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CRYPTO ASSETS
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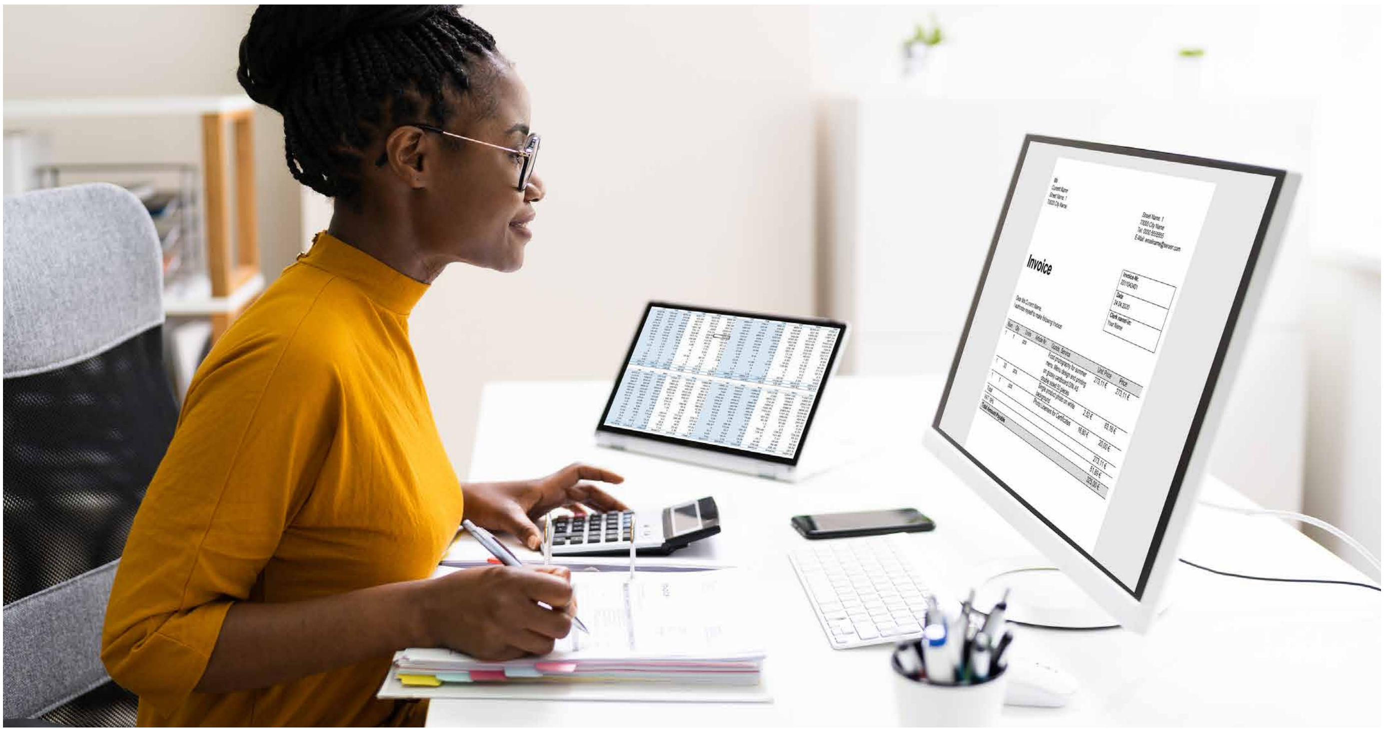
RECORD-KEEPING AND DISCLOSURE

Some South Africans who have bought cryptocurrencies in recent years are being audited by the South African Revenue Service (SARS), who has sent them letters requiring more information about these investments.



Early in 2021, SARS Commissioner Edward Kieswetter confirmed that undisclosed cryptocurrency holdings will be a big area of focus for the tax agency this year.

Some taxpayers have received audit letters that request that they provide reasons for their cryptocurrency investments, and provide letters from trading platforms confirming the investments.

The cryptocurrency platform Luno, which has seven million trading "wallets" (or accounts) in South Africa, confirms that it has seen an increase in requests from South Africans to download their transaction histories, presumably for tax purposes. Luno does not provide tax certificates to users because calculating tax on bitcoin earnings requires the consideration of multiple factors and is not straightforward. The platform says while it is relatively simple to download a transaction history from its site, these are not "SARS-ready" documents. It is working on making the process more user-friendly. Luno does not share customer information with SARS on a routine or ongoing basis.

Contrary to what many traders and investors believe, cryptocurrency investments can be tracked and traced with the correct expertise and resources. Bank transfers by a taxpayer to a cryptocurrency platform can be traced, and SARS is building technical expertise to allow other sleuthing capabilities. Remember, technology does not forget and once you have clicked on even a cryptocurrency ad, your digital footprint is already there.

SARS has already included questions about cryptocurrency investments in the capital gains tax portion of tax returns, creating source codes for cryptocurrency-trading profits (2572) and losses (2573), respectively.

This means that there is no room for a taxpayer to manoeuvre in light of non-disclosure in their returns.

What must be declared?

All cryptocurrency transactions must be declared – not only if you cashed out.

If you bought any cryptocurrency, or exchanged any cryptocurrency for another cryptocurrency, it must be declared on your tax return. You must also state if you mined cryptocurrency. Furthermore, SARS is very clear that you need to declare it if you were in any way paid in cryptocurrency.

How will my income from cryptocurrency be taxed?

SARS doesn't view cryptocurrency as a currency.

If you made money from your cryptocurrency investment, it can either be taxed as income, or attract capital gains tax. This depends on whether you are an active trader in cryptocurrencies, or are investing for the long run.

Here's when you should declare your crypto gains as income, or as a capital gain (according to tax platform *TaxTim*):

	Gross income	Capital gains
Are you actively trading with cryptocurrency?	Yes	No
Did you purchase the cryptocurrency as a long-term investment?	No	Yes
Did you purchase the cryptocurrency more than three years ago?	No	Yes

If you were paid for your services in cryptocurrency, this will be considered to be remuneration for tax purposes and is subject to normal tax.

How much tax will I pay?

If you are found to be a short-term investor or trader in cryptocurrencies, you will pay tax at your personal income tax rate (which can be upwards of 40% if you earn more than R782 200 a year). For longer-term investors, capital gains tax (18% for individuals) is payable.

Here's what the calculation will look like (according to *TaxTim*):

	Gross income	Capital gains
Income	Income received from trading with cryptocurrency.	Proceeds from selling the cryptocurrency.
Deduct	All expenses incurred to produce the cryptocurrency income.	Base cost of the cryptocurrency.
Profit	Included in your total taxable income that will be taxed as per normal tax tables.	It will be added to the total of capital gains for the year (less R40 000 annual exclusion) and then 40% of the balance will be added to your taxable income that will be taxed as per normal tax tables.
Loss	Loss will most likely be ring-fenced unless you can prove you are trading as a business.	Will be set off against capital gains from other assets.

"Unlike shares, the purchase price of the cryptocurrency is determined on the date you received it."

"Taxpayers who fail to correctly disclose their cryptocurrency-related income or comply with an audit request by SARS may be convicted for an offence and be liable to a fine or imprisonment for up to two years."

Unlike shares, the purchase price of the cryptocurrency is determined on the date you received it.

How will I be taxed if I mine cryptocurrencies?

This is not clear, says *TaxTim*:

> "SARS provides little guidance on how you will be taxed if you mine your cryptocurrency. The assumption is that the crypto earned through mining will automatically be seen as trading. The stick in the mud is that it can also be seen as capital gains depending on your intention [in respect of] your cryptocurrency."
>
> [*Editorial comment*: In the hands of the miner, the value of currency created would, at the outset, be trading income. Thereafter the currency may be held as capital assets.]

What are the penalties if I don't disclose cryptocurrency income?

Taxpayers who fail to correctly disclose their cryptocurrency-related income or comply with an audit request by SARS may be convicted for an offence and be liable to a fine or imprisonment for up to two years.

If found guilty of gross negligence, a taxpayer could face penalties more than double the owed amount, plus interest. And if found guilty of tax evasion, the penalties could be more than triple the original amount.

What should I do if I haven't declared my cryptocurrency holdings over recent years?

Contact the SARS voluntary disclosure programme (VDP), which offers more favourable penalty amounts than if you were to be found guilty. The unit can be contacted directly at VDP@sars.gov.za.

Tax Consulting South Africa

Tags: cryptocurrency investments; cryptocurrency-trading profits; cryptocurrency transactions; short-term investor; proceeds; base cost.

ESTATE DUTY: VALUE OF ASSETS SOLD

On 11 December 2020 the Johannesburg tax court had to decide whether an asset had been disposed of "in the course of the liquidation of the estate of the deceased", as contemplated in the Estate Duty Act, 1955, or rather "during" the liquidation of the estate. For the reasons discussed in this article, the distinction can have an impact on the estate duty liability. In addition to failing in her contention that the latter interpretation applied, the unfortunate executrix also found that, for legal precedent to assist a litigant, the facts of the precedent case must be closer than merely similar to those of the litigant. Although the case reference is Mr X v CSARS*, [2020], the appellant was the deceased estate of Mr X.*

Ms B was the sole heir and executrix in the estate of her deceased father, who died intestate on 18 August 2015. The asset in question consisted of 1673 Kruger Rands (the Coins), and the question was whether they should be valued for estate duty purposes in terms of section 5(1)*(a)* of the Estate Duty Act, as SARS contended, or of section 5(1)*(g)*, as asserted by Ms B. Before the estate had been finalised, Ms B had sold the Coins in several tranches between 27 May and 25 November 2016.

Section 5(1)*(a)* would apply if the Coins had been sold in the course of the liquidation of the estate, while section 5(1)*(g)* would apply if they had accrued to Ms B on the death of Mr X and she had sold them in her capacity as owner consequential upon inheriting them. At date of death of Mr X, the value of the Coins was about R26,6 million, while the total proceeds of the sales were about R31,2 million.

Section 5(1)*(a)* provides that, for purposes of its inclusion in the estate, the value of any property disposed of in the course of the liquidation of the estate is the price realised, namely R31,2 million in the view of SARS in the present matter. Section 5(1)*(g)* prescribes that the value of any other property (that is, in effect, property not sold but awarded to the heir) is the value at the date of death of the deceased person. This would be R26,6 million if Ms B had her way.

The crisp question was whether Ms B had disposed of the Coins in her capacity as the only heir, and not as executrix "in the course of the liquidation of the estate"; or whether she had sold them as executrix. Alternatively, if she had sold them in her capacity as executrix, whether she had done so "during liquidation".

The appellant cited three judgments in arguing for section 5(1)*(g)*:

CSARS v Estate late HE Kelly, [2004], where the court stated: "The norm is that estate duty is based on the value of the estate assets as at the date of the deceased's death";

De Leef Family Trust and Others v Commissioner for Inland Revenue, [1993]. Here the court stated: "Besides, according to our modern system of administration of deceased estates, the heir or legatee of an unconditional bequest obtains a vested right (*dies cedit*) to be entitled to the bequest on the death of the testator (*a morte testatoris*)"; and

Harris v Assumed Administrator, Estate Late Macgregor, [1987]. Although this case was about an intestate estate, the statement relied on by the appellant in the present matter was that the estate vests on the date of death when the heirs have been determined.

