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NAVIGATION TO NORMAL:

Dealing with the aftermath

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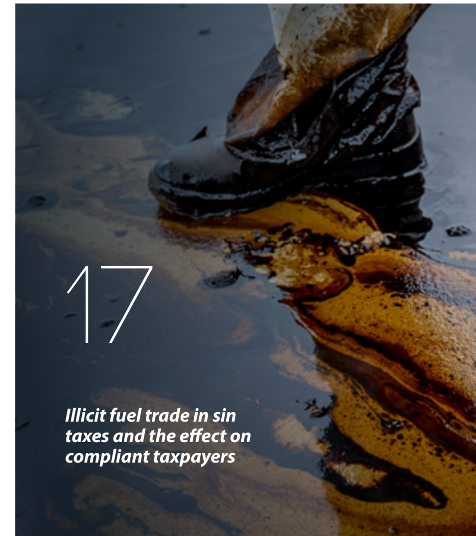
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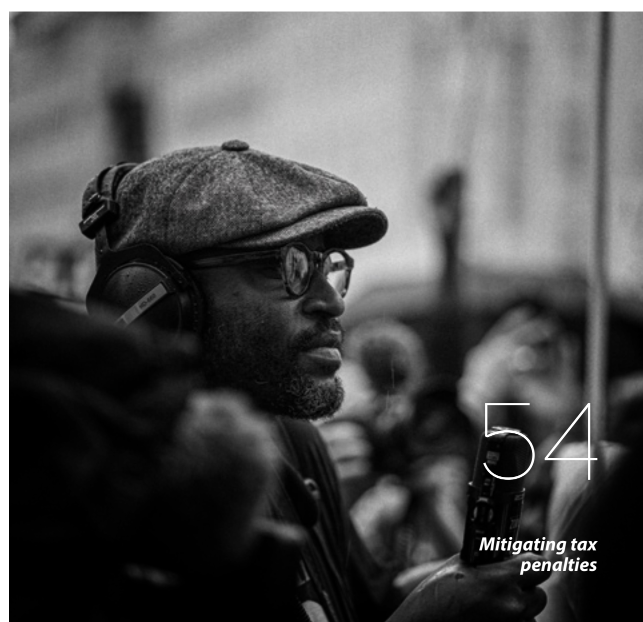

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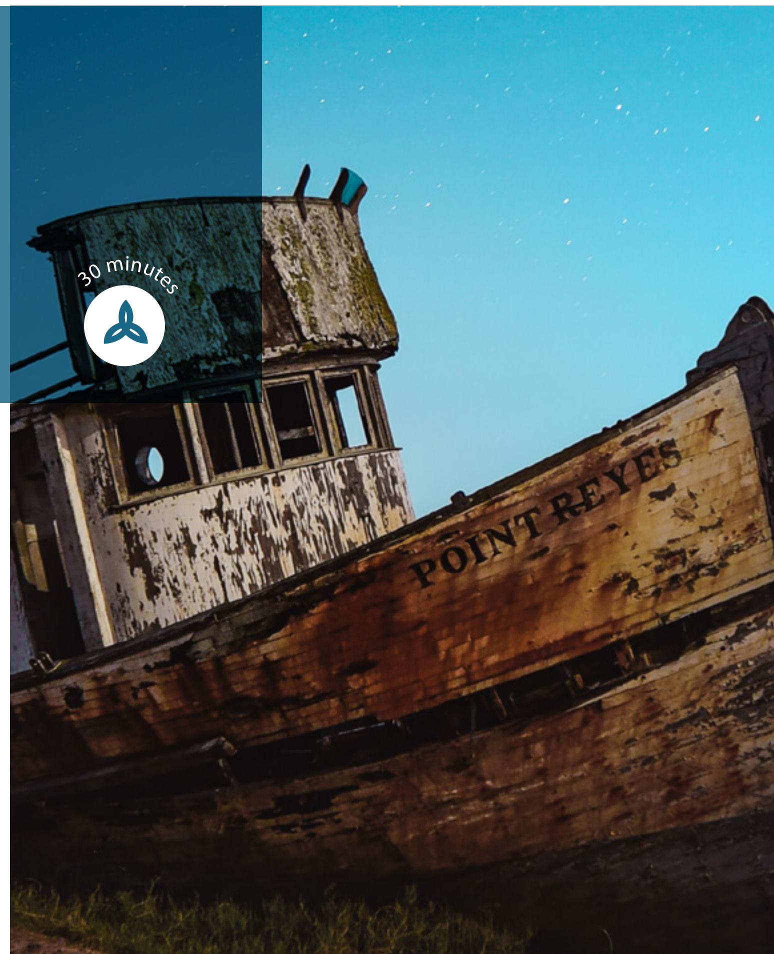
MANAGING SOUTH AFRICA'S TAX BASE AS THE ECONOMY SHRINKS



▶ **CLAUDE DE BAISSAC,** CEO at Eunomix

The obliteration of South Africa's (SA's) tax base over the past decade is the unavoidable consequence of the methodical undermining of the economy by this and the previous government. It is utterly unsustainable; it looks like those of Greece, Lebanon and Sri Lanka before their collapses. If profound microeconomic reform is immediately needed, danger signs are ignored, and talk of a wealth tax on the remaining super-rich shows an absent reform mandate.

No reform, no improvement of the tax base

Much has been written about managing the tax base in SA's shrinking economy. Treasury has repeatedly emphasised the importance of protecting, consolidating, and growing this critical foundation of economic sustainability and for good reasons.

These range from structural narrowness to shrinking and to high dependency on personal income tax. Managing the tax base in a shrinking economy is a contradiction in terms. The 2022 budget states that *"A broader taxbase — ideally as more businesses register and grow, or more people earn income from stable jobs – would allow for lower headline tax rates to improve competitiveness and growth"* (2022 Budget, 28 February 2022). Here, in this briefest of statements, is SA's problem; it is not solvable without profound, urgent reform. Until then, managing the tax base fits the Titanic deck chair analogy.

Wither South Africa's growth, Treasury's growth forecasts, and real incomes

The cliché of ministries of finance being filled with grey-looking people dressed in grey — working in grey offices is only a slight exaggeration. These are serious places, tasked with the grave custody of a nation's scarce finances toward some form of durability and thus with societal well being.

The task is difficult enough in good times. It is punishingly perilous in hard times. In SA, it has become an impossible one; it pushes Treasury to the edge of cognitive and programmatic dissonance — its annual budgets increasingly distant from reality.

Eunomix has calculated from Treasury's annual budgets (http://www.treasury.gov.za/documents/national%20budget/default.aspx) that since 2011 Treasury's growth forecasts have overestimated growth in 15 out of 21 years. This bias has been getting worse; the average annual overstatement on 2-year forecasts increased from 0.8 percentage points in 2005 – 2009 to a very significant 1.2% in 2010 – 2014, to an enormous 1.4% in 2015 – 2019. Had its 2-year forecast been correct, all other numbers remaining equal, the economy would have been 25% larger in 2019 than it was.

The 2.2% growth for 2022 forecasted in the 2021 budget was modestly revised down to 2.1% in the 2022 budget. In an unusual move, the International Monetary Fund (IMF) just lifted its 1.9% expectation to a decidedly rosy 2.4%. It bears saying that this figure, which no doubt gave the increasingly desperate happy-clappies at the Church of the Greenshoots much to sing and dance about, was calculated before the latest and already worst-ever load shedding. It also bears saying that before the pandemic, growth had reached a just-over-the-cliff 0.8% average annual for 2015 – 2019. This number includes the one-off 2017 confidence boost of the New Dawn (a mere 1.4%), without which the average annual would have been 0.7%.

Real income are what really matters in a country marred by world-beating unemployment, inequality, and world-busting losses in productivity. These started declining in 2014, they tumbled by 8% in 2020 while GDP fell by 7%, and they were the same in 2021 as in 2005. South Africans wake up every morning slightly poorer than when they went to sleep. Inflation and population growth outpace real income, which have so declined that SA will have slid down from a middle-income to a lower-middle-income country by 2030. It was an upper middle income country in 2010 . . . If ever economic destruction was a criminal offence, there lies the indictment . . .

Story of a South African economy, or how to destroy it in a decade

In this context, past the expected rebound of the post-pandemic, what could possibly boost lasting and meaningful growth in a global context marred by incivility between nations and by a domestic social collapse grave enough to warrant a stern warning from former President Mbeki?

Ministries of finance do not manufacture growth unless they cheat the economic game by borrowing or printing money — which eventually catches up with them. They enable growth. But they need two preconditions that they do not control: 1) a microeconomic policy that makes it economical to produce and consume and; 2) the actors and factors that produce and consume; this is where SA has gone deadly wrong and the reason why growth projections are systematically off the mark, revenue targets are missed, and public expenditure is greater than budgeted for. These preconditions simply do not exist — on the contrary.

As regards the first precondition, in combining commission, omission and gross neglect, this and the previous government have methodically undermined, when not actively destroyed, the economy. As for the near future, besides rumbling in the crumbling of Eskom, there is yet no political mandate for the immediacy, breadth and depth of reforms needed. As regards the second precondition, a Eunomix proprietary model of economic sustainability ranks over 200 countries against 21 markers of performance in five clusters: input, value creation, consumption and income, government sector, and growth — effectively a trajectory, comparative input-output model. SA ranks from average to poor for 2015–2019 on just about all markers. It displays: 1) low savings/low investment/low employment/high debt; 2) medium-low productivity/moderate-low mineral rents/medium-low industry/low manufacturing/high services/medium-low exports/high imports; 3) high consumption/medium income/high inequality/high social transfers; 4) high tax/high government expenditure (and debt); and 5) low-negative growth. And all these indicators are moving in the wrong direction. In our model, SA increasingly looks like Greece, Lebanon and Sri

Lanka shortly before their collapses. SA's economy has indeed become gravely unsustainable, trapped in a self-feeding and largely self-created downward cycle. It consumes too much to save, saves too little to invest, invests too little to produce, produces too little to export, exports too little to bring in foreign earnings, etc. It funds its consumption through indebtedness, a growing part of which is incurred by the government and directed to its own vast wage bill to the vast and expanding social programmes that make SA the world's largest welfare state per capita, and to fast-rising debt servicing produced by a reckless and failed pursuit of the famed economic multiplier effect of government expenditure. On this point, over the past decade, there has been an inverse relationship between this government's borrowing and economic growth. This is not some spurious correlation. Evidence strongly suggests that government expenditure is destructive of economic activity, in part because less than 10% of it goes to capital investment and in part because the rest of it goes to expenditures (public sector wages prime among them) that cost more than they return. This is a phenomenon that famed Russia expert Hélène Carrère d'Encausse called 'value retraction', which she measured in the 1980s to accurately predict the eventual collapse of the Union of Soviet Socialist Republics (USSR). Economics is not some imagined cultural invention; it is based on a complex interaction of the material and the psychosocial. That it is called 'the dismal science' is not for nothing.

The gap between consumption, production and funding keeps widening. Normally, market mechanisms would adjust to restore some balance. But key ones are actively stopped from functioning by the government:

- mass unemployment should drive labour costs down, but the opposite has occurred; failed yet critical parastatal monopolies rank amongst the world's worst performing, but alternatives have been rejected; savings should be invested elsewhere to protect retirements, but capital controls have forced them into a succession of bubbles: first in real estate and retail, now in government bonds which benefit from a 10-year yield double the Repo rate — a warning sign of danger that is mostly ignored; retirement funds and individuals who are still convinced of the safety of their dwindling savings.

The tax base: Collateral damage to ongoing economic abuse

The destruction of the tax base is the unavoidable consequence of this wanton self-harming. Registered taxpayers, according to SARS data, were down by 4.3 million in 2019 from a 6.3 million peak in 2012. In 2019, there were only 1 million registered taxpayers, more than in 2003 when the population was 46 million to today's 60 million. Here, two factors are at play. The first factor is the withering away of the wage-earning working, and middle-classes. In 2012, these accounted for 85% of registered taxpayers but only 56% in 2019.

Unemployment and inflation have done their nasty jobs. A rise in upper-income registered taxpayers has been insufficient and economically dangerous as the tax base narrows to the point of suffocation. Hence, the second factor is the fleeing of the skilled and wealthy. Data on this is patchy but sufficient to confirm an exodus — acted and planned — to less inauspicious shores. And if the data does not convince one, then drive around the country's wealthy neighbourhoods on a Sunday and count the 'for sale' signs at each street corner.

In today's world, wealthy taxpayers are a focus of courting by governments. In SA, where the population on welfare is four times than that of registered taxpayers and ten times than that of the upper-income ones, the talk of the moment is about a wealth tax to pay for more welfare. In SA, managing the tax base is thus not just a contradiction in terms. It is an act of deliberate obliteration.

Post-script: Beware Sri Lanka

On 15 August, Sri Lankan writer Indrajit Samarajiva penned an article in the New York Times titled: *Sri Lanka Collapsed First, but It Won't Be the Last.*

"Former President Gotabaya Rajapaksa deepened our debt problems, but the economy has been structurally unsound across administrations. We simply import too much, export too little and cover the difference with debt. This unsustainable economy was always going to collapse. But we are just the canary in the coal mine. The entire world is plugged into this failing system and the pain will be widespread."

