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THE LIMITS OF NEW GROUNDS OF APPEAL

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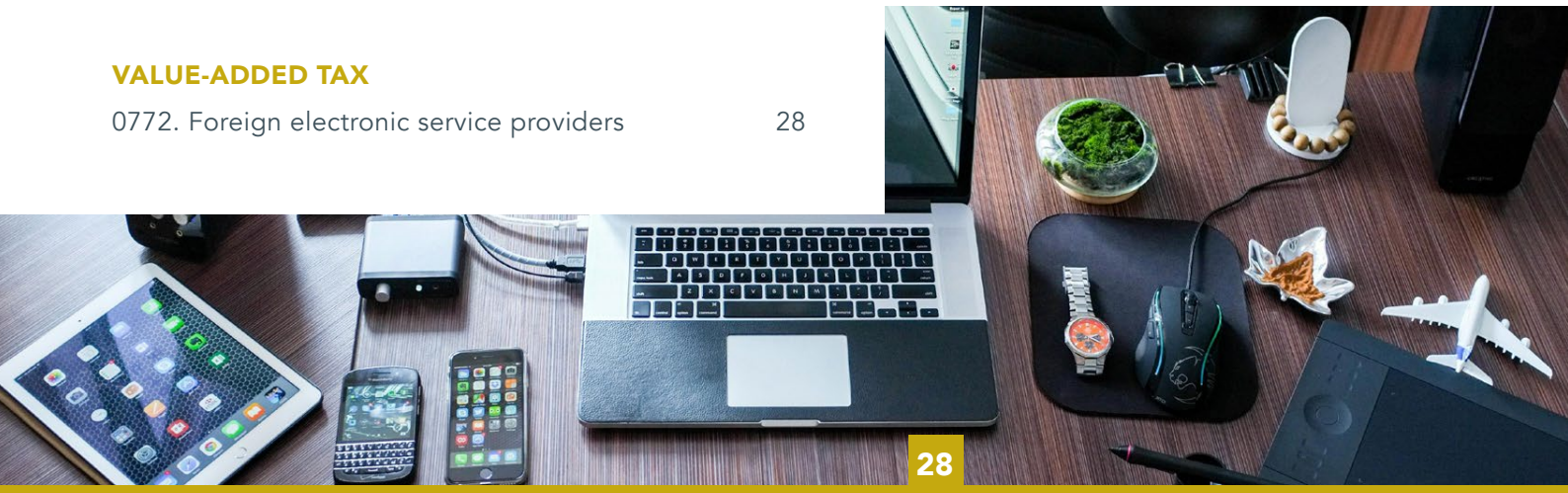


THE *THISTLE TRUST* AND MULTI-TIER TRUST DISTRIBUTIONS

The Constitutional Court (CC) handed down judgment on *The Thistle Trust v Commissioner for South African Revenue Service* [2024] on 2 October 2024.

The facts of the dispute were common cause. The Thistle Trust (the Trust) received distributions of capital gains from Zenprop, which is a group of trusts. The Trust then distributed the capital gains to its beneficiaries and the capital gains were taxed in the hands of the beneficiaries.

The judgment dealt with whether the conduit principle in section 25B of the Income Tax Act, 1962 (the Act), would apply to the capital gains distributed by the Trust to its beneficiaries, or whether paragraph 80(2) of the Eighth Schedule to the Act would apply to the distributions.

Essentially, the Trust argued that the conduit principle applied to the distributions and the distributions of capital gains were correctly taxed in the hands of the beneficiaries. SARS disagreed and argued that paragraph 80(2) codified the conduit principle only where there was a distribution of capital gains for a trust where the trust had disposed of the assets giving rise to the capital gains.

PARAGRAPH 80 APPLIED TO THE DISTRIBUTIONS

There were majority and dissenting judgments. Both were very well written and reasoned and have contributed substantially to the constitutional jurisprudence of tax disputes.

The majority held that there are clear indications that the conduit principle on the taxation of capital gains in the hands of trusts and beneficiaries is governed not by section 25B but by paragraph 80.

Paragraph 80 governs how the conduit principle is to be applied to establish which taxpayer is liable for taxation on the capital gains realised by the sale of assets by a trust. Paragraph 80 goes beyond quantification of taxable capital gains. Paragraph 56 of the CC judgment reads that paragraph 80 of the Eighth Schedule

> "seeks to identify the taxpayer who is liable for capital gains tax on a capital gain realised by the disposal of an asset by a trust and distributed to a beneficiary in the same year of assessment in which the disposal took place."

"Essentially, the Trust argued that the conduit principle applied to the distributions and the distributions of capital gains were correctly taxed in the hands of the beneficiaries."

Paragraph 80(2), as it read in the 2014 to 2018 years of assessment, provides for the conduit principle to apply to a trust where the trust vests the capital gain derived from the disposal of an asset to the beneficiaries of the trust.

The Trust did not derive the capital gain from the disposal of an asset it owned. The Trust received the distributions of capital gains from Zenprop where Zenprop had disposed of the assets. Zenprop was the only trust that could be "the trust" contemplated in paragraph 80(2)*(a)*. Therefore, the conduit principle could only apply to Zenprop and not to the Trust.

The capital gains received from Zenprop which are distributed by the Trust should thus be taxed in the trust (with a tax rate of 45% * 80% = 36%) and not in the hands of its beneficiaries (with the highest effective tax rate for individuals of 18% being 45% * 40%).

TRUST ACTED REASONABLY ON LEGAL ADVICE

On the question of the meaning of "*bona fide* inadvertent error", the CC held that the issue raises an arguable point of law of public importance because it will affect how SARS and the courts approach the imposition of understatement penalties in thousands of future tax cases. It will also affect the attitude that SARS takes to individual taxpayers who understate their income in even more cases that do not reach the level of disputes before the tax court.

However, despite the public importance, it was not in the interests of justice to grant leave to appeal as the CC would have to determine the meaning while sitting as the court of first and last instance in relation to this issue. This is because the tax court in this case upheld the appeal on the merits, and the SCA did not reach the issue of penalties because SARS did not argue the issue and was understood to have conceded the issue.

It was hoped that the CC would have taken the opportunity to pen a few paragraphs in *obiter* to clarify the meaning of "*bona fide* inadvertent errors" which prevent the imposition of understatement penalties (USP). However, the CC's reasoning for not doing so is appreciated. Nevertheless, the CC's dismissal of the SARS cross-appeal to impose USP is most welcomed.

The Trust had adopted the tax position taken in the return based on legal advice from senior counsel. Despite the existence of legal advice, SARS was of the view that there should be USP based on "no reasonable grounds" for the tax position taken and "reasonable care not taken" in completing the return. (These are behaviours (iii) and (ii) in the USP percentage table of section 223 in the Tax Administration Act, 2011.)

Importantly, the CC confirmed that SARS bears the onus of proving the facts that would bring the understatement of the Trust within either of these categories.

The CC held that the Trust had reasonable grounds to adopt the tax position taken as it had relied on legal advice. Further, the tax position adopted was upheld by the tax court in a reasoned judgment that engaged with the conduit principle and the relevant provisions of the Act. Therefore, the SARS argument that the Trust had no reasonable grounds for the tax position taken, must fail.

SARS further argued that if the Trust had taken reasonable care in completing its returns, it would have ignored the legal advice given to it and followed the stated SARS position which that advice expressly considered and rejected. The CC rejected the SARS position. The CC observed in paragraph 89 that the SARS argument is based on the

> "proposition that no taxpayer can act reasonably on advice that differs from SARS' statements of its interpretation of tax legislation. The argument would elevate SARS to the status of an authority that can decree the only reasonable interpretations of tax legislation. It is an untenable argument." (Own emphasis.)

There is a long list of cases where taxpayers who relied on legal advice were held to have acted reasonably. It is reassuring that the CC, as the highest court of the land, has reconfirmed this position in this case.

Tax has become a complex, high-risk specialist field where taxpayers inevitably must rely on legal advice or professional advice from experts for guidance to ensure that they act within the confines of the law. It is submitted that to impose USP on taxpayers when they have done their best to remain compliant would be unduly punitive on them.

Joon Chong

Webber Wentzel

Acts and Bills

- Income Tax Act 58 of 1962: Section 25B; Eighth Schedule: Paragraph 80(2) (specific reference to item *(a)*);
- Tax Administration Act 28 of 2011: Section 223 (percentage table: items (ii) & (iii)).

Cases

- *The Thistle Trust v Commissioner for South African Revenue Service* [2024] CCT 337/22 (2 October 2024); 2024 JDR 4267 (CC): Specific reference to paragraphs 56 & 89.

Tags: conduit principle; beneficiaries of the trust; *bona fide* inadvertent error; understatement penalties; no reasonable grounds.

THE REAL COST OF GREEN ENERGY FOR THE MINING SECTOR

According to the 2023 South African Energy Sector Report, *the primary source for South Africa's energy supply is still coal. Renewable energy contributed only 1% to the total energy supply in 2021, while 80% of domestic energy production was generated by domestically produced coal.*

During his speech at the Climate Resilience Symposium 2024, President Cyril Ramaphosa emphasised that a collaborative and balanced approach to energy transition is crucial to combat the threats it poses to South Africa's economy, society and environment. President Ramaphosa continued to state that South Africa's ability to compete on a global level is being undermined by the country's reliance on emissions-intensive energy systems. Furthermore, the European Union's Carbon Border Adjustment Mechanism has the potential to damage economic stability, by creating international trade barriers.

Pursuing investments in green infrastructure will not only mitigate the effects of climate change and international trade barriers but is also expected to contribute to job creation and economic growth. It is estimated that between 85 000 and 275 000 green jobs will be created in South Africa by 2030. It is predicted, however, that 40% of these jobs will require highly skilled and specialist resources.

[Data from *Forecasting Green Jobs in Africa* report, https://www.esi-africa.com/resources/jobs/south-africa-holds-greatest-potential-for-green-energy-jobs/.]

A report published by the International Renewable Energy Agency (IRENA), *World Energy Transitions Outlook 2023*, highlighted that a key challenge is the temporary nature of jobs created during the construction phase of renewable energy projects. Therefore, skills development programmes should be introduced to ensure that green job creation is sustainable.

The Minerals Council of South Africa estimates that the mining sector employs 479 228 people and that 25% of management positions in mining companies are now held by women. The mining sector has also made significant investments in training and development and social initiatives, which are estimated to have created 19 431 jobs during 2023. Taxes paid by the mining sector in 2023 amounted to R85.5 billion, and the mining sector also contributed 6.3% to South Africa's gross domestic product (GDP) in 2023. [See *2023 Comprehensive Facts and Figures* report published by the Minerals Council South Africa.]

Evidently, the mining sector continues to play a significant role in the South African economy, even despite a deterioration in the availability of energy supply. The industrial sector is responsible for 44% of the total domestic energy consumption. The industrial sector includes the mining sector, which is one of the major consumers of domestic energy. A sufficient and reliable energy supply plays an important role in the economic viability of the mining sector. This has motivated several mining companies to invest in renewable energy. The Minerals Council of South Africa also confirmed that the mining sector supports renewable energy investments.