The facts of *Kelly*, on which the appellant mainly relied, were that Mrs Kelly at the time of her death in 1981 was married out of community of property to Mr D Kelly, who was the executor of her estate. The estate assets included ten units of Karoo land on which *bona fide* farming operations were carried on. Mr Kelly owned an undivided half share of five of these units. Mrs Kelly bequeathed her own farms to her son J Kelly (including the five units she owned outright) and the five half shares to her son F Kelly, in both instances subject to a usufruct in favour of her husband.

In 1983, while the estate was still being wound up, Mr Kelly and J Kelly entered into a redistribution agreement in terms of which Mr Kelly became the sole owner of the five half shares bequeathed to J Kelly, subject to a bequest price. For estate duty purposes the total value of all ten units was determined at R289 177.50, being the Land Bank value as was permitted at that time.

In 1984, Mr Kelly, in both his personal capacity and as usufructuary, and F Kelly as bare dominium holder, sold the ten units to one P for R1 750 000.

In 1985 the executor filed the liquidation and distribution account, in which the ten units were reflected at the R289 177.50 Land Bank value in terms of section 5(1)*(g)*.

In 1997 SARS became aware of the 1984 sale and revised the estate duty calculation to reflect the selling price, on the grounds that the sale had taken place in the course of the liquidation and that section 5(1)*(a)* applied. The estate objected and appealed on the grounds that the sale had taken place during and not in the course of the liquidation. The matter ended up in the then Appeal Court, where the learned judge held: "I conclude that a sale 'in the course of the liquidation of the estate' in s 5(1)*(a)* of the Estate Duty Act means a sale between which and the liquidation process there is some relationship. Put another way, it means a sale effected in the exercise of the functions involved in the liquidation. In short, the sale must be one in implementation of the liquidation process. It must therefore be by the executor or on behalf of the executor, in the latter's capacity as executor, not in the latter's personal capacity as beneficiary." And further: "Quite apart from the consideration that in selling to P the respondent did not purport to act as executor but only in his personal capacity as usufructuary, and as his son, F Kelly's, representative, the following further facts demonstrate that the sale was not in the course of the liquidation:

[1] All the units of land were sold together as one. The merx included the respondent's undivided half share in five of the units. This property was not an estate asset, it was not part of the liquidation process to sell it.

[2] It was not necessary for any estate purpose to sell any of the immovable estate assets prior to finalisation of the account.

[3] The sale was consequent upon the decision by the respondent and F Kelly to sell, pursuant to the redistribution agreement, in advance of their receiving transfer from the estate."

Fortified by this decision as precedent, Ms B contended for the same result. Perhaps made aware of the *Kelly* decision by her agent, who had experience as an executor, Ms B in emails with her financial advisor treated the sales as being concluded in her personal capacity as sole heir. Significantly, as it turned out, the estate did not have sufficient cash to meet the liquidation and estate duty costs. Ms B had to provide these from the proceeds of the Coins. She claimed to have done so following her undertaking to pay the liabilities of the estate, and admitted that part of the reason for the sale had been to pay the liabilities and cover the administration costs of the estate.

The court found that the management of the liabilities and administration of the estate is inherently the function of the executor and not the heir. Ms B's reliance on *Kelly* "falls at the first hurdle of the legal requirement, as the sales in question were fundamentally in the function of the executor and could not have been undertaken in the personal capacity of the beneficiary". Moreover, it had been necessary to sell some of the Coins for estate purposes, in contrast with the *Kelly* position.

In conclusion, the court found that:

"[69] In the absence of any legal or factual congruence between the appellant's case and the authority, there is no basis on which the appellant can rely on *Kelly*.

[70] The case of *Kelly* confirms that SARS' opinion that the sale was in course of the liquidation of the estate is correct, in that:

> [70.1] The sale could only have been undertaken by an executor;
>
> [70.2] The sale only involved estate assets which the heir had no ownership over; and;
>
> [70.3] The sale was necessary to cover the debts of the estate."

Executors and heirs therefore need to be wary of uncritically relying on *Kelly* unless the facts, and especially point [2] above from *Kelly*, are in their favour.

Prof Peter Surtees

Acts and Bills

- Estate Duty Act 45 of 1955: Section 5(1)*(a)* & *(g)*.

Cases

- *CSARS v Estate late HE Kelly*, JOL 12754 "(SCA)" [2004];
- *De Leef Family Trust and Others v Commissioner for Inland Revenue* [1993] 55 SATC 207; [1993] (3) SA 345 (A);
- *Harris v Assumed Administrator, Estate Late Macgregor* [1987] (3) SA 563 (A);
- *Mr X v Commissioner for the South African Revenue Service* [2020] Case No 24863.

Tags: liquidation of the estate; estate assets; redistribution agreement; liabilities of the estate.

CONSIDERATIONS FOR RESIDENTS EMPLOYED IN THE UAE

Because South Africa (SA) follows a residence-based tax system, SA residents are taxed on their worldwide income, irrespective of the jurisdictional source of their income. This means that a SA tax resident who becomes entitled to remuneration in respect of his employment services performed in the United Arab Emirates (UAE) will, as a rule, be subject to income tax in SA.

However, relief is given under section 10(1)*(o)*(ii) of the Income Tax Act, 1962 (the Act), which exempts from income tax, in a year of assessment, a maximum amount of R1,25 million, which is calculated on a proportionate basis (see Interpretation Note 16 (Issue 3), published by the South African Revenue Service (SARS) on 31 January 2020). This exemption may be helpful to tax residents entitled to a remuneration equal to that maximum amount (or lower) in respect of their employment exercised in a foreign country, such as the UAE, provided that all other requirements of section 10(1)*(o)*(ii) are satisfied (ie, the individual is physically outside SA for 183 days in total during any 12-month period of which at least 60 days must be spent outside SA continuously).

In light of the limited application of the section 10(1)*(o)*(ii) exemption, it is frequently asked whether SA individuals (who will retain their SA tax residency – see below), can obtain complete relief from SA income tax under the double tax agreement concluded between SA and the UAE (the UAE DTA). By way of example, let us say there is Mr X, a SA resident individual who accepts an offer to work on a full-time basis for a UAE-based employer for two years (receiving remuneration in excess of R1,25 million per annum), after which he will return to SA. Mr X will retain his SA tax residency and would like his remuneration during this period to be fully exempt from SA income tax.

The SA/UAE DTA

Article 14 of the UAE DTA gives taxing jurisdiction over the remuneration derived by a SA resident employee, between the state where the employment is exercised (ie, the UAE) and where the employee is tax resident (ie, SA). In this regard the general rule of Article 14 is contained in paragraph 1, which reads as follows:

"… salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State".

In applying Article 14(1) to Mr X's situation, it means that the remuneration derived by him will be taxed by SA as the state of residence, and may also be taxed by the UAE, being the state where the employment is exercised, but only to the extent that it is derived from employment exercised in the UAE. Thus, even though the UAE obtains a right to tax employment income under Article 14(1), it may not necessarily have the right to tax that income under the DTA if the income is not taxable in the UAE (which would likely be the case, as the UAE does not currently have an income tax regime on employment income).

Interestingly, some commentators have interpreted the words "unless the employment is exercised in the other Contracting State" in Article 14(1), as removing SA's taxing right completely and diverting the taxing right to the UAE, exclusively. However, this approach is likely incorrect, as confirmed in international case law such as the recent United Kingdom Supreme Court case of *Fowler (Respondent) v Commissioners for Her Majesty's Revenue and Customs (Appellant)*, where the court expressly held that

"… Article 14(1) does not prohibit the state in which an employee is resident from taxing him on his income earned abroad, but it merely permits (but does not require) the state where he is physically working to tax him".

A similar view was held in the First-Tier Tribunal's case of *Russell Fryett v The Commissioners for Her Majesty's Revenue and Customs*, [2018], in relation to Article 14(1) of the tax treaty concluded between the United Kingdom (UK) and Hong Kong (which is worded similarly to the SA/UAE DTA). The Tribunal stated that

"the second part of paragraph 1 (the words following 'unless…') provide an exception to the rule set out in the first part where the employment is exercised in Hong Kong. The exception enables both the UK [i.e. State of residence] and Hong Kong to have taxing rights when the employment is exercised in Hong Kong" (own emphasis).

This, of course, allows for the incidence of double tax. In such an instance, Article 22 of the UAE DTA comes into operation to avoid double taxation, by requiring the state of residence (ie, SA) to give credit for any tax paid in the state where the employment was exercised (ie, the UAE). In the absence of any taxes in the UAE, of course, no credits will be given in SA.

It is worth noting that other Articles in the DTA are more specific in relation to which country has an exclusive taxing right, such as those dealing with directors' fees, pensions, social security, students, trainees, teachers and researchers, and any income must, at all times, be tested against these specific provisions.

In summary, where SA tax residents retain their tax residency and receive employment income in the UAE, the income will remain taxable in SA and they will, at most, be entitled to the R1,25 million exemption (provided that all of the requirements of section 10(1)*(o)*(ii) have been met).

Whilst there is an exception in Article 14(2), it only prohibits the state where the employment is exercised to tax the income from the employment. As the employment is exercised in the UAE (and in the absence of income tax in the UAE, at least for the time being) this provision does not assist in the dilemma faced by SA tax residents, such as Mr X in our earlier example.

WHAT IF INCOME TAX IS PAYABLE IN THE FOREIGN STATE?

If the UAE does in future impose tax on employment income, it appears that SA tax residents will potentially not be liable for income tax in the UAE if all three of the following conditions are satisfied:

1. the individual is present in the UAE for a period or periods not exceeding the aggregate of 183 days in any 12-month period that begins or ends during the taxable year concerned (ie, the taxable year in which the services are performed);

2. the remuneration is paid by, or on behalf of, an employer who is not a resident of the UAE; and

3. the remuneration is not borne by a permanent establishment or fixed base that the employer has in the UAE.

In the meantime, the above exception will be helpful in source states (ie, states in which the employment is exercised) with a higher individual tax rate than SA, assuming that SA has a tax treaty with them. An example of such a state would be Austria, with a maximum marginal tax rate of 55% for individuals with income in excess of €1 million. Therefore, should a SA tax resident derive remuneration in respect of their employment exercised in Austria and satisfy the three conditions above (see Article 15(2) of the SA/Austria DTA), that person would likely be taxed in SA only, regardless of the fact that their employment services would have physically been performed in Austria.

As illustrated above, South Africans will not be able to escape their SA income tax liability, on any structuring, whilst retaining their SA tax residency. Relinquishing tax residency in SA (commonly referred to as tax emigration) is an option; however, such a decision is entirely fact-dependent and may, in addition, trigger an "exit tax" in SA as a result of the deemed disposal rules under the Act. Tax emigration is usually worthy of consideration in instances where an individual intends to move to another jurisdiction permanently and take up employment there. However, for individuals intending to return to SA at some point (therefore working outside of SA for a short-term period), this may not be the best option considering the potential tax triggered. More importantly for tax emigration, an individual is also required to convince SARS that their residency status has, in fact, changed. This process has become quite formal and requires more administration to place it on record with SARS, considering the additional forms required to be completed upon exiting SA, and the requirement to apply for a tax compliance status letter (TCS letter) and to submit various supporting documents to SARS.