"Ministries of finance do not manufacture growth unless they cheat the economic game by borrowing or printing money — which eventually catches up with them"

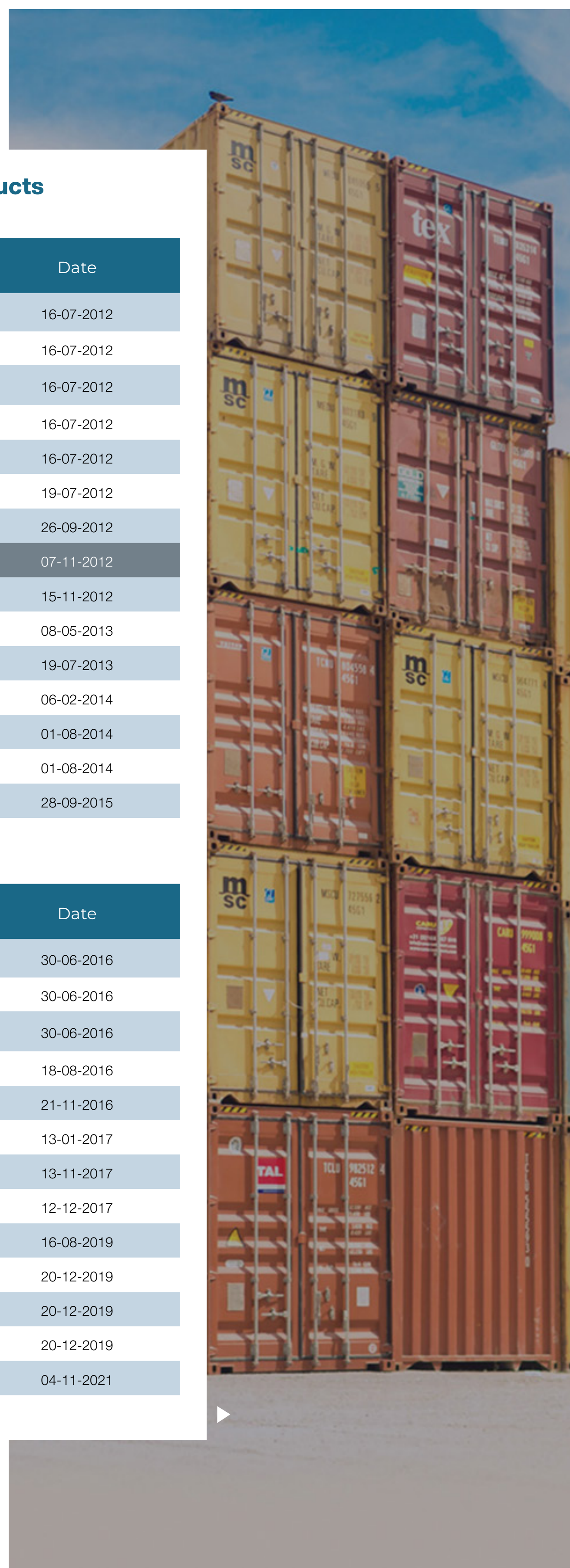
STATE OF LOCALISATION IN SOUTH AFRICA

LUNCEDO MTWETWE, Managing Director at Vantage Advisory

Whereas South Africa supports African free trade, the Department of Trade, Industry, and Competition (dtic) is pushing for local production content. How far will these efforts go and will these efforts run contrary to the free trade commitment?

What exactly is localisation? This is a question that many businesspeople seem to be asking. It has become a buzzword for any major project that the government has recently embarked on. But this is not all that recent; the local content policy has been in place in South Africa since 2011. The policy was introduced through the amended Preferential Procurement Policy Framework Act 5 of 2000. Put simply, it tackles the government's headache of de-industrialisation of our manufacturing sector intending to reduce imports through state organs procuring goods and services that are locally manufactured. On 18 May 2021, the dtic issued a statement clarifying its position on the localisation policy; the policy will stay and it will go ahead. It seems to be inspired by East Asian countries that have implemented these policies and have worked in those jurisdictions.

Policy implementation started taking shape in 2012 when the dtic appointed the South African Bureau of Standards (SABS) as the sole verification agency to verify whether state organs procure goods and services that meet the local content requirements. As of 2022, 28 products have been designated for localisation. There will be more products that will be localised in the near future.



Minimum Local Content Thresholds for designated products

Designated products	LC Threshold	Date
RAIL ROLLING STOCK	65%	16-07-2012
POWER PYLONS	100%	16-07-2012
BUS BODIES	80%	16-07-2012
CANNED/ PROCESSED VEGETABLES	80%	16-07-2012
TEXTILE, CLOTHING, LEATHER, AND FOOTWEAR SECTOR	100%	16-07-2012
SOLAR WATER HEATERS	70%	19-07-2012
SET-TOP BOXES	30%	26-09-2012
CERTAIN PHARMACEUTICAL PRODUCTS	PER TENDER	07-11-2012
FURNITURE PRODUCTS	85%	15-11-2012
ELECTRICAL AND TELECOM CABLES	90%	08-05-2013
SOLAR WATER HEATERS	70%	19-07-2013
VALVES PRODUCTS AND ACTUATORS	70%	06-02-2014
WORKING VESSELS	60%	01-08-2014
RESIDENTIAL ELECTRICITY AND WATER METERS	70%	01-08-2014
TRANSFORMERS AND SHUNT REACTORS	90%	28-09-2015

Designated products	LC Threshold	Date
TWO-WAY RADIO TERMINALS	60%	30-06-2016
SOLAR PV COMPONENT	70%	30-06-2016
RAIL SIGNALLING SYSTEM	65%	30-06-2016
WHEELIE BINS	100%	18-08-2016
FIRE FIGHTING VEHICLES	30%	21-11-2016
STEEL PRODUCTS AND COMPONENT FOR CONSTRUCTION	100%	13-01-2017
RAIL PERWAY (TRACK) INFRASTRUCTURE	90%	13-11-2017
PUMPS & MEDIUM VOLTAGE MOTORS	70%	12-12-2017
PLASTIC PIPES & FITTINGS	100%	16-08-2019
AIR INSULATED MV SWITCHGEAR	50%	20-12-2019
BULK MATERIAL HANDLING	85%	20-12-2019
INDUSTRIAL LEAD ACID BATTERIES	50%	20-12-2019
CEMENT	100%	04-11-2021

Source: *DTIC website.*

"The reality is that our local manufacturing capacity has shrunk from contributing 19.8% to the GDP in 1994 to contributing 11.8% by 2020. Many factors have caused this decline"

Since the localisation policy is part of the 2017 preferential procurement Regulations, you might be aware of the Constitutional Court judgment between the *Minister of Finance vs Sakeliga NPC (Previously Known as Afribusiness NPC) And Others Cct62/22* about procurement regulations and their repercussions. As much as government is in the process of rectifying these regulations, it has brought doubts about the process that government follows to enact these regulations in South Africa. The government has not been clear on the consultative process about the type of goods that are to be localised.

The government is moving ahead with its post-COVID recovery plan called, 'The South African Economic, Reconstruction and Recovery Plan', which proposes a huge rollout of infrastructure programmes to boost the economy. Presumably, this is where local content production will play a huge role in reducing imports. However, we need to ask, 'are our industries' value chains up to date to meet the local content requirements?'

The reality is that our local manufacturing capacity has shrunk from contributing 19.8% to the GDP in 1994 to contributing 11.8% by 2020. There are many factors that have caused this decline. One of these factors is globalisation: some products are far cheaper if they are imported and as a result, they are more appealing to businesses than locally manufactured products.

Impact of localisation on free trade commitments

South Africa is part of the G20, African Union, and Brazil, Russia, India, China and South Africa (BRICS); it is one of the largest economies in Africa (until 2014, we held the top spot). We have signed on to the African Continental Free Trade Area agreement (AfCFTA). Thus, our policy decisions will have an impact on our global partners and on us.

The World Bank report titled, *'The African Continental Free Trade Area: Economic and Distributional Effects'*, states the following:
"The AfCFTA agreement will create the largest free trade area in the world measured by the number of countries participating. The pact connects 1.3 billion people across 55 countries with a combined gross domestic product (GDP) valued at US$3.4 trillion. AfCFTA would significantly boost African trade, particularly intraregional trade in manufacturing. The volume of total exports would increase by almost 29 per cent by 2035 relative to the baseline."

Trade experts have warned that the way in which the localisation strategy is set up is not aligned with AfCFTA and undermines our trade partners. The question is what impact localised goods will have on our trade commitments. If other countries also implement their localisation plans, then what will happen to our non-localised goods and services? The answer is that no trade partner will buy them. South Africa has more industrial capacity compared to other African countries and should be careful to limit itself by imposing policies that serve its own interests only.

AFCTA implemented carefully will open more trade routes for our goods that are manufactured locally and will add value to our economy. The infrastructure investment in rail or road will need to be improved for these policies to be effective. Without infrastructure development on the continent, the efforts to make this continent a shining example of free trade will certainly fail. The global economy is focusing on climate change and reducing carbon emissions; if we fail to invest in research and development (R&D), Africa may likely be left behind. There is a huge market that South Africa can access via AfCFTA. Localisation should not in any way undermine other African countries; instead, treat them as equal partners.

The South African government does state that the localisation is not against any trade rules and will be implemented with caution, however, it is not clear how this will happen.

Solutions for localisation to work

The intent and use of localisation as a tool to industrialise are clear and welcomed by industries. However, its implementation should be carefully considered, preferably by consulting with all economic players about which products or industries need to be prioritised. This would allow the government to designate goods that the country can manufacture within strategic industries that are of value to South Africa. This also allows the country to protect the industries that might be susceptible to global supply shocks as experienced in Europe owing to the war in Ukraine and globally during COVID-19. Investment in research and development is key in any economy that wants to succeed; our industries are being left behind in global competition owing to a lack of investment in R&D. Engineers and trade experts should be consulted in the creation and implementation of these plans.

It is important to note that there are no clear results of the impact that localisation has had on the economy. A reporting and monitoring framework must be created to track the impact of local content regulations on the economy.

Owing to the government's inefficiency in running state-owned entities, there is a high risk that some of these policies will look like failures. Eskom's power cuts are a major threat to the growth of the economy. Rising input costs owing to a lack of energy, infrastructure, and logistical nightmares will derail the localisation plan without a doubt. State-owned organisations should be well run and rail infrastructure should be upgraded. If strict measures on crime and corruption that undermine our economic activities are enforced, then successful policies will follow. Most importantly, no policy works in isolation.

Localisation and protectionism are not new, but what matters, is how they are implemented. We should be careful not to use localisation to fix our bad economic decisions, while other factors are contributing to our economic woes such as the crises of corruption, energy, and crime. Supporting our local economy should be a priority for each citizen. South Africans will buy locally manufactured goods if the price is fair. The latest inflation rate reports have shown that consumers are financially strained and that for businesses, the costs of production have increased owing to electricity, logistics, and labour costs. The higher the cost of production, the more we will fall short in global economic competitiveness; ultimately, this will lead to the localisation agenda being a failed policy.

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ILLICIT FUEL TRADE IN SIN TAXES AND THE EFFECT ON COMPLIANT TAXPAYERS

15 minutes

MANGADI DIKOTLA, Head of Tax for TotalEnergies Marketing SA

This article highlights the nature of illicit fuel trading in sin taxes and its effect on companies, society, and the environment.

According to the report published by Transnational Alliance to Combat Illicit Trade (TRACIT) in collaboration with the UN Conference on Trade and Development (UNCTAD), it is estimated that US$133 billion worth of fuel is lost due to theft, adulteration, and fraud. South Africa is currently experiencing an increase in illicit fuel trade due to the rising fuel prices and the impact of the COVID-19 pandemic. The illicit fuel trade is not widely publicised compared to the illicit trade in tobacco and alcohol, despite the fact that the fuel levy is the fourth biggest contributor of tax revenue to SARS.

Illegal mixing of diesel with paraffin termed 'adulteration'

It is commonly known that paraffin is cheaper than diesel, the poor uses it for cooking and lighting; consequently, it is tax-free. Chemically, diesel is very similar to paraffin. As a result, unscrupulous fuel traders tend to illegally dilute it with paraffin, selling the product as diesel to make huge profits. Most consumers and fuel traders cannot tell the difference between legal and illegal diesel, even if they can see or smell it. However, if the price of diesel is very cheap compared to that of competitors, it should raise alarm bells as one may be buying adulterated diesel.

According to the Department of Mineral Resources and Energy (DMRE), the volumes of paraffin sold during the past five years have increased dramatically from approximately 600 000 litres to just over 1 000 000 litres per year. This could be due to the use of paraffin in diesel. The illegal mixing of diesel with paraffin robs the poor of the fuel that they use for cooking and lighting. It also undermines the government's efforts to incentivise the poor by making paraffin tax-free so that it is easily accessible and affordable. For motorists, the use of adulterated diesel can cause engine damage that could result in increased repair costs and lower fuel efficiency, leading to increased air pollution.

Section 37A was added to the Act to compel manufacturers and importers of paraffin to blend paraffin with an invisible tracer marker so that, should it be mixed with diesel, its presence can be detected if diesel is tested. Section 37A(4)(a)(i) of the Act provides that *"no person shall mix any marked goods (paraffin) in any proportion with diesel"*. Through its Road Fuel Testing Unit (RFTU), SARS can enforce section 37A by testing diesel at any facility, including the roadside, to check for the presence of any paraffin. Furthermore, section 37A(4)(b) of the Act says that *"Any person who so mixes or uses or sells or disposes or acquires or possesses any marked goods shall be liable for the payment of an amount not exceeding the duty that may be leviable on diesel . . . "*.

"According to the Department of Mineral Resources and Energy (DMRE), the volumes of paraffin sold during the past five years have increased dramatically from approximately 600 000 litres to just over 1 000 000 litres per year. This could be due to the use of paraffin in diesel"

- The contravention of section 37A(4)(a)(i) of the Act is considered a serious offence in terms of section 80(1)(a). Anyone found guilty of this offence could receive: a fine not exceeding R20 000 or three times the value of the goods, whichever is the greater; or imprisonment for a period not exceeding five years; or both a fine and a prison sentence. It is clear that the contravention of section 37A is not only limited to traders but includes those found to be using or in possession of the adulterated diesel — unless they are able to prove otherwise.

Outright fuel theft from Transnet's multi-product pipeline

Transnet operates a multi-product pipeline that transports petroleum and gas on behalf of its customers. The pipeline spans over 3 000 km across five provinces and pumps about 100 million litres per week. Apparently, criminals illegally connect to the pipeline or tamper with the valves and steal the fuel. Transnet has been losing fuel of about 27 million litres during the financial years from 2020 to 2022. At the current average price of R25 per litre, this is more than a R600 million loss. Moreover, tampering with high-pressure pipelines is dangerous, especially to those people living in areas nearby the pipelines, since it can lead to fires and explosions that can result in death.

In addition to infrastructure damage and health risks, fuel-theft incidents can also cause massive environmental damage due to diesel spilling into farmlands and rivers.

A further impact of fuel theft is that oil companies might face unfair competition and might have to carry the cost of stock losses; Transnet is likely to pass those costs on to its customers by increasing pipeline tariffs. The Transnet Pipeline stated in its 2021 financial results that the fuel theft incidents had the following impact on its operational performance: lines being shut down for repairs, environmental costs for spillage clean-up as required by law, and increased security costs. Some of the stolen fuel is sold locally, resulting in large amounts of discounted diesel. Stolen fuel is also smuggled out of the country by using fake customs declarations.

