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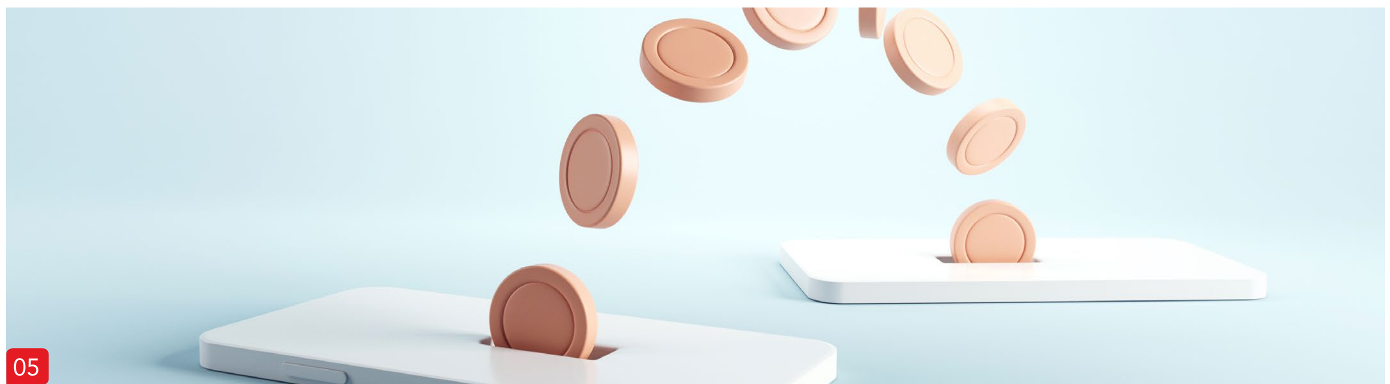
TAX CHRONICLES MONTHLY

Official Journal for the South African Tax Professional

CRYPTO ASSETS
EXCHANGE CONTROL OVER ASSETS EXPORTED

GENERAL
SARS INTEREST RATES

TAX ADMINISTRATION
READILY APPARENT UNDISPUTED ERRORS


05

07

24

33

CARBON TAX
0394. Summary of selected recent developments 03

CRYPTO ASSETS
0395. Exchange control over assets exported 05

DEDUCTIONS AND ALLOWANCES
0396. Contributions to share incentive schemes 07

EXEMPT INCOME
0397. Taxpayers working on ships 11

GENERAL
0398. Dates when tax liabilities arise 12
0399. Disposals following foreign relisting of securities 14
0400. SARS interest rates 16
0401. Transfer of assets between spouses: Income tax and CGT implications 18

INTERNATIONAL TAX
0402. Ceasing to be SA tax resident 20
0403. Most favoured nation clause in DTAs 22

TAX ADMINISTRATION
0404. Limited opportunity to add to grounds of objection? 24
0405. Readily apparent undisputed errors 26
0406. Vexatious proceedings and abuse of court processes 28

VALUE-ADDED TAX
0407. COVID-19 indemnity payments 31
0408. Transfer duty and notional input tax 33

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SUMMARY OF SELECTED RECENT DEVELOPMENTS

The Carbon Tax Act, 2019 (the CT Act), is a piece of legislation that was passed into law with effect from 1 June 2019. It is likely that the pace of legislative amendments and administrative guidance will remain strong in the future as organisations of all shapes and sizes and across all industry sectors adapt to the implications of a price on carbon. The regime has created an expansive regulatory framework that assigns responsibility for different aspects of the carbon tax regime to the South African Revenue Service, the Department of Forestry, Fisheries and the Environment and the Department of Energy. Over time these initiatives will have a transformative effect on the South African economy. This article contains a summary of recent carbon tax developments.

CARBON BUDGETS

The draft Climate Change Bill (the draft Bill), as approved by Cabinet, was submitted to Parliament in terms of parliamentary rules in October 2021. Although the Minister of Forestry, Fisheries and the Environment (the Minister) after that gave notice of her intention to introduce the Bill, it had not been tabled in Parliament by the end of January 2022. In terms of the draft Bill the Minister will be required to allocate a carbon budget to any person that conducts a greenhouse gas emitting activity listed in terms of clause 23(2). In terms of clause 23(2) the Minister must, by notice in the *Gazette*, publish a list of greenhouse gas emitting activities that emit one or more of the greenhouse gases listed in terms of clause 23(1) and which the Minister reasonably believes cause or are likely to cause or exacerbate climate change.

The approach adopted in the draft Bill involves imposing the carbon tax and the carbon budget on all entities that are expected to be regulated by each instrument. Many entities will be subject to a carbon budget and will also have to pay carbon tax on all of their emissions. Entities whose emissions are within their carbon budget do not receive any additional concessions other than the allowances and deductions to which they already are entitled in terms of the CT Act.

Significantly, clause 24(3) of the draft Bill states that where the carbon budget as allocated to a person for any period under review is exceeded, that person will be subject to a higher carbon tax rate on emissions above the carbon budget as provided for in the CT Act. In order to give effect to these provisions, amendments will be made to the CT Act to provide for the higher carbon tax rate. Hence, the penalty for exceeding the carbon budget will be a higher rate of carbon tax.

"Significantly, clause 24(3) of the draft Bill states that where the carbon budget as allocated to a person for any period under review is exceeded, that person will be subject to a higher carbon tax rate on emissions above the carbon budget as provided for in the CT Act."

In contrast, there is no provision that permits an entity to carry forward its unused budget. For instance, if an entity is allocated a carbon budget of 100 for 3 years and the carbon dioxide equivalent of its greenhouse gas emissions is 90 in year 1 then its carbon budget will remain 100 in year 2. The saving of 10 in year 1 carbon budget will not increase to 110 in year 2. The rationale for this approach is presumably that such an entity already benefits by paying less carbon tax.

In addition, a person to whom a carbon budget has been allocated must prepare and submit to the Minister, for approval, a greenhouse gas mitigation plan.

TAXATION LAWS AMENDMENT ACT 2021

On 28 July 2021 the draft Taxation Laws Amendment Bill 2021 (the draft TLAB 2021) was published proposing amendments to numerous provisions in the CT Act. These include clarification concerning the beneficiaries of the renewable energy premium. Unlike the allowances reducing a taxpayer's carbon dioxide equivalent emissions (CO_2e emissions), the renewable energy premium provides for a rand-for-rand deduction against the taxpayer's carbon tax liability. The Taxation Laws Amendment Bill, 2021, was introduced in the National Assembly on 11 November 2021, passed, as amended by Parliament, on 15 December 2021, and promulgated as Act 20 of 2021 on 19 January 2022.

The renewable energy premium deduction reduces "the amount of tax payable by a taxpayer in respect of the generation of electricity from fossil fuels". The words "in respect of" suggest that where a taxpayer carries on multiple emissions generating activities including the generation of electricity from fossil fuel and it purchases renewable electricity, then it can only claim the renewable energy premium deduction against the carbon tax liability that arises from the generation of electricity from fossil fuel instead of its total carbon tax liability.

However, the actual formula by which the carbon tax of fossil fuel electricity generators is determined requires the deduction of the renewable energy premium from "the amount of tax payable in respect of a tax period determined" in terms of section 6(1) of the CT Act; this suggests that the renewable energy premium may be deducted from the total carbon tax liability.

Hopefully, this issue will also be explained in the proposed clarifications to the renewable energy premium.

CARBON OFFSETS

On 8 July 2021 amendments to the Carbon Offsets Regulations were published. The CT Act makes provision for the carbon offset allowance permitting taxpayers to reduce their carbon tax liability by either 5 or 10 per cent of their total greenhouse gas "GHG" emissions through investment in projects that reduce their emissions provided that these projects occur outside their taxable activities.

Among the amendments made was the suggestion that the current wording in the Carbon Offsets Regulations could be interpreted to mean that a taxpayer claiming any section 12L allowance for any project will be prohibited from claiming any carbon tax offsets allowance, despite the project being completely unrelated. Since this was not the intention of the legislation, a new subregulation 4(2) was inserted to specify the exclusion of 12L projects as eligible carbon offsets. It specifies that: "A taxpayer may not receive the allowance in respect of an offset of a project in which any allowance has been received in terms of section 12L of the Income Tax Act, 1962".

CARBON TAX RENEWALS

On 2 July 2021, SARS issued a carbon tax communiqué, informing taxpayers that the validity period for licences for customs and excise manufacturing warehouses for the generation of emissions liable to carbon tax is from the effective date until 31 December 2021 and thereafter 31 December of the following year. All such licensees must annually apply to renew their licences *on or before 31 December of each year*, as from 2021, by submitting an updated form for licensing (DA185 and its annexure DA185.4B2) *with the required supporting documents* to the SARS Excise Registration and Licensing Hub at the *Alberton branch office*.

The deadline for renewals *on or before 31 December of each year* is confusing as SARS normally requires renewal applications to be made 30 calendar days before the expiration date. It is recommended that taxpayers exercise caution and submit their renewal applications before the end of November of a given year. *The reference to required supporting documents is a departure from the previous practice that no supporting documents were required for renewal applications*. And the reference to the SARS Excise Registration and Licensing Hub at the Alberton branch office appears limiting as SARS usually accepts renewal applications at their Alberton, Bloemfontein, Cape Town, Durban, Port Elizabeth, Pretoria, Stellenbosch and Upington branches.

Mansoor Parker

ENSafrica

Acts and Bills

- Carbon Tax Act 15 of 2019: Section 6(1);
- Income Tax Act 58 of 1962: Section 12L;
- Taxation Laws Amendment Bill 22B of 2021;
- Draft Taxation Laws Amendment Bill, 2021 (published on 28 July 2021);
- Draft Climate Change Bill, 2021: Clauses 23(1) & (2) & 24(3);
- Taxation Laws Amendment Act 20 of 2021.

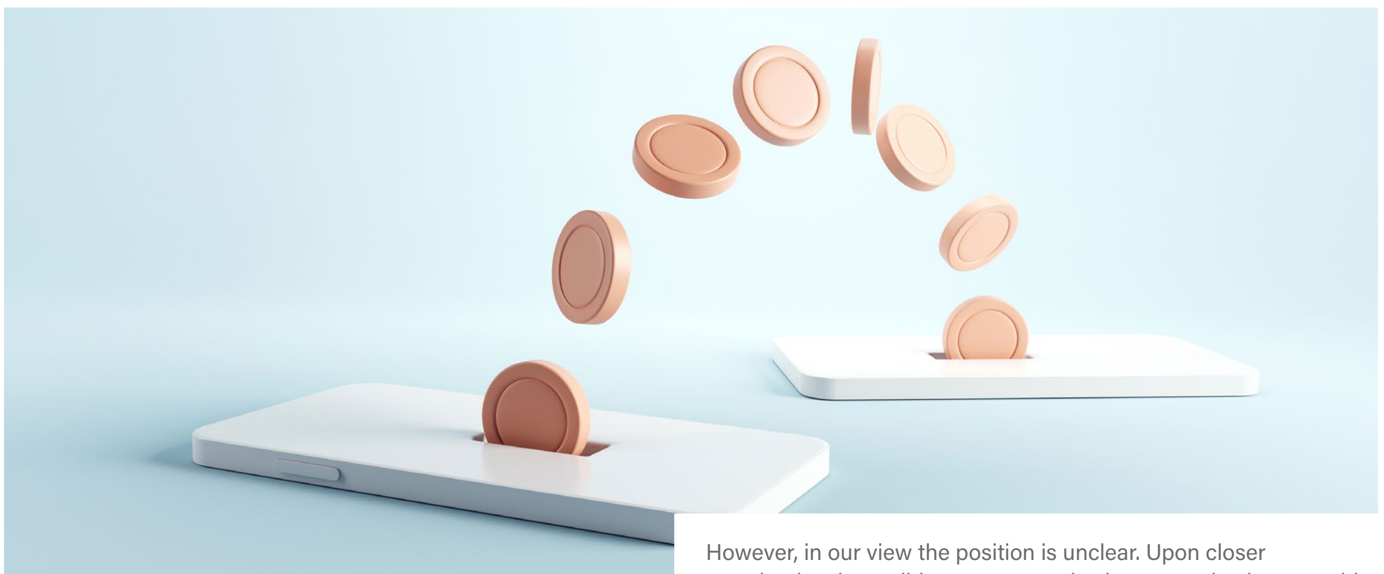
Other documents

- Carbon Offsets Regulations: Regulation 4(2) (new subregulation (2)) (8 July 2021);
- Carbon tax communiqué (issued by SARS on 2 July 2021);
- Form DA185 (+ annexure DA185.4B2) – licensing update.

Tags: greenhouse gas emitting activities; carbon budget.

