

PROFESSIONAL

# TAXTALK

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## ROAD TO RECOVERY

*Rebuilding economies*

saït

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# STALINGRAD DEFENCE VERSUS TAXPAYERS' RIGHTS



► **PROF THABO LEGWAILA**, CEO at Office of the Tax Ombud

One can only dodge the tax man for so long; eventually he comes and collects. However, SARS also holds a responsibility to be fair. In this article we explain this dynamic.



## Stalingrad defence versus taxpayers' rights — overstretching the reach

Generally, taxpayers voluntarily comply with their tax obligations. However, some taxpayers persevere in being non-compliant and use any means to evade tax obligations. It is this latter clutch of taxpayers that entrench the need for tax laws to contain harsh provisions to enable tax authorities to collect taxes from the non-compliant. Unfortunately, these laws could be and often are, misapplied to taxpayers that have not been proven to be non-compliant.

SARS is both tasked with the responsibility to collect taxes and armed with the necessary legislative apparatuses to collect the taxes. Rightly so! Without these severe laws, tax collection from defiant taxpayers would be so impossible that it would encourage those voluntarily compliant taxpayers to not pay too. After all, how many would want to pay if there is a scot-free option to not pay? However, at times it is not the actual laws that are harsh, but the failure to apply the laws correctly that results in the harsh treatment meted to taxpayers. In what follows is a few instances where the tax collector blatantly disregarded the law it is supposed to administer.

## When Caesar must pay, Caesar must pay – the issue of tax refunds

We all know very well that we need to give to Caesar what belongs to Caesar. And for those who did not know, they should know now and act accordingly. But, oftentimes, we give to Caesar more than what belongs to Caesar and, in that case, Caesar must pay us back the excess money. Tax authorities tend to think of their roles as collecting money and never paying money. Hence, you find that when tax authorities should pay any money, there are set-off provisions, verification requirements, multiple levels of red tape on refunds, lower rates of interest on debts owed by tax authorities to taxpayers, delays in refunds and the list goes on.

In *Rappa Resources (Pty) Ltd and Another v CSARS (20/18875) [2020] Zagpphc (5 November 2020)* (Rappa), the taxpayer claimed a VAT refund which SARS withheld on the basis that SARS was conducting an audit. The audit commenced in March 2020 and by November 2020 it had still not been concluded. The taxpayer approached the court to instruct SARS to, inter alia, conclude the audit and refund the taxpayer. The court, in



this case, found that SARS cannot be allowed to take an indefinite time to complete an audit. If SARS were allowed to do so, it would mean that the Tax Administration Act (TAA) is inherently unfair towards taxpayers. The court ruled that the audit has to be completed in a reasonable time, taking into account the circumstances, and ordered SARS to complete the audit by 11 December 2020, which was within 36 calendar days from the date of the judgment.

In the case of *Top Watch (Pty) Ltd v the Commissioner of the South African Revenue Service 2018 JDR 1311 (GJ)* (Top Watch), SARS refused to pay certain VAT refunds to the taxpayer on the grounds that the taxpayer owed an income tax debt, which SARS alleged was due and payable. Low and behold, SARS could not even prove the existence of the tax debt!

### **Third-party appointments – may the tax collector please comply?**

The TAA allows SARS to appoint a third party to satisfy tax debts on behalf of taxpayers. So, in effect, SARS appoints an agent on behalf of a taxpayer and instructs that agent

to pay a taxpayer's debt from money that the agent holds or will hold or owes or will owe for or to a taxpayer. In recent times, SARS has been found wanting with regard to third-party appointments.

In the case of *SIP Project Managers (Pty) Ltd v Commissioner for the South African Revenue Service ((11521/2020) 2020 ZAGPPHC 206* (decided on 29 April 2020)) (SIP), SARS issued a third-party appointment to a bank in respect of a debt owed by the taxpayer without delivering the final letter of demand to the taxpayer. In this case, the court held that the requirement "is unambiguous and clear – the notice to a third party 'may only be issued after delivery of a final demand for payment which must be delivered at least 10 business days before the issue of the notice....'. This is a peremptory requirement before the step can be taken to issue a third party notice for recovery of an outstanding tax debt" (par 22).

Yet, despite this clear, unambiguous and comprehensible judgment (remember that it was handed down on 29 April 2020), on 22 June 2020, SARS issued a third-party notice to Impala Platinum Limited (Impala) to ►

- ▶ pay over to SARS an amount of about R6.3 million from amounts owed by Impala to WPD Fleetmas CC (Fleetmas). Impala paid over the amount to SARS on 8 July 2020. This matter was brought to the court in the case of *WPD Fleetmas CC v Commissioner of the South African Revenue Services and Impala Platinum Limited* (case no 31339 2020 (unreported) 19-08-2020 (GNP)), where Fleetmas indicated that it only received the final letter of demand on 7 July 2020, which means that SARS failed to comply with the ten-day requirement in the TAA. SARS relied on the final letter of demand that was purportedly sent to Fleetmas on 20 May 2020. However, SARS could not prove that the letter was delivered to Fleetmas. In a surprising confession, SARS' counsel conceded that the final demand dated 20 May 2020 should have appeared on Fleetmas's eFiling profile, but it is not there.

In this case, SARS needed to show that the demand was delivered via the electronic eFiling profile of the applicant and this would satisfy the requirement of delivery to the tax debtor of final demand. But, according to the evidence in court, this did not take place. The court yet again concluded that SARS failed to comply with the provisions of the TAA and therefore the notice to appoint a third party was declared null and void.

It is not surprising that the courts in both the SIP and the Fleetmas cases made cost orders against SARS. This is telling of the court's discernment of the negligence on the part of SARS. These cases also expose the incompetence on the part of SARS' staff dealing with third-party appointments. It boggles the mind that SARS issued the defective Fleetmas final notice after SIP was decided. One would have expected the SIP decision to have resonated prominently within SARS, especially within the division responsible for third-party appointments to be more diligent and avoid any further negative exposure. In addition, in 2017 the Office of the Tax Ombud highlighted to SARS that this deficiency is a systemic issue that SARS needed to resolve. It is therefore startling that SARS still finds itself in situations where it is unable to prove that documentation was indeed sent to taxpayers.



SARS could not have reasonably expected to win these cases. As to why SARS even bothered spending taxpayers' hard-earned taxes defending these matters in court, only SARS knows!

#### What does this do?

One of the things to be conscious about is that SARS defends claims against itself using the funds contributed by the same taxpayer it is defending claims against. This explains the rationale behind the call that taxpayers should be assisted in instituting and lodging legal claims against SARS, pretty much the same as legal aid does for indigent litigants.

At the end of it all, when you have a tax authority that complies with both substantive and procedural laws applicable to it, you need fewer controls to protect taxpayers against it. While cost orders were awarded in favour of taxpayers in some of the cases discussed herein, that does not provide any comfort for taxpayers who cannot even imagine themselves instituting claims against SARS for various reasons, including the time and human resources required for the case, lack of financial resources and fear of reprisal.



These cases arise at a time when tax morality is said to be at its lowest and the tax compliance carrot is provided mainly by changes and improvements at SARS and the stick by what some may consider being 'draconian' administration laws that are applicable. Flaunting the very rules by the tax administration may have an unacceptable and uncoded extension of the wrath of the tax laws. That cannot be good for tax morality!

How widespread are these power abuse incidents? We might never know, as not many taxpayers contest these to the level of the courts. It is costly. Some taxpayers have taken these matters to the free services of the Tax Ombud who has made various recommendations to SARS on these and similar matters for SARS to release or pay refunds and follow the correct processes with regard to third-party appointments.

Most importantly, the consequences of withholding refunds are dire. In Rappa, the taxpayer's business depended on the VAT refunds for liquidity, and it was accepted that without such refunds the taxpayer's business could fail. Spare a thought, at this stage, for

*"If taxpayers receive income from multiple funds or entities, they need to add up all the income received to determine whether any tax will be owed to SARS."*

the multitudes of (small) businesses which experience cash flow challenges to death, and then add SARS' inadvertent withholding for such a scrawny business.

### Conclusion

I hold a very strong view that SARS, being the tax administrator, should have the capacity to administer the tax laws accurately. Its staff has or should have more knowledge of taxes than an average businessman or woman. Every staff member must apply the law accurately. Failure to do so, which could have dire consequences on small and other businesses, should be reproached with the strongest action. There should be no tolerance or indulgence on SARS on issues of tax application. Tax on its own is a deprivation of property, legally executed, and anything done outside the precincts of the law is deplorable and should be met with the contempt it deserves.





# THE SOUTH AFRICAN TAX GAP:

## ANYTHING LEFT TO TAX?

► **TERTIUS TROOST**, Tax Manager at Mazars

South Africans have been hard hit by the pandemic and this has left taxpayer coffers empty. This article takes a closer look at the options left for Government to get tax funding.

From lockdowns and load shedding to the coronavirus and climate crisis, South Africa has had its fair share of troubles this year but so has SARS. With a growing tax revenue gap and very few means to close it, it is easy to assume that SARS has reached the ceiling on taxation.

Before diving into the figures, it is worth noting that this year's tax revenue deficit can mainly be pinned to the adverse economic consequences of the COVID-19 pandemic. Similar to a snowball effect, it was further exacerbated by lockdowns, travel restrictions, load shedding and looting. On top of that, international confidence and investment in South Africa remained low due to a weak public sector balance sheet and low levels of competitiveness that impeded faster growth. All in all, it was a tough year, but where do we stand?

In the 2020 October Medium-Term Review Policy Statement (MTBPS), National Treasury was forced to revise the Budget of February due to the pandemic. If the 2021 tax collection figures are compared to the original budgeted figures estimated in February 2020, the tax revenue gap amounts to approximately R213 billion. During the February 2021 Budget Speech, Treasury set the target for revenue collection for the 2022 fiscal year at R1 520.4 billion. We will have to wait and see whether SARS will meet this target, and a clearer picture of their efforts will only come to light during this year's MTBPS in October.

We should also bear in mind that the 2022 target is approximately 11.5% higher than the 2021 target since Treasury expected to see a significant recovery in the global economy's growth this year. In South Africa, the natural resources sector has remained buoyant and agricultural exports keep outperforming expectations. If this can carry over into tax revenue collection and counteract the effects

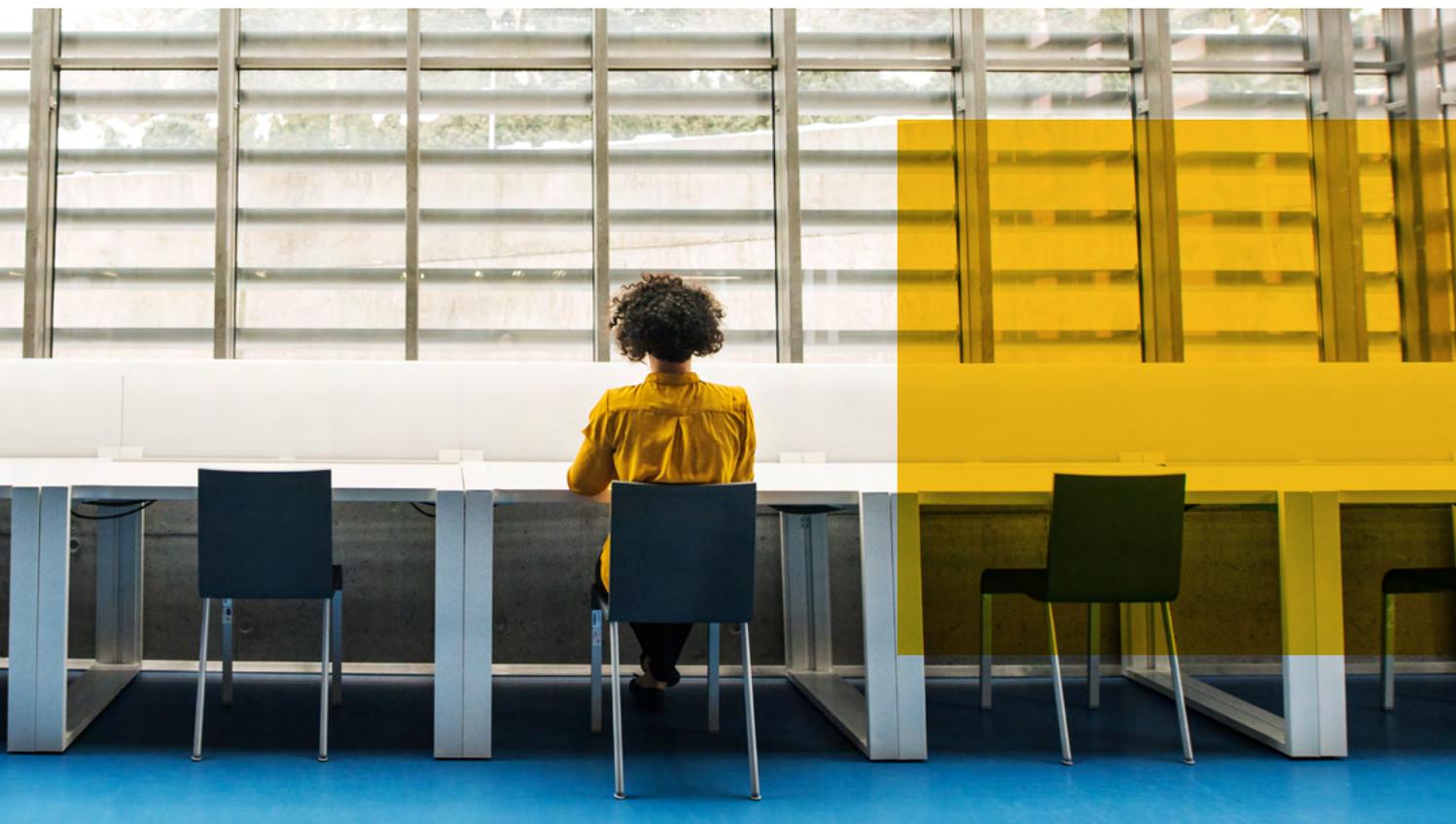


of additional lockdowns, load shedding and the recent looting that we experienced, SARS might just meet its targets. If not, the burning question arises: Is there anything left to tax?

In my opinion, Treasury should focus on growing the economy (and thereby the tax base) instead of implementing additional taxes, because at some stage they will need to choose between running up taxes or running out of citizens. That being said, below are four areas of taxation where I think there is still room to explore but hopefully not exploit.

### 1. Coin it by taxing crypto assets

Although there is no specific tax framework for crypto assets, there is a lot of room for development in this uncharted territory. In April 2018, SARS stated that 'normal rules' will be applied to the taxation of crypto assets. However, the crypto market has evolved so rapidly over the last few years that 'normal rules' simply cannot cater to all the transactions in the market. My suggestion would be that further guidance (if not a complete tax policy reform) is required for the crypto landscape. Although SARS has made some headway on the taxation of crypto assets, it has been a slow process – and one



that is struggling to keep up with an ever-changing market.

I know many crypto connoisseurs might wonder what tax policies on crypto assets would look like in South Africa? Fortunately, South Africa is not alone in grappling with this dilemma as taxation authorities worldwide have been required to develop policies and apply existing laws in new ways for crypto assets. Eventually, SARS will have to do the same and when that time comes, they can look to countries such as Japan, the US and the UK for guidance.

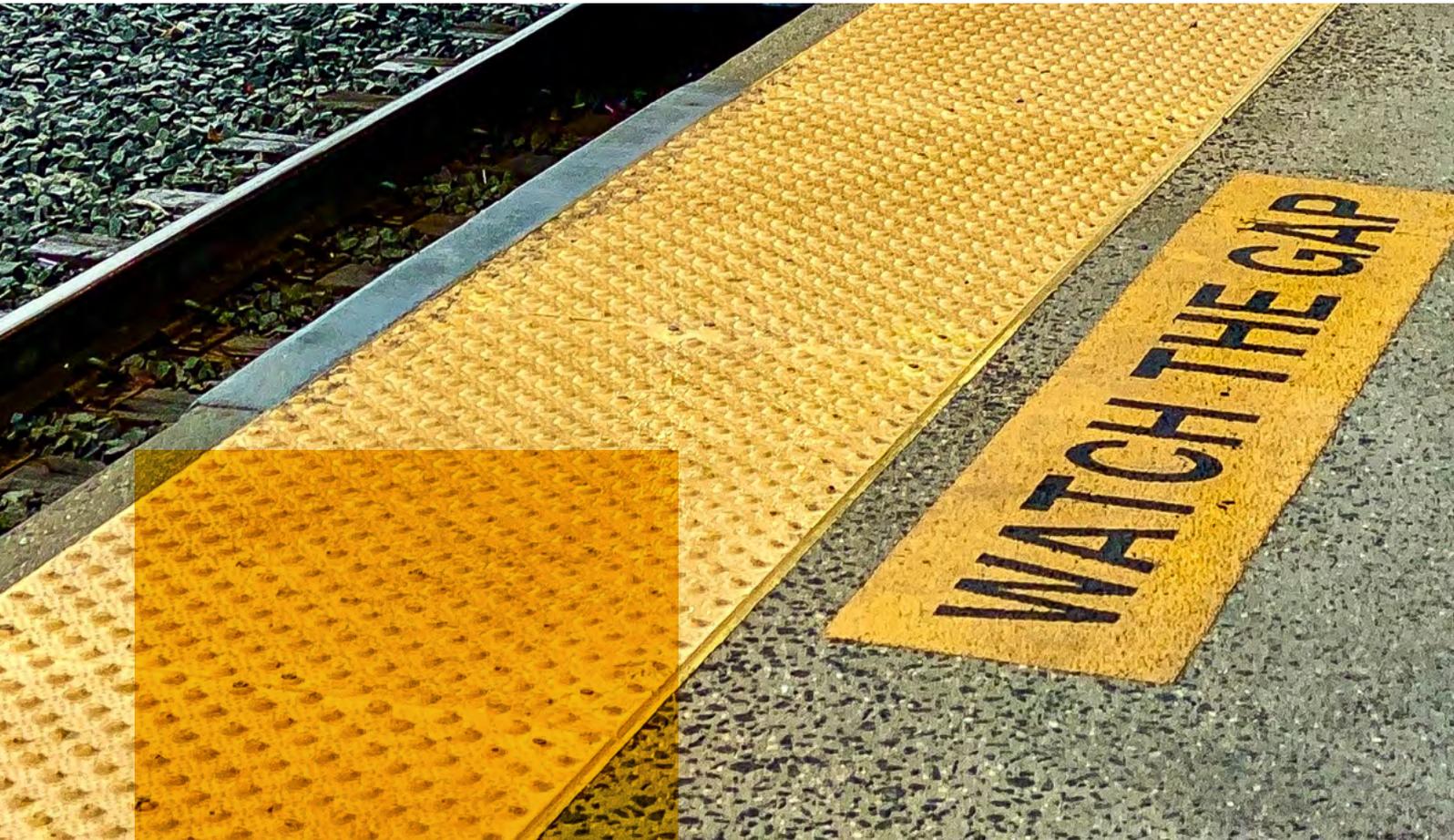
When considering the taxation of crypto assets, it is worth noting that the crypto environment contains several different transaction types. Currently, most of the focus is on mining crypto assets, receiving crypto assets as compensation for services or the sale of goods and trading or holding crypto assets. The problem is that, while most people are focused on these three types of transactions, there are also transactions like decentralised financing (DeFi), smart contracts, non-fungible tokens and staking. The more the crypto market evolves, the more difficult it will be to regulate and eventually tax.

## 2. Implement a one-off Solidarity Tax

In 1994, the then Finance Minister Derek Keys introduced a one-off wealth tax of 5% during his first budget speech – and the first for the democratic government. This one-off tax was aimed to be a ‘transition levy’ for the new South Africa and, after serving its purpose for one year, it was abolished in 1995.

