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FINDUS

Postal address
PO Box 712
Menlyn Retail Park
0063

Editorial head office
Riverwalk Office Park, Building A
C/o Garsfontein & Matroosberg Roads
Pretoria
South Africa
0081

THETEAM

Editor at Large
Tania Wolson
editor@thesait.org.za

Supporting Editor
Jeanne Viljoen
taxtalk@thesait.org.za

Editorial Advisor
Keith Engel

Design and Layout
Nastassja Hewitt
designer@thesait.org.za

Cover Illustration
matdesign24

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GUEST CONTRIBUTORS

Barbara Curson
batier@icon.co.za / 064 451 3088

Barbara is a freelancer and columnist who specialises in tax avoidance and financial reporting. She is a CA (SA) and holds the following qualifications: BCom (Economics and International Economics), Hons BAcc Science, HDip Tax and HDip International Tax.

Caoilfhionn van der Walt
cvanderwalt@reganvanrooy.com / 079 150 8817

Caoilfhionn is International Tax Partner at Regan van Rooy, specialising in international tax and structuring. She holds an MA, MSc and HDip International Tax and is a CA (ICAEW).

Donald MacKay
donald@xa.co.za / 082 494 1019

As Director at XA International Trade Advisors, Donald specialises in customs and international trade consulting. He holds an MBA.

Ine-Lize Terblanche
Ine-lize.terblanche@infidi.co.za / 083 253 8090

Ine-Lize is Director at inFidi, specialising in tax transformation, the tax function as a value-add to the business, tax governance, sustainable tax and voluntary tax reporting. She holds an LLM in Tax and Commercial Law.

Gasant Jacobs
gasant.jacobs@taxtechglobal.com / +971 50 699 6541

Gasant is Managing Partner at TAXTech Global, based in Dubai. He specialises in international taxation and tax technology and holds an MBA and a Masters in Taxation.

Jerry Botha
jerry@taxconsulting.co.za / 011 467 0810

Jerry is Managing Partner at Tax Consulting South Africa, dealing with expatriate tax, employee benefits, retirement funding, payroll taxes and more complex areas of taxation.

Madeleine Schubert
schubert.em@gmail.com / 083 665 5038

Madeleine is a practising attorney at Boshoff Inc, dealing with international and domestic tax. She holds a BProc (Cum Laude), HDip Tax and MCom, is an admitted attorney of the High Court of South Africa and a TEP and Fisa Member.

Moeketsi Marumo
mmarumo@cova-advisory.co.za

Moeketsi is an Associate Director at Cova, with a postgraduate qualification in Economics.

Neil Hughes
neil.hughes@rsmza.co.za / 011 329 6000

Neil is Tax Director at RSM SA Consulting and is a generalist in all areas of tax. He is a CA (SA) and holds a BCom (Hons) and a Postgraduate Certificate in Advanced Tax.

Patrick Grant McLennan
pmclennan@bdo.co.za / 082 417 9881

Patrick is Associate Director at BDO (Cape Town) and a specialist in transfer pricing economics. He holds an MA in Global Finance, Trade, and Economic Integration; and a BA in Political Science (Magna Cum Laude).

Ruan Botha
ruan@rvrtax.co.za / 072 826 3988

Ruan is Associate and Tax Practitioner at Roets & Van Rensburg Inc, specialising in tax disputes. He holds a BA (Law) and LLB.

Suzanne Smit
suzanne@nubis.tax / 081 409 0390

Suzanne is a Tax Specialist at Nubis.tax. She specialises in cross-border tax and exchange control advisory and tax dispute resolution. She holds an LLM (Tax).

30 minutes CPD

RISING TAXES ARE COMING

BARBARA CURSON, batier@icon.co.za

With a yawning deficit in government revenue, it seems inevitable that government will raise taxes. But how can this be done efficiently and fairly? Our article provides a background and proposes some scenarios.

"In the broader public sector, several state-owned companies and municipalities have insufficient funds to cover operational expenses."

The revised budget deficit for 2020/21 is expected to be R761.1 billion. Government is confident that it only needs to raise R5 billion from additional taxes, and the rest of the budget will be funded by cutting expenditure, mainly by cutting wages in the public sector. However, the unions are fighting back.

If government does not manage to cut wages in the public sector, the cash situation will be dire. Taking into account the current economic situation and the expected revenue situation, government will be left with two options: raising debt or raising taxes. More debt will risk strangling the economy with the heavy burden of paying finance costs.

2020 Medium-Term Budget Policy Statement

The South African economy is expected to contract by 7.8% in real terms in 2020. This had a negative impact on the revised budget deficit, which has ballooned to 15.75% of GDP (R761.1 billion). South Africa now has the largest debt-to-GDP ratio in the emerging economies, which is forecast to reach R4 trillion (81.80%) in 2020/21. GDP for 2020 is expected to be between -7.0% and -7.5%. The economy is only expected to recover to 2019 levels in 2024.

However, government is confident that a combination of expenditure and revenue measures will narrow the consolidated deficit from 15.7% of GDP in 2020/21 to 7.3% by 2023/24. Gross national debt is projected to stabilise at 95.3% of GDP by 2025/26.

The key factors affecting in-year revenue collection include the loss of salaries and wages under the lockdown, less VAT and customs duty resulting from reduction in imports, a drop in VAT due to less consumption, less excise duties resulting from a tobacco ban and stronger than expected corporate profitability.

In the broader public sector, several state-owned companies and municipalities have insufficient funds to cover operational expenses. Several state-owned companies have issued promissory notes and bonds, and there is a risk that interest payments may be defaulted. Lenders have called the guarantees of South African Express and the Land Bank, with a negligible effect on the fiscal framework. Larger calls on guaranteed debt are expected unless steps are taken to turn around the most indebted state-owned companies.

The Medium-Term Budget Policy Statement advised that revenue proposals to be announced in the 2021 Budget will amount to R5 billion in 2021/22, R10 billion in 2022/23 and R10 billion in 2023/24.

Government has proposed a five-year fiscal consolidation to narrow the budget deficit and stabilise government debt; expenditure will be cut, and zero based budgeting will be introduced in state-owned entities and municipalities.

Contingent liabilities

The Medium-Term Budget Policy Statement has forecast contingent liabilities to exceed R1 trillion by 2022/23. These liabilities comprise government guarantees to state-owned companies, the Renewable Energy Independent Power Producer Programme, public-private partnerships (PPPs), and obligations to the Road Accident Fund and other social security funds. Government's guarantees have increased from R680 billion in March 2019 to R693.7 billion in March 2020, and R583.8 billion has already been used. Eskom has been granted a facility of R350 billion.

Guaranteed debt redemptions are expected to average R35.6 billion over the next three years.

Unemployment risk

The unemployment risk has not been mentioned. In a population of 59.6 million, with a labour force of 18.4 million, only 14.1 million workers are employed.

This is unsustainable. Apart from the drop in tax revenue with the loss of some 4 million jobs, 45.5 million people have to be provided for.

> *"The question is, what is the cost of the pandemic, and what is the cost of state capture, corruption and malfeasance?"*

The hollowing out of SARS

SARS lacks the capacity and skills to go after the so-called big ticket items. Illicit tobacco trading is rampant. Complex tax cases take many years to get through the courts. Even if SARS has a current pipeline of large complex tax cases, such as transfer pricing, tax avoidance schemes and VAT schemes, it may take three to four years to resolve these matters in a court.

SARS requires the funds to upskill.

The taxing conundrum

In South Africa, as elsewhere in the world, the COVID-19 pandemic has exposed inequality. The pandemic was particularly hard on those with lower incomes, and devastating for those in the informal sector.

It has also created a huge fiscal hole, which has not bottomed out.

In my view, government will be forced to raise more than R5 billion in additional taxes in the 2021 budget. How then will they raise the additional tax revenue? Below are some possibilities.

Increases of the excise duties on alcohol and tobacco

There is an argument that further increases in excise duties on alcohol and tobacco stimulate the illicit tobacco trade. The local legal tobacco industry also has to recover from the COVID-19 depression and the impact of the ban on tobacco sales, and claw back market lost to illicit tobacco sellers.

The current tobacco stamp is not effective in curtailing the illicit tobacco trade.

Government has not yet ratified the World Health Organisation's Protocol to Eliminate Illicit Trade in Tobacco Products. It, however, started amending the Custom and Excise Act in 2016 to provide for the marking, tracking and tracing of tobacco products, which should restrict illicit trade. Meanwhile, SARS cancelled the tender bid for a track and trace system.

National Treasury will explore the Minimum Retail Selling Price (MPL) concept for tobacco, where it will be illegal to sell a packet of tobacco at below the amount of excise tax that would have been paid on the packet.

The so-called sin taxes will no doubt again be increased, but it is hoped that SARS steps up its efforts in curtailing the illicit tobacco trade.

VCC tax incentive

The venture capital company (VCC) tax regime was introduced to encourage the establishment and growth of small, medium and micro-enterprises (SMMEs), while creating jobs and addressing inequality. Government is reviewing both the impact of the tax incentive and its possible structural shortcomings. Currently, the sunset clause of June 2021 for the VCC tax incentive remains in place. Government is, however, reviewing the incentive. It is possible that changes to the incentive will be made in 2020/21.

Wealth taxes

“Wealth” is a dangling carrot that many countries have attempted to tax, with little success.

Cynically, placing the wealthy – the apparent 10% – in the spotlight is a tried and tested tactic to divert the attention away from unsolvable issues. Therefore, unsurprisingly, talk of a wealth tax has resurfaced.

South Africa already has wealth taxes in the form of transfer duty, estate duty and donations tax. Home owners and land owners already pay rates and taxes on the property valuation (and these valuations are often disputed).

There are many policy considerations, such as defining wealth, the threshold level, determining the amount that can be taxed and deciding on an artificial point in time to determine wealth. The exclusions will also have to be determined, such as an acceptable limit for a private residence. It would be unfair to exclude pension and retirement funds, as that would penalise those who have made their own retirement investments.

The pandemic highlights the illogicality of determining the value of shares and companies at a point in time. Consider the impact of the pandemic on valuations of shares and companies in March and April 2020. Within a couple of months, equity prices had recovered.

Would there be any compensation paid to a "wealth taxpayer" if their wealth disappeared as a result of some calamity?

Will the rewards of introducing a wealth tax exceed the costs (the costs of administering the system as well as the compliance costs). A wealth tax may be complicated to administer: does SARS have the expertise? SARS will no doubt grapple with unpacking basic wealth structures, never mind the valuation of intellectual property, and locating wealth that has been ferreted away in blind trusts and shell companies around the world.

If wealth is to be taxed, taxpayers will divert their savings to other vehicles which will provide protection; there will be a greater incentive to enter into aggressive structures that will disguise wealth.

The drafting of the legislation will be difficult – it may well be the straw that breaks the camel's back.

One-off 5% wealth tax

The government could consider a one-off wealth tax, payable on the value of assets over a particular threshold, at a point in time. Certain assets could be excluded, such as a private home. This could even be payable in instalments.

Company tax losses

Government proposes broadening the corporate income tax base by restricting the offset of assessed losses carried forward to 80% of taxable income for years of assessment commencing on or after 1 January 2021.

There is a fine line between raising revenue and disincentivising investment.

At the Tax Indaba 2020 online discussion, Cliffe Dekker Hofmeyr director and national head of tax and exchange control Dr Emil Brincker said SARS and Treasury are in a difficult position. Taxpayers are barely surviving, and the little bit of income they have been making since lockdown should not be paid in tax but be invested back in the business. Brincker emphasised that "we must do what we can to encourage investment".

Private equity – "carried interest" loophole

Carried interest, which is the share of profits over and above the management fees paid to the general partners of a private equity fund, is taxed as a capital gain. This has long been a contentious issue. Are private equity partners entrepreneurs who are taking risks and making a capital gain on their investments? Or are they actively leveraging their investments in a scheme of profit making?

In an environment where we are desperately short of tax revenue, this should be an easy problem for National Treasury to solve. It will also go a long way in taking away a special dispensation given to the wealthy. It will not bring in the billions that we need, though.

Levelling the capital gains tax

Levelling the capital gains tax rate to the average tax will be harsh, and will no doubt have unintended consequences. However, it will put an end to the many tax avoidance schemes that seek to arbitrage the differences between revenue and capital.

Other possibilities

- Raising the sugar tax.
- Raising VAT by 0.5% (excluding certain foodstuffs); the exclusion from VAT for foodstuffs should be widened.
- Raising VAT by 2% on motor vehicles and sports cars that cost over R1.5 million.
- Raising fuel taxes, which would be highly inflationary, and have a terrible impact on the poor.
- Introduce a withholding tax on advertising paid to offshore companies.

Social contract

In my view government has broken the social contract, by which citizens will pay their fair share of tax because the government has their back. State-owned entities have overpaid their executives and squandered money, with no consequence. The Nugent Commission of Inquiry into Tax Administration and Governance by SARS, the Commission of Inquiry into allegations for impropriety regarding the Public Investment Corporation (the Mpati Commission) and the Commission of Inquiry into State Capture (the Zondo Commission) have opened the public's eyes to extraordinary examples of state capture, corruption and malfeasance. The total cost to the state's coffers is as yet unknown.

The question is: what is the cost of the pandemic, and what is the cost of state capture, corruption and malfeasance? Perhaps government should first claw back the cost of state capture, corruption and malfeasance from the perpetrators, before it attempts to pass the cost onto its citizens.

THE RISING GLOBAL TIDE OF WEALTH TAXES

15 minutes CPD

MADELEINE SCHUBERT, schubert.em@gmail.com

For some fresh views on the desirability and feasibility of wealth taxes, read our article!

Global political conflict between the left and the right wing has resulted in much debate on how an individual may acquire wealth and, in those cases where an individual has not acquired any, to what degree government must assist in levelling the playing field between the wealthy and the poor.

Historically, the right wing supported and promoted a market-driven economy focusing on individual initiatives, productivity growth and self-determination. In their view government's interference should be limited to the bare minimum. On the other side of the spectrum, the left wing supports the pack methodology, promoting collective negotiations implemented via unions and the continued support of social and political strategies to promote equity amongst all. They support strong government interference and believe that it must penetrate to the heart of the productive process.

However, as noted in one of well-known French economist Thomas Piketty's earlier works, both sides agree that where the financial benefit that befalls an individual arises due to factors beyond the individual's control – like an inheritance or other windfall gain – one could consider actions to impose measures to move some of these windfall gains to the less fortunate.

Distributing wealth

In the current context this can imply the introduction of a wealth tax.

According to Wikipedia, a wealth tax (also called a capital tax or equity tax) is a tax on an entity's holding of assets. This includes the total value of personal assets, including cash, bank deposits, real estate, assets in insurance and pension plans, ownership of unincorporated business, financial securities, and personal trusts. The definition is then further expanded to permit the deduction of liability to result in a net position on which a tax is levied, therefore also known as a "net wealth tax".

In simplistic terms, wealth tax is mainly driven towards an individual's balance sheet. However, it is wider than that and can (and should?) include other indirect "assets" such as pensions and trust instruments.

The questions that one must now raise are:

- Is the introduction of a wealth tax a feasible method to equalise the distribution of wealth in a country and/or globally?
- Has the imposition of wealth taxes worked in the past?

To find a response to these questions, reference is made to Thomas Piketty's book *Capital in the Twenty-First Century*.

Piketty emphasises that it is important to understand the capital/income ratio relating to individuals residing in a country. The ratio is an important indicator of inequality in their society. The higher the number, the higher the inequality in that country. Typically, in countries where the result is high the wealth is in most cases concentrated in old capital. Income generated from productivity then seldom achieves the same level of wealth.

"Even though a country can impose higher taxes on the private sector, individuals with means can opt to leave a country if the taxation system no longer suits them."

In addition, in his view, he confirms that in the twenty-first century most wealth vests in private hands. This leaves the governments of countries with two options: to either borrow from the private sector or to tax the private sector. The private sector would prefer lending funds to government to earn more income from the same, as opposed to diminishing their wealth in the form of paying taxes. Currently Slovenia has the highest personal tax rate in Europe at 61.1%, indicating its move towards the left.

The option to leave

A noteworthy comment is that even though a country can impose higher taxes on the private sector, to date, individuals with means can opt to leave a country if the taxation system no longer suits them. The wealthy can elect to remain in tax-free havens and live off their capital, with the option to travel and enjoy a debt-free lifestyle without necessarily contributing towards the tax base of the country of which they are nationals. Although there are international taxation agreements that aim to regulate this position, many of the traditional tax havens are not party to this. In some European countries, like Switzerland, an individual may even negotiate their tax rates with a local municipal district. The latter luxury is often not available to individuals with low capital resources and those may often have to endure residing in the country of their birth, or opt to become migrant workers earning income in another country, without the means to initially create a substantial capital base.

A global tax on capital?

This brings one back to the way true wealth is transferred from generation to generation, being inheritance. Many wealthy families have over time understood the correct use of offshore trusts in tax-free zones, which own the family's passive investments and interests in multi-generational family businesses. Ultimately each generation builds on the family's endowment, which is protected against government inheritance taxes and other possible risks.