EXCHANGE CONTROL OVER ASSETS EXPORTED

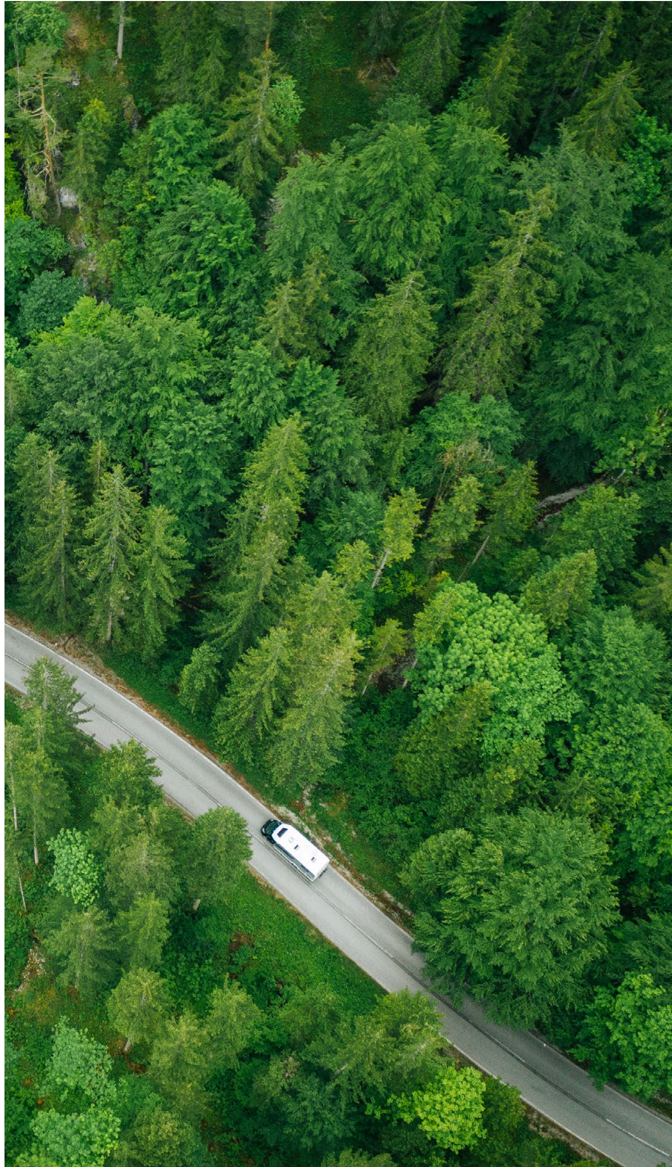
The Financial Surveillance Department of the South African Reserve Bank (FinSurv) has made its views known on exchange control issues relating to the movement of crypto assets between digital wallets on a South African crypto exchange (such as OVEX) and a foreign crypto exchange (such as Binance) via the frequently asked questions section of the Intergovernmental Fintech Working Group website. FinSurv states that it considers this to be an unlawful export of capital in contravention of regulation 10(1)(c) of the Exchange Control Regulations (made in terms of section 9 of the Currency and Exchanges Act, 1933) and a criminal offence. This has become a topical issue as the popularity of crypto assets has soared over the past year. In our view, the authority for this position is questionable, and will depend on each person's facts and circumstances.



Cryptocurrency is an intangible asset. Traditionally, the *situs* of an intangible asset has been regarded as the place where it can be effectively dealt with. This was particularly relevant to assets such as shares, based on where the share register is located, or a trademark, based on where the register is maintained (see *Spier Estate v Die Bergkelder Bpk and Another,* [1988]). On the face of it, perhaps one could argue that a crypto asset can be effectively dealt with wherever the exchange carries on business, since the exchange keeps a record of ownership of the assets that it holds on behalf of investors. Therefore, arguably moving the crypto asset to an exchange in different jurisdictions may change its *situs* and is therefore an export of capital.

"Cryptocurrency is an intangible asset. Traditionally, the *situs* of an intangible asset has been regarded as the place where it can be effectively dealt with."

However, in our view the position is unclear. Upon closer examination, intangible assets may also be categorised as movable or immovable, and this also has implications for the *situs* of an asset. In the case of a movable intangible asset, the asset has no link to any particular place, and its *situs* follows the domicile of a person (eg, a debtor). It may well be that crypto assets are movable as they may have no particular location, in which case the asset would follow the domicile of the owner of the asset, since there is no other party involved. This would make the export of a crypto asset impossible without a change in the owner's domicile. In the case of the immovable intangible asset, its *situs* follows the place where it has a physical connection (eg, where a register is kept). In this case, the asset cannot be exported. This was the finding of the Supreme Court of Appeal in *Oilwell (Pty) Ltd v Protec International Ltd and Others*, [2011], where it held that a trademark was not capable of being exported for the purposes of regulation 10(1)*(c)*. This led to a specific amendment to regulation 10, in 2012, by the addition of subregulation (4), where "intellectual property" was included in the definition of "capital". However, it appears incorrect to categorise a crypto asset as immovable, as we know that, unlike a share register or a trademark register, a crypto asset's record of ownership exists in the blockchain, which does not have a physical location.



FinSurv has not provided any detailed reasoning for its position, and in our view, it seems unlikely that its position will prevail in circumstances where all that the person has done is move the crypto asset between South African and foreign crypto exchanges, and later returns the crypto asset (or other crypto assets for which the original crypto assets were exchanged) to his or her wallet on a South African crypto exchange. The position also creates uncertainty for investors who simply move the asset from a local crypto exchange wallet to a hardware wallet or a private wallet for security reasons. Again, in these circumstances, FinSurv would not be able to argue that the investor has exported capital. If FinSurv wants to stop this practice it should ensure that specific and clear provisions regarding crypto assets are included in forthcoming amendments to the Exchange Control Regulations.

Of course, there are other circumstances where FinSurv is right. If the person, having moved the crypto asset to a foreign crypto exchange, sells the crypto asset for foreign currency or assets which have a physical location which is outside of South Africa as part of a preordained scheme for exporting funds from South Africa, then it would seem that there is an export of capital in contravention of regulation 10(1)*(c)*. In any event, even if there is no export of capital from South Africa, an obligation arises for the person to repatriate the foreign currency or asset to South Africa in terms of regulations 6 and 7, respectively.

Therefore, if a person finds himself or herself in hot water with FinSurv for having moved a crypto asset from a wallet on a local crypto exchange to a wallet on a foreign crypto exchange or another wallet, advice should be obtained based on the person's particular circumstances. There might not be a contravention of regulation 10(1)*(c)*, and any penalty imposed by FinSurv may be inappropriate (particularly if the penalty is equal to the entire value of the crypto asset – which is not uncommon). For now, the safer route for investors would be to use their single discretionary allowance of R1 million per calendar year or their foreign investment allowance of R10 million per calendar year to fund their account with a foreign crypto exchange. In that case, the crypto assets purchased will form part of their authorised foreign assets and can remain outside of South Africa indefinitely.

Kyle Fyfe

Werksmans

Acts and Bills

- Currency and Exchanges Act 9 of 1933.

Other documents

- Exchange Control Regulations (made in terms of section 9 of the Currency and Exchanges Act): Regulations 6, 7 and 10(1)*(c)*.

Cases

- *Spier Estate v Die Bergkelder Bpk and Another* [1988] (1) SA 94 (C));
- *Oilwell (Pty) Ltd v Protec International Ltd and Others* [2011] (4) SA 394 (SCA).

Tags: intangible asset; movable intangible asset; immovable intangible asset; blockchain; export of capital.

CONTRIBUTIONS TO SHARE INCENTIVE SCHEMES

On 15 October 2021, in Commissioner for the South African Revenue Service v Spur Group (Pty) Ltd, *[2021] (*C:SARS v Spur*), the Supreme Court of Appeal (SCA) handed down judgment on whether a capital contribution made by an employer taxpayer to a trust established for purposes of an employee share incentive scheme was deductible for income tax purposes. The SCA also determined whether prescription applied in the circumstances. This article discusses the case and the impact of its findings on share incentive schemes in South Africa.*

CONTEXT

Employee share incentive schemes are, among other things, designed to align shareholder and employee interests and, therefore, incentivise employees to contribute more meaningfully to the success and growth of the business with a focus on performing in the interests of the business over the long term. It is a long-accepted manner of remuneration and compensation of employees and holders of office in a company.

Importantly, from a tax perspective, it is generally accepted from a policy point of view that remuneration derived by employees from these types of schemes are taxed in the hands of employees as normal income, ie, akin to salaries). In other words, it is often commercially beneficial to compensate employees by way of awarding them shares in the company as opposed to paying a cash bonus. In these circumstances, the gain derived by employees pursuant to the implementation of the scheme is, by and large, taxed as normal income in accordance with section 8C of the Income Tax Act, 1962 (the Act).

Notably, however, while payments of salaries or cash bonuses to employees are generally deductible in the hands of an employer as it is generally considered a business expense, the issuing of shares to employees is typically not allowed as an income tax deduction. There are, however, various alternative share incentive schemes that potentially support the claiming of an income tax deduction by the employer, depending on the circumstances. The claiming of an income tax deduction by the employer ensures these share incentive schemes are attractive and aligned from a commercial perspective with paying cash bonuses and the like.

While the South African Revenue Service (SARS) has issued several rulings based on slightly different sets of facts that confirmed the principle that a capital contribution pursuant to a share incentive scheme may well be deductible in the hands of the employer companies, it was conversely announced in the Budget Review documents as far back as the 2013 National Budget Speech that Government was reviewing the deductibility of expenditure in relation to share incentive schemes. It is against this backdrop that we examine the judgment in *C:SARS v Spur*, which has raised intensive debate as to the ongoing attractiveness of share incentive schemes as a form of compensation.

"The Spur Group (including Spur and Spur HoldCo) resolved in 2004 to implement a share incentive scheme in terms of which eligible employees of Spur were afforded the opportunity to participate in the share incentive scheme to promote the growth and profitability of the Spur Group."

BACKGROUND FACTS

Spur Corporation Limited (Spur HoldCo) is the holding company and 100% shareholder of Spur Group Proprietary Limited (Spur). Spur, the main operating company of the Spur Group, is thus a wholly owned subsidiary of Spur HoldCo. The Spur Group (including Spur and Spur HoldCo) resolved in 2004 to implement a share incentive scheme in terms of which eligible employees of Spur were afforded the opportunity to participate in the share incentive scheme to promote the growth and profitability of the Spur Group.

After 18 months of planning, Spur HoldCo established the Spur Management Share Trust (the Trust). Importantly, Spur HoldCo was at that stage the sole capital and income beneficiary of the Trust. Spur made a capital contribution of R48,471,714 (the Contribution) to the Trust in the 2005 year of assessment, having agreed to contribute a non-refundable expense to the Trust to fulfil its purpose. The participants in the share incentive scheme (employees of Spur) were added in December 2010 as beneficiaries of the Trust, but only stood to benefit from dividends received by the Trust and nothing further. Spur HoldCo remained the sole capital beneficiary of the Trust.

The participants in the share scheme were offered the opportunity to acquire ordinary shares in a newly incorporated private company (NewCo) at par value in proportions determined by Spur HoldCo. The purchase price of the NewCo shares was settled in cash by each participant upon the issuing of the NewCo shares on 15 December 2004. The participants were not entitled to freely dispose of the NewCo shares for a period of at least seven years. Those participants who left Spur's employment during this period forfeited their shares, which were then reallocated to other participants.

Separately, the purpose of the Contribution was for the trustees of the Trust to apply the Contribution (and any income derived from it) by subscribing for preference shares in the NewCo, which in turn, would apply the aggregate subscription price received towards the acquisition of Spur HoldCo shares. In simple terms, the Contribution by Spur to the Trust of R48 million was used by the Trust to purchase the NewCo preference shares. The NewCo would then use the subscription price for the preference shares to acquire the shares in Spur HoldCo.

After the scheme had been implemented and commenced operating, the NewCo received dividends from time to time through its holding of the Spur HoldCo shares. The NewCo retained the dividends to assist in meeting its preference share obligations towards the Trust. In December 2009, the NewCo redeemed the preference shares for an amount of approximately R48 million while the preference dividends in the amount of approximately R22 million were distributed to the Trust. Notably, the redemption of the preference shares and the payment of the preference dividends were settled by way of the NewCo distributing a total of 6,688,698 Spur HoldCo ordinary shares to the Trust. The Spur Holdco shares had a total agreed value equal to the redemption of R48,471,714 and preference dividends of R22,562,254.

Soon after settling its preference share obligations, the NewCo declared dividends to the holders of the NewCo shares (ie, the employee participants). The share incentive scheme was subsequently terminated and the NewCo was deregistered on 10 December 2012. The Trust remains in existence and continues to hold Spur HoldCo shares that were distributed to it by the NewCo.

ISSUE IN DISPUTE

Spur claimed the Contribution as a deduction against its taxable income in terms of the provisions of section 11*(a)* of the Act. The claimed deduction was (in terms of section 23H of the Act), spread over the seven-year period of the anticipated benefit to be derived, ie, between 2005 and 2012. SARS initially allowed the deductions; however, after conducting an audit into Spur's tax affairs for the 2010 to 2012 tax years (which was later extended to include the 2004 to 2009 tax years), SARS disallowed the deduction by way of issuing additional assessments. The basis of the disallowance was that the expenditure (ie, the R48 million Contribution) was not "in the production of income" and therefore did not qualify for a deduction under section 11*(a)*.

The matter proceeded to the tax court (sitting in Cape Town), which found that the purpose of the expenditure was to incentivise key staff members of Spur through a share incentive scheme. In the result it found that there was a sufficiently close causal connection between the Contribution paid by Spur to the Trust and its production of income.

SARS then appealed the tax court judgment and the matter proceeded to the Western Cape High Court (before a full bench with three judges). The majority (two out of three judges) found in favour of the taxpayer and one held against the taxpayer. The High Court was satisfied that Spur had established a sufficiently close connection between the Contribution and Spur's income-earning operations. It was specifically held that the purpose of the expenditure, ie, the Contribution of R48 million, directly served to incentivise the participants and key managerial staff, and to promote the continued growth of Spur. The matter then proceeded to the SCA.

SARS' ARGUMENT BEFORE THE SCA

SARS argued that Spur had made the Contribution to the Trust, of which Spur HoldCo was the sole beneficiary. Spur HoldCo was thus the only party to have benefited directly from the Contribution to the Trust in that it would receive the investment in the NewCo preference shares. In other words, the Contribution of R48 million and the preference share dividends at the time when the NewCo redeemed the NewCo preference shares would be for the benefit of the Trust and its beneficiary, being Spur Holdco and not the employee participants. The causal link required in terms of section 11*(a)* between the expenditure incurred and the income earned was thus lacking. There was (if anything) only an indirect and insufficient link between the expenditure and any benefit arising from the incentivisation of Spur's key staff.

TAXPAYER'S ARGUMENT BEFORE THE SCA

While the Contribution could arguably have been to retain the money within the Spur Group, it was submitted by Spur that the dominant purpose in the establishment and implementation of the scheme was to protect and enhance Spur's business and its income by motivating its management employees to be efficient and productive and to remain in Spur's employ. This would entitle it to claim an income tax deduction.