After the harrowing impact of the COVID-19 pandemic on the economy, a similar tax injection might be warranted today. If Treasury can guarantee that it will only be a one-off event and that tax rates will return to normal, they may just be able to justify a solidarity tax of some sort.

On the one hand, this upfront tax revenue injection can be used to cover specific COVID-19 related expenses. If managed wisely, it can also be used for specific economic activities that would stimulate economic growth. On the other hand, there is always the risk that money will be mismanaged or not used for specific projects. Treasury would need to provide a detailed analysis of what the levy will be used for and provide the country with equally detailed feedback on how it was spent. Additionally, if this tax increase ►



*“It is worth noting that this year’s tax revenue deficit can mainly be pinned to the adverse economic consequences of the COVID-19 pandemic.”*

- ▶ is retained after promises of removal, it could adversely affect the trust relationship between taxpayers and the state – a relationship that is essential to ensure compliance.

### 3. Welcome remote workers

One of the few upsides of the COVID-19 pandemic is that it has accelerated the adoption of a remote working culture across the world. Suddenly, South Africa is an attractive destination not only for tourists but for remote workers too. There is ample opportunity to generate tax by allowing remote workers into the country – a concept that countries such as Dubai and Australia have already embraced.

South Africa could create a type of visa that allows remote workers earning above a certain threshold to work in the country for 365 days at a time. As these persons (usually white-collar workers) are based in South Africa, they will under certain circumstances be liable for tax on their remuneration earned while they are in the country. They will also add additional tax revenue to the fiscus through indirect taxes, such as VAT and fuel levies. This might be

one of the best ways to showcase what the country has to offer, and it could even lead to some of these remote workers permanently immigrating to South Africa.

There are, however, some challenges that may impact the feasibility of remote working in South Africa, such as visa regulations and specific rules with regard to UIF and SDL. Before ironing out these logistics, many foreign employers might circumvent the administrative burden and discourage employees to work remotely in South Africa.

#### 4. Step up the reinforcement at SARS

Last but not least, we should fix things that are broken before scouting for new buys. Yes, this may be a cliché and no, I am not saying SARS is broken – but there is room for improvement. It is widely accepted that the informal economy (e.g. the taxi industry) has a lot of potential to provide additional tax revenue; however, SARS together with Treasury would need to think outside the box to incentivise this sector to fall within the tax net. For example, an initial tax holiday to register businesses and thereafter a hard clampdown on non-compliant businesses or incentivising vendors to provide pre-numbered invoices which form part of a weekly or monthly lottery.

Additionally, the current tax legislation already caters for harsh penalties. Therefore, no change in legislation is required for more stringent penalties. SARS simply needs to obtain better means of identifying taxpayers who are not paying their fair share and penalise them accordingly. We currently see SARS wasting resources on taxpayers who comply with legislation, while overlooking taxpayers who are deliberately evading taxes. The more SARS is able to demonstrate that tax evaders are brought to book, the more SARS will maintain and strengthen

its credibility. Penalties lead to additional tax revenue that can play a big role in closing the tax revenue gap.

#### The endgame: Everyone wants what is best for South Africa

No matter how we look at it, increasing taxes could lead to even further capital flight. While all four of the above-mentioned avenues can open the door to more taxes, higher taxes without a corresponding increase in public services could lead to the mass exodus of taxpaying individuals and businesses. This in turn will lead to even less investment in South Africa by foreign businesses. Unlike decades ago, when many of our tax policies were drawn up, it is much easier to move individuals, businesses and capital in the twenty-first century, and what we are seeing is that many South Africans are not hesitating to pack up and leave the country.

Essentially, taxpayers want to feel that they are getting what they pay for. I think South Africa needs to ditch the short-term view of its public finance and strap in for the long run. It needs to create incentives for international investment and thereby grow the tax base, rather than over-tax the existing tax base. As the popular saying goes, “A smaller part of a larger pie can lead to more than a large part of a small pie”.

At the end of the day, SARS, Treasury, the South African Government and the taxpaying citizens of this country all want the same thing – to boost the economy. I would think through less red tape and more incentives to promote business and employment, the economy will flourish. Instead of attempting to right the wrongs of the past, these incentives should be aimed at sectors of the economy that have the most growth potential.





# The Remote tax practice: make it happen with CaseWare CloudTax

CloudTax helps tax practitioners solve many of today's challenges and lays the foundation for the tax practice of the future.

In the age of lockdowns and working from home, both practitioners and their clients find themselves having to run their businesses remotely. Many tax practices experienced revenue losses when the initial lockdowns were introduced. Others have been victim of cyber-attacks and ransomware. At the same time, SARS also increased auto-assessments to grow collection revenues, which has introduced additional challenges for practitioners to ensure assessments contain appropriate information.

One thing has become clear: there is a burning need for tax practitioners to effectively manage data and client information, to find better ways of assisting their clients from any location, whilst continuing to ensure that their clients' tax affairs remain in order.

Covid-19 has certainly reemphasized the urgency for tax practices to future proof their firms. There's no doubt that smart tax practices have already seen the writing on the wall and are looking to transition to cloud-based solutions. Research shows that this is where future-fit accountants still have considerable room to grow, with less than 20% of accountants using tax-preparation software, whilst the rest are still managing their practices using manual processes.

But moving to tax-preparation software is only the beginning. Whilst preparing the tax return is the final deliverable, it must be recognised that it is the result of a process that starts much earlier.

In fact, most taxpayers spend between 75% to 90% of their time gathering information and documents. As anyone who has done it knows, it's daunting to collaborate with clients via the phone or e-mail, and response times can often be very long. Another major issue is the use of spreadsheets to calculate and check numbers - an approach that introduces errors and that is time-consuming. It also means that the information is all over the place, wherever people are working on it—instead of in one central location where everybody can access it.

In addition, when information is dispersed, version control becomes a continuing and difficult issue to manage. And, of course, there is the time-consuming and inefficient process of submitting each tax return manually.

## A better way

Tax practitioners who transition to cloud-based solutions can quickly overcome previous challenges and take advantage of significant benefits. For one thing, moving to a cloud-based solution means that the firm is always assured of using the latest technology—without the upfront capital costs of acquiring a licence every time a product is upgraded or needing to roll out upgrades to every user.

## Some of the main benefits of moving to the cloud are:

- **Better cost model.** Costs are predictable and easy to manage, and practitioners do not need to invest in server and security infrastructure. This introduces considerable savings.
- **Better security.** Data is stored safely and securely on multiple remote servers, without needing any resources or costs from the practitioner to maintain. The firm's data, and that of its clients, is much more secure—no small thing given the Protection of Personal Information Act (PoPIA) and its stringent penalties.
- **Accessibility.** Tax practices and their teams can work from anywhere at any time, and all they need is a browser and access to the internet. This means that firms can save costs on VPN connections and do not need to coordinate software update installations with their IT teams.
- **Centralised Storage.** Clients don't have to struggle with managing multiple copies of the same information in different places. In addition, the cloud offers unlimited storage space and comes with useful features like automatic backup, so practitioners don't have to worry about losing or redoing any work.
- **Enhanced productivity.** Greater security is complemented by greater availability. Centrally located data is accessible to all who need it, from wherever they are. Tax professionals can service their clients from wherever they happen to be, and do not need to be in their offices to do so. Another big advantage is that any number of tax professionals can work on the same documents simultaneously.

## Why tax practices need CloudTax

Adopting CloudTax is a great starting point for the move to the cloud because it has been specifically designed with the needs of the tax practitioner in mind. CloudTax enables tax professionals to access all the benefits of the cloud while minimising the risks. Some of the main benefits are:

- **Easy collaboration with clients.** Practitioners can make use of built-in queries and customisable questionnaires and send those to clients directly from within the app. Clients then respond easily by logging into their personal portal, answering the questions and uploading any necessary documents—even via smartphone. The system notifies the tax professional when new information is provided.
- **Deadline Management.** CloudTax keeps track of important deadlines and users can easily monitor provisional and annual return progress and status for all their entities.
- **SARS Integration.** CloudTax integrates directly with SARS eFiling, which means practitioners can process all taxpayer details, correspondence and tax return submissions automatically in bulk.

**SARS Compliance.** Tax return forms and calculation frameworks are frequently kept up to date to ensure that they are compliant with all relevant tax legislation, greatly simplifying the tax return process.

- **Seamless Data Integration.** Trial balance information can easily and automatically be imported from CaseWare Working Papers, Xero, QuickBooks and Excel to pre-populate tax returns.
- **Optimisation.** Checklists, questionnaires and schedules are built-in that intelligently expand or collapse according to the complexity of the return.
- **Prepare, calculate, and submit tax returns directly to SARS eFiling.** CloudTax supports Provisional (IRP6), Individual (ITR12), Corporate (ITR14) and Trust (ITR12T) tax returns with built-in calculations aligned to SARS.

With CloudTax, tax practitioners are now more empowered than ever with a holistic cloud-based tax return solution, that can be used seamlessly for all provisional and annual returns for Corporates, Individuals and Trusts. The tax practice of the future will be cloud-based. With CloudTax, tax practitioners can take a very meaningful step towards setting up their firms for future success.

## Prepare, Calculate & Submit Tax Returns



Provisional Tax  
(IRP6)



Individual Tax  
(ITR12)



Corporate Tax  
(ITR14)



Trust Tax  
(ITR12T)

## Key Features



Deadline  
Management



Client  
collaboration



SARS  
Integration



SARS  
Compliance



Seamless Data  
Integration



Optimisation



Tax  
Management



Multiple-Taxpayer  
Support



# THE FUTURE OF LOW TAX

15 minutes CPD



# JURISDICTIONS IN A POST-PILLAR WORLD

► **CELIA BECKER**, Africa Regulatory and Business Intelligence Executive at ENSafrica

Breaking down forms of taxation in Pillar I and Pillar II administration.

**B**y 9 July 2021 132 jurisdictions had joined the new Pillar II framework for international tax reform initiated under the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting.

Pillar I is aimed at a fairer distribution of profits and taxing rights among jurisdictions and applies to multinational enterprises (MNEs), other than extractive and regulated financial services companies, with a global turnover exceeding €20 billion and profit before tax/revenue above 10%. 20-30% of profit in excess of 10% of revenue. The so-called residual profit is to be allocated to 'market jurisdictions' where goods or services are used or consumed when the MNE derives at least €1 million from that jurisdiction (€250 000 in the case of countries with a GDP of less than €40 billion).

Pillar II seeks to introduce a global minimum corporate tax rate of at least 15% to protect the tax bases of respective countries and to curb international corporate tax competition. MNEs meeting the country-by-country reporting threshold of €750 million are subject to the Global anti-Base Erosion Rules (GloBE Rules) which levies a 'top-up' tax payment on a parent entity in respect of the low taxed income of a constituent entity.

The OECD expects that, under Pillar I, taxing rights on more than \$100 billion of profits will annually be reallocated to market jurisdictions, while the global minimum tax rate of at least 15% should generate around \$150 billion in new annual tax revenues (OECD, July 2021). However, not everyone is equally optimistic about the anticipated benefits of the plan.

### **The view of the African Tax Administration Forum**

Although the African Tax Administration Forum (ATAF), an African network that aims at to improve tax systems in Africa, welcomes the framework as a milestone in achieving global consensus on tax challenges in digitised economies, it has expressed various reservations on the potential effectiveness of the proposed provisions for Africa. ATAF commented on the blueprint proposals issued in October 2020 and highlighted that the Pillar I rules were far too complex and would only result in a very modest amount of profits being reallocated to smaller market jurisdictions (ATAF, May 2021).

The new Pillar I rules were subsequently simplified, but the network still maintains that reallocation of profits should rather be calculated as a portion of the MNE's total profit, instead of its residual profit. It is of the view that this would simplify determining allocable profits and ensure a fairer treatment of businesses with a current taxable presence in a market jurisdiction as compared to those without. If the residual profit basis is to be retained, it argues that at least 35% of residual profit should be allocated to market jurisdictions. ATAF also argues that the minimum effective tax rate under Pillar II should be at least 20% to effectively guard African tax bases and curb illicit financial flows from the continent (ATAF, July 2021).

### **The impact on small open economies**

Other stakeholders have raised more fundamental issues regarding the potential impact of the Pillar II framework on smaller economies. The European Centre of International Political Economy (ECIPE) highlights that limited economic impact assessments of Pillars I and II's proposals have been done and it is of the view that the OECD's analysis is of static nature and has a narrow focus on changes in governments' revenue, which is deceptive. It expects that the framework would transfer taxing rights and economic activity away from small open economies to the world's largest countries, which generally currently levy high corporate income tax rates (ECIPE, April 2020).

- ▶ The ECIPE argues that, on the one hand, the world's most open economies in terms of trade/Gross Domestic Product (GDP), imports/GDP and exports/GDP are often small economies, which rely on international trade. Larger countries, on the other hand, are generally more self-reliant, having substantial natural resources and being in a position to produce various products and services. The significant size of markets in large countries also facilitates attracting investors. Export-intensive countries are generally more tax competitive, allow a substantially higher degree of economic freedom and are less restrictive to international trade and investment than the least export-intensive countries. Information published by the World Bank and Fraser Institute also suggests that many large countries among the least export-intensive countries perform poorly with respect to the state of the rule of law.

World Bank data shows that the top 30 Inclusive Framework countries with the highest export intensities include small open economies, such as Luxembourg, Singapore, Malta, Ireland, Seychelles, the Netherlands, and Switzerland, whereas the 30 countries with the lowest export intensities include the Russian Federation, China, Brazil, the USA and Nigeria (World Bank, 2011).

The ECIPE is of the view that the OECD's impact assessment of the two-pillar framework does not take into consideration how governments and international companies would react to the change in taxing rights under Pillar I and the limitations on tax competition introduced by Pillar II. Tax competition may even increase under the proposed limitations. Governments of high-tax countries are expected to lower effective corporate tax rates to counter the negative impact on outward and inward investment, thereby reducing the tax differential with lower-tax countries and ultimately eliminating the tax advantage of small open economies with low effective corporate tax rates. Small countries would become less attractive to international businesses and domestic businesses would be

incentivised to relocate to larger countries with more sizeable markets.

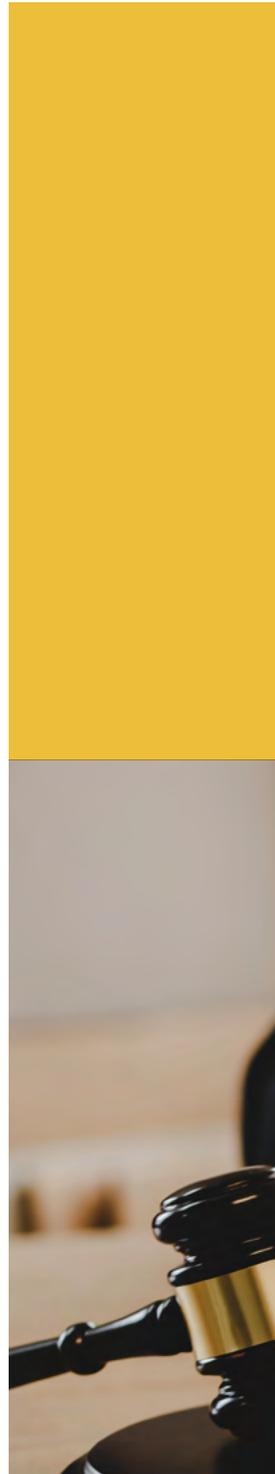
ECIPE's calculations based on the methodology of the OECD (2017) illustrate that changes in inward investment resulting from the full elimination of effective corporate tax rate differentials would negatively affect many small open economies. For example, Ireland should expect a decrease in the inward investment of 40%, Switzerland 19%, Luxembourg 11%, and the Netherlands 10%, whereas larger economies, such as the US and Australia, can anticipate benefiting from an increase in inward investment of 11% and 20%, respectively.

Small open economies that generally provide tax incentives to encourage private sector investment and innovation are often home to research- and knowledge-intensive MNEs. ECIPE's research indicates that the Pillar II framework could result in reduced investment in research and development and innovation, with adverse implications on existing research clusters and high value-added jobs.

### Conclusion

ECIPE is of the view that the implementation of Pillars I and II's proposals would not improve the global allocation of capital and that trade and investment flows would still be subject to tax competition. The framework would likely incentivise the governments of large high-tax countries to reduce their corporate income tax rates and maintain or even enhance prevalent trade and investment barriers to restrict market access for businesses from small open economies.

In addition, it should be reconsidered whether corporate income taxes do in fact make a significant contribution to economic development, redistribution and fairness in taxation. Research by the OECD and Tax Foundation in 2018 on the tax revenues in OECD countries show that taxes on corporate income account for only 9.5% of OECD countries' total tax revenues. In addition, new taxes on digital services would only account for a negligible share of governments' total annual tax revenues. Yet, the annual tax revenue per national citizen is significantly higher in the case of employees' tax and sales tax.



*“The ECIPE is of the view that the OECD’s impact assessment of the two-pillar framework does not take into consideration how governments and international companies would react to the change in taxing rights under Pillar I and the limitations on tax competition introduced by Pillar II.”*

The ECIPE believes that consumption-based taxes provide a much more efficient mechanism to generate tax revenues from economic activities and user participation. Value added taxes or sales taxes are a tool that is already available in many jurisdictions and accounts for relatively high shares of overall tax revenue. A move towards tax systems with a stronger focus on employees’ taxes, capital income and consumption (VAT/sales) taxes is expected to have a positive impact on global capital allocation, with governments having additional motivation to encourage foreign trade and investment and lowering barriers.

The two-pillar framework is expected to be finalised in October 2021, including an implementation plan to develop model legislation, guidance and a multilateral treaty in 2022, with implementation from 2023. Only time will tell if the plan will achieve its optimistic objectives of a fairer distribution of taxing rights and an elimination of international corporate tax competition.



# POST-COVID REBOUND

► **DIRK MOSTERT**, Senior Economist at PwC

The show goes on despite the heavy drawback of COVID-19. This article delves deeper into how global economies are clawing back.



## The pandemic still hampers economies from functioning fully, 18 months on

It has been a year and a half since COVID-19 became a very real local threat, arriving on South African soil on 5 March 2020. Yet, 18 months on, we still live in a world where the global pandemic remains prevalent. We witness continued outbreaks and reintroduced lockdowns across both developing and developed nations, which is set to continue for an uncertain period. Amid a shortage of vaccinations in many developing countries, many developed nations with ample doses see a reluctance among sections of their populace to be vaccinated. All the while, new variants of the virus emerge, threatening to drag out this battle. Due to this ongoing inequality, uncertainty and risk, the virus continues to hamper a full recovery of a functioning domestic and global economy.

