend and a foreign dividend). Under paragraph 19 this capital loss must be disregarded to the extent that it does not exceed any exempt dividends. An exempt dividend is one that is exempt from both dividends tax and normal tax under section 10(1)*(k)*(i) (local dividend), 10B(2)*(a)* (participation exemption for foreign dividends), *(b)* (country-to-country exemption for foreign dividends) or *(e)* (distribution *in specie* from a listed share). In the context of local dividends, paragraph 19 would generally apply to a resident corporate shareholder for which the dividend is likely to be exempt from dividends tax and normal tax. Paragraph 19 will not apply to the extent that paragraph 43A applies.

Paragraph 43A treats a corporate shareholder as having additional proceeds when it disposes of shares in a company (including by way of a share buyback) and it held a "qualifying interest" in that company at any time during the 18 months prior to the disposal. A "qualifying interest" is defined in paragraph 43A(1) as, in relation to shareholdings in listed companies, at least 10% and, in relation to unlisted companies, at least 50% or 20% when no one else together with connected persons holds the majority of the shares. The shareholder is deemed to have proceeds equal to any exempt dividends comprising extraordinary dividends in respect of the shares. An exempt dividend is exempt from both dividends tax and normal tax under section 10(1)*(k)*(i) and section 10B(2)*(a)* or *(b)*. An extraordinary dividend is defined separately in relation to a preference share and any other share. In relation to any other share, it means so much of any dividend received or accrued –

- within a period of 18 months prior to the disposal of that share; or
- in respect, by reason or in consequence of that disposal,

as exceeds 15% of the higher of the market value of that share at the beginning of the period of 18 months and at the date of disposal of that share.

Although a share buyback falls within the second bullet point, it seems that the dividends falling within both bullets must be aggregated, given the reference to "any dividend" in the opening words.

Section 22B contains rules equivalent to those in paragraph 43A in respect of shares held as trading stock.

BUYBACK FROM EMPLOYEES AND DIRECTORS

When a share buyback involves employees or directors who acquired equity instruments contemplated in section 8C, the dividend element of the share buyback will not qualify for exemption. This is the broad effect of provisos *(dd)*, *(jj)* and *(kk)* to section 10(1)*(k)*(i).

REPORTABLE ARRANGEMENTS

A company that buys back shares from one or more shareholders for an aggregate amount exceeding R10 million and which issued or is required to issue any shares within 12 months of the buyback is required to report the arrangement to SARS (see GN 140 in *GG* 39650 of 3 February 2016). Failure to report the arrangement attracts substantial monthly penalties under section 212 of the Tax Administration Act, 2011. These penalties start at R50 000 a month for the participant and R100 000 for the promoter and run for 12 months, and depending on the magnitude of the tax benefit, are doubled or tripled.

CONCLUSION

The buyback by a company of its own shares has been characterised by many aggressive tax avoidance arrangements, necessitating some complex anti-avoidance rules and harsh penalties for the non-reporting of reportable arrangements. Being acquainted with the provisions affecting share buybacks is essential if costly mistakes are to be avoided.

This article was first published in *ASA November 2021*.

"When a share buyback involves employees or directors who acquired equity instruments contemplated in section 8C, the dividend element of the share buyback will not qualify for exemption."

Duncan McAllister

Webber Wentzel

Acts and Bills

- Income Tax Act 58 of 1962:
  - Section 1(1) (definitions of "company" (particularly paragraph *(e)*(ii)), "contributed tax capital" (particularly paragraphs *(a)(bb)* & *(b)(bb)* and the proviso to the definition), "dividend" (paragraphs *(a)* & *(b)*), "foreign dividend", "foreign return of capital" & "gross income" (paragraph *(k)*);
  - Sections 9C, 10(1)*(k)*(i) (particularly provisos *(dd), (jj)* and *(kk)* to subparagraph (i)), 10B(2)*(a), (b)* & *(e)*, 22B, 35(3)*(a)* & 47 (particularly definition of "liquidation distribution" in subsection (1));
  - Eighth Schedule: Paragraphs 11(1)*(a)* & (2)*(b)*, 19, 35(3)*(a)*, 38, 43A (particularly definition of "qualifying interest" in subparagraph (1)), 74 (definition of "distribution" (deleted by Act 24 of 2011)) & 75;
- Tax Administration Act 28 of 2011: Section 212;
- Companies Act 71 of 2008: Sections 1 (definition of "distribution"), 4, 35(5), 46 & 48;
- Securities Transfer Tax Act 25 of 2007: Sections 1 (definition of "transfer") & 8(1)*(a)*(v);
- Taxation Laws Amendment Act 24 of 2011;
- Taxation Laws Amendment Bill, 2011.

Other documents

- Explanatory Memorandum on the Taxation Laws Amendment Bill, 2011;
- Binding Private Ruling 336 ("*Liquidation distribution*"), dated 6 December 2019;
- JSE Limited Listings Requirements (particularly the terms "general repurchase" and "specific repurchase");
- GN 140 in *GG* 39650 of 3 February 2016: "*Public notice listing arrangements for purposes of sections 35(2) and 36(4) of the Tax Administration Act, 2011*".

Cases

- *ITC 1420* (1986) 49 SATC 69 (T) (at 74);
- *Grootchwaing Salt Works Ltd v Van Tonder* [1920] AD 492.

Tags: share buybacks; disposal at market value; liquidation distribution; securities transfer tax; contributed tax capital; foreign dividend; foreign return of capital; qualifying interest.

DEDUCTION OF INCOME TAX AND CGT WHEN CALCULATING ESTATE DUTY

The net value of an estate for estate duty purposes may be reduced by income tax, capital gains tax (CGT) payable on the sale of assets by the executor, and income tax on the sale of trading stock.

In 1789 Benjamin Franklin said that "in this world nothing can be said to be certain, except death and taxes". He was right about death but anyone who has had to interpret our tax laws would know that the task is fraught with uncertainty. This article examines whether income tax (including CGT) can be deducted from the net value of an estate for estate duty purposes.

The net value of a deceased estate under the Estate Duty Act, 1955 (the EDA), as referred to in section 4, is equal to the total value of all property included in the estate under section 3, less the deductions specified in section 4. Section 4A provides that the dutiable amount of the estate is equal to its net value less an abatement of R3.5 million. The abatement is increased by any portion of a previously deceased spouse's abatement that was not used. In terms of paragraph (1)*(a)* of the First Schedule to the EDA, estate duty is levied at a rate of 20% on the first R30 million of the dutiable amount and at 25% above that amount.

For income tax purposes, a person's year of assessment comes to an end on the date of death and a new entity, the deceased estate, comes into existence. [*Note*: In terms of paragraph *(b)* of the definition of "person" in section 1(1) of the Income Tax Act, 1962 (the Act), the estate of a deceased person is included in that definition.] The deceased person is deemed to have disposed of all assets at market value on the date of death under section 9HA(1) of the Act, with some exceptions, such as assets bequeathed to a surviving spouse. In terms of paragraph (i) of the proviso to section 66(13)*(a)* of the Act, the executor must submit the final tax return for the deceased person as well as tax returns for the deceased estate until the liquidation and distribution account becomes final.

For persons dying on or after 1 March 2016, any income or taxable capital gain derived by the deceased estate must be accounted for by the deceased estate under section 25. For persons dying before this date, under the old section 25 – before 1 March 2016, when the section was substituted by section 48(1) of Act 25 of 2015 – a deceased estate would need to register as a taxpayer only if the heirs or legatees could not be ascertained with certainty or if it derived a taxable capital gain. Paragraph 40 of the Eighth Schedule established the base cost of assets acquired by the estate from the deceased. SARS registered pre-31 March 2016 deceased estates as special trusts.

THE VALUE OF PROPERTY FOR ESTATE DUTY PURPOSES

Section 5(1)*(a)* of the EDA provides as follows in relation to assets disposed of by the executor:

> "5. **Determination of value of property**
>
> (1) The value of any property for the purposes of the inclusion thereof in the estate of any person in terms of section 3 or the deduction thereof in terms of section 4, determined as at the date of death of that person, shall be—

(a) (in the case of property, other than such property as is referred to in paragraph *(f)bis* or the proviso to paragraph *(g)*, disposed of by a purchase and sale which in the opinion of the Commissioner is a *bona fide* purchase and sale in the course of the liquidation of the estate of the deceased, the price realized by such sale;"

Thus, it is the price realised by the executor that must be taken into account, except when the asset is one falling within section 5(1)*(f)bis* or the proviso to paragraph *(g)*, or if the Commissioner considers the price realised not to be *bona fide*.

Section 5(1)*(f)bis* provides that unlisted shares must be taken into account at their value on the date of death of the deceased person, subject to a number of valuation rules. The proviso to paragraph *(g)* provides that conditions requiring a lesser value to be determined on the date of death must be disregarded, unless the Commissioner otherwise directs.

As regards CGT, not only will the deceased person be subject to estate duty on the price realised on the sale of an asset (other than unlisted shares), but the deceased estate will also be subject to CGT on any capital gain realised on such sale post death. The question arises whether such CGT can be claimed as a deduction against the net value of the estate.

DEDUCTION OF INCOME TAX

Section 4 of the EDA deals with deductions from the net value of an estate and the relevant paragraphs provide as follows:

"4. Net value of an estate

The net value of any estate shall be determined by making the following deductions from the total value of all property included therein in accordance with section 3, that is to say—

(a) [n/a]

(b) all debts due by the deceased to persons ordinarily resident within the Republic [...] which it is proved to the satisfaction of the Commissioner [to] have been discharged from property included in the estate;

(c) all costs which have been allowed by the Master in the administration and liquidation of the estate, other than expenses incurred in the management and control of any income accruing to the estate after the date of death;"

Meyerowitz, in *Meyerowitz on Administration of Estates and their Taxation*, notes that the words "debt due" are used in a wider sense of any debts that the deceased was obliged to pay. Section 4*(b)* would thus apply, for example, to any income tax owed by the deceased person for the period up to and including the date of death, even if the assessment is raised after death.

It is submitted that the CGT attributable to the disposal of assets by the executor falls under section 4*(c)*, since it comprises a "cost of administration and liquidation" which should be allowed by the Master. Since a capital gain is not income, CGT is not excluded as an expense incurred in the management and control of any income accruing to the estate.

In *Van Zyl NO v Commissioner for Inland Revenue,* [1997], the court concluded that the words "cost of administration and liquidation" could be interpreted to include post-liquidation income tax under section 97(2)*(c)* of the Insolvency Act, 1936:

"The answer to the point raised by the applicant to the effect that the Insolvency Act makes no provision for the ranking of income tax which accrues post-liquidation, is that post-liquidation income tax falls within the rubric "all other costs of administration and liquidation" in section 97(2)*(c)* of the Insolvency Act. (See *In re Beni-Felkai Mining Co Ltd* (1934) 1 Ch 406 at 417–419 and *Re Mesco Properties Ltd* [1979] 1 All ER 302 (Ch) at 305b–306h.) And there can be no objection to this state of affairs, for where the liquidator causes liabilities to be incurred by the company in the course of winding-up he must pay them in full. Where he invests money or carries on business during winding-up, the liquidator causes the company to earn income which, if it attracts tax, is payable in full as a cost of administration and liquidation. (cf *De Wet & Andere NNO v Stadsraad van Verwoerdburg* 1978 (2) SA 86 (T) at 98A–F.)"