In practice, proof of citizenship in the new country of residence would assist a SA taxpayer to prove tax emigration. However, this may be quite difficult to obtain in other jurisdictions, especially the UAE, as individuals with work permits in the UAE are usually not permitted to obtain citizenship by mere reason of working there (and an individual's ownership of property or a business in the UAE does not necessarily entitle them to citizenship). Article 8 of the UAE's Federal Law No 17 of 1972 (Federal Law 17) provides that citizenship may be granted to a person if that person has, *inter alia*, continuously resided in the UAE for a period not less than 30 years and is proficient in the Arabic language. There are instances in which certain individuals may be granted UAE citizenship earlier than the 30-year requirement (ie, Article 9 of Federal Law 17 provides that those who render "marvellous deeds for the country may be granted citizenship regardless of their period of residence"); however, what constitutes a "marvellous deed" for purposes of Federal Law 17 is beyond the scope of this article, and will ultimately depend on the circumstances of each case.

CONCLUSION

Where SA tax residents receive employment income in a foreign country, they will remain taxable in SA and will, at most, be entitled to the R1,25 million exemption, provided that all other requirements of section 10(1)*(o)*(ii) have been met. When considering the (rather drastic) decision to emigrate, it is clear that an all-round approach cannot be adopted for every individual taking up an opportunity to work abroad, and the circumstances of each case, ie, the legal, tax, commercial and personal factors, must all be carefully considered in order to achieve the best outcome for each individual.

Moreover, those individuals already permanently living and working abroad (with no intention to return to SA) must ensure that they have emigrated compliantly and that they have settled their tax affairs prior to leaving the country, as their permanent residence in a foreign country will not prevent SARS from holding them to account for non-compliance.

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Section 10(1)(o)(ii).

Other documents

- Double tax agreement between South Africa and Austria: Article 15(2);
- Double tax agreement between South Africa and the UAE: Articles 14 & 22;
- Interpretation Note 16 (Issue 3) ("Exemption from income tax: Foreign employment income");
- Tax compliance status letter (TCS Letter);
- Tax treaty between the United Kingdom and Hong Kong: Second part of paragraph 1:
- UAE: Federal Law 17 of 1972: Articles 8 & 9.

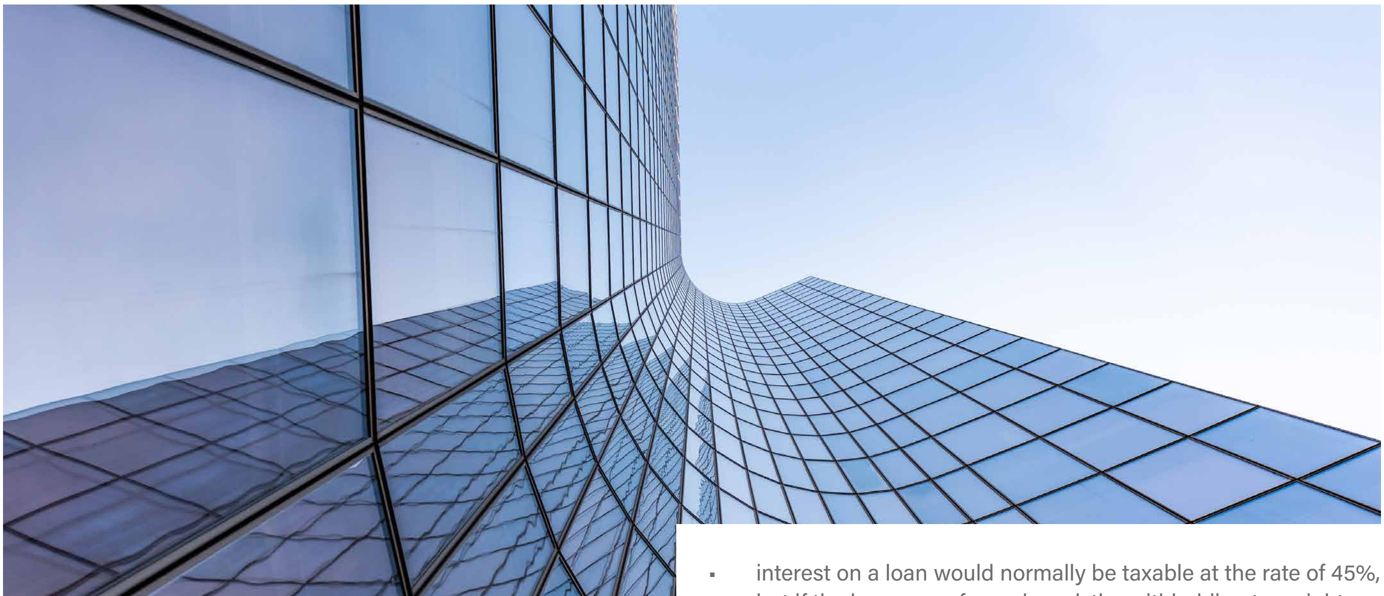
Cases

- *Fowler (Respondent) v Commissioners for Her Majesty's Revenue and Customs (Appellant)*, [2018] (Case ID: UKSC 2018/0226);
- *Russell Fryett v The Commissioners for Her Majesty's Revenue and Customs*, [2014] TC03360 (24 February 2014).

Tags: double tax agreement; tax resident; individual tax rate; income tax liability; tax compliance status letter.

LOOP STRUCTURES: REMOVAL OF RESTRICTIONS

On 4 January 2021 the Financial Surveillance Department of the South African Reserve Bank (FinSurv) issued a circular on the removal of the so-called "loop" prohibitions contained in the Currency and Exchanges Manual for Authorised Dealers *(the Manual), wherein are set out the approved practices for use by Authorised Dealers, ie, the commercial banks.*



At the outset, it must be noted that the basis of what is allowed or not allowed under the Manual is what is contained in the Exchange Control Regulations, 1961, and the discretions given to FinSurv and the Minister thereunder, but that the word "loop", or any prohibition against such a "loop", is not found anywhere in those regulations. This is entirely an interpretation of the prohibition in regulation 10(1)*(c)* of those regulations (the Regulation) that a South African resident may not, without approval, export capital or the right to capital from South Africa.

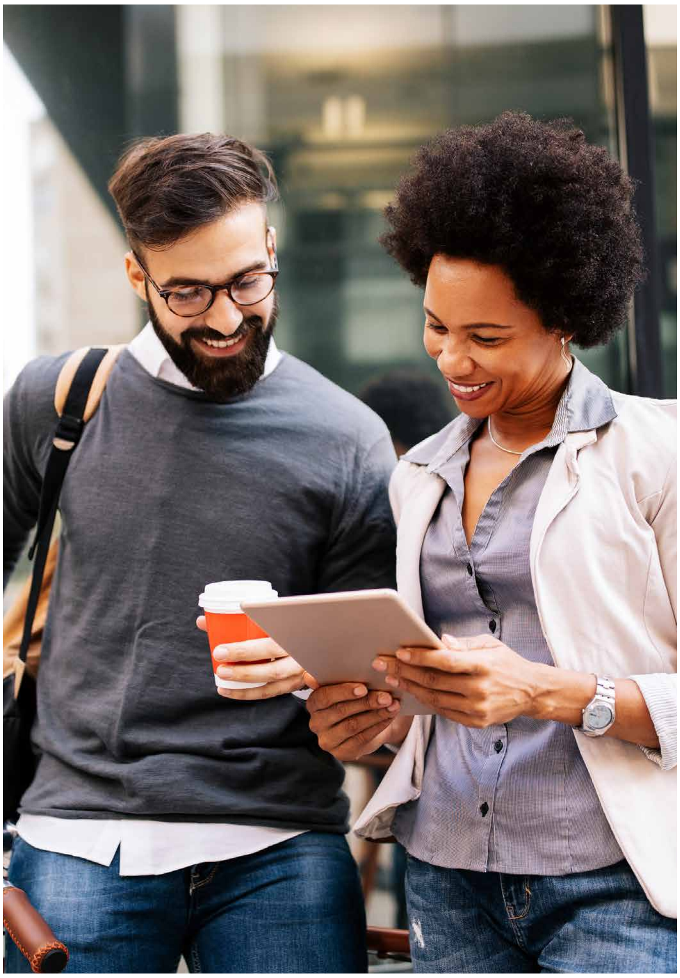
While sending out money to invest back into South Africa might well, in certain circumstances, represent a breach of the Regulation, hitherto FinSurv (and as a result, the Authorised Dealers) have given the prohibition a far wider interpretation than a proper legal interpretation would allow. There is no doubt, in our view, that many of the so-called unlawful structures would, if brought before the courts, be found not to be in breach of the Regulation, where the courts would apply proper rules of interpretation of statutory instruments.

Be that all as it may, whereas originally the prohibition of a loop – where a South African resident invests in an offshore structure (eg, a foreign company or a foreign trust) which, in turn, invests into South African assets – was in place to protect South Africa's foreign currency reserves from an exchange control point of view, for many years FinSurv has not been terribly concerned about this aspect, but has enforced the prohibition rather for the purpose of protecting the tax base. For example, whereas –

- interest on a loan would normally be taxable at the rate of 45%, but if the loan came from abroad, the withholding tax might be limited to 15% (or less, if the lender is resident in a country with an applicable double tax agreement with South Africa);
- dividends tax is at the rate of 20%, but if the investment came from a foreign company resident in a suitable jurisdiction with a favourable double tax agreement, the withholding tax might be reduced to as low as 5%; and
- shares in a South African company held locally would be subject to CGT, but if held through an offshore structure, it would usually be exempt from CGT.

And if there was any doubt about this motivation, it was dispelled in the 2020 Budget, where it was announced that the loop prohibition would be removed following amendments to the Income Tax Act, 1962, which removed, in certain instances, the benefits mentioned above in relation to dividends and CGT. As those amendments were passed by Parliament at the end of 2020, we are seeing the removal of the loop prohibitions contained in the Manual.

"At the outset, it must be noted that the basis of what is allowed or not allowed under the Manual is what is contained in the Exchange Control Regulations, 1961, and the discretions given to FinSurv and the Minister thereunder"



In summary, the changes are as follows:

- Up until now, South African resident individuals, using their foreign investment allowances, South African corporates, using their allowances to make foreign direct investments and South African private equity funds wishing to invest abroad, between them would be entitled to hold up to 40% of a foreign company which, in turn, had invested into South Africa. (Originally nothing would have been allowed, but the rules were gradually relaxed.) The changes now allow the individuals, corporates and private equity funds with authorised foreign assets themselves to invest into South African assets (though it is not quite clear how this will be designated so as to enable the income to flow abroad, and any profits to be able to be remitted abroad, as opposed to the investment effectively constituting a repatriation of the capital).

- In addition to what is stated above, the individuals/corporates/funds may invest in South African assets through an offshore structure (ie, a loop structure). In this case, however, the investment must be reported to an Authorised Dealer and there must be an annual progress report to FinSurv via the Authorised Dealer. Moreover, the Authorised Dealer must view an independent auditor's confirmation or suitable documentary evidence verifying that the transaction is concluded on an arm's length basis and for a fair and market-related price.

- Similarly, individuals who received foreign inheritances were prohibited from investing them back into South Africa. This prohibition has been removed.