Piketty also alerts to the fact that in the current century, income divergence between individuals is greater than in previous eras. History shows that the wealthy never used to work; they lived from the income generated from their capital. Today the wealthy are fortunate to access the best education at the best schools and universities, have connections to secure the most lucrative business positions and earn the most income. One only needs to consider the pay of a top CEO in the USA versus that of a minimum wage earner in the same company. In South Africa similar numbers are often cited in the media.

Another suggestion that Piketty makes, which may be the ultimate route to go, is the globalisation of tax on capital for the wealthy. Such a tax will be raised regardless of tax residency or the entity holding direct or indirect interest of such a wealthy individual. However, as he rightly suggests, such a global tax may be the utopia, but this could be a step in the right direction.

If one considers the buy-in by countries into the Base Erosion and Profit Shifting (BEPS) Actions and the common reporting standard of the Organisation for Economic Cooperation and Development (OECD), as well as its USA equivalent being the Foreign Account Tax Compliance Act (FATCA), one may be moving closer to such a possibility in time.

The OECD Tax Policy Reforms report of 2020 assesses tax reform trends before COVID-19 and these may change due to the global economic crisis resulting from it. Nonetheless, the following are noteworthy:

- Personal income tax reductions continued.
- Corporate income tax rate cuts continued.
- Regarding international taxation, BEPS Action steps have continued to pick up momentum in an attempt to address global tax avoidance practices.
- There has been an increased focus on property taxation, showing a clearer trend towards increases in property taxation.

If one takes Piketty's view, and aligns it with the OECD 2020 report, it is noteworthy that there is a move away from looking at labour to continue funding governments and a slight trend towards increasing tax on capital. Of course, COVID-19 may have interrupted this trend, but at the same time it may just be the trigger that accelerates the movement towards a wealth tax.

According to a recent *Business Insider* article, Democrats in the USA have suggested the introduction of a wealth tax to curb the power held by the wealthy in the USA. Wealth taxes are not new, and in 1990 twelve European countries had this form of taxation. However, currently there are only four countries, being Norway, Switzerland, Spain and Belgium. Furthermore, the amount of taxes raised via this system has been minimal.

Administering a wealth tax

One of the main criticisms of this type of tax is that it is difficult to administer and often results in a flight of capital from the applicable country, with a change of tax residency often tied to it.

Locally, Judge Davis and the Davis Tax Committee have also been outspoken on this tax. They stated that while a wealth tax would add to the legitimacy of the tax system in a country with vast inequality, it would require significant institutional capacity that cannot be switched on like a light. In my view, they correctly state that administering a wealth tax will require a dedicated team to track down assets, some of which are not disclosed and are held via offshore trusts and structures. Something a global wealth tax may solve?

The global village

As to the feasibility of a wealth tax, it would be fair to state a response such as "it is complicated, but not impossible". As the world is becoming a global village, the ultimate centralisation of governments into a single unit may result in a global tax system where individuals and structures cannot escape any form of taxation.

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HOPE FOR SARS REJUVENATION

45 minutes CPD

▶ **GASANT JACOBS,** gasant.jacobs@taxtechglobal.com

After the devastation at SARS and, in the face of economic challenges, can SARS regain the respect of taxpayers and its position as enforcer of equitable tax laws?

Introduction

As 2020 finally came to an end, no one considered it soon enough. It was that hard a year. But 2020 was not all doom and gloom. Yes, we had a global pandemic, we had the collapse of the global economy, and many South Africans were plunged into even greater hardship. It is hard to conclude which was worse, the economic devastation or the health and social meltdown South Africa had to endure because of this pandemic.

The year ended with the announcement of the discovery of a range of vaccines, and hopefully this will herald a new beginning for 2021. As the country looks to rebuild the South African economy and ease the societal devastation caused by the premature passing of many of our loved ones, one thing crept up on us almost unnoticed: a rejuvenating SARS.

Much has been written over the last few years about the systemic breakdown of the once widely admired tax administration. The devastation of the systematic hollowing out of SARS not only had a human toll, but gradually SARS was beginning to lose its awe and aura in the eyes of the tax-paying public. SARS became just another state institution: inept and run by government-appointed, pliable management, with little or no experience and even less respect from the taxpayers. For many taxpayers, it was no longer a simple decision to be compliant, because SARS was no longer perceived as that institution which will ensure that there will be consequences for non-compliance.

Over the last few years, SARS appeared in the media mostly for all the wrong reasons. This continuous blitz that we were accosted with had the inevitable consequence of taxpayers beginning to think that if SARS is so corrupt in itself, how could the tax administration even morally expect that hard-working South Africans should pay their taxes, especially if the titans of state capture were paid by SARS instead of them paying SARS?

The silver lining to an otherwise dark cloud

One silver lining of an otherwise dark 2020 is that South Africa appointed Edward Kieswetter in the year before the pandemic wreaked such devastation. As if it was not hard enough to turn the once mighty SARS into an institution that was to be respected again, the first anniversary of the appointment of the new Commissioner was marked by SARS having to give the country a half a trillion rand as COVID-19 relief; money the country simply did not have to give.

In March 2019, SARS appointed the new Commissioner on a five-year contract, and now, almost two years into this appointment, substantive, systemic changes have become apparent. At the beginning of 2020, SARS released its first five-year strategic plan with the new Commissioner at the helm, and it was like the old SARS came back. The plan included:

- Re-building public trust and confidence
- Providing clarity and certainty
- Making it easy for taxpayers and traders to comply with their obligations
- Detecting taxpayers and traders who do not comply
- Expanding the use of data
- Modernising its systems to provide digital and streamlined online services

The strategic plan is part of an offensive that is intended to sway public opinion and looks to the above interventions to serve as a measure that helps to ensure that the top three words the public associates with SARS are all positive. It also aspires to reduce the tax gap to 10–15%. It is because of this tax gap that we argue later in this article that the money is in fact there.

At the end of 2020, the green shoots of rejuvenation are becoming self-evident. During the last quarter of the year, SARS appeared in the news on multiple occasions, and this time for all the right reasons. Tax cases were being finalised (and seen to be finalised) with many delinquent taxpayers either going to jail or having to pay SARS the outstanding taxes, coupled with heavy penalties and interest. Of course, SARS is losing some of the cases as well, but this bodes well for our legal system, showing that the taxpayer can dispute a SARS claim and have full confidence that he or she will get a fair shake when the matter is heard.

When the new Commissioner was appointed in 2019, SARS was in serious decline. Less than 67% of the public had confidence in SARS. Voluntary tax compliance was estimated to be less than 67%. Yet, less than 30% of audit interventions yielded results.

Is the money really out there?

The Davis Tax Committee had its role expanded by the Finance Minister in 2019 and was mandated to examine the "tax gap", that is, the gap between what should be and what is actually collected. Since then, it has been working closely with authorities to figure out the sum total of losses. The estimated R50 billion figure includes losses from customs, VAT, base erosion and profit shifting (BEPS) and the non-payment of tax by wealthy individuals. Judge Dennis Davis, head of the committee, suggested that the figure could potentially be higher, with the amount lost due to VAT fraud and tax evasion by high-net-worth individuals yet to be quantified. "If you take all of that, a R50 billion estimate is very conservative", he said.

Over the last few years, SARS struggled with performance issues and tax revenue collection has been below forecasts for some time, compounded by the fact that the country is in a deep recession. The pandemic accelerated debt levels and the unemployment rate, while at the same time state enterprises require constant bailouts. Even before the pandemic, National Treasury identified poor economic conditions, low business confidence and a lack of reliable electricity supply as some of the key contributors to the decline in tax revenue witnessed over the past few years.

According to SARS, about three million South Africans accounted for 97% of the country's personal income tax collected in 2019. In Q4 of 2020, President Ramaphosa presented the South African Economic Reconstruction and Recovery Plan to Parliament. This plan warned that South Africa will not be able to meet the Finance Ministry's debt targets and it may be undesirable for it to attempt to do so when the economy is being battered by the fallout from the coronavirus. In short, South Africa is running out of money, and time to address its financial woes.

Instead, the President's plan proposed a number of tax hikes and changes to be considered, including:

- Increases to the fuel levy and estate taxes
- A three-year "solidarity tax" that would increase taxes for higher earners
- The introduction of a basic-income grant that could cost R243 billion a year and would necessitate tax increases
- Pension funds and other private investors backing infrastructure projects if there is a clear pipeline for the next 10 to 20 years

The South African tax base

In its last annual report, SARS and the National Treasury indicated that only 3 million out of the country's population of 56 million paid almost all of the personal income tax in 2019. This constitutes a group of just over 5% of the country that has to fund the rest. Added to that, the contributions from companies – the third largest contributor to state coffers – were down substantially in the tax returns submitted during the 2019 fiscal year.

SARS TABLE SHOWING INCOME BY TAX TYPE

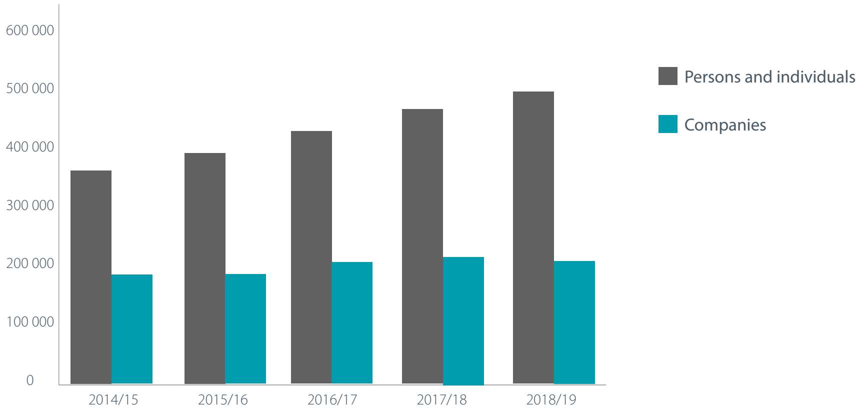
TAX TYPE	PRINTED ESTIMATE FEB 2019	REVISED ESTIMATE FEB 2020	ACTUAL RESULT	INCREASE/ DECREASE ON PRINTED ESTIMATE	INCREASE/ DECREASE ON REVISED ESTIMATE
	R million	R million	R million	R million	R million
Personal Income Tax	554 807	529 309	529 172	-25 634	-137
Company Income Tax	232 940	219 229	214 986	-17 954	-4 243
Dividends Tax / Secondary Tax on Companies	31 893	29 144	27 930	-3 963	-1 215
Value-Added Tax	360 471	344 202	346 761	-13 711	2 559
Domestic VAT	*406 210*	*399 433*	*399 288*	*- 6 922*	*-144*
Import VAT	*187 422*	*182 666*	*179 987*	*-7 434*	*-2 679*
VAT Refunds	*-233 161*	*-237 897*	*-232 515*	*646*	*5 382*
Fuel Levy	82 958	79 277	80 175	-2 782	896
Customs Duties	60 029	56 325	55 428	-4 601	-897
Specific Excise Duties	42 354	46 765	46 827	4 473	62
Taxes on Property	17 159	16 038	15 980	-1 179	-58
Skills Development Levy	18 759	18576	18 486	-272	-90
Other Taxes and Duties	20 840	20 069	20 021	-819	-48
Total Tax Revenue	**1 422 208**	**1 358 935**	**1 355 766**	**-66 442**	**-3 168**
Customs And Excise Revenue	392 615	384 276	381 631	-10 984	-2 644
Tax Revenue (excl. Customs and Excise)	1 029 593	974 659	974 135	-55 458	-524
Total Tax Revenue	**1 422 208**	**1 358 935**	**1 355 766**	**-66 442**	**-3 168**

SARS' data show that personal income tax, corporate income tax and VAT remain the largest sources of tax revenue, comprising approximately 80% of the total tax revenue collections.

Astonishingly, according to SARS figures, only 24% of companies that submitted tax returns were profitable. "Sluggish economic growth, structural challenges in some sectors of the economy, low confidence levels and political uncertainty" were pointed out as factors that impacted on company profits and tax contributions. This is an illogical situation. A cursory glance at the country's stock exchange will show that shareholder value has increased exponentially over the last five years. Is it inconceivable that shareholders can continue to increase their value but their companies are not profitable?

The graph below is just as astonishing.

SARS GRAPH SHOWING TAXES ON INCOME AND PROFITS



How is this even logical? Companies are reporting record profits, the stock markets around the world are breaking through the barriers, company stock prices are soaring on all global bourses, but the tax burden of companies remains about the same as about a decade ago? How is this even possible? The table and graph are a manifestation of what has commonly been referred to as BEPS, and it seems to continue unabated, despite the vast policy changes which were introduced by tax administrations around the world.

So, what can SARS do to secure stable sources of revenue to provide the social goods expected by the South African populace?

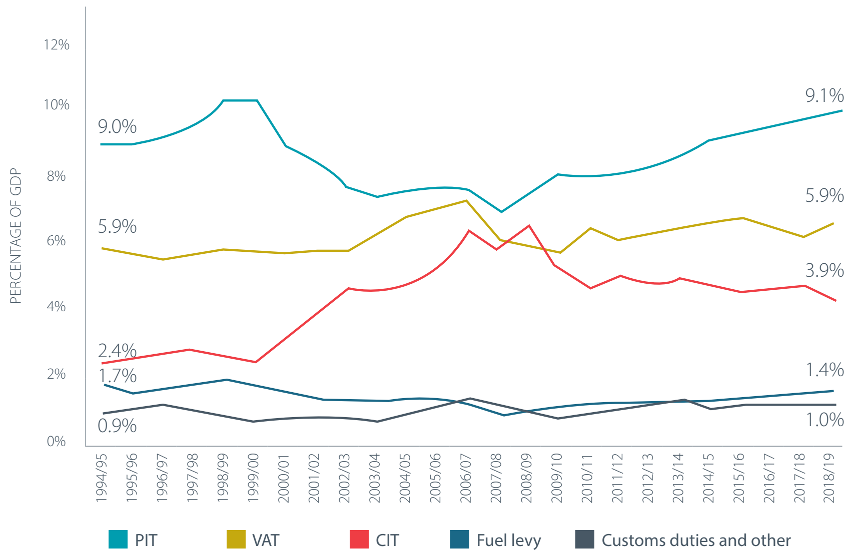
The required interventions

There has been a marked improvement at SARS since 2019. The Rogue Unit report (and all the baggage that comes with it) has finally been put aside. This will allow SARS to regain the moral high ground, which is absolutely imperative if SARS hopes to succeed in securing that holy trinity of public confidence, voluntary compliance and reducing the tax gap. The answer lies in transparency. As taxpayers, we need to know that we can trust SARS to act with integrity. And given the current political climate, and apparent lack of consequence management for almost any kind of malfeasance, the public needs to know that SARS is once again sitting on that perch of being beyond moral reproach.

Artificial intelligence and reliance on data

The Commissioner is known to be a big supporter of improved technology to increase tax efficiency. The fact that SARS introduced auto-assessments for this past tax year is indicative that SARS is addressing the digital demands of collecting tax from individual taxpayers. SARS now needs to show a similar determination to introduce the tools that will curtail the rampant transfer pricing abuses that affect tax administrations throughout the African continent.

SARS GRAPH INDICATING TAX REVENUE BY CATEGORY



Over the last few years, only corporate income tax reduced markedly, while revenue for every other form of tax increased over the same period. Are we to imagine that company profits are on a sustainable decline whilst shareholder wealth has increased exponentially over the same period?

The decision by SARS to re-establish its Large Business Centre (LBC) will go a long way to ease the administrative and compliance burden of corporate taxpayers and multi-nationals. It should enhance tax collections of a component of the tax base where they have fallen sharply since the centre was dismantled in 2015 following major restructuring under Commissioner Tom Moyane.

Hopefully, the new LBC will encourage compliance, ensure responsible enforcement and offer specialised and sector-specific expertise to large businesses. Sector-specific expertise needs to be developed in the most crucial sectors in the economy, including financial services, e-commerce, mining and agriculture. Expertise in highly complex tax legislation, notably international taxation, including transfer pricing, needs to be nurtured to ensure that revenue is taxed where it is generated. This will arm SARS with greater administrative knowledge, better risk-profiling in terms of audits, and better audit and dispute outcomes; ultimately, cajoling corporate taxpayers to greater levels of voluntary compliance.

We saw, towards the end of 2020, the SARS Commissioner was appointed as the Vice Chair for ATAF. This is a significant signal to the international community that SARS is back to reclaim its rightful place as a leader in tax administration on the African continent. It is essential that SARS rekindles its multilateral relationships in the sphere of international tax, especially so in Africa that could potentially become a massive unitary trading block.

In March 2020, we saw the change in tax law that dealt with the treatment of foreign income. Before the change, South African tax residents who earned foreign income had their income fully exempted by SARS if they were outside the country for more than 183 days. The law has now been amended. South African tax residents who earn foreign income will have the first R1.25 million of that income exempt from tax but will have to pay tax on the income in excess of the first R1.25 million. This simple change in the legislation is akin to the introduction of a whole new tax revenue stream. Hitherto, those who earned foreign income were deemed outside of the tax net. Though the change in the law was touted long before the new Commissioner joined SARS, the Commissioner's belief in technological advancement for an increasingly efficient SARS should go a long way to ensure that this new revenue stream is adequately tapped.