Smuggling fuel into South Africa

Smuggling fuel into the country only occurs on a very small scale; this normally happens through the Maputo corridor via tanker trucks. However, it can generate large returns for criminals owing to significant price differences, currency imbalances, and forgery of customs declarations. Fuel products coming from Mozambique are mostly priced in US dollars and are sometimes much cheaper compared to South African products. Therefore, dollar and fuel price fluctuations in South Africa can sometimes generate substantial profits for illegal fuel traders.

For imports from Maputo, fake customs documents are used to smuggle fuel into the country. In November 2020, SARS issued a statement that:

> *"it won a case against Drontech Engineering (Pty) Ltd (case not publicised) regarding illegal fuel import. The Gauteng High Court in Pretoria has upheld the seizure by SARS of the horse and trailer used for the transport of fuel unlawfully imported into South Africa. SARS has similarly seized the fuel and the court has also upheld SARS' seizure in that regard. This was after SARS found that the fuel was unlawfully imported into South Africa by means of the truck and trailer, and that the truck and trailer had also been used on previous occasions to smuggle fuel from Mozambique into South Africa. In all instances, the fuel was declared and ostensibly destined for Zimbabwe, but was introduced into the South African market without the applicable taxes and fuel levies having been paid. Find the SARS press release here (judgment publication pending)."*

Ghost fuel exports or round-tripping

Another type of illegal fuel trading used by criminals to make money is called 'ghost exports' or 'round-tripping'. The illegal traders' fake customs declarations state that they exported fuel, yet the goods had never left the country. Some illegal traders even collude with customs officials so that trucks can cross the border and drive back into the country with the same fuel.

Compliance requirements have become stringent and burdensome, causing cash flow constraints, especially for bunkering businesses and non-integrated fuel companies (non-refiners) as they are subject to refund claims. Most of these businesses are almost disappearing from the export market. *In Tunica vs Commissioner of SARS,* Tunica applied for a refund of excise and fuel levy in November 2014. The court decided in April 2022 in Tunica's favour and SARS was advised to reconsider its decision to refuse the refund. Tunica might still be in business, even after almost ten years of not having been paid the refund, but one wonders what impact this has had on Tunica's business.

Conclusion

Currently, the fuel price includes fuel taxes of just over R6 per litre payable to SARS. Small differences in the fuel price can generate substantial profits for illegal traders due to the amount of fuel consumed. Fuel tax is payable to SARS at source, termed 'Duty at Source' (DAS), when fuel moves out of the manufacturing warehouse but not at the sales or consumption point.

DAS is mainly payable by oil refiners, i.e. TotalEnergies, Sasol, BP, etc. since they are registered as licensed customs and excise manufacturing warehouses in terms of Customs and Excise Act no 91 of 1964 (the Act) because they are in the business of manufacturing petroleum products. Diesel is not regulated, which means that the government does not set the price; the retail price at the pump consequently differs from one service station to another, whereas petrol is regulated. Therefore, customers should be wary of diesel prices that are much lower than those of competitors.

The government is losing millions of rands in tax revenue that could be used for public services and investment in infrastructure. Oil companies are also losing millions of rands in revenue owing to unfair competition and their reputation may be unfairly tarnished. Illicit fuel trading robs the country of job-creation opportunities and threatens existing jobs; therefore, it has a negative impact on economic growth. In conclusion, the government should work together with the oil industry to develop a policy framework that prioritises compliance with taxpayers while simultaneously managing and combating illicit trading.

ESTIMATED ASSESSMENTS AND THIRD-PARTY DATA–FUTURE TRENDS

SOMAYA KHAKI, Project Director: Tax Administrative Advocacy at SAICA

In early 2020, SARS announced its Vision 2024: the start of its journey towards a 're-imagined SARS of the future' where SARS' work will increasingly be informed by 'data-driven insights, self-learning computers, artificial intelligence and interconnectivity of people and devices'.

The advent of the COVID-19 pandemic-related lockdowns, and the shift to remote working accelerated this Vision 2024 process, resulting in significantly more automation of services over the last couple of years than initially planned.

Introduction of 'estimated' assessments and how it works

For the individual taxpayer and related third parties, one of the bigger components of Vision 2024 deals with the issuing of automated assessments for certain individual taxpayers, something which SARS first introduced in the 2020 Filing Season. For the first time this year, SARS has issued these estimated (auto) assessments as 'estimated assessments', which SARS believes it is empowered to do in terms of section 95 of the Tax Administration Act, 2011. It is questionable as to whether this is the correct interpretation of that section, which requires that SARS issues an assessment based on an estimate in instances where taxpayers fail to timeously submit returns or relevant material.

Concerning the process, SARS currently uses the information submitted by third parties, including employers, medical schemes, financial institutions, attorneys, estate agents, etc. to generate these estimated (auto) assessments. Currently, this is facilitated by the creation of an estimated tax return on eFiling. With regard to the public notice to submit returns, the taxpayer's gross income, exemptions, deductions, and rebates reflected in the records of the Commissioner must be complete and correct.

Where this is not the case, the taxpayer must complete and submit a return. Taxpayers are therefore expected to check the information; if in agreement, no further action is required. If the taxpayer believes that the information is incorrect or incomplete, a corrected return must be submitted within a specified timeframe. Ultimately, while SARS is 'automating' the process, the responsibility of ensuring the accuracy and completeness of the related information still falls on the taxpayer. This includes engaging third parties if there is a deficiency in the information reported to SARS — often not a simple task.

> *"In terms of the frequency of reporting, SARS is working towards a requirement of monthly submissions of data by all third parties currently obliged to report, as well as those who will be obliged to report to SARS in the future"*

Third-party data improvement on timing and accuracy

Based on engagement with SARS, it does seem that third-party data submissions are improving regarding timing and accuracy. SARS has also advised that it will take a harsher stance on non-compliance by third parties. This is obviously necessary to ensure that the correct information is available in a timely manner to issue an estimated (auto) assessment at the commencement of the filing season. Currently, specified third parties are, *inter alia,* obliged to submit such returns annually prior to the commencement of the tax filing season.

Who is subject to 'estimated' assessments?

Theoretically speaking, it should only be those individuals receiving remuneration income and income from third parties obliged to report to SARS, who should be subject to the auto-assessment process. However, this is not always the case, as there are taxpayers in receipt of other types of income or who historically claimed allowances or deductions, who seem to be inadvertently caught in the auto-assessment net. As the years progress, SARS will be refining the process to ensure that it impacts only those who fit within the appropriate parameters.

SARS' plans for the near future

Despite reservations as to whether current legislation allows SARS to issue such estimated assessments upfront, it seems that this process is here to stay. SARS is actively working on expanding the pool of data that it uses to prepopulate returns and to increase the frequency of third-party data submissions.

Regarding the expansion of data being collected, SARS is working on business requirement specifications to facilitate the declaration of resident trusts by trustees; of amounts vested in beneficiaries of these trusts; and of donations received by approved 18A institutions and related donors. The collection of this kind of data will presumably contribute to reducing the instances of incorrect or non-disclosure in relation to income vested in trust beneficiaries and fraudulent claims of donations.

Concerning the frequency of reporting, SARS is working towards a requirement of monthly submissions of data by all third parties currently obliged to report, as well as those who will be obliged to report to SARS in the future. The intention of this requirement is to move towards a situation where third-party data will be reported monthly in 'real-time' with details of the information and related tax calculations available to taxpayers on a new SARS application (App) to be developed as part of Vision 2024. If any tax is due for a particular month, payment may be facilitated via the App.

It seems that the idea is for an effective tax rate to be calculated considering all income and deductions in respect of the taxpayer. This is to ensure more accurate and timely calculation and collection of tax or payment of refunds on a monthly basis as opposed to the current annual assessment process applicable to individual taxpayers. This could include provisional taxpayers whose only income is sourced from third parties who are obliged to report such information to SARS.

At this stage, it is not clear how this will impact taxpayers who receive income from other sources unless SARS relies on affected taxpayers to accurately and completely report this on a monthly basis. This is not always possible for the ordinary taxpayer who may rely on others to prepare such information which, realistically speaking, is sometimes only finalised close to or even after the current filing season deadlines. It is also questionable whether taxpayers are fully aware of their obligations from a tax perspective.

The 2022 Budget proposals referred to a review of the provisional tax system given changing circumstances and international developments. A discussion paper on this subject is to be published — the timing of this is not yet clear. It may well be that this review will include changes to give effect to SARS Vision 2024, but we will have to wait and see. As we understand it, the ultimate 'vision' is for no filing season from the year 2025 onwards.

Ongoing stakeholder engagement and involvement

It is encouraging that SARS is engaging with various stakeholders during the process of designing and implementing Vision 2024. However, despite reservations regarding the proposed timing; the impact on some of the smaller, under-funded third parties; the maturity of the taxpayers; and whether there must be legislative changes to realise SARS' vision, it seems that many changes will go ahead in accordance with SARS' proposed timelines.

It is imperative that stakeholders use the engagement opportunities to effectively address potential challenges in order to ensure the actualisation of a realistic vision for the benefit of the country.

TAX OMBUD'S ROLE **IN THE COMPILATION OF TAXPAYERS' RIGHTS**

PROF THABO LEGWAILA, Chief Executive Officer of the Office of the Tax Ombud

Human rights are basic rights that belong to all of us simply because we are human. They embody key values in our society such as fairness, dignity, equality, and respect. They are an important means of protection for all, especially those who may face abuse, neglect, and isolation.

Special categories of rights exist for the protection of people in special groups such as children, women, and workers as well as the LGBTQ+ community and even arrested or convicted persons. Another special category of persons, namely taxpayers, finds its members in a special situation where tax administrators, collectors, and authorities are more often than not bestowed with excessive powers to enable them to collect taxes. Mostly, these powers are bestowed justifiably because there are 'taxpayers' who invest a lot of time, energy, and effort in cheating the systems by not paying their taxes, not paying their taxes on time, and the like. At the same time, care always needs to be taken in administering the laws and exercising the powers bestowed accordingly. Yes, taxpayers should have rights. Taxpayers do have rights. Simply because they are taxpayers. And not only should those rights be respected, but they should also be protected. This has been acknowledged from time immemorial when taxpayer protection rules such as the *contra fiscum* rule, were coined.

When it comes to rights, the adage 'knowledge is power' cannot be more apposite. A person who does not know their rights is as disempowered as a person who does not have rights at all. And it is in this spirit that the Office of the Tax Ombud (OTO) issued a Compilation of Rights, Entitlements, and Obligations (the Compilation) in a simple, concise and easy-to-read reference guide. This is the OTO shouting the often quoted blurb 'know your rights' out loud. Thus, the Compilation is an empowering tool for those who do not know that they have rights or what those rights are and entail.

- A tax system can only be 'mature' if, on the one hand, it invests its resources by ensuring that all taxpayers pay their fair share of the tax liability and by not punishing the tax-compliant taxpayers because they are easy and effortless low-hanging fruit. On the other hand, it can ensure that compliant taxpayers are aware of and can exercise their rights against the tax authority in the quest for equality, fairness, dignity, and many other rights embraced in an improved and consequently healthy tax citizenry with high tax morality. Therefore, in a healthy tax system, the tax administrator does not take advantage of taxpayers' lack of knowledge of the complex tax laws, interpretations, and calculations to collect more to meet financial targets — it seeks to maintain taxpayers' fairness and dignity by informing, educating, and even assisting taxpayers to determine the correct amount of tax payable by the taxpayer and not a cent more or less.

"Yes, taxpayers should have rights. Taxpayers do have rights. Simply because they are taxpayers"

The Compilation by the OTO does not and seeks not to create rights and entitlements or obligations. It acknowledges that most taxpayers do not know these rights and entitlements; therefore, it puts them out there for easy access by taxpayers. These rights are contained in many provisions of various pieces of legislation, mainly in tax Acts and in the Tax Administration Act of 2011 (TAA).

The salient difference between SARS's Service Charter (the Charter) and the Compilation is that the gist of the Charter comprises commitments made by SARS, some of which relate to legal obligations, whereas the Compilation refers taxpayers to specific legal provisions that state how SARS and taxpayers must conduct themselves. Basically, in the Charter, SARS sets itself targets of service delivery in terms of which SARS publicly states that it will perform as required by law in a range of between 50% and 90% of the time (i.e. in 5 out of 10 times to 9 out of 10 times). Therefore, it follows that when it concerns Alternative Dispute Resolution, for example, SARS acknowledges that in 50% of the cases, it may not comply with the very laws that it is set to administer. This could be because of a shortage of resources, managing taxpayers' expectations, or any other reason. Whatever the reason, this further perpetuates the imbalance in power dynamics because a taxpayer who complies only up to 90% of the requirements or time, often receives a 100% share in the consequences. For example, if a VAT vendor makes a commitment to only file or pay 9 out of 10 of its VAT returns or liabilities respectively within the prescribed period, that one return or late payment will be met by automatic penalties and interest accruing as well as SARS's collection steps, which could include a civil judgment being instituted.

Some of the taxpayers' main concerns which the Charter does not address are consequence management and accountability. Taxpayers would like to know what sanctions, if any, befall negligent SARS employees. For example, the person who fails to approve or pay a refund on time or a person who issues a third-party appointment without following the right process. Non-compliant behaviour by taxpayers is met with hefty and often automatic punitive measures, whereas non-compliant behaviour by SARS carries no apparent repercussions.

The question that this article seeks to answer is whether these documents hit the mark in defending the taxpayers' rights without hindering enforcement. Enforcement needs to be correct and accurate. SARS, being a creature of statute and governed by statutes, has a legal obligation to comply with the laws. Enforcement that is contrary to laws or that breaches the laws is simply illegal! This was confirmed in the *SIP Project Managers (Pty) Ltd v C:SARS [2020] ZAGPPHC 206* at par 26, where the Court stated that even if a valid debt exists, SARS could not be excused if it had used an unlawful process to collect that debt. In this case, SARS was ordered to repay an amount recovered in a manner contrary to the prescriptions of the Tax Administration Act (TAA), even though SARS could immediately take collection steps again.

On the one hand, the Compilation seeks to assist SARS in creating or enhancing the balance from which SARS and taxpayers comply with the law and are both accountable for their actions or lack thereof. Thus, it is more of an enabler than a hindrance. On the other hand, the Charter seeks to enhance tax administration by pledging to taxpayers the level of service that the taxpayers can expect from SARS in administering the laws. The level of service is of concern to the OTO and the OTO is in discussions with SARS in this regard. Unfortunately, though, these documents are only informative; they cannot defend taxpayer rights. Ultimately, it is up to taxpayers to enforce and protect their rights from infringement, as in the case of SIP Project Managers.