JUDGMENT

The court unpacked the principles underpinning what is required in terms of section 11*(a)*. In particular, the key issue was whether the expenditure incurred was "in the production of income" or not. In this regard, the court referred to the well-known case of *Port Elizabeth Electric Tramway Co Ltd v CIR*, [1936], in which it was held that two questions arise when considering whether an expense is in the production of income, namely:

1) whether the act, to which the expenditure is attached, is performed in the production of income; and

2) whether the expenditure is linked to it closely enough (ie, there must be a sufficiently close link).

The SCA furthermore referred to *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd*, [1955], where it was held that in deciding how the expenditure should properly be regarded, one has to assess the closeness of the connection between the expenditure and the income-earning operations, having regard both to the purpose and to what it actually effects.

With reference to the leading authority, the SCA in this case concluded that there are two criteria that must be satisfied: firstly, the purpose of the taxpayer in incurring the expenditure in question, and whether the purpose was to produce an income; and secondly, whether a sufficiently close nexus or link exists between the expenditure and the ultimate production of income. It was, however, noted that these criteria establish that a mere existence of a nexus or link between the expenditure and the earning of income is not, on its own, sufficient to justify a deduction under section 11*(a)*. A taxpayer must show an "adequate closeness" between the expenditure and the production of income.

The SCA commented that the participants did not benefit either directly, or even indirectly for that matter, from the making of the Contribution. In support of this finding, the SCA referred to the taxpayer's evidence in the tax court in which the following was stated:

> "[t]he 48 million in the form of now Spur Corporation shares is still sitting in the trust so directly they [the participants] have not benefited from the 48 million."

The SCA held that the Contribution of R48 million was used, wholly, to subscribe for preference shares in the NewCo. Furthermore, only the Trust held the NewCo preference shares, and only it was entitled to the return of the R48 million Contribution plus the preference dividend on those shares. It was concluded that the participants had no right to any part of the Contribution, or to the preference dividends that flowed from the investment thereof. Importantly, in terms of the Trust Deed, only Spur HoldCo would, as the capital beneficiary, have any right to the ultimate delivery of the R48 million Contribution and any yield from it.

Separately, it was explained by the taxpayer that the Contribution by Spur was in effect a funding mechanism for the scheme, which was to remain in place for most of the duration of the scheme. In this manner, the participants were not exposed to the risk of a decrease in the price of Spur HoldCo shares, whereas the NewCo bore this risk. As per the taxpayer's evidence referred to by the SCA, the purpose was always for the R48 million to remain within the Spur Group and not to transfer it to the benefit of the participants, which is ultimately what the Contribution achieved.

Applying the principles in, amongst others, *PE Tramway*, the SCA concluded that the purpose of Spur in incurring the expenditure was not to produce income, as required by section 11*(a)*, but to provide funding for the scheme, for the ultimate benefit of Spur HoldCo. There was only an indirect and insufficient link between the expenditure and any benefit arising from the incentivisation of the participants. The Contribution was therefore not sufficiently closely connected to the business operations of Spur such that it would be proper, natural and reasonable to regard the expense as part of Spur's costs in performing such operations. The income tax deduction of R48 million was thus disallowed.

PRESCRIPTION

Interestingly, the SCA then dealt with the prescription issue second, whereas ordinarily, the prescription issue is dealt with first and then only the merits of the matter. At issue was whether the additional assessments were issued by SARS lawfully, notwithstanding that the three-year period of limitation had already passed by the time it issued the additional assessments. SARS argued that section 99(2)*(a)* of the Tax Administration Act, 2011 (the TAA), being an exception to the general three-year period of limitation, was applicable in that the amount of tax chargeable in terms of the additional assessments was not so assessed by SARS in the relevant years of assessments due to misrepresentation and non-disclosure of material facts by Spur.

The basis for this argument was that in submitting its 2005 income tax return, Spur answered "no" to the following questions:

- Were any deductions limited in terms of section 23H?
- Did the company make a contribution to a trust?
- Was the company party to the formation of a trust during the year?

Furthermore, in its 2005 to 2008 income tax returns, Spur disclosed the amount of the deductions under "other deductible expenditure" as opposed to the specific line item provided for in relation to section 23H. The SCA held that these acts by Spur amounted to deliberate misrepresentation and a non-disclosure of material facts and it commented that it simply could not amount to any inadvertent error. In assessing the second requirement to raise an assessment in terms of section 99(2)*(a)* (ie, the causal link between the act and the outcome of SARS under-assessing), it was held that the disclosures by Spur in its return resulted in the matter not coming before an auditor within the three-year period.

The SCA had the following further harsh warning to taxpayers:

> "[A]s a matter of policy, a court would be loath to come to the assistance of a taxpayer that has made improper or untruthful disclosures in a return. Clearly, this would offend against the statutory imperative of having to make a full and proper disclosure in a tax return."

The SCA thus held that SARS was not precluded by section 99(1) of the TAA to raise the additional assessments despite the three-year period having elapsed.

OBSERVATION

There has been extensive debate regarding the two important decisions handed down by the SCA in this case in respect of capital contributions to share incentive schemes and prescription of tax assessments. It is important to bear in mind that while there is a long line of cases on the requirement of "in the production of income" in the context of claiming a section 11*(a)* income tax deduction, each set of facts and circumstances is different. In this case, the SCA focused on specific facts that distinguished it from other share incentive schemes, especially the fact that the Contribution remained within the Spur Group and that the participant employees only indirectly benefited (if at all) from the Contribution. Therefore, while the judgment is important for all taxpayers embarking on share incentive schemes and one should heed the warnings contained in the judgment, it does not mean the end of share incentive schemes. Taxpayers, however, would be well advised to carefully consider their current arrangements in light of the judgment and to take every precaution that their tax returns are correctly submitted.

Jerome Brink

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 8C, 11*(a)* & 23H;
- Tax Administration Act 28 of 2011: Section 99(1) & (2)*(a)*.

Other documents

- Budget Review documents (as far back as the 2013 National Budget Speech).

Cases

- *Commissioner for the South African Revenue Service v Spur Group (Pty) Ltd* (Case no 320/20) [2021] ZASCA 145 (15 October 2021);
- *Port Elizabeth Electric Tramway Co Ltd v Commissioner for Inland Revenue* [1936] CPD 241 (8 SATC 13);
- *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd* [1955] (3) SA 293 (A).

Tags: share incentive schemes; normal income; cash bonuses; in the production of income; preference shares; preference dividend.

TAXPAYERS WORKING ON SHIPS

In search for opportunities abroad, many South Africans have taken to the seas. It might not be the same as working in a new country, but it offers a change of scenery while earning a foreign income. Working on a rig, a yacht or a cruise ship is not for the faint-hearted, though. Long hours, physically demanding work and diverse groups of people confined to narrow spaces are some of the challenges you can expect to face. Nevertheless, it is also an adventure filled with memories to revisit for years to come.

Seafarers, who are in the same boat as standard expatriates, also encounter rough seas as soon as they start evaluating their financial matters. When the time comes for them to submit their annual tax returns, there are many concerns or grey areas that come to light. Here are a few grey areas that often leave taxpayers scratching their heads.

THE IMPORTANCE OF AN EMPLOYMENT CONTRACT

It is not uncommon for two South African citizens who work side by side on the same vessel to have different tax obligations. There are many factors that could impact the way sea-based earnings are taxed. Essentially, the tax responsibility depends on the type of vessel and the position held on that vessel.

For instance, under section 10(1)*(o)*(i)*(bb)* of the Income Tax Act, 1962 (the Act), when an officer or crew member is solely employed for the purposes of navigating a vessel that will be used for prospecting, exploring or mining of minerals from the seabed outside of South Africa, they will be exempt from paying tax on their foreign earnings. If the officer or crew member's job description does not form part of the navigation of a vessel, this exemption will not apply to them. They might, however, still qualify for the exemption on part of their foreign earnings under section 10(1)*(o)*(ii), provided that they meet the requirements listed under that section.

Due to the complex nature of seafarer taxation, it is of paramount importance to understand the intricacies of the employment contract prior to setting sail. Consulting an immigration or tax professional in the early stages of negotiating a contract of employment could keep the tax pirates from raiding the seafarer's foreign loot.

UNDERSTANDING THE DAYS REQUIREMENTS

The Act provides that individuals who spend more than 183 days, work- and non-workdays, in aggregate, of which 60 days are continuous, outside of South Africa, are exempt from paying tax on the first R1.25 million of foreign remuneration earned, should all the other requirements be met in conjunction. The limitation amendment, which came into operation on 1 March 2020, provides that foreign employment income is no longer fully exempt under section 10(1)*(o)*(ii); this amendment applies in respect to the 2021 tax year of assessment and for years of assessment after that, during which the requirements of section 10(1)*(o)*(ii) are met.

Because of the COVID-19 pandemic, the South African Revenue Service (SARS) realised that global travel restrictions would make it difficult to qualify for the 183-day requirement. Consequently, in the Taxation Laws Amendment Act, 2020 (the TLAA), the 183-day requirement was reduced to 117 days, exclusively for the 2021 year of assessment. This means that taxpayers who spent more than 117 days outside South Africa during that period may still qualify for an exemption (section 10(1)*(o)*(ii)*(aa)* & *(bb)*) provided the 60-consecutive-days requirement has been met.

CLARITY ON GROSS TAXABLE INCOME RECEIVED

One of the biggest stumbling blocks for taxpayers is the notion of income. Not only do they misinterpret what is meant by gross taxable income, but they discover too late that the burden of proof rests on them to prove their income to SARS.

The term "gross income" is largely defined in section 1(1) of the Act as the total amount, in cash or otherwise, received by or accrued to a resident during a year of assessment which is not of a capital nature. In addition, paragraph *(c)* of this definition specifically includes "any amount, including any voluntary award [allowances, gratuities, etc], received or accrued in respect of services rendered or to be rendered."

It is vital for seafarers to keep record of *any* income received or accrued. This may include pay or salary slips, bank statements, employment letters, contracts, etc. The nature of your employment might make it challenging to keep record of everything that takes place on a vessel. For example, if you are a waitress on a cruise ship, it might seem impossible to track your own tips. Whether you are a barman, part of the cleaning crew on a yacht or a geologist on a rig, you must be vigilant in keeping track of any income generated.

Lambert Roberts

Tax Consulting SA

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "gross income", more specifically paragraph *(c)*); 10(1)*(o)*(i)*(aa)* & *(bb)* & (ii)*(aa)* & *(bb)*;
- Taxation Laws Amendment Act 23 of 2020.

Tags: foreign earnings; foreign employment income; gross taxable income.

DATES WHEN TAX LIABILITIES ARISE

Case law and the Tax Administration Act, 2011 (the TAA), provide clear authority that income tax liabilities arise when the ITA34 assessments are issued by SARS, and for VAT and payroll tax liabilities, on the date that the relevant payments and returns are due.

When the ranking of tax debts is discussed, an observation can be made that income tax liabilities arise on assessments, unlike VAT and payroll tax liabilities, [*Author's note*: In this article, "payroll tax liabilities" refer to employees' tax or "PAYE", unemployment insurance fund (UIF) contributions, and skills development levies (SDL), ie, the amounts due in the EMP 201 returns.] which arise in the relevant period of supply or payroll period. This article provides the authority behind this view.

Income tax liabilities arise on assessments

In both *Caltex Oil (SA) Ltd v Secretary for Inland Revenue*, [1975], and *Commissioner for Inland Revenue v Golden Dumps (Pty) Ltd*, [1993], the Appellate Division held that:

> "[I]t is only at the end of the year of assessment that it is possible, and then it is imperative, to determine the amounts received or accrued on the one hand and the expenditure actually incurred on the other during the year of assessment…".

This principle is also cited in other Supreme Court of Appeal judgments, such as the *Anglovaal Mining Ltd v Commissioner, South African Revenue Services*, [2010]; *South African Revenue Service v South African Custodial Services (Pty) Ltd*, [2012]; *Commissioner, South African Revenue Service v Labat Africa Ltd*, [2013]; and *New Adventure ShelfZA122 (Pty) Ltd v Commissioner*, *South African Revenue Services*, [2017].

In other words, it is only at the end of the year of assessment that the gross income and deductions for that year can be determined and disclosed in the ITR14 returns. SARS will issue the ITA34 assessment based on the ITR14 return submitted. The income tax liabilities arise on the date of the original assessment, which is the date when the ITA34 is issued by SARS.

Section 91 of the TAA creates a distinction between income tax assessments, and self-assessments which are the VAT 201 and EMP 201 returns. Section 91(1) provides for SARS to make an original assessment (ie, the ITA34) based on the returns submitted by the taxpayer where the return (ie, the ITR14) does not contain a determination of a tax liability.

VAT and payroll tax liabilities arise on the dates payments and returns are due

Section 91(2) of the TAA provides that where a taxpayer is required to submit a return which incorporates a determination of the amount of a tax liability (ie, the VAT 201 and EMP 201), the submission of the return is an original self-assessment of the tax liability. The VAT vendor and employer, not SARS, determine the tax liabilities when filing the VAT 201 and EMP 201 returns.

The unanimous judgment of the Constitutional Court approved the difference in *Metcash Trading Ltd v Commissioner, South African Revenue Service and Another*, as follows:

> "… The first significant point to note is that VAT, quite unlike income tax, *does not give rise to a liability only once an assessment has been made*. VAT is a multi-stage tax, it arises continuously. Moreover VAT vendors/taxpayers bear the ongoing obligation to keep the requisite records, to make periodic calculations of the balance of output totals over and above deductible input totals (and any other permissible deductibles) and to pay such balances over to the fiscus. It is therefore a multi-stage system with both continuous self-assessment and predetermined periodic reporting/paying.
>
> [17] An even more important feature of VAT, particularly in contradistinction to income tax, is that vendors are in a sense involuntary tax-collectors. In principle VAT is payable on each and every sale; the VAT percentage, the details for its calculation and the timetable for periodic payment are statutorily predetermined, and it is left to the vendor to ensure that the correct periodic balance is calculated, appropriated and paid over in respect of each tax period.
>
> …". (Our emphasis.)