ECONOMIC EFFICIENCY OF GREEN INITIATIVES

Current and proposed legislation aims to drive behavioural change. This is achieved by creating a tax policy which is not economically efficient. An economically inefficient tax policy is one that provides incentives to encourage good behaviour and imposes higher taxes to discourage bad behaviour.

An example of a punitive approach is the imposition of carbon taxes. A person's carbon tax liability is determined by multiplying the total greenhouse gas (GHG) emissions by the determined carbon tax rate. The carbon tax rate is determined in accordance with the formulas prescribed by section 4 of the Carbon Tax Act, 2019 (the Carbon Tax Act).

One of the components included in the carbon tax rate formulas is the fugitive emission factors as contemplated in Schedule 1 to the Carbon Tax Act. The Taxation Laws Amendment Act, 2024 (the 2024 TLA Act), expanded the fugitive emission factors to include coal mining, oil and gas operations. This means that mining companies conducting these operations would potentially become liable for carbon taxes, effective from 1 January 2024. The financial implications of the proposed retrospective application of the relevant provisions of the Carbon Tax Act could be catastrophic for these mining companies.

No doubt, the Legislator is trying to influence the behaviour of these companies in the hope that they will take action and increase investment in renewable energy infrastructure.

Another mechanism that is used to influence behaviour is to reward desired behaviour by granting incentives to taxpayers where certain requirements are met.

One of these incentives is included in section 36(11)*(d*A*)* of the Income Tax Act, 1962 (the Act). The deduction is available for the acquisition of any new and unused machinery, plant, implement, utensil, or article owned and brought into use for the first time by the taxpayer in their trade on or after 1 March 2023 and before 1 March 2025. The qualifying assets should be used to generate electricity from wind, solar energy, hydropower or biomass comprising organic wastes, landfill gas or plant material.

Batteries used for storage and inverters may also qualify for the income tax allowance if they are part of a system of assets generating electricity and are not used separately. The allowance can also be applied to improvements, as well as any foundation or supporting structure deemed to be part of the qualifying assets.

For qualifying renewable energy infrastructure investments, the taxpayer is entitled to claim a deduction of 125% of the cost. The capital expenditure deductible is limited to the mining income for that year and any balance of unredeemed capital expenditure is carried forward to the next year of assessment.

Section 15*(a)* of the Act specifically excludes the deduction of the certain accelerated allowances (for example, deductions provided for in section 12B(1)*(h)* and section 12BA of the Act) from income derived from mining operations; however, these allowances may be claimed against non-mining income earned.

Section 12BA mirrors the basic principles included in section 36(11) *(d*A*)* and allows the taxpayer a deduction of 125% of the cost of the qualifying assets; however, the allowance may not be deducted from mining income.

"The Taxation Laws Amendment Act, 2024 (the 2024 TLA Act), expanded the fugitive emission factors to include coal mining, oil and gas operations."

"Section 12BA mirrors the basic principles included in section 36(11)*(d*A*)* and allows the taxpayer a deduction of 125% of the cost of the qualifying assets; however, the allowance may not be deducted from mining income."

Unlike section 12BA, section 12B(1)*(h)* includes second-hand assets. The qualifying assets per section 12B(1)*(h)* are similar to the assets included within the ambit of section 12BA, except for the fact that there is a megawatt threshold included in relation to electricity generated from photovoltaic solar energy or hydropower. For qualifying renewable energy infrastructure investments, the taxpayer is entitled to claim a deduction of an accelerated income tax allowance of 50% of the cost in the first year, 30% in the second year, and 20% in the third year. However, for assets that generate photovoltaic solar energy not exceeding 1 megawatt, taxpayers are entitled to deduct an income tax allowance of 100% in the year in which the expenditure is incurred.

The 2024 TLA Act does not include any amendments or enhancements to the provisions of section 36(11)*(d*A*)*, section 12B and section 12BA of the Act. Incentives included in the 2024 TLA Act focus more on the automotive industry. The 2024 TLA Act now includes the newly inserted section 12V, which provides for an accelerated income tax allowance in respect of new and unused buildings, machinery, plant, implements, utensils and articles that are used in the production of electric or hydrogen-powered vehicles.

CONCLUSION

Investment in renewable energy is becoming a cornerstone of international trade facilitation. Therefore, renewable energy initiatives cannot be ignored, and the South African government has to take action in the interest of the South African economy.

Mining companies require reliable energy supply. Investment in renewable energy infrastructure not only provides a more reliable energy supply, but also enables mining companies to manage their carbon tax liability and contribute to South Africa's GHG reduction goals. The tax incentives for capital expenditure are certainly attractive if there is sufficient mining income available for set-off. The sunset date is, however, approaching with no indication of an extension on the horizon. Mining companies ready to take the leap would have to take decisive action before 1 March 2025 to benefit from these incentives.

From a carbon tax perspective, mining companies will need to keep abreast of the changes in legislation to minimise any potential tax exposure. While the initial investment in renewable energy infrastructure is significant, the time for going green is now.

Evádne Bronkhorst & Marilize de Kock

Forvis Mazars in South Africa

This article was also published in African Mining: The real cost of green for the mining sector

Acts and Bills

- Income Tax Act 58 of 1962: Sections 12B(1)*(h)*, 12BA, 12V, 15*(a)* & 36(11)*(d*A*)*;
- Carbon Tax Act 15 of 2019: Section 4; Schedule 1;
- Taxation Laws Amendment Act 42 of 2024.

Other documents

- 2023 South African Energy Sector Report;
- President Cyril Ramphosa's speech at the Climate Resilience Symposium 2024 (in July 2024) – published by Government Communications on behalf of the South African Government;
- Forecasting Green Jobs in Africa report [*https://www.esi-africa.com/resources/jobs/south-africa-holds-greatest-potential-for-green-energy-jobs/*];
- *World Energy Transitions Outlook* [2023] (Report published by the International Renewable Energy Agency (IRENA));
- *2023 Comprehensive Facts and Figures* report published by Minerals Council South Africa (August 2024).

Tags: carbon taxes; retrospective application; qualifying assets; accelerated income tax allowance.

BAD AND DOUBTFUL DEBTS

In the current economic climate, especially given the high interest rates, businesses often experience financial difficulties. This often results in an inability to settle outstanding debts owed and, conversely, to recover debts due by customers.

Irrecoverable or doubtful debts owed by or to a taxpayer may result in an additional or reduced income tax liability. It is important to bear income tax principles in mind when dealing with these situations. This article focuses on the key income tax considerations for taxpayers relating to irrecoverable and doubtful debts. Banks and other types of moneylenders will generally be subject to other forms of tax treatment that are not covered here.

A taxpayer may become entitled to a deduction in terms of section 11*(i)* of the Income Tax Act, 1962 (the Act), for bad debts when a debt owed to that taxpayer becomes irrecoverable. Such a deduction can only be claimed in the year of assessment that the debt first becomes irrecoverable. This would be the year in which there is no reasonable prospect of recovering such debt, irrespective of the accounting classification thereof. The taxpayer should be able to substantiate the basis for writing off the debt, for example, the insolvency of the debtor, and any steps taken to recover the debt. To qualify for this deduction, the underlying amount must have been included in the taxpayer's income in the current or a prior year of assessment. To illustrate, while a bad debt resulting from the sale of goods or the rendering of services would qualify for this deduction, a deduction would not be permitted in respect of a loan of money as this would result in a capital loss upon disposal of the debt, including by way of abandonment by the creditor of its claim. Depending on the circumstances, the capital loss may, however, have to be disregarded altogether if it is a loan to a "connected person". Furthermore, a taxpayer is only entitled to this deduction if the debt is due to that taxpayer when it becomes bad. A deduction is thus unavailable for debts ceded to another person unless ceded "with recourse". If a debt in relation to which this deduction was claimed is subsequently recovered, it will trigger a recoupment in the hands of the creditor.

"If a debt has not become irrecoverable, the creditor may become entitled to a section 11*(j)* allowance for the debt as a doubtful debt."

If a debt has not become irrecoverable, the creditor may become entitled to a section 11*(j)* allowance for the debt as a doubtful debt. Like the section 11*(i)* deduction for bad debts, this allowance can only be claimed in respect of debts due to the taxpayer at the end of the year of assessment where the underlying amount had previously been included in the taxpayer's income. The qualification for and calculation of the allowance depends on whether IFRS 9 is applied in relation to the debt for financial reporting purposes. An important point to note is that VAT levied by the taxpayer that is included in the debt must be excluded from the deductions claimed in terms of section 11*(i)* and 11*(j)*.

Where IFRS 9 is applied, the allowance is calculated as 40% of the sum of the lifetime expected credit loss and any bad debt written off for financial accounting purposes that was not allowed as a bad debt deduction in the current or previous years of assessment. For other impaired debts to which IFRS 9 is applied, a 25% allowance is permitted.

Where IFRS 9 is not applied, the allowance is calculated as the sum of the following amounts: 40% of debt that is 120 days or more in arrears plus 25% of debt that is 60 days or more in arrears. The value of security provided in respect of the debt must be considered in calculating the allowance.

A taxpayer may apply to the Commissioner for SARS for a directive to increase the 40% allowance to an allowance of up to 85%, based on various factors prescribed in section 11*(j)*. The doubtful debt allowance claimed in a given year of assessment must be reversed, ie, included in the taxpayer's income, in the subsequent year of assessment.

From a capital gains tax perspective, a disposal event will be triggered, among other things, by the waiver, discharge, cancellation or abandonment of a debt that a taxpayer holds as an asset. This may give rise to a capital loss for the creditor which, as noted above, may have to be disregarded or may be available for set-off against the creditor's other capital gains. It is important to note that an allowable bad debt deduction in respect of the debt must be subtracted when determining the base cost of the debt and would thus effectively reduce the amount of the capital loss.

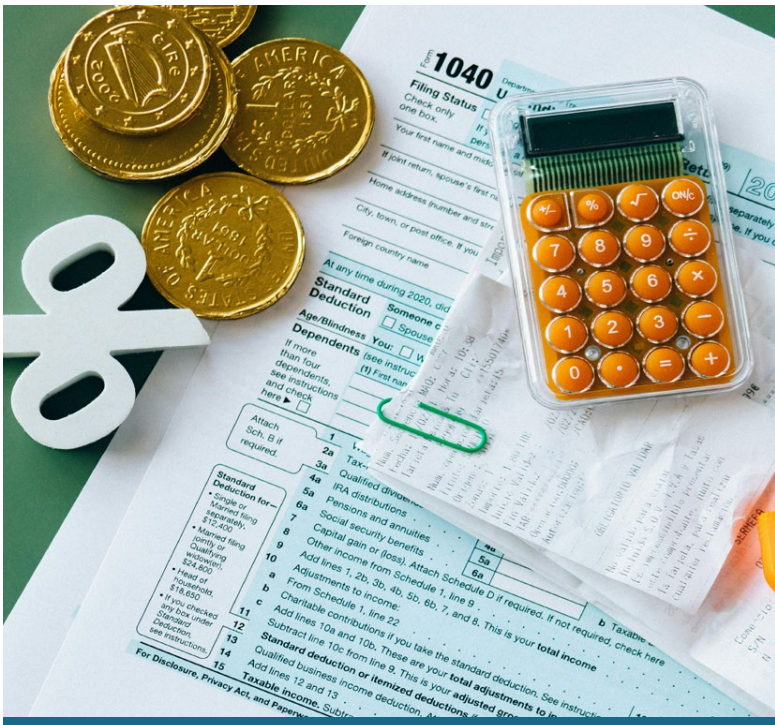
A capital loss arising on the disposal of a debt owed to the taxpayer by a "connected person" must be disregarded, unless (and to the extent) that the debt represents –

- gross income or a reduction in a balance of assessed loss of the debtor;
- a capital gain in the hands of the debtor;
- the reduction of expenditure or base cost of an asset of the debtor that was funded by the debt; or
- gross income or a capital gain in the hands of an acquirer of the debt (subject to the creditor proving this).