MANAGING DEBTS

IN A BARELY POST-COVID-19 ECONOMY

30 minutes

BENJAMIN MBANA, Director and Head of tax at Allen & Overy (South Africa) LLP

As we move into a post-COVID-19 era, South African businesses, especially small to medium-sized businesses, are still trying to recover from the shocks of the pandemic and the civil unrest of 2021.

In this post-COVID-19 economy, the economic recovery of many businesses will largely depend on their ability to manage their expenditure and, in particular, debts that arose during the pandemic. However, the government's recent tightening of the rules on interest deductibility and limitation of assessed losses may result in increased tax liabilities, forcing businesses to redirect any profits that they are starting to recover.

Why the government ventured to change how companies are taxed in South Africa

In the 2020 Budget Review by National Treasury, the government initially proposed: (i) a limitation of assessed losses under section 20 of the Income Tax Act No 58 of 1962; and (ii) a tightening of the interest deduction limitation under section 23M of the Tax Act. However, these proposed changes were delayed due to the COVID-19 pandemic and the civil unrest of 2021 after the government recognised that many businesses were in survival mode and could not immediately cope with more taxation. The changes are primarily designed to enable the government to lower the corporate income tax rate from 27% to 26% on a fiscal neutral basis while also tightening South Africa's anti-avoidance rules. These changes will most likely help the country expand its tax base, promote increased investment, and increase corporate tax revenue collections.

However, the changes are unlikely to be very popular with the business community. Whereas these changes are not necessarily devastating for start-ups and smaller businesses, the country's medium to larger businesses would especially need to consider the impact of the changes on their tax position and start planning to manage their future tax liability effectively.

"As part of the tax amendments contained in the Tax Laws Amendment Act no. 20 of 2021, section 20 will now restrict the offset of the balance of assessed losses carried forward to the higher of R1 million or 80% of a company's taxable income"

Limitation on utilisation of assessed losses

Before changes were made to the rules on the utilisation of assessed loss balances (section 20 of the Tax Act), the law said that South African corporate taxpayers were permitted to use the full balance of an assessed loss to shield their taxable income in a year, provided that all the requirements of section 20 are met. Now, section 20 will restrict the offset of the balance of assessed losses carried forward to the higher of R1 million or 80% of a company's taxable income as part of the tax amendments contained in the Tax Laws Amendment Act no. 20 of 2021. These provisions will only apply to corporate taxpayers if they are in a positive taxable income position, that is, if they had made a tax profit that year. Depending on the amount of the assessed loss brought forward, taxpayers may be subject to income tax on a minimum of 20% of their taxable income calculated for any year of assessment. This is especially relevant if we consider the commodities boom in 2020/2021, which resulted in significantly increased profits by corporate taxpayers. In the past, these profits would not have been accessible to the government; they would be shielded by large assessed loss balances resulting from high long-term costs that some companies incur to become fully operational.

In what might be described as a victory for the private sector, the government took heed of requests to delay the implementation of the changes to give all businesses more time to recover from the pandemic and to cut small businesses with small profits slacker.

As a result, the revised rules will only be effective for years of assessment ending on or after 31 March 2023 and the 'de minimis rule' of R1 million was included. The 'de minimis rule' will benefit small to medium-sized taxpayers who experience cyclical profitability such as emerging farmers, seasonal tourist businesses, or new small businesses, which will initially incur tax losses with incremental profits as the business picks up.

Here is a simple example of how the 'de minimis rule' works: Company A had an assessed loss of R1.5 million in the first year and generated a taxable income of R1 million in the second year. The balance of the assessed loss that it may set off against its taxable income in the second year is limited to the higher of R1 million or R800 000 (80% of its taxable income). The full taxable income of R1 million in the second year will be absorbed by the assessed loss brought forward — no tax liability will arise. The excess assessed loss amount of R500 000 will be carried forward to the following year of assessment and set off against Company A's taxable income in that year.

Tightening of interest deduction limitation rules

In recent years, a key focus of the government has been to minimise the erosion of the South African tax base. In this regard, National Treasury has sought to amend the domestic anti-avoidance rules to limit the use of various funding mechanisms in reducing the tax liability of companies. The legislative changes are largely influenced by the Organisation for Economic Co-operation and Development's (OECD) 2015 final report on Action 4 of the Base Erosion and Profit Shifting Project:

- *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments.* Section 23M forms part of the domestic anti-avoidance rules contained in the Tax Act. It limits the deduction of interest in a South African debtor company's hand where the creditor is (i) not subject to tax on interest in South Africa; and (ii) in a 'controlling relationship' with the debtor. A 'controlling relationship' will arise where a person directly or indirectly holds at least 50% of the equity shares in a company or at least 50% of the voting rights in a company. The interest, which is not deductible, may be carried forward to the following year of assessment.

  These provisions generally apply in circumstances where the creditor is a foreign holding company of the South African debtor and is not subject to tax on the interest income from South Africa. In contrast, the debtor would be allowed to deduct the interest against its taxable income, thus reducing the group's tax liability; such structures result in the erosion of the South African tax base.

  The provisions can also apply where the creditor is a South African tax resident company that is exempt from tax. For instance, if it is a Public Benefit Organisation and has a controlling relationship with the debtor.

  The amendments to section 23M will, *inter alia*, have the following impact:
  - The definition of the term 'interest' will be broadened. Section 23M will now also apply to interest rate swap agreements, the finance cost element of finance leases, and foreign exchange differences. This change is meant to prevent companies from reclassifying payments that are economically equivalent to interest in an effort not to fall within the provisions of section 23M.
  - Back-to-back loan arrangements, which previously allowed taxpayers to circumvent the application of section 23M, will now fall within the provisions.
  - In the case of creditors who are subject to interest withholding tax at a reduced rate under a double tax treaty, the limitation under section 23M will apply to the extent that the creditor is not subject to a reduced withholding tax rate under a double tax treaty. This means interest, which previously would not have been subject to section 23M on the basis that it was subject to tax in South Africa, will now partly fall within the ambit of section 23M. This change is significant as it will result in more cross-border interest-bearing loans being subject to section 23M.
  - In line with the recommendations of the OECD Report on base erosion and profit sharing (BEPS) Action 4, the net interest expense deductible by companies will now be limited to 30% of their tax earnings before interest, taxes, depreciation, and amortisation (EBITDA).

These changes will require South African multinational groups to carefully consider the tax leakage that may arise because of using internal debt funding to fund the South African operations, where those operations are generating low profits. This consideration will be particularly important to foreign companies looking to set up new operations in South Africa.

Similar to the assessed loss provisions amendments, the revised rules will be effective for years of assessment ending on or after 31 March 2023.

A final assessment

Aside from small businesses and entrepreneurs, businesses still trying to recover from the COVID-19 pandemic will have to reconsider their economic recovery plan as these changes will likely have an impact on them.

Only time will tell the extent to which these amendments will have an impact on businesses. Meanwhile, it is in all companies' interest to accept the changes and to start managing their cash flows now so that they can survive the first round of payment of new taxes that may be applicable.

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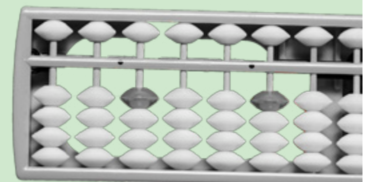

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NAVIGATING THE FAST-CHANGING ELECTRONIC SERVICES LANDSCAPE:

A LOOK AT THE CURRENT VALUE-ADDED TAX CONSIDERATIONS

▶ **SUZANNE VAN DER MERWE,** Director in the Deloitte Africa Tax & Legal

There is no doubt that technology continues to evolve rapidly and revenue authorities are globally taking definite views on the tax treatment of electronic services. We have seen some significant changes in the interpretation and application of the value-added tax (VAT) legislation pertaining to electronic services in South Africa.

Entities from all industries, far wider than the traditional technology companies are being impacted, especially multinationals. As the South African VAT legislation does not contain a business-to-business exclusion, this substantially widens the VAT net from the very beginning. As a result, entities that do not have registration obligations in other jurisdictions may have a liability to register in South Africa.

Below are some of the key considerations and current developments in respect of the South African VAT legislation pertaining to electronic services.

Differing schools of thought on 'electronic services' when a service is performed by a person

VAT on electronic services aims to tax all services supplied by means of an 'electronic agent', 'electronic communication' or the 'internet'. The definition of an 'electronic service', as contained in the prescribed Regulation, published in Government Notice 429 of 18 March 2019, is intentionally broad to cater for an evolving industry. In recent years, however, two very different viewpoints have developed regarding the interpretation of this definition.

Upon closer examination of the definition of 'electronic services' and the terms used therein; one could conclude that there is a commonality in that they all involve the communication of data in electronic form ▶

"Upon closer examination of the definition of 'electronic services' and the terms used therein; one could conclude that there is a commonality in that they all involve the communication of data in electronic form not conducted by a natural person"

not conducted by a natural person. This school of thought does not view the mere electronic delivery of a service performed by a person as an 'electronic service'; it considers not only the manner of the supply but also the content of what was supplied. Thus, on the one hand, the mere fact that a service is performed by a person and simply delivered by electronic means does not result in that service being an 'electronic service' as defined.

SARS, on the other hand, applies a broader interpretation of the definition which views all services that are delivered electronically to qualify as an 'electronic service'; it focuses on the way in which the supplies are being delivered to the recipient rather than the content of the supply. As such, a service that involves significant participation of a person and minimal communication of data in electronic form such as a helpdesk or the drafting of a legal opinion, could be considered to be 'electronic services', where those services are provided using electronic forms of communication, e.g. telephone, email, etc. This view is contrary to the explanatory memorandum of 18 March 2019 about the regulations prescribing electronic services in order to define 'electronic services' in section 1(1) of the Value Added Tax Act, 1991 (the Act). The policy intention of the new regulation is to "subject to VAT those services that are provided using minimal human intervention, for example, legal advice prepared outside the Republic by a non-resident and sent to a person in the Republic via email, will not be subject to these regulations".

The limited application of the group exclusion

Where the group company exclusion applies, supplies are not considered to be electronic services as defined. For this exclusion to apply, however, very specific requirements have to be met. The first hurdle relates to shareholding, where a minimum of 70% shareholding is required within certain parameters.

The second hurdle is more complex as the non-resident entity itself is required to supply the services exclusively for the purpose of the resident entity consuming the services. The revenue authority currently applies a very narrow interpretation of this second test. According to the Frequently Asked Questions Guide (FAQ Guide) on Supplies of Electronic Services (Example 3 and Example 8 of Question 20) issued by SARS, the electronic service must be exclusively discovered,

devised, developed, created, or produced by the non resident. If any of the elements of the service is acquired or procured from another party and not exclusively produced by the non-resident entity, the group company exclusion may not apply based on the narrow interpretation of the legislation. This would also be the case, even in instances where a non-resident is contractually responsible to deliver services to the local recipient and procures part of the services from a third party. The non-resident cannot procure any supplies from third parties in order to make its supplies to the local recipient.

Management fees or royalty charges typically include shared information technology costs, centralised support, and human resources platforms, among other operational costs, all of which are negotiated at a group level and charged to group subsidiaries. These services, in respect of which some element was acquired from a third party, would need to be carefully analysed to determine whether this or any other exclusion would apply.

Intermediaries accounting for VAT on behalf of the principal — no free pass

When certain requirements are met, the intermediary of a supply (i.e. a person who facilitates the supply and issues the invoice as well as collects the payment) has an obligation to account for VAT if the non-resident principal supplier of the electronic service is not registered for VAT in South Africa. In terms of the SARS FAQ (Question 26), the non resident principal supplier could still be required to register for VAT when the registration requirements are met, irrespective of whether an intermediary has accounted for the VAT on the principal supplier's behalf. The principal supplier is thus not released from its liability to account for VAT where an intermediary has done so on its behalf. This could lead to double taxation, where the principal supplier and non-resident are not aligned and where the intermediary continues to account for VAT where the principal supplier is a registered VAT vendor.

In contrast, section 54(2B) of the Act provides for 'intermediaries' to be *deemed the principal supplier* of electronic services in specific circumstances. It does not hold the principal supplier liable once the intermediary has accounted for its transactions.

In addition, the legislation dealing with intermediaries has limited application as detailed above. This creates difficulties for intermediaries required to be registered for VAT and to issue tax invoices on behalf of multiple principals, some of whom are registered, some not, and some required to be registered. This needs very sophisticated and expensive system capabilities that can isolate these transactions. This also creates significant room for error where only some transactions are accounted for, whereas others need to be excluded.

For this reason, proposals were made for legislation to be introduced for intermediaries or agents making supplies on behalf of a principal supplier to ensure that the output tax is declared and that related input tax is claimed, regardless of the registration status, or the principal, or the place where the supply takes place. This would limit the risk of non-compliance and relieve some of the practical difficulties experienced.

Intermediaries and the proposed amendment to section 23 of the Act

The draft Explanatory Memorandum on the Taxation Laws Amendment bill, 2022 (the Bill) issued on 29 July 2022, states that before 21 July 2019, the Commissioner issued rulings to foreign entities, which formed part of a group of companies, to allow one of the group companies registered as a vendor to register a branch in South Africa. This branch entity was allowed to account for VAT and submit a single VAT return on behalf of the entire group of foreign entities. It is generally accepted that such an entity is much better able to account for VAT on behalf of the group of companies and perform the various administrative responsibilities that accompany such liability.

- It is therefore proposed that section 23 of the Act be amended and that a new subsection (2A) be inserted. This new section will allow the resident registered vendor to register a single branch registration in respect of the entire group of foreign entities that form part of the same group of companies. Currently, it is proposed in the Bill that this amendment will come into operation on 1 January 2023.

It is assumed that where a local group entity, which also performs activities as intermediary as defined in the Act, will be able to engage the benefits of this new section. Thus, even where the group of foreign entities each have an independent liability to register for VAT because of supplies of electronic services, the local intermediary, where it is part of the same group, can register a branch and account for the VAT on behalf of the group.

When looking back to the policy intention of the legislation, the imposition of VAT on non-resident electronic services suppliers was done to level the playing field with local suppliers. The legislation in South Africa and globally, however, continues to evolve and requires input from all stakeholders to create a neutral and equitable landscape where the VAT law is effective and efficient — leading to certainty and fairness among all taxpayers.