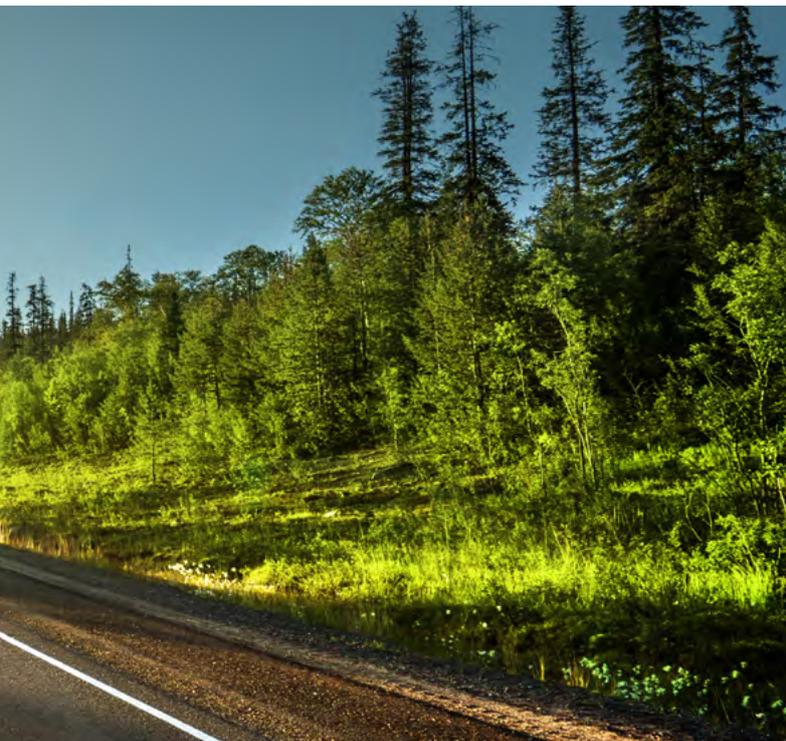
## The US and Chinese economies are spearheading the global recovery

The disruption in the global economy during 2020 due to the COVID-19 pandemic continues to induce aftershocks that impact the unequal economic recovery in some parts of the world: Empty shipping containers are stranded in less-frequented ports, while there have been shortages on busier

routes. Furthermore, temporary shortages of commodities have occurred amid shifting spending patterns; for instance, increased expenditure towards housing and work-from-home electronics.

However, despite these constraints on international trade, in June 2021, the World Bank expressed their expectations for the global economy to stage "its most robust post-recession recovery in 80 years in 2021", with a forecast of 5.6% for this year and 4.3% for 2022. This sentiment is echoed by the International Monetary Fund (IMF) World Economic Outlook (WEO) Update that, in July 2021, forecast a global economic expansion of 6.0% and 4.9% in 2021 and 2022, respectively.

The World Bank's and IMF's current forecasts for the advanced economies group is based on the significantly improved outlook of the US economy – with the World Bank forecasting a 6.8% growth rate in 2021 – which reflects the anticipated legislation targeted at boosting infrastructure investment and strengthening the social safety net. The Chinese economy, which registered positive economic growth of 2.3% in 2020, is expected to grow by 8.5% in 2021 as the country's focus shifts to reducing financial stability risks. Growth prospects for advanced economies have improved as



their vaccine rollout continues and governments look to additional financial support in the second half of 2021. The World Bank expects advanced economies to grow by 5.4% in 2021.

Amidst the strengthening global recovery, commodity prices are expected to increase at a significantly faster pace. Oil prices are expected to rise close to 60% above their low base in 2020. Non-oil commodity prices are expected to rise close to 30% above 2020 levels, reflecting particularly strong increases in the price of metals and food.

### **The recovery will be slower for most emerging and low-income countries**

While some emerging economies will benefit from the resource boom, the recovery of many countries is constrained by resurgences of COVID-19, uneven vaccination and a partial withdrawal of Government economic support measures. For example, growth prospects in India have been downgraded following the country's severe second COVID-19 wave during March to May and expected slow recovery in confidence from that setback. Similar dynamics are at work in the ASEAN-5 group (Indonesia, Malaysia, Philippines, Thailand and Vietnam) where recent infection waves are causing a drag on economic activity. The World Bank expects growth in emerging economies – excluding China – to unfold at a more modest 4.4% growth rate in 2021.

For the low-income economies, which have been the hardest hit by the pandemic and where vaccination has lagged, the World Bank expects growth of 2.9% for 2021. Barring 2020, this is the slowest pace of expansion for this group of countries in two decades.

### **How long before the global economy recovers to pre-pandemic levels?**

Using World Bank estimates of a global contraction of 3.5% in 2020 and growth of 5.6% for 2021, the global economy would surpass pre-pandemic levels by the end of 2021 already. COVID-19 might therefore only have wiped out a year's worth of global growth but will have widened inequality further across the globe and will have lowered per capita incomes in emerging and low-income countries for years to come. South Africa is as good a case study as any to understand this.

### **South Africa's recovery path**

#### *Vaccine rollouts continue but are still lagging its emerging market peers*

The IMF commented in July 2021 that nearly 40% of the population in advanced economies has been fully vaccinated, with less than half that number in emerging market economies. South Africa is lagging behind its emerging market peers. By mid-August, the country had fully vaccinated only 7.5% of the population (4.2 million adults) with roughly 13% of the population having received at least one of their two Pfizer doses as the country ramped up its vaccine rollout. However, despite the accelerated vaccine rollout over the past several months, the impact of the third wave remains severe. Additionally, the National Department of Health has expressed its concern in seeing a dwindling amount of the population taking up appointments or opportunities to receive vaccinations. This latter observation risks dragging out the current wave and increasing the risk and severity of future waves of infection.

#### *Easing of lockdown restrictions, fiscal support and Eskom's role in the recovery*

The severity of the mid-year third wave, and the accompanying strictness of associated lockdowns, is the primary driver behind the nature of the economic recovery. Level 3 lite lockdown stayed in place for the whole of August as COVID-19 numbers improved. Restrictions eased to Level 2 during September as the third wave of infections tapered out. There is also likely a fourth wave of infections starting around the December holidays.

*“For the low-income economies, which have been the hardest hit by the pandemic and where vaccination has lagged, the World Bank expects growth of 2.9% for 2021.”*

- ▶ In addition to lockdown considerations, we also considered the positive impacts of fiscal and monetary stimulus in our economic forecasts. Finance Minister Tito Mboweni announced on 29 July that Government is planning a R38.9 billion support package and that this will include R5 billion in revenue measures (i.e. tax breaks) and spending of R33.9 billion. The package will be funded by better-than-expected fiscal revenues – mostly from the mining industry – and will not need additional borrowing by the state.

Electricity load shedding also remains a large detractor to economic output, with 2021 having the potential to be the year with the highest number of kilowatt hours lost than any previous year. Furthermore, it is yet to be seen what the full extent of the damage to the economy will be following the unrest that shook KwaZulu-Natal and Gauteng – collectively responsible for half of South Africa’s economic activity – in early July 2021. The ramifications to supply chains and business operations could last years rather than months.

### **How long before the South African economy recovers to pre-pandemic levels?**

The World Bank’s growth forecast for South Africa is 3.5% in 2021, 2.1% in 2022 and 1.5% in 2023. This three-year average forecast is in line with our own baseline view of 2.5% and 2.0% per year up to 2024.

Our 2.5% forecast for 2021 is at the lower end of the range of forecasts currently available. The SARB said in July it expects the economy to grow by 4.2% this year. However, the central bank admitted in its latest Monetary

Policy Committee statement that the recent unrest, the impact thereof on the vaccine drive, a longer-than-expected lockdown, the limited energy supply (i.e. electricity load shedding) and policy uncertainty ‘pose downside risks’ to economic growth. It is likely that the major difference between the SARB’s current forecasts and our own projections is that we already incorporated more adverse impacts from these downside risks into our assumptions. For example, we already accounted for this year’s load shedding being of the same magnitude as experienced during 2020. PwC estimates that power outages added more than two percentage points to the depth of last year’s 7.0% recession.

When comparing South Africa’s economic contraction of 7% in 2020 with the global 3.5% (i.e. twice as severe) and the World Bank’s global forecast of a 5.6% rebound in 2021 to South Africa’s 3.5% (roughly 40% lower), it is evident that our recovery will take more time to reach pre-pandemic levels. Our estimation is in line with the World Bank’s estimate that it will take between three and four years to reach February 2020 levels.

### **Unemployment will lag behind the GDP recovery**

The economic recovery will be unequal and the disparity between GDP growth and employment levels will be one of South Africa’s largest, most pressing challenges over the coming decade.

The expected employment growth will be insufficient to make a meaningful impact on the unemployment rate. After closing last year at 32.5%, the narrowly defined unemployment rate is expected to moderate only marginally in 2021 to 32.3%. A forecast of 32.4% for end-2022 signals the start of a slow upward trend over the long term as local job creation continues to lag behind the needs of a growing labour force. Considering this, we expect that even if South Africa manages to grow at an annual average of 2% over the next decade, the narrowly defined unemployment rate could still not reach pre-pandemic levels of 28% by 2031.

COVID-19 has changed the world as we know it. More than ever, South Africa needs policy action fostering a globally competitive and attractive business environment to retain and attract investment to establish strong, inclusive economic growth.





# THE BATTLE FOR POST-RETURN INFORMATION — how can SARS and taxpayers meet in the middle?

► **JULIA CHOATE**, Senior associate at Bowman Gilfillan Inc.

This article delves deeper into the issue of taxpayer information verification by SARS. It also looks at the whys and benefits of the process of requesting additional information.

**A**cross a broad spectrum of behaviours encompassing everything from differences of opinion and genuine errors to deliberate tax evasion, there are many reasons why the information submitted by taxpayers to SARS may be incorrect or incomplete.

SARS, therefore, needs to verify the information it receives from taxpayers as far as possible to ensure that all taxpayers pay their fair share of tax.

## **SARS' information-gathering powers – challenges for taxpayers**

In South Africa, the Tax Administration Act (TAA) provides SARS with broad powers to request information from taxpayers, including the ability to request anything which, in their opinion, is relevant for administering tax legislation.

The 2020 Tax Administration Laws Amendment Act further entrenched these powers in amendments to the TAA, allowing SARS to issue an estimated assessment in circumstances where taxpayers fail to comply with a request for relevant material. Taxpayers cannot dispute these estimated assessments until after they have provided SARS with the information requested.

In practice, requests for relevant material present numerous challenges to taxpayers. SARS may ask for an incredibly broad range of information, and the volume of information contained in a single request can run into terabytes or thousands of pages, which requires taxpayers to incur significant financial and human resources costs (especially where key personnel are required to devote significant portions of their working hours to locating and collating information) in complying.

*“It is not in a taxpayer’s best interests to avoid engaging with SARS on an information request.”*

- ▶ SARS may also request information for historical periods outside of the record retention periods set out in the TAA, in which case it may be difficult or even impossible for taxpayers to locate the information required (which may, in turn, violate taxpayers' right to finality, a well-recognised principle in our law).

In addition, requests for relevant material can often be unintentionally vague or overly formulaic, making it difficult for taxpayers to understand what SARS is trying to elicit. This may lead to disputes around the completeness of the taxpayer's response or the format in which the information is provided (with SARS often obtaining data that is difficult to work through).

#### *Navigating the challenges of information requests*

It is not in a taxpayer's best interests to avoid engaging with SARS on an information request. Aside from the risk of an estimated assessment being issued (which cannot be disputed until the requested information has been located and provided to SARS), it is a criminal offense to fail to respond to a request for relevant material.

The TAA also places the onus on taxpayers to prove that their tax position is correct in the event of a dispute with SARS; so providing information to SARS in the context of a request for relevant material is the first step in preventing a potentially adverse assessment.

How can taxpayers comply with their obligations, while protecting their rights and avoiding (or at least minimising) the difficulties outlined above? The answer lies in proactive information management and engagement with SARS. Some suggestions follow.

#### *Keep a complete record of supporting documents, preferably electronically*

Taxpayers need to ensure that complete records (all substantiating information and documents) are kept in respect of all submissions to SARS. This is particularly important in relation to significant transactions, and any tax positions involving the application of complex or contentious tax principles (e.g. claiming unredeemed capital expenditure in respect of mining operations or allowances in terms of section 24C of the Income Tax Act).

When compiling these records, taxpayers need to include all pertinent information and documentation that support their position. Taxpayers should bear in mind that individual employees and roles within a business may change over the years and that physical documents are easily misplaced or even destroyed. An electronic database is a much safer option for storing supporting information.

#### *Separately file confidential or legally privileged documents*

It is also crucial to ensure that all confidential and legally privileged documentation is excluded from these records to prevent taxpayers accidentally waiving legal professional privilege or otherwise violating confidentiality.

#### *Obtain tax advice ahead of filing your return*

It is beneficial to engage suitably qualified legal advisors (with expertise in tax administration and tax disputes) to assist in compiling the information that SARS may need to verify a tax position in the future.

Consulting with advisors who can provide legal privilege, advise on which documents are likely to be relevant and assist in tying the various categories of information together to present a clear picture to SARS ensures that, should SARS ever decide to request relevant material to verify your tax position, the process will go as smoothly as possible.

It may also be helpful to get a 'TAA opinion' (a 'more likely than not' opinion issued by an independent tax practitioner) for any contentious positions. This may help you to provide clear and concise information to SARS and persuade them of your position in the event of a later query, but at a minimum, should prevent SARS from imposing understatement penalties, if they disagree with the position taken.

#### *Request an extension where necessary*

Engaging proactively with SARS after a request for relevant material has been received is equally important. The TAA allows SARS to grant extensions of the period in which the information is required, where insufficient time has been allocated for the taxpayer to locate and provide the information.

#### *Clarify what SARS wants and what can reasonably be provided*

SARS is also required to request relevant material with 'reasonable specificity', and, in terms of the Constitution, SARS must act fairly and transparently, be responsive to people's needs and use resources efficiently, economically and effectively.

Where SARS has issued a request for relevant material that is too vague, taxpayers should reach out promptly to clarify the exact scope, nature and format of the information as far as possible. In instances like this, it is often beneficial to request a meeting with the SARS officials responsible for the request. This provides the taxpayer with an opportunity to explain its tax position in detail, allowing SARS to clarify and refine the request.

Where SARS requests a large volume or excessively broad scope of information, taxpayers should similarly reach out to SARS to streamline the request (e.g. agreeing to send a selected or random sample set of data or excluding 'red herrings' that are unlikely to assist SARS).

Where SARS requests historical documentation that no longer exists or is likely to prove difficult or impossible



to locate, this fact should be brought to SARS' attention as quickly as possible. This will help to avoid any implication that the taxpayer is deliberately refusing to respond to the request.

### Considerations for SARS

Regarding SARS' constitutional obligations and its mandate to collect revenue, it stands to reason that SARS should aim for the information-gathering process to be as efficient as possible. However, the challenges experienced by taxpayers are often equally detrimental to SARS and the fiscus as a whole.

### SARS needs to communicate more clearly and openly

Currently, there is a general lack of engagement between SARS officials and taxpayers in the information-gathering space. Requests for relevant material are often broad and generic, and there is little communication between SARS and the taxpayer regarding the reasoning and context behind the information request.

At best, this leads to confusion – SARS may not have the context necessary to frame a sensible information request or make a valid additional assessment later on, and the taxpayer is then placed in the unfortunate position of being unable to formulate a proper response.

At worst, taxpayers may feel that SARS is being unnecessarily authoritarian and harsh, which leads to disengagement and, ultimately, a decline in tax morale and voluntary compliance.

### Apart from 'jeopardy' situations, SARS would benefit from a more collaborative approach

There are certain circumstances where SARS cannot communicate openly with the taxpayer, such as instances of suspected fraud or tax evasion (where alerting the taxpayer to the intent behind the enquiry may result in information being deliberately destroyed and funds and assets being dissipated).

However, as SARS frequently emphasises in its stakeholder communications and publications, most taxpayers want to be compliant. The approach of tailoring the tone and content of an information-gathering request to the compliance history and conduct of the taxpayer has been successful in other jurisdictions (e.g. Australia and the UK). SARS would almost certainly benefit from adopting a more cooperative and collaborative approach in its interactions with the majority of taxpayers.

### Aggressive attitudes by SARS increase tax avoidance and evasion

Post-return information-gathering processes are also designed to deter taxpayer noncompliance. In a 2017 paper titled *the backfiring effect of auditing on tax compliance*, Mendoza *et al.* indicated that detection risk (the likelihood of revenue authorities detecting noncompliance) is an important element of voluntary tax compliance.

However, they also concluded that recent research strongly supports the hypothesis that a heavy-handed approach to auditing and information-gathering results in a decrease in voluntary compliance (and a corresponding increase in avoidance and evasion behaviours).

### Conclusion: SARS should work with taxpayers, in an open and fair manner

Providing taxpayers with context (in appropriate instances) and engaging more openly allows taxpayers to participate meaningfully in the information-gathering process. This minimises confusion and miscommunication between SARS and taxpayers, reducing the administrative burden on both parties and fulfilling SARS' constitutional obligations. Taking this approach will enable SARS to identify and obtain the information it needs, making the information-gathering process as efficient and procedurally fair as possible.





# MORE (TAX) REASONS TO #STAYHOME

► **JOON CHONG**, Partner at Webber Wentzel

As more South Africans adjust to the new normal of working from home, we explain what tax deductions are available to help offset the expenses.

The lockdown has demonstrated to individuals and their employers that remote working arrangements can work successfully. An online survey conducted for the Old Mutual Savings and Investment Monitor, published in August 2021, showed that 56% of respondents were still working from home at least part of the time.

Working from home may save on transport costs, but it entails other expenses. The rules for tax-deductibility of those expenses are slightly different for employees earning a salary and those earning more than 50% of their remuneration as commission.

## Salaried employees

In very limited circumstances, salaried employees can claim deductions for expenses incurred in providing services to an employer. Travel expenses from home to the employer's office are not claimable as deductions. Expenses incurred in maintaining a home office are also not claimable, except in specific circumstances set out in the Income Tax Act.

An individual who runs a business from home as a sole proprietor or independent consultant is usually not restricted in claiming home office expenses proportionate to the area used for business. Such individuals can claim rent, rates, interest on the bond, cleaning, repairs, and wear and tear allowances on business equipment.

However, individuals who earn remuneration from an employer can only claim proportionate home office expenses if:

- Their home offices are equipped and regularly and exclusively used in working for the employer from whom they earn remuneration; and
- At least 50%
  - » of their remuneration is variable (such as commissions or bonuses) – commission earners (see further below); or
  - » of their working days are spent working in their home offices for their employers.

To claim home office expenses, employees should retain invoices and statements of these expenses, and prepare a running spreadsheet of the number of days worked at home for the tax year. Any communication from the employer about working from home would also be useful to justify the number of days worked in this spreadsheet.

These documents will need to be retained for five years and submitted to SARS if the ITR12 return is selected for verification. An apportionment calculation of square meters of the home office area relative to the total residence, with the same ratio applied to expenses such as rates and interest, will also need to be submitted.

The flip side of claiming home office expenses as deductions is that, on selling their homes, these employees would need to exclude any capital gains on the home office portion of the house from the primary residence capital gains exclusion. This exclusion provides for the following to be disregarded – capital gains of up to R2 million on the disposal of a taxpayer's primary residence or all capital gains if the selling price is less than R2 million.

An easier option might be for employees to be reimbursed their expenses by the employer, with supporting invoices. Costs that can be claimed include fibre connectivity, cellphone, stationery and computer equipment if these have been incurred mainly in the employer's business. These amounts would not be part of the remuneration and no PAYE would be withheld from the reimbursed payments.

In the 2021 Budget Review, issued on 24 February 2021, National Treasury said it was reviewing tax provisions for travel and working from home. "In light of the large-scale migration to working at home over the past year, the National Treasury will review current travel and home office allowances to investigate their efficacy, equity in application, simplicity of use, certainty for taxpayers, and compatibility with environmental objectives. In recognition of the potential effect on salary structuring, this will be a multi-year project, starting with consultations during 2021/22."

To date, we have not seen any draft amendment or discussion paper on the proposals. However, we have seen that SARS is asking for very strict documentation from taxpayers who claim home office expenses in the 2021 filing season. In certain instances, taxpayers were required to provide house plans or photographs of the study used regularly and exclusively for home office use.

SARS has warned taxpayers to consider carefully any home office expenses claimed as deductions and it has strict views on what constitutes 'exclusive use' of a home office. It appears in the updated draft interpretation note issued on 14 June 2021 issued for comment that only dedicated exclusive home office spaces for the sole use of the taxpayer, where no one else is allowed to use such space, even if ancillary or out of working hours, is the only way to

claim home office expenses. Home office expenses for shared home office spaces between spouses are also not allowed. Insurance costs are also generally not claimable as bond insurance is expressly not allowed and most likely capital in nature. Household insurance ordinarily relates to contents and not the premises itself. There is a high likelihood that taxpayers that claim home office expenses in their ITR12 returns will be subject to verification or audit.