From the debtor's perspective, income tax consequences would apply if the debt was rendered void with no legal force or validity through insolvency or prescription or if there was an "arrangement" in terms of which the debt was cancelled or waived. The fact that the creditor may have claimed a section 11*(j)* allowance or 11*(i)* deduction for the debt does not of itself affect the debtor's position.

In the case of the debt being rendered void through insolvency or prescription, the debt reduction provisions (section 19 and paragraph 12A of the Eighth Schedule) would not usually apply because even though there would have been a "cancellation" of the debt, such "cancellation" would usually not have occurred because of an "arrangement". The term "arrangement" is not defined for purposes of the debt reduction provisions and it is considered that in context, it must take its ordinary meaning as given in the Cambridge online English dictionary as "an agreement between two people or groups about how something happens or will happen". However, if the debt was used to fund amounts that result in tax deductions, a recoupment may result in terms of section 8(4)*(a)* and if it represents the amount outstanding for the purchase of a capital asset from the creditor, the base cost of the asset may have to be reduced in terms of paragraph 20(3)*(b)* of the Eighth Schedule.

This article has considered the general income tax consequences that may arise from irrecoverable or doubtful debts. However, it should be borne in mind that exceptions may apply to the general rules, depending on the nature of the taxpayer or the structure of the transaction. Further implications may also arise from a value-added tax perspective. It is therefore advised to consult with a professional tax advisor when encountering these types of transactions.



Doria Cucciolillo & Adjunct Associate Professor David Warneke

BDO

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "connected person"), 8(4)*(a)*, 11*(i)* & *(j)* & 19; Eighth Schedule: Paragraphs 12A & 20(3)*(b)*.

Other documents

- IFRS 9 (International Financial Reporting Standard 9);
- Cambridge online English dictionary: Definition of "arrangement".

Tags: Irrecoverable or doubtful debts; bad debt deduction; section 11*(j)* allowance; section 11*(i)* deduction.

KUWAIT/SA PROTOCOL TAKES EFFECT

On 18 September 2024, Kuwait ratified the amending Protocol which was signed on 1 April 2021 by South Africa and Kuwait.

To briefly recap:

- South Africa introduced dividends tax on 1 April 2012. For present purposes the import of this was that dividends paid to non-resident beneficial owners then became subject to dividends tax (DT), which at that time was levied at a standard rate of 15% (now 20%).
- A double taxation agreement (DTA) between South Africa and another jurisdiction could reduce the standard rate. It should be noted that such a reduction in the standard rate is subject to compliance with various administrative requirements.
- Prior to the introduction of such legislation, South Africa and various other jurisdictions agreed to amend the DTAs to ensure that the minimum rate that applied was 5%. Prior to such amendments, South Africa's DTAs with some countries contained a rate of 0%.
- Fortunately or unfortunately, such an amendment was not concluded between Kuwait and South Africa. The rate in this DTA therefore remained at 0%.

One would think that this would not affect the South African (SA) fiscus to a large degree because there do not appear to be many significant Kuwaiti resident shareholders of SA resident companies.

What did affect the fiscus to a much larger degree, was that due to the dividend withholding tax rate between South Africa and Kuwait being at 0% and through the interplay (the "Most Favoured Nation" clause) of the DTAs between South Africa and Sweden, South Africa and the Netherlands and South Africa and Kuwait, dividends payable to beneficial owners resident in the Netherlands and Sweden would also be subject to the 0% dividends withholding tax rate. It is submitted that this was an unintended consequence.

The Netherlands is often used as the jurisdiction in which to house intermediate holding companies, which may hold shares in various companies, including SA resident companies.

To stop such zero per cent withholding, either the DTA with the Netherlands needed to be amended or the DTA with Kuwait needed to be amended.

As mentioned above, DT was introduced in 2012, and while it is not known what inter-jurisdictional negotiations were being held (between South Africa and Kuwait), nothing changed in this regard, until 2021.

In terms of the Protocol between South Africa and Kuwait that was signed on 1 April 2021, dividends would be taxed at 5% and, rather unusually, the Protocol would be backdated to be effective from the date that South Africa introduced DT (1 April 2012).

Per the *Government Gazette* (22 November 2024) (*GG*), the Protocol entered into force on 2 October 2024; however, the Protocol still contains the provision that it is effectively backdated to the introduction of DT.

Due to the above, arguably the Protocol would effectively introduce a back-dated 5% DT for dividends payable to beneficial owners who were resident in Kuwait and arguably would do the same for dividends payable to beneficial owners who were resident in the Netherlands. However, the Protocol will only be brought into force (including the backdating) when it has been ratified by each state and each state has exchanged the ratification instruments. The date of notification of the last state to notify will provide the date when the Protocol is brought into force.

Two issues became apparent when looking at the Protocol. Firstly, is the backdating of the protocol to 2012 constitutional? Secondly, while it was signed by both parties, it will only be brought into force when it has been ratified by each state and each state has exchanged the ratification instruments. Therefore, if one declared a dividend on, say, 30 July 2021 to a beneficial owner resident in the Netherlands, in terms of the law as at 30 July 2021 (when the Protocol was not in force), effectively no DT applied.

Legally no DT was due, but what would happen if the Protocol came into force later? One may have taken the view that the Protocol at the time when DT was due was not in force or that it was not yet in force and that it may never be brought into force and therefore no DT applied.

"On the positive side, it would seem that foreign shareholders should very soon be on a more equal playing field in that DT should be levied at a minimum of 5% irrespective of their jurisdiction of residence."

At last, there is some finality, and it appears that the Protocol will be brought into force, meaning that DT will need to be paid on dividends payable to beneficial owners who are resident in the Netherlands. At least on the face of it, there would be a good argument that such DT would be due.

It is not known whether the necessary notifications have been exchanged which, as stated above, is required before the Protocol will come into force. However, due to the *GG* referred to above one would assume that the notifications have been exchanged as the Protocol was effective from 2 October 2024 (with the Protocol then allowing for DT to effectively be backdated).

The question to taxpayers who have paid or who want to pay a dividend to beneficial owners who are resident in the Netherlands, is from when the Protocol would be effective: 1 April 2012 (introduction of DT), 1 April 2021 (date the Protocol was signed), 18 September 2024 (when Kuwait ratified the Protocol) or 2 October 2024 (when the Protocol was effective), or even 22 November 2024 (when the GG was published)?

One can advance arguments supporting each of the above dates. However, it is submitted that, due to the Protocol now being effective, it would be a bold taxpayer who pays a dividend to beneficial owners who are resident in the Netherlands and applies a zero withholding rate...

On the positive side, it would seem that foreign shareholders should very soon be on a more equal playing field in that DT should be levied at a minimum of 5% irrespective of their jurisdiction of residence.

Hylton Cameron

BDO

Other documents

- Convention between the Republic of South Africa and the Kingdom of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (GN 1985 published in *GG* 16890 of 22 December 1995);
- Protocol Amending the Convention between the Republic of South Africa and the Kingdom of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (GN 319 published in *GG* 35268 of 23 April 2012);
- Convention between the Republic of South Africa and the Kingdom of the Netherlands for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital agreement (GN 34 published in *GG* 31797 of 21 January 2009);
- Protocol Amending the Convention between the Republic of South Africa and the Kingdom of the Netherlands for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, with protocol – (GN 32 of 2009 of 23 January 2009);
- Agreement between the Government of the Republic of South Africa and the Government of the State of Kuwait for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (GN 356 published in *GG* 29815 of 20 April 2007);
- Protocol to the 2004 South Africa-Kuwait double tax agreement (DTA) (signed by South Africa and Kuwait on 17 December 2019 and 1 April 2021, respectively, and ratified by Kuwait on 18 September 2024. The National Assembly approved the Protocol on 31 August 2022 and it came into force on 2 October 2024 (see *GG* 51637 of 22 November 2024).

Tags: dividends tax (DT); double taxation agreement (DTA); "Most Favoured Nation" clause; beneficial owners.

SARS INTEREST RATES

TAX, VAT, FRINGE BENEFITS, LOANS, DONATIONS TAX AND DIVIDENDS TAX

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): 11.5% per annum with effect from 1 January 2025 (was 11.75% per annum from 1 September 2023).

  Payable by SARS on refunds of tax (where interest is applicable): 7.5% per annum with effect from 1 January 2025 (was 7.75% per annum from 1 September 2023).

  If the refund is made after a successful tax appeal or where the appeal is conceded by SARS, the interest rate is 11.5% per annum with effect from 1 January 2025 (was 11.75% per annum from 1 September 2023).

- **VAT**

  Payable to SARS on late payments: 11.5% per annum with effect from 1 January 2025 (was 11.75% per annum from 1 September 2023).

  Payable by SARS on VAT refunds after prescribed period: 11.5% per annum with effect from 1 January 2025 (was 11.75% per annum from 1 September 2023).

- **Fringe benefits**

  Official interest rate for loans to employees below which a deemed fringe benefit arises: 8.75% per annum with effect from 1 December 2024 (was 9.00% per annum with effect from 1 October 2024). See below for details of historical changes.

"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%."

- **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: 8.75% per annum with effect from 1 December 2024 (was 9.00% per annum with effect from 1 October 2024). See below for details of historical changes.

- **Donations tax**

  Loans to trusts by connected natural persons with interest charged at rates below the official rate create a deemed 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.

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 amount of the tax benefit must be calculated as accruing to the employee with reference to 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 is not charged on the loan at the "official" rate (or market-related rate in the case of foreign currency loans) and to the extent that fringe benefits tax is not payable on an interest-free (or subsidised-interest) loan where the shareholder is an employee.

It is not the amount of the loan but the interest not charged which is deemed to be a dividend. Relevant 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 connected natural persons with interest charged below the official rate create a donation subject to donations tax at 20% (25% if cumulative lifetime donations of the donor amount to more than R30m) 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 currently stands at 7.75% per annum (with effect from 1 December 2024).

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

With effect from		*Rate per annum*
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%
1 April 2022	–	5.25%
1 June 2022	–	5.75%
1 August 2022	–	6.50%
1 October 2022	–	7.25%
1 December 2022	–	8.00%
1 February 2023	–	8.25%
1 April 2023	–	8.75%
1 June 2023	–	9.25%
1 October 2024	–	9.00%
1 December 2024	–	8.75%

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

Kent Karro

Crowe

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

THE DEFINITION OF "PERSON"

The definition of "person" in the Income Tax Act, 1962 (the Act), and other taxing statutes forms a critical component of their charging provisions. If the target of the tax is not a person, no tax can be charged even if that target has a representative.