THE ORDINARY CASE OF SHARE BUY-BACK TRANSACTIONS

▶ **ITUMELENG NKADIMENG,** Partner (Director), KPMG Services

In essence, a share buy-back is a transaction whereby a company enters into an agreement or arrangement to buy back the shares held by one or more shareholders for cash consideration. A share buy-back transaction will typically be funded from the company's distributable reserves or structured as a return of capital. In some instances, the transaction may be funded as both a combination of return of capital and distribution, i.e. a portion of the consideration to be paid back to the shareholders will be funded from distributable or cash reserves (paid for as a dividend) and the balance will constitute a return of capital.

Assuming that the shareholders had originally acquired the shares with a capital investment intention and that the shares, therefore, do not constitute trading stock, the share buy-back transaction entered into would result in the realisation of a capital asset in the hands of the shareholder. Stated differently, the share buy-back would result in the transfer of the shares from the shareholders back to the company and in the termination of ownership of such shares in the shareholder's hand which, from a tax perspective, should qualify as a disposal.

The 'tax benefit'

A disposal event will trigger a capital gains tax event, which may or may not give rise to a taxable capital gain or loss. Structuring a transaction in the manner contemplated in any of the scenarios or alternatives highlighted above generally gives rise to a favourable tax position. This is because of the following reasons. ▶

- Proceeds funded by means of a return of capital will generally be equal to the base cost (acquisition cost) of the shares. The effect of this is that no capital gain or loss would be triggered; consequently, no adverse capital gains tax costs should arise on disposal. From a South African tax perspective, when structuring a transaction as a return of capital, one must pay attention to the concept of 'contributed tax capital' as defined in section 1 of the Income Tax Act No. 58 of 1962 (the 'Income Tax Act'). Cost to company (CTC) is essentially the share premium or stated capital of the company determined per class of share. The significance of this is that where a company makes a distribution in the form of a return of capital to a shareholder, such distribution will be determined as an amount which is in accordance and pro rata with the total CTC of that specific class of shares in which a specific shareholder holds shares immediately before the distribution. The return of CTC to a shareholder should not trigger any income tax costs. We explore and discuss the concept of CTC in more detail below.
- Proceeds, whether fully or partially received on realisation of the assets that are funded from unrealised reserves and distributed as a dividend by the company to the shareholder, will be subject to dividend withholding tax (DWT) at a rate of 20% levied on the 'beneficial owner' (i.e. the shareholders) of the share. The DWT rate is much lower than the corporate tax rate, currently at 28%. In the instance where the shareholders qualify as South African resident companies, the dividend will be exempt where certain administrative requirements are met.

While there might be other commercial reasons for instituting a share buy-back transaction, such as to improve the financial ratios of the company, it is not uncommon that a transaction of this nature is entered into to facilitate an exit or realisation of shareholder's investment in anticipation of a sale or restructure. The effect of a share buy-back, where such buy-back is limited to a specific shareholder(s), is that it restores the number of available shares in the 'market' that is available for sale.

As with other transactions, a buy-back transaction could have been implemented differently. An example of this is where a buy-back transaction is implemented in anticipation of facilitating, for example, a sale transaction — the shareholders could have directly disposed of their shareholding in the company to proposed buyers through a sale and purchase agreement. However, one must be reminded that taxpayers are entitled to structure their affairs in a tax-efficient manner.
So why all the fuss?

Reasons for introducing a CTC definition

Perhaps it may be useful to start at the beginning. Given the direct and indirect dependency of the company law principles and definitions and the need to align with the implementation of the provisions of the Companies Act No. 71 of 2008 (the 'new Companies Act') which extended to the modernisation of the capital maintenance rules for determining dividends, the concept of CTC was introduced into the Income Tax Act with effect from 1 January 2011.

An important aspect relating to the introduction of CTC as part of the income tax provisions, which largely remains a tax concept, was its exclusion from the definition of a dividend — amounts transferred to shareholders that resulted in the reduction in the CTC of a company.

Thus, regarding the fact that a company can make a distribution to shareholders in the form of either a dividend or a return of capital, the introduction of the CTC provisions made it clear that the proportionate return of capital, namely the amounts contributed to the company in exchange for the issue of shares, would not result in an amount to be taxed. Put differently, only distributions in excess of the pro rata proportion will be deemed to be dividends and taxed as such under the DWT provisions.

Clarification of the CTC legislation

As noted above, the return of capital in the form of CTC is limited to a shareholder's pro rata share of the total CTC within a specific class of shares. However, it appears that the simplicity of the CTC provisions resulted in some 'abuse' by taxpayers.

As part of the Taxation Laws Amendment Act (2021), the amendments sought to amend the definition of CTC through the introduction of a further proviso which included a requirement that *". . . all holders of shares in that class participate in the transfer in the same manner and are actually allocated an amount of contributed tax capital based on their proportional shareholding within that class of shares . . .",*

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excluding the general repurchase of listed shares by companies listed on the Johannesburg Stock Exchange or other South African recognised exchanges. National Treasury noted in its Explanatory Memorandum on the Taxation Laws Amendment Bill (2021) that the reason for the introduction of this proviso was to curb the alleged abuse by taxpayers who allocated CTC to certain shareholders on a share premium basis, which did not apply to all shareholders.

The introduction of this further proviso had unintended consequences and had an impact on legitimate transactions in the market, for example, share buy-back transactions in respect of or implemented in relation to specific shareholders (buy-back transactions not extending to all shareholders).

However, it was subsequently announced that, following public comment and consultation, National Treasury was to postpone the effective date of the proposed amendments to allow for more time for both National Treasury and taxpayers to reconsider the impact of the proposed amendments.

Conclusion

On 29 July 2022, National Treasury has released the draft Taxation Laws Amendment Bill (draft TLAB) for public comment. The draft TLAB is set to clarify the proposed changes to the CTC definition to ensure that the proposed amendments have a minimal impact on legitimate business transactions and specifically address the abuse that they seek to curb. In this regard, the draft TLAB proposes that further proviso to the CTC definition as included in the Taxation Laws Amendment Act (2021) be replaced with the following wording:

> *". . . Provided further that an amount transferred by a company . . . must not comprise a transfer of contributed tax capital unless all holders of shares in that class to which transfers are made within a period of 91 days before or after the date of that transfer are actually allocated an amount of contributed tax capital based on their proportional shareholding within that class of shares . . ."*

- The proposed amendments under the draft TLAB seek to enforce a principle of allocation as opposed to participation, which requires an allocation of the pro rata CTC; this results in a kind of 'lock-in' mechanism of the pro rata CTC applicable to shareholders to whom a transfer is made at a particular point in time, while still allowing room for taxpayers to effect specific share buy-back transactions. However, it is unclear whether the wording of the draft proposed amendment achieves the intended objective.

Therefore, it remains to be seen whether, following the 2022 consultative process, the proposed revised amendments will be enacted in their current form.

"An important aspect relating to the introduction of CTC as part of the income tax provisions, which largely remains a tax concept, was its exclusion from the definition of a dividend — amounts transferred to shareholders that resulted in a reduction in the CTC of a company"

TAX INCENTIVES AND GRANTS: The seemingly difficult road ahea

NADIA K RAWJEE, Executive Director, Uzenzele Holdings and Chairperson of the steering committee on Business Incentives

South Africa's gross domestic product (GDP) growth is expected to remain below 2% in 2023 and 2024, which is well below the required growth to sustain our growing socioeconomic needs.

Tax incentives and cash grants are economic stimulus tools offered by the fiscus to incentivise foreign and domestic investment; South Africa is no different.

The largest pools of incentives and grants in South Africa are offered through;

- the Department of Trade Industry and Competition (the dtic) — R6 billion per annum;
- Sector Education Training Authorities (SETAs) — R3 billion per annum;
- South African Revenue Service (SARS) in collaboration with the Department of Science and Innovation (DSI) and the Department of Mineral Resources and Energy (DMRE), among others; and
- Provincial governments and others.

As the uncertainties and destruction of markets and supply chains brought on by COVID-19 constrained the availability of incentive budgets in South Africa and internationally, countries have taken a step back to re-evaluate their incentives under the following World Bank framework:

The world bank helps countries design and implement incentives strategically

A	B	C	D	E
• Is the incentive conceived to address specific & measurable policy goals? • Is the incentive best suited to address the market ffailure/ obstacle? • Have alternative policy instruments been considered, weighing the advantages, challenges and risks?	• Is the eligibility criteria tied to the specific policy goal? • It is targeting those investors likely to be swayed by the incentives? • Is the eligibility criteria objective and conceived to minimize distortions to competition?	• Is the incentive profit or cost/performance based? • Do the analytics and evidence demonstrate that the benefits outweigh the costs?	• Are incentivised firms subject to frequent review and rigorous monitoring?	• Are there effective safeguards in place to prevent abuses through shifting of incentives? • Does the incentive incorporate a sunset-clause?

Source: *Kronfol, H and James, S. 27 May2021, Taxing Times: The role of investment incentives in economic recovery and growth, World Bank Group.*

This re-evaluation means we are likely to see stricter rules and eligibility — more red tape — and a greater assessment of projects. For applicants looking to access these funds, more rigour will be necessary in determining a project's viability and eligibility for these incentives and grants upfront.

Let us explore how the SA incentives landscape ffairs. In doing so, I shall try to elaborate by using some examples.

Well-defined policy objectives

The South African incentives landscape is becoming increasingly focused on eligibility aligned to: the National Development Plan (NDP) sectors; relevant sector master plans such as the Automotive Master Plan (the drive for 60% local content by 2030); and transformation policy to redress the past by preferring transformed business and businesses that comply with Broad-Based Black Economic Empowerment (B-BBEE).

With an increasing focus on B-BBEE policies, we are seeing ever-increasing compliance requirements, particularly in accessing the dtic's cash incentives. Examples include:

- The Black Industrialist Scheme (BIS) which is only available to 51% black-owned and controlled industrial businesses and requires a minimum Level 4 B-BBEE level of compliance at submission and throughout the project;
- The Automotive Investment Scheme (AIS) which has moved from a Level 8 B-BBEE requirement historically to a Level 4 B-BBEE requirement by 2023; and
- The Critical Infrastructure Programme (CIP) moving from a Level 8 to a Level 6 B-BBEE requirement.

With greater complexity in B-BBEE policy, including sector-codes on one line, if possible and deadlines to apply and implement B-BBEE in a financial year, businesses wishing to access incentives must deliberately work towards their compliance. This results in added pressure and, in some cases, costs to achieve the B-BBEE levels required in order to unlock and benefit from the cash grants and incentives that are available.

Targeted eligibility criteria

Combining economic, industrial, and B-BBEE policy into incentives has deterred the level of investment that an incentive should promote while working in other sectors.

For example, the agro-processing sector's dtic cash grant, the Agro-processing Support Scheme (APSS), has struggled due to the overextension of policies. The APSS grant requires applicants to commit to procuring a minimum of 30% of raw input, including farmed inputs from black suppliers and farmers into the processing facility that is to be funded. Whereas this requirement theoretically promotes both economic, industrial and B-BBEE policy, it fails to address the reality that the primary agricultural sector in SA is largely untransformed and cannot support the 30% requirement. This leaves applicants with good projects unable to succeed in raising the grant.

Whereas the automotive sector's requirement to achieve a B-BBEE Level 4 by 31 December 2023 for eligibility. The tax (APDP2) and cash (AIS) incentives available is creating a lot of stress. It also pushes the sector to find solutions to continue to benefit from these incentives.

The need to achieve Level 4 B-BBEE compliance in the automotive sector has incentivised South Africa's seven Original Equipment Manufacturers (OEMs) to contribute an estimated R2 billion in cash into the Automotive Industry.

The term 'black people' is a generic term which means Africans, Coloureds and Indians
(a) who are citizens of the Republic of South Africa by birth or descent; or
(b) who became citizens of the Republic of South Africa by Naturalisation
 (i) before 27 April 1994; or
 (ii) on or after 27 April 1994 and who would have been entitled to acquire citizenship by naturalisation prior to that date.

Source: https://www.bbbeecommission.co.za/frequently-asked-questions/who-qualifies-as-a-black-person-for-purposes-of-b-bbee/

The Transformation Fund (AITF) is to be reinvested into the sector to support majority black-owned businesses in the automotive value chain. In addition, and more importantly, these OEMs must contribute to market access for these majority black-owned value chain participants.

> *"The need to achieve Level 4 B-BBEE compliance in the automotive sector has incentivised South Africa's seven Original Equipment Manufacturers (OEMs) to contribute an estimated R2 billion in cash into the Automotive Industry Transformation Fund (AITF)"*

The capacity of the AITF could further grow to 35 component manufacturers awaiting the dtic's confirmation of their inclusion in the fund, which will add cash to the fund and include further market access requirements.

Cost effective instruments

The combination of a financially strained balance sheet and income generation in South Africa, simply means that policy makers and instrument designers have a heightened responsibility to make incentives as cost-effective as possible. This has led to incentives moving toward a blended finance approach.

Blended finance is the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries. Blended finance attracts commercial capital towards projects that contribute to sustainable development, while providing financial returns to investors.

Blended finance de-risks Government's participation in projects and crowds in project owners, project stakeholders, private investors and other development funding institutions who are risk takers.

Rigorous Monitoring and Evaluation (M&E)

Whereas South Africa's incentives have M&E built in as a rule, the cost of M&E in some incentives such as the Jobs Fund, can be prohibitive if unbudgeted for by applicants.

Monitoring and evaluation, including the measurement of impact in jobs created and retained; revenue; taxes generated; training provided; waste reduced; renewable energy generated; etc. are the trade-offs or 'costs' of incentives that are far lower than the cost of capital If measurement is not done correctly, the deployment of the incentives could be at risk.

These impacts are what drive macroeconomic improvement and are the scorecard of effectiveness.

Clear Exit Policy

Whereas there are sunset-clauses on most tax incentives, we have found less communication and certainty regarding the life of the dtic and other incentives. Planning is vital in order to access many of these incentives and uncertainty about cash incentives can make this difficult at times.

Rule-based administration and strong governance

South Africa's incentives are already highly rule-based but they have no formal playbook to speak of. The World Bank's focus on a rule-based administrative instrument means more red tape and longer lead times can be globally expected for incentives.

The more an incentive is rule-based, the more people are required to administer it, but many departments are under-staffed. They are finding that many of their most experienced and skilled personnel are opting to move to new departments or the private sector.