Conclusion

We believe the money is out there. It might require some policy tweaks but, more importantly, it requires inspirational leadership. As 2020 came to a conclusion Elon Musk, the South African-born CEO of Tesla, sent out a memo to his staff imploring them to keep up the levels of production over the festive season to ensure that their clients who are waiting to take delivery of their vehicles are not disappointed. He later sent a second memo, imploring those same individuals to collectively put their heads together to come up with ways of how the company can be more cost efficient. This, let me remind you, is from the world's richest man, addressing the employees of one of the world's most valuable companies, imploring them to improve productivity and reduce costs!

SARS says its vision is to "build a smart, modern agency with unquestionable integrity that is trusted and admired". We now look to 2021 to see how SARS regains our trust as an admirable tax administration; whether SARS will succeed in getting tax compliance, voluntary or otherwise.

We believe that in the foreseeable future the institution will be restored to its former glory, as can be seen by the green shoots which appeared in an otherwise dark 2020. Still, it needs the fullest cooperation from tax professionals and industry bodies who advise on tax strategies.

15 minutes CPD

IN-HOUSE TAX DIRECTORS AND BOARDS: BEWARE OF THE TAX RISKS AHEAD

▸ **INE-LIZE TERBLANCHE,** ine-lize.terblanche@infidi.co.za

Our article takes in-house tax directors and members of tax boards through the risks and their obligations in an ever-changing environment.

"Transparency is vital as we manage our way through our increasingly dynamic tax world."

The job of the in-house tax director is growing harder every day – from the threat of increased taxes to more aggressive enforcement across the African continent. We take a brief look at what an in-house tax director and a company's governing board must consider to ensure proper tax governance and to mitigate the tax risks ahead.

Corporate taxes in the spotlight

According to the International Monetary Fund the tax landscape has been profoundly affected by COVID-19 in three significant ways, with lasting implications. They predict the following:

1. There will be an increase in intolerance for aggressive tax minimisation by large taxpayers – however legal it may appear.
2. Developing countries are likely to see a significant decline in their average tax-to-GDP ratio in 2020 and onwards. In addition to emergency funding, even more effort will go into longer-term fiscal sustainability and the importance of improving domestic revenue mobilisation.
3. The fundamental work already being carried on in many lower income countries to reform and build tax collection, tax modernisation and tax governance capacity will become an even higher priority, as it is central to a development strategy aimed at delivering on the United Nations Sustainable Development Goals.

The Global Forum on Transparency and Exchange of Information for Tax Purposes, in its *Tax Transparency in Africa 2020 Report*, also indicates the urgency with which key elements of a functional infrastructure for exchange of information is being implemented. For instance, the exchange of information networks of African countries have expanded significantly to 3 262 bilateral relationships compared to 2 523 in 2018. More African countries are using cross-border exchange of information requests in their tax investigations. The number of exchange of information requests sent increased by 48% between 2018 and 2019, which translated into additional tax revenue. Between 2014 and 2019, a group of eight African countries identified $189 million of additional taxes in this manner.

"Now more than ever, the work on increasing transparency is important for Africa, and the collaborative efforts of ATAF and the Global Forum will ensure that African countries increase their exchanges of information, while contributing to the fight against illicit financial flows."
– Logan Wort, Executive Secretary of ATAF

At the 4th High-Level Tax Policy Dialogue of the African Union in August 2020 Victor Harison, the Commissioner of Economic Affairs for the African Union, called on African countries to participate towards vigorous tax policy aimed at multinational companies, so that profits from their wealth can be shared more equitably on the continent and to strengthen domestic revenue mobilisation.

People, planet and prosperity: Tim Mohin, the outgoing Chief Executive of the Global Reporting Initiative, called on business leaders, stating that *"they need to take off the blinders and realise that corporate (and investor) interests are served only when companies consider, and meet, the needs of all its*

stakeholders and not just its shareholders, meaning that business leaders need to manage a fine balance between profit and purpose".

The King IV Report on Corporate Governance (King IV Report™) recognises companies as integral parts of the broader society. Also, King IV defines corporate governance as the exercise of ethical and effective leadership by management towards the achievement of defined governance outcomes: ethical culture, good performance, effective control and legitimacy.

Being socially responsible includes being a responsible and transparent taxpayer. There is a widespread perception that not all companies pay their fair share of taxes. Many stakeholders that argue this point often leave out the fact that businesses contribute to society in many ways, not just corporate income tax. In the past year regulators and policymakers have demonstrated a growing desire to address the connection between financial risks (including tax) and environmental, social and governance related concerns. They also call for organisations to consider appropriate steps to publicly demonstrate their commitment to adding value and building trust. Consequently, the governing body should oversee and monitor how the consequences of the organisation's activities and outputs affect its status as a responsible corporate citizen. This includes having targets and measures agreed with management, related to a responsible and transparent tax strategy. Simply paying tax "that is due" is not enough, if a business' behaviour does not stack up to public expectations.

According to the Principles for Responsible Investment these are views shared by institutional investors who may have the means to steer companies to focus on genuine economic activity as opposed to tax behaviour that can negatively impact their profitability and sustainability and reduce wider portfolio returns. There is an imperative for long-term institutional investors to understand aggressive tax practices within their investments, support a shift away from tax practices that are short-term and unsustainable, advocate the creation of a level playing field in tax policy matters and communicate expectations to companies in order to drive broader societal and economic objectives.

Although 2020 is a uniquely challenging year, these are just some examples indicative of an even more challenging tax environment for taxpayers going forward. Tax risk is an inherent part of doing business – it is not possible to reduce tax risk completely, given the changing landscape. However, effective tax governance should be on the agenda of the in-house tax director, with accountability of the governing board to work towards building justified trust in the economies in which they operate. Organisations need to be aware of their exposure and ensure that effective tax risk management – aligned with an enterprise-wide governance, risk and assurance framework – is embedded in the culture and day-to-day activities of the business.

What are the pertinent questions that governing body members and in-house tax directors should ask in this context?

Is the company's position on tax ethical and effective in light of the changing tax landscape and priorities?

It is well known by now that the King IV Code™ requires of the governing body to be responsible for a tax policy that is compliant with the applicable laws, that is also congruent with responsible corporate citizenship and that takes account of reputational repercussions. This implies that ethical values are applied to decision making and tax conduct to balance tax compliance with business activities and ethical, societal and sustainable development-related expectations. It can include the organisation's tax principles, its attitude to tax planning, the degree of risk the organisation is willing to accept and the organisation's approach to engaging with tax authorities. In addition it implies that those responsible act with due care, skill and diligence and take responsibility for anticipating, preventing or otherwise ameliorating tax risk.

The organisation's tax strategy, in line with the organisation's core purpose, its risks and opportunities, strategy, business model, performance and sustainable development are all inseparable elements of the value creation process.

Are there appropriate processes, projects, programmes and initiatives that support adherence to the approach to tax set by the organisation?

Without a formalised tax control framework and generally accepted tax risk management principles it is challenging to keep a finger on the pulse of what is happening within the business and how it impacts tax.

The tax control framework should be a best fit for the organisation to proactively address internal and external tax risk, with clearly defined roles and responsibilities at an executive level, within specialist tax functions that facilitate and oversee tax risk management and compliance and at the level of line functions that own and manage risks. Due consideration should be given to who in the organisation is accountable for tax governance and it is important to satisfy the degree to which the highest governance body in the organisation has oversight thereof.

The success of the tax control framework in achieving its objective will be determined by the manner in which it is communicated and embedded across the organisation and whether it is regularly evaluated, monitored, tested and maintained.

Does the tax function have the resources, skills, competency and experience to execute on the tax strategy?

Tax functions are continuously transforming to meet KPIs, such as agility and cost-effectiveness, value add and transparency. Whether it is technical expertise, local understanding, strategic thinking, technology enabled or good governance practice, the tax function needs to make choices and prioritise what they can do in-house and what can be outsourced. It may also mean upskilling staff or transferring tasks to enable valuable resources to focus more on strategic activities.

Are accountability and responsible citizenship demonstrated?

Transparency is vital as we manage our way through our increasingly dynamic tax world. However, it is still regarded by many as irrelevant or unnecessary. Being socially responsible includes being a transparent taxpayer on a variety of matters, such as tax strategy, governance and risk management initiatives, stakeholder engagement, contribution to tax policy and total economic contribution. Being transparent about taxes is much more than a narrative confined to corporate reports. Think of it as part of the organisation's story of value creation and accountability. This story of tax requires an organisation to look not just at financial data, but also at the bigger sustainability picture. Becoming transparent about taxes is an incremental journey that evolves over time and requires collaboration and communication with both internal and external stakeholders.

There are visible trends globally and locally that indicate the important role of tax governance not only to create shareholder value, but also to move towards providing enduring value by building justified trust with stakeholders and ensuring sustainable participation in societies.

30 minutes CPD

COLLECTING TAX DEBTS: Spare The Rod, Spoil The Child

▶ **RUAN BOTHA,** ruan@rvrtax.co.za

How much tax debt is actually outstanding and does SARS have the capacity to collect all revenues due?

South Africa has passed its first wave of COVID-19 and, with no ace up its sleeve, it takes no hustler to see what hand our economy has been dealt. In his Medium-Term Budget Policy Statement (MTBPS), Finance Minister Tito Mboweni charted the course in securing the country's economic recovery post COVID-19 by undertaking to stabilise our fiscal deficit and debt-to-GDP ratio. This is, however, not merely for the asking as our economy is expected to contract by at least 7.8%, in comparison to the global forecast of 5.2%.

With whispers of a tax revolt and a foreshadowed fiscal cliff soaking up collected revenue, government's "bad hand" leaves no room to bluff when it comes to the billions of rands in uncollected tax revenue. The situation looks even more dire as Edward Kieswetter, Commissioner of SARS, estimated the revenue shortfall to be approximately R285 billion. In the current landscape where many non-compliant taxpayers are getting their own way because they are not being held accountable, this begs the question whether collection of outstanding revenue and admitted tax debts is feasible by SARS. This while compliant taxpayers are not getting what they are paying for and bear the brunt of deficits in basic service delivery.

The Finance Minister acknowledged in his MTBPS that "recent tax increases have generated less revenue than expected, and evidence suggests that tax increases can have large negative effects on GDP growth". This statement perhaps alludes to the revenue service's mind shift from over legislating to collecting of current and historic revenue.

SARS' burden to collect tax

SARS is the revenue collecting authority of South Africa and was established in terms of the South African Revenue Service Act of 1997, with the mandate and key objectives of efficient and effective collection of revenue. These objectives must in turn be achieved by the efficient and effective use of resources and the widest possible enforcement of national legislation concerning the collection of revenue.

SARS must further advise the Finance Minister of all matters concerning revenue, including the collection thereof, its powers and follow-through of revenue streams. The former seems to be neglected as SARS registered a revenue collection deficit of R14.5 billion against the revised revenue collection target in the 2018/2019 Tax Statistics Report, and in the MTBPS the Finance Minister predicted even larger revenue shortfalls that will persist over the medium term in 2020/21. This mirrors the historic revenue collection statistics, wherein SARS indicated that billions of rands in historic uncollected tax revenue remain outstanding, all of which fully admitted to being payable.

The Finance Minister further detailed in his MTBPS the key factors affecting current revenue collection: a significant decline in compensation, weaker import outlooks and lower VAT collections, drop in excise duties resulting from the (now lifted) tobacco ban, and reduction in corporate income tax and dividends tax receipts. A possible explanation for SARS' lack in collecting taxes due is hinted at in the Tax Ombud's report on investigation into systemic issues. Two of the major issues outlined by the Tax Ombud was the fluidity of the PAYE statements of account and SARS' inability to adhere to the dispute resolution timeframes, in that there is a possible aptitude and/or capacity issue.

Commissioner Kieswetter, in a 2020 press release, stated that "SARS would come down harder than ever before". Contrary to the point and with current revenue collection spiralling downward, outstanding historic revenue seems to be at the bottom of the list of things to do – the big question is whether the historic tax debt is in fact real if it is owed but insufficient steps are taken by SARS to ensure taxpayer accountability.

SARS' collection mechanisms and triumphs

The Tax Administration Act holds tax compliance as a central value, shapes the weapons in SARS' arsenal, and enables SARS to issue assessments and select taxpayers for inspection or verification and conduct audits. Some of the Act's creative mechanisms include third-party appointments in terms of section 179 and issuing of civil judgments by virtue of section 172. SARS may also apply to court for a warrant of execution and, where intent is proven, imprisonment may be sought in terms of sections 234 and 235 of the Act. At this point it is important to note that SARS is a creature of statute and cannot perform any action or exercise any power that is not contained in the Act.

A recent example where SARS applied its mind to collect historic tax debt for the 2006 to 2012 years of assessment is reported in the judgment of the rhino poaching kingpin *Joseph Nyalunga v CSARS* (90307/2018). The matter revolved around the reviewing and setting aside of assessments in terms of sections 95(1) and 100(1)(a) and (b), wherein the court held that if a taxpayer has not submitted any returns SARS is entitled to issue an assessment based in whole or in part on an estimate, and found in favour of SARS as the taxpayer's time period to raise an objection had passed.

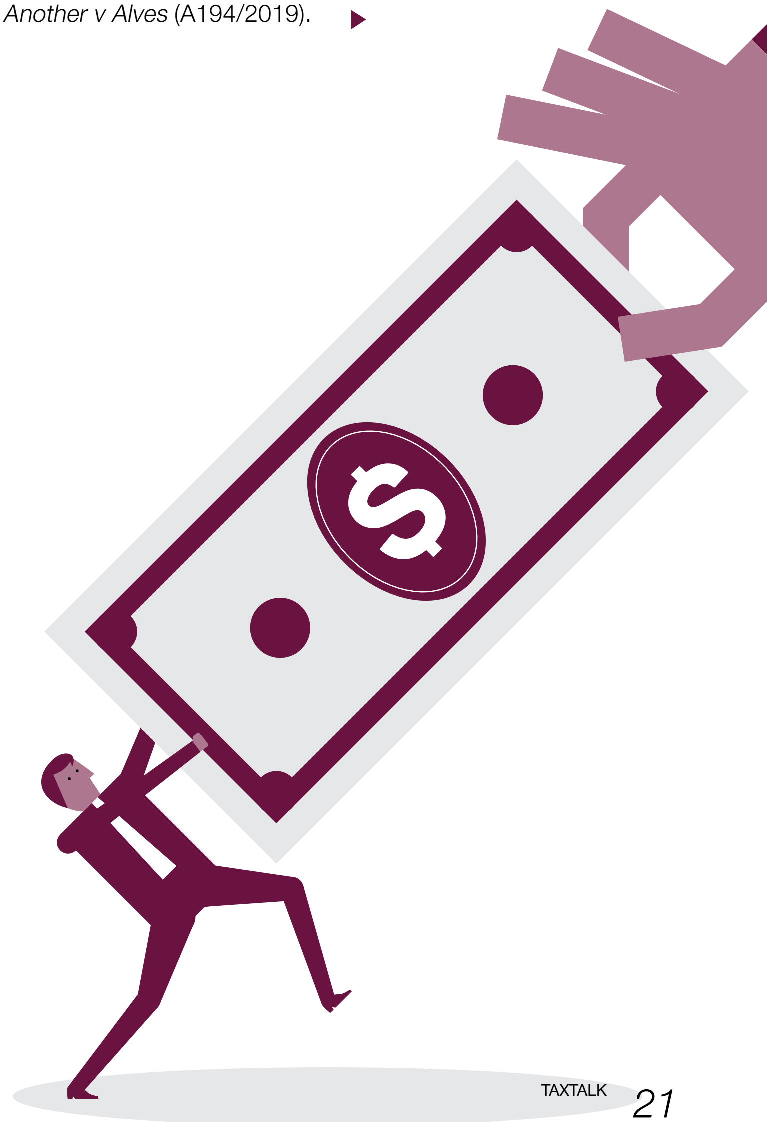
In the matter of *Barnard Labuschagne Inc v SARS and Another* (23141/2017) SARS went the extra mile by providing the taxpayer with one of its employees on a full-time basis to assist the taxpayer to get their affairs in order. This dispute relates to the taxpayer's tax debt comprising VAT, PAYE, UIF and SDL for the dates 2009 to 2017. SARS in terms of section 172 issued a certified statement (to be treated as a civil judgment). The taxpayer applied to court to have the civil judgment rescinded. However, the court held that although a certified statement may be treated as civil judgment for purposes of recovering outstanding revenue, it is not a civil judgment by a court and therefore cannot be rescinded.

In 2019, after obtaining a civil judgment and warrant, SARS moved in on cigarette baron Adriano Mazzotti, and attached assets at his private property for the outstanding tax debt of R33 955 228.22.