### Commission earners who receive remuneration

The position for commission earners is similar to that of a salaried employee, but less onerous. Commission earners who earn more than 50% of their total remuneration as commission income are not limited in the type of business expenses they can claim, as long as these are incurred in the production of their income and are not capital or personal in nature.

To determine if these employees are entitled to claim business expenses, commission income recorded under code 3606 should be more than 50% of the total remuneration on the IRP5, which is the sum of gross retirement funding income (3697) and gross non-retirement funding income (3698). Total remuneration includes basic salary, medical aid contributions, group life premiums and any retirement fund contributions made by the employer.

Unlike salaried employees, commission earners can claim for home office expenses if their work performance and duties are performed more than 50% other than in the office provided by the employer. (Salaried employees discussed above can claim home office expenses as deductions if they perform more than 50% of their employment services for their employers in their home offices.)

Other expenses which commission earners can claim include any service fees, such as accounting, legal, administration and sales and marketing fees paid to service providers. Salaried earners are only allowed accountancy fees if they receive income other than a salary, pension or annuity.

### Closing

Although working from home may be more convenient for many employees, it comes with an added administrative burden. To ensure work from home does not place an unfair cost burden on employees, they should track all the legitimate work-related expenses they are incurring and either claim them back from their employer or, where possible, from SARS.





# TAXING THE DIGITAL ECONOMY:

## Multilateral, bilateral or unilateral, the option is yours

► **LUTANDO MVOVO**, Executive Head: International Tax at Vodacom Group

The digital economy is fast growing daily and many traditional ways of countries acquiring tax income have run dry because of it. This article discusses how this is being addressed globally.

### The OECD's multilateral approach

In 2013, the OECD and G20 countries adopted a 15-point Action Plan to address Base Erosion and Profit Shifting (BEPS). Action 1 of this 15-point Action Plan identified the spread of the digital economy as posing challenges for international taxation. The final report on Action 1 (2015 report) identified unique challenges and complexities presented by the digital economy, but noted that it would be difficult to ring-fence the digital economy. While identifying several options to address taxation of the digital economy, no consensus was reached.

Following the 2015 report, an interim report was issued in 2018, which provided an in-depth analysis of the tax challenges posed by highly digitalised business models and value creation. However, this interim report also outlined divergent positions on the need to and how to reform the international tax system to address the challenges of the digital economy.

In 2019, the OECD released a policy note proposing a two-pillar approach as the foundation for a consensus-based solution. This note was adopted by the OECD in 2020. In October 2020, the OECD published blueprints on Pillar I and Pillar II. These blueprints were subsequently adopted by the OECD on 1 July 2021 and approved by the G20 Ministers of Finance on 12 July 2021.

Pillar I allows for the re-allocation of taxing rights to market jurisdictions for multinational enterprises (MNEs) with a global turnover above €20 billion and profitability above 10%. It expands the taxing rights of market jurisdictions where there is active and sustained participation of a business in the economy of that jurisdiction through activities in or remotely directed at that jurisdiction. A new taxing right, amount A, will be adapted to re-allocate residual profit to market jurisdictions by using a formulaic approach applied at the MNE Group level. This new taxing right can become applicable without any physical presence in a market jurisdiction. For MNEs falling within the

*"Countries seeking to tax the digital economy are represented with options between the OECD's multilateral Pillar I option, the UN's bilateral option and the unilateral option of DSTs. The OECD's option is more complex than the other two options since its scope is much wider as it covers ADSs and CFBs."*

scope of Pillar I, between 20% and 30% of residual profit, which is defined as profit over 10% of revenue, would be allocated to market jurisdictions where there is nexus. For purposes of this allocation, profit or loss would be determined by reference to financial accounting income. Losses would be carried forward. Extractive companies and regulated financial services companies are excluded from the scope.

Further, there will be a new special-purpose nexus rule permitting allocation of Amount A to a market jurisdiction when the MNE falling within the scope of Pillar I derives at least €1 million in revenue from that jurisdiction. For jurisdictions with a GDP lower than €40 billion, the nexus will be set at €250 000.

Furthermore, segmentation would be applied in exceptional circumstances where, based on the segments disclosed in the financial accounts, a segment of an MNE would meet the scope rules. Where the residual profits of an in-scope MNE are already taxed in a market jurisdiction, a marketing-and-distribution-profits safe harbour would apply to cap the residual profits that are allocated to the market jurisdiction.

Two categories of activities included in the scope of the new taxing right are Automated Digital Services (ADSs) and Consumer-Facing Businesses (CFBs). The definition of ADSs is divided into a positive list and a negative list. If an activity is on the positive list, it is an ADS and if it is on the negative list, it is not an ADS. The positive list includes, amongst others, online advertising services, sale or other alienation of user data, online search engines, social media platforms, online intermediation platforms, digital content services, and cloud computing services. If an activity is not on the positive list, the next step would be to determine if it is on the negative list. The negative list includes, amongst others, customised professional services, customised online teaching services, online sale of goods and services other than ADS and services providing access to the internet or another electronic network. CFBs would include businesses that generate revenue from the sale of goods and services of a type commonly sold to consumers.

Double tax relief is to be provided under the exemption or credit method for profit allocated to market jurisdictions under the new rules. These new rules will be implemented through a multilateral instrument which is expected to be opened for signature in 2022, with the new rules coming into effect in 2023.

## Emergence of unilateral digital services tax

The delay in reaching a global consensus-based solution has resulted in a significant increase in the domestic pressures on governments to address the tax challenges arising from digitalisation unilaterally. This has led to the introduction of unilateral digital service taxes (DSTs) or similar measures in several jurisdictions.

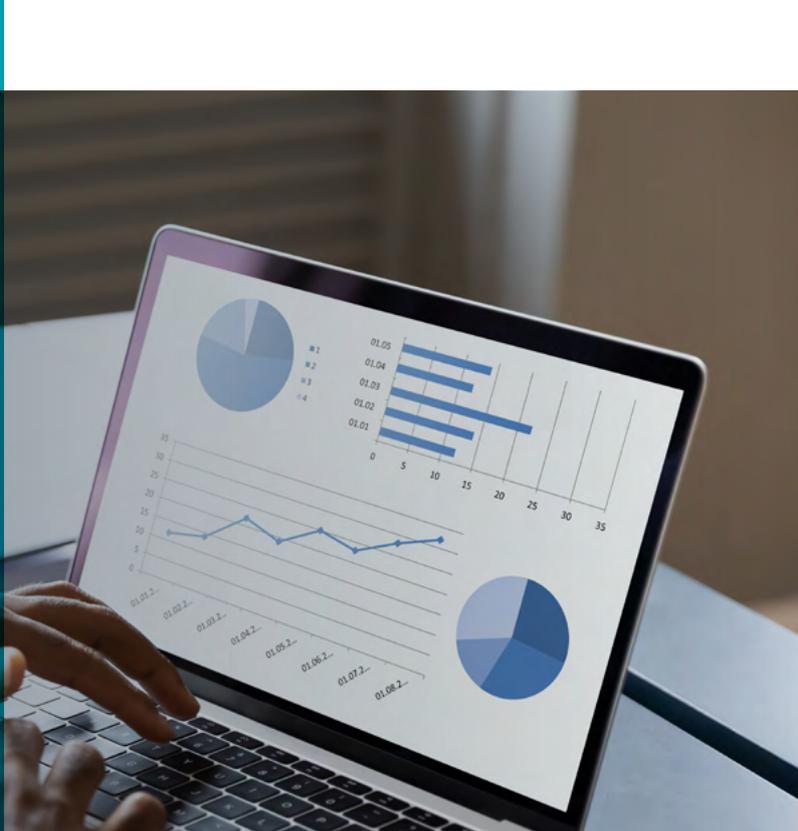
Currently, over 30 countries have already introduced unilateral DSTs and over 22 countries have enacted these measures. Four African countries (namely Zimbabwe, Nigeria, Tunisia and Kenya) are amongst the abovementioned 30 countries. These measures take a range of forms and, even where they align in concept, the rate and base for taxation differ significantly. These DSTs are generally designed to be taxes on revenue and not on income, thus falling outside the tax treaty network and potentially giving rise to double taxation with no right to claim foreign credit.

The rise of DSTs has, however, triggered retaliatory trade threats from the US government. These threats include the imposition of new tariffs on goods from countries that have introduced DSTs. These tariffs would impose additional *ad valorem* duties of 25% on specified products from each country.

## UN's bilateral option

During its fifteenth session held in October 2017, the UN Committee of Tax Experts (the Committee) identified income from ADSs as a matter of priority to be dealt with, especially for developing countries. The Committee decided to focus on a standalone tax treaty article under the UN Model Double Tax Convention (UN Model) that would enable jurisdictions to apply their domestic legislation levying taxes on income derived from digital business models. The Committee presented the first draft of the new Article 12B, titled *Income From Automated Digital Services*, in October 2020. The Committee approved this new article during its twenty-second session in April 2021 for inclusion in the 2021 update of the UN Model.

The new article allows for cross-border payments in consideration for the ADSs to be taxed by a source state on a gross basis if the payment is made by its resident or by a non-resident with a permanent establishment (PE) or fixed base in that source state provided that the payments are borne by the PE or fixed base. The tax will be in the form of a withholding tax at a rate to be negotiated bilaterally. The decision to adopt the withholding tax mechanism on the gross amount was based on the general view that it is an effective method of collecting the tax imposed on a non-resident because it simplifies compliance for companies since they would not be required to compute their net profits or file tax returns unless they choose the option of net income basis taxation. However, because the taxation of income from ADSs will be on a gross basis and may result in double or other excessive taxation, the Committee recommended what it regards as a modest rate in the order of 3-4% of the gross amount. The new article allows the non-resident provider the option to require taxation on a net basis on its qualified profits. The qualified profits are defined to be 30% of the amount arrived at by applying the profitability ratio of the beneficial owner's ADSs business segment to the gross annual revenue derived from such services in the source state. This option is intended to provide



relief for taxpayers that may have a lower tax liability or where the taxpayer has a global business loss or a loss in the relevant business segment during the taxable year.

Excluded from the application of the new Article 12B are payments that already qualify as royalties or fees for technical services and where the relevant ADS income is attributable to a PE in the source state.

## Concluding thoughts

Countries seeking to tax the digital economy are represented with options between the OECD's multilateral Pillar I option, the UN's bilateral option and the unilateral option of DSTs. The OECD's option is more complex than the other two options since its scope is much wider as it covers ADSs and CFBs. While the UN's bilateral option is intended to provide a simple solution that is easy to administer, especially for developing countries with limited administrative capacity, countries that adopt this article in their tax treaties will need to introduce a withholding tax on ADSs in their domestic law because a tax treaty does not create tax but allocates taxation rights. Further, the process of renegotiating existing tax treaties might take years to finalise as countries where the digital companies are tax resident might be reluctant to include this article in their tax treaties. This might result in developing countries resorting to introducing unilateral DSTs. Furthermore, while the implementation of the UN's option might be less complex than the OECD's Pillar I approach, the scope of the UN's option is narrow because it is limited to ADSs. The unilateral DST option is easier to implement and amend than the other two options, but its downside is the potential trigger of retaliatory measures, such as trade tariffs from other countries.





# VALUE-ADDED TAX AND COMPANY GROUPS

► **DR FERDIE SCHNEIDER**, Director at STA Konsult (Pty) Ltd

The definition of “company” read with that of “connected person” with reference to companies as outlined in this article will be used as the meaning of a group of companies for purposes of VAT.



The Value-Added Tax (VAT) Act does not contain provisions allowing for VAT grouping as in certain other VAT jurisdictions. VAT grouping allows for a group of companies to, in certain respects, be treated as one VAT vendor. Instead, the VAT Act treats company groups mainly regarding the connectivity between the companies in the group and provides for anti-avoidance measures in such circumstances, but does not allow for VAT grouping. Several provisions regulate transactions between group companies, including the definition of connected persons, VAT time of supply rules, VAT value of supply rules and non-payment of amounts owing. These are discussed below.

## Company groups and connected persons

### Definition of company

The VAT Act defines a company as it is defined in section 1(1) of the Income Tax Act. The Income Tax Act defines a ‘company’ to include:

- “An association, corporation or company (other than a close corporation) incorporated or deemed to be incorporated by or under any law in force or previously in force in the Republic or in any part thereof;
- A body corporate formed or established or deemed to be formed or established by or under any such law;



#### *Definition of “connected persons” in the context of companies*

The VAT Act defines the term ‘connected persons’ with specific reference to companies. The term ‘connected persons’ includes any company (other than a close corporation) and any other company the shareholders in which are substantially the same persons as the shareholders in the first-mentioned company or which is controlled by the same persons who control the first-mentioned company.

The definition of ‘company’ read with that of ‘connected person’ with reference to companies as outlined above will be used as the meaning of a group of companies for purposes of VAT and this article.

#### **VAT time of supply**

##### *The general time of supply*

In terms of the VAT Act, the general time of supply rule determines that a supply takes place when an invoice is issued by the supplier or the recipient in respect of the supply or the time any payment of consideration is received by the supplier in respect of the supply, whichever time is earlier.

##### *Time of supply between connected persons*

The time of supply between connected persons is if a supply of goods are to be removed, at the time of the removal; and if a supply of goods are not to be removed, at the time when they are made available to the recipient; and if it is a supply of services, at the time the services are performed. These provisions do not apply if an invoice is issued in respect of the supply or any payment is made in respect of the supply on or before the day on which the return is furnished for the tax period during which that supply would, but for the proviso, have been made; or the last day prescribed by the VAT Act for furnishing the return for the tax period during which that supply would, but for the proviso, have been made. These provisions also do not apply if

- *An association, corporation or company incorporated under the law of any country other than the Republic or body corporate formed or established under such law;*
- *Any co-operative or any association formed in the Republic to serve a specified purpose, beneficial to the public or a section of the public; and*
- *Any portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in pursuance of any arrangement in terms of which members of the public are invited or permitted to contribute to and hold participatory interests in that portfolio through shares, units or any other form of participatory interest; or portfolio of a collective investment scheme in property that qualifies as a real estate investment trust as defined in the listing requirements of an exchange approved in consultation with the minister and published by the Prudential Authority.”*

The VAT Act does not define a group of companies.

*“In terms of the VAT Act, the general value of supply rule determines that a supply is valued as the amount of the consideration for the supply, determined in accordance with the open market provisions less the amount that represents tax.”*



- ▶ the whole of the consideration or part thereof for the supply of goods or services cannot be determined at the time the goods are removed or made available or at the time the services are performed, and the recipient would have been entitled to claim a normal input tax deduction of the full amount of tax in respect of that supply.

### **VAT value of supply**

#### *The general value of supply*

In terms of the VAT Act, the general value of supply rule determines that a supply is valued as the amount of the consideration for the supply, determined in accordance with the open market provisions less the amount that represents tax.

#### *Amount of consideration*

The amount of any consideration referred to immediately above is to the extent that the consideration is a consideration in money, the amount of the money; and to the extent that the consideration is not a consideration in money, the open market value of the consideration.

#### *Value of supply between connected persons*

The VAT Act applies special value of supply provisions for supplies between connected persons in certain instances. These provisions can only apply to a supply made by a person for no consideration or for a consideration in money which is less than the open market value of the supply or the consideration cannot be determined at the time of supply. Finally, these provisions will only apply if a consideration for the supply equal to the open market value of the supply had been paid by the recipient, he or she would not have been entitled to claim a normal input deduction of the full amount of tax in respect of the supply. If these circumstances are present, the consideration in money for the supply is deemed to be the open market value of the supply. These provisions do not apply to the supply of a fringe benefit or advantage of employment.

### **Non-payment of amounts owing**

If a vendor accounting for tax on the invoice basis has claimed an input tax deduction in respect of a taxable supply made to him or her and has not within a period of 12 months following the tax period within which such deduction was made paid the full consideration for the supply, an amount equal to the tax fraction of that portion of the consideration which has not been paid is deemed to be tax charged in respect of a taxable supply made in the tax period following the expiry of the period of 12 months. If a written contract in terms of which the supply was made provides

for the payment of consideration or any portion thereof to take place after the expiry of the tax period within which such deduction was made in respect of such consideration or portion, the 12-month period must be calculated as from the end of the month within which such consideration or portion was payable in terms of that contract.

### Agent versus principal

In terms of the VAT Act, if an agent makes a supply of goods or services for and on behalf of any other person who is the principal of the agent, the supply is deemed to be made by the principal and not by the agent. If the supply is a taxable supply and the agent is a vendor, the agent may issue a tax invoice or a credit or debit note to the supply as if the agent had made a taxable supply and to the extent that the tax invoice or credit or debit note relates to the supply, the principal may not also issue a tax invoice or a credit or debit note.

In terms of the VAT Act, if a vendor makes a taxable supply of goods or services to an agent who is acting

on behalf of another person who is the principal for the purposes of that supply, the supply is deemed to be made to the principal and not to the agent. The agent may request to be provided with a tax invoice, and the vendor may issue a tax invoice or a credit or debit note as if the supply were made to the agent.

It is important to note that the nature of a supply often determines whether a person can act as principal or an agent on behalf of another person. This is especially important in a group of companies.

### Conclusion

The VAT Act gives special treatment to groups of companies through the definition of 'company' and 'connected persons' and certain other provisions. The Act aims to curb avoidance. Special time and value of supply rules may apply to groups and credit transactions. Trading as a group can result in higher VAT compliance costs, but should be weighed against the business imperatives. Group reorganisation can be considered as an alternative.



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# TARGETING CORRUPTION —

## WILL SOUTH AFRICA

## EVER RECOVER



► **CHAD THOMAS**, CEO at IRS Forensic Investigations

South Africa has been plagued by corruption for years. This has led to investors pulling out and junk status. This article looks at how SARS can assist in convicting guilty parties.

### Clawing back the stolen money – remedies available

It has been said that South Africa has the necessary legislation to fight crime and is capable of initiating proceedings to achieve some form of financial restitution. However, it lacks the willpower to execute these proceedings or make full use of the legislation. This may not be the case, and the authorities have made several successful attempts at clawing back misappropriated funds and, in many instances, have been very successful.

Financial restitution has been used as a bargaining tool since the introduction of the Criminal Procedure Act in 1977. Many an astute prosecutor and sometimes a sharp defence attorney will enter into a section 105 plea deal between the state and the accused tied into restitution of funds in terms of section 297 or section 300 of the Criminal Procedure Act. Although successfully used, these particular sections of the Criminal Procedure Act come with their own unique set of challenges — such as limitation of amounts that can be claimed. Specifically, in regard to section 300, which is the preferred choice of defence attorneys, there is no particularly enforceable sanction should funds not be repaid, except a civil judgment.