Similarly, these words should also include CGT incurred by a deceased estate for the purposes of section 4*(c)*. Arguably, CGT on unlisted shares incurred post death by the estate should not qualify for deduction because the opening words of section 4 seem to limit the deductions to the total value of property included in the net value of the estate. Unlisted shares are included at market value on the date of death and hence their value does not include post-death growth.

EXAMPLE – CGT AND THE DUTIABLE VALUE OF AN ESTATE

Facts:

X died holding listed shares with a base cost of R20 000 and a market value of R100 000. The executor sold the shares for R130 000. Both X and X's deceased estate are on the maximum marginal CGT rate of 18% (45% × 40% inclusion rate). Disregard the annual exclusion.

Result:

X is deemed to sell the shares for R100 000 under section 9HA(1) and will realise a capital gain of R80 000 on which tax of R14 400 is payable. X's estate will realise a capital gain of R30 000 (R130 000 – R100 000) [section 25(2) of the Act determines the base cost for the estate] on which tax of R5 400 is payable. The net value of X's estate is R130 000 (s 5*(a)*) – R14 400 (s 4*(b)*) – R5 400 (s 4*(c)*) = R110 200.

TRADING STOCK

Assume in the above example that the asset comprised trading stock rather than listed shares. The deceased would have a tax liability of R80 000 × 45% = R36 000, while the deceased estate would have a tax liability of R30 000 × 45% = R13 500. Can the tax of R13 500 be claimed against the net value of the estate, given that the net value would include the price realised of R130 000? Section 4*(c)* denies a deduction for "expenses incurred in the management and control of any income accruing to the estate after the date of death". Applying the definition, in section 1(1) of the Act, of "income", being gross income less exempt income, there would clearly be no deduction. But the word "income" is not defined in the EDA and so bears its ordinary grammatical meaning, taking into account the context in which it appears and the apparent purpose to which it is directed. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the provision. (See *Natal Joint Municipal Pension Fund v Endumeni Municipality*, [2012], and *Cool Ideas 1186 CC v Hubbard & Another,* [2014].)

In *CIR v Visser* [1937] TPD 77; 8 SATC 271 (at 276)) Maritz J stated the following:

> "If we take the economic meaning of 'capital' and 'income', the one excludes the other. 'Income' is what 'capital' produces, or is something in the nature of interest or fruit as opposed to principal or tree."

On this meaning, income tax on income in the form of dividends, interest and rent would rightly not qualify for deduction because it does not form part of the net value of the estate. But the realisation of trading stock held by the deceased would represent the sale of the "tree" and not fall foul of the exclusion.

It might also be argued, depending on the facts, that the executor is simply realising assets to the best advantage for heirs and that realisation is not trading.

Such an interpretation would avoid economic double taxation and be consistent with the deduction of CGT.

In summary, a deduction for –

- income tax owed by the deceased person up to the date of death qualifies under section 4*(b)*;
- CGT on the sale of assets by the executor qualifies under section 4*(c)*;
- income tax on the sale of trading stock, livestock and produce may also qualify under section 4*(c)*; and
- income tax on income derived by the estate in the form of dividends, interest and rent amongst others ("fruit from the tree") does not qualify under section 4*(c)*.

It is submitted that an amendment to clarify the deductibility of post-death taxes is needed. Perhaps it is time for the legislature to reconsider whether subjecting taxpayers to estate duty on post-death growth in the value of their assets is appropriate, given that the value of these assets on the date of death must in any event be determined for CGT purposes.

This article was first published in *ASA March 2022*.

"It is submitted that an amendment to clarify the deductibility of post-death taxes is needed."

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Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definitions of "gross income", "income" & "person" (paragraph ***(b)***), 9HA(1), 25 [old section – before 1 March 2016], 66(13) *(a)*(i) (proviso to subparagraph (i)); Eighth Schedule: Paragraph 40;
- Estate Duty Act 45 of 1955: Sections 3, 4*(a)*, *(b)* & *(c)*, 4A, 5(1)*(a)*, *(f)bis* & *(g)* (proviso); First Schedule: Paragraph (1)*(a)*;
- Taxation Laws Amendment Act 25 of 2015: section 48(1);
- Insolvency Act 24 of 1936: Section 97(2)*(c)*.

Other documents

- D Meyerowitz *Meyerowitz on Administration of Estates and their Taxation* 10 ed (2010) in 28.4 (i).

Cases

- *Van Zyl NO v Commissioner for Inland Revenue* [1997] (1) SA 883 (C), 59 SATC 105;
- *In re Beni-Felkai Mining Co Ltd* [1934] 1 Ch 406 (at 417–419);
- *Re Mesco Properties Ltd* [1979] 1 All ER 302 (Ch) (at 305b–306h);
- *De Wet & Andere NNO v Stadsraad van Verwoerdburg* [1978] (2) SA 86 (T) (at 98A–F);
- *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2012] (4) SA 593 (SCA) (at 604);
- *Cool Ideas 1186 CC v Hubbard & Another* [2014] (4) SA 474 (CC) (at 484).

Tags: deceased estate; cost of administration and liquidation; unlisted shares.

INTERPRETATION OF CONFLICTING PROVISIONS

A February 2023 tax court judgment added valuable jurisprudence to the often-litigated issue of the interpretation of two conflicting legislative provisions.

In the matter of *A v The Commissioner for the South African Revenue Service,* [2023], the taxpayer ceased her South African tax residence on 3 September 2017. Whilst resident, she was a member of a partnership, which owned a passenger aircraft and carried on a chartering business in the United Kingdom. For South African tax purposes, the partnership was tax transparent and not assessed as a separate taxpayer. Rather, each partner accounted for a portion of the partnership's income, expenses, allowances, etc, in accordance with the partnership ratios.

The taxpayer accounted for her proportionate share of the partnership's income and claimed her proportionate share of the expenses of the air charter trade, as well as a proportionate share of the depreciation allowances available in respect of the aircraft. The result of her accounting for her portion of the partnership's income and deductions was that she accumulated an assessed loss in respect of the foreign charter business.

South African tax resident taxpayers are not eligible to set off any foreign trading losses against their South African source income. As a result, the taxpayer accumulated and carried forward to the 2018 tax year a substantial assessed foreign trade loss.

On 3 September 2017, the taxpayer permanently relocated to the UK and ceased to be a "resident" for South African tax purposes. This gave rise to certain automatic tax consequences, one being that the taxpayer was deemed to have disposed of her proportionate share of the aircraft business on the date immediately preceding the date on which she ceased to be resident. This deemed disposal triggered a recoupment in respect of depreciation allowances claimed on the aircraft in the foreign charter trading operation, which formed part of her accumulated, unutilised, assessed foreign trade loss.

This recoupment was included in the taxpayer's income for the 2018 tax year, but she set off the accumulated foreign trading loss against this recoupment. SARS disallowed the set-off in its entirety on the basis that the recoupment was, in terms of the legislation as it applied at the time, deemed to be South African source income against which an accumulated foreign trading loss could not be set off. The taxpayer objected to the disallowance of the set-off and appealed to the tax court adjudicating over this matter.

"The fundamental issue in dispute in the appeal was whether the taxpayer was entitled to set off the balance of the foreign assessed trade loss resulting from the foreign aircraft partnership trade against the recoupment triggered by the deemed disposal of her portion of the partnership's aircraft."

ISSUE AND ARGUMENTS

The fundamental issue in dispute in the appeal was whether the taxpayer was entitled to set off the balance of the foreign assessed trade loss resulting from the foreign aircraft partnership trade against the recoupment triggered by the deemed disposal of her portion of the partnership's aircraft. The dispute turned on whether the source of the recoupment was South African or foreign.

SARS based its argument on the fact that, at the time, paragraph *(n)* of the definition of "gross income" in section 1(1) of the Income Tax Act, 1962 (the Act), provided that an amount which is recouped is deemed to be income from a South African source.

The taxpayer relied on a later enacted provision, section 9(4)*(d)* of the Act, which expressly provides that amounts resulting from the disposal of an asset which does not fall within the specific South African source provisions of section 9, are from a foreign source. The South African source provisions apply, essentially, to the disposal of assets associated with immovable property or permanent establishments in South Africa. The aircraft, which triggered the deemed disposal in this matter, did not meet either of these two South African source provisions, as it was clearly not associated with immovable property nor was it part of a South African permanent establishment (as it was used in a business in the United Kingdom). Consequently, if the provisions of section 9(4)*(d)* are to be applied to the source of the recoupment resulting from the deemed disposal of the foreign aircraft, the source will not be South African.

The taxpayer and SARS applied different approaches to the interpretation of the legislation with SARS following a technical and literal interpretation of the abovementioned provisions, whereas the taxpayer argued that a more unitary approach considering the history and context of the legislation should be followed.

JUDGMENT

The court, with reference to the Supreme Court judgment in *Natal Joint Municipal Pension Fund v Endumeni Municipality,* [2012], and the Constitutional Court judgment in *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism and Others,* [2004], agreed with the taxpayer and held that a unitary approach should be followed, where the language used in the legislation is the point of departure; however, it must be read in its context, having regard to "the matter of the statute, its apparent scope and purpose, and within limits, its background". Moreover, the court held that the *contra fiscum* rule, which stipulates that should a taxing statutory provision reveal an ambiguity, it should be interpreted in a manner that favours a taxpayer, is accommodated in this unitary approach.

In applying the above principle, the court held that one must have regard to the legislative history of the provisions in question. **In this regard, the court took into account the following:**

- The provision on which SARS relied was enacted during the source-based regime as an anti-avoidance provision designed to prevent taxpayers from exporting depreciated assets and then arguing that the proceeds on disposal were from a source outside South Africa, and hence not subject to recoupment tax in South Africa.
- The newer section 9 provision on which the taxpayer relied was enacted during the residence-based tax regime to create a uniform set of source rules to remedy uncertainty and anomalies and eliminate the concept of "deemed source" that existed during the source-based regime.
- Accordingly, the court held that SARS' argument was based on a literal and isolated interpretation approach, disregarding the context, and that the legislature's intention limits the application of the deemed source rule for recoupments to the "gross income" definition and its scope did not extend to other sections of the Act.

In relation to the clear inconsistency between the two provisions, the court held the following:

- The general rule regarding interpretation in this context is that the court is to regard an earlier enactment as impliedly repealed by a later one if there is an irreconcilable conflict between the provisions.
- The Act expressly states that section 9 applies to all amounts received or accrued, without exception (from tax years ending on or after 1 January 2012), and there was no scope for an argument that it did not regulate the source of some receipts or accruals.
- Accordingly, the section 9 provision relating to source rendered the deeming proviso in the definition of "gross income" obsolete, ineffectual and superfluous.

Finally, regarding the proper interpretation of the Act, the court held that regard should be had to the impact of the two approaches suggested by the litigants, and to ask

> "whether they gave rise to sensible and business-like results, as opposed to insensible or even absurd consequences that could not have been intended".

The court then went on to discuss five reasons why it would result in unbusinesslike consequences to follow SARS' approach where the deeming proviso is elevated above its original purpose (which was a limited anti-avoidance measure under the source basis of taxation). The court, therefore, agreed with the taxpayer's interpretation as it resulted in the proper symmetry between the foreign income from the deemed disposal of the aircraft and the deduction of the foreign assessed loss arising from the same foreign trade. The recoupment was, therefore, correctly regarded as being of a foreign source and the taxpayer was eligible to set off the accumulated foreign assessed trade loss against the recoupment.