This principle was further cited with approval in the Supreme Court of Appeal decision of *Commissioner, South African Revenue Service v Pretoria East Motors (Pty) Ltd*, [2014].

These authorities clearly confirm that VAT and payroll tax liabilities which arise from self-assessments do not arise as a result of filing, respectively, the VAT 201 and EMP 201 returns.

Late payments of VAT and payroll taxes after the due date result in penalties and interest

The due date for VAT vendors depends on the relevant category of tax period under which they fall; this could be tax periods of 12 months, six months, two months or every month. (Section 27 of the VAT Act.) The VAT 201 returns and VAT must normally be filed and paid by the 25th of the month following the end of the tax period. (Section 28 of the VAT Act.) Payments after the 25th will result in a 10% late payment penalty (Section 39(1) of the VAT Act.) and interest. (Section 187(3)*(a)* of the TAA.) [*Editorial comment*: If the form and payment are effected and paid electronically, extension to the last business day of that month is permitted.]

VAT liabilities thus arise on the due date for payment, regardless of whether the VAT returns have been submitted.

The same principle would apply for payroll tax liabilities. The EMP 201 returns must normally be filed and the payroll tax amounts paid by the 7th of the month following the payroll month. (Paragraph 2(1) of the Fourth Schedule to the Income Tax Act, 1962.) Late payments after the 7th will result in 10% penalties (Paragraph 6(1) of the Fourth Schedule.) and interest. (Section 187(3)*(a)* of the TAA.)

Payroll tax liabilities thus arise on the 7th of the month following the payroll month, regardless of whether the EMP201 returns have been submitted.

FILE THOSE RETURNS …

The above principles from case law and the TAA highlight the difference between a situation where income tax liabilities arise, and one where VAT and payroll tax liabilities arise. Late submissions of ITR14 income tax returns could result in income tax liabilities arising *after* the date of commencement of business rescue, even when the returns are for financial years *before* commencement. This is not the case for VAT and payroll tax liabilities. Business rescue practitioners should, as far as possible, ensure that all returns are up to date prior to the date of commencement of business rescue, especially income tax returns.

Joon Chong

Webber Wentzel

Acts and Bills

- Income Tax Act 58 of 1962: Fourth Schedule: Paragraphs 2(1) & 4(1);
- Tax Administration Act 28 of 2011: Sections 91(1) & (2) & 187(3)*(a)*;
- Value-Added Tax Act 89 of 1991: Sections 27, 28 & 39(1).

Other documents

- ITA34 assessments;
- ITR14 returns;
- VAT 201 and EMP 201 returns;

Cases

- *Caltex Oil (SA) Ltd v Secretary for Inland Revenue* [1975] (1) SA 665 (A) (at 674B–D);
- *Commissioner for Inland Revenue v Golden Dumps (Pty) Ltd* [1993] (4) SA 110 (A) (at 115I–116D & 117G–J);
- *Anglovaal Mining Ltd v Commissioner, South African Revenue Services* [2010] (2) SA 299 (SCA) (at 312H);
- *Commissioner, South African Revenue Service v South African Custodial Services (Pty) Ltd* [2012] (1) SA 522 (SCA) (at 535H);
- *Commissioner, South African Revenue Service v Labat Africa Ltd* [2013] (2) SA 33 (SCA) (at 36F);
- *New Adventure ShelfZA122 (Pty) Ltd v Commissioner, South African Revenue Services* [2017] (5) SA 94 (SCA) (at 101F);
- *Metcash Trading Ltd v Commissioner, South African Revenue Service and Another* [2001] (1) SA 1109 (CC);
- *Commissioner, South African Revenue Service v Pretoria East Motors (Pty) Ltd* [2014] ZASCA 91.

Tags: income tax liabilities; payroll tax liabilities; self-assessments.

DISPOSALS FOLLOWING FOREIGN RELISTING OF SECURITIES

Agility in capital markets, including the ability for companies to easily raise capital from as broad a range of sources as possible, is a major positive for the ease of doing business in a country. South Africa is facing a constrained economic space, exacerbated by the effects of the COVID-19 pandemic. In this environment, listed companies may seek more liquid capital markets in foreign jurisdictions. Allowing companies to delist from a South African exchange and relist their securities on a foreign exchange enables these companies to access fresh capital, while retaining local business operations.

Since the February 2020 Budget, the South African Government has undertaken a programme of modernising the exchange control regime. Section 9K of the Income Tax Act, 1962 (the Act), was introduced as part of these reforms. It provides for a deemed disposal and reacquisition of securities held by a natural person or trust, where such securities are delisted from a South African exchange and relisted on a foreign exchange. Section 9K came into operation on 1 March 2021 and applies in respect of any security listed on an exchange outside the Republic on or after that date. Its enactment was accompanied by a liberalisation of the requirement to obtain South African Reserve Bank (SARB) approval for the export of capital in the form of securities, where a delisting from a South African exchange and relisting on a foreign exchange occurs.

In August 2021, the South African Revenue Service released Issue 8 of Interpretation Note 43 – "Circumstances in which certain amounts received or accrued from the disposal of shares are deemed to be of a capital nature" (IN43). The focus of IN43 remains section 9C of the Act but has now been updated to provide guidance on the deemed disposal and reacquisitions to take place under section 9K.

THE PROVISIONS OF SECTION 9K

Section 9K(1) provides that where a natural person or trust holds a security in a company that is listed on an "exchange", as defined in section 1(1), and licensed under section 9, of the Financial Markets Act, 2012, and that security is subsequently delisted and relisted on a foreign exchange, then such natural person or trust will be treated as having –

- disposed of that security for an amount equal to the market value of that security (as defined in section 9H(1), ie, a price which could be obtained upon a sale of that security between a willing buyer and a willing seller dealing at arm's length in an open market) on the day on which the security is listed outside of South Africa; and
- reacquired that security for an amount of expenditure equal to the market value on that same day.

The effect of the deemed disposal and reacquisition depends on whether the security is held as a capital or revenue asset by the particular taxpayer. Should it be held as a revenue asset, then an income tax event will be triggered with either taxable income or a potentially deductible loss accruing to the taxpayer. Should the security be held as a capital asset, a capital gains tax event is triggered and, depending on the base cost of the relisted security in the taxpayer's hands and the market value of the security on the day of relisting, a capital gain or loss may arise.

INTERPRETATION NOTE 43 AND SECTION 9K

While IN43 mainly deals with the interpretation of the deeming provisions in section 9C, Issue 8 includes guidance on the application of section 9K. It provides an authoritative, although non-binding, interpretation of the section 9K considerations to be applied where a natural person or trust holds a security which is delisted from a South African exchange and subsequently relisted on a foreign exchange.

IN43 provides guidance on the tax principles and related provisions of the Act to be considered for deemed disposals and reacquisitions under the provisions of section 9C. These same principles apply to the deemed disposal and reacquisition under section 9K.

As noted above, section 9K does not deem the disposal to be of a particular nature and therefore it may result in proceeds and expenditure of either a capital or revenue nature. Therefore, where section 9K applies, the taxpayer must determine the nature of the deemed proceeds and expenditure in their hands regarding the relisted shares.

IN43 indicates that where section 9K(1) is triggered, section 9K(2) requires that the relisted security be treated as the same security as the delisted security for the purposes of section 9C(2). Section 9C(2) is also a deeming provision, which deems the proceeds or expenditure in relation to an equity share to be of a capital nature where that equity share is held by a taxpayer for three years or more.

It is important to note that section 9C(2) only applies to equity shares. Meaning that where an equity share, as defined in section 1(1) of the Act, is relisted on a foreign exchange, if the relevant shareholder has held that equity share for three years or longer, the deemed disposal under section 9K will result in capital proceeds.

Therefore, where any other type of listed securities is relisted, the taxpayer must apply ordinary tax principles of capital and revenue to determine how to account for the deemed accrual and expenditure.

COMMENT

The modernisation of the exchange control system and particularly reductions in the scope of activities that require SARB approval is a welcome development. It ought to enable businesses to react to the needs of the day faster, having to traverse fewer regulatory hurdles. This will lead to better economic outcomes for South Africa at large.

"With the introduction of section 9K, government may be seeking to cushion the potential unforeseen consequences of this deregulation by requiring natural persons and trusts to account for a deemed tax where a relisting of previously South African securities takes place."

With the introduction of section 9K, government may be seeking to cushion the potential unforeseen consequences of this deregulation by requiring natural persons and trusts to account for a deemed tax where a relisting of previously South African securities takes place.

However, this means that natural persons and trusts may have to pay a “dry” tax where securities they hold are relisted on a foreign exchange, as there will be no actual proceeds to fund this cost. Fortunately, taxpayers who bear this cost will enjoy the benefit of an increase in the base cost of their relisted securities, leading to a reduced tax cost when the securities are later disposed of or sold.

Tsanga Mukumba & Louis Botha

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962; Sections 1(1) (definition of “equity share”), 9C, 9H(1) (definition of “market value”) & 9K(1) & (2);
- Financial Markets Act 19 of 2012: Sections 1(1) (definition of “exchange”) & 9.

Other documents

- Interpretation Note 43 (Issue 8) – Circumstances in which certain amounts received or accrued from the disposal of shares are deemed to be of a capital nature.

Tags: deemed disposal; capital gains tax event.

SARS INTEREST RATES

TAX AND VAT – INTEREST RATE INCREASES

The SARS interest rates have been increased as detailed below.

It is important to remember that interest and penalties paid to SARS are not deductible expenses for income tax purposes. On the other hand, interest received from SARS is fully taxable (after deducting the current initial exemption of R23 800 per annum (R34 500 if you are 65 or older) for all local interest income earned by natural persons).

- **INCOME TAX, PROVISIONAL TAX, DIVIDENDS TAX, ETC**

  Payable to SARS on short payments of all such taxes (other than VAT): 7.25% per annum from 1 March 2022 (was 7% per annum with effect from 1 November 2020).

  Payable by SARS on refunds of tax (where interest is applicable): 3,25% per annum from 1 March 2022 (was 3% per annum with effect from 1 November 2020).

  If the refund is made after a successful tax appeal or where the appeal is conceded by SARS, the interest rate is 7.25% per annum from 1 March 2022 (was 7% per annum from 1 November 2020).

- **VAT**

  Payable to SARS on late payments: 7.25% per annum from 1 March 2022 (was 7% per annum from 1 November 2020).

  Payable by SARS on VAT refunds after prescribed period: 7.25%% per annum from 1 March 2022 (was 7% per annum from 1 November 2020).

- **FRINGE BENEFITS**

  Official interest rate for loans to employees below which a deemed fringe benefit arises: 4.75% per annum from 1 December 2021 and 5% per annum from 1 February 2022. See below for details of historical changes.

- **DIVIDENDS TAX**

  Official interest rate for loans (designated in rands) to shareholders below which the interest on such loans can be deemed to be dividends on which dividends tax is payable: 4.75% per annum from 1 December 2021. See below for details of historical changes.

- **DONATIONS TAX**

  Loans to trusts by natural connected persons with interest charged at rates below the official rate create a donation subject to donations tax at 20% on the interest forgone each year.

- **PENALTIES**

  The amount of penalties for late payments (where applicable) are substantial (at least 10%) and are in addition to interest charged.

"The amount of penalties for late payments (where applicable) are substantial (at least 10%) and are in addition to interest charged."

FRINGE BENEFITS, LOANS, DONATIONS TAX AND DIVIDENDS TAX – INTEREST RATES

- If inadequate interest is charged to an employee (including working directors) on loans (other than for the purpose of furthering their own studies) in excess of R3 000 from their employer (or associated institution), tax on the fringe benefit may be payable. Unless interest is charged at the "official" rate or greater, the employee is deemed to have received a taxable fringe benefit calculated as being the difference between the interest actually charged and interest calculated at the "official" rate.

  For employees' tax purposes, the tax deduction must be made whenever interest is payable; if not regularly, then on a monthly basis for monthly paid employees, weekly for weekly paid employees, etc.

- Subject to a number of exceptions, distributions of income and capital gains from a company / close corporation are normally subject to dividends tax at the flat rate of 20%. Loans or advances to or for the benefit of a shareholder / member will be deemed to be dividends but only to the extent that interest at less than the "official" rate (or market-related rate in the case of foreign-currency loans) is payable on the loan, or fringe benefits tax is payable on an interest-free (or subsidised-interest) loan to an employee.

  It is not the amount of the loan but the interest reduction which is deemed to be a dividend. Low-interest loans are accordingly subject to dividends tax payable by the company and only in respect of the interest benefit.

- Loans to trusts by natural connected persons with interest charged below the official rate create a donation subject to donations tax at 20% on the interest forgone each year.

- With effect from 1 March 2011, the official rate has been defined as the rate of interest equal to the South African "repo rate" plus 1%. For foreign-currency loans, the rate is the equivalent of the foreign "repo rate" plus 1%. The South African repo rate is currently 4.00% per annum.