SARS is not only clamping down on individuals but also corporate entities, as illustrated in CSARS v Zikhulise Cleaning and Maintenance and Transport Service (14886/16). This matter revolved around a final winding-up order in terms of section 177 of the Tax Administration Act and section 346 of the Companies Act, 1973. The taxpayer, to the detriment of the fiscus, went as far as ceding its contracts to other parties which in turn resulted in a tax debt of R204 million. The court held that should SARS fully comply with the provisions of section 177(3) of the Tax Administration Act, the taxpayer may be liquidated pending the outcome of an assessment under appeal.

SARS has been scrutinising personal income tax and corporate income tax non-compliance and has also zoned in on taxpayers disobeying the provisions of the Customs and Excise Act. This was clearly illustrated in *BP Southern Africa (Pty) Ltd v CSARS* (19955/2020; 22772/2020), where the taxpayer sought a refund through set-off against import duties where exportation was completed. However, the court found that the taxpayer failed to produce documentation proving export of fuel and SARS correctly snubbed the set-off.

Shortly after the judgment, on 4 September 2020, SARS issued a media statement in which it again stressed the importance of taxpayers providing the necessary supporting documents to comply with the Customs and Excise Act. SARS put this point to the full bench in the Bloemfontein High Court in the matter of *CSARS and Another v Alves* (A194/2019).



"For some it might seem as if SARS is grasping at straws but compliant taxpayers must keep faith that SARS will be able to collect the historic debt."

On the VAT front, a couple of cases have been doing the rounds. However, the most noteworthy must be that of horseracing enthusiast Ms Hariram who was sentenced to 10 years' effective imprisonment for theft and fraudulent VAT claims amounting to R1 981 762.19.

A new tomorrow

Glimpsing into the future, we might see SARS building on a plan of action. SARS and Treasury have detailed their near-term objectives to collect current and historic tax debts as closing the tax gap, remaining focused on international taxes, increasing enforcement to eliminate syndicated fraud and tax crimes, continuing to use third-party data to find non-compliant taxpayers, collecting PAYE and VAT debt, and ensuring that outstanding taxpayer returns are filed and liabilities paid.

As SARS has shown its teeth, one wonders whether the bluff is real, since the revenue collection statistics suggest a different story. With that being said, taxpayers are now more curious than ever as to whether SARS' plans to recover the mammoth outstanding revenue will be successful.

SARS' uncollected revenue – how real is the debt and feasibility of collection?

In a culture of spoiled, non-compliant taxpayers that do not blink at SARS' well stocked arsenal, SARS must put all its cards on the table and clean its house. Late in 2020 the HAWKS decided to wash the dirty laundry, as one of SARS' own was arrested at their Bloemfontein office – accused of attempting to solicit a bribe from a taxpayer to write off a historic debt for a mere R20 000. This attests to the sad state of the previous administration and suggests SARS still has a long way to go.

Trapped in economic stagnation SARS cheekily missed its revenue collection target by R300 billion in the past fiscal year and still faces the national debt of R4 trillion. With all its collection powers at hands, why is it then that SARS keeps on missing its revenue collection targets? The Tax Ombud report again sheds some light in confirming that an average of above 80% of matters referred to it were resolved in favour of taxpayers. This demonstrates that even if SARS are missing their targets, the outstanding revenue might not be the country's real debt as not all assessments issued reflect the true tax position of taxpayers. To make matters worse, not all taxpayers are aware of their rights in terms of the Tax Administration Act and may be oblivious to simple mechanisms of dispute resolution.

Clearly there is a debt. However, how real it is, is up for debate. The more pertinent question is: what does a short-staffed and incapacitated SARS stand to do when faced with section 171 of the Tax Administration Act, which imposes a ban on SARS commencing revenue collection proceedings after 15 years from date of assessment?

This time limit places even more pressure on SARS: it is now time to go all in, weed out corruption, rebuild its house and ensure collection of what is due to the fiscus. Due to the previous administration's mismanagement, the feasibility of collecting outstanding revenue remains doubtful. For some it might seem as if SARS is grasping at straws but compliant taxpayers must keep faith that SARS will be able to collect the historic debt. The new administration has set the pace. It is too soon to tell what the future holds but one truth remains: when the rod is spared the child is spoilt.

THE OECD PILLARS
THAT ARE ABOUT TO CHANGE THE INTERNATIONAL TAX WORLD

15 minutes CPD

▶ **PATRICK GRANT MCLENNAN,** PMcLennan@bdo.co.za

The OECD's Pillars 1 and 2 represent the biggest changes to the international tax paradigm since the initial model tax treaties of the late 1920s. Read our article to see whether the move away from the tax treaty system means that the days of low-tax jurisdictions are due to come to an end.

After much anticipation in the tax world, on 12 October 2020 the Organisation for Economic Co-operation and Development (OECD) released the blueprints on Pillars 1 and 2 – the recommended approach to the taxation of the digital economy. The public was requested to provide input by 14 December, which will have passed by the time this article has gone to press. Now, the tax world is in another waiting game for the finalised reports, which are due to be completed mid-2021.

Perhaps now is a good time to reflect on the potential structural changes which may result from the implementation of the Pillars. A key aim of the Pillars is to address structural issues related to the taxation of the digital economy, particularly attributed to perceived base erosion and profit shifting (BEPS) from high-tax jurisdictions to low-taxation jurisdictions (with little to no substance). If implemented, the Pillars will represent a shift from the existing tax treaty network to a multilateral and consensus-based approach, reliant on complex formulaic-type mechanisms and a mixture of quantitative and qualitative scoping factors. Will these changes shift the attractiveness of low-tax jurisdictions for corporate structuring? Probably not. However, to understand this hypothesis, we need to explore how the world got to the current international tax infrastructure and the facts that led up to the OECD Pillars.

How did we get here?

The modern tax treaty network, including the concepts of alleviating issues of double taxation, go back nearly 100 years to the aftermath of World War I and the creation of the League of Nations, the ill-fated predecessor of the United Nations. Amongst many factors, war and subsequent tax burdens (to largely fund rebuilding efforts) pushed the concept of double taxation to the forefront of policymakers' and businesses' concerns. The threat of double taxation was viewed as a hindrance to the movement of capital, which could otherwise help war-ravaged economies rebuild. In an effort to address these issues, the League, which is often reviled for its post-war peace-keeping efforts, entered into the fray of double taxation.

The League of Nations subsequently published a number of commercial reports on double taxation, including the *Double Taxation and Tax Evasion Report,* presented by the General Meeting of Government Experts on Double Taxation and Tax Evasion (1928). In essence this provided the model treaty for the prevention of double taxation in the sphere of "impersonal or personal taxes". As a result, hundreds of international tax treaties were entered into through 1939.

The 1920s was a short-lived era in international cooperation; not necessarily due to issues of double taxation, but the economic and political fallout from the Great Depression and its aftermath, and the rise of fascism in Europe and the outbreak of World War II.

It was not until the post-World War II era (roughly 1945 through to the 1960s) that international cooperation was, again, taken seriously. This era is best known for the subsequent founding of some of the key international institutions that we still recognise today, including the United Nations, World Bank, International Monetary Fund, General Agreement on Tariffs and Trade (now the World Trade Organisation), and the OECD.

The first draft OECD Model Tax Convention occurred in 1963 and, then, only a few dozen tax treaties were in place. However, now, according to the OECD, over 3 000 treaties are in place, which generally follow the OECD approach.

Flash forward to today

The world's economy looks very different than it did in the 1920s and 1940s–1960s. Not only are we trading more services and tangible goods across borders due to the facilitation of more globalised trade (communication and travel advancements also helping to enhance these), but the digital economy is more relevant than ever. Now, we are interacting with friends and family via the internet and, specifically, social media networks like Facebook; purchasing products through e-commerce marketplaces like Amazon; or even double-checking historical facts (e.g., for this article) through Google. Even 30 years ago, these things would have been largely unfathomable.

The previous "founding" eras for the current tax treaty system, the 1920s and 1940s - 60s, did not account for this digital economy. While the system accounted for physical presence, or nexus, in devising tax treaties, they may not cater for a transaction, or entire business for that fact, where the user's or consumer's activities are in South Africa, but the enterprise is located in Seattle (for example).

Hence, the OECD Pillars are here to address this very issue. In fact, the first paragraph of the blueprint on Pillar 1 reads: *"[W]eaknesses in the current rules create opportunities for base erosion and profit shifting (BEPS), requiring bold moves by policy makers to restore confidence in the system and ensure that profits are taxed where economic activities take place and value is created."*

Here, in the form of the Pillars, are the first steps in the bold moves. Whilst the Pillars rely more or less on the infrastructure of the existing tax treaty network, they also seek to confront their pitfalls in light of the characteristics of a twenty-first-century economy. The Pillars represent a large-scale change to the way we look at the international tax system, and a multilateral and consensus-driven solution, rather than one that is based on bilateral negotiations of tax treaties.

In short, Pillar 1 focuses on nexus and profit allocation, whereas Pillar 2 is focused on a global minimum tax intended to address remaining BEPS issues. Pillar 2, referred to as Global Anti-Base Erosion (or GloBE) is an international tax framework where countries can tax income earned in other countries if that income is taxed below a minimum effective rate. The Pillars represent the updated work related to BEPS Action 1, which identified the various broader tax challenges related to the digital economy. As such, if the Pillars are addressing BEPS, does that mean that tax authorities will see a movement of profits away from low-tax jurisdictions?

Goodbye low-tax jurisdictions?

It is suggested that many multinational enterprises operating in the digital economy are the perpetrators of BEPS, not only due to the inadequacy of the existing international tax infrastructure to deal with the digital economy, but also through complex corporate structures that often utilise companies in low-tax jurisdictions. Famous cases include Apple (in Ireland) and Amazon (in the EU).

Will low-tax jurisdictions become less relevant for multinational enterprises, particularly those party to the "digital economy"? The bold answer to this is no. First, and mostly obvious, people do in fact live and work in jurisdictions with low corporate tax rates. For example, Dubai, United Arab Emirates, which is often seen as a "low-tax jurisdiction", is home to over 3 million people and two of the

"The infrastructure exists through the tax treaty network to reduce the uncertainty around double taxation (but not eliminate it)."

world's major global airlines and has become a global hub of technology innovation. (The World Expo was supposed to occur there in 2020, but was delayed due to the ongoing pandemic.) If tax authorities think they will make places like Dubai less attractive by only focusing on tax, they are in for a surprise, or at the very least they will be let down.

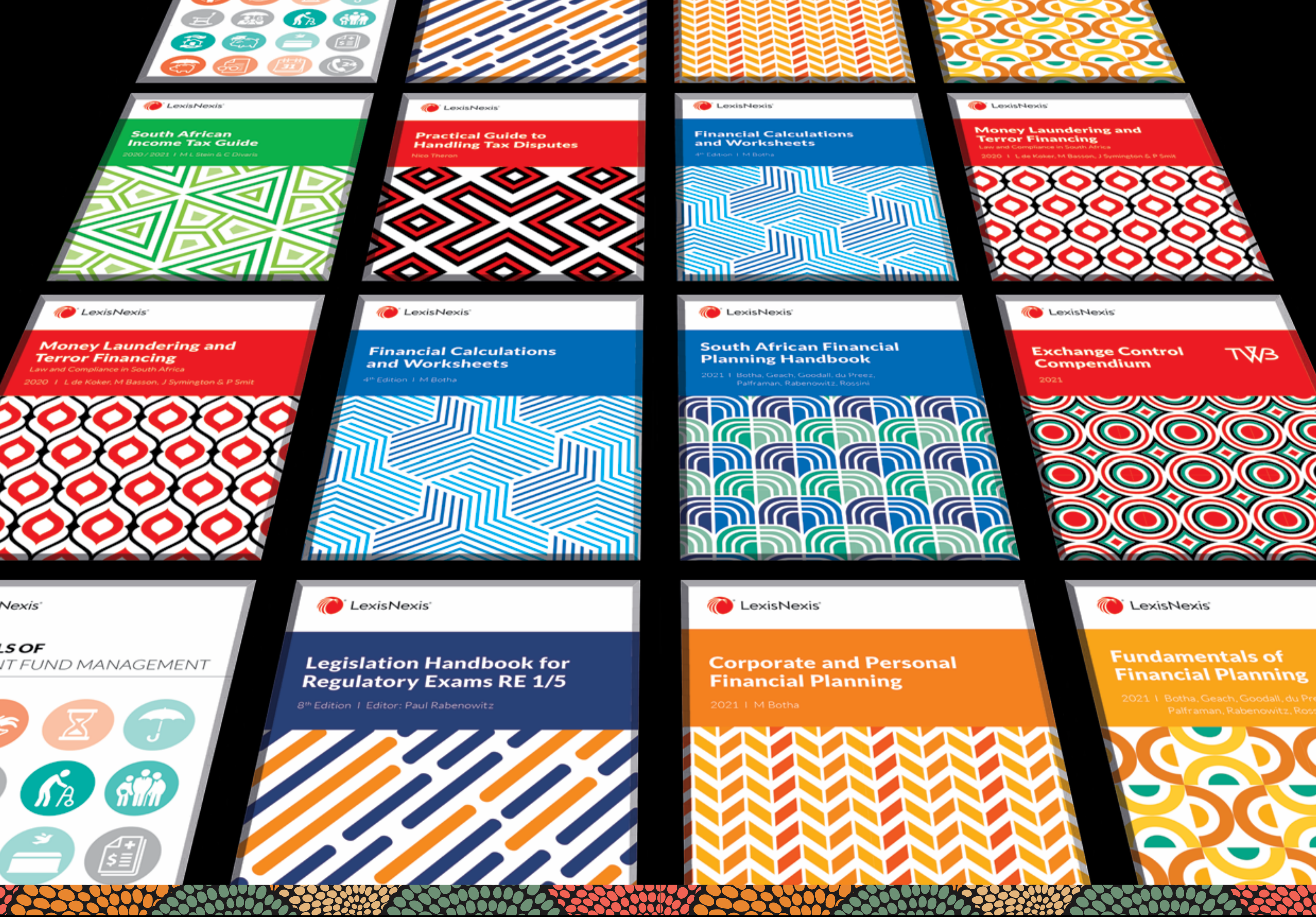
Remember, taxation is one of many factors multinational enterprises consider when it comes to corporate structuring. Companies, or at least the ones I have interacted with, are concerned about tax certainty rather than tax rates – they want to do business. There are other factors that are also significantly important. According to the 2019 World Bank "ease of doing business" index, this includes the ease of:

- Starting a business
- Dealing with construction permits
- Getting electricity
- Registering property
- Getting credit
- Protecting minority investors
- Paying taxes
- Trading across borders
- Enforcing contracts
- Resolving insolvency

Furthermore, in terms of the "paying taxes" category – the "sub-factors" focus on more procedural items (like timing to comply with refunds and tax return corrections) rather than the rate at which tax is paid. The top five countries in the index are New Zealand, Singapore, Hong Kong, Denmark and South Korea. Of these, only Singapore and Hong Kong are sought as ideal locations for multinational enterprise tax structuring, but the others have, arguably, high corporate income tax rates.

I would add to the World Bank's index that such factors as protection of intellectual property and capital, limited or ease of exchange control, proximity to key suppliers and supply chains, and government transparency and the strength of government-adjacent institutions (including an independent and efficient judiciary) are also critical to business decision-making. In fact, they are probably more important factors.

So, will the Pillars force companies to rethink structuring their businesses in low-tax jurisdictions? Probably from a technical and compliance standpoint – because change is coming. However, taxation will not be the only factor to force wholesale changes. The infrastructure exists through the tax treaty network to reduce the uncertainty around double taxation (but not eliminate it). The Pillars may bring this up to speed with the characteristics of a twenty-first-century (digital) economy. However, low-tax jurisdictions are likely here to stay.



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CONTINUING CRACKDOWN ON LOAN FUNDING TO TRUSTS

15 minutes CPD

NEIL HUGHES, neil.hughes@rsmza.co.za

Setting up a trust and loaning money to the trust at no or reduced interest used to be an effective estate planning tool. Our article takes you through the history and the current version of section 7C of the Income Tax Act.

The concept of granting a loan to a trust was commonly used in the past as an effective estate planning strategy. The general approach was that growth assets or funds were transferred into a trust, at their market value, with a resultant loan owing to the individual.

By transferring assets at their market value, this avoided exposure to any immediate donations tax. In addition, the growth on the underlying assets accrued in the trust and not in the hands of the individual; hence the estate planning benefit. In most instances, these loans would not carry any interest, thus avoiding any further accrual of income for the individual; that granted the loan.

It was just these avoidance aspects that SARS sought to shut down when it introduced section 7C of the Income Tax Act, with effect from 1 March 2017.

History of section 7C

When the new laws were initially proposed in the 2016 Budget Speech, they attracted significant feedback. In the initial proposal, the intention was to deem interest income in the hands of a person who granted an interest-free or low-interest loan to a trust. It was then also intended that the individual should recover from the trust the tax resulting from the deemed interest. Failing to do so would result in a dividend.

Prior to the effective date, the proposals were subject to significant revision. The main change related to scrapping the deemed interest approach and rather deeming the amount of interest foregone to be a donation. As a result, where the interest earned on a qualifying loan was zero or less than the official interest rate, then that benefit is deemed to be a donation, subject to the donations tax rules.