- When South African residents borrow from abroad they had to confirm that there was no direct or indirect South African interest in the foreign lender. This requirement has been abolished.

- Interestingly, whereas previously the prohibition on investing from offshore related to investing into any Common Monetary Area (CMA) country – being, in addition to South Africa, Lesotho, Eswatini and Namibia – now the requirement to report to the Authorised Dealer, as set out above, applies only to investments into South Africa. The absence of a prohibition to invest via offshore into another CMA country, and limiting the requirement to report only when investing into South Africa, gives rise to a clear implication that there is no longer any restriction upon a South African investor investing into one of the other CMA countries via an offshore structure, and that there is no need to report such investment. On the basis that the loop prohibition was to protect the tax base, which is no longer necessary, this makes perfect sense, because an investment into another CMA country is simply a foreign investment for tax purposes, no different to any other foreign investment. And the fact that it is a requirement for the investment into South Africa via an offshore structure to be reported to FinSurv seems to indicate that this information is being gathered so it can be shared with SARS.

- Even while the previous relaxations allowed South African resident individuals to invest into offshore companies which invested into South Africa, subject to the 40% maximum, the relaxation never went so far as to allow offshore trusts with South African beneficiaries to invest into South Africa. Given the wide wording of the new rules (ie, the circular uses the expression "offshore structure") it is now clear that an offshore trust investing back into South Africa, either directly or through an offshore company, is no longer prohibited – what is required is that it be reported.

From a tax perspective, in brief, when South African residents hold the majority shares in a foreign company which, in turn, holds shares in a SA company, (a) the usual exemption from SA tax on the foreign dividend will not be available to the extent that the foreign dividend is attributable to any dividend received by the foreign company on the shares in the SA company, and (b) the usual exemption from CGT on the sale of the shares in the foreign company will not be available to the extent that the gain is attributable to the shares in the South African company held by the foreign company.

Werksmans

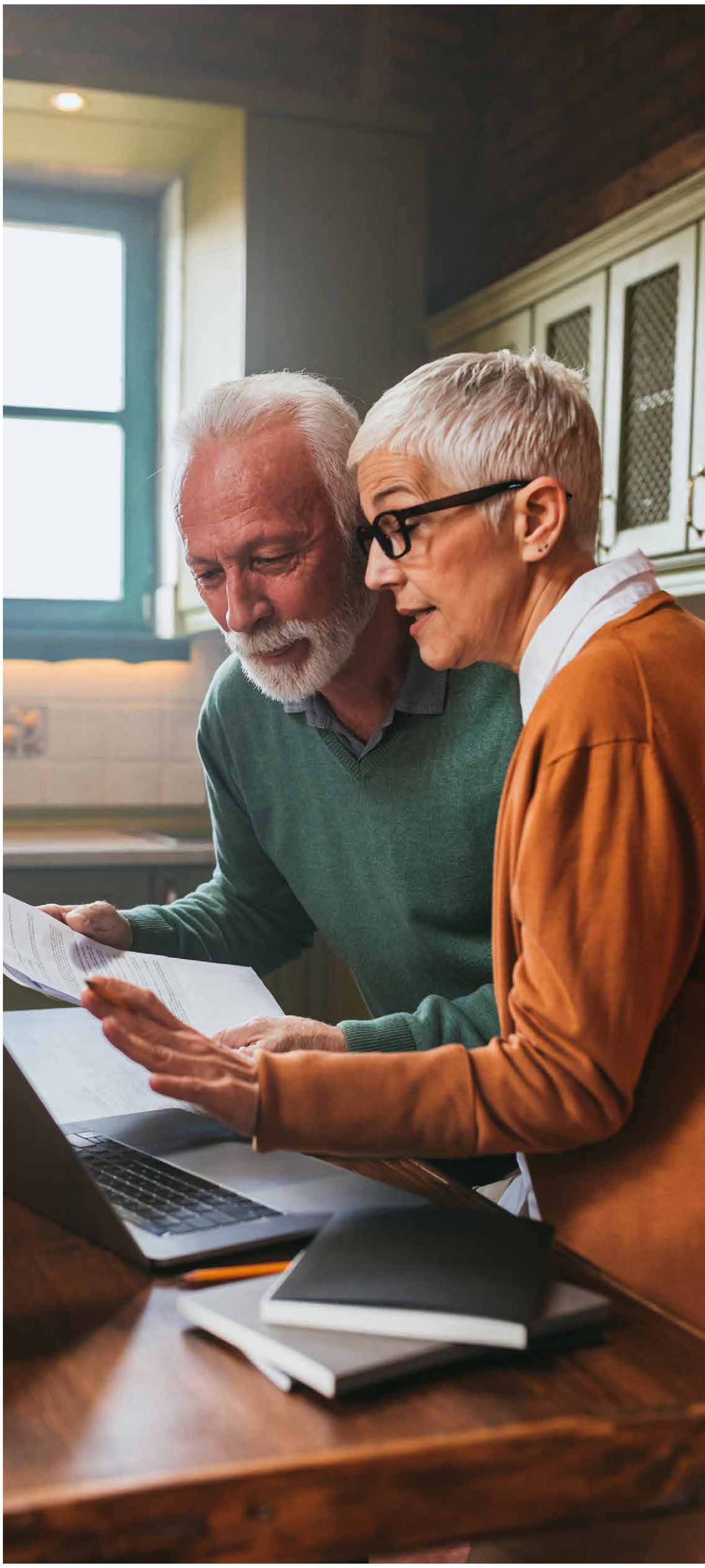
Other documents

- *Currency and Exchanges Manual for Authorised Dealers*;
- Exchange Control Regulations, 1961: Regulation 10(1) *(c)* (published under section 9 of the Currency and Exchanges Act 9 of 1933).

Tags: Exchange Control Regulations; withholding tax; double tax agreement; Authorised Dealer; offshore trusts; foreign dividend.

RETIREMENT ASSETS OF EMIGRANTS

The Budget Review 2021 includes a proposal to impose a deemed retirement withdrawal tax on retirement assets of emigrants as an exit tax. The proposal is unclear and there are numerous issues surrounding it.



Data from various sources suggests that around 23 000 South African (SA) tax residents emigrate each year in search of greener pastures. Individuals who cease to be tax residents currently pay an exit tax on their worldwide assets, with certain exclusions. At present, immovable properties and retirement funds that remain invested in South Africa are excluded from the exit tax net.

DEEMED RETIREMENT WITHDRAWAL TAX ON THE DAY BEFORE EXIT

National Treasury proposed in the Budget Review 2021 (the Budget) to include the SA retirement funds of an emigrant within the net of assets which are subject to an exit tax.

Emigrants will be deemed to have withdrawn from their retirement funds in full on the day before they cease to be SA tax residents; this will result in a deemed retirement withdrawal tax (the RWT).

However, payment of the RWT will be deferred until actual payments are made from the funds or on retirement if the funds remain invested in South Africa.

The proposal in the Budget is unclear and appears to suggest that the RWT *plus interest* will be withheld against actual payments received from the retirement funds by the emigrants in the future. (An actual payment could be received due to an allowed pre-retirement or retirement election, a divorce settlement or on death.)

There is no effective date mentioned in the Budget.

PREVENT LOSS TO THE FISCUS

The purpose of the proposal is to address the loss to the fiscus when an individual has emigrated to become tax resident in another country, eg, the United Kingdom (the UK).

The double tax agreement (DTA) between South Africa and the UK provides for the UK to have sole taxing rights on the SA pensions and annuities of the emigrant. This means that the SA pensions and annuities received by the emigrant who has become UK tax resident would not be subject to tax in South Africa, but only in the UK.

Other countries with similar sole taxing rights in their DTAs with South Africa include Australia, New Zealand, the People's Republic of China, Hong Kong SAR, Denmark, Germany, Italy, Portugal and Spain.

INTEREST ALLOWED TO ACCRUE UNFETTERED TO REDUCE RETIREMENT BALANCE

Capital gains, interest and dividends on retirement funds are not subject to South African tax in the hands of the retirement funds. This is based on the policy that the funds should be allowed to grow their asset base as much as possible to provide maximum value on retirement when such amounts are taxed.

The proposal will erode the asset base with a deemed interest on the RWT. This could be interest accruing over long periods until retirement. A significant portion of the retirement funds of the emigrant would not be used for retirement but to pay the RWT and interest. This runs counter to the policy to encourage retirement savings in South Africa generally.

MAP IS A POTENTIAL REMEDY

The mutual agreement procedure (MAP) is a remedy in a DTA for the revenue authorities of both countries (eg, SARS and HMRC (UK equivalent of SARS)) to interact with each other to resolve international tax disputes.

If the HMRC holds the view that the RWT plus interest *cannot* be validly imposed in terms of the UK / SA DTA, there could be double tax on the SA pensions and annuities received by the emigrant. The HMRC would not give a credit for the RWT plus interest against any UK income tax due.

A possible remedy for the emigrant would be to refer the issue to MAP and for the HMRC and SARS to discuss the validity of the RWT plus interest. This could take years to resolve. In the interim, the UK retiree would be without any pension or would receive a significantly reduced pension due to the RWT and interest, plus any UK tax.

INTEREST OVER THE THREE-YEAR WAIT

Recent amendments effective 1 March 2021 affecting preservation and retirement annuity funds provide that an emigrant can only access these funds after three years of ceasing to be a SA tax resident.

The proposal means that the emigrant will now also be liable for the RWT plus interest over this three-year waiting period, which will further reduce the value of the retirement balance.

ANOTHER REASON TO WITHDRAW

We hope that many aspects of the proposal which are unclear at this stage will be clarified in the draft tax bill to be circulated around mid-2021.

The proposal may result in emigrants electing to withdraw their SA retirement funds in full where possible and to pay any SA tax due as the risks of leaving these funds to grow in SA until retirement are too uncertain. The *fiscus* will receive some tax immediately. However, the withdrawal is an overall loss for the economy as the pool of retirement funds in SA will be reduced and the tax base on any growth of the funds had they not been withdrawn will be gone.

Webber Wentzel

Other documents

- Budget Review 2021;
- Double tax agreement between South Africa and the UK.

Tags: exit tax; retirement funds; retirement withdrawal tax; double tax agreement; mutual agreement procedure (MAP).

ESTIMATED ASSESSMENTS

The amendments to tax administration laws that were promulgated in January 2021 are indicative of SARS' need to focus on maximising collections and preserving liquidity.

The amendments to the Tax Administration Act, 2011 (the TAA), proposed in the Tax Administration Laws Amendment Act, 2020, and Taxation Laws Amendment Act, 2020, were promulgated on 20 January 2021. Taxpayers should take careful note of SARS' new powers to issue estimated assessments in the context of requests for relevant material.

Section 95 previously allowed SARS to issue an estimated assessment if a taxpayer failed to submit a return, or to provide information to SARS. The amendment authorises SARS to also issue an estimated assessment where the taxpayer "does not submit a response to a request for relevant material under section 46, after delivery of more than one request for such material".

In addition, section 95(5) of the TAA now provides that taxpayers may not object to, or appeal, an estimated assessment until the outstanding tax return, or relevant material is submitted to SARS. SARS is entitled to extend the period for submission of the outstanding information, until the end of the three- or five-year limitation period contemplated in section 99(1), at which point the estimated assessment will become final.