THE "OFFICIAL" RATE OF INTEREST OVER THE PAST FIVE YEARS

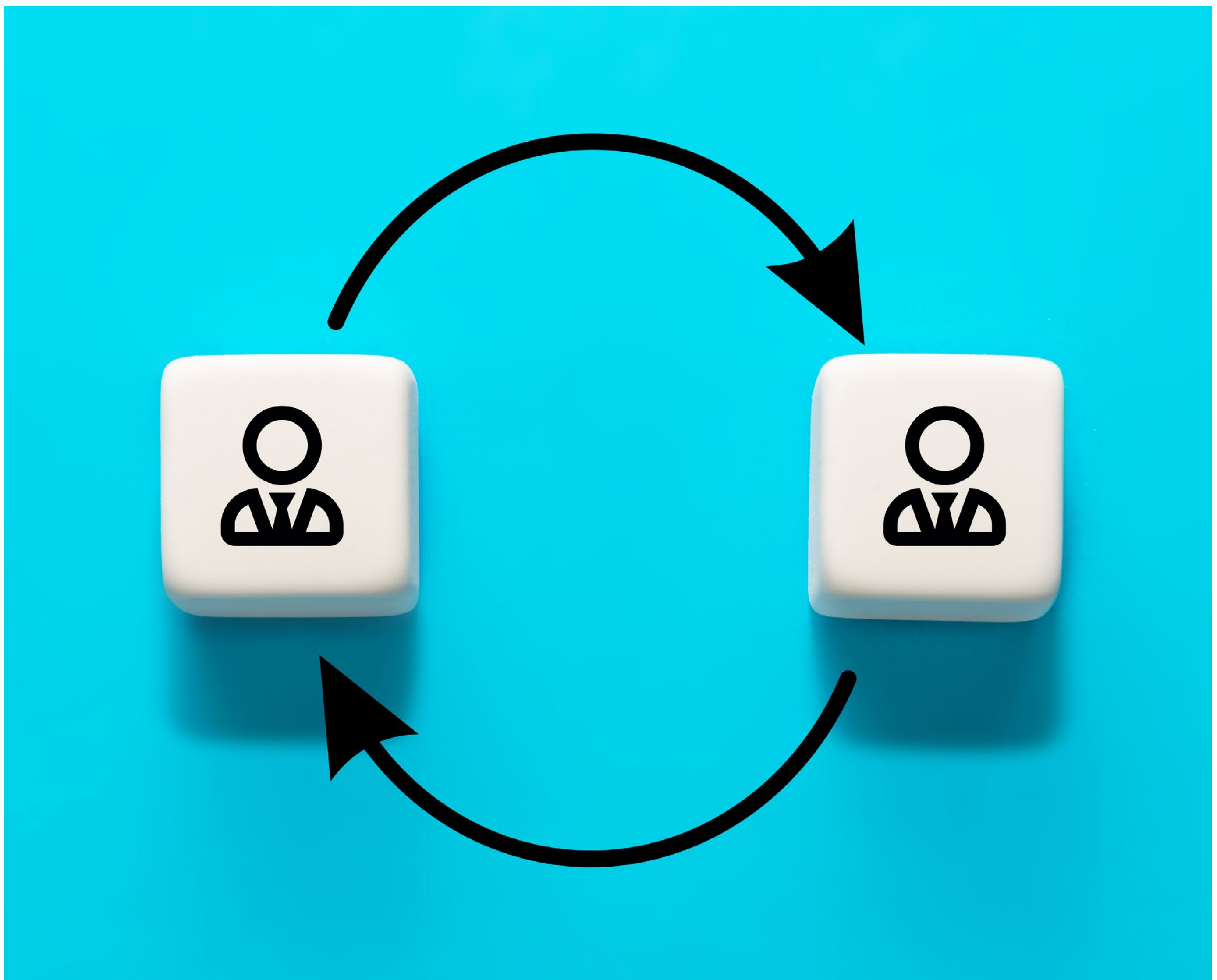
With effect from		*Rate per annum*
1 August 2017	–	7.75%
1 April 2018	–	7.50%
1 December 2018	–	7.75%
1 August 2019	–	7.50%
1 February 2020	–	7.25%
1 April 2020	–	6.25%
1 May 2020	–	5.25%
1 June 2020	–	4.75%
1 August 2020	–	4.50%
1 December 2021	–	4.75%
1 February 2022	–	5.00%

Kent Karro

Tags: deductible expenses; natural connected persons; donations tax; taxable fringe benefit; low-interest loans; repo rate.

TRANSFER OF ASSETS BETWEEN SPOUSES: INCOME TAX AND CGT IMPLICATIONS

Section 9HB of the Income Tax Act, 1962, provides for a roll-over of a capital gain or capital loss when an asset is transferred between spouses during their lifetimes. The roll-over is mandatory, and spouses therefore do not have the option to elect out of it. The policy rationale for the roll-over is that the transferor spouse must benefit from not immediately having tax exposure on a transaction since the transferee spouse will pay the downstream tax when they eventually dispose of an asset, or when it becomes part of the estate.



Importantly, the roll-over relief in section 9HB will only apply when a person disposes of an asset to a spouse who is a resident unless the asset is immovable property, an interest therein or connected to a permanent establishment of the non-resident spouse in South Africa.

"Importantly, the roll-over relief in section 9HB will only apply when a person disposes of an asset to a spouse who is a resident unless the asset is immovable property, an interest therein or connected to a permanent establishment of the non-resident spouse in South Africa."

On a practical level, the relief works as follows:

- The disposing spouse (transferor spouse) must disregard any capital gain or loss when disposing of an asset to his or her spouse (transferee spouse).
- The transferee spouse takes over all aspects of the history of the asset from the transferor spouse. The transferee spouse is deemed to have –
    - acquired the asset on the same date that the asset was acquired by the transferor;
    - incurred an amount of expenditure equal to the expenditure that was incurred by the transferor in respect of that asset;
    - incurred that expenditure on the same date and in the same currency that it was incurred by the transferor; and
    - used that asset in the same manner that it was used by the transferor.

Notably, apart from outright transfers, the following events are treated as disposals between spouses:

(a) A deceased spouse

In the event of the death of one spouse, if the deceased estate of that spouse acquires ownership of an asset in settlement of a claim arising under the Matrimonial Property Act, 1984, the resident surviving spouse must be treated as having disposed of that asset to the deceased spouse immediately before the date of death. [*Editorial comment*: Then the reverse situation could also occur where the estate has a claim against the survivor in terms of that Act.]

(b) A divorce or court order

A person must be treated as having disposed of an asset to his or her spouse if that asset is transferred to that spouse in the following situations:

- Divorce;
- a religious marriage or civil union, where an agreement of division of assets has been made an order of court.

The special rules under section 9HB must be considered to determine the tax implications when a person disposes of an asset to his or her spouse. While providing for a roll-over of a capital gain or capital loss when an asset is transferred between spouses during their lifetimes, it also ensures that a resident spouse to whom an asset is disposed of, takes over all aspects of the history of the asset from the transferor spouse.

T Roos

Acts and Bills

- Income Tax Act 58 of 1962: Section 9HB;
- Matrimonial Property Act 88 of 1984.

Tags: capital gain; capital loss; transferor spouse; transferee spouse.

CEASING TO BE SA TAX RESIDENT

Many individuals are aware that if they cease to be South African (SA) tax resident, there is a so-called capital gains tax "exit charge" that applies. In fact, the exit charge applies not only to individuals but also to other "persons", including companies and trusts, upon cessation of SA tax residence.

The capital gains tax exit charge is achieved by deeming the person to have disposed of their worldwide assets, with certain exceptions, at market value to a person who is SA tax resident. This disposal is deemed to have occurred on the date immediately before the day on which the person's SA tax residency ceased. The person's year of assessment is also deemed to have ended on the date of the deemed disposal.

Where the person is a provisional taxpayer, in terms of a strict reading of the Income Tax Act, 1962 (the Act), the second provisional tax return and accompanying payment are due on that date as well, being the last day of the year of assessment. SARS apparently expects the provisional tax return and payment to be filed by such date, failing which penalties and interest may apply. However, this strict interpretation of the provisions leads to anomalies in some cases. For example, where an individual is SA tax resident due to the physical presence test and is physically absent from South Africa for at least 330 full days, the individual is deemed not to have been SA resident from the first day of the period of continuous absence. However, when the individual leaves South Africa, they may not know at that point whether or not they will return within the 330-day period. In such cases, the expectation to submit a second provisional tax return on the date of departure from South Africa is unrealistic.

Assets that do not give rise to the exit charge include immovable property in South Africa and personal-use assets. The definition of "personal-use asset", as contemplated in paragraph 53 of the Eighth Schedule to the Act, includes assets that are used by the individual mainly for purposes other than the carrying on of a trade. However, various assets such as financial instruments, immovable property and certain types of boats and aircraft are excluded from the definition of a personal-use asset.

In the case of a company that ceases to be SA tax resident, an additional dividends tax "exit charge" arises. On the date immediately before the day on which the company ceased to be SA tax resident, the company is deemed to have declared and paid a dividend *in specie*, which dividend *in specie* may be subject to dividends tax at the full rate (20%), exempt from dividends tax or subject to dividends tax at a reduced rate, depending on the nature of the shareholders and the shareholders' jurisdictions of residence. The application of an exemption or reduced rate further depends on whether or not declaration and undertaking forms are held by the company by the date of the deemed declaration and payment. The amount of the dividend *in specie* is calculated as the sum of the market values of all the shares in that company on the date of the deemed declaration and payment, less the sum of the contributed tax capital of all the classes of shares in the company on that date. The dividend *in specie* is deemed to have been declared and paid to the shareholders in accordance with their effective interest in the shares of the company.

Also, in the case of a company that ceases to be SA tax resident, certain anti-avoidance claw-back measures have been enacted. These claw-back measures apply to foreign dividends that were previously exempt from income tax in the hands of the company within three years prior to the cessation of its SA residence, due to the application of the "participation exemption". Capital gains that arose on the disposal of shares in a foreign company within the previous three-year period that were excluded due to the "participation exemption", are also clawed back. Prior to amendments brought about by the 2020 Taxation Laws Amendment Act (the 2020 TLAA), a company could enjoy exemption from the deemed dividend *in specie* upon cessation of its SA tax residence if, for example, its shareholders were SA tax resident companies. However, what was perceived to be a loophole arose in that once the company had become non-resident, if such shareholders held at least 10 per cent of the equity shares and votes in the company, the disposal of shares in the (now) non-resident company could enjoy exclusion from capital gains tax in the hands of such shareholders, by virtue of the "participation exemption".

This loophole was closed with effect from 1 January 2021 (date on which section 9H(3A) of the Act, as inserted by section 7 of the 2020 TLAA, came into operation) by deeming a shareholder that holds at least 10 per cent of the equity shares and voting rights in a company that ceases to be resident, to have disposed of the shares at market value on the date immediately before the day on which the company ceased to be resident. This provision is presumably only intended to apply if the deemed dividend *in specie* was exempt from the dividends tax "exit charge" discussed above, although the wording is unclear in a number of respects.

Previously, while it was still possible for individuals to "financially emigrate" from an exchange control perspective, a common fallacy was that financial emigration equated to cessation of SA tax residency. In fact, South Africa has a two-pronged tax residency test in the case of individuals, namely the "ordinary residence" test and the "physical presence" test. An individual's exchange control residency status was not determinative of their tax residency status under either test. The "ordinary residence" test is a common-law test that seeks the location of the individual's true or real home, or the place to which they would return after their wanderings.

On the other hand, the physical presence test essentially requires a person to have been physically present in South Africa for periods exceeding 91 days in aggregate during the current year of assessment as well as each of the preceding five years of assessment in addition to having been physically present in South Africa for an aggregate period exceeding 915 days in the previous five years of assessment. The physical presence test does not apply to a person if they were resident in SA in terms of the ordinary residence test during a particular year of assessment.

In the case of a juristic person such as a company, South Africa also has a two-pronged tax residency test. The company is deemed to be SA tax resident either if it was incorporated in South Africa or if its place of effective management is located in South Africa.

Where a double tax agreement exists between South Africa and the person's new jurisdiction of residency, it is important to consider whether the agreement deems the person to be exclusively resident in the other jurisdiction. In such a case, the SA domestic definition of "resident" deems the person not to be SA tax resident. This applies both to individuals and juristic persons. Generally, if an individual is resident both in South Africa and a foreign jurisdiction, there are a series of tiebreaker tests in the double tax agreement to determine in which jurisdiction they are ultimately deemed to be tax resident. For example, the SA-UK double tax agreement's first tie-breaker test is the jurisdiction in which he or she has a permanent home available, failing which the next tie-breaker test is the so-called "centre of vital interests". In the case of a juristic person, the tiebreaker is generally the location of the juristic person's place of effective management.

Where the majority of a company's board of directors move offshore on a permanent basis, it may well be that the company's place of effective management is no longer located in South Africa. If the company's place of effective management is no longer in South Africa and it becomes a tax resident of a jurisdiction with which South Africa has a double tax agreement, the company would normally have ceased to be SA tax resident. From the company's perspective, this may therefore trigger the capital gains tax as well as the dividends tax exit charges discussed above; it may also have triggered a capital gains tax exit charge from the directors' individual perspectives.

Given the complexity of the provisions and potential quantum of tax usually at stake, it is critical that taxpayers obtain detailed tax advice covering not only the SA tax position but also the position in their new jurisdictions of residence, well prior to their move offshore.

Professor David Warneke

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Acts and Bills

- Income Tax Act 58 of 1962: Section 9H(3A); Eighth Schedule: Paragraphs 1 (definition of "personal-use asset") and 53;
- Taxation Laws Amendment Act 23 of 2020: Section 7.

Tags: provisional taxpayer; SA tax resident; "ordinary residence" test; physical presence test.

MOST FAVOURED NATION CLAUSE IN DTAS

The international tax community was abuzz on 18 January 2019, when the Dutch Supreme Court passed down the much-anticipated Hoge Raad Judgment (17/04584) in favour of the taxpayer.The judgment considered the interpretation of the "most favoured nation" (MFN) clause in the double taxation agreement between South Africa and the Netherlands, dated 10 October 2005, as amended by the protocol dated 8 July 2008 (the Dutch DTA). In finding in favour of the taxpayer, the judgment concluded that to the extent that any other double tax agreement (DTA) entered into by South Africa with any other country provided a more favourable dividends withholding tax rate than the Dutch DTA, that more favourable rate must automatically apply. The judgment in the 2016 Cape Town Tax Court case of ITC 1925 also supported this interpretation from a South African perspective.

Interestingly, the South African Revenue Service (SARS) never appealed the tax court judgment; however, SARS together with Government, have taken steps to close this loophole and prevent taxpayers from exploiting the MFN clause. In order to understand the significance of the judgment and the proposals made by SARS, it is necessary to understand the mechanics of the MFN clause and how SARS has sought to negate this tax optimisation tool.