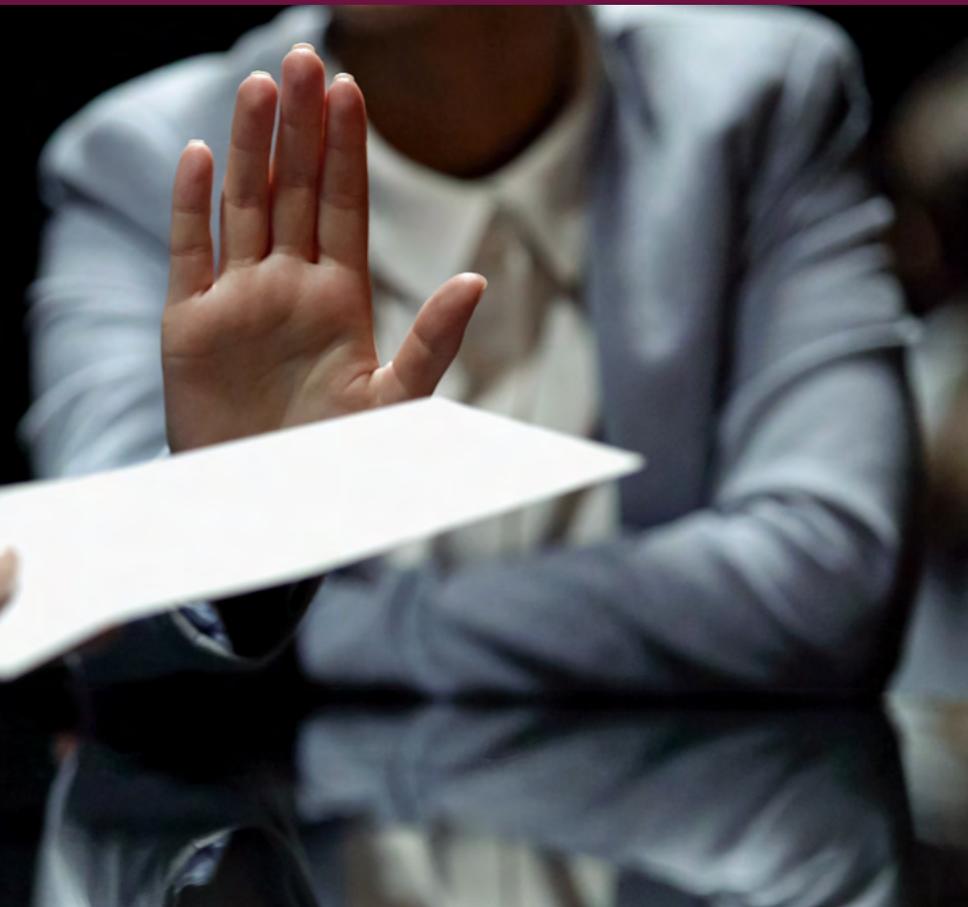
In the mid-1990s, President Mandela supported the formation of a Special Investigating Unit (SIU) linked to a Special Tribunal to investigate and recover funds that had been plundered in the Eastern Cape, specifically funds linked to state projects and state assets. The SIU was created in terms of the Special Investigating Units and Special Tribunals Act. This unit was headed by Judge Willem Heath and became known as the 'Heath Special Investigating Unit'; despite some success, Judge Heath called the new government under President Mbeki 'soft on corruption'. Around that time, the Constitutional Court ruled that a judge could not head the SIU. The SIU ceased operations shortly thereafter. In July of 2001, President Mbeki established a new SIU in terms of proclamation R118. This new SIU had jurisdiction throughout South Africa and by virtue of Presidential proclamations, the SIU's sole mandate was to investigate crimes involving state funds and assets. However, due to certain legal challenges, the Special Tribunal was stripped of its powers and was only reintroduced by President Ramaphosa in February 2019 with the requisite changes.

The SIU and Special Tribunal have been two of South Africa's success stories in terms of the

processes introduced to investigate and recover funds and assets belonging to the state. In 1970, the US passed legislation known as the Racketeer Influenced and Corrupt Organizations Act (RICO). RICO was a game-changer in the fight against organised crime in America, yet was only used for the first time in 1979.

South Africa's equivalent of RICO is the Prevention of Organised Crime Act (POCA). Unlike the US, the office of the National Director of Public Prosecutions was quick to set up a unit to focus on chapters 5 and 6 of POCA, of which the primary aim is to seize criminal assets. To this end, the Asset Forfeiture Unit (AFU) was established in May 1999 under the command of Willie Hofmeyr, and the unit's members hit the ground running. In 2001, the AFU became a full division of the National Prosecuting Authority (NPA), and Hofmeyr was made a Deputy National Director of the NPA. The AFU remains a success story in South Africa, and its tentacles spread wide as was seen in the case of the fugitives, Ronald and Darren Bobroff, wherein 2017, the AFU working with its Israeli and Australian counterparts were successful in obtaining a preservation order against funds held by the Bobroff in foreign accounts.

The issue of the AFU's powers outside South Africa were tested in an appeal brought by the Bobroffs in 2020. In May 2021, the Supreme Court of Appeal dismissed the appeal with two amendments, thus confirming the authority of the AFU in other jurisdictions as contemplated in terms of the International Co-operation in Criminal Matters Act and in particular section 19 of this particular Act (see *Bobroff and Another v the National Director of Public Prosecutions*).



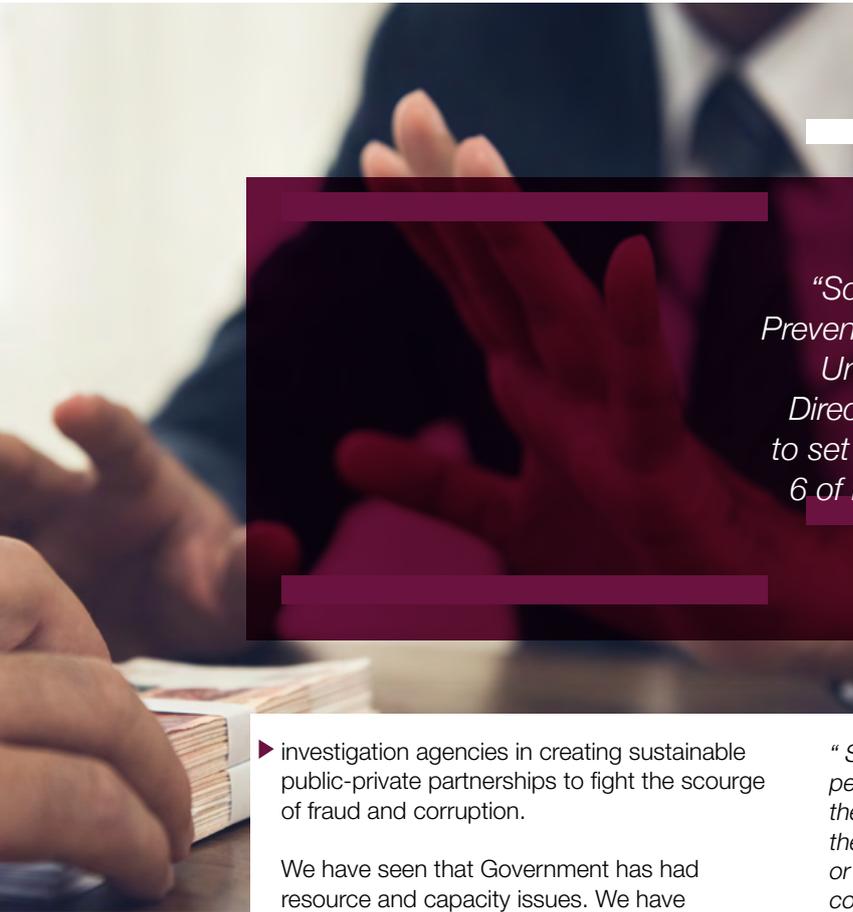
### The AFU has most definitely lived up to its credo of 'Taking the Profit out of Crime'

There are other mechanisms available to the state and the private sector in the clawback of misappropriated funds process. The mechanisms that can be used include targeting the pension of an employee accused of causing a material loss to an employer through the misappropriation of funds or other corrupt acts that have prejudiced the employer financially.

These mechanisms may also include:

- A mutual separation agreement with an agreed payback clause.
- Disciplinary hearing leading to dismissal and the laying of criminal charges.
- Cession of a pension fund in terms of a written acknowledgement of liability contract or judgment (see *Multimatics (Pty) Ltd v Corporate Selection Umbrella Retirement Fund*) or claiming directly from the pension fund (see *Moodley v Scottburgh / Umzinto North Transitional Council*).
- The clawback of misappropriated funds from the pension fund of an employee, suspect, or person found guilty of the offence of which they are accused is covered under section 37D(1)(b)(ii) of the Pension Funds Act. This section of the Act was again recently tested at the Financial Services Tribunal in February 2021 in the case of *Ngqengelele v Afrisam*.
- As mentioned, the use of section 297 or section 300 of the Criminal Procedure Act can be used as a means of restitution as well as preservation orders in terms of chapters 5 and 6 of the Prevention of Organised Crime Act.

At the outset of this article, we wrote that South Africa has the legislation in place to ensure that funds can be clawed back, but not necessarily the willpower to do so. Let us clarify this – Government is now demonstrating the willpower to hold those to account that have engaged in what is now known as the State Capture. Nonetheless, Government cannot act in isolation in trying to claw back funds stolen from the fiscus. It is often said that there is a symbiotic relationship between the public sector and private sector criminals, namely the ultimate aim of plundering the public purse. Conversely, we should see a similar symbiotic relationship between the public sector and private sector ►



*“South Africa’s equivalent of RICO is the Prevention of Organised Crime Act (POCA). Unlike the US, the office of the National Director of Public Prosecutions was quick to set up a unit to focus on chapters 5 and 6 of POCA, of which the primary aim is to seize criminal assets.”*

► investigation agencies in creating sustainable public-private partnerships to fight the scourge of fraud and corruption.

We have seen that Government has had resource and capacity issues. We have also seen in the past where Government investigations agencies, such as the SIU and Anti-Corruption Task Team (ACTT), have used the private sector — where there have been successful prosecutions and clawback of funds by exploiting the skill sets brought to the table by both the public servants as well as their counterparts in the private sector.

Currently, South Africa has case law and legislation that allows for the private sector to legally investigate persons of interest in a crime, albeit limited to crimes committed in the private sector unless formally appointed by a State agency to assist in the investigation of a target. This has led to several well-established private investigation companies being instructed to conduct complex financial crime investigations which are then handed to the State authorities for further investigation and ultimately prosecution and financial restitution.

The Private Security Industry Regulatory Act, which regulates private investigators and other security service providers, defines a private investigator as:

*“ Sec 1(1)... ‘private investigator’ means a person who, in a private capacity and for the benefit of another person, investigates the identity, actions, character, background, or property of another person, without the consent of such a person...”*

The High Court has expressed its acceptance of the fact that private investigations occur, for example in *S v Botha and Others* and *S v Dube*.

In *S v Botha and Others*, the defence attorney argued that, according to section 215(b) of the interim South African Constitution, only police officials could investigate crime and that no persons possess such authority. The judge ruled that it was not the purpose of section 215(b) to prevent someone who is not a member of the SAPS to conduct an investigation, and conceded that many in the private sector conduct their investigations before handing their results to the police for the institution of prosecution.

In *S v Dube*, a private investigator set a trap for an employee of a motor manufacturer who was suspected of being involved in theft. He arranged for his meetings and negotiations with the suspect to be photographed and tape-recorded. The court held the evidence to be admissible, since section 252(a) of the



Criminal Procedure Act, which regulates the use of traps and undercover operations, does not apply to private investigators but only to law enforcement officers or State officials.

South Africa has legislation, such as the Prevention and Combating of Corrupt Offences Act (PRECCA) which has a reporting obligation in terms of section 34 of this Act to report corruption. PRECCA also allows for the reporting of fraud over R100 000. This legislation, together with the Protected Disclosures Act, allows for the reporting of fraud and corruption. Furthermore, section 29 of the Financial Intelligence Centre Act allows for the reporting of suspicious activity or suspicious transactions to the Financial Intelligence Centre.

So, we have the laws and we have the willpower; we now need buy-in from all to ensure that those who have actively participated in the plunder of the public purse are held to account and, more importantly, that the clawback of funds is seen as an active tool to discourage the pervasive culture of corruption that has seeped into our young democracy.



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# THE BUMPY RIDE OF THE AFRICAN CROSS-BOARDER INVESTMENT

► **TAYO OGUNGBENRO**, Partner and Head Consumer and Industrial Markets/Transfer Pricing Tax, Regulatory and People Services at KPMG in Nigeria

Africa is the land of endless possibilities for many investors. We look at the different jurisdictions and how they affect investments.

## Introduction

Africa still represents investors' continent of choice. The returns from most types of investment is still one of the highest, albeit in local currency, relative to any other continent in recent time. The reason is not far-fetched. Africa still unforgivably lags behind in terms of the availability of infrastructure and the means of sustenance for its ever growing population. Its demographic growth rate far exceeds the level of change in subsistence and infrastructure support level.

The continent is also divided into several jurisdictions with high regulatory barriers that make it difficult for conglomerates to optimise economics of scale required for reduced production cost. Thus, any foreign investor that can design and customise its production or supply chain system to fit into the peculiar African system is bound to reap the benefit. From experience, while many multinational enterprises have been able to do this, some others have gotten their fingers burnt.

The essence of this article is to examine the factors that make the investment ride into Africa a bumpy one, where only the fittest and not necessarily the strongest survives.

## Some factors that make the investment ride into Africa bumpy

One of the major factors for consideration in a profit-orientated venture for new investment is a positive return on capital. Once it is projected that an investment will yield higher than any other competing one without inhibition to repatriate both the capital and returns, most investors will vote for it. Theoretically, most financial models developed to assess direct investment into Africa give a positive outcome.



*“The essence of this article is to examine the factors that make the investment ride into Africa a bumpy one, where only the fittest and not necessarily the strongest survives.”*

The qualitative factors that may, however, make the investment ride into Africa bumpy are hardly available in any textbook. Neither the successful nor the failed investors document their experiences that would help future venturers. The African academic community is also not properly funded to do this. In this article, we examine some of these factors:

#### *Volatile policies*

- In most African countries, economic policies are intertwined with politics. The economic institutions are not only controlled by the government, but are also not independent and strong enough to insulate economic policies from politics. This makes long-term planning difficult.
- Most African economies are also too vulnerable to external factors. The economies can hardly withstand changes in external factors. For instance, Nigeria’s economy is so dependent on the international crude oil market that its performance positively correlates with the movement in international crude oil prices. Thus, it is difficult for investors to predict the performance of these economies with any reasonable degree of accuracy that is required for long-term planning. In the last three years, the foreign exchange rates of the three major leading economies in sub-Saharan Africa lost more than 25%. They all succumbed to the impact of the pandemic.

#### *‘Disruptors’*

- Generally, foreign investors enter a territory with a focus on mostly economic factors. They hardly realise that the beneficiaries of the status quo deem and inwardly treat them as disruptors that must be resisted. These establishments are also influential enough to create a problem for them along the line. The well-grounded establishments, therefore, set booby traps that are difficult to decipher by any innocent bystander.
- Lee Kuan Yew, the former Prime Minister of Singapore did not spend much time in Africa in the early 1960s before he realised that African “...tribal loyalties were stronger than their sense of common nationhood”. It, therefore, behooves any foreign investor to fashion a way to work with these establishments if it is to succeed in its ride into the African territory.

#### *Culture shock*

- An African adage states that “a behaviour accepted in one community, might be a taboo in another”. Foreign investors come into Africa with practices that are generally acceptable elsewhere but considered disrespectful in most African countries. For instance, while it is an accepted practice for companies to ‘sponsor and support’ politicians in the

*“One of the major factors for consideration in a profit-orientated venture for new investment is a positive return on capital. Once it is projected that an investment will yield higher than any other competing one without inhibition to repatriate both the capital and returns, most investors will vote for it.”*

- ▶ US and other advanced democracies under the guise of ‘lobbying and other terminologies’, it is considered bribery and corruption when such is provided in Africa.
- Unfortunately, when foreign investors run into problems, they hardly have any highly connected politicians to stand up for them. There is a need for foreign investors to create a balance in their relationship with the government if it is to smoothen its bumpy ride into the continent.

#### *Image or perception*

- “Facts matter not at all. Perception is everything. It is a certainty” — Stephen Colbert.
- Most African countries were previously colonised. Some local civil societies have created a negative impression of foreign investors. This perception influences the attitude of an average African towards cross-border investors. Thus, despite all efforts to change the perception through a massive Corporate Social Responsibility programme, the investors still find it very difficult to wriggle themselves out of this mess, especially when there is a revolt.
- In 2019, when there were xenophobia attacks in South Africa, Nigerians retaliated by looting supermarkets that were deemed to belong to South Africans. Many of the looters did not appreciate the fact that they were at the receiving end of their action in the form of job losses and a potential rise in the cost of living arising from the reduction in supplies. The rich of these properties suffered little since they were either compensated by insurance companies or Government or both.

#### *Multilateral global transfer pricing guidelines*

- Transfer pricing regulations are currently a new wave in taxation of income of cross-border investment. Most foreign investors are at the receiving end of these guidelines. The tax authorities in some African countries do not also have adequately knowledgeable specialists in the government to implement the policies.
- This has further increased the level of uncertainty in the taxation of the interests of foreign investors. Indeed, some multinational enterprises have simply suspended, where possible, the provision of cross-border services or supply of intangibles to avoid exposure to potential additional tax liabilities that may arise from transfer pricing adjustment. It is therefore another bump in the ride of cross-border investments into Africa.

The bumpy-causing factors to cross-border investment in Africa are quite numerous, the same way that the continent that is not up to the US and China combined in landmass, harbours more than 53 countries, each with its own set of laws and regulations. An investor that intends to have an appreciable presence in the continent therefore has multiple and sometimes incompatible laws and regulations to contend with. It is therefore difficult to itemise all the factors that may affect cross-border investments into Africa in one article.

Thus, in the rest of this article, we suggest some options that may be considered when investors are venturing into the continent.

### **Suggestions for a not-too-bumpy ride into Africa**

#### *Pre-investment study with equal attention to non-financial, legal and regulatory factors*

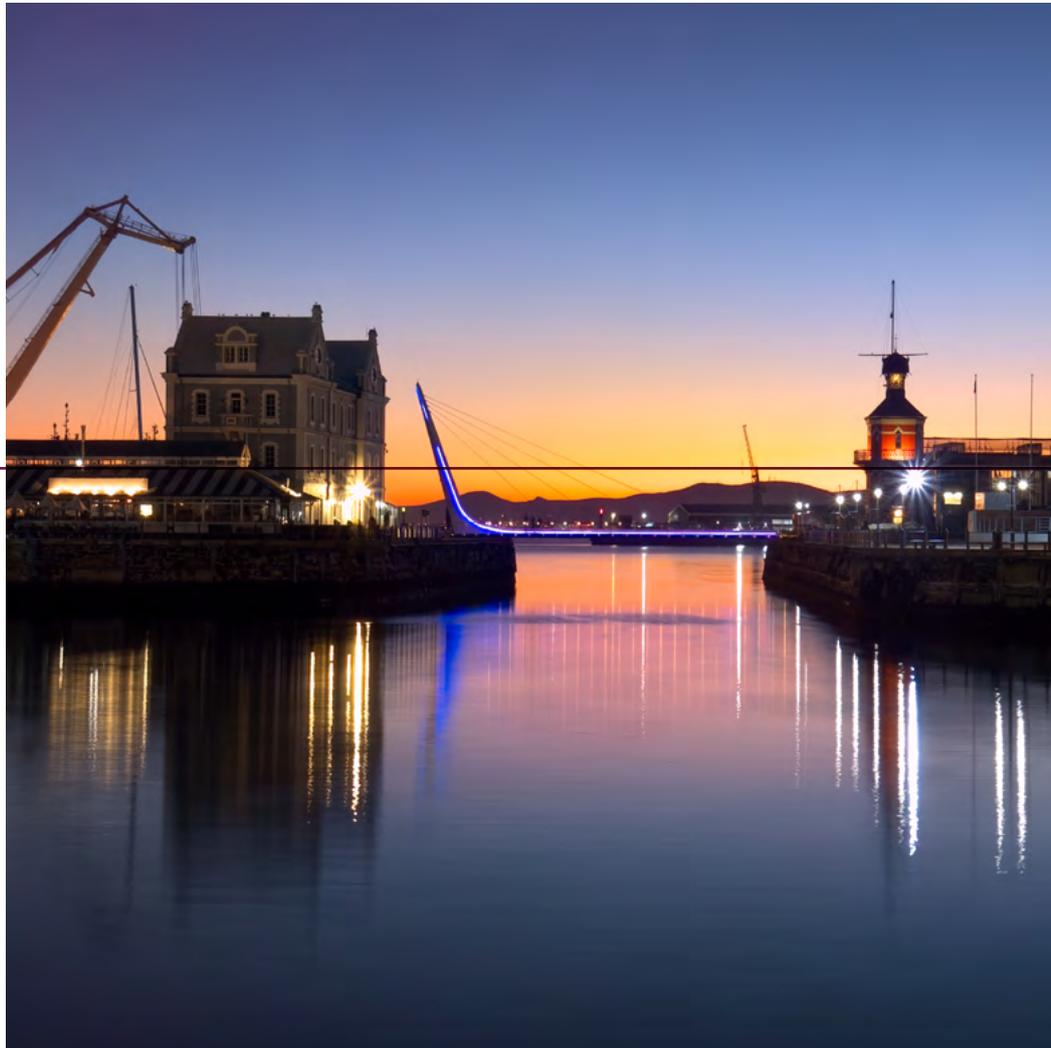
Often, cross-border investors make decisions mostly on financial projections and assessment of regulations. However, experience has shown that the unseen factors may be equally important. It is therefore suggested that potential investors spend quality time and resources to analyse these other factors before diving into the continent.