The procedure for determining whether the target is a person involves a three-step process. First, examine the definition in the taxing Act, secondly, examine the definition in section 2 of the Interpretation Act, 1957, and finally, examine the ordinary meaning of the term. It must then be determined whether there are grounds for departing from the defined meaning.

THE TAXING ACT DEFINITION

For the purposes of this article, the definition in the Act will be examined, but some other tax Acts will be mentioned later.

Section 1(1) of the Act defines a person as follows:

> "'**[P]erson**' includes—
>
> *(a)* an insolvent estate;
>
> *(b)* the estate of a deceased person;
>
> *(c)* any trust; and
>
> *(d)* any portfolio of a collective investment scheme,
>
> but does not include a foreign partnership;"

THE INCLUSIONS

In *Jones and Co Ltd v Commissioner for Inland Revenue* [1926] (at 10) Gardiner AJP stated the following on the use of the word "includes":

> "Now 'includes', as a general rule, is not a term of exhaustive definition; sometimes it is so employed, but, as a general rule, it is a term of extension ...."

The word "includes" in the definition of "person" is used to extend the meaning of the term by including entities that would not otherwise be persons. However, in some instances, such as in the definition of "trading stock" in section 1(1), "includes" may imply an exhaustive list. [*De Beers Holdings (Pty) Ltd v Commissioner for Inland Revenue* [1986] at 256.]

DECEASED ESTATE

The definition of "person" in the principal Act published in 1962 included only the estate of a deceased person. That inclusion followed *Commissioner for Inland Revenue v Emary NO* [1961], a case falling under the Income Tax Act 31 of 1941 (1941 Act), in which the Appellate Division (AD) had held that a deceased estate was not a person under the common law, Interpretation Act or the 1941 Act. In fact, the 1941 Act contained no definition of "person".

TRUST

The inclusion of a trust, backdated to years of assessment commencing on or after 1 March 1986 by the Income Tax Act 129 of 1991, resulted from *Trustees of the Phillip Frame Will Trust v CIR* [1991], confirmed on appeal to the AD in *Commissioner for Inland Revenue v Friedman and others NNO* [1993], in which it was held that a trust was not a person. This inclusion needs to be read with the definition of "trust", which is defined in section 1(1) to mean:

> "any trust fund consisting of cash or other assets which are administered and controlled by a person acting in a fiduciary capacity, where such person is appointed under a deed of trust or by agreement or under the will of a deceased person".

The impact of including a trust as a person is still under debate today. It arose in the *Thistle Trust* case [heard in the SCA in 2023 (*Commissioner for the South African Revenue Service v The Thistle Trust*), and in the Constitutional Court (CC) on 8 February 2024]. In the CC it was argued by the appellant that making a trust a person had no impact on the conduit principle. SARS, on the other hand, argued that the conduit principle fell away when a trust was made a person and the principle was embodied in section 25B. [Judgment in the CC was delivered on 2 October 2024 (*Thistle Trust v Commissioner for the South African Revenue Service*).]

It appears to be implied that when an entity is defined as a person, it assumes ownership of the related pool of assets and liabilities controlled by its representative. In the case of a trust, this representative would be its trustees. This conclusion finds support in the Eighth Schedule to the Act, specifically paragraph 11(1)*(d)*, which refers to "an asset of a trust", as well as in the definition of "trust" in section 1(1).

INSOLVENT ESTATE

In the 1975 case of *Thorne and Another NNO v Receiver of Revenue*, [1976] an insolvent estate was ruled not to be a "person". However, it took 22 years for an insolvent estate to be included in the definition of "person" under the Income Tax Act, 1997. The lack of urgency in addressing this gap can likely be attributed to the relatively small risk of fiscal loss, as insolvent estates of natural persons typically do not generate significant income during winding-up. Since 2001, capital gains can arise in an insolvent estate when the trustee realises the estate's assets, providing further justification for the inclusion of an insolvent estate in the definition of "person". The situation differs for a company in liquidation: it remains the same taxable entity until it is finally dissolved, and no separate estate comes into existence when a company enters into liquidation. [See *Van Zyl NO v Commissioner of Inland Revenue* [1997].]

PORTFOLIO OF A COLLECTIVE INVESTMENT SCHEME

Paragraph *(d)* of the definition of "person" in the Act encompasses a portfolio of a collective investment scheme. When first inserted into the definition of "person" by the Taxation Laws Amendment Act 17 of 2009, paragraph *(d)* referred to "any portfolio of a collective investment scheme in securities" (CISS). Since then, it has been expanded to include all collective investment schemes. Its insertion coincided with the deletion of a portfolio of a CISS from paragraph *(e)*(i) of the definition of "company" in section 1(1). A collective investment scheme is typically structured as a type of vesting trust although it can also take the form of an open-ended investment company. [See definition of "collective investment scheme" in section 1 of the Collective Investment Schemes Control Act. 2002.] Given that a portfolio of a collective investment scheme is not a person – it is simply a separate pool of assets of a collective investment scheme – it makes sense that it was necessary to include it as a separate legal entity. Interestingly, a portfolio of a collective investment scheme does not have its own distinct tax rate in the annual Rates and Monetary Amounts and Amendment of Revenue Laws Acts. In practice, SARS treats it as a trust for tax rate purposes.

In *Van der Merwe NO and Others v Minister of State Expenditure and Others* [1999] the court held that the short-term insurance business of an insurance company, which had been placed under the control of liquidators, does not qualify as a "person" for income tax purposes and should not be confused with the company itself. Surprisingly, this omission from the definition of "person" has never been addressed, presumably because such situations are relatively rare.

What unites all these cases is that they deal with situations in which the target of the charging provision is essentially an aggregate of assets and liabilities managed by someone acting in a fiduciary capacity, such as a trustee or liquidator. Without recognising this target as a legal "person", the fiscus would be unable to enforce tax obligations and collect revenue.

"Section 23C of the Act requires the cost or value of an asset to be reduced by input tax when the taxpayer is a vendor. This would seem to be problematic as the vendor is the partnership and not its individual members and perhaps needs to be clarified by the legislature."

EXCLUSION

A "foreign partnership" as defined in section 1(1) is excluded as a person even if it is given legal personality under a foreign statute. The definition of "foreign partnership" describes it as a "partnership, association, body of persons or entity formed or established under the laws of any country other than the Republic", which in simple terms is transparent for tax purposes (that is, the partners pay the income tax).

THE INTERPRETATION ACT

The Interpretation Act, 1957, defines "person" as follows in section 2:

> " '**person**' includes—
>
> *(a)* any divisional council, municipal council, village management board, or like authority;
>
> *(b)* any company incorporated or registered as such under any law;
>
> *(c)* any body of persons corporate or unincorporate;"

This definition applies to the interpretation of any law in South Africa unless to do so would be "repugnant to such provisions or unless the contrary intention appears". [Section 1 of the Interpretation Act.]

Similar to the definition of "person" in the Act and other taxing statutes, this definition in the Interpretation Act also starts with the word "includes" and broadens the ordinary meaning of the term.

A "body of persons corporate" includes a *universitas personarum*, a separate legal entity under the common law which has perpetual succession with rights and duties independent of the rights and duties of its members. [*Ex-TRTC United Workers Front and Others v Premier, Eastern Cape Province* [2010]]

According to *Oxford Reference.com* [accessed 3 April 2024] a "body unincorporate" means:

> "An association that has no legal personality distinct from those of its members (compare *corporation*). Examples of unincorporated bodies are partnerships and clubs."

UNINCORPORATED ASSOCIATIONS

In *Commissioner for Inland Revenue v Witwatersrand Association of Racing Clubs* [1960] the association had arranged a race meeting at the race course of the Johannesburg Turf Club, the proceeds from which were to be paid to two charities. Readers will probably be familiar with the principle established by this case, ie, that income cannot be disposed of for tax purposes after accrual, which resulted in the association being taxed on the proceeds. But the case is also important because it found that the association was a body unincorporate under the Interpretation Act and thus was a taxable entity despite not having a constitution or any written rules or legal *persona* separate from its members.

PARTNERSHIPS

In *Chipkin (Natal) (Pty) Ltd v Commissioner, South African Revenue Service* [2005] Cloete JA stated the following:

> "The definition of 'person' in section 1 does not include a partnership and a partnership is not a person at common law."

While it is true that the definition in section 1(1) of the Act does not specifically include a partnership, neither the tax court [*ITC 1784* (2004)] nor Cloete JA in the SCA made any mention of the Interpretation Act and, on the face of it, the statement is wrong because a partnership is a body of persons unincorporate. That a partnership is such a "body of persons" is confirmed by the dictionary meaning cited earlier, and in fact finds support in paragraph *(b)* of the definition of "representative employer" in paragraph 1 of the Fourth Schedule to the Act, which refers to "in the case of any municipality or any body corporate or unincorporated (other than a company or a partnership) …". If a body unincorporated did not include a partnership, there would be no point in excluding it.

The difference between a body of persons corporate such as a *universitas* and a body of persons unincorporate is that the former has, under the common law, legal personality while the latter does not. Yet, the lack of legal personality did not stop the court in the *Witwatersrand Association of Racing Clubs* case from taxing the unincorporated association because the association was given legal personality by the Interpretation Act. Comparing the position of an unincorporated association with a partnership, the court stated the following:

> "The express provision, contained in section 67(7) of the Act, directing that partners are to be separately assessed is, I think, in harmony with what I have said above in relation to sections 5 and 10(1)*(e)*, and also points away from the Special Court's view that only such associations as have a *persona* separate from their members are taxable."

By way of explanation, section 5 of the 1941 Act is similar to section 5 of the current Act in that it imposes income tax on the taxable income of a person. Section 10(1)*(e)* exempted various associations, including those which were unincorporated bodies. There would have been no need for such exemption if such bodies were not subject to income tax.

Section 67(7) of the 1941 Act provided:

> "(7) Separate assessments shall be made upon partners, the provisions of sub-section (15) of section fifty-five notwithstanding."

Section 55(15) provided:

> "(15) Persons carrying on any business in partnership shall make a joint return as partners in respect of such business, together with such particulars as may from time to time be prescribed, and each such partner shall be separately and individually liable for the rendering of the joint return."

Similar provisions in the form of sections 66(15) and 77(7) were contained in the 1962 Act, although they were deleted as a result of the introduction of the Tax Administration Act, 2011. The point the judge was making was that a partnership, as a person, was required to submit a return, but despite this, the Act placed the liability for the tax on the partners.

While a partnership may be a person for purposes of the Act, it is not a taxpayer, since section 24H(5)*(a)* deems the income of the partners received by or accrued to them in common to be received or accrued to them individually. Similarly, paragraph 36 of the Eighth Schedule treats a partner's share of the proceeds on disposal of an asset to accrue to the partner at the time of disposal. This tax treatment was recognised in the *Chipkin* case, in which Cloete JA stated: [at 67 SATC 249]

> "A partnership cannot have a taxable income, simply because it is not a taxable entity."