Although SARS has always had the means to enforce its information-gathering powers, the limitation of taxpayers' rights to dispute an estimated assessment poses a new and significant risk. An estimated assessment also creates an immediate liability for tax in terms of the "pay-now-argue-later" principle.

Although the amendments to section 95 do not prevent taxpayers from applying to SARS for the suspension of the obligation to pay the assessed amount (in terms of section 164 of the TAA), the granting of a suspension is entirely within SARS' discretion.

Critically, if the taxpayer does not initiate a dispute within the 30 days (or an extended period) provided for by the TAA, any suspension granted by SARS is automatically revoked with immediate effect. A senior SARS official is also entitled to deny or revoke a suspension of payment if satisfied that the taxpayer lacks a genuine intention to dispute the tax debt owed to SARS, which may well be the case for taxpayers who still owe outstanding returns or information.

The intention behind the amendment to section 95 is to enable SARS to effectively compel unscrupulous taxpayers who deliberately ignore their obligations, to respond. However, the overzealous application of these new powers could also have unintended, negative effects.

For example, there is no definition of "adequate" information. In practice, requests for relevant material are sometimes overly broad and impractical to implement, and SARS and taxpayers frequently disagree about the precise scope covered by an information request. In circumstances where taxpayers cannot locate all of the requested information, or where there is a dispute regarding the disclosure of privileged advice, SARS' ability to issue estimated assessments could take on an unintended, coercive slant.

It is therefore more important than ever for taxpayers to ensure that their contact details are correct and up to date, and to involve tax advisors from the outset when engaging with SARS in the context of a request for relevant material.

Although a taxpayer's ability to object to an estimated assessment may be compromised by the new section 95(5), the decision to issue an estimated assessment still constitutes administrative action, which will be subject to review if the decision-making process does not comply with the Promotion of Administrative Justice Act, 2000.

Bowmans

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 46, 95, 99(1) & 164;
- Taxation Laws Amendment Act 23 of 2020;
- Tax Administration Laws Amendment Act 24 of 2020;
- Promotion of Administrative Justice Act 3 of 2000.

Tags: estimated assessments; "pay-now-argue-later" principle; administrative action.

JUDICIAL REVIEW OF SARS DECISIONS

In 2020, the ability to review a decision of the South African Revenue Service (SARS) to audit a taxpayer was considered by the High Court in the matter of Cart Blanche Marketing CC and Others v Commissioner for the South African Revenue Service*, [2020].*

The entitlement of a taxpayer to review a decision by SARS in the High Court (rather than to pursue the dispute resolution procedures provided for in chapter 9 of the Tax Administration Act, 2011 (the TAA)), was once again considered by the High Court in the recent judgment of *ABSA Bank Limited and Another v Commissioner for the South African Revenue Service*, [2021]. In this case, the court had to determine whether the decision taken by SARS not to withdraw notices issued by it in terms of section 80J of the Income Tax Act, 1962 (the Act), and additionally the decision to issue letters of assessment pursuant to such notices, were capable of being reviewed under South African administrative law.

FACTS

The applicants in this case were ABSA Bank Limited (ABSA) and United Towers Proprietary Limited (United), and the origin of the dispute before the High Court was whether the applicants had participated in a so-called impermissible tax avoidance arrangement.

The transactions constituting the purported impermissible tax avoidance arrangement can be summarised as follows:

1. ABSA acquired tranches of preference shares in a South African company (PSIC 3), the acquisition of which shares entitled ABSA to dividends when declared.

2. PSIC 3 then bought preference shares in another South African company (PSIC 4).

3. As part of a capital outlay investment, PSIC 4 invested in an offshore trust (DI Trust), which trust then lent money to a South African company (MSSA) by means of subscribing for floating rate notes. MSSA was a subsidiary of a group of companies domiciled in Australia.

4. DI Trust also made investments by way of the purchase of Brazilian government bonds, in respect of which DI Trust received interest income.

The effect of these transactions was such that PSIC 4 received interest on its capital investment in DI Trust, as a result of which PSIC 4 could declare a dividend to PSIC 3 and PSIC 3 could declare a dividend to ABSA. By reason of the fact that a dividend was declared between two South African resident companies, the dividend received by ABSA was tax-free.

SARS' belief that ABSA was party to an impermissible tax avoidance arrangement stemmed from the Brazilian investment made by DI Trust and the purported impermissible tax benefit received by ABSA in the form of a tax-free dividend. It was contended by SARS that the lawful result of these transactions ought not to have been the receipt of tax-free dividends by ABSA, but rather the receipt of interest income, which interest would attract tax.

ABSA, however, argued that its purchase of the preference shares in PSIC 3 was premised on the understanding that PSIC 3 and MSSA had a back-to-back relationship and that the funds would flow directly to MSSA in order to settle a debt with its parent company. ABSA was unaware of the intermediary role fulfilled by PSIC 4 and DI Trust, and more specifically it was unaware of the Brazilian investment made by DI Trust. To this end, ABSA stated that it could not, in a state of ignorance, have participated in an impermissible tax avoidance arrangement, nor did it have a tax avoidance motive when it acquired the preference shares in PSIC 3.

Pursuant to its belief that ABSA had participated in an impermissible tax avoidance arrangement, SARS issued notices in terms of section 80J of the Act informing ABSA of the reasons on which this belief was based. ABSA submitted reasons to SARS why the provisions of Part IIA of the Act (comprising sections 80A to 80L, which deal with impermissible tax avoidance arrangements and the general anti-avoidance rules) should not apply and requested that SARS withdraw its section 80J notices. While SARS considered this request by ABSA (and prior to its ultimate refusal to withdraw the notices) SARS issued letters of assessment in respect of a tax liability imposed in terms of section 80B of the Act.

ABSA brought a review application to the High Court to review SARS' refusal to withdraw the section 80J notices and to review the issuance of the correlating letters of assessment.

"Section 104 prescribes that a taxpayer may object to and appeal against 'any other decision that may be objected to or appealed against under a tax Act'."

JUDGMENT

The first point of contention that had to be addressed was whether the decisions taken by SARS in this matter were open to review by the High Court.

In an argument premised on the findings of the High Court in the *Cart Blanche* case, SARS contended that the dispute resolution provisions contained in South Africa's tax legislation are extensive and that they provide adequate channels for taxpayers to resolve their grievances and disputes with SARS. As such, it was argued that it would be inappropriate for a taxpayer to circumvent the extensive process of objections and appeals provided for in the fiscal legislation by directly approaching a court of law at the inception of a disputed tax liability.

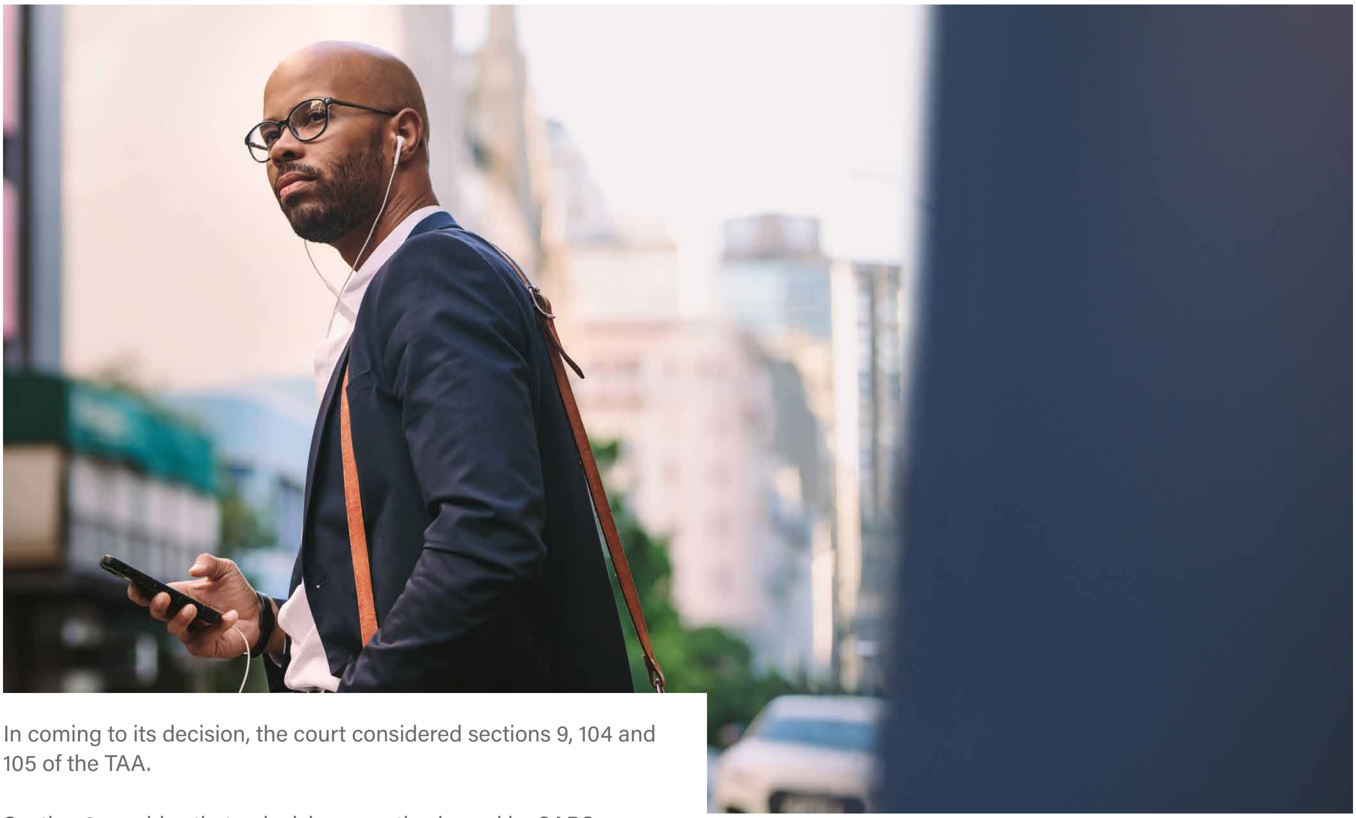
SARS' approach was refuted by ABSA on the basis that:

1. the scope of the dispute was a pure point of law, as a result of which the court would be entitled to depart from the usual procedures applied in the resolution of a tax dispute; and

2. the guarantee in section 34 of the Constitution (pertaining to access to the courts to resolve a dispute) has not been impeded by the provision in fiscal legislation of a system of internal remedies.

To this end, it was argued that in so far as a court has a discretion to deal with a tax dispute, that court would regard a pure point-of-law dispute as an appropriate rationale to deal with the matter rather than condemn the parties to the potentially protracted dispute resolution process provided for in the TAA.

"It was held that the inclusion of the words 'unless a High Court otherwise directs' in section 105 plainly denotes an environment for dispute resolution in which there is more than one process, and that a court has a discretion to approve a deviation from the prescribed procedures in the TAA."



In coming to its decision, the court considered sections 9, 104 and 105 of the TAA.

Section 9 provides that a decision or notice issued by SARS, excluding a decision given effect to in an assessment or a notice of assessment that is subject to objection and appeal, may at the request of the person affected by that decision, be withdrawn by a SARS official. On this basis, if such decision is not withdrawn, it may be subject to review by a court.