All in all, my assessment is that some incentives are working, and others need a rethink. But what is abundantly clear is that applicants require help to understand the requirements and navigate the red tape to unlock billions of rands available to them; in this way, our country can put the allocated incentive budgets to work in the economy.

CONTROLLED FOREIGN CORPORATIONS AND THE FUTURE OF THE BUSINESS ESTABLISHMENT EXEMPTION

▶ **DEBORAH TICKLE,** Adjunct Associate Professor at the University of Cape Town

The Base Erosion and Profit Shifting (BEPS) Action Plan was undertaken to address tax avoidance by multinational enterprises (MNEs). The process which has resulted in the 'OECD Pillar II initiative' has been ongoing since October 2015, following the finalisation and issue of the other 14 (of 15) Organisation for Economic Cooperation and Development (OECD) BEPS Action Plan Reports. Since then, the actions set out in the other reports have been in various stages of implementation by the countries comprising the 'Inclusive Framework' — now almost 140 countries.

The aim of Action 1 was to address 'Tax Challenges Arising from Digitalisation'. However, it was soon realised that 'digitalisation' could not be isolated to any particular industry or activity; rather, it is pervasive in today's business world.

The Action 1 initiative has thus morphed into a much broader project. This now has two elements: Pillar I and Pillar II. Work on Pillar I is ongoing but work on Pillar II, which essentially sets a requirement for the payment of a minimum global tax, has culminated in the final commentary on the Global Anti-Base Erosion (GloBE) Rules, which were released in December 2021 and on their accompanying technical guidelines, which were issued in March 2022.

Once each participating country has enabling legislation, these documents will assist in explaining how to apply the rules to relevant MNE groups and tax authorities. The OECD has indicated that it will still issue an Implementation Framework to further assist tax authorities in implementing and administering the rules.

Pillar II — the minimum global tax rate

After considerable debate, the Pillar II minimum global tax rate currently settled on, is 15%. Thus, relevant MNE groups must assess the effective tax rate paid in each jurisdiction in which they operate; where it is lower than 15%, a 'top up' amount of tax has to be paid by the ultimate parent entity or other intermediaries that are determined by applying one of the defined mechanisms. These comprise the Income Inclusion Rule (IIR) and the Undertaxed Payments Rule (UTPR), depending on the circumstances. A detailed discussion of each of these is beyond the scope of this article; suffice to say that regardless of the method used to determine the effective tax rate paid in each country, the MNE may exclude income that arises from the adequate substance within the jurisdiction.

What is the Pillar II substance-based income exclusion?

The substance-based income exclusion is dependent on a numerical calculation of the extent to which the income in the low-tax jurisdiction is derived from employees (the payroll carve out) and capital assets (the tangible asset carve-out).

However, it must first be stated that a constituent entity, as defined, may not claim the substance-based income exclusion if it is an investment entity. A constituent entity is a company or permanent establishment, which is looked at as a separate entity for Pillar II purposes, that is being examined to establish if additional tax must be paid.

It excludes entities that comprise, among others, government entities, non-governmental organisations (NGOs), and pensions.

Constituent entities may also annually elect whether to apply the substance-based income exclusion or not. The election is affected by simply not performing the calculation or excluding it from the computation for the top-up tax for the relevant jurisdiction.

This election is designed to reduce administrative complexity where it is obvious that the calculation will not give rise to any reduction in the amount of top-up tax to be paid.

The payroll carve-out is calculated as 5% of the eligible payroll costs in respect of eligible employees (both terms are very specifically defined) in the relevant jurisdiction. These costs exclude employee costs that are capitalised and included in tangible assets as well as costs attributable to any international shipping income.

Similarly, the tangible asset carve-out is calculated as 5% of the carrying value of the relevant jurisdiction's tangible assets; the carrying value is the average of the value after depreciation, amortisation, or depletion at the beginning versus the end of the year. Tangible assets are specifically defined as property, plant, equipment, natural resources, a lessee's right of use of tangible assets, and a license or similar arrangement from the government for the use of immovable property or exploitation of natural resources that entails significant investment in tangible assets. Land and buildings held for sale, lease, or investment (i.e. they are not used in the business being carried on) and specified international shipping assets are specifically excluded. The holding of intellectual property is thus not viewed as giving rise to substance — only if employees are working on such assets will they assist in determining the carve-out.

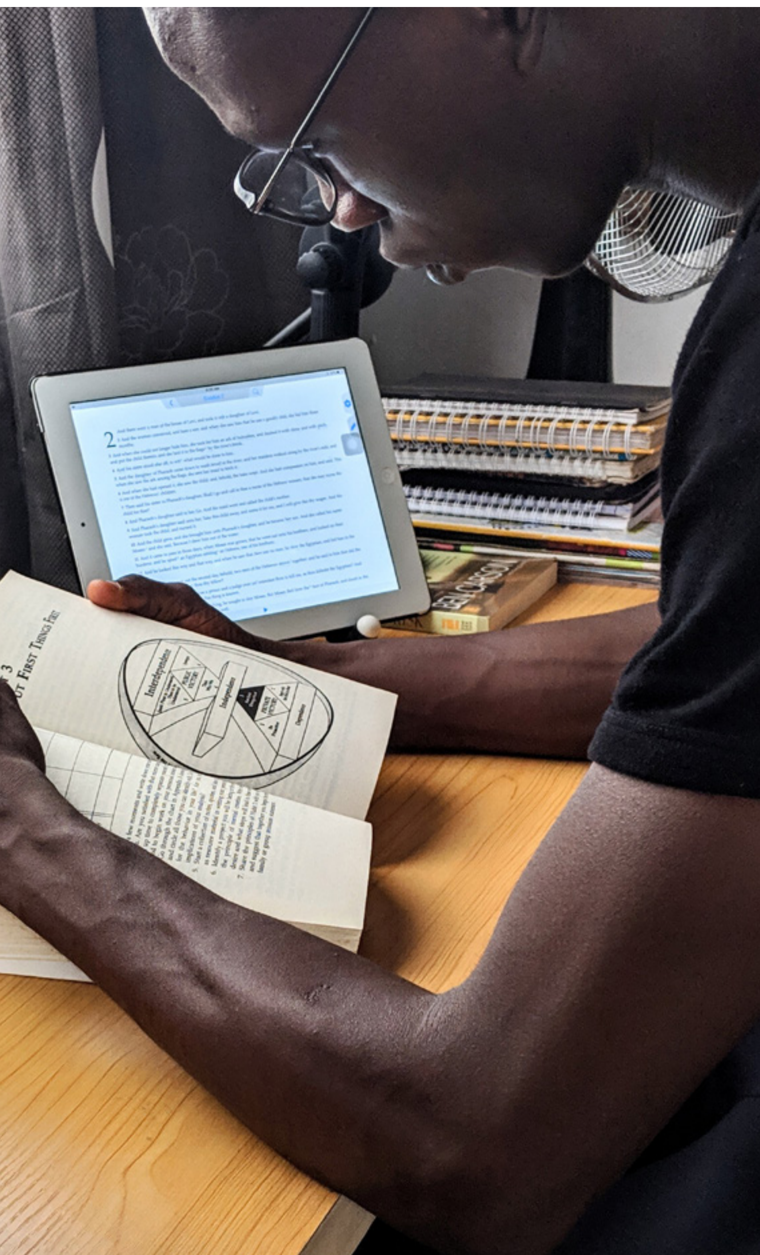
Based on these determinants, the OECD indicates that it ultimately expects income to be generated by people and tangible assets such that they provide a return of 5% — an objective approach. Any greater return would be considered excessive and the top-up tax would thus be payable. However, it should be noted that the 5% level will only be reached in 2033 as there is a transitional rule phase-in which starts at 10% for payroll and 8% for tangible assets and reduces to 5% over the ten years.

A question that then arises relates to the fact that many multinational groups have companies that qualify as controlled foreign companies (CFCs) in countries that have tax rates lower than 15% (or where incentives operate that will result in the effective tax paid to be less than 15%). The question also relates to how these CFC rules interact with the Pillar II requirements.

The CFC FBE

Qualifying shareholders of CFCs must determine whether the CFC legislation in their home country requires them to attribute some or all net income of the CFC into their own (high) tax computations. However, in determining this, various exemptions

> *"The payroll carve-out is calculated as 5% of the 'eligible payroll costs' in respect of 'eligible employees' (both terms are very specifically defined) in the relevant jurisdiction"*



and exclusions may apply. These essentially exist to retain the competitiveness of companies where the shareholder's country believes that income has not been diverted away from itself. One of these is that the operation in the other country is a genuine active business activity.

In South Africa, this is termed the 'foreign business establishment exemption' or 'FBE'. This applies to exclude attribution of any income in the CFC which directly arises from its primary business carried on at a fixed place in the relevant country for at least a year, using a suitably equipped office, shop, warehouse, or other structure and suitably qualified operational employees and management. However, various items of income may negate the FBE if they satisfy prescribed 'diversionary' rules that relate largely to passive-type income and transactions with South African residents. In addition, to qualify for the FBE the sole or main purpose must not be tax avoidance.

Even concerning intellectual property (IP), the FBE simply requires that the CFC directly and regularly creates, develops, or substantially upgrades that IP. It also requires that the IP was not originally owned in South Africa.

Consequently, the nature of the business will define what facilities, equipment, and people are needed. This must be evaluated on a case-by-case basis; therefore, it is largely subjective.

The Pillar 1 substance-based income exclusion versus the SA CFC FBE

Occasions may arise when South African shareholders who can demonstrate that the FBE applies to exempt them from attributing a CFC's net income are nevertheless required to ensure that additional tax is paid to achieve the Pillar II 15% minimum effective tax rate. This is because the FBE and substance-based income exclusion tests are so very different.

However, it should be understood that the OECD does not contemplate that the implementation of Pillar II will render CFC rules redundant. Pillar II specifically states that where the net income of a CFC is attributed to the shareholder company, that tax must be treated as tax paid by the CFC in the low-tax country for the minimum 15% effective tax computation.

What is the future of the FBE?

The question is increasingly arising: Will the current FBE have validity once the Pillar II rules are legislated?

- Pillar II only applies to MNE's with global annual revenue of greater than EUR 750 million (approximately R12.5 million in today's terms). This is determined by reference to the consolidated annual financial statements of the MNE's ultimate parent entity (as defined) for at least two of the four years preceding the year being looked at. Although this is designed to cover 90% of global corporate revenues, it will affect only 10% to 15% of all MNE groups (these statistics are from paragraph 53 of the BEPS Action 13 Report on country-by-country reporting, which uses the same requirement). South Africa has very few global MNE groups with revenues that exceed EUR 750 million, so most South African groups are unlikely to be affected by the Pillar II requirements.

  In addition, even if the MNE group does satisfy the global revenue requirement, an election may be made by it for the 'top-up tax' to be zero if, for the current and previous two tax years the average GloBE revenues of all constituent entities in a specific jurisdiction (being one with an effective tax rate lower than 15%) are less than EUR 10 million and the average GloBE income or loss in such jurisdiction is a loss or is less than EUR 1 million for the same entities over the same period. Again, this will exclude many of the companies in South African multinational groups which operate in low-tax jurisdictions.

  Additional *de minimus* exclusions also apply for up to five years during an MNE's setup period.

  Furthermore, it must be borne in mind that the FBE is designed to protect the competitiveness of South African groups that have CFCs which are not 'diverting' income. The question arises whether the Pillar II substance-based income exclusion will equally protect that competitiveness.

  Consequently, it can be concluded that the FBE still has a place in South Africa's CFC legislation.

Final Word

Treasury and SARS may consider putting legislation in place that replaces the FBE in South Africa's CFC legislation with the Pillar II substance-based income exclusion. However, it is submitted that this would be a policy decision and not because the FBE exclusion no longer has relevance for South African businesses.

INCOME TAX IMPLICATIONS

FOR EMPLOYERS WITH REMOTE WORKING AND OTHER EMPLOYEES

SEBUENG MTHEMBU, Director providing tax advisory services at Selomong (Pty) Ltd

With the onset of the COVID-19 pandemic in 2020, many employees found themselves working from their homes. In some instances, employees that were meant to move to different countries found themselves stuck in either their home countries or other countries other than those where they are based in.

Post the pandemic, several employers are now offering flexible working arrangements which include working remotely from a home office or even other countries other than where the offices of that employer are based.

The ability to work remotely has raised several tax implications for both the employer and the employee. These include the following:

1. Has the presence of an employee in a different country from the one where the employer has its offices created a taxable presence for the employer in the other country?
2. If a taxable presence has been created, how should this taxable presence be taxed?
3. What are the obligations that the employer has in the other country for paying tax both from a company perspective and in its capacity as an employer?
4. Does the employee's presence create labour law obligations for the employer?
5. Does the employee's presence create emigration law obligations for the employer?

Most double tax agreements (DTAs) that are concluded by many countries, including South Africa are based on the OECD Model Tax Convention (MTC). In terms of Article 5 of the MTC, an entity that is not tax resident in a foreign company can only be taxed in that foreign country only if it has a permanent establishment (PE) in that foreign country.

- A PE is defined as a fixed place of business from which a company undertakes its business in the other country. Typically, a company's business is carried out through its employees. Consequently, where an employee carries out activities on behalf of their employer in another country at fixed premises which have some level of permanence, they are likely to create a PE for their employer. This may happen when they work remotely undertaking their normal day-to-day duties in another country.

  DTAs that are modelled on the OECD MTC provide for activities that will not result in a PE even if undertaken through a fixed place of business (the so-called exclusions). These activities are generally of an auxiliary or preparatory nature. Activities that are stated as being of an auxiliary or preparatory nature which does not create a PE include the following:

  1. the use of facilities solely for storage, display, or delivery of goods or merchandise belonging to the company;
  2. the maintenance of a stock of goods or merchandise belonging to the company solely for storage, display, delivery, or processing by another company;
  3. the maintenance of a fixed place of business solely to purchase goods or merchandise or of collecting information, or carrying on any other activity of a preparatory or auxiliary character for the company;
  4. the maintenance of a fixed place of business solely for any combination of activities mentioned in the paragraphs above), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

  The second instance when the presence of a person or entity in a source country would not create is if the entity or person does not conclude contracts on behalf of the foreign entity.