Nevertheless, the Act does recognise a partnership as a person for purposes of procedural convenience. For example, the definition of "agent" in section 1(1) includes a partnership and paragraph 2A of the Seventh Schedule treats a partnership as an employer for the purposes of paragraph 2 of the same Schedule.

By contrast, the definition of "person" in the Value-Added Tax Act, 1991 (the VAT Act), specifically includes a body of persons unincorporated, which seems unnecessary in view of their inclusion under the Interpretation Act. Section 51 of the VAT Act contains rules which deem a partnership to be a vendor carrying on an enterprise separate from the members of the body as well as other rules such as those governing registration and payment.

Section 23C of the Act requires the cost or value of an asset to be reduced by input tax when the taxpayer is a vendor. This would seem to be problematic as the vendor is the partnership and not its individual members and perhaps needs to be clarified by the legislature.

The definition of "person" in section 1 of the Securities Transfer Tax Act, 2007 (the STT Act), includes "any body of persons (incorporated or unincorporated)". The STT Act is concerned with a change in beneficial ownership of a security. [See also the definition of "transfer" in section 1 of the STT Act.] Since under the common law ownership of securities rests with the individual partners [*Michalow, NO v Premier Milling Co Ltd* [1960]], it would seem that the incidence of the tax falls on the partners and not on the partnership. Such an interpretation can be justified on the basis that [*Johannesburg Municipality v Cohen's Trustee* [1909] at 823]

> "it is a sound rule to construe a statute in conformity with the common law rather than against it, except where and so far as the statute is plainly intended to alter the course of the common law".

In practice, when the partnership acquires listed securities, the STT would be paid by the nominee or general partner on behalf of the partners. For unlisted securities, the STT is payable under section 6 of the STT Act by the company whose shares are being transferred but it has a right of recovery against the acquirer under section 7 of that Act, which could be the partnership or an individual partner, depending on the circumstances.

Thus, when an individual partner sells their interest to an incoming partner, the STT would need to be imposed on the incoming partner's fractional interest in the share portfolio. There is a *de minimis* threshold of R40 000 (R100 × 100/0,25) to prevent STT on small value changes in ownership. [See section 8(1)*(r)* of the STT Act.]

THE ORDINARY MEANING OF "PERSON"

Natural persons are not mentioned in the Interpretation Act but clearly are persons in the ordinary sense of the word. [*Commissioner for Inland Revenue v JW Jagger & Co (Pty) Ltd* [1945]; *Friedman and Others NNO v Commissioner for Inland Revenue: In re Phillip Frame Will Trust v Commissioner for Inland Revenue* [1991] at 170.] After examining the ordinary meaning of "person" according to various dictionaries, Grosskopf JA held in *Van Heerden and Another v Joubert NO and Others* [1994] that a stillborn baby was not a person.

CONCLUSION

In a 1948 speech to the British House of Commons, Winston Churchill said that "those who fail to learn from history are doomed to repeat it". Those words seem particularly apposite when looking at the history of the inclusions in the definition of "person" in the Act and the string of adverse findings by South African courts against SARS. Understanding the background to the definition and the role of the Interpretation Act, remains as relevant and important as ever.

This article was first published in ASA June 2024

Duncan McAllister

Webber Wentzel

Acts and Bills

- Income Tax Act 58 of 1962: Section 1(1): definitions of –
  - "agent";
  - "company" (deletion of paragraph *(e)*(i));
  - "foreign partnership";
  - "person" (reference in paragraph *(d)* to "portfolio of a collective investment scheme");
  - "trading stock"; and
  - "trust";

  Sections 5, 23C, 24H(5)*(a)*, 25B, 66(15) & 77(7); Fourth Schedule: Paragraph 1 (paragraph *(b)* of the definition of "representative employer"); Seventh Schedule: Paragraphs 2 & 2A; Eighth Schedule: Paragraphs 11(1) *(d)* & 36;
- Income Tax Act 31 of 1941: (no definition of "person"); sections 5, 10*(e)*, 55(15) & 67(7);
- Income Tax Act 129 of 1991;
- Income Tax Act 28 of 1997;
- Taxation Laws Amendment Act 17 of 2009: Section 7(1) *(v)* (insertion of paragraph *(d)* ("portfolio of a collective investment scheme") in definition of "person" in section 1(1) of the Income Tax Act, 1962);
- Tax Administration Act 28 of 2011;
- Value-Added Tax Act 89 of 1991: Section 51;
- Interpretation Act 33 of 1957: Sections 1 & 2 (definition of "person");
- Securities Transfer Tax Act 25 of 2007: Sections 1 (definitions of "person" & "transfer"), 6, 7 & 8(1)*(r)*;
- Collective Investment Schemes Control Act 45 of 2002: Section 1 (definition of "collective investment scheme");
- (annual) Rates and Monetary Amounts and Amendment of Revenue Laws Acts.

Other documents

- *Oxford Reference.com*: definition of a "body unincorporate"

  [https://www.oxfordreference.com/display/10.1093/oi/authority.20110803110707292 [Accessed 3 April 2024].]

Cases

- *Jones and Co Ltd v Commissioner for Inland Revenue* [1926] CPD 1; 2 SATC 7 at 10;
- *De Beers Holdings (Pty) Ltd v Commissioner for Inland Revenue* [1986] (1) SA 8 (A); 47 SATC 229 at 256;
- *Commissioner for Inland Revenue v Emary NO* [1961] (2) SA 621 (A); 24 SATC 129;
- *Friedman and Others NNO v Commissioner for Inland Revenue: In re Phillip Frame Will Trust v Commissioner for Inland Revenue* [1991] (2) SA 340 (W), 53 SATC 166 at 170;
- *Commissioner for Inland Revenue v Friedman and others NNO* [1993] (1) SA 353 (A); 55 SATC 39;
- *Commissioner, South African Revenue Service v The Thistle Trust* [2023] (2) SA 120 (SCA); 85 SATC 347;
- *Thistle Trust v Commissioner for the South African Revenue Service* [2024] JDR 4267 (CC); 2 October 2024 (Case CCT 337/22 [2024] ZACC 19);
- *Thorne and Another NNO v Receiver of Revenue* [1976] (2) SA 50 (C); 38 SATC 1;
- *Van Zyl NO v Commissioner of Inland Revenue* [1997] (1) SA 883 (C); 59 SATC 105;
- *Van der Merwe NO and Others v Minister of State Expenditure and Others* [1999] (4) SA 532 (T); 62 SATC 18;
- *Ex-TRTC United Workers Front and Others v Premier, Eastern Cape Province* [2010] (2) SA 114 (ECB);
- *Commissioner for Inland Revenue v Witwatersrand Association of Racing Clubs* [1960] (3) SA 291 (A); 23 SATC 380;
- *Chipkin (Natal) (Pty) Ltd v Commissioner, South African Revenue Service* [2005] (5) SA 566 (SCA), 67 SATC 243 at 246 & 249;
- *ITC 1784* [2004]; 67 SATC 40 (G);
- *Michalow, NO v Premier Milling Co Ltd* [1960] (2) SA 59 (W);
- *Johannesburg Municipality v Cohen's Trustee* [1909] TS 811 at 823;
- *Commissioner for Inland Revenue v JW Jagger & Co (Pty) Ltd* [1945] CPD 331, 13 SATC 430;
- *Van Heerden and Another v Joubert NO and Others* [1994] (4) SA 793 (A).

Tags: person; includes; conduit principle; collective investment scheme; collective investment scheme in securities (CISS); foreign partnership; body unincorporated; representative employer; agent; beneficial ownership.

MANAGING SA TAX FOR EXPATRIATES

South African expatriates working abroad must deal with complex tax challenges due to the interplay of South African tax laws and those of host countries.

Effective tax management, thorough understanding of laws, ensuring compliance, and optimising tax liabilities through strategic planning and meticulous record keeping are vital.

As of 1 March 2020, South African tax residents living and working abroad are required to pay tax of up to 45% on their foreign employment income in excess of R1.25 million per year. There are, however, mechanisms embedded in the tax legislation which could assist in alleviating some of the high tax burden.

Similarly, foreign expats working in South Africa for foreign multinationals can also find themselves in a predicament if they are not South African tax residents but nevertheless are present in the country for more than 183 days in any 12-month period. This presence would render them liable to be registered and to pay tax in South Africa as well as in their home country.

In both cases effective tax management, thorough understanding of laws, ensuring compliance, and optimising tax liabilities through strategic planning and meticulous record keeping are vital.

Below is an overview of some key tax considerations for South African expatriates working abroad:

DETERMINING TAX RESIDENCY

Determining whether an expatriate is or is not a tax resident of South Africa is crucial as it affects the taxation of worldwide income versus South African income.

In South Africa there are two tests which determine an individual's tax residency:

- Ordinary Residence Test: This test is used to determine where an individual normally resides and considers as his or her home.
- Physical Presence Test: This test calculates the number of days the individual physically spent in South Africa – 183 days in any tax year and at least 91 days in each of the preceding five years means that the individual is deemed to be a South African tax resident from the first day of the sixth year.

Both these tests can be over-ridden by a relevant double tax treaty finding the individual to be tax resident outside South Africa.

It is advisable that expatriates, either South Africans living and working abroad or foreigners living and working in South Africa keep detailed travel and residency records and consult with a tax professional to accurately determine their tax residency status.

DOUBLE TAXATION

Expatriates may find themselves in a situation where they face taxation in both South Africa and the host country, leading to double taxation. South Africa has double taxation agreements (DTAs) with numerous countries that regulate the taxing rights of each country in relation to the type of income earned and provide mechanisms for tax relief. In some cases, foreign income may be exempt from South African tax if it has been taxed in the host country. Tax credits for taxes paid abroad can also be used to offset South African tax liabilities

Understanding the taxing rights afforded under DTAs is essential to apply exemptions or credits to avoid double taxation. It is recommended that a tax advisor is consulted to assist with the intricacies associated with DTAs and tax credits in order to determine how they would apply to expatriates working in South Africa, or South Africans working abroad.

COMPLIANCE WITH SOUTH AFRICAN TAX LAWS

Navigating South African tax laws can be complex, requiring registration, timely filing, and payment of taxes. Expatriates may need to ensure they are registered with the South African Revenue Service (SARS) and comply with their tax obligations.

Expatriates who are South African tax residents must declare all worldwide income and file tax returns in South Africa.

Expatriates who are considered non-residents may need to declare income sourced from South Africa and may need to register and file returns. Companies may have to withhold tax on payments to non-residents and are responsible for filing and remitting these taxes to SARS. For income not subject to PAYE, provisional tax payments must be made based on estimated income.

METICULOUS RECORD KEEPING

Maintaining detailed records of all income, expenses, and tax payments is critical. Expatriates should keep copies of employment contracts, payslips and correspondence with tax authorities.

UTILISING TAX-EFFICIENT STRUCTURES

Without strategic planning, expatriates may miss opportunities to reduce tax liabilities. Where legally permissible, using offshore trusts or companies can aid in managing income and assets in a tax-efficient manner.

Effective tax management for South African expatriates involves understanding residency status, utilising double taxation agreements, ensuring compliance with local laws, and employing strategic tax planning. By addressing these issues with informed solutions and seeking professional advice, expatriates can optimise their tax liabilities and focus on their professional endeavours. Proper documentation and proactive planning are essential to navigate the complex tax landscape and achieve financial efficiency.