At that time, the transactions that were subject to the deemed donation anti-avoidance provisions were a loan, advance or credit provided by a natural person, directly or indirectly, to a trust, where that person is a connected person in relation to the trust. The provisions also extended to a loan, advance or credit provided by a company to the trust, at the instance of a natural person, where that person holds at least 20% of the shares or voting rights in the company, and is a connected person in relation to the trust.

There are certain exemptions that apply to the rules. These include, amongst others, loans granted in return for a vested interest in the income and assets of the trust. Also exempted are loans to a trust established for the benefit of a person with a disability, or a loan to a trust where the funds were used to acquire a fixed property that was throughout the year of assessment used as the primary residence of that person or their spouse.

Closing the loopholes

A shortfall or potential loophole that existed in the section 7C provisions in their first form related to the scenario whereby a trust owned the shares in a company. If the individual connected person to the trust granted the loan directly to that company owned by the trust, as opposed to granting the loan to the trust, it did not fall within the scope of the section 7C provisions.

The legislators quickly noticed this trend being adopted to bypass the section 7C exposure, and revised the section with effect

from 19 July 2017. The result of the changes was to include into the scope of section 7C any loan, advance or credit made by a natural person, if that amount is provided to a company of which at least 20% of the equity or voting rights are held by a trust and that person is a connected person in relation to the trust.

This broadening of the scope of the section 7C provisions limited opportunities to plan or structure affairs to mitigate exposure to the deemed donation provisions.

One of the alternatives, and perhaps the intention of the anti-avoidance provisions, is for the qualifying loan to be interest bearing, at the official rate of interest, so as not to be exposed to an ongoing annual deemed donation. However, the imposition of interest on the loan does need to be carefully considered, for the following reasons:

- The interest expense may not be deductible for tax purposes in the hands of the borrower, depending on the application of funds and nature of activities of the borrower.
- The interest earned by the lender will be taxable at their marginal rate, and if not paid will increase the value of the loan asset in that person's estate.

The challenge with the introduction of anti-avoidance provisions is that certain parties will continue to seek out alternate methods of structuring affairs to circumvent the anti-avoidance rules. This scenario has led to the latest proposed revision to section 7C.

Preference share structures

The latest structure identified by the authorities, which is being used to circumvent the anti-avoidance provisions of section 7C, relates to preference shares. This involves a natural person subscribing for preference shares, with no return or a low rate of return, in a company that is owned by a trust that is a connected person in relation to the natural person.

In order to curb this avoidance structure, amendments have been proposed to section 7C in the 2020 Draft Taxation Laws Amendment Bill. The proposed amendment firstly includes a deeming provision whereby the subscription price of the preference share issued will be deemed to be a loan advanced and dividends accruing in respect of those preference shares are deemed to be interest in respect of the deemed loan.

In the Draft Response Document, a concern was raised around the proposed definition of a preference share and, in response, National Treasury has proposed to adopt the same definition of a preference share that is used in section 8EA of the Income Tax Act. Section 8EA defines a preference share as any share other than an equity share or, in the case of an equity share, where the dividends relating to such equity shares are based on or determined with reference to a specified rate of interest or the time value of money.

The draft amendments have also been refined to deem as interest both dividends and foreign dividends, accrued in respect of the preference share. The term accrued as opposed to declared in respect of the dividends has been used to align with the principle of interest incurred.

The proposed effective date for the implementation of these amendments is 1 January 2021, and the changes will apply in respect of any dividend or foreign dividend accruing during any year of assessment commencing on or after that date.

What to do?

It is clear that ongoing steps are being taken to extend the anti-avoidance provisions to limit any structures aimed at reducing the exposure to donations tax or estate duty by transferring wealth into a trust structure. Taxpayers need to be continually aware of these amendments to appreciate and understand any exposure to potential ongoing deemed donations where qualifying loans exist.

Any taxpayer with a trust structure should consult a tax practitioner to understand the potential section 7C exposure, quantify the exposure and decide how best to manage this. That may include consideration of making the loan interest bearing at the official rate, or assessing the ability and impact of a repayment.

EXPATRIATE TAX CONSIDERATIONS FOR THE MODERN TAX PRACTICE

45 minutes CPD

▸ **JERRY BOTHA,** jerry@taxconsulting.co.za

A new regime for South Africans working abroad created a furore. Our article looks at the background and the current situation from the viewpoint of an opportunity for tax practitioners to apply their expertise.

There can now be little doubt that National Treasury and SARS were correct when they explained in Parliament that most South African expatriates abroad were non-compliant on their personal taxes. This came to light when National Treasury and SARS were probed on why they decided to change the dispensation that exempted foreign employment income, which worked perfectly well since the introduction of a residency basis of taxation. They were ready with their answer. According to SARS' records, less than 4 800 South Africans have submitted tax returns claiming the section 10(1)(o)(ii) exemption. When they added the number of South Africans who have done South African Reserve Bank financial emigration, the numbers simply indicated widespread non-disclosure and non-compliance.

Business case for tax practices making expatriates a focus area

There are two main reasons why the modern tax practice should focus on expatriate taxes and international individuals. Those who love the tax profession know that ensuring your clients are compliant yet tax efficient often means fighting a battle on two fronts – keeping your clients on the straight and narrow, but also having to deal with SARS, taken their own collection pressures and inherited inefficiencies. But how does this support a sustainable business model for the modern tax practice?

Earn more client fees

Normal tax work remains the bread and butter in your practice, but more specialised tax services is the area where the client ultimately gets true value. Out of interest, as a specialised tax practice, we never use the SARS internal complaints system or Tax Ombud, and seldom refer matters to alternative dispute resolution. We know there are more efficient ways to get to a legally correct tax outcome. The better paying tax work includes tax dispute processes, tax debt compromises, SARS debt collection, all forms of SARS litigation and voluntary disclosure programme applications. Expatriate employees and international individuals fall within this category and we would recommend any tax practitioner who is seeing hard times, or who needs to optimise their practice, consider also making this a focus area.

Expatriate risk and SARS prosecution

We can see from SARS audit questions crafted for expatriate employees that they have shifted gear and are now starting to ask more in-depth and penetrating questions. Coupled with the carefully executed National Treasury and SARS amendment to the legislation enabling criminal prosecution, it is only a matter of time before SARS will show its first successes against a delinquent expatriate and/or their tax practitioner.

Tax practitioners working together

These items have forced expatriates, but also their tax practitioners, to reconsider their position as well as the technical and practical nuances of the expatriate tax. As National Treasury and SARS have predicted, the simple conclusion often drawn is that there has been past non-compliance. Our tax practice has had the privilege to work with so many tax practitioners and accountants, assisting them to address any past mistakes and ensuring a well-planned approach for the future. This has been a remarkable journey, where we now often find ourselves as the advisor to tax practitioners and accountants, both looking after the best interest of the expatriate client.

What are the signs of past non-compliance?

We respectfully submit, having worked on many expatriate cases, that the number one case of non-compliance remains tax returns which are simply not submitted or where simply a "zero" tax return was incorrectly submitted. It takes a simple walk through of the history of the taxpayer to show that the tax returns submitted in the past do not align with the facts of the expatriate. It serves to note some of the most telling signs in this regard.

First year of being an expatriate

This is always an interesting year, especially where the expatriate did not leave exactly at the end of February, which results in a so-called "split year" treatment. What makes expatriate taxes so interesting is that there is no one-size-fits-all, but normally there is an IRP5 certificate for part of the year, which reflects some form of retirement funding preservation or encashment and the resultant tax claims for logbook, medical aid, etc. But what about the remainder of the income, where the expatriate has left South Africa to work abroad? Was the section 10(1)(o)(ii) exemption claimed or did the expatriate become a non-resident for tax purposes? In cases of non-residency, was a financial emigration process followed or belatedly done (which we believe is still correct in law), or is there a tax residency certificate on file for the foreign tax jurisdiction? Did the family remain in South Africa and, if not, is there a rental income disclosed from the previous residential property? In cases of non-residency, there may be a capital gains tax disposal, even where you look back 15 years or more, as prescription does not protect the expatriate against, e.g. material non-disclosure.

Year Two onwards

We always find it remarkable how the following years of tax compliance do not align with prior year tax submissions. This appears to have become a lost skill, i.e. to ensure a simple and consistent tax filing strategy. There may be merit in a view that this point would equally apply to how some SARS audits are being conducted on expatriates but, with technology, no information is lost and inconsistency is a permanent risk.

Expats taxed on foreign income for the first time

A quick recap

When the initial announcement was made on the expatriate tax, it was indicated that expatriates would only be taxed where they paid no income taxes somewhere else. This appears to have been the original mischief, but the amendment has undergone some evolution. When the expatriate exemption was proposed to be completely deleted, the proposed amendment was widely perceived by the expatriate community as unjust. This prompted Barry Pretorius to form the Expat Petition Group and to oppose the amendment alongside Tax Consulting South Africa. The battle, spearheaded by Mr Pretorius, was taken to the steps of Parliament, where government ended up making an important concession: instead of a complete deletion, the exemption would be capped at R1 million and the effective date was postponed until 1 March 2020. But we were in for one more surprise: on the eve of the effective date, in the 2020 Budget Review, the Minister of Finance announced the cap on the exemption would be raised to R1.25 million, which took effect on 1 March 2020.

The results after Year One

We are now approaching the end of the first year of assessment where expatriates were taxed on their foreign employment income and it would be very interesting to know how much additional revenue SARS actually collected on account of the amendment.

From our perspective, the amendment caused a massive headache for employers, who approached us with complicated payroll questions and who had to make tough policy decisions with regard to their expatriate base. Beyond that, many of those who would have been affected by the amendment employed measures to fall beyond its application or to mitigate its impact with proper tax planning.

In practice we have seen many expatriates opt to cease their South African tax residency in one way or another to avoid the impact of the amendment completely, leading to an ever shrinking tax base – stakeholders warned National Treasury of this outcome from the outset.

We will likely have to wait another couple of years before we can properly assess the outcome of government's decision to push ahead with the amendment, despite being cautioned against doing so. In any event, in light of the COVID-19 pandemic, it will be very difficult to assess the "success" of this amendment based on the 2021 year of assessment.

COVID-19 relief for expatriates

With the restrictions imposed on international travel under COVID-19, many South African expatriates were precluded from leaving South Africa. This meant they spent more time in the country than initially anticipated, leaving many concerned that they would no longer qualify for the exemption.

Over the course of lockdown in South Africa, government continuously announced expansion to our tax legislation to provide relief in respect of the pandemic. But none of the drafts of the Disaster Management Tax Relief Bills came to the aid of expatriates who were stuck in South Africa.

Unexpected government help

Much to the public's surprise, even though not initially included in the draft tax Bills published on 31 July 2020, the response document issued by National Treasury and SARS revealed that government heard the plight of expatriates.

The response document proposed that the 66 days that commenced on 27 March 2020 and which ended on 31 May 2020, when the country operated under COVID-19 Alert Levels 5 and 4, should be subtracted from the 183-day threshold. In other words, if a taxpayer spent more than 117 days outside South Africa, they may still qualify for the exemption. The concession only extended to the aggregate number of days, and the continuous period of more than 60 days remained unchanged.

The relief was included in the final draft of the Taxation Laws Amendment Bill, tabled with the Medium-Term Budget Policy Statement on 28 October 2020. It is unclear what made the powers that be grant the relief. Perhaps they were swayed by the fact that other governments have made concessions where lockdown restrictions resulted in distorted tax implications for their taxpayers. Or, perhaps, this served as the extension of an olive branch to expatriates, whose plight has largely fallen on deaf ears.

In any event, this is good news for South African expatriates, many of whom could greatly benefit from the concession.

Phasing out the SARB process and a lock-up of retirement funds

Current dispensation

Currently, taxpayers may withdraw their retirement funds prior to their retirement age upon emigration, where such emigration is recognised by the South African Reserve Bank.

As noted previously, the government made some big announcements on the eve of the effective date of the expat tax. The government announced in Budget 2020/21 that the SARB process will be phased out and individuals who seek to withdraw their retirement funds upon emigration will be subject to a different process.

The Budget Review touted the change as one that is purely a product of impending changes to the exchange control regime in South Africa and that they want to "phase out the administratively burdensome process of emigration through the South African Reserve Bank." That may have been the case but the surge in financial emigration applications filed in the wake of the expat tax could have played some part as well.

Big changes

Based on the Budget Review, everyone expected the change to be directed at procedure only, but with the publication of the draft tax Bills it was revealed that the "phasing out" of financial emigration meant something more profound. In terms of the final tax Bill tabled in Parliament, a person will only be permitted to withdraw their retirement funds if they can prove they have not been tax resident in South Africa for at least three years.

The cited purpose of moving to a more modern and less burdensome process is at variance with the new test. By any measure, a lock-in of three full years is more draconian than the current process. National Treasury and SARS' response document stated the reason behind the three-year lock-in as a preventative measure against cases where individuals withdraw their retirement funds under pretence of emigration, only to return to South Africa shortly after.

Key issues
The validity of National Treasury’s argument is questionable, as it tries to prevent a mischief that will only occur in a handful of cases to the detriment of the majority who genuinely intend to emigrate permanently and who may need their retirement funds to finance their relocation. Then there are problems with the new proposed test itself. Determining residency is not a tick box exercise and considering the burden of proof rests with the taxpayer, the question is what will be accepted as proof of cessation of residency? This is yet to be confirmed.

Time is running out
National Treasury made a concession to allow for financial emigration applications filed before the effective date of 1 March 2021 to be finalised under the old dispensation. Those who miss the boat, however, will be subject to the new uncertain process.

Conclusion

The legislative interventions aimed at expatriates arguably form part of a bigger picture. Seemingly, government is trying to manage a fragile but equally important segment of the tax base with ongoing policy changes. We foresee that the role of tax practitioners will become extremely important for any international employee to have a fully compliant, yet tax-optimised, approach to their taxes.

"The validity of National Treasury’s argument is questionable, as it tries to prevent a mischief that will only occur in a handful of cases."

IS POOR TAX COMPLIANCE AKIN TO CULPABLE HOMICIDE?

15 minutes CPD

Our article looks at a recent change to the non-compliance provisions in three tax Acts where it is no longer required for SARS to link poor compliance with wilful intent in order to prove a criminal offence –and how this affects taxpayers' rights.

▸ **SUZANNE SMIT,** suzanne@nubis.tax

On 31 July 2020, National Treasury and SARS published the 2020 Draft Tax Administration Laws Amendment Bill (Draft TALAB). It proposed, inter alia, to remove the term "wilful" in order to include both intentional and negligent conduct within the ambit of criminal offences.

Wilful intent no longer required

Before exploring the recent tax law changes relating to tax compliance, it is important to lay the landscape of the applicable criminal legal concepts. The penultimate principle of criminal liability is summarised by *actus non facit reum nisi mens sit rea,* i.e. "an act is not unlawful <u>unless there is a guilty mind</u>". (Own emphasis.)

In order to establish criminal liability the State must therefore prove beyond a reasonable doubt that the accused has committed *actus reus*, i.e. unlawful voluntary conduct, with criminal capacity and *mens rea*, i.e. fault in the form of either intention (*dolus*) or negligence (*culpa*).

Dolus (intent) per the Merriam Webster dictionary means "the doing of anything that is contrary to good conscience" whereas *culpa* (negligence) means "the failure to use the care and diligence demanded". The test for *dolus* is subjective, i.e. based on the specific circumstances, whereas the test for *culpa* is objective, i.e. the accused's conduct is measured against the standard of a reasonable person.

In the South African context, intention includes both deliberate and foreseen conduct.

Dolus eventualis, i.e. legal intention, exists where the accused does not intend for the unlawful act to happen, but can reasonably foresee the possibility that it could happen and then proceeds with the intended conduct regardless.

Practically speaking this is the difference between murder and culpable homicide: Murder requires intent (including *dolus eventualis*) whereas culpable homicide only requires negligence. Both are unlawful and punishable by law, but the punishment will differ proportionally to the specific circumstances.

Removal of "wilfulness" from statutory offences

South African tax Acts stipulate specific offences in respect of which the taxpayer may be liable for a fine or imprisonment. The following provisions were affected by the recent Draft TALAB:

- Paragraph 30 of the Fourth Schedule to the Income Tax Act
- Section 58 of the Value-added Tax Act
- Section 234 of the Tax Administration Act

Each of these provisions required that a taxpayer must commit the relevant act "wilfully and without just cause" before the taxpayer could be found guilty of the applicable offence. The effect of removing "wilfulness" basically negates the requirement for SARS to prove intent before the said taxpayer, i.e. the accused, could be found guilty of the applicable tax offence and it is therefore easier for SARS to impose either the fine or imprisonment.

SARS' justification

National Treasury and SARS contended in the Draft TALAB that the National Prosecuting Authority (NPA) is of the view that the current wording relating to criminal offences substantially undermines the ability of SARS to ensure compliance based on the objective standard expected of the reasonable person. No official communication from the NPA to National Treasury and SARS was included in support of this contention. Its motivation further contended that due to "wilful" being included in the tax Acts, it may hamper the criminal prosecution of non-compliant taxpayers by the NPA in seeking to prove the elements of the crime.