While it was SARS' view that section 9 of the TAA does not apply to the section 80J notices and section 80B assessments (on the grounds that they are subject to the TAA's objection and appeal processes), the court held that the exclusion contemplated in section 9 refers to assessments that have already been given effect to, and not to assessments that have not yet been given effect to. In the present matter, the court agreed that this exclusion did not apply as the section 80J notices (on the basis of which the section 80B assessments were issued) did not constitute a decision that had been given effect to in an assessment (or notice of assessment). Furthermore, it was contended by ABSA, and accepted by the court, that –

> "the right question to ask is not whether the tax regime offers two routes but whether the court's jurisdiction is plainly excluded. In the face of clear precedents, the court has dealt with tax disputes on points of law and has not compelled aggrieved taxpayers to exhaust internal remedies."

On this basis, the court held that the decisions in question were not excluded from the application of section 9 of the TAA.

The court then considered section 105 of the TAA, which provides that

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

Section 104 prescribes that a taxpayer may object to and appeal against "any other decision that may be objected to or appealed against under a tax Act".

It was held that the inclusion of the words "unless a High Court otherwise directs" in section 105 plainly denotes an environment for dispute resolution in which there is more than one process, and that a court has a discretion to approve a deviation from the prescribed procedures in the TAA. To this end, it was found that, in appropriate circumstances, a taxpayer may seek approval for such deviation simultaneously in the proceedings seeking a review. However, in order for the deviation to be granted, it was acknowledged that a court would require a justification to depart from the usual procedure, which justification should constitute "exceptional circumstances". To this end, it was held that

> "...the quality of exceptionality need not be exotic or rare or bizarre; rather it needs simply be, properly construed, circumstances which sensibly justify an alternative route. When a dispute is entirely a dispute about a point of law, that attribute, in my view, would satisfy exceptionally."

As such, the court agreed with ABSA's submission that in the event that there is a pure point-of-law dispute, a party to the dispute would be entitled to approach the court directly, without following the dispute resolution proceedings provided for in the TAA.

"Ultimately, the court found in favour of ABSA and concluded that SARS' refusal to withdraw the section 80J notices, and its decision to issue the notices of assessment, constituted decisions that stood to be reviewed and set aside"

After concluding that SARS' decision could constitute the subject matter of a review, it had to be decided on what basis the decisions might be reviewed. In particular, the court considered whether the decisions constituted "administrative action" that stood to be reviewed in accordance with the provisions of the Promotion of Administrative Justice Act, 2000 (PAJA), or alternatively whether the decisions merely were an exercise of public power and were therefore reviewable under the principle of legality. It was found that the decision to issue the notices in terms of section 80J was not "fully-final" because they placed no immediate adverse burden on ABSA and therefore had no "external or legal effect". As such, this decision was not administrative action as contemplated in PAJA. On the other hand, the letters of assessment and the refusal by SARS to withdraw the section 80J notices did have an external or legal effect, as a result of which it was concluded that these decisions did constitute administrative action.

However, ABSA did not invoke PAJA for purposes of reviewing SARS' decisions but relied on the principle of legality. The court did not deem it necessary to decide whether or not the use of PAJA may have been more appropriate in this case as –

> "the attributes of [SARS'] decision to refuse lies in the borderlands of which review-regime should prevail, ie, PAJA or Legality".

The court found that SARS' refusal to withdraw the notices undoubtedly had an effect, even if that effect was not necessarily final. Of critical importance, so it was held, was that the decision to refuse was a decision by an organ of state exercising its statutory powers and that the non-final effect thereof did not preclude the decision from being reviewed, precisely because that decision nevertheless had an impact. As such, the court was satisfied that SARS' decisions could be reviewed under the principle of legality.

Since it had been established that a pure point-of-law dispute may be subject to review under the principle of legality, the court was required to ascertain whether the dispute between the parties in this case could be classified as a pure point-of-law dispute.

ABSA relied on multiple passages contained in the section 80J notices (which identical passages were included in the notices of assessment) to demonstrate that SARS had accepted that ABSA was ignorant of the intricate workings of the series of transactions that constitute the alleged impermissible tax avoidance arrangement, and therefore accepted that ABSA had no knowledge of the Brazilian investment made by DI Trust. Upon consideration of these passages, it was found that SARS had failed to make any statement alleging that ABSA was indeed aware of the Brazilian investment, or that any of the facts advanced by ABSA regarding its involvement in the series of transactions were false. In its answering affidavit, SARS again failed to rebut ABSA's factual contentions that ABSA was ignorant of the transactions.

SARS argued that the relevant passages in the section 80J notices did not indicate SARS' acceptance of the facts forwarded by ABSA, and that the process of objection and appeal (where employees of ABSA may be subject to cross-examination and discovery of documents may be demanded) would be appropriate in order to test the veracity of ABSA's claim of ignorance.

This view was rejected by the court on the basis that the notices of assessment were issued on the factual premise set out in the section 80J notices. In essence, the court emphasised that if SARS intends to assess tax on the basis that it is due despite ABSA being ignorant, then SARS would not be entitled to claim that it deserved a "chance to go behind the premise of the assessment levied, so [it] can afterwards attempt to prove Absa did have knowledge."

As SARS was unable to distance itself from the premise (as set out in the section 80J notices) on which it chose to rely in order to issue the assessments, the court held that there was no room for a plausible dispute of fact. On this basis, the dispute before the court was found to be a pure point-of-law dispute which constituted the exceptional circumstances required to justify the court's approval for deviation from the normal despite resolution proceedings as contained in the TAA.

After concluding that the course of action taken by ABSA to institute review proceedings was appropriate, the last enquiry that the court was required to make was whether the decisions by SARS correctly stood to be reviewed. ABSA contended that SARS had made two substantive errors of law in its analysis of whether ABSA was involved in an impermissible tax avoidance arrangement. In particular, ABSA first argued that it was an error to suppose that ABSA could be a "party" to an impermissible tax avoidance arrangement as defined in section 80L of the ITA, and secondly that the transaction to which ABSA was a party did not result in it escaping from any tax liability.

In respect of ABSA's first substantive ground of review, the court held that the definition of "party" in section 80L requires a taxpayer to "participate or take part" in an arrangement. This, it was said, requires volition on the part of the taxpayer such that the taxpayer is not merely present in the arrangement but is participating therein. To this end, the court held that the fact that a taxpayer may be the unwitting recipient of a benefit derived from an impermissible tax avoidance arrangement cannot be construed as that taxpayer "taking part" in the arrangement.

Regarding the arrangement contended for by SARS, the court held that such arrangement must –

> "encompass all the transactions described. An arrangement which is alleged to comprise several distinct transactions must therefore be a scheme. It is plain that the scheme requires a unity to tie the several transactions into a deliberate chain. A mere series of subsequential events does not constitute a chain".

As SARS had failed to demonstrate a factual basis for its allegation that ABSA was anything more than an investor, it could not be found that a scheme (in which ABSA was involved) had been established. In addition, the court held that there was no basis to support an inference that ABSA's investment in PSIC 3 was motivated by an intention to obtain relief from an anticipated tax liability (a necessary attribute of an "arrangement").

In respect of ABSA's second substantive ground of review, the court stated that whether a tax liability is evaded by a taxpayer must be determined by applying the "*but for*" test to a future anticipated tax liability. To this end, it had to be determined, but for the purchase of preference shares in PSIC 3, how might an anticipated tax liability have been evaded by ABSA? The court concluded that SARS had set out no foundation to demonstrate how an anticipated tax liability was to be evaded by ABSA in these circumstances, with the result that SARS' conclusion that ABSA had escaped an anticipated tax liability was irrational.

Ultimately, the court found in favour of ABSA and concluded that SARS' refusal to withdraw the section 80J notices, and its decision to issue the notices of assessment, constituted decisions that stood to be reviewed and set aside. The court also granted a cost order in favour of ABSA.

COMMENT

It appears that the frequency with which taxpayers are instituting review applications in respect of decisions made by SARS is increasing. When contemplating the intricacies of the reviewability of SARS' decisions, however, it is evident that the particular facts and provisions of law that are applicable to a dispute will dictate whether a decision by SARS is subject to review by a court.

To this end, taxpayers should bear in mind that if they intend to review a decision by SARS, they will, at the very least, need to show that:

1. the decision forming the basis of the dispute stands to be reviewed rather than resolved by means of the dispute resolution procedures contemplated in the TAA; and

2. substantive grounds for review exist, such that a court may determine that the decision taken by SARS rightly ought to be reviewed.

It is readily apparent that not all decisions taken by SARS will be capable of review in the High Court and careful consideration should be given to the merits of a matter before such proceedings are instituted.

Of significance for taxpayers is the principle highlighted by the court in this case that when a pure point-of-law dispute arises from a decision taken by SARS, a taxpayer may directly approach an appropriate court for relief (by means of the review of the decision) rather than be subjected to the arduous and time-consuming processes that are prescribed in the TAA.

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 9, 104 & 105; Chapter 9 (sections 101 to 150);
- Income Tax Act 58 of 1962: Part IIA (sections 80A to 80L): More specifically sections 80B, 80J & 80L;
- Constitution of the Republic of South Africa, 1996: Section 34;
- Promotion of Administrative Justice Act 3 of 2000.

Cases

- *Absa Bank Limited and Another v Commissioner for the South African Revenue Service*, [2021], (2019/21825) [2021] ZAGPPHC 127 (11 March 2021);
- *Cart Blanche Marketing CC and Others v Commissioner for the South African Revenue Service*, [2020], (26244/2015); 2020 (6) SA 463 (GJ); [2020] ZAGPJHC 202; (31 August 2020).

Tags: dispute resolution procedures; preference shares; tax-free dividends; letters of assessment; administrative action; tax liability.

SARS CAN DELAY INTEREST ON YOUR OVERPAYMENTS

The amendments to tax administration laws that were promulgated in January 2021 are indicative of SARS' need to focus on maximising collections and preserving liquidity.

The amendments to the Tax Administration Act, 2011 (the TAA), proposed in the Tax Administration Laws Amendment Act, 2020, and Taxation Laws Amendment Act, 2020, were promulgated on 20 January 2021. One of these amendments impacts SARS' obligations to calculate and pay interest on overpaid amounts.

In terms of South African common law (and most other legal systems), a party that has been deprived of the use of its funds, or capital, suffers a commercial loss, and is compensated for that loss by an award of interest. Accordingly, in most circumstances, the date on which a party is deprived of its funds is the date on which interest begins to run, until the date of final repayment.

This common-law principle is the foundation of a number of statutory interest provisions governing interest, and was previously reflected in the wording of section 187 of the TAA:

- Section 187(3)*(g)* of the TAA provided that where SARS makes an overpayment to a taxpayer, interest runs from the time that the excess amount was paid by SARS (the effective date) until the date that the taxpayer repays the excess refund to SARS; and

- Section 188(3)*(a)* of the TAA provided where a taxpayer pays SARS more than the assessed amount, interest runs from the later of the effective date or the date that the excess was received by SARS, until the date the overpayment is refunded to the taxpayer.

According to these sections, SARS and the taxpayer were treated equally in terms of compensating the other party for the benefit of receiving an overpaid amount to which that party had not legally been entitled.