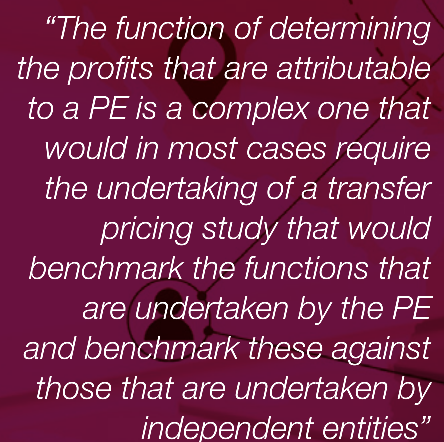
The OECD has noted that taxpayers are using various tax avoidance strategies using the PE rules. Methods that can be used by the tax countries of various countries to combat these tax avoidance strategies are dealt with in various OECD reports and initiatives which include its report addressing Base Erosion Profits Shifting (BEPS) as well as the Report on Preventing the Artificial Avoidance of Permanent Establishment Status (Action 7 Report, OECD 2015). Recommendations made include guidance on the PE exclusions and arrangements through which a non-tax resident company makes sales in a country through a commissionaire or a dependent agent who does not conclude contracts in that country to prevent the exploitation of these.

Methods highlighted as causing tax avoidance risks include the following:

1. where an entity has split various components of its business into different entities that result in it falling in the PE exclusions. The guidelines indicate that this typically happens in respect of digital sales. The tax authorities in the foreign country would be required to undertake a full analysis of all the various components of the businesses in which the entity operates in the foreign country to determine if these components are a business that would be taxable in the foreign company were it not split into the into various components.
2. Instances where an entity or individual habitually concludes contracts on behalf of the foreign entity but does not sign the contracts to circumvent being seen as a dependent agent. The tax authorities would need to analyse the transactions to ensure that these do not create a taxable presence in their country.

Employees that work remotely in a different country from their employer's activities will be scrutinised by tax authorities to ensure that these activities do not circumvent the PE rules. Should these activities create a PE, the next step will be to determine the portion of the entity's profits that are taxable in the country in which the PE operates.

In terms of Article 7 of the MTC, a company that has a PE in another country is taxable on the profits that are attributable to the PE. The profits that are attributable to a PE are those that the PE would be expected to make if it were a separate and independent legal entity that was undertaking those activities that are being undertaken through the PE. The function of determining the profits that are attributable to a PE is a complex one that would in most cases require the undertaking of



"The function of determining the profits that are attributable to a PE is a complex one that would in most cases require the undertaking of a transfer pricing study that would benchmark the functions that are undertaken by the PE and benchmark these against those that are undertaken by independent entities"

- a transfer pricing study that would benchmark the functions that are undertaken by the PE and benchmark these against those that are undertaken by independent entities.

In addition to determining if a PE does exist and the portion of the entity's profits that are attributable to the PE, employers of employees that work remotely and principals of agents that are regarded as being dependent agents will need to adherer to various administrative issues which include registering for tax and employee's tax in the PE jurisdiction, registering with the department of labour and potentially applying for work permits for the employee. All these obligations may become expensive, complex, and onerous for the employer, resulting in the termination of an employment contract or refusing to permit an employee to work remotely in a different country.

During COVID-19, the OECD and many countries enacted provisions in the law that suspended the application of the PE rules where an employee was forced to work in another country due to the restrictions in movement that the pandemic posed. The ability to work remotely benefits countries in more ways than tax collection. As well as being able to collect employee tax, employees that work remotely would generate cash into the economy of the country that they are based in as they would spend on housing, amenities, schools, and other items. From an employer's perspective, the ability to provide employees with the flexibility to work remotely creates engaged and happy employees. By imposing stringent PE rules, countries discourage employers from permitting employees to work in other countries unless these employers already have a presence in that country. In light of the new norm of being able to work remotely, it may be in the interests of countries to review the rules around PEs to make these more flexible in respect of remote working arrangements.

Khanyisa Cingo-Ngandu
Head of Tax: SNG Grant Thornton

In recent months several African governments published changes or proposed changes to tax legislation. Grant Thornton's Africa Tax Desk covers tax-related developments across some African countries.

Managing the tax risk is generally complex, it has become even more so in recent years due to increase in digitization. In some parts of the world we have also noted an expectation from the general public that if you earn revenue from their jurisdiction you must pay taxes, even if the law does not require the same. Managing the tax risk can therefore be time consuming and a costly exercise for Group CFOs and Regional Tax Leaders. Where tax compliance and risk management have been outsourced, reporting in many instances is still centralized either at group level or head office level. Grant Thornton formalized a long existing practice of collaboration amongst its member firms in Africa; to assist clients with tax risk management and other business needs where the operation cuts across different jurisdictions.

Over the years, SNG Grant Thornton has developed an automated solution that allows business leaders everywhere to track the compliance status of each Subsidiary or Branch, including any potential exposures from various jurisdictions. The tax compliance solution is able to track rulings issued and when they are due to expire, prompting tax teams that are impacted to take appropriate action on time.

Beyond the technology developed, seamless collaboration, right expertise in law, economics, tax, Islamic finance and an understanding of norms and customs in different jurisdictions, is key to seamless operations in the African region. What separates these experts from any other is their businesses mainly like SNG Grant Thornton in South Africa were founded by local and passionate entrepreneurs who understand the challenges associated with building a business from the ground up. The level of support and dedication that each client of Grant Thornton receives, is a testament to our shared experience.

The African Desk also shares developments in a number of jurisdictions in Africa. Visit our website for latest developments in the finance Acts and other similar legislations in East and West African Countries.

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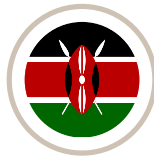
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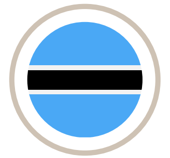
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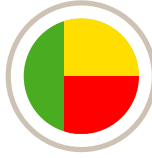
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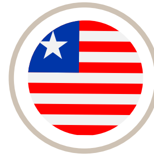
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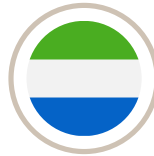
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VALUE-ADDED TAX FOR EMPLOYERS WITH REMOTE CROSS-BORDER WORKING ARRANGEMENTS

ANNELIE GILES, Tax Manager at ENSafrica

Cross-border working arrangements are not new; situations where employers and their employees are in different jurisdictions are increasingly becoming the norm. While the corporate tax and related permanent establishment considerations are usually foregrounded, the relevant VAT implications can catch entities by surprise if these are not mindfully managed.

Digital advances are blurring formal legal distinctions based on physicality and are making remote and hybrid working arrangements more accessible. Remote working arrangements can easily result in a business incurring the obligation to be registered as a VAT vendor because an employee has decided to live in another jurisdiction for lifestyle reasons.

These arrangements typically occur when a South African resident business is challenged with the task of managing overseas employees or when a non-resident business starts having South African-based employees. Although specific considerations are relevant to each scenario when considered on their own, the primary consideration from a VAT perspective in both cases is that there is a VAT registration risk in the jurisdiction where an entity's employees are based.

VAT 'enterprise'

In a South African context, an entity is not required to register for VAT unless it is carrying on a VAT enterprise in or partly in South Africa and unless the total value of its taxable supplies of goods or services exceeds the compulsory VAT registration threshold of R1 million in any consecutive 12 month period.

The concept of a VAT enterprise is similar to that of a permanent establishment. However, unlike the extensive guidelines provided by the Organisation for Economic Co-operation and Development (OECD) in this area, there are no clear guidelines as to when an entity will be regarded as carrying on an enterprise in or partly in South Africa for VAT purposes; each case must be considered based on the relevant circumstances.

What constitutes an 'enterprise' is vastly broad (or extremely narrow, depending on how one looks at it) as it generally involves any activity or enterprise that is carried on continuously or regularly in or partly in South Africa in the course or furtherance of which goods or services are supplied by one person to another for consideration (i.e. a taxable business). In its most traditional form, an enterprise requires some form of physical in-country presence before a VAT registration risk arises and the rise of cross-border working arrangements has brought certain fundamental considerations back into focus.

In practice, the following main enterprise indicators are generally considered and, in each case, the duration and extent of the entity's activities in South Africa will play an important role, namely whether an entity:

- has a physical presence in South Africa such as a fixed place of business (e.g. office or building) or employees located in South Africa;
- seconds or sends any employees or representatives regularly to South Africa;
- delivers or imports goods and ownership transfers while the goods are located in South Africa;
- physically performs services in South Africa through employees or representatives;
- sub-contracts services to South African agents, affiliates, or third-party service providers to render services directly to the entity's clients for and on its behalf; or
- negotiates and/or concludes any agreements in South Africa.

Substance of presence

The mere presence of an entity's employees in South Africa by itself is not sufficient to create a VAT registration obligation for that entity. In determining whether an entity has a VAT presence in South Africa or not, the role, functions, number of employees, and period for which they are in South Africa should be considered.

In *South African Rugby Football Union v Commissioner for South African Revenue Service (90/98) [1999] ZASCA 80; [1999] 4 All SA 444 (A),* the Supreme Court of Appeal (SCA) held that, while the position of one of the foreign entities (i.e. the Rugby World Cup [Licensing] BV, a Dutch company with its principal place of business in Rotterdam) to whom rugby tickets were supplied was not that clear concerning the fixed place of business considerations; it was physically represented in South Africa through accredited employees and agents. This enabled it to carry on its business of exploiting commercial rights at the various venues in South Africa for the duration of the World Cup tournament. The SCA further stated that the probability was overwhelming that, at the very least, the entity conducted its activity and had a fixed place within South Africa relating thereto.

Therefore, in addition to having 'feet on the ground', an entity will generally only be regarded as carrying on a VAT enterprise in or partly in South Africa if there is a fixed or permanent place in South Africa from which it carries on its activities. However, the fact that an employee may be performing their activities from a fixed location such as their home, does not automatically render this location a fixed place of business from where the non-resident employer is carrying on an enterprise; much will depend on the exact functions of that employee.

For example, one or more business-facing employees located in South Africa and tasked mainly with administrative support functions that are consumed by the non-resident employer only, will typically not give rise to a VAT registration risk. But the activities of client-facing staff based in South Africa pose a significantly increased risk regardless whether these activities are performed from the employees' respective homes instead of in a typical office environment.

This risk is enhanced even further should any of these employees take part in contract negotiations or are capable of binding the non-resident employer in contractual arrangements.

Duration of presence

In terms of the principles advocated by the OECD, certain minimum periods apply to the carrying on of certain activities before a permanent establishment risk arises. For example, Article 5 of the OECD Model Tax Convention states that a building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months. Furthermore, the OECD Commentary provides some practical guidance on the interpretation of permanent establishments in the context of other activities. In general, permanent establishments are not considered to exist in situations where a business is carried on in a country for less than six months.

Although a wealth of international case law exists on the interpretation and practical application of the permanent establishment concept, South African guidance on this remains limited. In addition, no minimum scope of activity or a specific period of continuous or regular activity has been established as sufficient to fulfil the enterprise requirement from a VAT perspective. Depending on the nature and scope of the entity's activities in South Africa, a period as short as three months could arguably be sufficient to constitute the carrying on of an enterprise for VAT purposes.

Therefore, even short-term secondments of employees to South Africa can potentially give rise to a VAT presence in South Africa for the non-resident employer and should be implemented with caution.

Is there a place for a 'VAT permanent establishment'?

Although the principles are similar, the concept of a 'VAT permanent establishment' does not exist in a South African context. The considerations explored above give rise to the question whether there is a place for a substantive VAT permanent establishment in-country before concluding that there is indeed a VAT enterprise and thus an obligation to register for VAT in South Africa.

A substantive VAT permanent establishment would minimally include: a fixed or permanent place of business through which a business is wholly or partly carried on (and not merely an employee living in-country); the infrastructure required to perform

business functions; and the authority to bind the business in that jurisdiction by having authority to conclude contracts.

In an era where there appears to be an (over) eagerness to tax, a sensible approach whereby a VAT registration obligation is limited to those businesses with a fully fledged in-country presence, will go a long way in managing time, cost, and resources as well as being deployed where best needed.

Conclusion

As remote working arrangements become the norm, their VAT consequences should be considered alongside the usual corporate tax, employment tax, and regulatory considerations to adequately mitigate tax risks. At the same time, it creates the opportunity to further develop the concept of a 'place of supply' as life becomes more digital.

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MITIGATING TAX PENALTIES

▶ **MMANGALISO NZIMANDE,** Executive | Tax at ENSafrica & **JULA MABENA,** Associate | Tax at ENSafrica

Over the past few months, the Commissioner of SARS, Edward Kieswetter, has cautioned that SARS is robustly targeting non-compliant taxpayers.

SARS has indicated that it will impose penalties of up to 200% of a taxpayer's tax liability where they have failed to fully declare their income, have deliberately attempted to claim impermissible expenses or have understated their income. Penalties are increasingly becoming a common feature of disputes, with penalties sometimes becoming a bigger feature in resolving the disputes than the underlying tax liability.

Therefore, taxpayers have to consider ways of mitigating the risk of penalties. This can be done before filing the tax return, after filing the tax return and during an audit by SARS.

Before filing the tax return

The importance of obtaining a tax opinion before filing a return was canvassed by the Supreme Court of Appeal (SCA) in *Commissioner for the South African Revenue Service v Capitec Bank Limited.* Though Capitec Bank Limited was unsuccessful on the merits of the dispute relating to underpayment of VAT, arising from the deduction of notional input tax in respect of the loan cover pay-outs, the SCA found that there were reasonable grounds for the bank to claim the deduction.

The finding on the basis of the favourable opinion obtained by Capitec from a senior counsel and the only way in which the bank could reasonably test the issue, was to claim the deduction in its tax return. In such circumstances, the SCA remitted the 10% late payment penalty, stating that it cannot be said that the contesting of the amount was unreasonable. ▶

Had Capitec not first obtained an opinion from a tax practitioner, the court might have dismissed their plea to have the administrative penalties remitted.

Administrative penalties may be minuscule in the bigger picture compared to the possible understatement penalties SARS may impose, where a taxpayer takes an unconventional position in a tax return as a result of an interpretation of a statutory provision, which differs from SARS' view. It seems prudent to consult a tax professional and obtain advice in relation to important disclosures in a tax return, given the potential penalty repercussions of not being able to justify a tax position taken. Consideration and advice should also be taken in relation to the tax return itself, which is often not conducive to explaining a particular tax position taken by a taxpayer.