COMMENTS

Although the legislature repealed the deeming provision in the definition of "gross income" in 2019, resulting in the subject matter of this dispute no longer being contentious, the value of this judgment is that the court set out clear guidelines for the proper interpretation of conflicting provisions in tax legislation.

In summary, these guidelines are:

- An interpreter should follow a unitary approach of interpretation (which encapsulates the *contra fiscum* rule of interpretation) where the language used in the legislation remains the point of departure, but the legislation must be read in its specific context;
- when considering the context of legislative provisions, the interpreter should pay attention to the legislative history of the provisions in question;
- where there is an irreconcilable conflict between two provisions, an interpreter should regard an earlier enactment as impliedly repealed by a later one; and
- an interpreter should apply the sensible and businesslike test, where the interpreter should have regard to the impact of the interpretative approach followed, by asking "whether it gives rise to sensible and businesslike results, as opposed to insensible or even absurd consequences that could not have been intended".

Doelie Lessing & Luke Magerman

Werksmans Attorneys

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "gross income": paragraph *(n)*) & 9(4)*(d)*.

Cases

- *A v The Commissioner for the South African Revenue Service,* [2023] (Case No 46206);
- *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2012] (4) SA 593 (SCA);
- *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism and Others* [2004] (4) SA 490 (CC).

Tags: depreciation allowances; assessed loss; foreign trading losses; deemed disposal; *contra fiscum* rule.

TRUSTS AND PBOs SUBJECT TO FURTHER TAX FILING REQUIREMENTS

Additional filing requirements subjecting trusts to third-party reporting have been in the pipeline for a while. These requirements were somewhat clarified in a draft notice (Returns of information to be submitted by third parties in terms of section 26 of the Tax Administration Act, 2011) issued by SARS on 29 March 2023 and, following public comment, the final Notice 3631 issued on 30 June 2023.

The final notice will replace Notice 241 issued by SARS on 23 March 2018 (the 2018 notice). The 2018 notice already required certain persons to submit third-party returns, including *inter alia* banks, financial institutions, listed companies, medical schemes, estate agents, and attorneys practising for their own account, persons liable to pay withholding tax on interest and issuers of tax-free investments.

A third-party return is essentially where SARS requires a person who employs, pays amounts to, receives amounts on behalf of, or otherwise transacts with another person, or has control over assets of another person, to submit a return by a date specified in a public notice.

The draft notice had proposed maintaining the requirements applicable to the categories of persons already covered by the 2018 notice, with three notable additions:

- Trusts that are resident (per the definition of "resident" in the Income Tax Act);
- Public benefit organisations (PBOs) that issue section 18A receipts; and
- Persons who issue solar installation compliance certificates [*Author's note*: Thankfully, this category was removed in the final notice, most likely following public comment on the administrative burden it would place on installers].

Per the draft notice, trustees of all tax resident trusts would be required to issue an IT3(t) form (or data compiled in accordance with SARS' Business Requirement Specification: IT3 Data Submission) in respect of any amount vested in a beneficiary, including income (net of expenditure), capital gains and capital amounts distributed. This requirement would apply to 2023 and all following years. In terms of the final notice, while collective investment schemes and employee share incentive trusts have been excluded, non-resident trusts that are required to submit annual income tax returns are also being subjected to third party reporting along with resident trusts.

On the other hand, PBOs will be required to issue an IT3(d) form (or data compiled in accordance with SARS' BRS: IT3 Data Submission) containing information concerning any amount donated where a section 18A receipt was issued and information concerning the donor (extended in the final notice to all information required to be included on the section 18A receipt). PBOs will be subject to biannual submissions in the future, although special transitional rules will apply to PBOs that will be submitting third-party returns for the first time.

PBOs should be mindful that SARS' Notice 3082 issued in *Government Gazette* 48104 on 24 February 2023 now requires all section 18A receipts to also contain the following information:

- Nature of the donor (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;
- Electronic mail address of the donor;
- A unique receipt number; and
- Trading name of the donor (if different from the registered name).

The above listed information must be included on all section 18A receipts issued on or after 1 March 2023 together with the information previously required to be included on such receipts (being the date, amount or nature (if in kind) of the donation, the name, address and reference number of the PBO, the name and address of the donor and confirmation that the receipt is issued in terms of section 18A and that the donation has been or will be used exclusively for the object of the PBO).

SARS' BRS: IT3 Data Submission, updated on 7 October 2022, previously indicated that the following categories of information would be required in an IT3(t) submission by trusts (as further detailed in the BRS document):

- Demographic information of the reporting trust;
- Demographic information of trust persons/beneficiaries;
- Taxable amounts distributed/vested in persons/ beneficiaries;
- Details of non-taxable income distributed; and
- Trust financial flow.

The first due date for the IT3(t) submission by trusts per the draft notice was expected to be 30 September 2023, covering information for the period from 1 March 2022 to 28 February 2023. This date has been pushed out in the final notice to 31 May 2024, covering information for the period from 1 March 2023 to the end of February 2024. The change in the due date from September to May each year leaves trustees with a mere three months to attend to the submission, which is likely to receive opposition.

Trustees and PBOs should be mindful of the upcoming reporting requirements and consult their advisors where necessary.

"A third-party return is essentially where SARS requires a person who employs, pays amounts to, receives amounts on behalf of, or otherwise transacts with another person, or has control over assets of another person, to submit a return by a date specified in a public notice."

Esther van Schalkwyk

BDO

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definitions of "resident" & "trust") & 18A;
- Tax Administration Act 28 of 2011: Section 26.

Other documents

- Notice 241 issued by SARS in terms of section 26 of the TAA in *Government Gazette* 41512 on 23 March 2018;
- Notice 3082 issued in *Government Gazette* 48104 on 24 February 2023 (stipulating information that must be contained in all section 18A receipts);
- Draft notice to replace Notice 241 issued by SARS on 29 March 2023;
- Final Notice 3631 to replace Notice 241 issued by SARS in *Government Gazette* 48867 on 30 June 2023;
- SARS' BRS (Business Requirement Specification): IT3 Data Submission (updated on 7 October 2022);
- IT3(d) and IT3(t) forms;
- Section 18A receipts.

Tags:issuers of tax-free investments; third-party return; solar installation compliance certificates; tax resident trusts.

THE OECD'S LATEST REPORT ON TREATY SHOPPING

On 31 May 2022, the OECD published its Fifth Peer Review Report on Treaty Shopping*. The report includes extensive information on tax treaties concluded by the countries that were members of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) and assesses the implementation of the BEPS Action 6 minimum standard.*

The report shows that member countries are keeping their promise to apply the basic rule against treaty shopping, and it highlights the significance of the multilateral instrument (MLI) as the tool used by the majority of jurisdictions that have commenced implementation of the BEPS Action 6 minimum standard. This standard identified treaty abuse, particularly in the form of treaty shopping, as one of the main concerns to be addressed.

WHAT IS TREATY SHOPPING?

Treaty shopping occurs when there is an attempt to indirectly access the benefits of a tax treaty between two jurisdictions without being a resident of one of those jurisdictions.

The OECD states that, under BEPS, treaty abuse is highly undesirable for the following reasons:

- treaty benefits negotiated between the parties to a treaty are economically extended to residents of a third jurisdiction in a way the parties did not intend. The principle of reciprocity is therefore breached and the balance of concessions that the parties make is altered;
- income may escape taxation altogether or be subject to inadequate taxation in a way the parties did not intend; and
- the jurisdiction of residence of the ultimate income beneficiary has less incentive to enter into a tax treaty with the jurisdiction of source because residents of the jurisdiction of residence can indirectly receive treaty benefits from the jurisdiction of a source without the need for the jurisdiction of residence to provide reciprocal benefits.

WHAT HAS BEEN DONE TO ADDRESS IT?

As part of the BEPS package and included as one of the four minimum standards, members of the BEPS inclusive framework are required to include provisions dealing with treaty shopping in their tax treaties to ensure a minimum level of protection against treaty abuse. Some flexibility is permitted in the implementation of the minimum standard as these provisions have to be adapted to each jurisdiction's specific circumstances and the negotiation of individual tax agreements.

Under the minimum standard countries must include two components in their tax agreements. Firstly, an express statement must be made that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping arrangements.

Secondly, they are required to include in the treaty provisions one of the following three methods:

- a principal purpose test (PPT) equivalent to paragraph 9 of Article 29 of the 2017 OECD Model Tax Convention, together with either a simplified or a detailed version of the limitation on benefits (LOB) rule that appears in paragraphs 1 to 7 of Article 29 of the 2017 OECD Model;
- the PPT alone; or
- a detailed version of the LOB rule together with a mechanism (such as a treaty rule that might take the form of a PPT rule restricted to conduit arrangements, domestic anti-abuse rules or judicial doctrines that would achieve a similar result) that would deal with conduit arrangements not already dealt with in tax treaties.

Historically, countries have attempted to address treaty shopping by using different approaches. Reliance has been placed on specific anti-abuse rules based on the legal nature, ownership, and general activities of residents of the jurisdiction who are party to a tax agreement or who have utilised a general anti-abuse rule based on the purpose of transactions or arrangements.

WHAT PROGRESS HAS BEEN MADE?

The implementation of the Action 6 minimum standard is subject to a peer review process. Peer reviews were performed in 2018, 2019, 2020 and 2021. The peer review for 2022 is currently underway.

The latest peer review reveals that a large majority of Inclusive Framework members have modified or are in the process of modifying their tax treaty network to implement the minimum standard and other BEPS treaty-related measures. Several countries that have signed the MLI have listed almost all their treaties under the MLI.

For treaties for which the MLI is effective, tax authorities can now use effective treaty provisions to curb treaty shopping.

"The latest peer review reveals that a large majority of Inclusive Framework members have modified or are in the process of modifying their tax treaty network to implement the minimum standard and other BEPS treaty-related measures."