"Unfortunately, this amendment means that taxpayers will need to be considerably more vigilant when submitting returns and making payment to SARS, to ensure that they are not 'penalised' for accidentally paying SARS too much money."

However, the insertion of section 187(3)*(h)* into the TAA appears to skew the status quo in SARS' favour. Although we have yet to see how SARS will implement this amendment in practice, it appears that SARS is only required to calculate interest on an overpayment *after a 30-day period has elapsed*, while taxpayers will remain liable for interest on overpayments made to them by SARS, *from the date of payment*.

The rationale for this amendment is to provide SARS with enough time to review and correctly classify any overpayments, so that if the taxpayer has existing tax debts, the "excess" amount can be set off, so that SARS does not calculate and pay interest to taxpayers who simultaneously owe SARS outstanding tax and interest. However, it is unclear why Treasury chose an approach that appears to result in the forfeiture of interest for taxpayers.

A far more fair and impartial approach would be for SARS to delay the accrual of interest for a reasonable period, to allow SARS to analyse the taxpayer's account and allocate the overpaid amount to other tax debts, to the extent this is permissible (it is important to note that SARS is not permitted to set off refunds against other tax debts in circumstances where the tax debt is being disputed).

Once SARS has established that there are no outstanding tax debts and the amount is a "genuine overpayment", SARS could retrospectively calculate and pay the interest owing to the taxpayer, together with the refund.

SARS has indicated an intention to increase tax morale and voluntary compliance by reducing the administrative compliance burden on taxpayers. Unfortunately, this amendment means that taxpayers will need to be considerably more vigilant when submitting returns and making payment to SARS, to ensure that they are not "penalised" for accidentally paying SARS too much money.

Bowmans

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 187 (more specifically subsection (3)*(a)*, *(b)* & *(h)*) and 188(3)*(a)*;
- Taxation Laws Amendment Act 23 of 2020;
- Tax Administration Laws Amendment Act 24 of 2020.

Tags: statutory interest provisions; interest on an overpayment; tax debts.

SECOND TRANSFER PRICING CASE

It is no secret that revenue authorities the world over continue to place significant emphasis on Base Erosion and Profit Shifting (BEPS), with transfer pricing being one of the key focus areas. The South African Revenue Service (SARS) is no different. In fact, the Minister of Finance (the Minister) in the 2021 National Budget Speech specifically requested an additional spending allocation of R3 billion to SARS which would, amongst others, be used to expand SARS' specialised transfer pricing audit and investigative skills.

Despite the significant focus of SARS on BEPS and transfer pricing, it is interesting that there is a dearth of transfer pricing cases in South Africa. The question has been asked whether the *Crookes Brothers* case was South Africa's first proper transfer pricing case. With this context in mind, when first reading the recent (as yet unreported) judgment of *ABC (Pty) Ltd v Commissioner for the South African Revenue Service*, [2021], referred to herein as IT14305, the key words "transfer pricing"; "arm's length price"; "transactional net margin method"; and "full cost mark-up" certainly pique one's interest. In this article, we consider the discussion of transfer pricing principles and findings in this case.

BACKGROUND

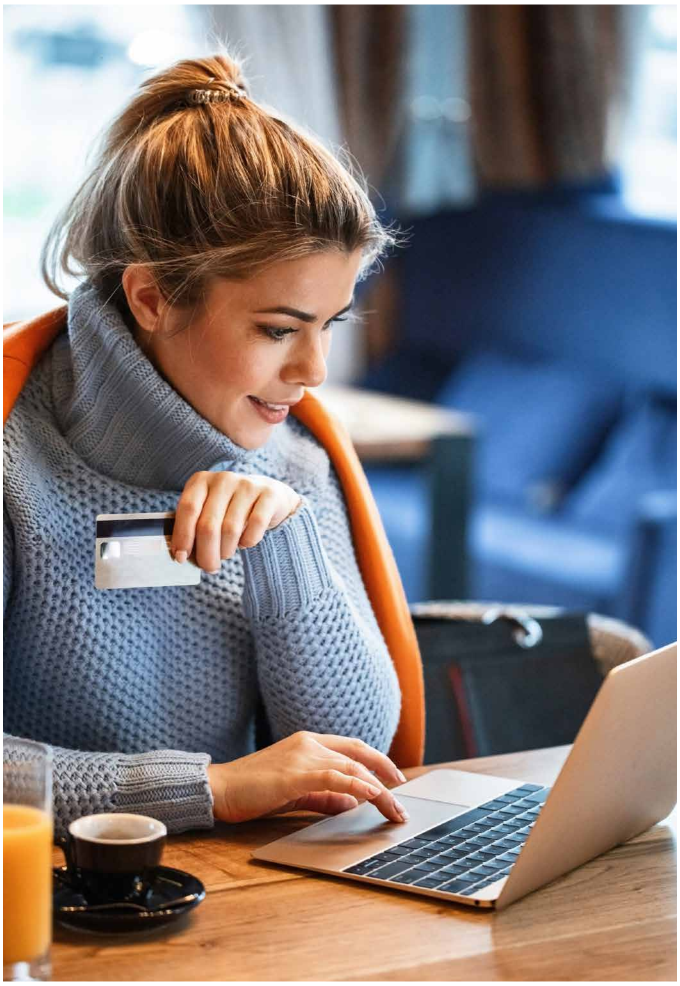
The Applicant in IT14305 was in the business of manufacturing, importing, and selling chemical products. In particular, one of its activities included the manufacture of catalytic converters, which (for the benefit of the layperson) perform a critical environmentally protective function for motor vehicles in reducing harmful exhaust emissions. In the course of this activity, the Applicant purchased certain metals, known as the Precious Group of Metals (PGMs), from a related party based in Switzerland (the Swiss Entity). On completion of manufacture, the catalysts would be sold to customers in South Africa known as original equipment manufacturers (OEMs) or, more simply, motor vehicle manufacturers.

SARS conducted a transfer pricing audit into the Applicant's 2011 year of assessment which included a consideration of whether the transaction between the Applicant and the Swiss Entity for the purchase of the PGMs was conducted at arm's length. After considering various aspects of the transaction including an analysis of the underlying cost base as well as the functions, risks and assets of the Applicant in purchasing and manufacturing the catalytic converters, SARS concluded that the Applicant's Full Cost Mark-Up (FCMU) of 1% fell between the minimum and lower quartile of SARS' arm's length interquartile range achieved by the comparable company dataset. Based on this, an adjustment was warranted.

While the Applicant did make submissions regarding SARS' proposed transfer pricing adjustment, it would appear that the Applicant did not specifically test (and document) the transactions for transfer pricing purposes which took place prior to the introduction of mandatory transfer pricing documentation (TPD) in 2016. SARS therefore based its findings on its own transfer pricing analysis drawn from the guidance in SARS' Practice Note 7 (PN7) and the OECD Transfer Pricing Guidelines (TPG). In this regard, SARS adjusted the Applicant's FCMU to the median of SARS' arm's length interquartile range achieved by the comparable company dataset. This set of facts follows a fairly standard transfer pricing audit into a taxpayer's affairs.

ISSUE

While the Applicant disputed SARS' additional assessment in that an income tax appeal on the merits is currently still pending, the matter to be determined by the present court was whether an application for separation of a legal issue in terms of Rule 33(4) of the Uniform Rules of Court, as provided for in terms of Rule 42(1) of the Tax Dispute Resolution Rules, should be granted in favour of the Applicant.



The purpose and rationale of separation as per Rule 33(4) of the Uniform Rules of Court were set out in *The City of Tshwane Metropolitan Municipality v Blair Atholl Homeowners Association*, [2019], as follows:

> "If, in any pending action, it appears to the court *mero motu* that there is a question of law or fact which may conveniently be decided either before any evidence is led or separately from any other question, the court may make an order directing the disposal of such question in such manner as it may deem fit and may order that all further proceedings be stayed until such question has been disposed of, and the court shall on the application of any party make such order unless it appears that the questions cannot conveniently be decided separately... The entitlement to seek the separation of issues was created in the rules so that an alleged *lacuna* in the plaintiff's case can be tested; or simply so that a factual issue can be determined which can give direction to the rest of the case and, in particular, to obviate the leading of evidence... ."

In simple terms therefore, it allows a separation of a question of law or fact to be decided first before any evidence is led in the main matter. Essentially it saves costs and time particularly where the separated issue is determined in such a way that puts paid to the matter proceeding thereafter. In civil cases, an obvious example is where the parties first agree to determine liability for damages whereas the quantum of damages is then determined subsequently. By determining liability first, it may be that determination of quantum becomes moot.

Para 22 of the judgment neatly summarises the crux of the issue in the present case as follows:

> "As a reminder, the point raised by applicant, which it seeks to separate from the issues raised in the appeal, concerns the powers of respondent as sanctioned by section 31(2) of the ITA. Applicant challenges that on a proper reading of section 31(2), respondent was only entitled to adjust the price/consideration paid for the PGMs as between itself and the Swiss Entity. Consequently, the act of adjusting its profits, pursuant to the application of the TNMM and the FCMU, was not a legitimate exercise of transfer pricing power authorized by section 31(2)."

It thus follows that while IT14305 raised an issue of separation, the court was nevertheless tasked with unpacking the provisions of the previous section 31(2) of the Income Tax Act, 1962 (the Act), in determining whether the application for separation should be granted.

ARGUMENTS MADE BY THE PARTIES

The Applicant essentially argued that section 31(2) of the Act (as it then read in 2011) only permitted SARS to adjust the consideration in respect of the transactions between it and the Swiss Entity to reflect an arm's length price for the purchase and supply of PGMs. It was submitted that SARS' powers thus did not extend to adjust the consideration between the Applicant and third party customers (ie, overall profitability of the Applicant). SARS' adjustment was (according to the Applicant) outside the scope of section 31(2) and was legally impermissible. The Applicant thus argued that the court should first determine whether SARS acted outside the scope of section 31(2) in adjusting the Applicant's profitability. If that was the case, then the matter would end there. On the other hand, SARS argued that the issue under consideration was inextricably bound with the main issue in the appeal, and that is whether the transactions between the Applicant and the Swiss Entity were at arm's length.

Interestingly, reference was also made to the amendment to section 31. In 2011, section 31 was substantially amended for purposes of introducing modernisation changes to the transfer pricing rules in accordance with the OECD TPGs. The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2011, further stated that the new wording of the section also removed previous uncertainties. In particular, it stated that the literal wording focused on separate transactions, as opposed to overall arrangements driven by an overarching profit objective.

The Applicant thus contended that the amendment to section 31 supported its argument for the separation of the issues. The point made by the Applicant was that a major reason for the amendment was that the section (as it then stood) limited SARS to adjust the consideration relevant to the impugned transaction. According to the Applicant it did not permit the wider approach that focused on overall profits.

SARS counter-argued that the Applicant was misguided in its understanding of the amendments. SARS stated that the amendments were effected to clarify what the legal position had always been. In this regard, SARS submitted that the adjustment contemplated in section 31 was always with reference to the profits declared by the taxpayer. The amendments in 2011 merely highlighted what was already in the legislation.