It was therefore proposed that the requirement of "wilful" conduct be removed with regard to criminal offences to enable the NPA and SARS "to measure a taxpayer against such objective standards where required". On 8 December 2020 the Tax Administration Laws Amendment Bill was passed by Parliament.

Is the change as adverse to taxpayer rights as some contend?

Specific South African principles relating to criminal offences

Section 1(c) of the Constitution of the Republic of South Africa, 1996, states that the Republic of South Africa is founded on the supremacy of the Constitution and the rule of law. Furthermore, section 35(3) of the Bill of Rights of the Constitution states that "every accused person has a right to a fair trial". In terms of the common law *ius certum* principle, i.e. the principle of certainty, the formulated crime should not be vague or unclear, i.e. the taxpayer should not be fearful of breaking the law inadvertently.

In addition, the well-established element of *mens rea* includes fault by either intent or negligence (own emphasis) in order to constitute criminal conduct. This common law element has been embedded in criminal law internationally over decades and cannot just be blatantly ignored. Furthermore, according to Kemp's *Criminal Law*, the "essential purpose of criminal law is to provide a mechanism for punishing the offender". (Own emphasis.)

Penalties are already included in the tax Acts especially for the infringement of specific tax requirements or sections as it may be prescribed. Section 210 of the Tax Administration Act, for instance, already provides for administrative non-compliance penalties as a deterrent for certain non-compliance omissions. Punishment, however, carries a heavier weight and it aims to inflict suffering for a crime. There is therefore a considerable difference between penalties and criminal punishment in the form of fines and / or imprisonment.

Administrative non-compliance and understatement penalties are already contained in our tax Acts especially to avoid the demanding resources required for prosecutions, including legal counsel, human resources and the financial means to see it through.

There are therefore conflicting principles and legal principles at play and it remains to be seen whether taxpayers will challenge this proposed change in court to align South African tax laws with common law and provisions contained in the Constitution.

International principles relating to criminal offences and tax

Globally it has become increasingly unpopular to criminalise conduct for minor administrative failures.

On 11 August 2019 the Indian Minister of Finance, Nirmala Sitharaman, tweeted: "I have instructed the revenue secretary to come up with measures to ensure that honest taxpayers are not harassed, and those who commit minor or procedural violations are not subjected to disproportionate or excessive action."

On 18 March 2019 the International Monetary Fund published a Tax Law Note, "Designing Interest and Tax Penalty Regimes" by Christopher Waerzeggers, Cory Hillier and Irving Aw. It confirmed inter alia that tax crimes usually involve an abuse of the tax system through intentional (own emphasis) and dishonest behaviour with the aim of obtaining a financial benefit. It generally includes tax fraud and tax evasion, which are different to an inadvertent "finger error". They further reiterate that the certainty of a specific tax crime is necessary to prevent taxpayers viewing the tax system as arbitrary and unfair, which in turn discourages compliance.

The latter aligns with submitted contentions to National Treasury and SARS that the proposed change to remove "wilful" will have unnecessary adverse consequences for taxpayers.

What does this practically mean for taxpayers?

After all is said and done, it comes down to taxpayers ensuring that they acquaint themselves with South African tax laws and their basic compliance requirements. Unfortunately, "human error" and other negligent errors could result in costly court battles and possible criminal sanctions.

Corporate taxpayers should review their tax policies and standard operating procedures to ensure that proper risk controls are in place to prevent possible personal prosecution of their accountable directors. In addition to King IV's corporate governance principle of "apply and explain", a further burden is placed on corporate taxpayers to ensure tax compliance and being able to substantiate their tax position with the relevant supporting documents and information. This also applies to individual taxpayers.

Generally the devil is in the detail and, as a starting point, taxpayers should submit tax returns timeously, but also with the correct information. Appointing public officers, updating bank account details or the change of address are not regarded by SARS as minor administrative compliance issues – they regard it as critical to be able to contact a taxpayer and / or serve legal documents where necessary. It is crucial to keep all of the above updated, as well as any other information which SARS requires. More now than ever it is best to obtain sound tax advice prior to submitting tax returns, responding to requests for information or audits.

Is it controversial that "wilful" will be removed from the relevant tax Acts? Yes, it is, but until this is challenged in court (and reversed), this will be the playing field for taxpayers and SARS. It is therefore best to be extra careful to ensure you do not find yourself in the same position as someone who is accused of culpable homicide.

NEW SCRAP METAL EXPORT TAXES: THE EFFECT ON RECYCLERS

▶ **DONALD MACKAY,** donald@xa.co.za

Our article explores the effect of a government-imposed preferential pricing system and an envisaged export tax on recyclers of scrap metal.

There is a space between the waste generated in a factory and the raw material used in a foundry: the metal recycling sector. Recyclers serve the very important purpose of converting waste metal, which would otherwise end up in a land fill, to a raw material of economic value. This is important to bear in mind as many of the latest trade policies around scrap recycling will quite possibly destroy this important sector.

Background

There are two important problems that government is trying to solve, both of which are complicated.

The first is that our infrastructure is stolen and certain scrap recyclers are facilitating this theft by acting as a fence for the stolen goods. No duties or export control will impact this trade any more than increasing the duties on cigarettes will reduce the smuggling of cigarettes into the country. This is a criminal matter and needs to be dealt with as such.

The second problem is a shortage of scrap metal (particularly a grade of steel scrap known as ISRI 201), the main raw material used in foundries and steel mini-mills.

Around 2013, Minister Patel, then the Minister of Economic Development, issued a trade directive to the International Trade Administration Commission to investigate the creation of a preferential pricing system (PPS). The PPS is a forced discount to the domestic market for the sale of scrap metal. Before the PPS was introduced, a metal recycler could sell their scrap to anyone they chose, either domestically or internationally. The result of this was domestic buyers of scrap needed to pay at least export parity price for the scrap, or the recycler would export the scrap. The domestic consumers did not want to deal with export competition and so lobbied for what eventually became the PPS. The PPS is connected to an export permit, which will only be issued if the recycler has first offered the scrap to the local market at discounted prices. The PPS saw the exports of scrap metal drop from R9.7 billion in 2010 to just over R4 billion in 2020 (and no, this is not a side-effect of COVID-19; exports have steadily fallen since the introduction of the PPS in 2013).

A positive outcome?

One of the outcomes government wanted to see was greater investment in foundries and mini-mills, which predictably happened. After all, the raw material was now subsidised by the recycling industry and the Industrial Development Corporation was funding most of these ventures, with (presumably) cheap finance. This saw greater demand for scrap metal but, unlike a manufactured product, the metal recyclers cannot simply create more scrap because demand has increased. The amount of scrap in the market is quite directly linked to the state of our manufacturing sector and the effectiveness of our state-owned entities (Transnet is the largest generator of scrap steel in the country). It is no secret that we are deindustrialising at a terrifying pace, which means less scrap metal entering the recycling stream. The other two sources of scrap are construction (we all know the mess this sector is in) and household scrap, such as used beverage cans. Given our shrinking economy, consumption is down, negatively impacting the volume of scrap available for recycling.

Supply and demand

In any normal market, this imbalance of supply and demand is regulated by the price of the product, but even though demand for scrap has increased and supply has decreased, the price cannot be adjusted to account for this and so the demand just keeps growing. This imbalance incentivises the downstream scrap consuming companies to keep requesting ever greater constraints on the exports of scrap metal, which has taken the form of increasingly onerous versions of PPS. In July 2020, Minister Patel banned the export of all scrap metal for two months (extended to three months). He then lifted the ban and replaced it with an even more restrictive version of PPS, which forces the recyclers to give credit to scrap consumers and to cover the inspection costs of the buyer of the scrap metal, irrespective of where they are located, amongst other things.

On 20 November 2020, yet another version of PPS was published for comment, adding even further constraints. If this version is finalised in its current form, the seller of scrap will have to cover the cost of transporting the scrap to the

"Export duties are a good compromise. They give predictability to the process and will likely see investment begin creeping back into the sector."

consumer as well as being forced to export the scrap as breakbulk, rather than containerised. A small breakbulk ship will hold 15 000 tons of material, compared to 20 tons in a container. You can very quickly see how exports will be close to impossible except for some very large companies. This, of course, is the intention, which would push the last remaining scrap into the local market. The fact that, at the aggregate level, we generate considerably more scrap than we consume seems not to have been factored into the calculation before the latest proposed amendment was published.

This should not, however, be seen as a fantastic success story because, in order for the scrap consumers to obtain their raw material at discounted prices, the discount must come from somewhere. It is not a government subsidy, which means it has to flow from the upstream scrap providers. This means the recyclers pay less for the scrap, removing this value from the manufacturing sector, the state-owned entities and the waste collectors (there are 300 000 waste collectors according to the Department of Trade, Industry and Competition).

Stuck in the middle

The recycling sector is stuck in the middle and being squeezed from both sides. As the price paid for scrap metal drops, the lower grades of scrap simply disappear from the recycling stream because it costs more to process and transport the scrap than it can be sold for. The waste collectors also quickly realise they are not being paid enough to warrant the effort and stop collecting certain types of scrap. We saw this when Minister Patel banned the export of scrap. Used beverage cans were suddenly not being collected because recyclers had no one to sell it to. Some recyclers would speculate and buy cheap in the hope that the price would shoot up when the ban was lifted, but this requires capital and when the ban was extended for an extra month, some companies could not afford the bet they had taken.

In spite of the PPS being replaced next year by an export duty, the rules around the PPS continue to be tightened and, most recently, Minister Patel has indicated he will run both PPS and export duties at the same time until the end of June 2021 when he will decide what to do. This could include extending the PPS even further as nothing legally prevents imposing both export duties and a PPS at the same time.

The pressure on the recycling sector has already seen a number of failures and if the pressure keeps increasing the whole sector will face failure. The latest proposed new PPS amendments could see that moment brought forward dramatically.

Forcing companies to only export breakbulk while still applying PPS and having export duties would completely devastate the recycling sector. This would flow through to the downstream foundries and mini-mills as they have no capacity to transform waste into the raw materials they need. You cannot leave a written-off car and old wheelbarrow at Scaw Metals and expect them to convert this into rebar; yet this would be the effect of the failure of the recycling sector.

This is not just a story told to keep us all awake at night. We can see what happens when the recycling sector collapses by looking at the number of car wrecks and used metal littering the countryside of Zimbabwe, which has close to no metal recycling capacity.

Export duties

This is not to say that the export duties, for example, are a bad idea. There is a general acceptance by the recycling industry that if they are to survive, they will have to make some compromises and export duties are a good compromise. They give predictability to the process and will likely see investment begin creeping back into the sector. And make no mistake, serious capital investment is required to set up a decent-sized recycling facility. However, this will not happen if the exports of your goods can simply be banned without notice (a risk which may live on beyond export duties if Minister Patel has his way).

As much as the Department of Trade, Industry and Competition loves the foundries and mini-mills, we need to understand that many of them exist only because of an artificial market situation. If we do not balance the interests of both the recyclers and the consumers, then the recyclers will fail, taking the downstream sector with them.

TERS and the way forward

▸ **MOEKETSI MARUMO,** mmarumo@cova-advisory.co.za

Read all about the need for TERS, the challenges related to its implementation, its impact and also its aftermath.

The COVID-19 pandemic has led to a global economic downturn, and most countries have had to adopt various policy instruments to sustain and preserve jobs. The economic crisis triggered by COVID-19 has put pressure on governments to be agile in response to the crisis and to ensure that vulnerable members of society are cushioned during lockdown.

But, equally so, the pandemic is testing the resilience of most economies – especially those of developing countries. The response of each country to the pandemic has depended on its fiscal position, the impact of the crisis, and that country's economic structure and political economy.

The need for TERS

On 23 March 2020, President Cyril Ramaphosa announced a national lockdown in South Africa, initially for 21 days from 27 March 2020, although it was amended and extended several times. Subsequent to this announcement, the government announced a R500 billion social and economic stimulus package.

Out of this package, government allocated R40 billion for income support payments to those workers whose employers would not be able to pay their salaries or wages. The scale of spending grew as the scheme was extended.

On 26 March 2020, the Employment and Labour Minister, Thembelani Nxesi, issued a Directive for the introduction of a National Disaster Benefit (known as TERS) to be used for social security during the lockdown.

Implementing TERS

As mentioned earlier, TERS was initially expected to be implemented for three months, and a R40 billion budget was allocated. To date, the Unemployment Insurance Fund (UIF), which runs TERS, has disbursed R52 billion and more than 1 million employers have benefited from the programme.

TERS was extended until 15 October 2020. The application window for the period starting 16 September to 15 October will have closed at the end of December 2020.

The implementation of TERS came with its own set of challenges and headaches. The TERS programme was launched with no existing IT system and limited capacity.

This resulted in delays in processing submissions and disbursement of funds from the UIF. When funds were finally disbursed, other headaches included overpayment and underpayment of claims.

One universal challenge faced by government is the integration of all the government IT systems. These include the Home Affairs system, and those of SARS, the South African Social Security Agency (SASSA) and the National Student Financial Aid Scheme (NSFAS).

Better integration would have assisted in picking up non-qualifying claims, for example those on behalf

of deceased individuals, students and pensioners.
On the other hand companies have had to deal with their own challenges. These range from governance processes, systems processes and capacity issues. In most companies, payroll and HR personnel were overwhelmed initially by all the administrative changes, such as who can claim and who cannot.

Communications from the Department of Employment and Labour also increased the pressure on employers when those employers had not made any payments to their staff. Dealing with, and resolving, queries remains one of the biggest challenges in the TERS process.

The impact of TERS

Having indicated all the challenges that government faced in implementing and rolling out the programme, the impact of TERS cannot be overstated – especially the way it has supported low-earning individuals.

TERS assisted those companies that applied to ensure that the jobs of ordinary citizens were sustained during the lockdown period.

The economic effect of COVID-19 has been immense, with the South African economy shedding more than 2 200 000 jobs during the lockdown period. Most economists are predicting that the knock-on effects of the lockdown period are expected to continue even when all economic sectors have started operating as normal once again.

Following all the challenges and headaches during the lockdown period, a remaining issue for the UIF is to ensure that it addresses all the queries related to all the claims which have been submitted.

Managing TERS

The tail-end of TERS comes when all payments owing have been made to companies, but there is still a painstaking process involving the reconciling of payments, and ensuring that in each instance the correct amount has been paid. There has been much concern voiced in Parliament and in the media about the problem of fraud, and government is under pressure to demonstrate that TERS was properly managed. This has not been made any easier by the suspension of the top tier of UIF management.

After the process of checking all payments, government still has to conduct audits to ensure that all payments made to companies were passed on to the correct beneficiaries – the workers themselves.

The Auditor General will be conducting such checks to verify that companies have complied with all the legislative requirements of TERS.

"There has been much concern voiced in Parliament and in the media about the problem of fraud, and government is under pressure to demonstrate that TERS was properly managed."

MAURITIUS: STILL AN INVESTOR'S PARADISE?

30 minutes CPD

▸ **CAOILFHIONN VAN DER WALT,** cvanderwalt@reganvanrooy.com

Mauritius finds itself increasingly under pressure from the OECD and elsewhere to close its low tax regimes. Some are questioning whether Mauritius is living up to its promise as an investor paradise. This article explores the recent changes to the GBC regime and the recent hike in personal taxes.

"In practice foreign tax credits can often be claimed even where the foreign tax was levied in contravention of a double taxation agreement (unlike in South Africa)."

Mauritius has been in the tax news a lot recently and mainly it has been bad news – first we had the end of the Category 2 Global Business Company (GBC2) and deemed credit regime, then the new substance requirements and the new controlled foreign company rules. Then, in 2020, various double taxation agreements were cancelled or ratification was delayed and, to top it all off, the July 2020 budget speech ushered in a 500% increase in the "solidarity levy", a type of personal tax applying to higher earners, as well as a new uncapped national insurance type levy.

And, as a final nail in the coffin, in May 2020 the EU Commission announced their intention to include Mauritius on its blacklist for financial centres with perceived weaknesses in anti-money-laundering controls, with the inclusion effective from October.

What more could go wrong? No wonder the Jersey Business was sponsoring articles referring to the "end of Mauritius". But is Mauritius really no longer a valid finance centre or offshore holding jurisdiction?

Here we explore the background to the changes, what has actually happened and conclude that Mauritius is actually more attractive than ever.

What are the changes?

Corporate tax changes

The 2018 Budget speech introduced a seismic shift in the Mauritian tax landscape by announcing the abolishment of both the GBC2 regime and the deemed tax credit regime. These regimes had previously been the bedrock of Mauritius' attractiveness as a holding company jurisdiction. A GBC2 was a specific type of entity for offshore activities that was exempt from all Mauritian tax and, under the deemed credit rules that applied to most other Mauritian entities, 80% of the headline tax of 15% was deemed to be a foreign tax credit, resulting in an effective 3% tax rate.

From 1 July 2021 neither the GBC2 nor the deemed credit will exist. GBC1 licences issued on or before 16 October 2017 will remain valid until 30 June 2021, and such entities will be allowed to claim the deemed tax credit until then. However, from 1 July 2021 the normal 15% Mauritian tax rate will ordinarily apply.