The MFN clause contained in the Dutch DTA contemplated that the automatic application of a more favourable rate should apply in respect of DTAs concluded after the Dutch DTA came into effect. However, the DTA concluded with Sweden on 25 December 1995 (as amended by the protocol on 18 March 2012) (the Swedish DTA) contained wording which extended its own MFN clause to retrospectively concluded DTAs.

The result was that taxpayers could apply the dividends withholding tax rate of 0% which was available in the DTA concluded between South Africa and Kuwait on 25 April 2006 (Kuwait DTA). Broadly speaking, if either the Dutch DTA or the Swedish DTA were utilised by a South African resident, then the most favourable dividends withholding tax rate contained in the Kuwait DTA could be applied.

"The Kuwait Protocol now imposes a dividend withholding tax of 5% if a shareholder owns at least 10% of the shares in the South African company."

SARS, however, took a significant step to effectively close this loophole by entering into a protocol to the Kuwait DTA on 21 April 2021 (the Kuwait Protocol). The Kuwait Protocol now imposes a dividend withholding tax of 5% if a shareholder owns at least 10% of the shares in the South African company. It is worth noting that the Kuwait Protocol has still not been ratified and is therefore not yet in effect. However, some of the proposed wording in the Kuwait Protocol has raised concerns.

Article 2(2) of the protocol (which is not accessible via SARS but rather through the Parliamentary Monitoring Group) provides that "the provisions of the Protocol shall thereupon have effect beginning on the date on which a system of taxation at shareholder level of dividends declared enters into force in South Africa". This seems to imply that SARS intends for the Kuwait Protocol to apply retrospectively from the introduction of dividends withholding tax in South Africa in 2012. If this is the case, there could be a sharp increase in tax litigation on this issue once the Kuwait Protocol is ratified. Interestingly, the ratification of the Kuwait Protocol by South Africa was due to take place on 1 September 2021; however, there have been additional delays and it remains to be seen when formal ratification in both countries will take place.

Keshen Govindsamy

Cliffe Dekker Hofmeyr

Other documents

- Double taxation agreement (DTA) between South Africa and the Netherlands (dated 10 October 2005), as amended by the protocol dated 8 July 2008;
- DTA between South Africa and Sweden (dated 25 November 1995), as amended by the protocol dated 18 March 2012;
- DTA between South Africa and Kuwait (dated 25 April 2006);
- Protocol to the Kuwait DTA (21 April 2021 – not yet ratified): Article 2(2).

Cases

- *Hoge Raad Judgment* (17/04584) (Dutch Supreme Court – 18 January 2019);
- ITC 1925 [2016]; 82 SATC 144 [2016] (Cape Town Tax Court).

Tags: dividends withholding tax; most favoured nation (MFN) clause.

LIMITED OPPORTUNITY TO ADD TO GROUNDS OF OBJECTION?

The process to be followed by taxpayers when disputing assessments issued by the South African Revenue Service (SARS) is set out in the Tax Administration Act, 2011 (the TAA), read with the rules promulgated under section 103 of the TAA (the Tax Court Rules). Where a taxpayer is aggrieved by an assessment issued by SARS, the taxpayer has a period of 30 days from the date of the assessment (or where a request for reasons is submitted to SARS by the taxpayer in terms of Tax Court Rule 6, the date of delivery of such reasons) to lodge an objection against such assessment.

The objection lodged by the taxpayer to an assessment issued by SARS must, in terms of Tax Court Rule 7(2)*(b)*, specify *inter alia* –

- the grounds of the objection in detail, including the part or specific amount of the disputed assessment being objected to; and
- the grounds of assessment that are in dispute.

In the event that the taxpayer's objection is disallowed by SARS, and the taxpayer decides to appeal such a decision, the taxpayer is, in terms of Tax Court Rule 10(3), prohibited from appealing on a ground that constitutes a new objection that was not raised in the taxpayer's objection. In addition, in terms of Tax Court Rule 32(3), once the taxpayer has lodged its appeal and received SARS' statement of grounds of assessment and opposing appeal, the taxpayer is prohibited from including in its statement of grounds of appeal a new ground of objection against the assessment which was not raised in the objection. A taxpayer's grounds of objection are thus of paramount importance, as these grounds of objection set the parameters for the taxpayer's dispute against the offending assessment.

The Tax Court Rules do not explicitly address the question as to whether, following delivery of an objection by a taxpayer, such objection can be amended to include new grounds of objection, thereby effectively granting the taxpayer a second bite at the dispute cherry.

It is interesting to note that, prior to the amendment by Act 60 of 2001 of the since repealed section 83(7)*(c)* of the Income Tax Act, 1962, SARS had the authority to agree to an amendment of a taxpayer's grounds of objection and that the Special Court could, on good cause shown, permit such amendment. No similar provision is included in the TAA or the Tax Court Rules.

This question was considered by the tax court in *ABC v The Commissioner for the South African Revenue Service*, [2019], where the taxpayer approached the court for leave to amend its objection in terms of Rule 28 of the rules regulating the conduct of the proceedings of the several provincial and local divisions of the High Court of South Africa (the Uniform Rules), read with Tax Court Rule 42(1). Tax Court Rule 42 provides that if the Tax Court Rules do not provide for a procedure in the tax court, the most appropriate rule under the Uniform Rules, to the extent consistent with the TAA, may be utilised by the tax court. As the Tax Court Rules do not provide for a procedure to amend an objection, the taxpayer submitted that the amendment of an objection falls within the realm of Tax Court Rule 42, and as such, the application was brought in terms of Tax Court Rule 42, read with Uniform Rule 28. Uniform Rule 28, essentially, provides for the amendment of a pleading or document other than a sworn statement filed in connection with any proceedings.

SARS opposed the taxpayer's application on the grounds that –

- the amendment sought to introduce new grounds of objection after the relevant time periods prescribed in the Tax Court Rules had expired;
- the amendment sought to introduce new grounds of objection after the assessment had become final; and
- the statutory provisions relied on by the taxpayer for the amendment sought do not apply in relation to the amendment of an objection.

"Finding in favour of the taxpayer, the tax court held that Tax Court Rule 42 does in fact permit an applicant to approach the court for an amendment of a document or pleading in terms of Uniform Rule 28."

Finding in favour of the taxpayer, the tax court held that Tax Court Rule 42 does in fact permit an applicant to approach the court for an amendment of a document or pleading in terms of Uniform Rule 28. The court held that this is not the end of the enquiry, as an applicant that relies on Uniform Rule 28 must fulfil the requirements for an amendment. The tax court made reference to the judgment in *Affordable Medicines Trust v Minister of Health*, [2006], which enunciated the principle that amendments will be allowed unless the amendment is made in bad faith, will cause prejudice to the opponent that cannot be remedied by an appropriate costs order, or the parties cannot be restored to the same position as they were when the pleading or document which is the subject of amendment was filed. In addition, the court made reference to the judgment in *Commercial Union Assurance Co Ltd v Waymark NO*, [1995], where the court outlined the principles to be considered in an application for an amendment as, *inter alia*, the demonstration by the applicant that *prima facie* the amendment is deserving of consideration and facilitates the proper ventilation of the dispute between the parties, and that an amendment should not be refused simply to punish the applicant for neglect.

Taking into consideration the submissions of the taxpayer, the tax court held that the taxpayer had indeed satisfied the requirements for requesting leave to amend its objection and held in favour of the taxpayer. Indeed, it is difficult to discern any demonstrable prejudice suffered by SARS upon the amendment of an objection, as SARS would be granted an opportunity to consider the amended grounds of objection, and either allow or disallow such amended objection. SARS may possibly, however, be inundated with requests by taxpayers to amend their objections where the taxpayers have not raised the appropriate grounds of objection for whatever reason. Whether this inconvenience to SARS overrides the importance for the proper ventilation of the disputes between SARS and taxpayers is, however, questionable.

The judgment of the tax court, if upheld in any subsequent appeals, will surely usher in an opportunity for taxpayers to amend their objections and "reset" the parameters of disputes with SARS where the taxpayers have omitted grounds from their objection. However, taxpayers must keep in mind that this would not signal that they may simply neglect to raise grounds of objection and rely on the courts to assist in the correction of such neglect and that the requirements for an amendment as outlined by the above-mentioned judgments would have to be satisfied.

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Acts and Bills

- Income Tax Act 58 of 1962: Section 83(7)*(b)*;
- Tax Administration Act 28 of 2011: Section 103;
- Second Revenue Laws Amendment Act 60 of 2001.

Other documents

- Tax Court Rules (promulgated under section 103 of the TAA): Rules 6, 7(2)*(b)*, 10(3), 32(3) & 42(1);
- Uniform Rules of the High Court: Rule 28.

Cases

- *Affordable Medicines Trust and Others v Minister of Health and Others* [2006] (3) SA 247 (CC);
- *Commercial Union Assurance Co Ltd v Waymark NO* [1995] (2) SA 73 (TK);
- *ABC v Commissioner for the South African Revenue Service* Case No 0092/2019.

Tags: statement of grounds of assessment; grounds of objection.

READILY APPARENT UNDISPUTED ERRORS

Taxpayers who are aggrieved by an assessment may object to it. Should an objection be disallowed, an appeal may also be pursued. Objections and appeals are governed by the provisions of chapter 9 of the Tax Administration Act, 2011 (the TAA), and the Rules promulgated under section 103 of the TAA (the Rules).

Chapter 9 and the Rules subject objections and appeals to specific timeframes and requirements. One such timeframe is that an objection must be lodged within 30 business days from the date of the relevant assessment or decision, unless a senior SARS official is satisfied that reasonable grounds exist for the delay in lodging the objection or, in the case of a delay of more than 30 business days, that exceptional circumstances exist which gave rise to the delay in lodging the objection.

Taxpayers are often unaware of the relevant timeframes or may only realise their aggrievement once the time for lodging an objection has passed. As ignorance of the law is not regarded as a reasonable excuse, those taxpayers are effectively barred from objecting, regardless of the merits of their case.

"Fortunately, the TAA allows SARS to issue a reduced assessment if it is satisfied that there is a readily apparent undisputed error in an assessment by SARS or by the taxpayer in a return."

What then is a taxpayer to do who discovers an obvious error in an assessment which resulted in the overpayment of tax? Fortunately, the TAA allows SARS to issue a reduced assessment if it is satisfied that there is a readily apparent undisputed error in an assessment by SARS or by the taxpayer in a return. This concession is subject to the prescription rules contained in the TAA, which means that, in the case of an original assessment relating to income tax, such a reduced assessment cannot be issued by SARS more than three years after the date of the original assessment. The meaning of the phrase "readily apparent undisputed error" has been subject to much debate and is the focus of a SARS Draft Interpretation Note, published on 16 August 2021 (the Draft Note – "Reduced Assessments: Meaning of 'Readily Apparent Undisputed Error'"); the Draft Note was open for public comment until 29 October 2021.

The Draft Note contains insight into SARS' interpretation of the law, which (though not binding) is useful information for taxpayers. A welcome part of the Draft Note is SARS' apparent recognition that it does not enjoy an unfettered discretion and must base its decision on reasonable grounds. In the Draft Note SARS also elaborates on the meaning of the words used in the section:

- Readily apparent – SARS interprets this as meaning an obvious mistake that should be easily determinable.
- Undisputed – in respect of which SARS notes that the confirmation of the error should require no more than a simple verification and not be of an interpretational nature.
- Error – which SARS argues is limited to an error by a taxpayer in a return and excludes omissions.

A curious proposition made in the Draft Note is that errors do not include omissions, which SARS purportedly bases on the ordinary meaning of the word "error". This is an overly narrow interpretation of the word "error" and runs contrary to the purpose of the section, which is to allow taxpayers a less formal mechanism to request corrections for obvious mistakes. Something can obviously be wrong due to an error of omission just as much as an error of commission. This view, held by SARS, also runs contrary to its past practice as reduced assessments have on occasion been issued in respect of omissions that constituted readily apparent undisputed errors.

SARS further states in the Draft Note that the remedy is limited to errors in an assessment or return and gives the example of an incorrect amount reflected on a section 18A receipt issued by a public benefit organisation (PBO). In the example the taxpayer, having submitted a return reflecting the incorrect amount, requests a reduced assessment after the PBO reissues the receipt reflecting the correct amount. According to the Draft Note, the request will be rejected as the error was in the supporting documentation and not in the return. With respect, what the Draft Note fails to appreciate is that the example contains two errors – the original error in the receipt issued by the PBO which led to the subsequent error in the return completed by the taxpayer. Based on the reissued receipt obtained from the PBO, it is submitted that the error in the return should be readily apparent and undisputed, therefore qualifying for relief.

A decision by SARS not to issue a reduced assessment is not subject to objection or to appeal. If unsuccessful, a taxpayer may request an internal review of the decision under section 9 of the TAA by *inter alia* a senior SARS official. A taxpayer may further take SARS' decision on review to the High Court. Needless to say, High Court applications can be very costly.

A request for a reduced assessment can be a useful tool for taxpayers where there is an obvious error in an assessment by SARS or the taxpayer in a return. However, taxpayers should be mindful of SARS' recently narrowed view of this remedy, particularly around omissions. It will be interesting to see if SARS' view will not be swayed by taxpayer submissions on the Draft Note. Where possible, taxpayers may rather opt to object to assessments containing errors and are advised to do so with the help of their tax adviser.

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Acts and Bills

- Income Tax Act 58 of 1962: Section 18A;
- Tax Administration Act 28 of 2011: Sections 9 & 103; chapter 9.

Other documents

- SARS Draft Interpretation Note ("Reduced Assessments: Meaning of 'Readily Apparent Undisputed Error'" – published for comment on 16 August 2021);
- Rules promulgated under section 103 of the TAA.

Tags: prescription rules; apparent undisputed errors.