Mark Badenhorst

ENSafrica

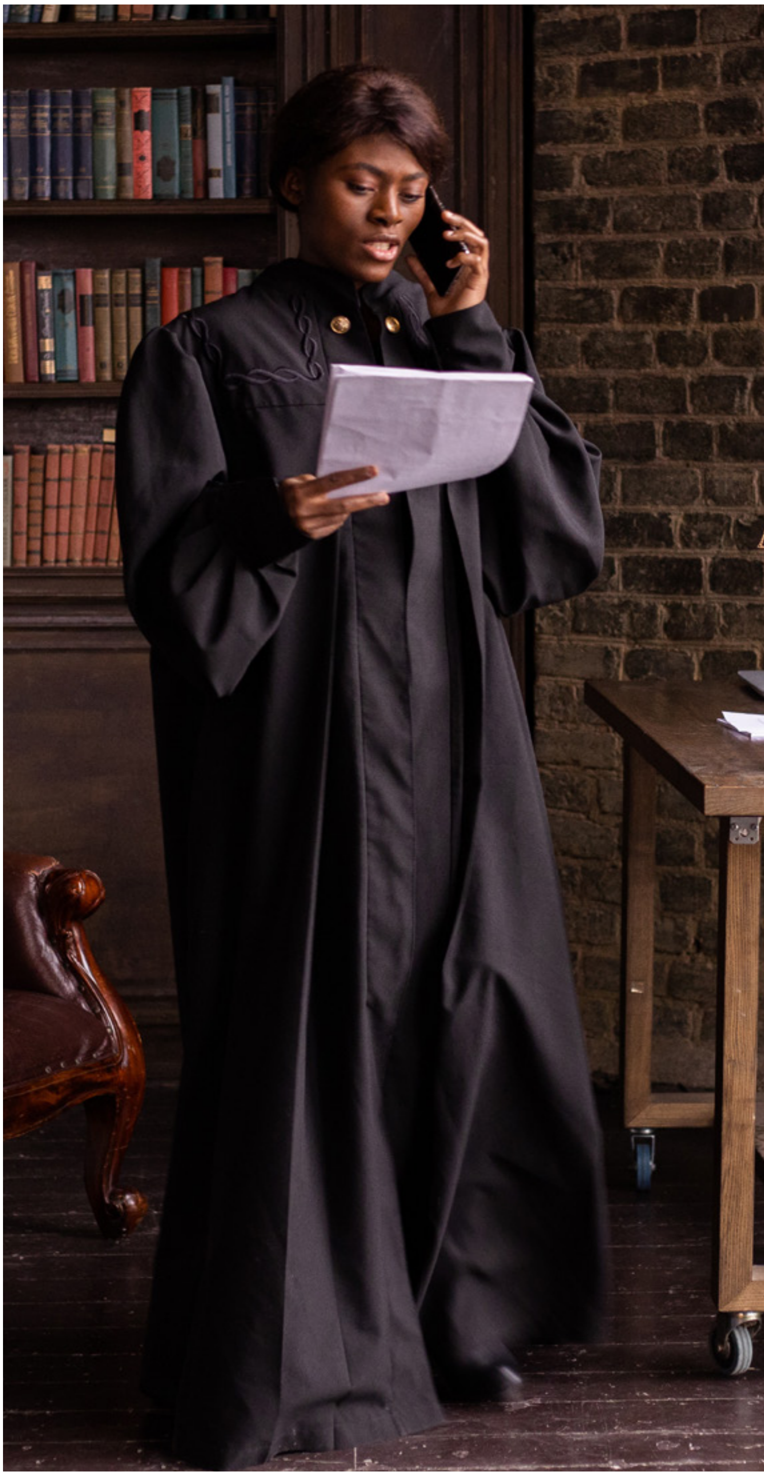
Sources

- Fifth Peer Review Report on Treaty Shopping (Prevention of Treaty Abuse) (published by OECD on 31 May 2022);
- BEPS Action 6 minimum standard;
- 2017 OECD Model Tax Convention: Article 29 (paragraphs 1–7 & 9);
- Principal purpose test (PPT);
- Limitation on benefits (LOB) rule.

Tags: treaty shopping; tax treaties; principal purpose test (PPT); limitation on benefits (LOB) rule; anti-abuse rules; peer review process.

CONDONATION IN THE CONTEXT OF DEFAULT JUDGMENT

In Commissioner for the South African Revenue Service v SAV South Africa (Pty) Ltd *(Case No IT25117) [2021] ZATC 22 (as yet unreported)) the tax court decided that, even though the South African Revenue Service (SARS) had complied with a notice issued in terms of rule 56(1) of the rules (the Rules) promulgated under section 103 of the Tax Administration Act, 2011 (the TAA), SARS' failure to apply for condonation due to not complying with rule 4, meant the default judgment application could be granted (IT25117).*



The effect of the default judgment is that the matter was decided in favour of the applicant, as contemplated in section 129(2) of the TAA, without the merits of the matter being heard.

However, tax court judgments do not create a precedent. In other words, a tax court judgment is not binding on other tax courts. Pursuant to this, on 23 March 2023, in *P Taxpayer v Commissioner for the South African Revenue Service,* (IT45935) [2023] ZATC 2, where the tax court was faced with the same question raised in IT25117, it reached a different conclusion. This judgment (IT45935) is discussed here.

LEGAL CONTEXT

Rule 56(1), both under the old rules and under the new rules that were published on 10 March 2023, provides for SARS and a taxpayer to apply to the tax court for default judgment, where either party has failed to comply with a period or obligation under the Rules. However, the applicant must first deliver a notice informing the defaulting party of its intention to apply for a final order under section 129(2) if the defaulting party does not remedy the default within 15 days of delivery of the notice. The 15-day period refers to 15 business days.

Considering the timing of the application, it appears that the tax court's judgment was based on the Rules as they read prior to 10 March 2023.

FACTS

Similar to the facts in IT25117, in the current matter (IT45935), the taxpayer delivered a notice in terms of rule 56(1)(a) and SARS delivered its outstanding pleading, its rule 31 statement of grounds of assessment, within the 15-day period provided for in the notice. In the current matter the taxpayer noted an appeal on 12 April 2019 with the matter being referred to alternative dispute resolution (ADR), but not resolved in terms of that process. The ADR process was terminated and SARS was given an extension until 13 October 2021 to deliver its rule 31 statement, but failed to deliver it by this date. The taxpayer then delivered a notice in terms of rule 56(1)(a) on 3 March 2022 and SARS delivered its rule 31 statement within the 15-day period provided for in the notice.

In the current matter (as was the case in IT25117), the taxpayer also brought an application in terms of rule 30, arguing that the delivery of the rule 31 statement, albeit before expiry of the 15-day notice period, constituted an irregular step.

JUDGMENT

The tax court's judgment was based on its interpretation of rule 56, read with rules 4 and 52 of the Rules. Rule 4, which deals with extension of time periods, states, amongst other things, that a period in the Rules may be extended by agreement between the parties, except where the extension of a period prescribed under the TAA or the Rules is otherwise regulated in Chapter 9 of the TAA or the Rules.

Rule 52(6) states that a party who failed to deliver a statement as and when required under rule 31, may apply to the tax court for an order condoning the failure to deliver the statement and the determination of a further period within which the statement may be delivered.

Rule 56(2) states, amongst other things, that the tax court may, on hearing an application for default judgment, make a final order in terms of section 129(2) if the defaulting party cannot show good cause, or give an order compelling the defaulting party to comply with the relevant requirement within a time it considers appropriate.

Relying on its interpretation of the above provisions, the tax court found in favour of SARS for the following reasons:

- The Rules pertain specifically to the procedures to lodge an objection and appeal against an assessment or decision under Chapter 9 of the TAA, the ADR procedures and the conduct and hearing of appeals before a tax board or tax court.

- Whereas rule 4(1) states that a period may be extended by agreement "except where the extension of a period prescribed under the Act [TAA] or these rules is otherwise regulated in Chapter 9 … or these rules", Rules 52(6) and 56 fall into the category of those rules which "otherwise regulate" the extension of a prescribed period. The tax court rejected the taxpayer's argument that rule 52(6) is peremptory, considering that a party "may" apply to the tax court for condonation, if its rule 31, 32 or 33 statement was not delivered timeously.

> "Rule 56(1), both under the old rules and under the new rules that were published on 10 March 2023, provides for SARS and a taxpayer to apply to the tax court for default judgment, where either party has failed to comply with a period or obligation under the Rules."

- Rule 52(6) applies where a party is in default, the other party has done nothing about it, and the defaulting party wishes the case to proceed, whereas rule 56 comes into play where the innocent party wishes to do something about the default. Considering the 15-day notice requirement, it is only if the defaulting party nonetheless fails to remedy the default within the 15-day period that the innocent party is entitled to apply to the tax court for a final order.

- Rule 56(2) supports the interpretation adopted in respect of rule 52(6). Specifically, rule 56(2) makes it clear that it is only when the tax court hears the application for a final order that it must consider whether or not condonation should be granted. If the defaulting party remedies the default within the 15-day period, then the statement in question (rule 31 statement here) is properly before the tax court and there is nothing for it to consider.

- It rejected the taxpayer's interpretation of the above provisions as being strained, including the taxpayer's arguments that rule 52(6) requires that a rule 31 statement delivered late must be accompanied by a condonation application and that, as the tax court is a creature of statute, rule 52(6) must be read as requiring strict compliance. Furthermore, it concluded that accepting the taxpayer's interpretation would render rule 56(1)(a) (containing the 15-day notice requirement) superfluous. This could not have been the intention of the rule maker, given that condonation is a matter for the court, not a party, to decide.

- With reference to IT25117, it indicated that that judgment does not assist the taxpayer as the facts in IT25117 are distinguishable from those in the current matter and considering, amongst other things, that as the judgment in IT25117 focused on rule 4(2), SARS' argument that its default was cured by compliance with the rule 56(1)(a) notice, was not dealt with. It concluded that in any event, tax court judgments are not binding on other such courts and are of persuasive value only.

On the issue of costs, the tax court decided that the costs of the application shall be costs in the cause of the appeal.

COMMENT

While one appreciates that the facts in IT25117 and those in IT45935 were accepted by the court as being distinguishable, it does appear that the approach taken by the tax court in both instances was different. Whereas Cloete J, in IT45935, analysed the interplay between rules 4, 52 and 56, a slightly different approach was taken by Mali J in IT25117. As one would not have been privileged to the hearing, heads of argument and oral submissions made in IT25117, not all details regarding the arguing of the matter would be known. The tax court's observation in IT45935, that the court in IT25117 appeared to focus mostly on the application of rule 4(2) and did not specifically deal with SARS' argument that its default was cured by compliance with the rule 56(1)(a) notice, is all one has to go on. The tax court's comment in IT25117 that rule 4(2) would not serve a purpose if it was allowed to be superseded by other rules also has merit.

The key difference between the two judgments appears to be the reliance on rule 52(6). In IT45935, the court expressly referred to this provision and indicated that the word "may" means that the provision (dealing with condonation) is not peremptory, whereas this provision and its application were not considered in IT25117. Both judgments were concerned with ensuring that a rule serves its intended purpose and is not rendered superfluous – rule 4(2) in IT25117 and rule 56(1)(a) in IT45935.

It remains to be seen whether either judgment will be appealed. If so, whatever the appeal court finds would reflect the interpretation that other tax courts would have to follow. For taxpayers, the key issue is the best practical approach to follow in light of two judgments that, at least to some extent, appear to be conflicting. The main risks a taxpayer (or SARS) faces by persisting with a default judgment application, where the defaulting party has remedied the default within the 15-day period, are costs and the delay in finalising the matter. An interesting question to consider is whether it may be better for an innocent party to deliver its rule 56 notice sooner after the defaulting party's non-compliance with a period in the Rules. That is one way in which the innocent party could attempt to ensure that the progress of the matter is not delayed. If the defaulting party delivers the outstanding document within 15 days, a potential delay will have been averted. If the defaulting party does not comply with the notice, the issue in the cases under discussion does not arise and the focus shifts to the question of "good cause" within the context of section 129(2).

Louis Botha

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 103 & 129(2); Chapter 9 (sections 101 –150).