New substance and CFC rules

From July 2019, GBCs have been required to satisfy new Mauritian substance requirements (in addition to the general requirements such as two local directors and a local bank account) by meeting the following two tests:

1. GBCs must carry out their core income generating activities (CIGAs) in or from Mauritius.
2. GBCs must incur a minimum level of expenditure and employ directly or indirectly an adequate number of qualified persons.

There is no specific guidance as to what constitutes a CIGA and it is interpreted based on the specific business in question. In the case of an investment holding company, the primary income is likely to be the dividend income, in which case the CIGA could be the monitoring of the investment and thus consideration should be given as to how to "demonstrate" that this takes place in Mauritius.

When determining the minimum level of expenditure and the adequate number of suitably qualified staff, the Financial Services Commission has set out an indicative guideline which it subsequently deleted, and it showed expenditure of at least USD12 000 per annum. However, this guideline is not prescriptive and facts will be considered on a case-by-case basis. The annual expenditure represents any expenses and costs that the GBC incurs during the course of doing business, and includes annual licence fees, management company costs as an agent to the company, any corporate secretary costs, employee costs, directors' fees, rent, utilities, tax advisor fees and audit fees.

In addition, GBCs are also required to be either managed and controlled from Mauritius, or be administered by a Mauritian management company.

Mauritian CFC rules

In 2019 Mauritius introduced controlled foreign company (CFC) rules for the first time, which came into operation on 1 July 2020 and generally apply to foreign companies which are majority-owned (directly or indirectly) by a Mauritian resident company, where the accounting profits exceed EUR750 000 per annum.

The CFC rules will not apply where:

- The accounting profits amount to less than 10% of operating costs (excluding the cost of goods sold) outside the CFC's country of residence
- The tax rate in the CFC's country of residence is more than 50% of the tax rate in Mauritius

The CFC rules provide that the foreign entity's income will be imputed, i.e. will be deemed to form part of the Mauritian resident's taxable income, if the Mauritian resident carries on business through the

CFC in a foreign country and the Mauritian Revenue Authority considers that the non-distributed income of the CFC arises from non-genuine arrangements which have been put in place for purposes of obtaining a tax benefit.

An arrangement is generally regarded as non-genuine where the CFC would not own the assets or would not have undertaken the risks which generate all, or part of, its income if it was not controlled by a company where the significant people functions, relevant to its assets and risks, are carried out and instrumental in generating the income of the CFC.

Increase in personal tax

Mauritius taxes individuals at a rate of 10% on annual taxable income up to MUR650 000, and at 15% on annual taxable income over MUR650 000, with various tax-free allowances available. The solidarity levy was introduced in Mauritius in 2017. This applied at a rate of 5% on all "leviable income" in excess of MUR3.5 million and applied in addition to the standard 10/15% tax on chargeable income. Leviable income is defined as the chargeable income of the individual plus dividends from a resident company or distributions from a resident trust. This meant that an individual was taxed at a rate of 10/15% on all chargeable income up to MUR3.5 million and at a rate of 20% (i.e. the income tax rate plus the solidarity levy) thereafter.

With effect from 1 July 2020, the solidarity levy increased to 25% (a five-fold increase!) and applies from a reduced threshold of MUR3 million. However, it is subject to a cap of 10% of total income, so provided the total salary is at least MUR5 million the solidarity levy only applies at 10%, meaning a top tax rate of 25%.

As the cap only kicks in at MUR5 million (i.e. the point where 10% of the total salary (MUR500 000) is less than 25% of the portion over MUR3 million (MUR5 million less MUR3 million × 25% = i.e. again MUR500 000), this means that salaries between MUR3 million and MUR5 million are disproportionately impacted, and the top tax rate for such individuals will be 40% on certain income (i.e. 15% plus 25% solidarity level where the cap does not apply), which is a significant increase for Mauritius.

In addition to the solidarity levy changes, changes were also made to the Mauritius national pension fund. The current pension fund has been replaced with a new system, the Contribution Sociale Generalisée (CSG), with effect from 1 September 2020.

For employees earning more than MUR50 000 per month, the contribution will be levied at a rate of 3% for employees and 6% for employers, as an uncapped contribution on an employee's total basic salary. As very little is obtained through this "pension" this is effectively another form of taxation, and the cumulative impact of the increased solidarity levy and the pension fund contribution amendments results in a very significant tax cost increase for individuals in Mauritius.

Why did these changes arise?

The corporate tax changes and new substance and CFC rules are largely as a response to pressure from the EU and OECD who saw the GBC2 regime and the deemed foreign credit as "harmful tax practices", and who specifically recommended that Mauritius introduce additional substance requirements as well as CFC rules.

As a result of these changes, Mauritius is no longer regarded as an uncooperative tax jurisdiction, which is a welcome development. The individual tax increases appear to be linked to COVID-19, and the stated intention is that the solidarity levy increases will be temporary, although only time will tell.

This sounds like bad news – is Mauritius now a high tax jurisdiction?

In short, no. Mauritius is still highly attractive from a tax perspective. Although the headline rate is indeed 15% in Mauritius, there are some very generous reliefs to avail of which mean that, particularly for a group with meaningful operations around Africa, the likely effective tax rate will still be close to 3%. This is due to three specific relief regimes.

Partial exemption regime

To "replace" the deemed tax credit, an 80% partial exemption is available on certain specified foreign-source income, resulting again in an effective tax rate of 3%. This applies in respect of:

- Foreign-source dividends
- Interest income
- Profits of a permanent establishment
- Income derived by a closed investment scheme (CIS), closed-end fund, CIS manager, CIS administrator, investment adviser or asset manager, or from reinsurance
- Income derived by companies engaged in ship and aircraft leasing and certain aviation advisory services
- Income derived from leasing and provision of international fibre capacity

Double taxation relief

Mauritius has a very generous double taxation relief system – foreign tax credits are not subject to limitation, and can be mixed, i.e. set off against other taxable foreign income with no restrictions.

In addition, in practice foreign tax credits can often be claimed even where the foreign tax was levied in contravention of a double taxation agreement (unlike in South Africa). Further, when a Mauritian company receives a foreign dividend, double tax relief is also available in respect of the corporate tax suffered on the profits out of which the dividend was paid. Therefore if the Mauritian company receives dividends from high tax countries, i.e. anywhere in Africa, substance double taxation relief will be available.

We note that while credits can be pooled, i.e. excess credits on one foreign income stream can be set off against the tax on another foreign income stream, excess credits cannot be carried forward.

Tax holidays

Mauritius also offers 19 generous tax holidays that result in a total exemption of corporate tax for a period of either five or eight years. Of particular relevance for larger groups is the global headquarter administration licence regime. This applies for eight years to a Mauritian business which conducts head office and support functions to at least three related entities. The holiday is subject to a number of conditions including that the company must have a physical office in Mauritius, employ at least 10 professional staff and incur an annual expenditure of MUR5 million.

A number of other tax holidays are available as follows:

- Global treasury or legal advisory activities
- Overseas family office
- Income arising from an investment by a non-citizen who has invested at least USD25 million in Mauritius
- Innovation-driven activities related to IP development in Mauritius
- Project development or project financing for developing infrastructure in special economic zones
- e-commerce platform activities
- Peer-to-peer lending
- Marina development
- Inland aquaculture
- Industrial fishing
- The exploitation of ocean water for air conditioning
- Tertiary education campus
- Manufacture of nutraceutical products
- Manufacture of pharmaceutical products or medical devices
- Food processing
- Sheltered farming scheme projects
- Manufacture of automotive parts

Conclusion

The more things change the more they remain the same. This is certainly true in the case of Mauritius. Although the deemed credit, i.e. a steady 3% effective tax rate, is now gone there are many options to ensure that a low effective tax rate can apply going forward, particularly for a group with substantive operations across Africa. Mauritius still works!

Case Law
WRAP-UP

THOMAS LOBBAN, thomas@taxconsulting.co.za &
JACO JANSEN VAN VUUREN, jacoj@taxconsulting.co.za

We present summaries of cases dealing with the taxation of shares granted to a taxpayer by his employer; whether a taxpayer's accruals and receipts are exempt from taxation under section 10 of the Income Tax Act; and an appeal against the decision to dismiss the taxpayer's application for default judgment.

CSARS V THE EXECUTOR OF THE ESTATE OF LATE NDLOVU [2020] ZAGPPHC (12 October 2020)

Issue

The issue in this matter concerned the taxation of shares granted to the taxpayer by his employer, as well as whether a dispute against interest imposed by SARS and not previously objected to may be brought on appeal by the taxpayer in the first instance.

Facts

The deceased taxpayer was granted options, by virtue of his employment, to acquire shares in his employer, which were exercised while he was employed. The shares were then sold by the taxpayer in three tranches and, as a result, he realised a gain of approximately R7.1 million.

The disposal of the shares was facilitated by the administrator of the relevant employer-established trust in respect thereof. However, no tax was deducted or withheld by the administrator in respect of the gain realised from the sale of the shares. Instead, the gain was noted as constituting "non-taxable earnings". This was advised to and accepted by the taxpayer, who subsequently did not declare same in his 2007 income tax return.

SARS later raised an additional assessment following an audit, including the gains from the disposal of the shares in the taxable income of the taxpayer. SARS further imposed interest in terms of section 89quat(2) of the Income Tax Act.

The taxpayer lodged an objection to the assessment on the basis that the gain from the sale of the shares could neither be subject to capital gains tax nor normal tax under section 8A and / or 8C of the Income Tax Act. However, the taxpayer did not object to the interest imposed under section 89quat(2). The objection was disallowed by SARS. In a letter dated 10 February 2012 (the SARS letter), SARS advised the taxpayer that certain adjustments would accordingly be made in the calculations of his taxable income for the relevant years of assessment.

The taxpayer noted an appeal against the disallowance of the objection by SARS, which was pursued by the executor of the taxpayer's estate after his passing. The Tax Court upheld the taxpayer's appeal and found that the SARS letter created a legitimate expectation on the part of the taxpayer that SARS would issue a further assessment and that the taxpayer would have objected thereto. Therefore, there would be no prejudice to SARS for a new ground of appeal vis-à-vis the interest to be introduced at the current juncture.

The matter was taken on appeal by SARS to the High Court.

The taxpayer's case

The taxpayer relied on his employer to ensure that the relevant tax amounts were withheld or deducted as required under the Income Tax Act. As such, there was no intention to evade tax or for the taxpayer to be in a non-compliant tax position. The issue of the interest imposed by SARS was accepted by the court a quo and on the basis that no prejudice would be faced by SARS in this regard.

SARS' case

On appeal, SARS contended that a person in the taxpayer's former capacity should have known that gains realised from share options are taxable. Further, the taxpayer did not declare the gains from the share options – it was only discovered upon SARS' audit that the taxpayer had not declared the amount or submitted the requisite tax certificate provided to him by his employer.

Whereas the taxpayer relied on his employer to deduct or withhold the apposite taxes, it was still his duty to determine whether this was done.

Outcome

The court found in favour of SARS.

Core reasoning

On the question of raising new grounds not included in the objection, the court referred to the principle established by the Supreme Court of Appeal in the *Brummeria Renaissance* case that "it is also in the public interest that disputes should come to an end … it would be unfair to an honest taxpayer if the Commissioner were to be allowed to continue to change the basis upon which the taxpayer were assessed until the Commissioner got it right".

Accordingly, the converse should apply insofar as it is in the public interest that a taxpayer cannot be allowed to continue changing the grounds of his objection and appeal. It would be unfair to the appellant, SARS, if a respondent is allowed to change the basis of its appeal at a late stage when appealing to the Tax Court.

With regard to the finding of the court a quo that the SARS letter created a legitimate expectation by the taxpayer that a further assessment would be raised, the High Court found that no such evidence was presented to the court a quo on which such finding could be made. Therefore, the court a quo could not have made the decision that the taxpayer was entitled to raise this issue only at the appeal stage of the dispute, thereby causing prejudice to SARS. The court a quo thus erred in finding that the interest should be waived.

Takeaway

Many taxpayers only seek assistance from a practitioner once a dispute has progressed past the objection stage. In such cases, it often becomes evident that the taxpayer failed to address certain pertinent aspects in the objection, which makes it difficult to salvage what may on the face of it have been a simple matter. An incomplete, unspecific or ill-informed objection can have serious consequences for the taxpayer concerned, including where the assessment in question is incorrect. As such, an objection should be viewed as the only chance for the taxpayer to properly dispute an assessment and professional advice should be sought in every instance.

CITY POWER (SOC) LIMITED V CSARS

(1147/2019) [2020] ZASCA 150 (20 November 2020)

Issue

The Supreme Court of Appeal had to determine whether the taxpayer's accruals and receipts are exempt from taxation under sections 10(1)(a) and (b) of the Income Tax Act.

Facts

The taxpayer is City Power (SOC) Limited, which is a state-owned company duly registered and incorporated in accordance with the company laws of the Republic of South Africa.

On 2 June 2014, SARS raised income tax assessments in respect of the taxpayer's 2010 to 2012 years of assessment, to which SARS disallowed the doubtful debt allowances that the taxpayer claimed in its income tax returns.

Dissatisfied with these assessments, the taxpayer lodged an objection. However, SARS disallowed the taxpayer's notice of objection, and as a consequence thereof, the taxpayer noted an appeal to the Tax Court, which appeal was subsequently dismissed with costs, including the costs of two counsel. On this basis, the taxpayer eventually noted an appeal to the Supreme Court of Appeal.

Taxpayer's case

The taxpayer contended that it qualified for an exemption under section 10(1)(b) of the Income Tax Act on the basis that it discharged the functions typically performed by the City of Johannesburg Metropolitan Municipality (City of Johannesburg).

Therefore, its receipts and accruals stood to be exempt, similar to the exemption which the City of Johannesburg enjoys.

SARS' case

SARS argued that the taxpayer does not qualify to be recognised as a local sphere of government as it fell short of the definition in terms of section 40 of the Constitution. It contended that the receipts and accruals of the taxpayer are not those which fall within any of the three spheres of government.

Outcome

The taxpayer's appeal was dismissed with costs, including the costs of two counsel.

Core reasoning

It was apparent that the taxpayer did not qualify as a municipality or local sphere of government. As a result, the taxpayer's accruals and receipts are not exempt from normal tax under sections 10(1)(a) and (b) of the Income Tax Act.

Takeaway

This case demonstrates that taxpayers should carefully consider the merits of their appeal before noting an appeal with the courts, as this may result in a costly and unsuccessful outcome for the taxpayer concerned.

VAN DER MERWE V CSARS (A322/2019)
[2020] ZAWCHC 140 (30 October 2020)

Issue
This was an appeal to the full bench of the High Court, Western Cape Division, against the decision to dismiss the taxpayer's application for default judgment.

Facts
The taxpayer filed her tax return in respect of the 2015 year of assessment, in which she declared a receipt of a gratuitous donation made to her for the sum of R142 901 673. This tax return also reflected the taxpayer's taxable income as being R365 919.

Subsequent to SARS' interrogation of this return, settlement negotiations ensued between the taxpayer and SARS. On 17 February 2016, SARS subsequently issued an agreed assessment in terms of section 95(3) of the Tax Administration Act. Therefore, the taxpayer was required to pay the sum of R44 175 675, without penalties or interest imposed.

More than two years later the taxpayer objected against the assessment stating the amounts paid in respect thereof were simply in terms of the "pay now argue later" principle. The taxpayer contended that she only received the assessment years after its issuance and she only objected once she registered for eFiling.

SARS allowed the late submission of her objection. However, it failed to respond within the necessary timeframes as prescribed by the Tax Administration Act. As such, the taxpayer delivered a notice of default judgment in terms of Rule 56 of the Dispute Resolution Rules. Shortly after, SARS issued a notice of invalid objection, stating that the additional assessment raised was an agreed assessment in terms of section 95(3) and thus not subject to objection or appeal. As a result, the taxpayer noted an appeal to the Tax Court. Again, SARS failed to deliver its statement of grounds for assessment and failed to ultimately oppose the appeal.

The Tax Court dismissed the taxpayer's application for default judgment with costs on an attorney and client scale.

Taxpayer's case
The taxpayer contended that SARS lacked *locus standi* to oppose the taxpayer's application for default judgment on the basis that it failed to file its answering affidavit timeously (albeit delivered five days before the Tax Court hearing) and to seek condonation for the late filing thereof. Furthermore, the taxpayer argued that she suffered severe prejudice by the fact that the Tax Court failed to address her application to strike out.

SARS' case
SARS opposed the taxpayer's appeal on various grounds. SARS contended that the additional assessment raised in respect of the 2014 year of assessment was an agreed assessment and not subject to objection and/or appeal. Insofar as the orders vis-à-vis the late filing of its answering affidavit and the application to strike out were concerned, SARS argued that orders of an interlocutory nature are consequently not appealable.

Outcome
There was also a dissenting judgment in this case, but ultimately the taxpayer's appeal was dismissed with costs.