#### *Culture of gratitude and appreciation*

It is part of African culture for people to show gratitude and appreciation, even in circumstances where the person is performing the work for which he or she is paid. In most instances, the appreciation and act of gratitude do not need to be in cash or kind. It is, however, expected that when Africans assist foreigners to successfully set up, there should be a legal way to appreciate such people especially those in government. Their assistance is usually invaluable when there is a problem.

#### *Corporate policies*

Most companies’ policies and codes of conduct are designed with a mindset that never anticipated expansion into Africa. These investors therefore want their African hosts to adjust their way of life to suit foreign policies, rather than the reverse. Cross-border investors must build dynamism to accommodate diversity in human nature and practices as they expand into new territory.



For example, a multinational bank with significant operations in Africa recently decided not to provide banking services to Politically Exposed Persons (PEPs). Unfortunately, their definition of PEP includes past and present office holders and their close relatives. It happened that a close relative of one of the people that facilitated the entrance of the bank into an African country assumed an important political position years after the bank commenced operations. The bank made efforts to sever its relationship with its long-term benefactor. The question then is: If all banks adopt a similar policy, does it mean that all political office holders and their close relatives will be denied banking services?

### Conclusion

Africa still represents investors' destination of choice despite all the challenges. Investors who want a successful ride should, however, recognise the uniqueness of the environment and modify their policies to reap the benefits.

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# OFFSHORE TRUSTS— STILL A VIABLE PROPOSITION?

► **MADELEINE SCHUBERT**, International and Domestic and Fiduciary Attorney

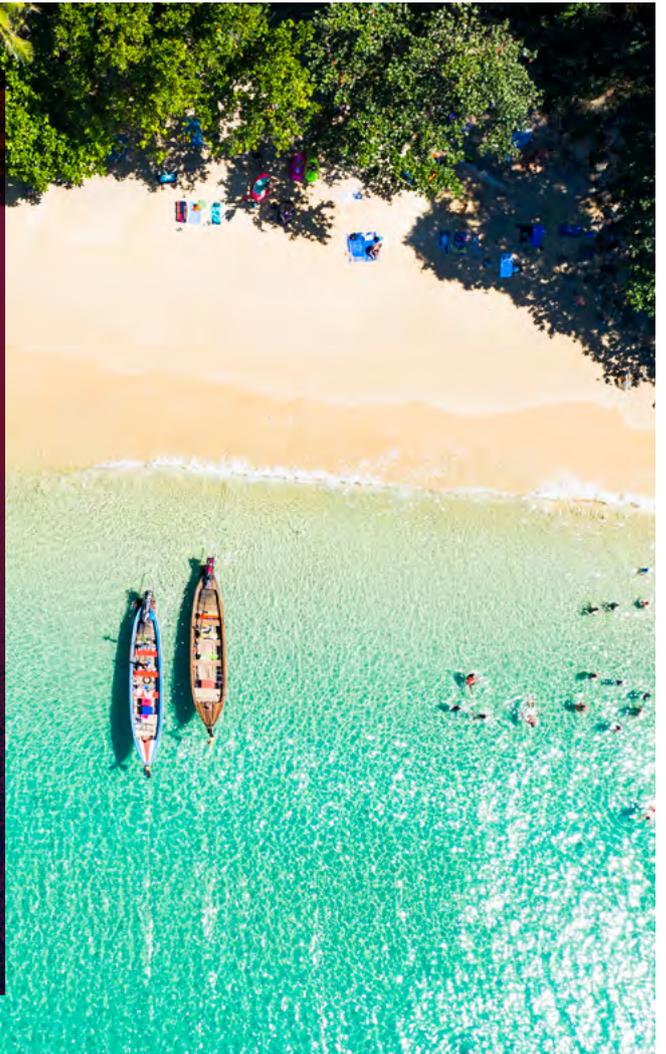
Do you have an offshore trust? Despite having started on the wrong foot, offshore trusts have gained credibility. In this article, we look at how offshore trusts have changed over the years.

To consider whether having an offshore trust is a viable option, the why in doing so for a South African tax resident is the key question.

In setting up an offshore trust, which is incorporated and effectively managed in and from another Sovereign Country, the South African tax resident brings another Sovereign into his or her relationship with the South African Government. By implication, this should be driven by a need for asset protection, which, hopefully, the other Sovereign Nation's fiscal, legal and creditor protection policies would provide.

In selecting a potential offshore trust jurisdiction, the ideal jurisdiction should be a tax haven. Already in 1998, the OECD listed four factors to identify a so-called tax haven, namely it being a jurisdiction that lacks transparency rules (factor 1), lacks exchange of information (factor 2), has no or minimal tax on income (factor 3) and lacks substance (factor 4).

Initially, a negative view was attached to tax havens; however, the same is not necessarily true today. Today, the OECD global forum acknowledges the commercial and business need for tax havens, provided that they are cooperative jurisdictions. Normally, a tax haven is regarded as cooperative if its economic and fiscal policies uphold, amongst others, international exchange of information and transparency laws as well as country-by-country specific international legal agreements, effectively diminishing the historic mischief listed in factors 1 and 2 above.



The OECD's Common Reporting Standards (CRS) and its US equivalent, Foreign Account Tax Compliance Act (FATCA), both address the historic concerns around factors 1 and 2 (amongst others). Ultimately, this legislation seeks, amongst others, to introduce a process where a South African tax resident's relationship to an offshore structure incorporated and effectively managed in a tax haven is being disclosed to the South African government, namely being a named discretionary beneficiary of an offshore trust (i.e. the ultimate beneficial owner (UBO) would be an example of this).

In addition to the CRS and FATCA, reference is made to the fact that the South African government has concluded various international exchanges of information and other transparency agreements with several countries, including tax havens, for this purpose.

If the selected tax haven is not a cooperative country, the probabilities are good that the OECD has included it on either its black and/or grey list, as updated from time to time, indicated that some of the policies and/or practices in that specific jurisdiction fall short of the OECD's global processes of transparency and exchange of information. Some countries have, in addition to the OECD lists, established their own black and/or grey lists that may include countries not included on the OECD's lists. Being included on a list may result in investment and/or business opportunities with other jurisdictions being denied and/or limited by compliant jurisdictions.

If your offshore trust is or you are about to set up an offshore trust in such an uncooperative tax haven, walk away. Just being there one is assumed to be guilty before proven innocent. And walking away is easier than you think and can be done by migrating the offshore trust management (trustees) to another jurisdiction or by incorporating a new trust in a cooperative jurisdiction, making it a trust beneficiary of the first trust, vesting all the capital of the first trust in the new trust and terminating the existence of the first trust.

The remainder of the two factors initially listed by the OECD still hold true, but, with regard to offshore trusts, one can clarify it as follows:

With regard to factor 3 (no or minimal tax involved), it is generally accepted that an offshore trust incorporated in a tax haven is not subject to any income and/or other taxes while income and capital are held (and owned) in that offshore trust. This is not tax evasion per se, as the offshore trust is incorporated and effectively managed in a cooperative jurisdiction which in terms of its own fiscal policy does not impose any tax liability subject to the rules and requirements it has established.

However, if the founder of an offshore trust in setting up the offshore trust has taken steps to purposely and illegally evade taxes from its own tax residency country, then that is of course another matter altogether. As a reminder, tax evasion and tax avoidance are not the same; tax avoidance is legal, whereas tax evasion is a crime.

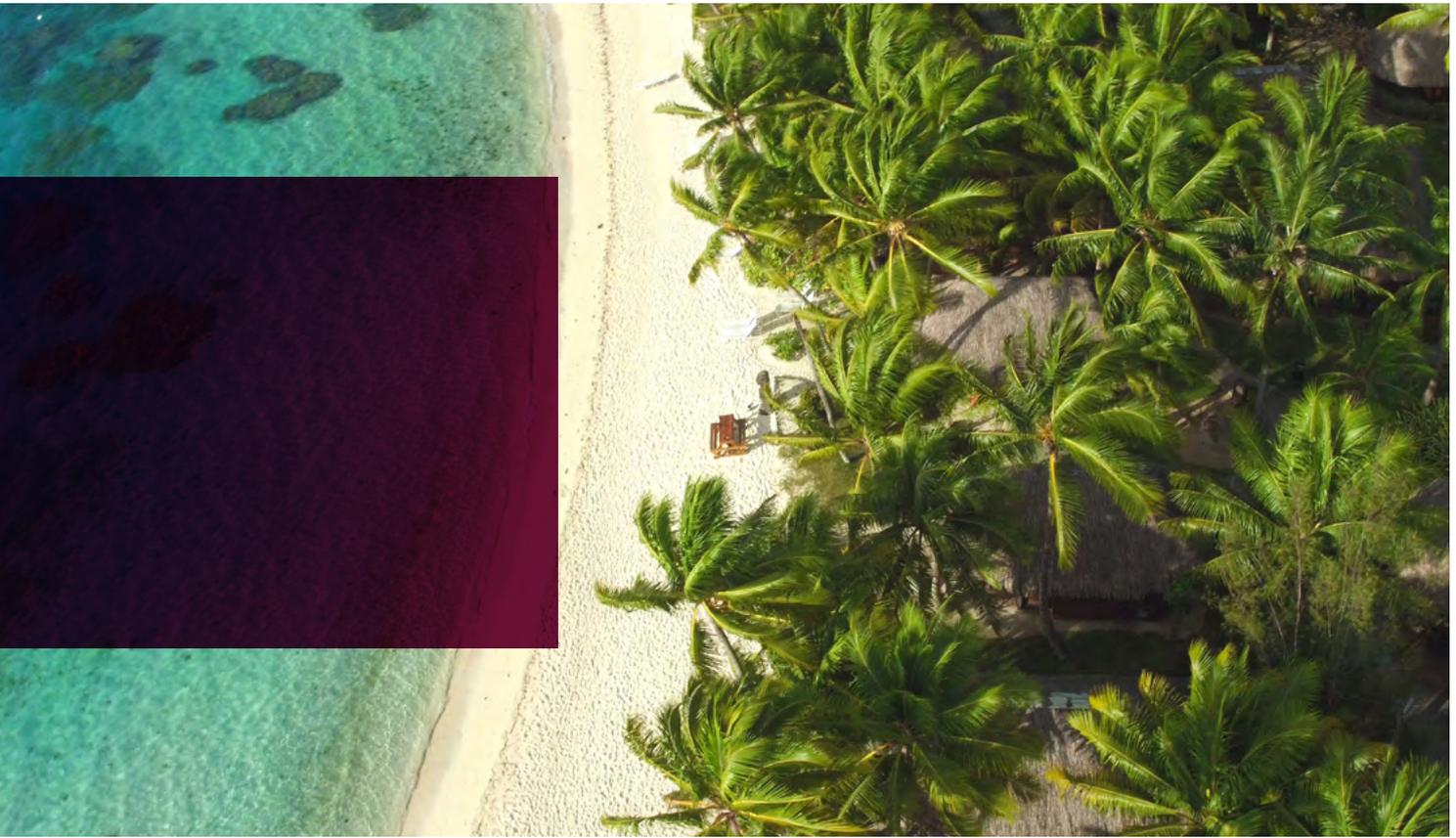
Therefore, if a South African tax resident sets up an offshore trust and implements various structuring steps that reduce or nullify his or her South African tax liability legally, such actions are not illegal, but they may nevertheless fall foul of various South African domestic tax avoidance rules. If the tax avoidance rules apply, the South African tax law would normally attach the tax consequences that would ordinarily have been applicable to the true commercial nature of the transaction and most often there would be an additional penalty charge too.

However, in *CIR v Conhage* (49/13) ZASCA 40 (31 March 2014), it was confirmed that, if there is more than one way to undertake a commercial transaction, the taxpayer is entitled to choose the method to achieve the commercial objective which yields the lowest tax charge and the taxpayer is under no obligation to choose a method that yields the highest tax charge. The same is true with regard to setting up and/or funding an offshore trust.

Other direct and indirect costs must also be observed, being the offshore trustees' risk and responsibility fees, fees pertaining to annual financial statement fees and other regulatory fees relating to meeting compliance deadlines as set out in CRS and FATCA. An assumption that because there is no tax charge in the cooperative tax haven per se will outweigh all other costs may therefore not be necessarily true.

As noted above and without going into the various technical complexities, the main tax concerns for a South African tax resident wishing to incorporate an offshore trust are:

- Contribution phase:
  - » Once the offshore trust is set up, it must be funded; this can be either at the time of creation or later (i.e. via a future bequest to the trust). If the offshore trust is, however, funded by donation and/or an interest bearing or interest free loan account, various tax implications can arise for a South African tax resident.
  - » In this case, the applicability of transfer pricing adjustment rules and/or the South African domestic attribution rules as set out in the Income Tax Act (the Act) must be observed.
  - » Preference is given to the applicability of South African transfer pricing legislation and, if applicable (i.e. in the case of an interest free or low interest bearing loan account below the market-related rate), a transfer pricing adjustment will result in such a South African tax resident having an increased income tax liability and, if a natural person, a deemed donations tax liability.
- Management and investment phase:
  - » Where a South African tax resident donated either cash and/or assets to an offshore trust and subsequently any income and/or capital profits arise in the offshore trust because of that donation, the foreign attribution rules set out in section 7(8) as read with paragraph 72 of the Eighth Schedule to the Income Tax Act apply and any taxable income arising in the offshore trust must be attributed back to the South African tax donor. ►



*“If your offshore trust is or you are about to set up an offshore trust in such an uncooperative tax haven, walk away. Just being there one is assumed to be guilty before proven innocent.”*

- ▶
  - » However, if the attribution rules do not apply (i.e. because the funding mechanism was a market-related interest bearing loan or, if not, the transfer pricing rules applied) then the profits in the offshore trust remains legally untaxable until the time of the vesting of an amount (see below).
  - » Where a South African tax resident, either in its capacity as founder, donor or protector of the offshore trust, assumes any strategic and high-level management over the offshore trust, the latter could fall into the definition of a South African tax resident and become liable for income tax on a worldwide basis to the South African government.
- Benefit phase:
  - » Where the offshore trustees vest any amount that represents taxable income and/or a capital gain in any South African tax resident UBO's it will result in normal income liability for such a tax resident in South Africa.

Lastly, with regard to the fourth factor, it should be noted that the OECD has historically excluded this factor in evaluating whether a specific jurisdiction has been cooperative or not and particularly with regard to offshore trusts. This makes sense as the purpose of the offshore trust is not to trade which normally requires substance, but it is intended to create a multi-generational assets protection structure for the UBO and the descendants.

Setting up and running an offshore trust is not cheap. Therefore, if the offshore trust investments to be created or have been created is substantial in quantum and, if the operating costs are reasonable, having an offshore trust is still a viable option for a South African tax resident. In particular with reference to the additional sovereign protection that its country of incorporation may offer, together with foreign tax benefits it has to offer being applicable to its jurisdiction but also with reference to other jurisdictions arising from the investment that could have triggered taxes in such other jurisdiction if assets were directly held by a natural person in such other jurisdictions at the time of his death i.e. situs taxes.



# PICKING UP THE PIECES – COMPANY TAKEOVERS OF VULNERABLE COMPANIES

► **KRISTEL VAN RENSBURG**, Director at ENSafrica

Taking a closer look at the good, the bad and the ugly of business rescue. Does business rescue secure a happy ending?

The low-cost airline Mango is the recent well known South Africa brand to go into voluntary business rescue following other brands, such as SAA, Edcon and Ster-Kinekor which are also all under business rescue. Not surprisingly, the Companies and Intellectual Property Commission (CIPC) reported that, between April and October 2020, 233 companies initiated business rescue proceedings. It is expected that this number will be higher in 2021 due to the COVID-19 pandemic and the recent unrest in South Africa.

## What is business rescue?

Section 128(1)(b) of the Companies Act defines 'business rescue' as "proceedings to facilitate the rehabilitation of a company that is financially distressed". Companies which initiate business rescue proceedings are afforded much needed relief under Chapter 6 of the Companies Act. This relief gives a distressed company some breathing space to restructure its affairs (including its assets, equity, debts, property and liabilities) to return to profitability.

## The business rescue plan

The appointed Business Rescue Practitioner (BRP) must prepare a plan that outlines the proposals of how the company will be rehabilitated. The BRP must consult with the management of the company, its creditors, employees and their representative unions, as well as

other affected persons in the preparation of the plan. Once adopted, it becomes binding on the company, its creditors and the shareholders. This does not take into account whether such person was present at the meeting, voted in favour of the plan or, in the case of creditors, proved their claims against the company.

In most instances, the adopted business rescue plan will determine if any pre-business rescue debts will be repaid and, if so, to which extent they will be repaid. It is not uncommon for the plan to provide that the pre-business rescue debts will be discharged or expunged in full. Accordingly, those affected creditors cannot enforce their debts against the company, even after the business rescue process is terminated and the company returns to profitability.

## The good, the bad and the ugly

### The good

Successful business rescue proceedings have many advantages. For example, a better return may be secured for the creditors as compared to liquidation. It may also assist the company in returning to profitability which, in turn, may preserve employment and assets.

### The bad

The reality is that business rescue does not secure a happy ending for most companies. Many business rescue plans include a restructure of the business through the disposal (or part disposal) of the business or its assets. In some instances, the business is sold as a going concern, followed by a liquidation. There are many proverbial pieces to pick up after the implementation of the business rescue plan, especially where a sale of a business or part thereof has occurred. These include potentially disgruntled employees who have not seen any increase in earnings for many years, who must adapt to a new work environment with limited or no proper change management being implemented, assets that were not maintained properly during the financially difficult years and the tax cost.



► *The ugly*

The tax cost suffered. The sale of the business or part thereof – may give rise to taxable recoupments and capital gains in the hands of the company. In addition, if the debt relief rules contained in section 19 and paragraph 12A of the Eighth Schedule to the Income Tax Act (ITA) apply to the discharged or expunged debts, it will give rise to further taxable recoupments and capital gains, which will constitute additional debts to be paid by the company. Effectively, the tax that arises will decrease the amount of the distributions that can be made to business creditors. In some cases, this results in complicated circular tax calculations.