Navigating the complex tax landscape without expert guidance can lead to costly mistakes and non-compliance. Expatriates should engage tax professionals with experience in expatriate tax issues to provide tailored advice and assist with compliance and optimisation strategies.

Devs Moodley

Forvis Mazars in South Africa

[This article was also published in African Mining: MANAGING TAX FOR SA MINING EXPATRIATES: ISSUES AND SOLUTIONS]

Tags: foreign multinationals; double taxation agreements (DTAs); ordinary residence test; physical presence test; tax credits.

INTEREST PAYABLE TO SARS

In the middle of the 1980s, formal correspondence in SARS was still typed on electric typewriters and circulated in the office in brown folders with a circulation list on their covers.

Much of this correspondence came from the Accounts Department and was pretty mundane but occasionally something interesting would catch one's eye. The Receiver (as the branch manager was then known) would make comments on bad grammar and other issues with a red pen. On one occasion he wrote "slang" next to a sentence informing the State Attorney that the taxpayer "was a guest of the state", meaning the taxpayer was in prison. A regular sentence used to state that "interest is a statutory charge and cannot be waived". This reason was no doubt intended to deter taxpayers, and is still being used by SARS today. But is it actually true?

The Tax Administration Act, 2011 (the TAA), contains the following sections in Chapter 12 dealing with interest:

- 187 General interest rules
- 188 Period over which interest accrues
- 189 Rate at which interest is charged

"The withholding taxes on foreign entertainers and sportspersons, royalties and interest are also payable by the end of the month following the month in which the amounts are received or accrued, and royalty or interest is paid (sections 47E, 49F and 50F of the Act)."

Section 272 of the TAA deals with the short title and commencement and provides that the TAA comes into operation on a date to be determined by the President in the *Gazette*. This is proclamation 51 in *Government Gazette* 35687 of 14 September 2012.

Section 272(2) provides that the President may determine different dates for different provisions of the TAA to come into operation and for the purposes of Chapter 12 and the provisions relating to interest in Schedule 1, the Minister may determine by public notice the date on which they come into operation in respect of a tax type.

SARS Interpretation Note 68 (Issue 3), dated 8 December 2020, sets out the interest provisions that have come into operation and those which are still governed by specified tax Acts.

In general, the interest provisions in the various tax Acts continue to apply except for understatement penalties, refunds not properly payable under section 190(5) of the TAA, and jeopardy assessments. These are dealt with in the TAA as they are not dealt with in any of the tax Acts.

SARS states that the reason for not migrating all the interest provisions to the TAA is because its systems need to first undergo substantial changes. Given that the TAA came into operation on 1 October 2012, more than 12 years ago, it seems SARS is in no hurry to upgrade its systems pertaining to interest.

The provisions relating to the payment of interest in the Income Tax Act, 1962 (the Act), are thus still set out in sections 89, 89*bis* and 89*quat*. Section 89*quin* contains provisions relating to changes in rate and authorises the Commissioner to introduce compound interest calculated monthly by notice in the *Gazette*, which thankfully has not yet happened.

SECTION 89(2)

Section 89(2) imposes interest at the "prescribed rate", as defined in section 1(1) of the Act, on any taxes not paid during the period for payment specified in a notice of assessment or within the period prescribed by the Act. Income tax assessments contain two dates: a payment date (usually the first day of a month) and an interest-free period (usually ending on the last day of the same month). [*Note*: The prescribed rates are available on the SARS website under Legal Counsel/Legal Counsel Publications/Tables of interest rates/Table 1.]

"Given that the TAA came into operation on 1 October 2012, more than 12 years ago, it seems SARS is in no hurry to upgrade its systems pertaining to interest."

Under section 60 of the Act, donations tax is payable by the end of the month following the month during which a donation takes effect or such longer period as the Commissioner may allow from the date upon which the donation in question takes effect.

Under section 64K of the Act, dividends tax is payable by the last day of the month following the month during which the dividend is paid.

The withholding taxes on foreign entertainers and sportspersons, royalties and interest are also payable by the end of the month following the month in which the amounts are received or accrued, and royalty or interest is paid (sections 47E, 49F and 50F of the Act).

The withholding tax on payments to non-resident sellers of immovable property in South Africa is payable by resident purchasers within 14 days of the date on which the tax is withheld, and by non-resident purchasers within 28 days of the same date (section 35A(4) of the Act).

Section 89(2) states that the interest is payable "unless the Commissioner having regard to the circumstances of the case grants an extension of such period and otherwise directs".

So, while interest may be a statutory charge, it is simply not correct to state that it can never be waived. Section 89(2) does not state under what circumstances the Commissioner will extend the due date for payment and on the face of it, the discretion is unlimited. But in practice, SARS will consider such a request only when the reason for the failure to make payment is outside the taxpayer's control. SARS' reasoning is that the taxpayer had the use of the money while SARS was correspondingly deprived of it. It is of course interesting that the circumstances prescribed in section 187(6) of the TAA (not yet in force) are limited to those beyond the taxpayer's control, and under section 187(7) comprise only three situations:

- a natural or human-made disaster;
- a civil disturbance or disruption in services; or
- a serious illness or accident.

But section 89(2) does not limit the circumstances in which the Commissioner can extend the date of payment.

In the days before eFiling, when assessments used to be sent by post, if an assessment was sent to the incorrect address and taxpayers had informed SARS of their correct address, SARS would extend the due date. There was a case in which an accountant had passed away and not attended to his clients' assessments which were found in his desk drawer by his partners. SARS extended the due date on those assessments.

Interest is payable for each completed month from the date of payment. Failure to pay the tax within the interest-free period will result in interest being calculated from payment date. But it also means that no interest will be charged for a period of less than a month, thus effectively creating a further interest-free period as long as the tax is paid before the end of the month.

Under section 7D, the common law *in duplum* rule under which the amount of unpaid interest may not exceed the capital does not apply to unpaid taxes under the Act.

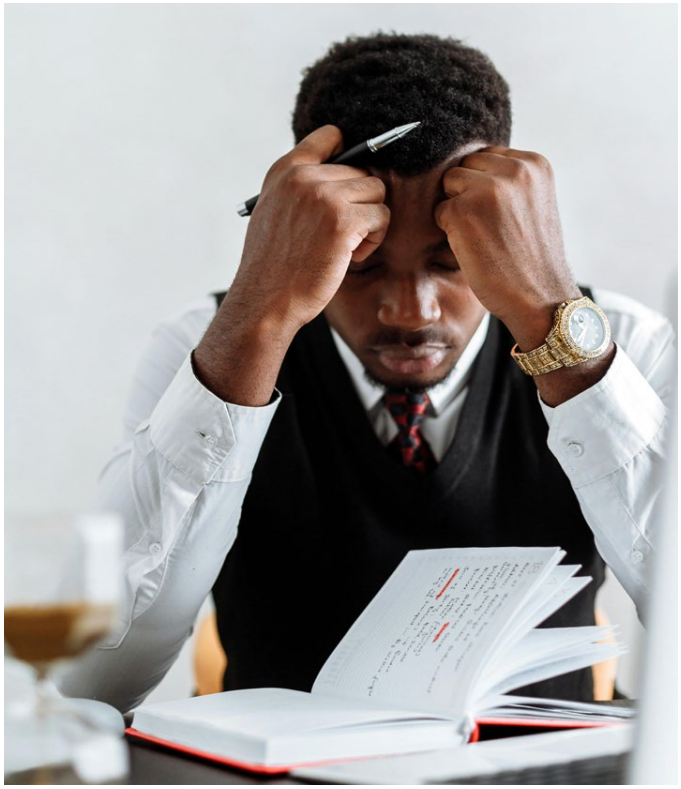
SECTION 89*bis*(2)

Section 89*bis*(2) contains the rules for unpaid employees' tax, provisional tax and the first two payments required under the turnover tax. [See paragraph 11(4A) of the Sixth Schedule to the Act.] Interest is calculated from the date for payment specified in the Fourth Schedule at the prescribed rate "unless the Commissioner having regard to the circumstances of the case otherwise directs".

As with the date extension power conferred on the Commissioner under section 89(2), no guidance is offered on what would constitute appropriate circumstances. Again, it would be difficult to persuade SARS to waive section 89*bis* interest unless the circumstances were outside the taxpayer's control.

An issue that frequently arises is whether a taxpayer should make a further second provisional tax payment if it is discovered that their second period estimate of taxable income was understated because of an oversight, such as a capital gain becoming apparent after the payment was made. Clearly, such a further second payment would be late and hence attract interest under section 89*bis*(2) and a 10% penalty under paragraph 27(1) of the Fourth Schedule. At the same time, the taxpayer with a taxable income of more than R1 million may face an under-estimation penalty under paragraph 20(1)*(a)* of 20% on the difference between the tax finally determined on 80% of taxable income and the taxes paid by way of provisional tax and employees' tax *by the end of the year of assessment*. [*Note*: A similar penalty applies to taxpayers whose taxable income is R1 million or less and was estimated below 90% of actual taxable income as well as the "basic amount".] Such a late payment will thus not avoid the paragraph 20 understatement penalty and it may be preferable to request remission of the penalty under paragraph 20(2) by showing that the estimate was seriously calculated and not deliberately or negligently understated.

Another alternative is to approach SARS to require the taxpayer to increase the estimate under paragraph 19(3). Under paragraph 19(5) such an adjustment is deemed to take effect during the period during which the taxpayer was required to make the payment, thus avoiding penalties and interest.



SECTION 89*quat*(3)

Section 89*quat* imposes interest when a provisional taxpayer has not discharged the full tax liability by the effective date. For persons with a February year end, this date is 30 September, and for companies with a different year end, it is six months after the year end.

Section 89*quat*(3) provides that when the Commissioner, having regard to the circumstances of the case, is satisfied that the interest payable under section 89*quat*(2) is a result of circumstances beyond the control of the taxpayer, the Commissioner may direct that interest shall not be paid in whole or in part by the taxpayer.

For years of assessment ending before 1 November 2010, section 89*quat*(3) enabled interest to be waived if the taxpayer could show that there were reasonable grounds for the income not having been declared as taxable or deductions having been wrongly claimed. The *Memorandum on the Objects of the Voluntary Disclosure Programme and Taxation Laws Second Amendment Bill, 2010* stated the following reason for the change:

> "The proposed amendment narrows SARS' discretion in terms of section 89*quat*(3) of the Act to waive interest charged on unpaid provisional tax. SARS is currently permitted to waive this interest if a taxpayer had reasonable grounds for taking the position that led to the underpayment. The question of whether a taxpayer had reasonable grounds for the position taken is a relevant factor in determining whether and what additional tax or penalties are due. Whether the taxpayer had reasonable grounds for the position taken or not, the fact remains that the taxpayer had the use of money due to the *fiscus*. Hence, the discretion to waive this interest is now narrowed to only cater for circumstances outside the taxpayer's control, similar to the provisions of the Value-Added Tax Act, 1991."