VEXATIOUS PROCEEDINGS AND ABUSE OF COURT PROCESSES

In the judgment of Commissioner for the South African Revenue Service v Van der Merwe and Others, *delivered on 21 September 2021, the Western Cape High Court delivered a punitive judgment against a taxpayer (both in his individual capacity and in his capacity as a trustee of the Eagle Trust) and several other individuals in their capacities as trustees of the same trust. The issue in this matter was whether the taxpayer had abused court processes by instituting frivolous and vexatious proceedings against the South African Revenue Service (SARS) and other entities.*

FACTS

In April 2019, SARS instituted an application for an order in terms of the Vexatious Proceedings Act, 1956 (the VPA), that no further legal proceedings may be instituted by Mr Gary Walter van der Merwe (GVDM) (in any capacity) or any of the trustees of the Eagle Trust (in their capacities as trustees of the Eagle Trust) without the prior leave of the relevant court.

The events and circumstances that culminated in SARS instituting these proceedings are long and convoluted. Suffice to say that in 2004, SARS investigated and ultimately charged GVDM with various fraud- and tax-related offences and this led to a multitude of litigious proceedings (including a second criminal trial for exchange control violations) that had, at the date of judgment in this present matter, not yet been finalised.

Despite its continued efforts, SARS had been unable to recover the tax liability for which GVDM had been assessed. As such, SARS obtained an ex parte preservation order (in terms of section 163 of the Tax Administration Act, 2011 (the TAA)) against the assets of GVDM, his daughter Candice (CVDM), Zonnekus Mansion (Pty) Ltd (Zonnekus), a company owned by Eagle Trust and managed by GVDM, and various other related entities. In addition, in 2013, after an inquiry into the tax affairs of the aforementioned parties had been concluded, SARS raised assessments against them.

Instead of pursuing the normal dispute resolution avenues provided for in the TAA, GVDM (and a consortium of the other people related to GVDM and the entities with which he was involved) instituted an array of action and application proceedings against SARS and various other parties (for example the liquidators of Zonnekus and Zonnekus' creditors), including (to name but a few):

- interdictory applications;
- four separate business rescue applications;
- a challenge pertaining to the authority of SARS' appointed attorneys to act on SARS' behalf;
- an urgent application for an order declaring the attorneys of Zonnekus' liquidators in contempt of a preservation order granted in 2014;
- an application for the removal of Zonnekus' liquidators and an order that the liquidation proceedings be stayed;
- multiple actions against the Minister of Finance and SARS seeking constitutional damages in the amount of R7,6 billion (cumulatively); and
- appeals against most of the unsuccessful applications or actions instituted by them.

In many of these instances, the applications instituted by GVDM et al were dismissed by the relevant courts with punitive cost orders against the applicants.

The order sought by SARS (prohibiting GVDM and the other respondents from instituting any further legal action without leave of the court in question) was accompanied by applications by both SARS and the respondents to strike out certain material contained in the affidavits filed by the opposing party.

JUDGMENT

The first issue addressed by the High Court pertained to the strike out applications that had been filed by each of the parties in the present matter. To this end, it was reiterated that, in terms of Rule 6(15) of the Uniform Rules of Court, the court may (on application) strike out from any affidavit any matter which is scandalous, vexatious or irrelevant in so far as the court has been satisfied that the applicant would be prejudiced if the matter were not struck out. Broadly speaking, included in the scope of matter that is "scandalous, vexatious or irrelevant" are the following:

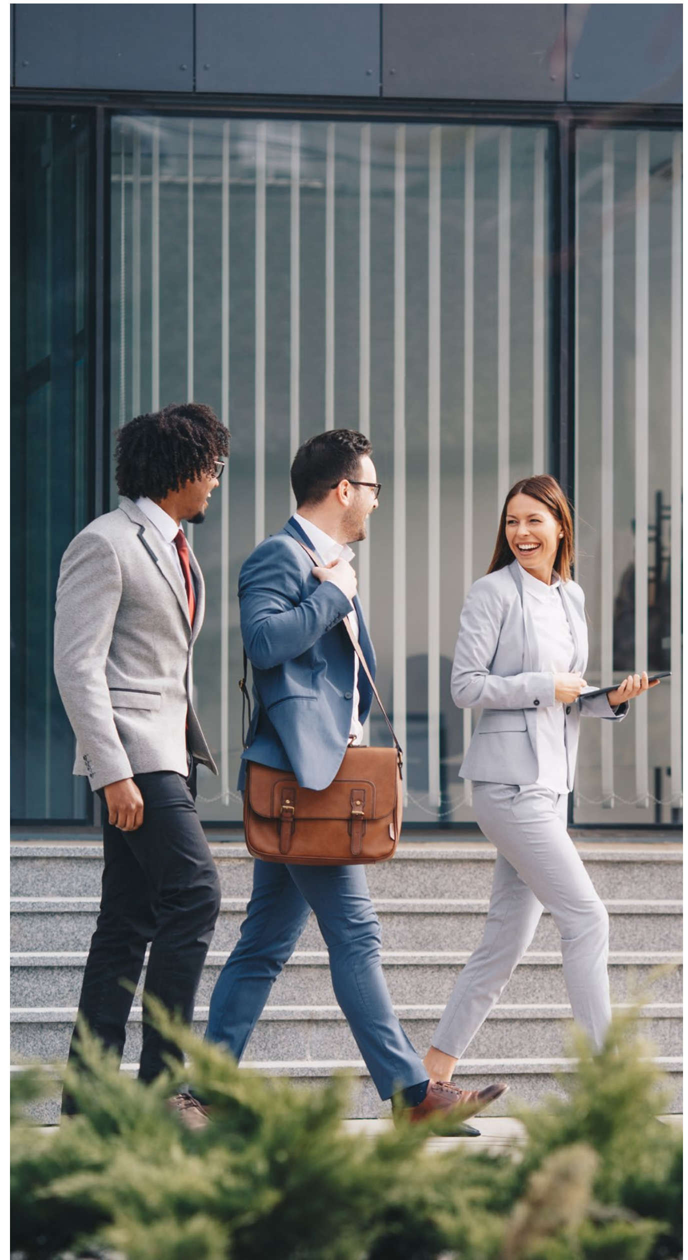
- allegations that are worded in an abusive or defamatory manner;
- allegations that are worded to convey an intention to harass or annoy; and
- allegations that do not apply to the matter at hand.

After examining each allegedly affronting matter in the relevant affidavits, the court dismissed the respondents' application to strike out on the basis that none of the content in question in SARS' affidavit was inadmissible, nor had there been a breach of confidentiality by SARS in disclosing the relevant information as the tax affairs of the respondents were directly relevant to the main issues to be decided in the hearing of the main application. SARS' application to strike out was, on the other hand, allowed by the court as the relevant content in the respondents' affidavit was found to be abusive and defamatory, as well as being vexatious in the sense that the content was intended to harass or annoy. On the basis that SARS was successful in its application to strike out, the court granted a cost order in favour of SARS, including the cost of two counsel.

Regard was then had by the High Court to SARS' application for an order declaring that GVDM and the other respondents are vexatious litigants. The court recognised that such a declaration ultimately limits the right of access to the courts but that such a limitation is justifiable and reasonable having regard to section 36 of the Constitution of the Republic of South Africa, 1996. To this end, it was held that the purpose of the relevant section of the VPA is to impose a procedural barrier to future litigation on persons who are found to be vexatious litigants in order to avoid the abuse of the judicial system by those persons.

The jurisdictional requirements for a "vexatious litigant" order in terms of the VPA are that –

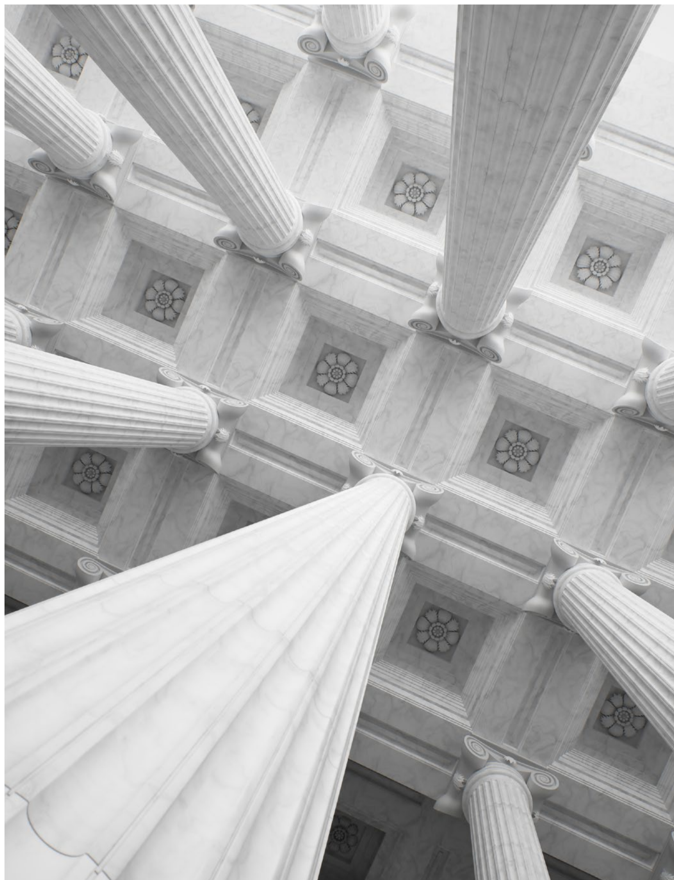
1. legal proceedings must in the past have been instituted, or there is reason to believe that proceedings will in the future be instituted, against the applicant; and



2. the court is satisfied that the respondent has persistently instituted legal proceedings without any reasonable grounds for such proceedings (whether or not those proceedings were instituted against the same person or against different persons).

As it was readily apparent that legal proceedings had previously been instituted by the respondents against SARS, the issue that had to be decided by the court was whether the respondents had been shown to have persistently and without any reasonable grounds instituted the relevant legal proceedings.

To this end, the court considered each of the actions and applications previously brought by the respondents and it was indicated that while reasonable grounds for a select number of the said proceedings did exist, many of the other proceedings (in particular those pertaining to the liquidation of Zonnekus and the ancillary applications thereto) lacked the necessary reasonable grounds to be properly adjudicated.



In particular, the court noted that underlying all of the aforementioned unreasonable applications was GVDM's opposition to the extent of the tax liabilities raised by SARS against Zonnekus (amounting to more than R42 million). Despite this being the case, GVDM and the other respondents had consistently failed to pursue the dispute resolution procedures provided for by the TAA. On this basis, the court concluded that each of the business rescue applications (and all of the related applications) were patently unwarranted, were instituted without any commercial justification, were doomed to fail, and were set out to achieve the extraneous objective of frustrating and delaying the liquidation of Zonnekus. The court also made direct reference to several other applications brought by the respondents and held that these were equally unmeritorious and unreasonable, were patently vexatious and constituted an abuse of court process.

In coming to its findings regarding the circumstances that constitute an abuse of court process, the court stated that, having regard to the relevant facts and circumstances, this type of abuse generally arises where procedures permitted by the rules of court to facilitate the pursuit of the truth are used for a purpose extraneous to that objective.

Ultimately the court held that the respondents had been shown to have persistently and repeatedly, and without reasonable grounds, instituted legal proceedings (whether against SARS or other persons) in a manner that was so persistent and unreasonable as to warrant an order being made that would restrict such litigation in the future. The court therefore granted the vexatious litigant order against GVDM (in his personal capacity and in his capacity as a trustee of the Eagle Trust) and the other respondents (in their capacities as trustees of the Eagle Trust). The court also granted a punitive cost order against the respondents.

"The vexatious litigant order granted by the court, in conjunction with the punitive cost orders that were made against the respondents, makes it abundantly clear that the improper use of court processes that results in the abuse of the judicial system will not be tolerated."

COMMENT

The judgment handed down by the High Court in this matter should serve as a cautionary tale to any taxpayer who would attempt to subvert their liability for tax (in respect of which they have been properly assessed) by frustrating the proper fulfilment of the statutory duties imposed on SARS in court.

The vexatious litigant order granted by the court, in conjunction with the punitive cost orders that were made against the respondents, makes it abundantly clear that the improper use of court processes that results in the abuse of the judicial system will not be tolerated. This is especially so in the tax context where specialised dispute resolution avenues have been provided for in chapter 9 of the TAA in order to effectively resolve most tax-related disputes between SARS and taxpayers without having to burden the court system unnecessarily.

To this end, taxpayers should always ensure that they follow the correct avenues of legal recourse when faced with a dispute with SARS in order to ensure that court processes are not abused.

Louise Kotze

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Section 163; chapter 9;
- Constitution of the Republic of South Africa, 1996: Section 36;
- Vexatious Proceedings Act 3 of 1956 (VPA).

Other documents

- Uniform Rules of Court: Rule 6(15).

Cases

- *Commissioner for the South African Revenue Service v Van der Merwe and Others* [Case No 7255/2019; [2021] ZAWCHC 197 (21 September 2021).

Tags: frivolous and vexatious proceedings; punitive cost orders; breach of confidentiality; vexatious litigant order.

COVID-19 INDEMNITY PAYMENTS

On 11 March 2020, the World Health Organization declared COVID-19 a global pandemic. President Cyril Ramaphosa declared a national state of disaster on 15 March 2020 and announced a national lockdown which commenced on 27 March 2020. This resulted in business disruptions and closures on a massive and unprecedented scale. In the wake of the COVID-19 pandemic and crisis, there has been a surge in business interruption insurance claims and lawsuits.

Many taxpayers instituted – and continue to institute – insurance claims under the business interruption clause of insurance agreements, for losses arising as a result of COVID-19.

Many of these claims are subject to potential litigation, with insurers disputing whether the loss is covered by the insurance agreement at all and, to the extent that it may be covered, arguing that a limit be imposed on the amount of the claim. This places these claims in doubt, as was seen in the two Supreme Court of Appeal decisions of *Guardrisk Insurance Company Limited v Café Chameleon CC*, [2020], and *Santam Limited v Ma-Afrika Hotels (Pty) Ltd & Another*, [2021], which dealt with these issues.