Section 223(3) of the Tax Administration Act, 2011 ('the Act') directs that SARS must remit a penalty imposed for a *"substantial understatement"* if SARS is satisfied that the taxpayer was in possession of an opinion by a tax practitioner when the return was due. The opinion must contain full disclosure of the facts, preferably including all supporting documents and circumstances specific to the arrangement, and confirm that the taxpayer's position is *"more likely than not to be upheld if the matter proceeds to court"*.

The Tax Court in *Benhaus Mining (Proprietary) Limited v Commissioner of the South African Revenue Services* dismissed the taxpayers' reliance on their tax practitioner's opinion, based on SARS' contention that full disclosure was not made and that the opinion was only obtained after the returns were submitted (the issue of the opinion became moot following Benhaus Mining's successful appeal in the SCA on the merits of the matter). Evidently, merely being in possession of a purported section 223(3) opinion is not sufficient to satisfy the requirements of the Act. Of interest to observe, SARS applied some leniency by reducing the additional penalty in *CSARS v The Executor of the Estate of Late Ndlovu* from 200% to 100%; then further reduced the penalty to 10% after taking into account further extenuating circumstances presented by the taxpayer. These included the reliance placed by the taxpayer on a confirmation letter from the taxpayer's scheme administrator that *"the earnings arising from the options exercised were non-taxable"*.

These judgments add to the plethora of case law reiterating that the mitigation of tax penalties commences before the return is filed and long before a dispute arises with SARS on the tax position taken by a taxpayer.

After submitting the return but before SARS initiates an audit

It is not uncommon for taxpayers to identify an error or omission in a tax return after it has been filed, for example, following a second opinion by a new tax advisor or new management. Adjusting the error may result in burdensome penalties imposed by SARS if they independently identify same during an audit. Is it then wise for taxpayers to inform SARS of the error before they deploy resources to investigate the taxpayers affairs? Certainly!

The Voluntary Disclosure Programme VDP provisions were introduced from 1 October 2012 by SARS, aimed at enhancing voluntary taxpayer compliance in the interest of good management of the tax system and the best use of SARS resources. VDP encourages taxpayers to come forward on a voluntary basis to regularise their tax affairs and avoid the imposition of understatement and administrative penalties.

Simply submitting a VDP application does not automatically grant the taxpayer the required relief. To ensure that a VDP application is valid, all the requirements set out in section 227 of the Act must be satisfied. One of the requirements is that the application must be voluntary. The interpretation of this requirement has, over the years, resulted in a lot of uncertainty for taxpayers.

"Administrative penalties may be minuscule in the bigger picture compared to the possible understatement penalties SARS may impose where a taxpayer takes an unconventional position"

The Gauteng High Court, in *Purveyors South Africa Mine Services (Pty) Ltd v CSARS,* held that disclosure by the taxpayer was not voluntary as SARS had initiated a VAT audit and was already aware that the taxpayer was liable for VAT, which it failed to pay penalties at the time when the taxpayer submitted an application for voluntary disclosure relief.

The taxpayer in the *Purveyors* case first informally engaged SARS regarding the default, thereby forewarning SARS of the default before submitting the VDP application. This action by the taxpayer disqualified it from placing a valid application before SARS in order to avoid penalties. The lesson that can be drawn from the *Purveyors* case is for taxpayers to seek advice from a tax professional as soon as an error or an omission is identified in a return, to advise on the most appropriate and procedurally correct manner to proceed.

If applied correctly, VDP not only mitigates possible understatement and administrative penalties, it also ensures that SARS will not pursue criminal prosecution for a tax offence arising from the default.

After SARS has initiated the audit

Taxpayers can still mitigate the risk of penalties even when SARS initiates an audit and they are not in possession of a section 223(3) opinion or have not filed a VDP application. Taxpayer behaviour has a large bearing on the penalty percentage SARS may impose should they find that there has been an understatement by the taxpayer.

The Act sets out understatement penalty percentages that vary depending on the behaviour associated with the understatement.

As a penalty may be increased, if the taxpayer is obstructive during the audit or in the case of a repeat case, it is important to be cooperative during the audit and to have clarity on when a case will be regarded as a repeat case. A repeat case means a second or further case of the specific behaviours in items (i) to (v) of the understatement penalty percentage table set out in section 223 of the Act.

- In the SCA judgment of *Purlish Holdings v The Commissioner for the South African Revenue Service,* the SCA confirmed that the burden of proving the facts in which SARS based the imposition of an understatement penalty rests on the Revenue Service; they must not only show that the taxpayer committed the conduct set out in items (a) to (d) of the definition of understatement in section 221 of the Act, but also that such conduct caused SARS or the fiscus to suffer prejudice.

The taxpayer in the *Purplish* case not only made an incorrect statement in the return, but also made an attempt to claim an undue refund from SARS.

The SCA held that prejudice to SARS in the context of understatement penalties should not only be measured in financial terms (as the taxpayer was in a refund position), consideration should be given to the additional resources allocated and time spent by SARS' employees to understand the affairs of a taxpayer, which also constitutes a prejudice to SARS. An understatement penalty of 25% was imposed on the basis of the taxpayer's behaviour constituting *"reasonable care not taken when completing the return".*

Conclusion

There are numerous mechanisms available to taxpayer to mitigate the exposure to penalties. It is prudent that a taxpayer has consideration for the possible tax risks prior to the submission of the return. Alternatively, the correct steps should be taken soon after the taxpayer is aware of an error in the return, with the assistance of a professional, so as to mitigate the risk of imposition of penalties by SARS at a later stage.

TAXING TIMES SURVEY – What did taxpayers say this year?

▶ **LOUISE SWART,** Tax Consultant at PwC Africa & **ELLE-SARAH ROSSATO,** Partner: Tax Controversy & Dispute Resolution at PwC

This article outlines the experiences of taxpayers as reported by PwC South Africa and its annual Taxing Times Survey.

The PwC Taxing Times annual survey was created five years ago to measure taxpayers' experiences of SARS. The survey is updated annually to accommodate any developments within the tax industry. This year, the survey was streamlined to test taxpayers' experiences in line with PwC's new global strategy called 'the New Equation' which seeks to help our clients build trust and deliver on sustained outcomes while ensuring that we continue to make a societal impact. SARS has also carved out a new strategy in 2021 called 'Vision 2024'; they have formulated nine strategic objectives as outlined in their Strategic Plan for 2020/202 to 2024/2025. The nine strategic objectives are to:

1. Provide clarity and certainty for taxpayers and traders of their obligations;
2. Make it easy for taxpayers and traders to comply with their obligations;
3. Detect taxpayers and traders who do not comply, and make non-compliance hard and costly;
4. Develop a high performing, diverse, agile, engaged and evolved workforce;
5. Increase and expand the use of data within a comprehensive knowledge management framework to ensure integrity, derive insight and improve outcomes;
6. Modernise our systems to provide digital and streamlined online services;
7. Demonstrate effective resource stewardship to ensure efficiency and effectiveness in delivering quality outcomes and performance excellence;
8. Work with and through stakeholders to improve the tax ecosystem; and
9. Build public trust and confidence in the tax administration system.

▶

Developments within SARS and the purpose of the survey

SARS has undergone major changes since 2019 when Mr Edward Kieswetter was appointed as Commissioner. Under his leadership, SARS has re-capacitated itself via additional resources, including a massive recruitment drive and amplified technological capabilities. It has further revived the Large Business and International Tax Division (previously known as LBC) and it has established specialised units such as High Wealth Individuals and the Illicit Economy Unit. The changes to SARS' structure and improved resources aim to enable this organisation to meet its mandate of collecting revenue in favour of the fiscus and to meet its nine strategic objectives.

It is crucial to understand, from a taxpayer's perspective, whether SARS is improving by testing the experiences of corporate taxpayers when dealing with SARS, focusing on SARS' strategic objectives. The survey outcomes are discussed with SARS (as a first instance). These discussions serve as a constructive platform to engage with SARS about how it can improve public trust, efficiency, and confidence in the tax administration system, as well as improve its stakeholder relationships. SARS has increasingly taken a keen interest in the findings of our survey; the results are annually shared with SARS.

As mentioned, the participants of the survey are corporate taxpayers from 23 industries. The Financial Services industry attracted the highest participation rate (30%), followed by Energy, Utilities and Mining (10%), 'Other' (10%), Retail and Consumer industries (8%) and Automotive (5%).

The 2022 Taxing Times Survey covers the following main areas:

- The verification/audit process:
  - Corporate income tax
  - Value-added tax
  - Transfer pricing — For these purposes the survey distinguishes between 'verifications' (high level, face value check) and 'audits' (more in-depth enquiry, often in the form of an investigative audit)
  - The debt management process
- Voluntary Disclosure Programme (VDP)
- SARS' service delivery

Survey outcomes

Below are some key findings:

Corporate Income Tax

- Verification: Just shy of half of the participants in the survey believe that they will be selected for verification upon submission of their corporate income tax (CIT) returns; this result is largely aligned with the results from previous years. In our experience, verifications often arise from being selected through SARS' automated risk-engine.

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- These results should be considered within the context of the consequences of being selected for verification, including the time it takes SARS to finalise a verification. This year, the participants reported an improved turn-around time in respect of the finalisation of CIT verifications compared to last year.
- Audits of CIT returns are more complex and often involve voluminous bundles of relevant material being submitted to SARS upon request. In this regard, the survey results reported a decrease in the turn-around time of audits, which often takes longer than 12 months to complete.
- Issuing of progress reports: During the audit process, it is important for SARS to take cognisance of taxpayers' rights and to follow due and fair administrative processes, which includes the issuance by SARS of reports regarding the stage of completion of audits. These reports are aimed at keeping the taxpayer informed during the audit process. This year, as was the case in previous years, SARS appears to have largely failed to comply with section 42 of the Tax Administration Act by not issuing progress reports when they were due. We have often seen progress reports that contain very little substance and are not informative at all.
- Proper consideration of representations made by taxpayers: Taxpayers may respond to SARS' letters of audit findings before SARS issues assessments. SARS must consider the responses objectively and determine whether the initial audit findings were accurate or whether they should be amended. This year, the majority of participants indicated that SARS did not consider the taxpayers' responses at all upon issuing a Letter of Assessment. This is a significant increase from the results reported in 2020 and 2021.
- Letter of Assessment: Upon considering the representations of a taxpayer, SARS must finalise the audit and, if adverse findings are made, proceed to issue additional assessments. SARS must however also issue a Letter of Assessment to outline the factual and legal bases of its additional assessment. Participants were asked to indicate whether the Letter of Assessment conveyed sufficient information to enable the taxpayer to formulate its grounds of objection to the extent that it wishes to lodge an objection to the assessment. The survey findings reveal that in a third of the cases, the finalisation of an audit letter has insufficient explanations regarding the basis of the assessments. These results may explain the large number of disputes (objections/appeals) currently being raised by taxpayers.

Understatement penalties

- This year, almost half of the participants indicated that they 'Strongly agree' with the proposition that SARS is aggressive in raising USPs.

Suspension of Payment applications

- The 2022 survey recorded an improvement in the number of applications for suspension of the payment of disputed tax debts, pending a dispute being approved by SARS. However, the results did indicate a concerningly high number of applications that were rejected without adequate reasons.

Requests for Correction

- Where a taxpayer has made an error in a return, it may request SARS to correct the error by issuing a reduced assessment. The survey results, however, reveal that only half of these requests are successful. The PwC detailed report discusses the challenges experienced by industry to successfully apply for a correction.

"It is crucial to understand, from a taxpayer's perspective, whether SARS is improving by testing the experiences of corporate taxpayers when dealing with SARS, focusing on SARS' strategic objectives"

Value-Added Tax

- The survey results reflect that a third of VAT returns are selected by SARS for verification. This is also the case for a third of the participants that have submitted VAT returns where a VAT refund is due. Unfortunately, we have seen a sharp decline in the turn-around time for SARS to finalise the VAT verifications. This is of concern to taxpayers, considering that VAT refunds are being withheld until the finalisation of the pending verification. More concerning is the fact that many participants

reported that VAT refunds were not being paid within 21 days, where no verification is pending or where a verification has already been completed.

Transfer Pricing

- The PwC survey results for 2022 recorded a decline in the number of transfer pricing audits being conducted by SARS. There was furthermore a positive decline in the number of unresolved transfer pricing disputes, suggesting that taxpayers and SARS have made strides in resolving these disputes. The most frequent modes of resolution were settlements and Multi Agreement Processes (MAP) between SARS and its international counterparts.

Voluntary Disclosure Programme (VDP)

- Year-on-year, PwC has seen that 40% of participants were making use of the VDP relief provided for in the Tax Administration Act. The VDP process appears to take quite a lengthy time to complete with less than a third of the participants reporting that the process took between one to three months to complete.
- Despite being a valuable revenue collection tool for SARS, the survey recorded that more than half of participants' applications were declined on the basis that the application was not 'voluntary'. Other reasons for rejecting the VDP applications included not being 'full and complete'. Participants also reported that the IT14SD returns have created significant obstacles for taxpayers to be eligible for VDP. There are several interpretational differences between SARS and taxpayers (or their representatives). Please see the full report for details.

SARS' service delivery

- We asked participants if they believed that the quality of the service delivered by SARS to taxpayers has improved since the introduction of the SARS Service Charter in 2018. Disappointingly, only 5% of participants 'strongly agree' while 34% 'agree'. Twenty percent of participants 'strongly disagree' with this statement.
- The bulk of participants believed that SARS was not living up to its own Service Charter and reported that SARS often fails to meet prescribed timeframes. There was, however, an improvement in the results in so far as "ease of complying with tax obligations" are concerned. These participants also reported that SARS' performance outcomes were of low quality.
- The participants were asked whether their trust in SARS has improved in the past 12 months. The number of participants that replied in the affirmative is concerningly low, considering the importance of the function that SARS fulfils.

Key take-aways

SARS' operations, the quality of its performance and the level of service it renders to taxpayers are crucial discussion points as they directly speak to taxpayer rights. SARS, like many other tax authorities around the world, strives to increase voluntary compliance on the part of its taxpayers and to avoid the extensive utilisation of public resources to detect and correct tax non-compliance. Some of the findings suggest an improvement in certain areas of SARS' functions. However, overall, there is still significant improvement required as far as resolving verification, audits, and the resultant disputes is concerned.

The full report provides comparative analyses of the findings and detailed discussions related to the survey questions and their outcome. The report can be accessed through the website of PwC South Africa (Tax/TCDR).

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