In *ITC 1958* [2021] the taxpayer had claimed deductions for leave and bonus pay, notice pay and severance pay under section 11*(a)*, relying for advice on its auditor. However, under section 7B the leave and bonus pay comprised variable remuneration and was deemed to be incurred when paid. The notice and severance pay did not qualify under section 11*(a)* or section 24C and hence fell to be disallowed. Given that SARS had not previously challenged the taxpayer's reasons for claiming the amounts and because the taxpayer had relied on its auditor, the court referred the matter back to the Commissioner for reconsideration as it appeared that the interest was incurred for reasons outside the taxpayer's control.

The decision to refer the matter back to SARS is interesting, particularly given what was stated in the Memorandum that supported the amendment introducing the "beyond the taxpayer's control" test for remission. It raises the question whether reliance on the opinion of a tax practitioner is something outside the taxpayer's control. If such an argument were to succeed, taxpayers would effectively be back to the pre-2010 position. It is unlikely to be accepted by SARS.

THE VALUE-ADDED TAX ACT

Section 39(7)*(a)* of The Value-Added Tax Act, 1991, permits the Commissioner to remit interest when the failure to make payment within the period for payment "was due to circumstances beyond the control of the said person".

In *Pricewaterhousecoopers Inc and Another v Minister of Finance and Another* [2021] the appellant sought to challenge the constitutionality of section 39(7)*(a)* on the basis of rationality. The appellant argued that the purpose of interest was to compensate the fiscus for loss of interest and not to act as a deterrent. The court found, based on the Metcash case [*Metcash Trading Ltd v Commissioner, South African Revenue Service, and Another* [2001] that [at SATC 264]

> "interest was one of the means of establishing a compliant tax system and beyond serving a compensatory function was also part of the package available to SARS to deter errant tax conduct and to incentivise taxpayers to act in accordance with what the law expects of them".

In the result, the court held that section 39(7) was rational and found in favour of SARS.

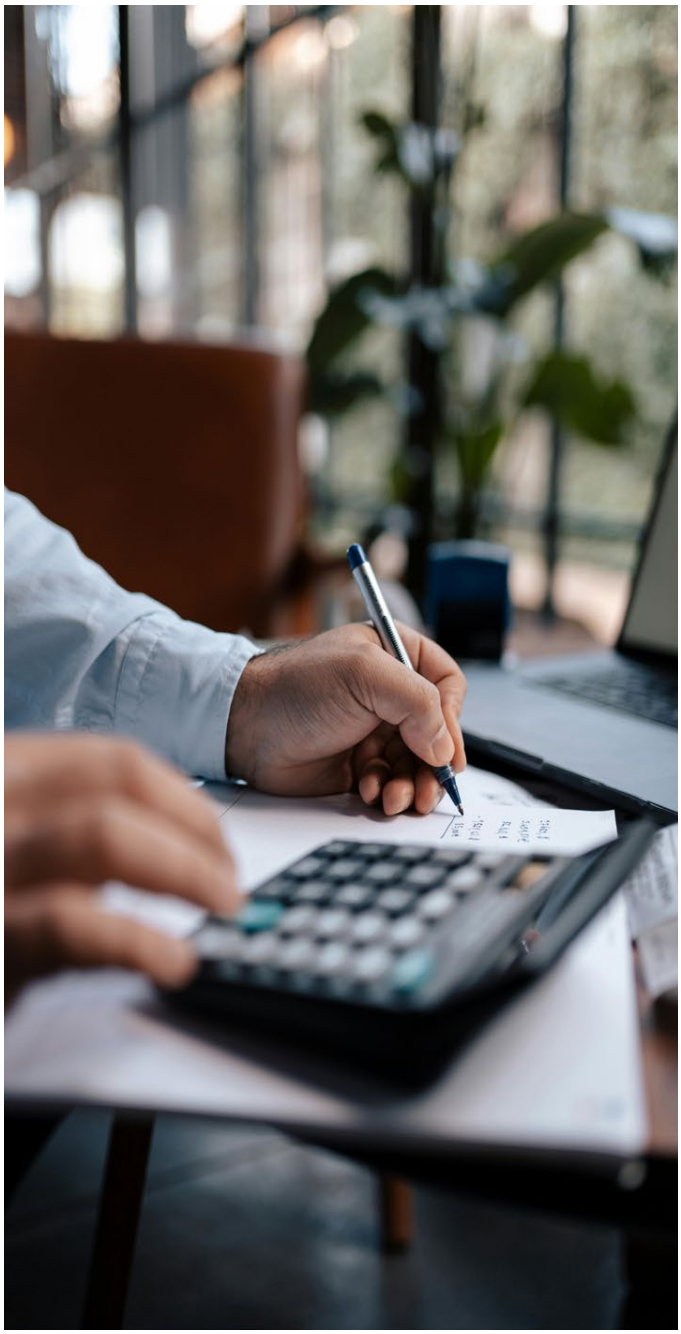
In *Commissioner, South African Revenue Service v Medtronic International Trading Sarl* [2023] the taxpayer had entered into a voluntary disclosure agreement with SARS as a result of its accountant having embezzled R537 million by submitting false VAT 201 returns. Under the agreement SARS waived all penalties but not the capital and interest. After signing the agreement, the taxpayer approached SARS to have the interest waived under section 39(7)*(a)* on the basis that the embezzlement was outside its control. SARS refused to consider the request. The SCA held that the matter should be remitted to SARS so that it could consider the request on its merits. SARS has lodged an appeal to the Constitutional Court.

CONCLUSION

Interest imposed under the Act may be a statutory charge but it can be waived in appropriate circumstances. Exactly what those circumstances are remains somewhat uncertain with SARS anecdotally resisting requests to waive interest unless the circumstances are outside the taxpayer's control. Even if it is accepted that SARS is constrained to such circumstances, there is still uncertainty as to what that means.

This uncertainty will be removed if and when section 187(7) of the TAA becomes effective.

This article was first published in *ASA August 2024*



Duncan McAllister

Webber Wentzel

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "prescribed rate"), 7B, 7D, 11*(a)*, 24C, 35A(4), 47E, 49F, 50F, 60, 64K, 89 (specific reference to subsection (2)), 89*bis* (specific reference to subsection (2), 89*quat* (specific reference to subsection (3)) & 89*quin*; Fourth Schedule: Paragraphs 19(3) & (5), 20(1)*(a)* & (2) & 27(2); Sixth Schedule: Paragraph 11(4A);
- Tax Administration Act 28 of 2011: Chapter 12 [sections 187 (General interest rules), 188 (Period over which interest accrues), 189 (Rate at which interest is charged)]; sections 190 & 272; Schedule 1;
- Value-Added Tax Act 89 of 1991: Section 39(7)*(a)*.

Other documents

- Proclamation 51 in *Government Gazette* 35687 of 14 September 2012;
- Interpretation Note 68 (Issue 3) dated 8 December 2020 (*"Provisions of the Tax Administration Act that did not commence on 1 October 2012 under Proclamation 51 in Government Gazette 35687"*);
- Prescribed rates (Interest Rates – Table 1)

  [https://www.sars.gov.za/wp-content/uploads/Legal/Rates/Legal-Pub-IRT-01-Interest-Rates-Table-1.pdf]
- *Memorandum on the Objects of the Voluntary Disclosure Programme and Taxation Laws Second Amendment Bill, 2010.*

Cases

- *ITC 1958* [2021] 84 SATC 432 (C);
- *Pricewaterhousecoopers Inc and Another v Minister of Finance and Another* [2021] (3) SA 213 (GP), 83 SATC 253;
- *Metcash Trading Ltd v Commissioner, South African Revenue Service, and Another* [2001] (1) SA 1109 (CC); 63 SATC 13] [at SATC 264];
- *Commissioner, South African Revenue Service v Medtronic International Trading Sarl* [2023] (3) SA 423 (SCA), 86 SATC 158.

Tags: understatement penalties; jeopardy assessments; *in duplum* rule; to waive interest.

THE LIMITS OF NEW GROUNDS OF APPEAL

Rule 32(3) of the rules promulgated under section 103 of the Tax Administration Act, 2011 (the Tax Court Rules), as amended, provides that the appellant may include in the statement a new ground of appeal unless it constitutes a ground of objection against a part or amount of the disputed assessment not objected to under Rule 7.

This issue came under scrutiny in the *TALT v Commissioner for South African Revenue Service* [2024] (27 August 2024) judgment as the Gauteng Division, Johannesburg High Court, had to determine whether the taxpayer is or should be permitted to raise in its appeal these "new grounds" of appeal not raised in its objection.

In this matter, the appellant, an *inter vivos* discretionary trust, in its 2012 tax return had disclosed its taxable capital gain as nil and the return was assessed by the South African Revenue Service (SARS) on 31 January 2013. On 6 March 2018, after certain tax audit findings, SARS issued the appellant with an additional tax assessment in respect of the 2012 tax year of assessment, in terms of which a sum of capital gain was included in the appellant's taxable income for that year. The appellant's objection to the 2012 additional assessment was limited to the understatement penalty levied. SARS disallowed the appellant's objection as well as objections relating to the additional assessments for the 2013 to 2015 years of assessment.

In 2018, the appellant "noted" an appeal to the tax court against SARS' decision to disallow the aforesaid objection. The appeal was stated to be in respect of all of the grounds of objection set out in the appellant's objection letter. On 28 June 2019, the appellant delivered a further letter of objection to the 2012 additional assessment, on the ground that the period of limitations for the issuance of an additional assessment had expired prior to 6 March 2018, having regard to the provisions of section 99(2)*(a)* of the TAA. The appellant was therefore of the view that the purported additional assessment dated 6 March 2018 was invalid. This latter objection was also disallowed by SARS and the appellant appealed to the tax court against this disallowance.

In the tax court appeal, SARS averred in its Rule 31 of the Tax Court Rules statement that the appellant impermissibly raised further grounds of objection to the assessment in addition to disputing the imposition of the understatement penalty and the prescription issue raised. The further ground of objection related to the so-called "merits" or the "capital" of the additional assessment in terms of which the appellant endeavoured to make out a case that it is not liable to pay the tax on the additional income which took into account the alleged capital gain. This was argued as an interlocutory matter before the tax court, where Bram J found in favour of SARS. The court ruled that these were new grounds of appeal on which the appellant did not rely in its objection.

"The judgment is welcomed as it confirms that subrule 32(3) permits the raising of a new reason or argument on appeal for why the Commissioner was wrong in disallowing the objection to an assessment, but does not permit the raising of a new factual or legal basis for objecting to an assessment, which amounts to a new objection to it, which was never raised at the time."

The appellant appealed the tax court's decision, with the key issue on appeal being whether the appellant is or should be permitted to raise in its appeal these so-called "new" grounds of appeal, not raised in its objection letters.

The court agreed with the submission that the contestation involved the inclusion of a taxable capital gain in the appellant's taxable income as well as the tax liability arising therefrom. Thus, the appellant's objection specifically pertained to this tax liability. The core issue was that the portion of the disputed 2012 assessment concerned the determination that led to the inclusion of the taxable capital gain in the appellant's taxable income, along with the resultant tax liability. The basis for this objection, or the ground of objection, was prescription.

Moreover, the disputed assessment objected to bears the same amount as the amount determined by SARS as being the "taxable capital gain" to be included in the appellant's taxable income.