It is not uncommon for companies in business rescue to have accumulated assessed tax losses. But the preservation of these tax losses may be crucial to shield against the tax associated with post-business rescue restructurings. It may also be vital in providing the company with much needed cash flow to fund ramp up stock acquisition or to undertake necessary maintenance on assets that were neglected during the difficult years. However, in certain instances, the business under rescue may cease to trade for the duration of the business rescue proceedings or while restructurings are carried out. This will place at risk the business's ability to use any accumulated assessed tax losses upon the commencement of trade. This problem will only be exacerbated if the proposed change to section 20(1) as contained in the draft Taxation Laws Amendment Bill is enacted. The proposed change will only allow the set-off of assessed losses up to a maximum of 80% of the taxable income. Accordingly, in the year when the business rescue plan is implemented, there could potentially be a taxable income to which the proposed limitation will apply. Conceivably, this will be adverse to the rescued company from a cash flow perspective.

### **Tax dispensations for companies in business rescue**

The ITA and the Tax Administration Act (TAA) provide some dispensations to companies in business rescue or liquidation. These include:

- Section 195 of the TAA: A senior SARS official may decide to temporarily 'write off' an amount of tax debt for the duration of the period that the debt is subject to business rescue proceedings. This does not absolve the debtor from the liability of that tax debt.
- Section 198(1)(c) of the TAA: A tax debt is irrecoverable at law if it is owed by a debtor that is subject to a business rescue plan referred to in the Companies Act to the extent that it is not enforceable in terms of section 154 of the Companies Act.
- Sections 19(8)(d) and 12A(6)(d) and (e) of the Eighth Schedule to the ITA: Sections 19(8)(d) and 12A(6)(d) of the Eighth Schedule to the ITA are identical and provide that the debt benefit rules will not apply to a debt benefit in respect of any debt owed by a company to another company that form part of the same 'group of companies' (as defined in section 41 of the ITA, which, inter alia, excludes foreign shareholders) if the company owing the debt has not carried on any trade during the year in which the debt benefit arises or the immediately preceding year. There are provisos to this exclusion, which essentially exclude debts arising from transactions in terms of the group rollover relief provisions in sections 42, 44, 45 and 47 of the ITA.
- Paragraph 12A(6)(e) of the Eighth Schedule to the ITA: This paragraph provides that the debt relief rules will not apply to a company where the debt is reduced in the course of or in anticipation of liquidation, winding up, deregistration or final termination of the existence of the company and the debt is owed to a connected person (as defined in section 1 of the ITA) in relation to the debtor. The debt benefit must not exceed the amount of the expenditure incurred for purposes of the base cost. Furthermore, the exclusion will not apply if the debt was reduced as part of an arrangement, transaction or scheme to avoid tax; the debtor became a connected person in relation to the creditor after the debt arose; or if the company has not taken steps as contemplated in section 41(4) of the ITA to liquidate, wind up, deregister or finally terminate its existence.

In reality, the above dispensations provide limited or no relief in most business rescue proceedings even in circumstances where the company is ultimately liquidated. It is interesting to note that when the debt relief rules in section 19 and paragraph 12A were

*“There are limited dispensations offered from a tax cost perspective to companies in business rescue or liquidation.”*

introduced in 2012 to replace the previous rules. The Explanatory Memorandum to the Taxation Laws Amendment Bill 2012 noted that the reason for introducing the new debt relief rules was to remove the added impediment that the tax system (at that time) caused to the recovery of taxpayers in financial distress. Although the debt rules, as introduced in 2012, were an improvement to the prior position, more can be done for financially distressed taxpayers.

It is clear from the above that there are limited dispensations offered from a tax cost perspective to companies in business rescue or liquidation. This is even more so for companies that form part of a multinational group of companies. The current economic climate and the limited dispensations offered from a tax perspective, especially to foreign investors, only serve to limit South Africa’s attractiveness as a jurisdiction for foreign investment. National Treasury is urged to evaluate the situation and effect legislative amendments that provide real tax relief to companies in business rescue or liquidation.

### **Conclusion**

We hope that Treasury addresses the situation regarding tax costs in respect of business rescue proceedings and liquidations as soon as possible. We fear that we will be seeing more and more companies file for business rescue and/or liquidation.

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# PROPOSED AMENDMENTS TO THE HYBRID DEBT RULES

30 minutes CPD

► **PIETER VAN DER ZWAN**, Associate professor at North West University and independent tax consultant and **KAREN STARK**, Senior Lecturer: Department of Taxation at the University of Pretoria

This article covers legislative process explored by OTO, and the grounds for the two interpretations.

Debt instruments with equity-like features pose a risk to the South African tax base. The hybrid debt rules aim to counter undue tax benefits from these instruments. Sections 8F and 8FA of the Income Tax Act<sup>1</sup> deem interest in respect of a hybrid debt instrument or hybrid interest to be treated similarly to the yields of an equity instrument. The interpretation of these rules seems to be contentious.

In the 2021 Budget Review, National Treasury indicated that these rules disallow the deduction of interest paid and it deems this interest to be an in specie dividend for the issuer of the instrument, without deeming it to be an in specie dividend for the recipient. SARS shares the view that the amount remains interest for the person to whom it accrues.<sup>2</sup> This position differs from that of some taxpayers and practitioners who consider the hybrid debt rules to affect the treatment of both parties to these instruments. Treasury proposed that the legislation be amended to address concerns of economic double taxation caused by a one-sided adjustment.

This article aims to contribute to the legislative process by exploring the grounds for the two interpretations. We consider the language used, the context provided by the explanatory memoranda and the practical results of each interpretation.<sup>3</sup> We conclude with our views on the importance of how the concerns relating to economic double taxation are resolved.

## The language used

Section 8F(2) reclassifies the returns in respect of a hybrid debt instrument.<sup>4</sup> It currently states:

*“Any amount that is incurred by a company in respect of interest on or after the date that the instrument becomes a hybrid debt instrument is—*

- a. *deemed to be a dividend in specie in respect of a share that is declared and paid by that company to the person to whom that amount accrued on the last day of the year of assessment of that company during which it was incurred; and*
- b. *not deductible.”*

The conflicting interpretations seem to relate to the phrase “...deemed to be a dividend in specie in respect of a share that is declared and paid by that company to the person to whom that amount accrued”. The point of contention is whether this phrase only affects the issuer company or whether it extends

to the person to whom the amount accrues who is also referred to in the text. One may gain some insight by comparing the words of the provision before and after its amendment (in 2017) as well as the wording used in similar deeming provisions.

The original wording dealt with the incurral and accrual of interest in two separate subparagraphs. The amendment in 2017 moved the reference to the incurral of interest to the introductory wording of section 8F(2), deleted the separate subparagraph dealing with accrual and inserted the phrase “to the person to whom that amount accrued” in subparagraph (a). At face value, this amendment merely seems to re-order and combine the wording of the subparagraphs. The explanatory memorandum created a similar impression of a technical correction, mainly of a textual nature, rather than a change in policy.<sup>5</sup>

The Act contains several provisions that deem dividends in specie to arise. These are sections 9H, 24BA and 31. Although these rules also refer to persons to whom the dividends are deemed to be paid, their application is explicitly limited to dividends tax (either stated or by excluding amounts from being dividends for purposes other than dividends tax). The deemed dividend in section 8F, however, is neither specifically excluded from the broader dividend definition in section 1 (similar to section 31(3)) nor only deemed to arise for purposes of dividends tax (similar to sections 9H(3)(c)(iii) and 24BA(3)(b)). The hybrid debt rules also differ from the other deeming provisions in the sense that it affects a transaction where both the recipient and the payer would ordinarily account for the payment for tax purposes. The other provisions do not involve transactions where the recipient would generally account for an amount received for tax purposes.

<sup>1</sup> References to a section refers to a section of the Income Tax Act.

<sup>2</sup> Comprehensive Guide to Dividends Tax (Issue 4) (at p88).

<sup>3</sup> In *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2012] 2 All SA 262 (SCA), Wallis J endorsed a similar approach to interpretation.

<sup>4</sup> Section 8FA(2) has similar wording in the context of hybrid interest. References to section 8F apply equally to section 8FA.

<sup>5</sup> It stated, “The proposed amendment of the opening words of paragraph (a) in subsection (2) of section 8F of the Income Tax Act were meant to apply to both paragraphs (a) and (b) of that subsection. This amendment gives effect to this.”

This is evident from the need to deem a distribution of an asset in them. These differences may suggest that the deemed dividend treatment in section 8F applies in a broader context that includes the recipient.

### Development of the hybrid debt rules

The intent of Treasury can be gleaned from the explanatory memoranda that accompanied the introduction and subsequent amendment of the hybrid debt rules. The initial explanation in 2013 was:

*“In applying the anti-avoidance rules, any amount of interest in respect of the instrument will be treated as a dividend in specie declared and paid by the issuer. The dividend in specie will be deemed to be declared and paid on the last day of the year of assessment of the issuer. In addition, a deduction of the interest will be denied. Similarly, the interest will also be treated as a dividend in specie accrued to the holder on the last day of assessment of the issuer.”*

In 2016, the scope of the provision was narrowed to prevent resident holders benefiting from their taxable interest yields being reclassified to exempt dividends where the interest deduction did not affect the South African tax base. The need for this amendment confirms that the reclassification affected both the issuer and the holder.

In 2017, the structure of the wording was amended, as discussed above. A further amendment in that year also involved these anti-avoidance rules and addressed concerns that a counterparty is deemed to have received an exempt dividend in specie, while a covered person could potentially enjoy the benefit of a deduction of the interest.<sup>6</sup> This amendment would have been unnecessary had the receipt by the holder been unaffected by the hybrid debt rules. It is significant that the amendment addressed the concern by making the non-deduction of interest for the covered person explicit. The need for this amendment, in the same year in which the wording of section 8F was changed, suggests that the effect of these rules remained consistent with the position in the 2013 explanatory memorandum.

### Consequences of a one-sided adjustment

The interaction between various taxes arguably yields odd results if one holds the view that the reclassification rules do not affect the recipient of interest.

In a domestic context, the dividend in specie that the company is deemed to pay to the recipient should, conceptually, be exempt from dividends tax since it represents income that is subject to normal tax in the hands of the recipient. This is in terms of section 64F(1)(l). This exemption only applies if the beneficial owner submitted the relevant declarations and undertakings to the company. This is doubtful if the recipient was neither aware of nor affected by the dividends tax suffered by the company.<sup>7</sup> In the absence of these documents, the profits from which the interest is paid would be subject to three layers of tax. Firstly, corporate tax in the hands of the paying company where the deduction is denied. Secondly, dividends tax in the hands of the

same company. Thirdly, normal tax on the interest in the hands of the recipient. While this treatment seems harsh, it is comparable to the one-sided adjustment for dividends from hybrid equity instruments under section 8E.

In a cross-border context, the interest that accrues to a foreign recipient is exempt from normal tax in terms of section 10(1)(h) unless the recipient has a taxable presence in South Africa.<sup>8</sup> Withholding tax on interest (WHTI) is generally levied on South African sourced interest paid to a foreign recipient who does not have a taxable presence in South Africa.<sup>9</sup> The foreign recipient of the interest is ultimately liable for the WHTI. It is unclear how a one-sided adjustment applies in this instance:

- One view is that the trigger for the WHTI is that an amount of interest must be paid to a foreign person. Since the hybrid debt rules focus on the classification of the payment by the company, one can argue that they deem this amount paid to be a dividend in specie and the WHTI does not apply. The receipt or accrual of interest remains exempt from normal tax in the hands of the recipient (as explained above). This implies that the hybrid debt rules are more onerous for domestic than foreign recipients. This seems an odd outcome given the OECD’s focus on the misuse of hybrid instruments in a cross-border context.
- Alternatively, one can contend that conceptually the hybrid debt rules do not affect the recipient of the interest. The foreign recipient arguably remains liable for the WHTI. Unlike section 64F(1)(l), no exemption deals with the overlap between dividends tax and the WHTI. The company remains liable for dividends tax on the deemed dividend in specie, irrespective of the fact that the recipient is also liable for the WHTI.<sup>10</sup> In this case, the amount will almost always be subject to three layers of tax. This is an unusual and no doubt inequitable outcome for a single transaction.

This interpretation seems arguably insensible and not justifiable if one considers that it appears to have stemmed from a technical amendment.

### Practical importance of the amendment

The analysis in this article leans towards an interpretation that the hybrid debt rules affect both the issuer and holder of an instrument. While this debate may soon appear to be academic when the law is amended, as proposed in the Budget Review, the potential consequences may linger.

The message that accompanies the proposed amendment will play an important role if disputes arise in relation to periods between 2017 and 2021. On the one hand, if presented as a change from the current status quo, taxpayers remain exposed to the insensible outcomes described for this period. If, on the other hand, the amendment is presented as a clarification of the position that has always been the case, as the analysis in this article favours, we believe this will result in an equitable outcome and avoid tax disputes about unintended consequences.

<sup>6</sup> Explanatory Memorandum to the 2017 Taxation Laws Amendment Bill (pp 55 and 56).

<sup>7</sup> The company’s interpretation of the treatment of the amount in the recipient’s hands may be crucial.

<sup>8</sup> In which case the outcome for the foreign recipient would be similar to that in a domestic context.

<sup>9</sup> Section 50B(2) read with exemptions in section 50D.

<sup>10</sup> It is unclear how treaty relief would be determined if the same amount is viewed as a dividend and interest.



# PROFESSIONAL ADVISORY SERVICES

Cova Advisory is a 51% black owned company with a specific focus on government programmes including grants and tax incentives. Cova has positioned itself as an independent advisor on matters ranging from Customs and Excise, Carbon and Energy strategy, green related funds, Carbon Tax and carbon policies, and renewable energy. Cova has also set up a strong local network within the private and government sectors. To offer a comprehensive service our team is made up of engineers, accountants and lawyers.

Cova Advisory is one of only 7 active inspection bodies accredited by the South African National Accreditation System (SANAS) to measure and verify energy savings (Certification Number EEMV0007). Our team comprises certified Measurement and Verification (M&V) professionals to do this inspection work.

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Cova Advisory has unrivalled expertise in 4 key areas:

- Providing advice on the tax incentives and government grants which the South African Government has on offer for new projects.
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- Customs and Excise advisory work.
- DFI finance raising

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Cova offers a comprehensive service to companies on the grants and incentives offered by government to various sectors of the economy. This includes the assessment of projects to determine the best support scheme(s) available and assistance with the preparation of applications, liaison with government agencies and the vital follow-up on successful applications to ensure all criteria for sustained support are

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Our Customs and Excise services include:

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- Customs dispute resolution
- Customs valuation opinions
- Customs registrations
- Stage consignment rulings
- SARS preferred trader programme
- IDZ / SEZ advisory
- Tariff opinion
- Trade Agreement advisory (including Rules of Origin and Authorised Economic Operator)
- Rebate compliance
- Trade agreements (e.g. AfCFTA) – impact and planning for the future
- Customs & Excise training



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# CASE LAW

## WRAP-UP

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In this case law study, we look at the case of the taxpayer in 2013 where the taxpayer applied an apportionment in terms of section 17(1) of the Value-Added Tax (VAT) Act which was based on an acceptance that the relevant goods and services were acquired partly for the consumption or use in the course of making taxable supplies. As well as the ruling thereof.

### *THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE VS TOURVEST FINANCIAL SERVICES (PTY) LTD (435/2020)*

#### Issue

The issue before the Supreme Court of Appeal (SCA) in this matter was whether the taxpayer, a licensed dealer in foreign exchange which conducts a currency exchange business through its branches, made both taxable and exempt supplies for VAT purposes or taxable supplies only.

#### Facts

Prior to September 2013, the taxpayer applied an apportionment in terms of section 17(1) of the Value-Added Tax (VAT) Act which was based on an acceptance that the relevant goods and services were acquired partly for the consumption or use in the course of making taxable supplies. As such, the taxpayer only claimed input tax on a portion of its goods and services acquired.

However, during 2013, the taxpayer changed its approach and took the view that all the goods and services acquired for its branches were used by it wholly in the course of making taxable supplies and not in the course of making exempt supplies. Accordingly, the taxpayer concluded that no apportionment was required and claimed back an input tax deduction of R24 million for VAT overpaid over the previous five years.

SARS refunded the amount and issued an additional assessment adding back the R24 million on the basis that the goods and services had been acquired by the taxpayer for use in the course of making both taxable and exempt supplies and contended that an apportionment of input tax was necessary.

#### The taxpayer's case

The difference between the sale or purchase price and the market value constituted the taxpayer's margin (or notional margin). According to the taxpayer, there should have been no apportionment for these transactions as the supplies made were wholly taxable and not exempt.





#### SARS' case

SARS conceded that the taxpayer carried on the exchange of currency as envisaged in section 2(1) of the VAT Act. This is, on the face of it, a defined financial service under section 2(1)(a) and would accordingly be an exempt supply. As such, only the commission charged by the taxpayer attracted VAT. Therefore, the taxpayer's supplies should be apportioned.

#### Outcome

The SCA found in favour of SARS and the appeal was upheld with costs.

#### Core reasoning

What would otherwise have been an exempt financial service is to an extent treated as a taxable supply as a commission carries VAT. However, this did not mean that the activity lost its exempt nature entirely. It remained an exempt supply for all other purposes, while the taxable component carried VAT. As a result, the proviso to section 17(1) of the VAT Act created a mixed supply out of an identified activity, rather than causing the activity to lose its exempt status entirely.

Furthermore, the Court held that the effect of the proviso in this context was merely to add a taxable element to what was and at its core remained an exempt financial service that turned the activity into a partly exempt and a partly taxable supply.

Based on the above, the Court concluded that the taxpayer's deduction of the full unclaimed input tax over the previous five years was impermissible and that the inputs ought to have been apportioned.

#### Takeaway

This case demonstrates why taxpayers should err on the side of caution and apply for a ruling from SARS to determine whether an apportionment method is applicable based on the facts and circumstances of each matter. The taxable portion of the consideration for a service should always be taken into account, regardless of whether the supply is exempt for VAT purposes or otherwise.



**RAPPA RESOURCES (PTY) LTD V THE COMMISSIONER  
FOR THE SOUTH AFRICAN REVENUE SERVICE  
(20/18875)**

### Issue

The issue in this matter was whether SARS' refusal to allow a VAT refund, in the value of approximately R1.6 billion, to the taxpayers (i.e. applicants) on the basis that an audit was pending in terms of section 190(2) of the Tax Administration Act (TAA) was correct.

### Facts

The applicants purchase and sell gold-bearing bars comprising an alloy of gold and silver. The applicants also sell gold extracted from the by-products of gold mining. The applicants contended that they do not mine gold themselves nor do they purchase second-hand goods that attract a 'notional VAT input credit'. The applicants paid input VAT on their purchases from local suppliers and all sales were exports which were treated as being zero-rated for VAT purposes. The applicants would then reclaim VAT refunds for the input tax paid to the suppliers.

SARS notified the applicants that it was conducting an audit and, in terms thereof, it stopped the payment of the applicants' VAT refunds, while the audit was taking place. The basis of the audit, according to SARS, was that there was reason to believe that the applicants were either directly or indirectly involved in unlawful activities which used the business model of the applicants as a front for disposing of either illegally mined gold or smelted Krugerrands, which are zero-rated for VAT purposes.

### The taxpayer's case

The applicants contended that they were entitled to a refund, as they submitted VAT returns, indicating that the refunds are due, and suggested that SARS' decision to withhold the refunds did not have a lawful or factual basis. As such, the applicants sought to have SARS' decision to withhold the payment of the refunds reviewed.

The applicants further argued that as section 190(2) of the TAA states that SARS "need not authorise a refund" until an audit is complete, instead of "must" or "may" not, this meant that the applicants were still entitled to the refunds. As such, SARS was obliged to pay the amount in terms of section 190(1) of the TAA and the institution of the audit proceedings did not change that.