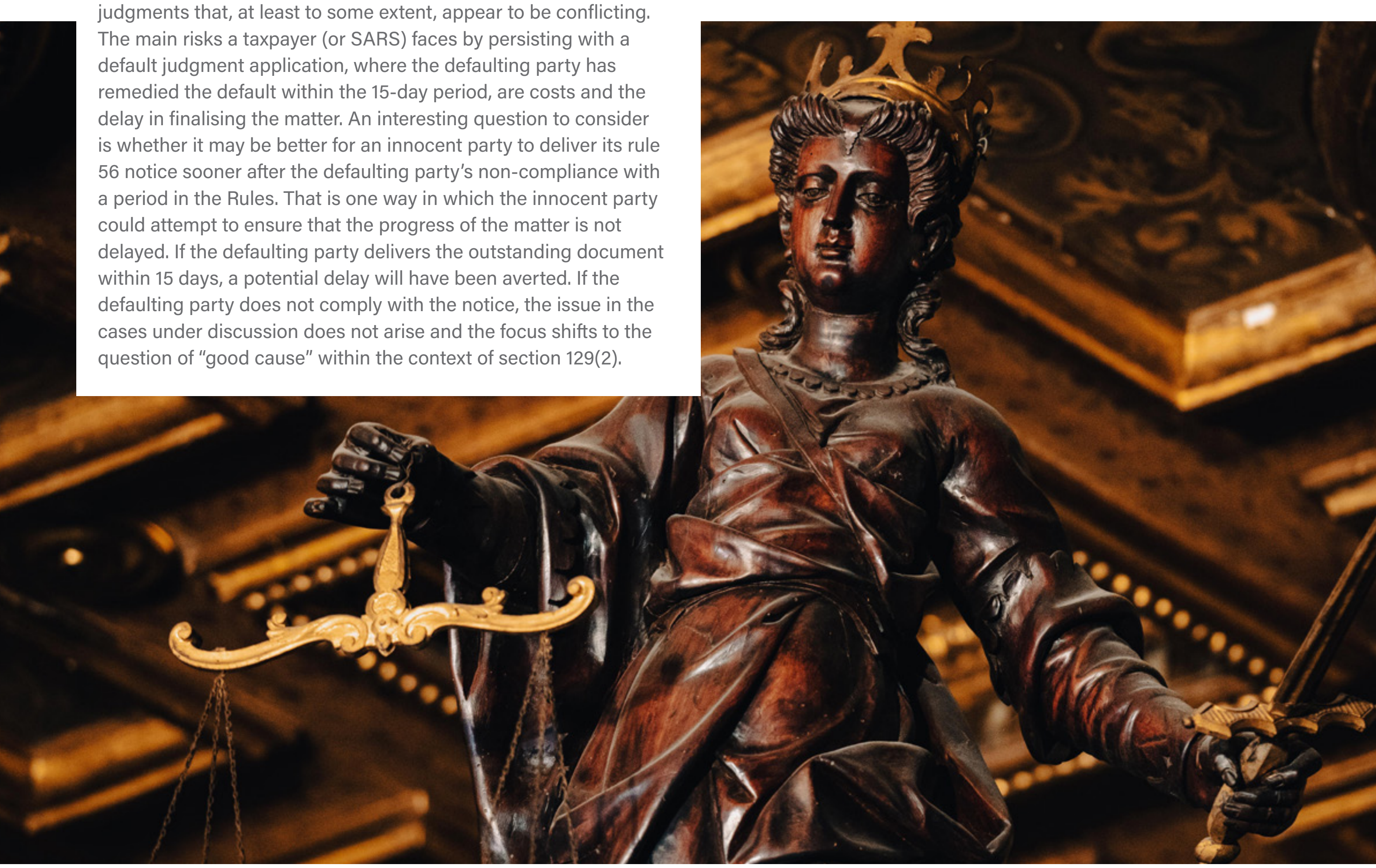
Other documents

- Rules promulgated under section 103 of the TAA: Rules 4(1) & (2), 31, 32, 33, 52(6), 56(1)*(a)* & (2).

Cases

- *Commissioner for the South African Revenue Service v SAV South Africa (Pty) Ltd* (Case No IT25117) [2021] (ZATC 22) (18 November 2021) (as yet unreported));
- *P Taxpayer v Commissioner for the South African Revenue Service* (IT45935) [2023] ZATC 2 (23 March 2023).

Tags: default judgment application; rule 31 statement of grounds of assessment; condonation application.



INTEREST REMISSION AFTER A VDP

Commissioner for the South African Revenue Service v Medtronic International Trading S.A.R.L. [2023] (*Medtronic* case)

On 18 June 2017, Medtronic International Trading (the Taxpayer) concluded a voluntary disclosure programme (VDP) with the South African Revenue Service (SARS) as the result of fraudulent transactions of a former employee. The capital amount of the VDP amounted to R311,602,431.49 and the total interest thereon amounted to R201,185,012.59. After the conclusion of the VDP agreement, the Taxpayer requested a remission of interest levied on the late payment of value-added tax (VAT).

The relief for which any taxpayer could qualify in terms of a VDP is encapsulated in terms of section 229 of the Tax Administration Act, 2011 (the TAA). The said relief provides that SARS must –

- not pursue criminal prosecution for a tax offence arising from the default;
- grant relief in respect of understatement penalties; and
- grant 100% relief in respect of administrative noncompliance penalties.

The crux of the *Medtronic* case lies in the fact that the relief provided in the VDP and in terms of Chapter 16 of the TAA is unclear with respect to the interest levied in terms of the VDP. The question which therefore arose before the Supreme Court of Appeal (SCA) was whether a taxpayer may, *after entering a VDP and after the agreement has been fulfilled (ie, having signed and agreed to the capital and interest payable on the VPD agreement and made full payment in accordance with the said agreement), request a remission of interest* outside the VDP process via section 39(7) of the Value-Added Tax Act, 1991 (the VAT Act).

The Taxpayer requested SARS to have the interest remitted in terms of section 39(7)*(a)* of the VAT Act, which states:

> "(7) Where the Commissioner is satisfied that the failure on the part of the person concerned or any other person under the control or acting on behalf of that person to make payment of the tax within the period for payment .... as the case may be –
>
> *(a)* *was due to circumstances beyond the control* of the said person, he or she may remit, in whole or in part, the interest payable in terms of section ...."

In addition, in terms of SARS Interpretation Note 61 (IN 61), the Taxpayer relied on the explanation of what constitutes "circumstances beyond a person's control", which stated that:

> "circumstances beyond a person's control are generally those that are external, unforeseeable, unavoidable or in the nature of an emergency, such as an accident, disaster or illness which resulted in the person being unable to make payment of VAT due."

On application of the above, the Taxpayer contended that the *fraud by an employee was a circumstance beyond its control.* SARS, however, argued that section 39(7)*(a)* of the VAT Act does not apply to any VDP agreement. Therefore, SARS stated the "remission of interest was not catered for in the VDP programme under the TAA" and contended that IN 61 was not binding on it. As a result, SARS considered the request for remission of interest invalid and informed the Taxpayer that it ought rather to submit a notice of objection.

The Taxpayer, however, did not follow this recommendation on the basis that the VDP agreement explicitly stated that objections to an assessment or determination issued or made by SARS were impermissible. It is also noted that section 232(2) of the TAA states that:

> "An assessment issued or determination made to give effect

to an agreement under section 230 is not subject to objection and appeal."

On 3 March 2023, the SCA found in favour of the Taxpayer and rejected the arguments raised by SARS, stating that *the refusal by SARS to consider the request for remission was unjustified and eligible to be reviewed under sections 6 and 8 of the Promotion of Administrative Justice Act, 2000 (PAJA), and dismissed the appeal with costs.* In particular, the court held that the VDP provisions contained in the TAA do not prohibit a request for remission of interest in terms of section 39(7) of the VAT Act, notwithstanding a VDP agreement being entered into. It is important to note that the SCA ruled in favour of the taxpayer in that SARS is obliged to consider such a request. However, the SCA did not rule that the interest itself be remitted and therefore it remains to be seen whether SARS will in fact remit the interest in this case.

In principle, this case demonstrates the fact that after a VDP process has been concluded, a taxpayer still has the right to apply for the remission of the interest imposed and is entitled to other remedies as contained in the tax legislation provided the criteria for such remission are satisfied. Whether SARS will entertain such remission on a case by case basis or in special circumstances is yet to be seen. In addition, a legislative change is perhaps possible, given that this judgment "encourages" a taxpayer to apply for remission of interest, particularly where the default relates to VAT.

Mohammed Mayet

PKF Octagon

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 229 & 232(2); Chapter 16 (sections 221–233);
- Value-Added Tax Act 89 of 1991: Section 39(7)*(a)*;
- Promotion of Administrative Justice Act 3 of 2000: Sections 6 & 8.

Other documents

- Interpretation Note 61 ("Remission of interest in terms of section 39(7)*(a)*").

Cases

- *Commissioner for the South African Revenue Service v Medtronic International Trading S.A.R.L.* [2023] ZASCA 20 (456/2021); [2023] (3) SA 423 (SCA) (3 March 2023).

Tags: voluntary disclosure programme (VDP); understatement penalties; circumstances beyond a person's control; administrative noncompliance penalties; remission of interest.

"The relief for which any taxpayer could qualify in terms of a VDP is encapsulated in terms of section 229 of the Tax Administration Act, 2011 (the TAA)."

LIMITS TO RIGHT OF DISCOVERY

In AB v The Commissioner for the South African Revenue Service, *[2022], which was heard by the tax court on 23 August 2022, the South African Revenue Service (SARS) requested the tax court to order that a matter, prior to its hearing, be referred back to SARS in terms of section 129(2)*(c) *of the Tax Administration Act, 2011 (the TAA).*

This was pursuant to a taxpayer alleging during the alternative dispute resolution (ADR) process that previous financial statements provided were incorrect. The tax court declined to grant the order as it held that it was not competent to do so in terms of the section – such an order could only be made pursuant to the hearing of the matter.

Following the tax court's judgment in this matter, SARS brought a further interlocutory application dealing with, amongst other things, the discovery of additional documents and the possible imposition of an increased understatement penalty. These issues are discussed here in the judgment of *Taxpayer DK v Commissioner for the South African Revenue Service,* [2023], decided on 15 March 2023.

THE ISSUE OF DISCOVERY

The question in this regard revolved around the application of rule 36(6) of the rules promulgated under section 103 of the TAA (Rules), which deals with the discovery of additional documents. SARS brought an application requesting the court to compel the taxpayer to discover certain additional documents. The court first considered the ambit of SARS' rights to request discovery. Whereas SARS argued that this power was broad, considering the definition of "relevant material" in section 1 of the TAA read with the broad powers conferred on SARS in terms of section 3 of the TAA, the taxpayer argued that in an appeal the tax court is confined to ordering discovery in terms of the Rules only. The court agreed with the taxpayer's contention, meaning that it was limited to considering the discovery request in terms of rule 36(6). The crux of the court's reasoning in this regard was that one should draw a distinction between the powers SARS exercises as an investigator and the rights it has to discovery as a litigant in an appeal.

The court then moved on to the question as to which of SARS' document requests exceeded its discovery rights as a litigant. Firstly, the court held that requests relating to the taxpayer's financial information in foreign jurisdictions were not relevant to the current dispute and these documents need not be discovered by the taxpayer. In considering the remaining document requests, the tax court considered that in its grounds of appeal, the taxpayer argued that SARS' contention that funds advanced by him to a certain Company A in the 2014 and 2015 tax years constituted an understatement of income, did not constitute gross income, was overstated and was incorrect. It also considered the taxpayer's contention in its grounds of appeal that an amount classified as an understatement of interest income was overstated and incorrect.