JUDGMENT

Given the dearth of South African transfer pricing cases, the court first discussed [at paras 25 to 27] three international transfer pricing cases to illustrate the point that, regardless of what transfer pricing method has been used to determine the arm's length consideration, ultimately, adjustments are made to the profits of the taxpayer to ensure that tax is levied on the correct amount of taxable income.

The court noted that the Applicant itself had in fact referred to the authoritative statement in both the TPGs and PN7 which seeks to tax profits that ought to have accrued to a party. On that basis, the court surmised that the Applicant had pursued its case on the basis that the transactions involving the PGMs had no transfer pricing implications as they were "flow through transactions". Therefore, the Applicant did not test whether the PGM transactions complied with the requirements of the arm's length principle. Given this, the court agreed with SARS that the issue sought to be separated raised no cogent point of law.

In dismissing the application for separation, the court held [at para 40] that the question of adjustment does not even arise prior to determining the arm's length nature of a transaction. The inquiry into the arm's length nature of a transaction is an overriding principle in transfer pricing matters and cannot be back-ranked. In other words, the establishment as a fact whether a consideration is or is not at arm's length precedes the question of adjustment, regardless of what transfer pricing method is employed. The ordering of separation was therefore, according to the court, of no practical benefit but would instead raise piecemeal litigation, increase costs, and delay finalisation of the matter.

DISCUSSION OF APPLICABILITY OF PRACTICE NOTE 7 AND OECD TRANSFER PRICING GUIDELINES TO SOUTH AFRICAN TRANSFER PRICING

SARS had relied on both PN7 and the TPGs in testing the arm's length nature of the transactions and adjusting the Applicant's taxable income. The Applicant, on the other hand, raised the argument that section 31 makes no reference to the TPGs or PN7.

"Given the dearth of South African transfer pricing cases, the court first discussed [at paras 25 to 27] three international transfer pricing cases to illustrate the point that, regardless of what transfer pricing method has been used to determine the arm's length consideration, ultimately, adjustments are made to the profits of the taxpayer to ensure that tax is levied on the correct amount of taxable income."

In relation to PN7 (which also refers to the TPGs with authority), the Applicant submitted that SARS' reliance thereon is misplaced given the judgment in *Marshall and Others v Commissioner, South African Revenue Service*, [2018]. In the *Marshall* case, the Constitutional Court held as follows in considering the authoritative nature of SARS interpretation notes:

> "Why should a unilateral practice of one part of the executive arm of government play a role in the determination of the reasonable meaning to be given to a statutory provision? *It might conceivably be justified where the practice is evidence of an impartial application of a custom recognised by all concerned, established by one of the litigating parties*. In those circumstances it is difficult to see what advantage evidence of the unilateral practice will have for the objective and independent interpretation by the courts of the meaning of legislation, in accordance with constitutionally compliant precepts. It is best avoided." [Our emphasis]

With reference to the fact that the Applicant itself had referred to PN7 and the TPGs in its pleadings, the court held that the *Marshall* case in fact supported SARS' reliance on PN7 in that PN7 and the TPGs demonstrate a practice that is internationally accepted and applied by both taxpayers and SARS alike.

"Given the increasing focus on transfer pricing matters by SARS and the emergence (albeit slowly) of judicial precedent, it may be that South Africa's first full transfer pricing case is just beyond the horizon."

In addition, while the Applicant raised the argument that South Africa is not a member of the OECD and that reliance on the TPGs is therefore tenuous, the court held that it is in fact necessary for countries to align themselves with the OECD TPGs to overcome challenges brought about by BEPS. Interestingly, the court commented on the decision of the *Australian Full Federal Court in Commissioner of Taxation v Glencore Investments Pty Ltd*, [2020], in which the Australian court purportedly rejected to apply the OECD TPGs. The court (in the present matter) stated that, given that the judgment was handed down in relation to the 2007 to 2009 financial years, it was doubtful that the same court would reach the same conclusion now. Even though judgment was handed down in the *Glencore* case in 2020, this was by virtue of the observation by the present court that BEPS now stood on a different footing as compared to when the assessments were raised.

The court then concluded that one cannot deny that the TPGs are a world standard in transfer pricing matters. Given the dearth of transfer pricing cases in South Africa, many taxpayers and SARS refer to the TPGs and PN7 for guidance. It is in this context that taxpayers would be well advised to take heed of this aspect of the judgment.

CONCLUDING REMARKS

It is evident that while IT14305 may not be South Africa's first true transfer pricing case, there is no doubt that it discussed various important issues pertaining to the application of section 31 of the Act. In particular, it highlights the need for taxpayers to properly test whether their related-party transactions comply with the arm's length principle. Given the increasing focus on transfer pricing matters by SARS and the emergence (albeit slowly) of judicial precedent, it may be that South Africa's first full transfer pricing case is just beyond the horizon.

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Section 31(2);

Other documents

- Explanatory Memorandum on the Taxation Laws Amendment Bill, 2011;
- OECD Transfer Pricing Guidelines (TPG);
- SARS' Practice Note 7;
- Tax Dispute Resolution Rules: Rule 42(1);
- Uniform Rules of Court: Rule 33(4).

Cases

- *ABC (Pty) Ltd v Commissioner for the South African Revenue Service* (IT 14305) [2021] ZATC 1 (7 January 2021);
- *Commissioner of Taxation v Glencore Investments Pty Ltd* (Australia) [2020] FCAFC 187;
- *Crookes Brothers Limited v Commissioner of the South African Revenue Service* (14179/2017) [2018] ZAGPPHC 311 (8 May 2018);
- *Marshall and Others v Commissioner, South African Revenue Service*, [2018], 80 SATC 400;
- *The City of Tshwane Metropolitan Municipality v Blair Atholl Homeowners Association* 2019 (3) SA 398 (SCA).

Tags: Base Erosion and Profit Shifting (BEPS); arm's length price; transfer pricing audit; flow through transactions.

VESTING OF INCOME IN A RESIDENT BENEFICIARY BY A FOREIGN TRUST

Section 7(8) of the Income Tax Act, 1962 (the Act), was substituted by section 5(1) of the Revenue Laws Amendment Act, 2004, as an anti-avoidance measure aimed specifically at ensuring that South African taxpayers who made use of foreign trusts were subject to tax in South Africa on the income they received from those trusts. Prior to the introduction of the section, South African tax residents were able to artificially shift assets offshore (sometimes to low-tax jurisdictions), and exclude income derived from those assets from the South African tax net.

Over the years, changes to anti-avoidance provisions which deal with, *inter alia*, the controlled foreign company rules and the attribution of income from foreign structures have resulted in some uncertainty as to the correct application of section 7(8) when read together with section 25B(1) of the Act.

On 2 March 2021, the South African Revenue Service (SARS) published Interpretation Note 114 (IN 114) to clarify the interaction and application of sections 7(8) and 25B(1) to provide taxpayers with guidance on how to correctly apply the aforementioned provisions.

Section 7(8) and section 25B(1) apply when income received by or accrued to a foreign trust by reason of or in consequence of a donation, settlement or other disposition by a South African tax resident, is vested in a South African tax resident beneficiary by the trustees of the foreign trust.

When a foreign trust derives income in consequence of a donation, settlement or other disposition by a donor and the trust vests that income, or a portion of it, in a resident beneficiary, a conflict arises because the amount is potentially economically taxed twice – herein lies the uncertainty as to how the provisions interact with each other.

Section 25B(1) provides that –

> "Any amount . . . received by or accrued to or in favour of any person…in his or her capacity as the trustee of a trust, shall, subject to the provisions of section 7, to the extent to which that amount has been derived for the immediate or future benefit of any ascertained beneficiary who has a vested right to that amount during that year, be deemed to be an amount which has accrued to that beneficiary, and to the extent to which that amount is not so derived, be deemed to be an amount which has accrued to that trust."

SARS states in IN 114 that the words "subject to the provisions of section 7" can be read to have the effect that if there is a conflict, inconsistency or incompatibility between section 25B(1) and section 7(8), section 7(8) is given dominance and must prevail.

"SARS states in IN 114 that the words 'subject to the provisions of section 7' can be read to have the effect that if there is a conflict, inconsistency or incompatibility between section 25B(1) and section 7(8), section 7(8) is given dominance and must prevail."

It accordingly becomes critical to correctly assess whether there is indeed a conflict, inconsistency or incompatibility between the provisions in order to understand whether section 7(8) must prevail (in the instance both provisions potentially apply), or whether section 25B(1) can be applied without regard to section 7(8).

By way of example, in the instance where a South African tax resident has advanced an interest-free loan to a foreign discretionary trust, and the foreign trust has utilised the loan to make an interest-bearing investment, vesting that interest income in a South African resident beneficiary (in the same tax year of assessment), then the tax consequences are as follows according to IN 114 (assuming the interest derived by the foreign trust is fully attributable to the interest-free loan and considering only how sections 7(8) and 25B(1) would apply in this context):

- As the trust is a separate person for income tax purposes, a determination needs to be made whether the interest derived by the trust is taxable in South Africa;
- consideration must be given to whether section 7(8) and section 25B both apply;
- in this instance, both provisions may potentially apply because for purposes of –
    - section 7(8), an amount has, by reason of or in consequence of a donation, settlement or other disposition by a donor, been received by a non-resident and had that non-resident been a resident, the amount of interest would have constituted income as defined; and
    - section 25B, an amount has been received by a trust, which section 25B(1) potentially deems to accrue to the trust or to a beneficiary.
- a conflict therefore arises in this example as both provisions potentially apply and, if both sections are applied, the amount is potentially economically taxed twice given that –
    - section 7(8) requires that any amount received by or accrued to the foreign discretionary trust which would have constituted income had the trust been resident, be included in the donor's income; and
    - section 25B(1) deems the amount vested in the beneficiary to have accrued to the resident beneficiary and therefore it would be included in the resident beneficiary's gross income.

In a scenario like the example above, IN 114 provides that section 7(8) must be applied in the first instance. Therefore, section 25B(1) is disregarded to the extent that the amount is attributable to a donation, settlement or other disposition and is included in the donor's income despite the fact that it may, subsequent to its receipt or accrual, have been vested in a resident beneficiary in the same year of assessment in which it was received by or accrued to the foreign discretionary trust.

In the instance that no conflict arises, (ie, when the amount derived by the trust is not attributable to a donation, settlement or other disposition) the remaining amount must be dealt with under section 25B(1).

The position set out in IN 114 ensures that no economic double taxation occurs in the event that the trust has vested the relevant amount of income in a South African resident beneficiary, because to the extent that section 7(8) applies, section 25B(1) will not apply. In other words, to the extent that the amount of income has been attributed to the donor, it is not taxed in the hands of a resident beneficiary in whom it has been vested.

South African taxpayers with foreign trusts should take cognisance of the guidance issued by SARS to avoid any unintended tax consequences. To the extent that South African taxpayers do not apply the provisions in accordance with IN 114, it may create future tax issues that will potentially be costly and time-consuming to rectify.

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 7, 7(8) and 25B(1);
- Revenue Laws Amendment Act 32 of 2004: Section 5(1).

Other documents

- Interpretation Note 114 ("Interaction between section 25B(1) and section 7(8) in case of conflict, inconsistency or incompatibility").

Tags: anti-avoidance provisions; interest-free loan; foreign discretionary trust.