In some instances, the parties may engage in settlement negotiations on compromised terms since, depending on the facts, it may be to their advantage to settle the dispute on this basis. Factors which are usually considered when entering into settlement negotiation include the potential cost of litigation which may outweigh the possible benefits, efficient use of resources from a time perspective, the prospects of success in court and whether the dispute concerns complex factual or legal issues.

Enter section 8(8) of the Value-Added Tax Act, 1991 (the VAT Act), which in essence provides that, where a vendor receives any indemnity payment under a contract of insurance, the payment shall, to the extent that it relates to a loss incurred in the course of carrying on an enterprise, be deemed to be consideration received for a supply of services performed on the date of receipt.

The practical implications of this are that the insured is deemed to be making a taxable supply and must account for output tax on the indemnity payment received. The output tax payable by the vendor is calculated by applying the tax fraction (15/115) to the amount received from the insurer.

Two requirements central to this deeming provision are that –

1. the payment must be an indemnity payment – this means that the payment must be payment in settlement of a claim, other than a payment made by the insurer for a supply of goods or services;
2. the indemnity payment must be made under a contract of insurance, which is a contract that guarantees against loss, damage, injury or risk of any kind whatsoever, whether pursuant to any contract or law, including reinsurance.

As noted above, the indemnity payment must be made under a contract of insurance. The dictionary definition of the word "under" is "as provided for by the rules of; in accordance with". The amount must therefore be an indemnity payment made "in accordance with" a contract of insurance.

The question arises what the consequences are of the deeming provision if the parties conclude a compromise agreement.

A compromise is an agreement by which parties settle a dispute between them at less than the full value of the claim. If the dispute (contractual, delictual or otherwise) concerns an existing obligation, that obligation is terminated by the compromise.

The compromise may give rise to a new obligation since the general principle in South African law is that a compromise terminates the parties' original rights and obligations and gives rise to new rights and obligations under the new agreement.

This usually depends on the consensus reached between the parties in settlement, and the original obligation could be discharged and a new obligation, based on the terms of the settlement, may come into existence. The ordinary principles relating to the determination of contractual consensus will apply in establishing whether or not an offer of compromise has been made and accepted.

It should be noted that there are a number of considerations in the determination of whether a compromise agreement has been concluded.

We see no reason why rights and obligations under a contract of insurance should be treated any differently to rights and obligations arising under other forms of agreements: they are discharged, created, and replaced in the same manner.

If the parties conclude a settlement agreement, it should be considered whether the agreement is a compromise agreement. The nature of the agreement raises important fiscal questions, such as whether it discharges the original rights and obligations under the insurance contract. Does a new obligation, based on the terms of the compromise, come into existence?

If the answer to these questions is yes, then the payment made under the compromise agreement may not be an indemnity payment made under (ie, in accordance with) a contract of insurance, but rather a payment made pursuant to a compromise agreement. If so, depending on the terms of the compromise agreement, it may not contain the *essentialia* (the minimum contents or requirements) of an insurance contract. Depending on the wording of the compromise agreement, it could be an independent contract, not capable of being described as an insurance contract.

Under these circumstances, section 8(8) of the VAT Act would therefore not likely apply to the payment made under the compromise agreement, and there would be no deemed supply.

This conclusion may, however, be impacted by the Supreme Court of Appeal decision *Ratlou v Man Financial Services SA (Pty) Ltd*, [2019] *(Ratlou)*, the facts of which were the following:

1. A company entered into several rental agreements in respect of trucks. These agreements were evidently not credit agreements. The company fell into breach of these agreements and subsequent negotiations resulted in a single written settlement agreement.

2. The company, represented by its owner (a natural person) in his personal capacity, undertook to be joint and severally liable for these debts of the company. The settlement agreement was then concluded with this natural person. The settlement amount was repayable over a period of 60 months and included additional fees, in the form of interest.

3. The question was whether the settlement agreement was subject to the National Credit Act, 2005 (the NCA), since the rights and obligations under the rental agreements (the underlying agreements) were discharged and replaced by fresh rights obligations under the settlement agreement.

In reaching its decision in *Ratlou*, the Supreme Court of Appeal held as follows:

1. It is artificial to argue that the underlying agreements (ie, the rental agreements) may not be examined for purposes of determining whether the settlement agreement falls within the parameters of the NCA. If the underlying agreements did not fall within the parameters of the NCA, then its compromise in terms of the settlement agreement cannot logically result in the agreement being converted into one that does.

2. The express reference in the settlement agreement to the underlying agreements – the rental agreements – is of vital significance. Clause 3 of the acknowledgement of debt provides that the agreement is "in full and final settlement of Man Financial Services' claims against PN Transport and Stephen [Mr Ratlou] with regard to the agreements listed therein". It was not in dispute that the accounts listed in the acknowledgement of debt related to the rental agreements. The compromise therefore remained linked to the underlying causa, being the rental agreements. Ignoring this is self-evidently artificial.

3. The court cited the case of *Ribeiro & Another v Slip Knot Investments 777 (Pty) Ltd*, [2011], which found that the underlying agreement remained extant (still in existence) despite settlement, and that the two agreements were interdependent and linked.

Taxpayers who have concluded or may conclude agreements of this nature should consult their tax advisors to determine the consequences which flow from the agreement. If a compromise agreement is concluded, it must be considered whether the circumstances and the wording of the compromise agreement are legitimately distinguishable from the findings of the Supreme Court of Appeal in *Ratlou* and whether the deeming provisions of section 8(8) of the VAT Act apply.

Edlan Jacobs

BDO

Acts and Bills

- Value-Added Tax Act 89 of 1991: Section 8(8);
- National Credit Act 34 of 2005.

Other documents

- Settlement agreement referred to in *Ratlou* – acknowledgement of debt: Clause 3.

Cases

- *Guardrisk Insurance Company Limited v Café Chameleon CC* [2020] ZASCA 173; (17 December 2020); [2021] (2) SA 323 (SCA);
- *Santam Limited v Ma-Afrika Hotels (Pty) Ltd* [2021] ZASCA 141 (07 October 2021);
- *Ratlou v Man Financial Services SA (Pty) Ltd* [2019] ZASCA 49; [2019] (5) SA 117 (SCA);
- *Ribeiro & Another v Slip Knot Investments 777 (Pty) Ltd* [2011] (1) SA 575 (SCA).

Tags: indemnity payment; compromise agreement.

TRANSFER DUTY AND NOTIONAL INPUT TAX

Where fixed property is purchased by a value-added tax (VAT) vendor from a non-vendor, transfer duty is payable by the purchaser. The purchaser is entitled to a notional input tax deduction if the property is to be applied in the taxable enterprise of the purchaser. The question regarding a vendor's entitlement to an input tax deduction in respect of the costs incurred to acquire the property in these circumstances has resulted in varying levels of uncertainty in recent years.

Prior to 10 January 2012, where a vendor acquired fixed property from a non-vendor (which is regarded as second-hand goods in terms of the Value-Added Tax Act, 1991 (the VAT Act)) for the purpose of making taxable supplies, its entitlement to a notional input tax deduction was limited to the transfer duty actually paid on the acquisition of this fixed property. With effect from 10 January 2012, the VAT Act was amended, and this limitation was removed. Since that date, the notional input tax deduction in respect of fixed property has been treated largely the same as the notional input tax deduction available for other second-hand goods. Vendors are therefore now entitled to a notional input tax deduction equal to the tax fraction (15/115) of the lesser of the consideration in money paid by the vendor for the supply of the fixed property purchased, or its open market value.

Although the position regarding a vendor's entitlement to a notional input tax deduction in respect of fixed property acquired from a non-vendor seemed to have been clarified by the amendment to the VAT Act, a second question then arose regarding whether the transfer duty costs associated with the purchase of fixed property from a non-vendor formed part of the "consideration" paid by the vendor for the fixed property for purposes of calculating the notional input tax deduction. To the extent that a vendor is able to include the transfer duty costs, this would result in a higher notional input tax deduction.

It has been the practice of the South African Revenue Service (SARS) to exclude the transfer duty incurred by a purchasing vendor from the amount of "consideration" when calculating the notional input tax credit. SARS' view was generally widely accepted and applied until it was challenged by a taxpayer in the Cape Town tax court. In Case No VAT 1857, the tax court was tasked with determining whether the amount of consideration for purposes of calculating the notional input tax deduction should include the amount of transfer duty paid in respect of the fixed property purchased. The judgment was handed down on 25 February 2020.

In deciding the matter, the tax court considered the definition of "input tax" and the definition of "consideration" as contained in section 1(1) of the VAT Act. In applying the principles of interpretation, the tax court applied the plain meaning of the words and held that the broad definition of "consideration", which includes *any payment made* in respect of the properties, is unambiguous and held that the clear language used includes transfer duty paid.

The tax court accordingly found in favour of the taxpayer and concluded that transfer duty must be included in the "consideration" paid for fixed property and stated that its conclusion was based on the clear language of the legislation, and that the conclusion was sensible and not unbusinesslike. Furthermore, it held that this conclusion was supported by the purpose of the notional input tax deduction allowed in respect of second-hand goods; the purpose being that it was introduced to eliminate double VAT charges on the same value added by allowing notional input relief in the absence of actual inputs.

The tax court judgment was contrary to SARS' practice and due to the significance of the judgment for SARS, it came as no surprise when SARS filed for leave to appeal, which was granted. Notwithstanding the significance of the judgment for the principles of VAT, the taxpayer withdrew from the appeal. A notice of withdrawal of opposition and abandonment of judgment in favour of SARS was therefore issued by the High Court under section 141 of the Tax Administration Act, 2011 (the TAA).

"Notwithstanding the findings of the tax court in VAT1857, and in line with its past practice, SARS has ruled that the term 'consideration' does not include any transfer duty imposed under the Transfer Duty Act, 1949."

It follows that although the tax court judgment was seemingly a win for taxpayers, the effect of the taxpayer's withdrawal of opposition to the appeal and abandonment of the judgment, is that the judgment is no longer binding against SARS as it relates to that particular taxpayer. Furthermore, it should be noted that while the judgment itself does not fall away, SARS issued Binding General Ruling (VAT) 57 (BGR 57), in which it restates and affirms its view, which is contrary to the judgment handed down by the tax court, making it clear that there is no doubt that SARS will challenge any reliance on the tax court judgment by other taxpayers going forward.

BINDING GENERAL RULING 57

On 20 October 2021, SARS issued the said BGR 57, in which it clarifies whether the term "consideration" includes an amount of transfer duty paid or payable on the acquisition of second-hand fixed property for the purposes of calculating a notional input tax deduction available to vendors who acquire fixed property from non-vendors for taxable purposes.

Notwithstanding the findings of the tax court in VAT1857, and in line with its past practice, SARS has ruled that the term "consideration" does not include any transfer duty imposed under the Transfer Duty Act, 1949. As a result, the amount of transfer duty paid by a vendor to acquire second-hand fixed property for taxable purposes cannot be included in the calculation of any notional input tax deduction which may be available to that vendor under the VAT Act.

SARS' ruling is issued on the basis that the transfer duty paid is not an amount of "consideration" paid for the supply of the property. SARS refers to its Interpretation Note 70, and states that "consideration" refers to the purchase price that must be paid to the supplier of goods or services by the recipient.

SARS states that, in terms of section 16(3)*(a)*(iiA) or (16(3)*(b)*(i) of the VAT Act, the payment in money is recognised to the extent that it has the effect of reducing or discharging any obligation relating to the purchase price for the supply during the tax period concerned. It states that transfer duty is a tax levied under the Transfer Duty Act on the "value" of the fixed property and is payable by the purchaser to SARS. It is not an amount paid to the seller. Transfer duty therefore does not form part of the purchase price of the property and the payment thereof cannot be regarded as an amount paid which reduces or discharges any obligation of the recipient relating to the purchase price of the property.

COMMENTS

The position taken by SARS in BGR 57 is in line with its previous practice and its arguments put forth in the tax court case, in terms of which it viewed the purchase price paid in respect of the sale of immovable property, to be the only "consideration" that may be used for the purpose of calculating the notional tax credit, and that the transfer duty paid must not be included for such purposes. On the basis that SARS has now confirmed its view as to whether the term "consideration" includes an amount of transfer duty for purposes of calculating the notional input tax deduction, vendors who applied the tax court judgment and calculated the notional input tax deduction based on the inclusion of the amount of transfer duty paid, should be aware of the potential risk that SARS may now seek to deny part of the deduction already claimed, as well as to raise penalties and interest in respect of the incorrect calculation.

A binding general ruling such as BGR 57 is issued under section 89 of the TAA. It is initiated by SARS and represents the general view of SARS on matters of general interest or importance and clarifies the SARS' application or interpretation of the tax law relating to these matters. A BGR is generally binding on SARS, but not on taxpayers; however, in terms of section 82(3) of the TAA, it may be cited in proceedings before SARS or the courts by either SARS or a taxpayer.

Notwithstanding that BGR 57 is not binding on taxpayers, it seems that vendors will be required to apply this position until SARS' view as set out in BGR 57 is challenged, if that ever happens, and then only if it is found to be incorrect by our courts.

Varusha Moodaley

Cliffe Dekker Hofmeyr

Acts and Bills

- Value-Added Tax Act 89 of 1991: Sections 1(1) (definitions of "input tax" & "consideration") & 16(3)*(a)* (iiA) & 16(3)*(b)*(i);
- Tax Administration Act 28 of 2011: Sections 82(3), 89 & 141;
- Transfer Duty Act 40 of 1949.

Other documents

- Binding General Ruling (VAT) 57;
- SARS Interpretation Note 70 (Issue 2) – "Supplies made for no consideration" (10 November 2021).

Cases

- Case No VAT 1857.

Tags: notional input tax deduction; second-hand fixed property; consideration.