SARS' request that certain journal entries referred to by the taxpayer in arguing that the previous version(s) of the financial statements should be discovered, was granted by the tax court as they were relevant to the issues in dispute and as SARS disputed their incorrectness. The court agreed with SARS' reliance on the judgment in *GB Mining and Exploration SA (Pty) Ltd v Commissioner for the South African Revenue Service,* [2015], where it was held that if incorrect information was included in balance sheets or accounts, evidence would have to be presented explaining the precise nature and extent of the incorrect information and how it was included. It was further held in that case that all relevant supporting documentation to verify the correct information would have to be submitted, along with a full explanatory note to clarify the amendment. The tax court concluded that the journal entries in question were examples of the supporting documentation referred to in *GB Mining*.

In relation to SARS' remaining requests for discovery in terms of rule 36(6), the tax court held as follows:

- The request for invoices issued by the taxpayer's accountants to him was declined, as the information was held to be irrelevant.

- In relation to a request for correspondence between the taxpayer and his accountants, it was held that some of the information would be relevant, but the way the request was framed was overbroad, which would require the discovery of irrelevant documentation as the request contained no restrictions as to content and duration. Although correspondence between them regarding the reconstruction of the financial statements during the period when the error was realised and corrected may be relevant, it was not for the court to rewrite it and therefore it was declined.

UNDERSTATEMENT PENALTIES

In relation to this issue, a key point in dispute was SARS' attempt at amending its Rule 31 Statement of Grounds of Assessment (Rule 31 Statement), to introduce a higher understatement penalty pursuant to the taxpayer's argument that the previous versions of the financial statements provided were incorrect. Specifically, SARS wished to impose an understatement penalty of 125%, on the basis that the taxpayer's behaviour constituted "gross negligence" and was obstructive. As part of the proposed amendment to the Rule 31 Statement, SARS alleged that the taxpayer's conduct "…as evidenced in the declarations made during the objection & appeal process and post appeal, is illustrative of a conscious, elaborate and well thought effort as opposed to an innocent error."

"The court agreed with SARS' reliance on the judgment in *GB Mining and Exploration SA (Pty) Ltd v Commissioner for the South African Revenue Service*, [2015], where it was held that if incorrect information was included in balance sheets or accounts, evidence would have to be presented explaining the precise nature and extent of the incorrect information and how it was included."

However, SARS' argument that if the taxpayer was found to have altered his financials on the facts, the concealment was worthy of a higher level of penalty for the taxpayer's understatement, was rejected by the tax court. It held that this is not a new case brought on by the tax court's decision in the interlocutory application (which SARS argued justified this amendment and other less contentious amendments to the Rule 31 Statement), as this has always been SARS' position. Furthermore, given the prejudice that would be suffered by the taxpayer, it was held that the amendment should not be made now.

COMMENT

It is not often that a tax court case involves multiple interlocutory applications, but while one appreciates the additional cost that may have been caused for the parties, the case assists with the interpretation of provisions that are not often in dispute before the tax court. For example, on the issue of discovery, the court's rationale for only compelling discovery of certain documents in terms of rule 36(6) is sensible. In particular, the principle that SARS' rights as a litigant are different to its rights as an investigator (at audit stage) is an important finding and appears to be consistent with the scheme of the TAA.

On the understatement penalty issue, although the court did not deal with the issue in detail, its finding that SARS could not amend its Rule 31 Statement to impose a higher understatement penalty, appears consistent with the significant amount of jurisprudence dealing with rule 31(3). Furthermore, it is also consistent with the Supreme Court of Appeal's judgment in *Purlish Holdings (Proprietary) Limited v The Commissioner for the South African Revenue Service*, [2019].

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Acts and Bills

- Tax Administration Act 28 of 2011: Sections 1 (definition of "relevant material"), 3, 103 & 129(2)(*c*).

Other documents

- Rules promulgated under section 103 of the TAA: Rules 31 (Statement of Grounds of Assessment) & 36(6);
- Rule 31 Statement of Grounds of Assessment.

Cases

- *Taxpayer DK v Commissioner for the South African Revenue Service* (35476) [2023] ZATC 6; [2023] (1) SACR 396 (WCC) (15 March 2023);
- *AB v The Commissioner for the South African Revenue Service* (35746) [2022] ZATC 9, which was heard by the Tax Court on 23 August 2022;
- *GB Mining and Exploration SA (Pty) Ltd v Commissioner for the South African Revenue Service* [2015] (4) SA 605 (SCA);
- *Purlish Holdings (Proprietary) Limited v The Commissioner for the South African Revenue Service* (76/18) [2019] ZASCA 04.

Tags: alternative dispute resolution (ADR) process; relevant material; understatement of interest income; understatement penalty; interlocutory application; Rule 31 Statement.

REVIEWING A SARS ASSESSMENT IN THE HIGH COURT

In the Supreme Court of Appeal (SCA) judgment in Commissioner for the South African Revenue Service v Rappa Resources (Pty) Ltd, *[2023], the South African Revenue Service (SARS) raised assessments against Rappa Resources (Pty) Ltd (Rappa) for the payment of value-added tax, interest and penalties.*

As is standard with an assessment, Rappa was informed that if it wished to object to the assessments raised, it would need to do so in accordance with section 104 of the Tax Administration Act, 2011 (the TAA).

Instead of filing an objection in the ordinary course, Rappa launched an urgent application to the High Court seeking, *inter alia*, the following relief:

Reviewing and setting aside the decision of the Commissioner to issue the Assessments (the decision);

2. Reviewing and setting aside the Assessments;

3. Declaring the decision of the Commissioner to issue the Assessments to be in conflict with the constitutional principle of legality and accordingly unconstitutional, unlawful and invalid."

Under the review in terms of Rule 53(1)(b) of the Uniform Rules of Court (Rules), Rappa further requested that the High Court order that SARS be obliged to make available the record of its decision under review. When SARS was not forthcoming with the record, Rappa instituted an interlocutory application to compel SARS to make the record available.

SARS' ARGUMENT

In its answering papers, SARS indicated that it would not produce the record, as Rappa's application for review (and the incidental application to compel) was not competent, due to it not following the usual procedure in terms of section 104. In addition, SARS argued that the High Court had not made an order in terms of section 105 of the TAA, which provides as follows:

> "A taxpayer may only dispute an assessment or 'decision' as described in section 104 in proceedings under this Chapter, unless a High Court otherwise directs."

On this basis, SARS contested Rappa's application for review, as well as its application to compel, as Rappa did not apply for the High Court's direction in terms of section 105. SARS stated that Rappa should have followed the procedure to dispute the assessment in accordance with section 104, or alternatively, made an application in terms of section 105 requesting that the High Court direct that the review could be heard by a High Court, as opposed to making an objection in the ordinary course, in accordance with section 104.

The High Court subsequently decided the application to compel in favour of Rappa and ordered SARS to provide Rappa with the record. SARS applied for leave to appeal this decision to the SCA, which was granted on the basis of SARS' main argument: that the High Court lacked jurisdiction in the review due to the provision in section 105, and therefore also could not make a decision on matters incidental thereto (in other words, the application to compel).

RAPPA'S DEFENCE

Rappa raised the defence that section 105 was not applicable in its review to the High Court, as the review was based on grounds relating to the legality of the assessments, as opposed to the merit thereof. In response to this defence, the SCA referred to the decision in *Africa Cash & Carry (Pty) Ltd v The Commissioner for the South African Revenue Service,* [2019], where it was held that:

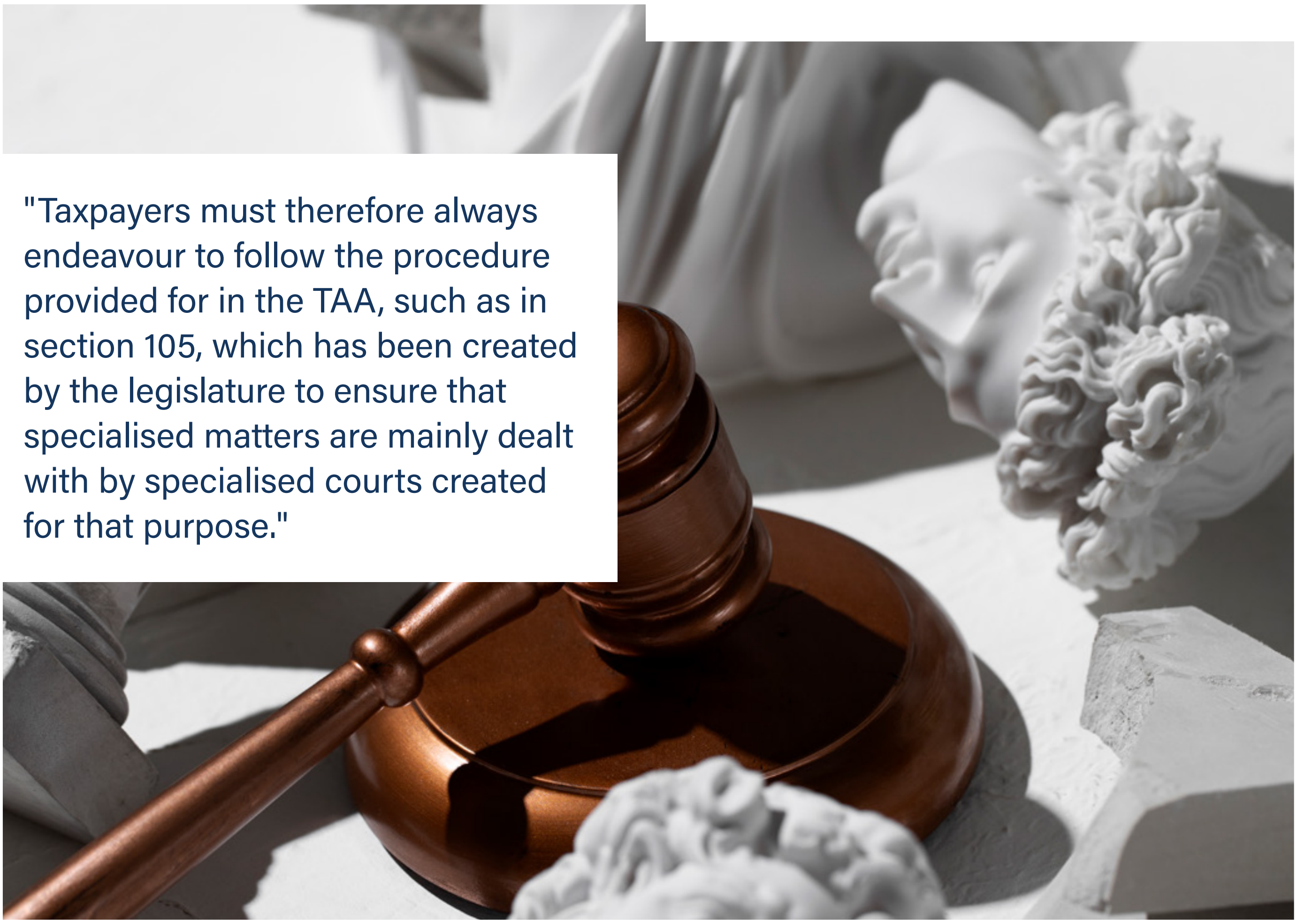
> "The point of departure should always be that a tax court is a court of revision and 'not a court of appeal in the ordinary sense.' The legislature 'intended that there could be a re-hearing of the whole matter by the Special Court and that the Court could substitute its own decision for that of the Commissioner', if justified on the evidence before it."

The SCA thereby refuted the defence raised by Rappa, stating that the "wide power of revision of the tax court includes the power to determine the legality of an assessment on grounds of review". Therefore, even where the merits are not contested by the taxpayer, the process in section 104 should still be the default route, and, in the alternative, the taxpayer can apply for direction from the High Court in terms of section 105.