Core reasoning
The court first determined if the taxpayer was entitled to default judgment. After a lengthy interpretive exercise the court found that the taxpayer followed the incorrect procedure – when SARS declared the objection invalid, even where the taxpayer disagreed with this decision, the taxpayer had to follow the procedure prescribed by the Dispute Resolution Rules. Ordinarily, the taxpayer can then submit a complaint or valid objection for reconsideration. But – as SARS' reason for the invalidity was that the taxpayer cannot object against the assessment in question – her recourse was to file an application in terms of rule 52(2) of the Dispute Resolution Rules, to challenge the invalidity of the objection.

Takeaway
The takeaway here is simply that it is fatal to your dispute with SARS if you do not follow the correct procedure in accordance with the Dispute Resolution Rules.

BINDING RULINGS

▶ **JACO JANSEN VAN VUUREN,** jacoj@taxconsulting.co.za & **JUALEEN OOSTHUIZEN,** jualeen@taxconsulting.co.za

The Rulings summarised here deal with the taxing of payments from a foreign pension fund, the nature of preference shares as hybrid equity instruments or third-party backed shares, and the cancellation of units in foreign collective investment schemes pursuant to their corporate re-domiciliation.

BINDING PRIVATE RULING (BPR) 355

Accrual of pension payments to a resident from a foreign pension fund

Issue

The Ruling determines the tax consequences of the accrual of pension payments to a resident from a foreign pension fund in respect of services rendered both in South Africa and outside South Africa, in terms of section 10(1)(gC)(ii) read with the definition of "gross income" in section 1(1) of the Income Tax Act.

Facts

The Applicant is a resident individual but a citizen of country X. Prior to taking up employment and residence in South Africa, the Applicant was employed in country X for 15 years by Company A, which has residence in country X. For the first 12 years of his employment, the Applicant rendered services solely to Company A. From years 13 to 15 of his employment, the Applicant was seconded to Company B, a resident company in South Africa, whilst employed by Company A.

At the end of year 15, the Applicant's employment and secondment with Company A ceased and he joined Company B as a permanent employee. He also became ordinarily resident in South Africa after year 15.

Throughout the 15 years of service, the Applicant was a member of a pension fund resident in country X.

The contributions to the pension fund are summarised as follows:

- For the first 12 years of the Applicant's employment, Company A made pension contributions to the fund.
- Similarly, Company B made pension contributions to the fund from years 13 to 15 of the Applicant's employment.
- As it was a non-contributory fund, the Applicant made no contributions to the fund.

The Applicant has reached retirement age in terms of the fund rules. Given that the Applicant is yet to make an election to receive the pension payments, the funds have not yet accrued to or been received by the Applicant.

The Applicant intends to notify the fund of his election to start receiving pension payments.

Such election to the fund triggers an accrual of pension payments in favour of the Applicant.

Ruling

The ruling is subject to the following conditions and assumptions:

- The Applicant is ordinarily resident in the Republic of South Africa and not deemed to be exclusively resident in country X or another country for the purposes of the application of any Double Taxation Agreement between South Africa and another country for the avoidance of double taxation and the prevention of fiscal evasion of income tax and capital gains tax.

The ruling issued by SARS is as follows:

- The pension amounts that will accrue to the Applicant from the fund must be included in the Applicant's gross income subject to the exemption of foreign pension under section 10(1)(gC), which shall apply proportionally.
- The portion of the pension amount that relates to services rendered outside South Africa will be exempt from normal tax under section 10(1)(gC).

The exempt amount can be determined as follows: (Period of services rendered outside the Republic ÷ Total period during which services were rendered) x Amount of lump sum or pension received or accrued = Amount exempt under section 10(1)(gC).

BINDING PRIVATE RULING (BPR) 356
Preference shares: hybrid equity instruments or third-party backed shares

Issue

The Ruling determines whether the preference shares issued by the Applicant are hybrid equity instruments or third-party backed shares in terms of the Income Tax Act.

Facts

The Applicant is a resident company which carries no trade and whose sole purpose is to act as a conduit for dividends. The Applicant concluded an agreement with Company A, a resident company, wherein the Applicant issued preference shares to Company A for the purposes of funding the acquisition of shares in Company B, another resident company.

The Applicant is 100% owned by a trust shareholder and the beneficiaries of the trust are members of a specified community.

The following is a summary of the terms of the agreement in respect of dividend distributions:

- Company B must pay 90% of the dividend distribution to Company A and the remaining 10% to the trust.
- The aforementioned dividend distribution ratios will subsist as long as preference shares are in issue.
- As security for the Applicant's obligations, the trust has provided the following to Company A:
  - » A first ranking share pledge over the trust's shares in the Applicant;
  - » A cession of the trust's loan to the Applicant; and
  - » A limited guarantee by the trust in favour of Company A.
- Company A will be indemnified on any tax liability arising from dividends paid on preference shares. The period of the indemnity is aligned with the terminal redemption date, being 17 years from the issue date of the preference shares, irrespective of the agreement being terminated or the preference shares being redeemed earlier.
- The Applicant will declare a preference share dividend to Company A in the near future.

Ruling

The ruling is subject to the condition that the terms of the preference shares remain unchanged.

In respect of the proposed transaction, the ruling issued by SARS is as follows:

- The preference shares are not hybrid equity instruments as defined in section 8E. Accordingly, section 8E will not apply in respect of future preference dividends declared and paid by the Applicant; and
- The preference shares do not constitute third-party backed shares as defined in section 8EA. Accordingly, section 8EA will not apply in respect of future preference dividends declared by the Applicant.

BINDING PRIVATE RULING (BPR) 076
Cancellation of units in foreign collective investment schemes pursuant to their corporate re-domiciliation

Issue
The Ruling determines the capital gains tax implications arising out of the exchange of units issued by an undertaking for collective investment schemes in transferable securities in country A for units issued by an undertaking for collective investment schemes in transferable securities in country B as part of the process of re-domiciling the applicant's investment business from country A to country B.

Facts
The Applicant is a company incorporated in and resident of country A, being the appointed manager of the country A fund. The country A fund is an undertaking for collective investment schemes in transferable securities incorporated in and a resident of country A. The country A fund manages the "country A sub-funds", being seven collective investment schemes in property and securities.

The country B fund is a new undertaking for collective investment schemes in transferable securities established in country B, and comprises the "country B sub-funds" being seven new collective investment schemes in property and securities established in country B and managed under the country B fund.

The Applicant is re-domiciling the country A fund to country B by means of a merger of each of the existing sub-funds with a corresponding equivalent or mirror sub-fund that has been established in country B. The procedure by which the proposed transaction will be effected is undertaken in accordance with Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009.

The proposed implementation steps are as follows:

- The investment assets held and the liabilities of the country A sub-funds will be transferred to the country B sub-funds and the country B sub-funds will directly issue units to the former investors of the country A sub-funds.
- The country A sub-funds will cancel the units which were previously held by investors.

The result will be that the class members will hold units in the country B sub-funds and the country B sub-funds will hold the assets and undertake the liabilities which were previously for the account of the country A sub-funds. The country A sub-funds will be terminated.

Ruling
The ruling made in connection with the proposed transaction is as follows:

- The exchange by each class member of an interest in a country A sub-fund for an equivalent interest in a country B sub-fund, in accordance with the merger process as determined by the relevant Undertaking for Collective Investment in Transferable Securities regulation, will constitute a disposal of an asset as defined in paragraph 1 read with paragraph 11(1)(b) of the Eighth Schedule to the Income Tax Act.
- The proceeds from the disposal of a unit in the country A sub-fund by each investor will, in accordance with paragraph 35(1) of the Eighth Schedule to the Income Tax Act, be equal to the market value of the equivalent unit in the country B sub-fund received by each investor.
- The base cost for a class member of a unit in the country B sub-fund will, in accordance with paragraph 20(1) of the Eighth Schedule to the Income Tax Act, be equal to the market value of the equivalent unit in the country A sub-fund on the date of disposal.

TAX for BOOKS 2021

TAX LEGISLATION

SAIT Compendium of Tax Legislation 2021

Juta Law Editors

R1 350 // JUTA

The 2021 edition incorporates all promulgated legislative changes, as well as amendments envisaged in the 2020 Amendment Bills, as at 1 January 2021, aided by Prelex and Pendlex. The *Other tax Acts* (extracts) section includes extracts from earlier Amendment Acts that are still in operation, as well as the 2020 Covid-related Acts. A useful digest of tax cases from 2007 to 2020 is also included. Furthermore, the *Tax in Practice* aids allow readers to easily navigate content within the different tax Acts. Related supplementary material has been incorporated in Volume 2.

JUTA's Indirect Tax 2021

Juta Law Editors

R895.00 // JUTA

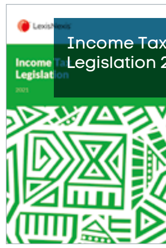
This annual subscription is a consolidated source of current indirect tax Acts and their supplementary material. It includes relevant promulgated legislative amendments, as well as proposed amendments envisaged by the 2020 Amendment Bills, as at 1 January 2021.

Professional Tax Handbook 2020/2021 (2 volumes)

LexisNexis Editorial Staff

R1 115.50 // LEXISNEXIS

This set includes two comprehensive legislative handbooks which contain all the direct tax and VAT acts, regulations, practices and interpretation notes. Updated to incorporate latest amendments in the 2020 Tax Amendment Acts (not yet available) as well as pending amendments.



Income Tax Legislation 2021

LexisNexis Editorial Staff

R632.50 // LEXISNEXIS

This book is a concise and handy reference to the consolidated Income Tax Act and Tax Administration Act. Updated to incorporate latest amendments in the 2020 Tax Amendment Acts (not yet available) as well as pending amendments.

Indirect Tax Handbook 2020/2021

LexisNexis Editorial Staff

R759.00 // LEXISNEXIS

This book comprises indirect tax acts, such as transfer duty and VAT, as well as tax administration. It also includes the related regulations, interpretation notes and practice notes. Updated to incorporate latest amendments in the 2020 Tax Amendment Acts (not yet available) as well as pending amendments.

MOST-USED STUDENT TAX BOOKS

SILKE: South African Income Tax 2021

Stiglingh, MD; Koekemoer, AD; Van Heerden; Wilcocks, JS & Van Der Zwan, P

R1 018.32 // LEXISNEXIS

The objective of the authors and publishers of *Silke: SA Income Tax* is to provide a book that simplifies the understanding and application of tax legislation in a South African context for both students and general practitioners.

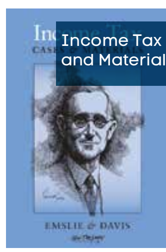
Tax Law: An Introduction

Legwaila, T (editor); Surtees, P; Oguttu, A; Muller, E; Williams, RC & Louw, C

R695.00 // JUTA

The 2nd edition of this book covers the basic policy rationale for the Income Tax Act and other key tax Acts.

CASE BOOKS



Income Tax Cases and Materials

Emslie, T & Davis, D

R1 800 // THE TAXPAYER

(STUDENT PRICE: R1 150)

This book offers students abbreviated cases supplemented by notes.

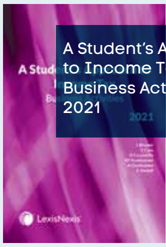
HANDBOOKS, GUIDES, INTRODUCTIONS AND STUDENT-SPECIFIC APPROACHES TO TAX LEGISLATION

South African Income Tax Guide 2020/2021

Divaris, C; Stein, ML

R598.00 // LEXISNEXIS

A concise and reliable guide to South African income tax law for the current tax year. All the taxes imposed by the Income Tax Act are dealt with, namely, income tax, capital gains tax, donations tax, the various withholding taxes, the turnover tax for micro businesses, employees' tax (PAYE) and provisional tax.



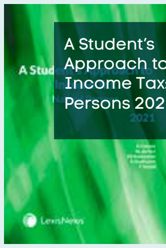
A Student's Approach to Income Tax: Business Activities 2021

Bruwer, L; Cass, SC; Cucciolillo, D; Koekemoer, A; Oosthuizen, A & Stedall, C

R810.51 // LEXISNEXIS

* Also available in Afrikaans

This book was written with the specific purpose of combining in one concise volume the provisions of the Income Tax Act 58 of 1962 (the Act) as it applies to business activities. The provisions of the Act regarding natural persons are dealt with in a separate book, *A Student's Approach to Income Tax: Natural Persons.*



A Student's Approach to Income Tax: Natural Persons 2021

Coetzee, K; De Hart, KL; Koekemoer, A; Oosthuizen, A & Stedall, C

R790.74 // LEXISNEXIS

* Also available in Afrikaans

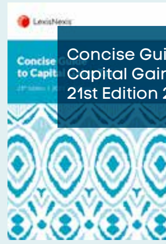
This book was written with the specific purpose of combining in one concise volume the provisions of the Income Tax Act 58 of 1962 (the Act) as it applies to individuals. The provisions of the Act regarding business activities are dealt with in a separate book, *A Student's Approach to Income Tax: Business Activities.*

Taxation of Individuals: Simplified 2021

De Hart, KL; Smulders, S; Hamel, E & Steenkamp; LA

R800.70 // LEXISNEXIS

The publication is aimed at an entry level of Taxation studies. The title is ideal for more practical and rudimentary tax courses.



Concise Guide to Capital Gains Tax 21st Edition 2021

Clegg, D

R437.00 // LEXISNEXIS

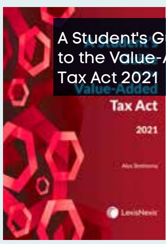
Easy to understand guide to the complex subject of capital gains tax. Makes use of simple examples to illustrate and clarify key points. Starts with the basic principles and identifies frequently misunderstood areas, explains the law in clear, non-technical terms and cross-references every statement made through footnotes to the Act.

Concise Guide to VAT 26th Edition 2021

Clegg, D & Wiid, E

R448.50 // LEXISNEXIS

This is a quick and easy guide for finance and accounting practitioners,and is also simple enough for the uninitiated taxpayer to grasp the complexities of the VAT system. Fully cross-referenced to the VAT Act and extracts from the Act, as well as a detailed index, are included for additional reference and guidance.



A Student's Guide to the Value-Added Tax Act 2021

Brettenny, A

R460.60 // LEXISNEXIS

The guide has been written with specific reference to the Examinable Taxation Pronouncements (the tax syllabus) for the Initial Test of Competence (ITC) of the South African Institute of Chartered Accountants (SAICA).

Tax Administration 2nd edition

Croome, B & Olivier, L

R1 463.00 // JUTA

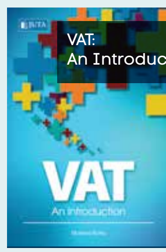
This book sets out the rules of tax collection, showing how areas of law interrelate and noting best international practice. It provides clear and authoritative guidance on aspects such as the registration and submission of tax returns, assessments, requests for information, penalties and interest, privilege, reportable arrangements, dispute resolution, advance tax rulings and remedies.

Street Smart Taxpayers A Practical Guide to Your Rights in South Africa

Croome, B & Croome, J

R497.00 // JUTA

This book explains the processes SARS must follow when working with taxpayers throughout the various stages of the tax process, and identifies the remedies available to taxpayers.



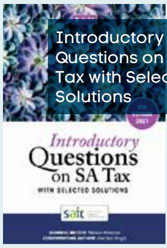
VAT: An Introduction

Botes, M

R771.00 // JUTA

The book will help students understand the practical mechanics of the South African VAT system.

SAMPLE TAX PROBLEMS



Introductory Questions on SA Tax with Selected Solutions

Singh, D *et al.*

R273.00 // JUTA

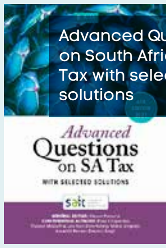
Introductory Questions on SA Tax 4th edition is the first of three publications in the *Questions on SA Tax* series designed to provide comprehensive tutorial coverage to taxation students. This book covers foundational topics typically dealt with in the first year of the study of tax at an undergraduate level.

Questions on SA Tax with Selected Solutions

Carpenter, R *et al.*

R355.00 // JUTA

Questions on SA Tax 22nd edition is the second publication in the *Questions on SA Tax* series designed to provide comprehensive tutorial coverage to taxation students. This book covers foundational topics and those typically dealt with in the study of tax at an undergraduate level.



Advanced Questions on South African Tax with selected solutions

Carpenter, R *et al.*

R350.00 // JUTA

Advanced Questions on SA Tax 6th edition is the third and final publication in the *Questions on SA Tax* series designed to provide comprehensive tutorial coverage to taxation students. This book covers advanced topics and integrated questions. Its complementary publications, *Introductory Questions on SA Tax* and *Questions on SA Tax*, cover foundational topics and those typically dealt with in the study of tax at an undergraduate level.

Graded Questions on Income Tax 2021

Mitchell, K & Mitchell, LD

R931.87 // LEXISNEXIS

The questions are based on the Income Tax Act 1962, the Tax Administration Act 2011, the Value-Added Tax Act 1991, the Estate Duty Act 1955 and the Transfer Duty Act 1949 – incorporating amendments up to and including the Rates and Monetary Amounts and Amendment of Revenue Laws Bill.

To place an order, use the contact information provided below.

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