The applicants further noted that SARS had withheld refunds for periods that were not yet subject to audit and only furnished the applicants with audit notices after they had raised a complaint with SARS.

### SARS' case

SARS argued that it had made no decision to withhold the refund. Therefore, there was no decision that would be subject to review, as the withholding of refunds when an audit is instituted is automatic. SARS' view was that security for the full amount of the refund should be offered and either the full amount of the refund would be payable or none at all.

### Outcome

The Court found in favour of the taxpayer and SARS was ordered to pay costs in the matter.

### Core reasoning

The TAA seeks to balance the interests of the applicants and SARS by allowing SARS to retain the refunds pending the outcome of an audit. The Court held that the scheme of the TAA does not lead to the necessary conclusion that section 190(2) of the TAA does not interfere with the applicants' entitlement set out in section 190(1). Any VAT vendor is entitled, in good faith, to a refund on submission of a self-assessment, even if nobody has confirmed the correctness thereof. The amount, however large, must be paid.

Section 190(2) of the TAA functions as a mechanism to rebalance the scales somewhat in favour of the fiscus to protect the money that may have been claimed wrongly or mistakenly as a refund. It would be fruitless if SARS was obliged to pay out refunds when there is doubt as to the correctness of returns or any other reason to doubt a taxpayer's entitlement to a refund. This is reinforced in section 190(3) of the TAA in that payment of a refund must be made if the taxpayer provides security in a form acceptable to SARS.

The applicants had not demonstrated a clear right to the VAT refund and could not provide security for the full amount of the refunds. On this basis, SARS refused to accept anything less than the full amount of the refund. The Court held that this is an unreasonable position to take and is not supported by the plain language or obvious purpose of the statute.

### Takeaway

SARS may not hold the view that, if security for the full amount withheld and subject to an audit is not provided, the taxpayer would not be entitled to even a proportional refund. Per section 190(3) of the TAA, SARS must refund a taxpayer for so much of the amount as the taxpayer is able to provide security.

**PERI FORMWORK SCAFFOLDING ENGINEERING  
(PTY) LTD V COMMISSIONER FOR THE SOUTH  
AFRICAN REVENUE SERVICE (A67/2020) [2021]  
ZAWCHC 165**

#### Issue

The High Court had to determine whether a 10% penalty in the amount of R1 064 607.69 (i.e., the penalty) as well as interest thereon raised by SARS on the late payment by the taxpayer of employees' tax may be remitted.

#### Facts

The taxpayer submitted its employer reconciliation declaration on 18 December 2017, which was due no later than 31 December 2017. In terms of this return, an amount of R10 648 340.93 (i.e. the employees' tax) was due to SARS, payment of which had to be made 'within seven days after the end of the month during which the amount was deducted or withheld', as provided for in paragraph 2(1) of the Fourth Schedule to the Income Tax Act.

On the same day, the taxpayer released an instruction to Nedbank to make payment of the employees' tax to SARS on 3 January 2018. However, due to insufficient funds, the payment could not be made on 3 January 2018 but was only made on Monday, 8 January 2018, when it was due on Saturday, 6 January 2018.

Regarding the reason for the late payment, the taxpayer submitted that it was waiting for payment from its debtors, which it projected would cover its liability to SARS. This did not realise, and it requested a R5 million overdraft from Nedbank which was approved on 5 January 2018. It received a payment from one debtor, but there was still a shortfall. The taxpayer then requested additional funds from another of its entities to make up the shortfall, and payment of the employees' tax was only made on Monday morning, 8 January 2018.

SARS was of the view that the payment of the employees' tax was late and raised the penalty pursuant to paragraph 6(1) of the Fourth Schedule to the Act and interest thereon in terms of section 89bis(2) of the Act, read together with section 213 of the Tax Administration Act (TAA).

The taxpayer approached the Tax Court for relief; however, it found in favour of SARS. The taxpayer, therefore, appealed to the High Court against the decision of the Tax Court.

#### The taxpayer's case

The taxpayer based its appeal on two grounds. Firstly, the taxpayer argued that the Tax Court erred in its computation of time in finding that the last date for making payment of the employees' tax was 5 January 2018 and not 8 January 2018.

Rather, it argued that the statutory method as provided for in the Interpretation Act applied and thus the declared payment was not made outside of the seven-day period; it was compliant with the Fourth Schedule to the Act and the TAA and the penalty should not have been imposed at all.

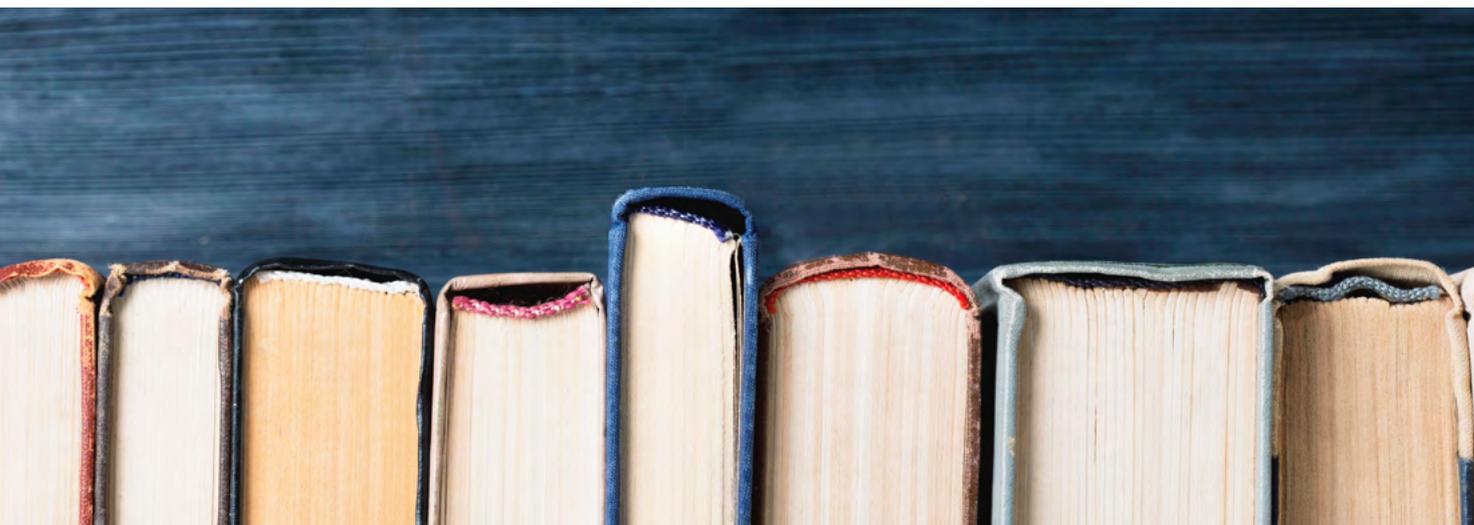
Secondly, the taxpayer contended that, should the High Court uphold the Tax Court's finding that it was indeed out of time, it provided reasonable grounds for its late payment and was therefore entitled to the relief in section 217(3) of the TAA. This section provides that, in the case of a penalty imposed under section 213, SARS may remit the penalty if it is satisfied that the penalty was imposed in respect of a "first incidence" of non-compliance, reasonable grounds for the non-compliance exist and the non-compliance in issue has been remedied. In terms of sections 89 and 89bis of the Act, SARS also has broad discretion to remit or reduce interest after having regard to the circumstances of the case in question.

The taxpayer submitted that it immediately remedied its non-compliance and it has never been late in paying employees' tax or even been non-compliant. It also relied on the case of *Attie v CSARS* [2016] ZAGPJHC 731 (i.e. *Attie*) to contend that it was reasonable to rely on their bookkeeper, as she had eight years' experience in preparing cash flow forecasts and her predictions of cash inflows for the period of the first week of January 2018. It argued that her behaviour was not risky or unreasonable but rather based on her historic cash flow methodology which has not failed previously. In any event, it argued that, notwithstanding that the predictions were inaccurate in this instance, her decisions were not unreasonable. Trade debtors paid less than R200 000 to the taxpayer on 5 January 2018. This eventuality, it argued, while not impossible, was highly improbable.

The taxpayer finally submitted that the penalty in the context of its non-compliance, which was the next business day after the due date, was not proportionate to the seriousness and duration of the non-compliance.

#### SARS' case

In opposition to the taxpayer's second ground of appeal, SARS advanced two arguments. Firstly, SARS argued that paragraph 2(1) of the Fourth Schedule establishes a fiduciary relationship between SARS and an employer, as the employer is duty bound to deduct or withhold employees' tax on any remuneration paid to an employee. SARS submitted that the taxpayer did not act in a manner of the highest degree of care in so collecting and paying over the amounts due to it and the taxpayer cannot state that "reasonable grounds" exist in circumstances where it



- ▶ treated employees' tax as its own and subjected such funds to the whims of its own business. Such conduct, it argued, was unreasonable and unacceptable.

Secondly, the employees' tax must be paid to SARS within a stipulated period as it is common cause that the amounts so deducted or withheld are collected on behalf of and for the benefit of SARS. SARS also argued that it matters not whether payment of the employees' tax was late by one or 20 days, for, as long as the taxpayer failed to pay the declared amounts of employees' tax withheld within the stipulated seven-day period, the imposition of the 10% penalty is triggered. SARS contended that it is directed, in a peremptory manner, to impose a penalty without any discretionary powers.

#### Outcome

The taxpayer's appeal was upheld with costs.

#### Core reasoning

The court dismissed the taxpayer's first ground of appeal and held that the Interpretation Act does not apply. Section 244 of the TAA is unambiguous and provides certainty for taxpayers as it clearly provides for eventualities where payments fall due on a Saturday, Sunday or public holiday and specifically states that, in such event, it calls for payment on the last day preceding such a day. Regarding the taxpayer's second ground of appeal, the court rejected SARS' counterargument that the relationship between it and an employer is akin to a fiduciary relationship and confirmed that the taxpayer cannot be precluded from using the money or be obliged to ring-fence it.

The court agreed with SARS that it was obligated to impose a penalty without any discretionary powers; various degrees of penalties, dependent on the various degrees of lateness, would only result in uncertainty and confusion in SARS' office and could lead to a plethora of unnecessary litigation. The current legislation ensures certainty that, in the event of non-compliance, SARS will levy a penalty of 10% on the amount owing to SARS, irrespective of the degree of lateness. However, on SARS'

approach to remission of percentage-based penalties, a penalty can be waived in the event of a 'first incidence' of non-compliance. The taxpayer's contention that it had a clean record and qualified under a 'first incidence' of non-compliance was not disputed by SARS. The Court remarked though that the reliance by the taxpayer's bookkeeper on payments from third parties to comply with its payment obligations towards SARS was unreasonable, but this was not the end of the matter.

Section 217(3) of the TAA envisages a mechanism to come to the aid of an aggrieved 'first incidence' non-complying taxpayer, who has, in addition, satisfied two further requirements; most notably, satisfied SARS that reasonable grounds exist for the non-compliance. The court held that a factor which SARS failed to consider, which could render it a reasonable ground, was the manner in which the taxpayer immediately attempted to rectify the deficiency.

The court held that there was neither prejudice to SARS nor any mala fides indicated. On the contrary, the taxpayer made every effort to comply with its obligations to SARS, which, in the circumstances, is a reasonable ground for the penalty imposed to have been omitted, especially considering that it was the taxpayer's 'first incidence' of non-compliance. As such, there was an unreasonable exercise by SARS of its discretion and the taxpayer's appeal was upheld.

#### Takeaway

Employers should ensure that they are aware of when exactly the payment of employees' tax must be made to SARS. If the last date for payment falls on a weekend or public holiday, payment must be made on the last preceding day. Failure to timeously pay employees' tax will result in an immediate penalty being raised by SARS. More importantly, in the case of taxpayers who are 'first incidence' non-compliers, they must ensure that the non-compliance is rectified as soon as possible, as this could assist in the possible remittance of any penalties raised, as provided for in section 217(3) of the TAA.



# BINDING RULINGS

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In this ruling, tax consequences for distribution in specie of shares by the applicant to its shareholders are determined.

## **BINDING PRIVATE RULING: BPR 366**

*Definitions of “dividend” and “return of capital”, paragraph 75 of the Eighth Schedule and distribution in specie of shares*

### Issue

This ruling determines the tax consequences of a distribution in specie of shares by the applicant to its shareholders. The applicant and its subsidiaries are holding companies with portfolios of interests in various companies. Their objective is to hold the investments on capital account.

### Facts

The applicant and its subsidiaries have commenced a corporate restructuring. The proposed transaction is the last step in the restructuring. Before the restructuring commenced, the applicant and its subsidiary structure was as follows:

- The applicant, a listed resident company, held all the ordinary shares in Company A, a resident company that is a wholly-owned subsidiary of the applicant.
- Company A held all the ordinary shares in Company B, a resident company that is a wholly-owned subsidiary of Company A.
- Company B held all the shares in Company C, a non-resident company. Company C has a primary listing of its ordinary shares on both the JSE and on a foreign exchange. Company C is a controlled foreign company in relation to Company B.

It is proposed that the shares in Company C be distributed to the shareholders of the applicant. The eventual distribution of the shares of Company C entails various transaction steps, some of which have already been implemented. The proposed transaction relevant to this ruling is the final transaction step.

Transaction steps one to three have been implemented as follows:

- Step one: Share consolidation – the issued ordinary shares in Company C were consolidated to eliminate fractional shares.

- Step two: Unbundling of Company C shares – Company B unbundled all its shares in Company C to Company A in accordance with paragraph (b) of the definition of “unbundling transaction” in section 46(1).
- Step three: Asset-for-Share Purchase – Company C acquired investment assets from Company B in exchange for the issue of its own shares to Company B.

Transaction step four will be implemented as follows:

- Step four: Equity Repurchase
  - I. Company A will repurchase a certain number of its own ordinary shares from the applicant at a certain consideration amount. The repurchase consideration will be settled by Company A transferring a certain number of shares in Company C to the Applicant which will reduce the contributed tax capital of Company A's ordinary shares. The base cost of shares that the applicant holds in Company A will also be reduced.
  - II. The applicant will acquire an aggregate base cost in Company C shares equal to the value of those shares. These values at which this transaction step will be done will be determined by the applicant.

The final step in the restructuring is the proposed transaction which will be implemented as follows:

- Step five: Distribution of Company C shares – the applicant will distribute in specie all the shares it holds in Company C to its shareholders. The distribution will reduce the applicant's contributed tax capital. ►

► **Ruling**

This ruling is subject to the following additional conditions and assumptions:

- The directors of the applicant will pass a resolution directing that the distribution of Company C shares will constitute a return of capital and not a dividend.
- The shareholders of the applicant hold their shares on capital account.

The ruling issued by SARS is as follows:

- The distribution in specie by the applicant of Company C shares to its shareholders will constitute a 'return of capital' as defined in section 1(1) of the Act.
- The distribution in specie by the applicant of Company C shares to its shareholders will fall within the ambit of paragraph 75 of the Eighth Schedule of the Act. Consequently, the resident company will be treated as having disposed of Company C shares for an amount equal to the market value on the date of distribution as contemplated in paragraph 74 of the Eighth Schedule of the Act.

**BINDING PRIVATE RULING: BPR 367**

*The Applicability of the Employee Tax Incentive to Students Employed by a Resident Company*

**Issue**

This ruling determines whether students in the proposed training programme are 'employees' as contemplated in the Employment Tax Incentive (ETI) Act and whether the applicant will be entitled to claim an employment tax incentive in respect of any of the students employed.

**Facts**

The applicant is a resident company and Company B is a resident non-profit company. The applicant and Company B will enter into an agreement with the stated purpose that students will be employed by the applicant for the purpose of obtaining a qualification. The students will participate in a training programme offered by Company B.

Company B will train the students for a year, supply a tablet, data and cash per month as an incentive to stay in the programme. Students will have to perform certain online tasks every week and meet for group discussions every second week.

The applicant will invoice Company B for payroll related services which the applicant will render monthly in respect of each student it proposes to employ. The applicant will sign agreements with the students for a period of 12 months and pay the students

a monthly salary. The applicant is not obliged to employ the students subsequent to the 12-month training programme being completed.

The students will consent to forfeit their monthly salaries in order to be trained by Company B. The students will be on the applicant's payroll and protected by its group life policy. The students are not required to do any work. The main duty of a student will be to virtually attend training courses at the skills centres as hosted by Company B. Furthermore, there is no expectation that a student will report to the applicant's offices on a daily basis. There may be times that the students would be expected to make themselves available to perform specific forms of work, such as marketing, printing and distribution of pamphlets. The applicant will only call on them to perform these ad hoc activities to the extent that doing so does not interfere with their studies.

Company B will exercise supervision and control over the students by way of mentors assigned to each student. The mentors will monitor and supervise the students to ensure they progress successfully through the training course.

**Ruling**

This binding private ruling is not subject to any additional conditions and assumptions. The ruling issued by SARS is as follows:

- No student will meet the definition of an 'employee' in section 1(1) of the ETI Act.
- The applicant will not be entitled to claim an incentive, as contemplated in the ETI Act, in respect of any of the students.

**BINDING GENERAL RULING: BGR 57**

*Application for a decision under section 72*

**Issue**

This ruling determines the requirements and conditions relating to an application for a decision under section 72, pursuant to section 72(2) read with section 90 of the Tax Administration Act (TAA).

**Facts**

Since the inception of VAT in South Africa, the VAT Act contained provisions in section 72 that provides the Commissioner for SARS with the discretionary powers to make arrangements or decisions as to the manner in which the provisions of the VAT Act shall be applied, subject to certain requirements being met.

Challenges regarding the application of the mandatory wording of the other provisions of the VAT Act versus the discretionary wording of the provisions of section 72 arose. In order to address these, changes were made in section 72 to align the provisions of this section with the construct and policy intent of the other provisions of the VAT Act.

The changes in section 72 introduced by the Taxation Laws Amendment Act with effect from 21 July 2019 limit the extent of the Commissioner's discretion in making a decision under this section by clarifying that a decision under section 72 cannot:

- Have the effect of reducing or increasing the liability for VAT; or
- Be contrary to the construct and policy intent of the VAT Act as a whole or any specific provision in the VAT Act.

In addition, the Commissioner must be satisfied that similar difficulties, anomalies or incongruities have arisen or may arise for any other vendor or class of vendors (other than the applicant) of the same kind or who make similar supplies of goods or services.

While the application for a decision under section 72 will be facilitated through the Advance Tax Rulings system, the decision will be under section 72. In this regard, certain provisions of the TAA relating to advance rulings were introduced in the amended section 72 to align with the process of application and issuing of decisions under section 72.

These include:

- A fee of R2 500 that is payable on applications for a decision under section 72 in accordance with section 81 of the TAA read with Public Notice 299; and
- The issuing, in accordance with section 90 of the TAA, of procedures and guidelines in the form of BGRs for the implementation and operation of the process to obtain a decision under section 72.

In addition, under section 72(3) read with Public Notice 300, the Commissioner may decline to make a decision in respect of the list of transactions set out in the said Public Notice.

This BGR sets out certain requirements and conditions relating to an application for a decision under section 72.

### Ruling

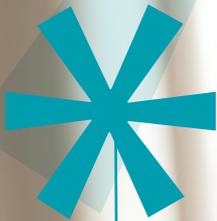
This ruling constitutes a BGR issued under section 89 of the TAA insofar as it relates to the items listed in (a) to (j):

- a) An application for a decision under section 72 must be made via eFiling.
- b) An application for a decision under section 72 may be made by one person who is a party to a transaction or by two or more parties to a transaction as co-applicants. If there is more than one applicant, each applicant must join in designating one applicant as the lead applicant to represent the others, provided that the applicants are vendors.
- c) A person may make an application for a decision under section 72 on behalf of a class of vendors.



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