Significantly, the SCA also confirmed, with reference to *Metcash Trading v Commissioner, South African Revenue Service and Another,* [2001], that the High Court is not barred from determining tax disputes, and may do so, subject to section 105. Section 105 allows for necessary judicial intervention in relation to a decision by the Commissioner, in certain circumstances, one of which includes the determination of the High Court's jurisdiction to determine tax cases.

THE DECISION

The SCA had to decide whether a High Court has jurisdiction in an application for review of an assessment made by a taxpayer who did not seek the High Court's prior endorsement in accordance with section 105.



"Taxpayers must therefore always endeavour to follow the procedure provided for in the TAA, such as in section 105, which has been created by the legislature to ensure that specialised matters are mainly dealt with by specialised courts created for that purpose."

The SCA discussed the case of *Competition Commission of South Africa v Standard Bank of South Africa Limited*, [2020] (*CCSA v Standard Bank*), specifically in relation to the ability of the High Court to make a decision in respect of production of a record, as well as the appealability of an interlocutory application to compel.

According to the decision in *CCSA v Standard Ban*k, a High Court cannot make an order for the production of a record in a review, where it has not first established whether it has jurisdiction in the main review. Furthermore, the court in *CCSA v Standard Bank* held that a decision made by a High Court in respect of an application to compel the delivery of a record, was indeed appealable.

The SCA held that, overall, the purpose of section 105 "is clearly to ensure that, in the ordinary course, tax disputes are taken to the tax court". Therefore, by not making an order in terms of section 105, the High Court did not have the necessary jurisdiction to hear the review application, nor issue the application to compel production of the record.

SARS' appeal was thus upheld with costs, and the order of the High Court was set aside and replaced with an order dismissing the application with costs, including those of two counsel.

CONCLUSION

It is important to note that the wording of section 105 is in fact peremptory as the SCA held that, "an order under section 105 … is not simply to be had for the asking". Furthermore, the SCA notably quoted *CCSA v Standard Bank*, where it was held that, "we 'should not pre-empt the [High Court's] decision on its jurisdiction'". Therefore, a taxpayer must first apply for the High Court's direction, prior to applying to a High Court for review.

Taxpayers must therefore always endeavour to follow the procedure provided for in the TAA, such as in section 105, which has been created by the legislature to ensure that specialised matters are mainly dealt with by specialised courts created for that purpose. Taxpayers cannot merely choose to follow the route of civil procedure instead of the specialised tax procedure. Therefore, regardless of the route chosen by a taxpayer seeking a review, the starting point must always be the TAA.

"Significantly, the SCA also confirmed, with reference to *Metcash Trading v Commissioner, South African Revenue Service and Another*, [2001], that the High Court is not barred from determining tax disputes, and may do so, subject to section 105."

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Acts and Bills

- Tax Administration Act 28 of 2011: Sections 104 & 105.

Other documents

- Uniform Rules of Court: Rule 53(1)(b).

Cases

- *Commissioner for the South African Revenue Service v Rappa Resources (Pty) Ltd* (Case No 1205/2021) [2023] ZASCA 28;
- *Africa Cash & Carry (Pty) Ltd v The Commissioner for the South African Revenue Service* (783/18) [2019] ZASCA 148;
- *Metcash Trading v Commissioner, South African Revenue Service and Another* [2001] (1) SA 1109 (CC);
- *Competition Commission of South Africa v Standard Bank of South Africa Limited* [2020] ZACC 2.

Tags: interlocutory application; specialised tax procedure.

TAX DISPUTES: DIRECT ACCESS TO HIGH COURT IS BY EXCEPTION

Finalising a dispute against an additional assessment or a SARS decision can be a "protracted slog" to the tax court. Recent case law suggests that relief in the High Court is only available in exceptional circumstances.

THE TAA PROCESS

Chapter 9 of the Tax Administration Act, 2011 (the TAA), and the dispute resolution rules (the Rules) provide for aggrieved taxpayers to dispute assessments and SARS decisions using the objection and appeal procedures.

If SARS disallows or partly disallows the objection, the taxpayer can appeal the disallowance. At this stage, taxpayers can select alternative dispute resolution (ADR) for the appeal. If the ADR is unsuccessful, the appeal proceeds to the tax court, with a pre-hearing stage when SARS and the taxpayer exchange various statements of grounds of assessment and appeal.

This is followed by the discovery of documents, setting down the appeal, pre-trial conference, witness interviews, possible subpoena of witnesses, and preparation of court bundles. Finally, the actual hearing takes place and then there is a wait for the tax court to deliver judgment. Tax court judgments are often appealed by taxpayers or by SARS, sometimes all the way to the Constitutional Court.

It may be tempting for taxpayers to avoid the long process to the tax court and approach the High Court for relief using, for example, an application for a declaratory order or a legality review of the assessment or SARS decision.

Here we summarise a few principles from recent case law on alternatives to the Chapter 9 dispute process.

1. **The tax court is a specialised court and the default route for tax disputes**

The TAA provides that the tax court is a specialised court, with exclusive jurisdiction for tax matters and procedural issues relating to tax matters. However, the TAA does not preclude the High Court from determining tax disputes.

In both *the United Manganese of Kalahari (Pty) Ltd v Commissioner for the South African Revenue Service,* [2023], and *Commissioner for the South African Revenue Service v Rappa Resources (Pty) Ltd,* [2023], judgments (both handed down on 24 March 2023), the taxpayers sought to have their additional assessments (issued after audits) set aside by the High Court. On appeal, the Supreme Court of Appeal (SCA) confirmed that a taxpayer may only dispute an assessment or a SARS decision using the objection and appeal process in Chapter 9 of the TAA and the Rules, unless the High Court directs otherwise (section 105).

The wording of section 105 suggests that more than one process of dispute resolution is possible, but express permission is required from the High Court if the default route to the tax court is not followed.

2. Exceptional circumstances required to claim relief from the High Court

Taxpayers can approach the High Court for relief in exceptional circumstances. Normally, tax disputes must be resolved in the tax court. An exceptional circumstance arises when the tax dispute turns wholly on a point of law.

It is submitted that it may be difficult to approach the High Court to review and set aside additional assessments after an audit when SARS and the taxpayer have differed on the interpretation of specific sections. The additional assessments are issued based on certain facts, and there may be a dispute about the facts leading to the legal issue. For example, how should "in respect of" be interpreted? Was there a causal link between the amount and the transaction or service in question? How close must the link be?

3. The exceptional circumstances should be expressly pleaded and argued as a preliminary point

In approaching the High Court for relief, a taxpayer must first obtain a section 105 directive that the High Court has jurisdiction in their specific dispute. In other words, the pleadings must clearly set out reasons why the High Court has jurisdiction to determine the tax dispute, and why the High Court is justified in deviating from the default route leading to the tax court.

Case law indicates that the pleadings must deal with, for example:

- why the issue in dispute is a pure point of law (*Absa Bank Limited and Another v Commissioner for the South African Revenue Service,* [2021]);
- why the denial of suspension of payment by SARS is unreasonable (*Africa Cash & Carry (Crown Mines) (Pty) Ltd v Commissioner for the South African Revenue Service,* [2021]); or
- why the refund should be paid, or the audit ended without further delays (*Rappa Resources (Pty) Ltd v Commissioner for the South African Revenue Service,* [2020]).

It is recommended that the founding affidavit to the application for relief should deal with the reasons why the section 105 directive should be issued, as well as the merits of the review.

Recent case law suggests that (i) procedural fairness issues in an audit or (ii) a review of the disallowance of an objection (when it appears that SARS auditors have not considered the documents provided during the audit process or grounds of objection) are unlikely to meet the high standard of exceptional circumstances to justify applying to the High Court for relief. It may be practical to argue these issues as preliminary *in limine* points at the tax court before hearing evidence on the merits.

4. Application for declaratory order in limited circumstances

In the October 2022 *MTN* case (*Mobile Telephone Networks (Pty) Ltd v Commissioner for the South African Revenue Service,* [2022]), MTN applied for a binding private ruling (BPR) that section 10(18) of the VAT Act applied to its sale of pre-paid vouchers. Effectively, MTN argued it should account for output VAT only when the vouchers were used to receive services, not when the vouchers were purchased. SARS disagreed. SARS argued that section 10(19) applied and that output VAT should be accounted for when the vouchers were purchased. In light of the disagreement, MTN applied to the High Court for a declaratory order that section 10(18) should apply to these multi-purpose airtime vouchers.

The SCA referred to, and cited with approval, many cases where courts have entertained applications for declaratory orders in tax matters in limited circumstances. The SCA held that there should at least be a discrete legal issue for the court to decide, and no factual dispute or lack of clarity on the facts.

Even when there is a clear legal issue with no dispute over the facts, the court will still decline to exercise its discretion to grant a declaratory order to prevent "the opening of floodgates for applications to court where certainty is sought from the court prior to applying a new strategy". The SCA concluded that MTN wished to obtain clarity from the High Court to depart from its prior practice of applying section 10(19) and held that the dispute should be resolved using the usual TAA process.

"Even when there is a clear legal issue with no dispute over the facts, the court will still decline to exercise its discretion to grant a declaratory order to prevent 'the opening of floodgates for applications to court where certainty is sought from the court prior to applying a new strategy.'"

It appears from the arguments raised that the SCA considers "the usual TAA process" would be for:

a. MTN to submit its VAT 201 return applying section 10(18);

b. SARS will reject the return and issue an additional assessment using section 10(19);

c. MTN will then object to the additional assessment;

d. SARS will disallow the objection;

e. MTN will appeal the disallowance, and

the process to the tax court will continue. MTN will be able to lead evidence at the tax court why section 10(18) should apply. Finality of the matter may take even longer if the losing party appeals the decision as far as the Constitutional Court.

APPLICATION FOR RULE 56 DEFAULT JUDGMENT

If SARS has not complied with the timelines or its obligations in the dispute process set out in the Rules, taxpayers may apply for a default judgment against SARS at the tax court in terms of rule 56. This can be a powerful and efficient remedy for taxpayers but must be preceded by a notice to SARS to remedy its default within 15 business days of delivery of the notice.

In the *Taxpayer N v Commissioner for the South African Revenue Service*, [2023], case, the taxpayer applied for a rule 56 default judgment due to the lateness of SARS' rule 31 statement.

The tax court held that the overarching consideration in determining whether default judgment should be granted is the broader interests of justice. The interests of justice are much broader than the interests of the immediate disputing parties, in other words, broader than the reasons for the delays, their *bona fide* actions and prospects of success.

The tax court held that it was in the public interest for the dispute to be fully ventilated and for the tax court to determine the lawfulness of the taxpayer's claim for employment tax incentives, which SARS had disallowed.

The tax court condoned the late rule 31 statement despite the January to July 2022 delays by SARS in filing the statement and the court finding that "the matter simply slipped through the cracks" at SARS. The taxpayer's rule 56 application to uphold the appeal and for SARS to issue reduced assessments was dismissed.

The only win for the taxpayer in this rule 56 application was that SARS was held liable for costs on an attorney and client scale.

CONCLUSION

It is possible in very specific circumstances for aggrieved taxpayers to approach the High Court rather than the tax court for relief. It is necessary for the taxpayer to seek the express permission of the High Court to circumvent the default route, setting out the reasons why the High Court has jurisdiction in this matter. Taxpayers are urged to seek expert advice on these issues.