The court concluded that the appellant's objection to the inclusion of the specified amount in its taxable income on the basis of "prescription" did not imply that it had not objected to the inclusion of that amount itself. The court was of the view that, in fact, this was the essence of the objection, although it was framed in terms of prescription. The court provided that the new ground relied on by the appellant relates to the same part (capital gain) and the same amount and, as such, this new ground constituted merely an auxiliary basis that reinforces the same aspect and amount of the disputed assessment previously contested.

The judgment is welcomed as it confirms that subrule 32(3) permits the raising of a new reason or argument on appeal for why the Commissioner was wrong in disallowing the objection to an assessment, but does not permit the raising of a new factual or legal basis for objecting to an assessment, which amounts to a new objection to it, which was never raised at the time. This ruling also underscores the principle that SARS, as an organ of the state subject to the Constitution, should not seek to exact tax which is not due and payable as it allows for the true issues between the parties to be fully ventilated. Ultimately, this decision provides clarity on the boundaries of appeal grounds in tax disputes.

Mmangaliso Nzimande & Oreneile Jibilili

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Acts and Bills

- Tax Administration Act 28 of 2011: Sections 99(2)*(a)* & 103.

Other documents

- Rules promulgated under section 103 of the Tax Administration Act 28 of 2011: Rules 7, 31 & 32(3);
- Rule 31 of the Tax Court Rules statement.

Cases

- *TALT v Commissioner for South African Revenue Service* (A2023/077887) [2024] ZAGPJHC 827 (27 August 2024).

Tags: *inter vivos* discretionary trust; additional tax assessment; taxable capital gain; prescription.

FOREIGN ELECTRONIC SERVICE PROVIDERS

The much-anticipated amendments to the regulations for purposes of the definition of "electronic services" in section 1(1) of the Value-Added Tax Act, 1991 (the VAT Act), were released for public comment on 1 August 2024.

THE PROPOSED AMENDMENTS IN RESPECT OF B2B SUPPLIES

Under current law, any non-resident person who supplies services to a resident person "by means of the internet" or other electronic communication will be required to register for VAT and levy VAT (at the standard rate, currently 15%) on such supplies, when it conducts an "enterprise" as defined in paragraph *(b)*(vi) of the definition of an "enterprise" in section 1(1) and the value of services exceeds R1 million in a 12-month period. This obligation arises regardless of the identity of the recipient of the service, and (especially in context of business-to-business (B2B) transactions) regardless of whether the recipient is entitled to deduct the VAT so levied as input tax. The obligation on non-residents to register for VAT in South Africa therefore arises even if no additional revenue is collected for the benefit of South Africa.

The proposed amendments have left the "core definition" of "electronic services" untouched, ie, an electronic service is, in principle, still *any service supplied by means of an electronic agent, electronic communication or the internet for any consideration* (importantly, note comments below regarding the interpretation of the "core definition" and "minimal human intervention").

The exclusions to the above definition are, however, proposed to be expanded, in most relevant part, to remove from the scope of the electronic services regime "services supplied from a place in an export country by a person that is not a resident of the Republic where such services are supplied **solely** to vendors registered in the Republic in terms of section 23 of the [VAT] Act" (emphasis added). The above will be referred to as the "New Exclusion".

WHAT THIS MEANS FOR NON-RESIDENT SUPPLIERS

The draft explanatory memorandum published together with the draft regulations on 1 August 2024 states that the New Exclusion "is a form of [B2B] exclusion". This is correct insofar as the New Exclusion applies only to business-to-vendor supplies. The onus will therefore sit with non-resident suppliers to confirm the VAT registration status of each of their South African recipients in order to conclude that the New Exclusion will apply.

The draft explanatory memorandum records that the policy rationale behind the New Exclusion "is to ease the administrative burden on…suppliers and recipients where there is little or no gain to the fiscus", and "to encourage compliance where legal jurisdiction to enforce compliance may be a challenge". Despite this insight, it is unfortunate that the **effective date** of the New Exclusion (and the new regulations as a whole) is proposed to be **1 April 2025.**

There is accordingly no relief on the cards, it seems, for non-residents who are caught by the soon-to-be replaced current regulations. It is unfortunate that the effective date of the New Exclusion has not been fast-tracked to put an end to uncertainty and the many enforcement efforts by the South African Revenue Service where there is "little or no gain to the fiscus", and likely jurisdiction issues.

WHAT IF SERVICES ARE NOT SUPPLIED "SOLELY" TO REGISTERED VENDORS?

The New Exclusion in its current form reads as an "all or nothing": if a non-resident supplier of electronic services supplies **some services** to South African non-vendors, there is a risk that the provision in its current form will mean that **all services** supplied to South African residents would be subject to VAT. Such a result, it is submitted, would perpetuate the very same inefficiencies that the New Exclusion is directed to correct. The New Exclusion should therefore be refined to cater for this nuance to avoid unbusinesslike outcomes.

The "solely" requirement in the New Exclusion also does not indicate whether regard will be had to the **value of the supplies** made by a non-resident to South African non-vendors. If this requirement were to remain (in some form) in the New Exclusion, it should be reworded to *inter alia* capture services of non-resident suppliers **only to the extent that** the services are supplied to non-vendors and **provided that** the value of such supplies exceeds the VAT registration threshold of R 1 million in a 12-month period.

WHAT THIS MEANS FOR RESIDENT RECIPIENTS

The obligation on resident recipients of foreign services to declare output tax on imported services to the extent that the services are used for purposes other than taxable supplies remains unchanged.

The reverse charge mechanism in section 7(1)*(c)* of the VAT Act therefore continues to apply. Section 9 of the Tax Administration Laws Amendment Act, 2024, however, provides that section 14 of the VAT Act be amended to increase the days within which reverse VAT should be declared from 30 to 60.

THE PROPOSED AMENDMENTS IN RESPECT OF INTRA-GROUP SUPPLIES

The electronic services regulations were amended in 2019 to exclude services supplied between companies in the same group. The above will be referred to as the "Intra-group Exclusion".

The Intra-group Exclusion in its current form essentially states that excluded from the scope of the electronic services regime are services supplied by a non-resident group company to a South African group company if the first company "itself supplies those services exclusively for the purposes of consumption…by the company that is a resident of the Republic".

The new draft regulations propose that the Intra-group Exclusion be amended to refer to only services supplied by a non-resident group company in instances where those services were "exclusively discovered, devised, developed, created or produced for the purposes of consumption…by the company that is a resident of the Republic".

According to the draft explanatory memorandum, the proposed amendment is directed specifically at intra-group supplies involving global contracts. Careful attention should be paid to this proposed amendment by global enterprises with any corporate presence in South Africa. It is common practice (often in line with transfer pricing requirements) that global contracts are recharged to South African subsidiaries. Such recharges may result in the South African VAT registration of, for example, a foreign head office. For this reason, it is strongly recommended that industry-participants keep abreast of developments in this area.

It is submitted that the interaction between the New Exclusion and the Intra-group Exclusion should be made clearer by National Treasury.

THE "CORE DEFINITION" AND "MINIMAL HUMAN INTERVENTION"

One of the stated intentions of the "electronic services" definition (referred to in the explanatory memorandum published along with the current version of the regulations) was that only services involving "minimal human intervention" would be captured.

The new draft explanatory memorandum attempts to retract the above guidance and states that the interpretation of which services fall within the regulations and therefore the VAT Act should be interpreted "as wide[ly] as possible with no regard to the words 'minimal human intervention'". It is not necessarily clear how the intention of the "core definition" could be amended after its promulgation without amendment to the core definition itself.

The due date for comment on the new draft regulations was **31 August 2024.**

"The obligation on resident recipients of foreign services to declare output tax on imported services to the extent that the services are used for purposes other than taxable supplies remains unchanged."

Jo-Paula Roman *(reviewed by **Charles de Wet**)*

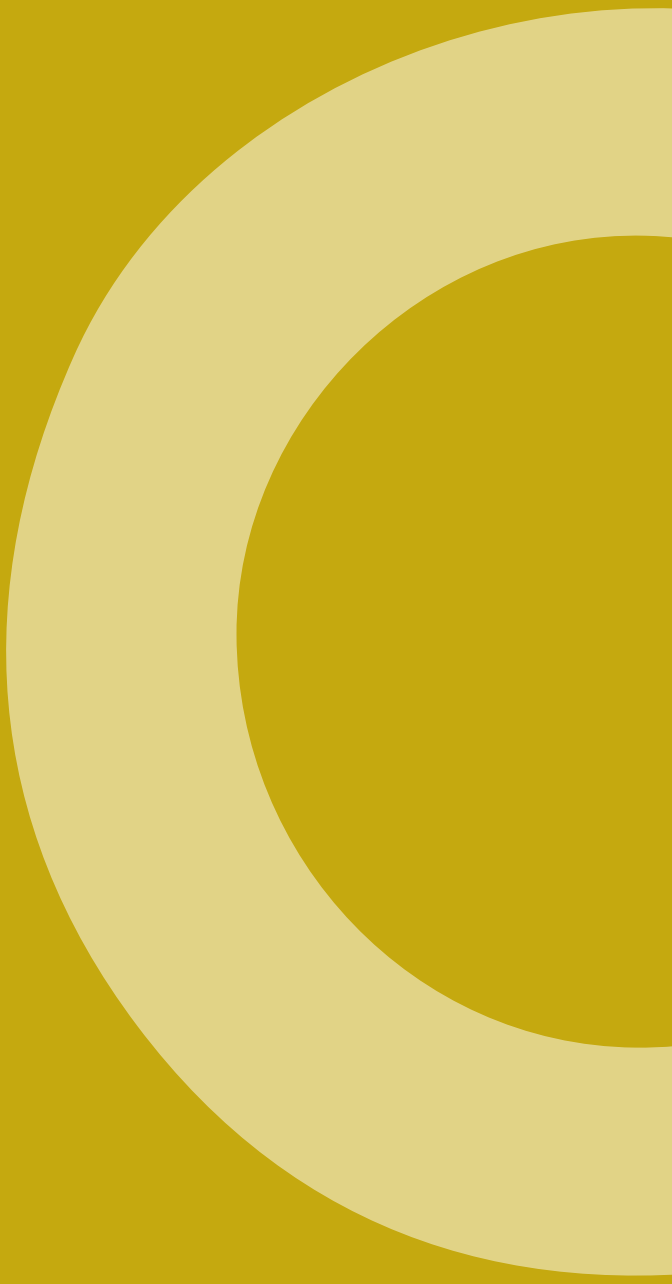
Acts and Bills

- Value-Added Tax Act 89 of 1991: Section 1(1) (definitions of "electronic services" & "enterprise"), 7(1)*(c)*, 14, 23;
- Tax Administration Laws Amendment Act 43 of 2024: Section 9 (amends section 14 of the VAT Act).

Other documents

- Regulations for purposes of the definition of "electronic services" in section 1(1) of the Value-Added Tax Act 89 of 1991;
- Draft amendments to the regulations for purposes of the definition of "electronic services" in section 1(1) of the Value-Added Tax Act, 1991 (the VAT Act).

Tags: electronic services; enterprise; taxable supplies; reverse charge mechanism.



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