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Webber Wentzel

Acts and Bills

- Value-Added Tax Act 89 of 1991: Sections 10(18) & (19);
- Tax Administration Act 28 of 2011: Sections 103 & 105, Chapter 9 (sections 101–150).

Other documents

- Dispute resolution rules made in terms of section 103 of the TAA: Rules 31 & 56;
- SARS' rule 31 statement;
- VAT 201 return.

Cases

- *United Manganese of Kalahari (Pty) Ltd v Commissioner for the South African Revenue Service* (1231/2021) [2023] ZASCA 29 (24 March 2023));
- *Commissioner for the South African Revenue Service v Rappa Resources (Pty) Ltd* (1205/2021) [2023] ZASCA 28 (24 March 2023);
- *Absa Bank Limited and Another v Commissioner for the South African Revenue Service* (2019/21825 [P]) [2021] ZAGPPHC (11 March 2021);
- *Africa Cash & Carry (Crown Mines) (Pty) Ltd v Commissioner for the South African Revenue Service* [2021] ZAGPPHC (31 May 2021);
- *Rappa Resources (Pty) Ltd v Commissioner for the South African Revenue Service* (20/18875) [2020] ZAGPPHC (5 November 2020);
- *Mobile Telephone Networks (Pty) Ltd v Commissioner for the South African Revenue Service* (805/2021) [2022] ZASCA 142 (24 October 2022);
- *Taxpayer N v Commissioner for the South African Revenue Service* (2022/37) [2023] (23 February 2023).

Tags: additional assessment; alternative dispute resolution (ADR); section 105 directive; disallowance of an objection; *in limine* points; declaratory order; rule 56 default judgment; rule 31 statement.

THE RIGHT OF APPEAL DOES NOT EXCLUDE THE RIGHT OF REVIEW

SARS plays a vital role in the collection of revenue, which is the life blood of the country and finances the wheels of government. Given its critical role, SARS is granted draconian powers. But, with respect, SARS can be less than transparent and does not always fight fairly.

The landmark decision by the Supreme Court of Appeal in March 2023 in the case of *Commissioner for the South African Revenue Service and Another v Richard's Bay Coal Terminal (Pty) Ltd,* [2023], however, highlights that the decisions made by SARS in respect of tariff determinations (and value determinations) which allow for a wide right of appeal, are also capable of review.

SARS argued that because the Customs and Excise Act, 1964 (the CEA), allows for a wide appeal – effectively the High Court can decide the issue *de novo* on the same evidence or on new evidence – the taxpayer does not have the right of review, nor can the taxpayer call for the documents constituting the record that gave rise to the impugned decision in terms of Uniform Rule 53 [alternatively, discovery in terms of Uniform Rule 35(11)].

The decision is ground-breaking. The case, or factual matrix, is not discussed here in detail. This article is aimed at highlighting several of the important principles confirmed by the court.

It was held that the audit of the taxpayer, the findings and the decision of the Excise Appeal Committee (EAC) were quintessentially administrative action as defined by the Promotion of Administrative Justice Act, 2000 (PAJA). After an analysis of several cases, it was held that the right to administrative action that is lawful, reasonable and procedurally fair as provided for in section 33 of the Constitution of the Republic of South Africa, 1996 (the Constitution) – and as fleshed out by PAJA – is an integral part of our law, the rule of law and principle of legality. The court quoted the Constitutional Court with approval stating that PAJA is not ordinary legislation; it was enacted to give effect to the provisions of section 33 of the Constitution and the right to just administrative action. Statutes allowing for administrative action must therefore be read with PAJA.

The court held further that the argument put forward by SARS that a wide appeal excludes a right of review flies in the face of the principles that underpin the exercise of all public power as set out in section 33 of the Constitution.

Section 195 of the Constitution provides:

"195. Basic values and principles governing public administration

(1) Public administration must be governed by the democratic values and principles enshrined in the Constitution, including the following principles:

(a) A high standard of professional ethics must be promoted and maintained.

(b) Efficient, economic and effective use of resources must be promoted.

(c) Public administration must be development-oriented.

(d) Services must be provided impartially, fairly, equitably and without bias.

(e) People's needs must be responded to, and the public must be encouraged to participate in policy-making.

(f) Public administration must be accountable.

(g) Transparency must be fostered by providing the public with timely, accessible and accurate information."

The court noted that although a decision may be (substantively) correct, it might be made unlawfully or unfairly, which may give rise to a right of review of the impugned decisions.

While it is more complicated, simply put, an appeal focuses on the outcome, ie, the decision itself, whereas a review focuses on the process leading to that outcome, ie, the reasonableness and procedural fairness in arriving at the outcome, which is governed by section 33 of the Constitution and PAJA.

In rejecting the argument put forward by SARS that a wide appeal excludes the courts' jurisdiction of review, it was found that such an interpretation was untenable and would be in conflict with –

i. PAJA and section 33 of the Constitution, which both seek to protect the right to just administrative action;

ii. the rule of law and section 169 of the Constitution, which gives the High Court the power to decide any violation of the principle of legality; and

iii. section 172 of the Constitution, which empowers the court to make a declaratory order that the conduct complained of is inconsistent with the Constitution and invalid to the extent of such inconsistency and in the circumstances to make an order that is just and equitable.

In looking at the specific wording of the relevant sections of the CEA, it was held that they do not exclude the right of review. (It is submitted that any attempt by SARS to amend the legislation to avoid the finding in the judgment and to exclude the right of review will be in conflict with the Constitution and ought to be struck out as unlawful.) The court then made several strong comments towards the end of the judgment to the effect that:

1. The duty to discover documents is a tool for discovery of the truth.

2. There is a heightened need for a record where SARS has not provided reasons. SARS cannot shield its own conduct from scrutiny by refusing to make disclosure of details relevant to its conduct. It is, moreover, a duty on public officials to take the court into their confidence and to disclose all relevant information to enable courts to make an informed decision in the public interest and to ensure good governance.

3. Based on the *Helen Suzman Foundation v Judicial Service Commission,* [2018], case, the court quoted, with approval, the decision of the majority of the Constitutional Court in exercising the importance of openness and accountability as well as the danger of legalities being concealed from scrutiny, and the impact of non-disclosure on the fairness of the trial.

This decision will be far-reaching and is a welcome confirmation that the basic values and principles governing public administration provided for in section 195 of the Constitution must be upheld and that a taxpayer's rights in terms of section 33 of the Constitution read with the provisions of PAJA are not to be ousted.

As was stated by the Constitutional Court in *Janse van Rensburg NO and Another v Minister of Trade and Industry and Another NNO,* [2001]. in a modern state where administrative functionaries are granted more and more power, the safeguards imposed by the observance of procedural fairness ensure that the functionary has an open mind and a complete picture of the facts leading to a measured decision that is both fair and regular.

It is hoped that the fact that SARS must act transparently and can be compelled to disclose a record giving rise to impugned decisions, will lead to reasoned and better decision making.

"While it is more complicated, simply put, an appeal focuses on the outcome, ie, the decision itself, whereas a review focuses on the process leading to that outcome, ie, the reasonableness and procedural fairness in arriving at the outcome, which is governed by section 33 of the Constitution and PAJA."

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Acts and Bills

- Customs and Excise Act 91 of 1964;
- Promotion of Administrative Justice Act 3 of 2000;
- Constitution of the Republic of South Africa, 1996: Sections 33, 169, 172 & 195.

Other documents

- Uniform Rules of Court: Rules 35(11) & 53.

Cases

- *Commissioner for the South African Revenue Service and Another v Richard's Bay Coal Terminal (Pty) Ltd* Case No 1299/2021) [2023] ZASCA 39 (31 March 2023);
- *Janse van Rensburg NO and Another v Minister of Trade and Industry and Another NNO* [2001] (1) SA 29 (CC) (at paragraph 24)).

Tags: administrative action; right of review; procedural fairness.

INPUT TAX: HOLDING COMPANIES

*Vendors may deduct input tax on goods or services acquired for purposes of making taxable supplies in the course or furtherance of their enterprise. This article considers a tax court judgment (*Taxpayer ZAW v Commissioner for the South African Revenue Service, *[2023],) issued in March 2023 that dealt with input tax deducted by a group holding company.*

FACTS

The taxpayer is ZAW, a VAT vendor and listed company. It held shares in various operating subsidiaries, locally and abroad.

ZAW raised capital through a rights offer to residents and non-residents to repay a bridge facility that it used to fund the acquisition of the shares of an Australian department store. ZAW procured services from local and foreign providers to arrange and execute the facility and rights offer. It claimed input tax on the raising fees incurred in respect of the shares issued to non-residents, a zero-rated taxable supply.

DISPUTE AND ARGUMENTS

SARS disallowed this input tax deduction on the basis that the services were not acquired to make taxable supplies in the course or furtherance of ZAW's enterprise. ZAW's trading activities were not to issue shares. It also seems that SARS contended that the services relating to capital raising were not sufficiently closely related to the management services (taxable supplies) that ZAW rendered to subsidiaries.

"Although not considered in this case, the judgment could also be relevant to questions about the deductibility of input tax in respect of raising costs more broadly. This topic in itself is contentious."

ZAW described its enterprise as a listed, active investment holding company, with activities which included acquiring and holding investments, capital management of those investments, and providing financial and management services to its investment subsidiaries. Raising capital, as an aspect of capital management, was an integral element of these activities.

The dispute essentially centred around ZAW's enterprise as a group holding company and the connection between this enterprise and the capital-raising services.

HOLDING COMPANY'S ENTERPRISE

SARS relied on the *De Beers* case (*Commissioner, South African Revenue Service v De Beers Consolidated Mines Ltd,* [2012]), where the SCA concluded that services in connection with a takeover transaction were unrelated to, and did not contribute to, the taxpayer's enterprise of mining, marketing and selling diamonds. The tax court concluded that ZAW's case is distinguishable. It considered the provision of financial and management services to its subsidiaries for remuneration as an integral part of ZAW's business. Relying on *Consol Glass (Pty) Ltd v Commissioner for the South African Revenue Service*, [2020], the tax court concluded:

> "Taxpayer ZAW's actions in expanding its business and incurring costs, both local and foreign, in the course thereof has a functional link to the making of its VAT taxable supply of management services to its subsidiaries and that the expenses incurred in this regard were incurred wholly for the purpose of consumption, use or supply in the course of supplying goods and services (taxable supplies) and in the course or furtherance of its enterprise".

The judgment provides support for holding companies deducting input tax in connection with management services they render. It further recognises that the enterprise in question may consist of an integrated set of activities involving shareholding and related group financing.

Although not considered in this case, the judgment could also be relevant to questions about the deductibility of input tax in respect of raising costs more broadly. This topic in itself is contentious.

Pieter van der Zwan

Cases

- *Taxpayer ZAW v Commissioner for the South African Revenue Service,* [2023] (VAT 1922) (14 March 2023);
- *Commissioner, South African Revenue Service v De Beers Consolidated Mines Ltd* (503/11) [2012] ZASCA 103, [2012] (5) SA 344 (SCA) (1 June 2012);
- *Consol Glass (Pty) Ltd v Commissioner for the South African Revenue Service* (1010/2019) [2020] ZASCA 175 (18 December 2020).

Tags: taxable supplies; capital-raising services.

South African Institute of Taxation