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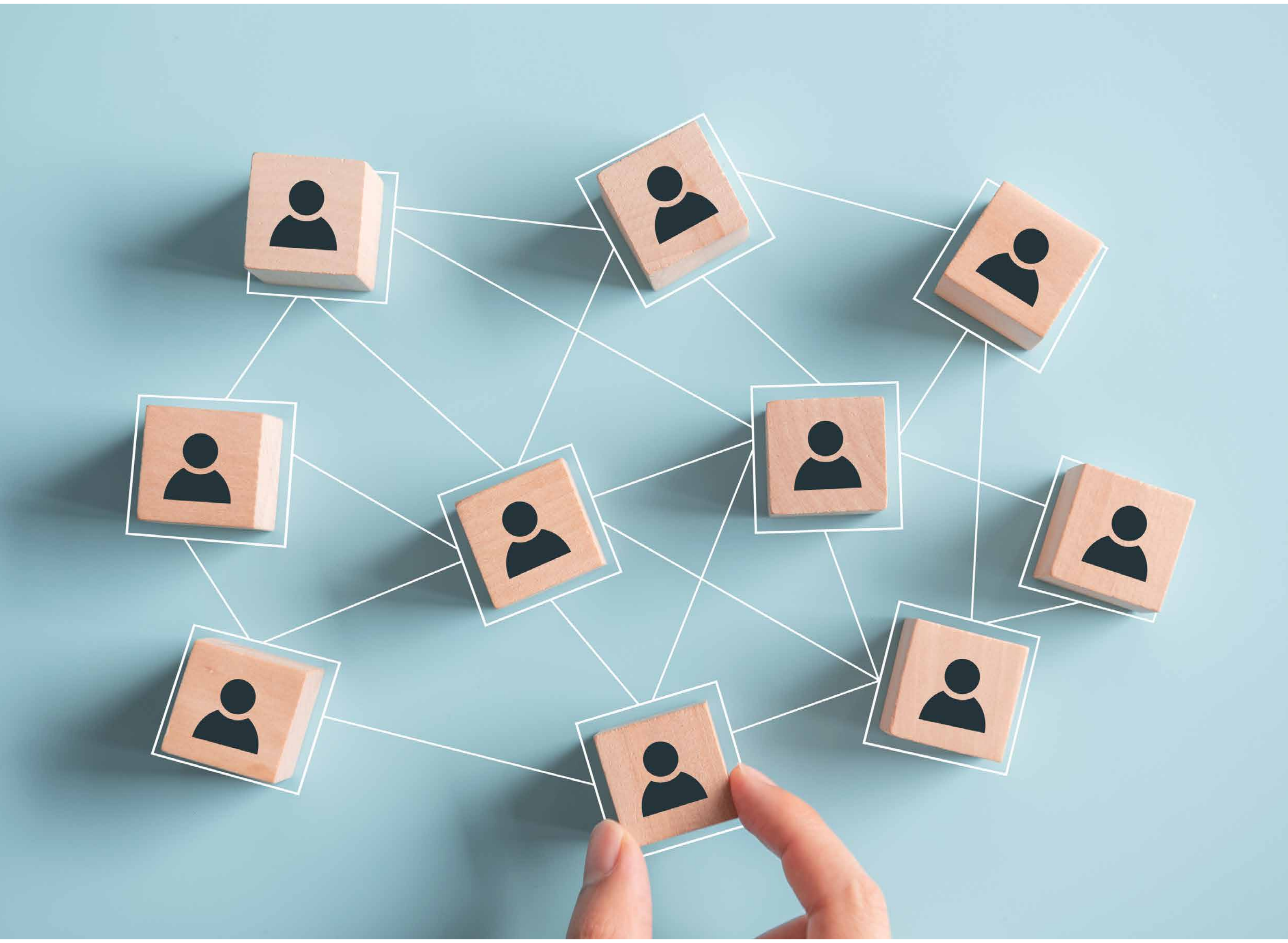

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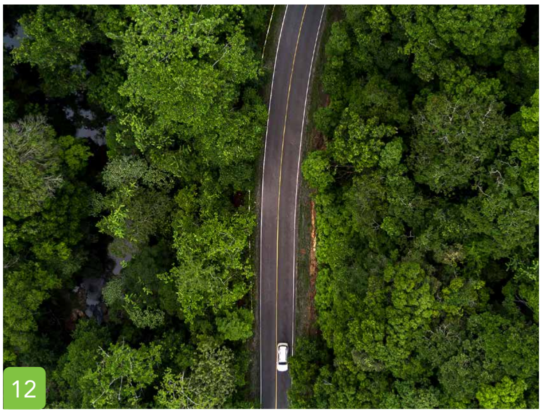

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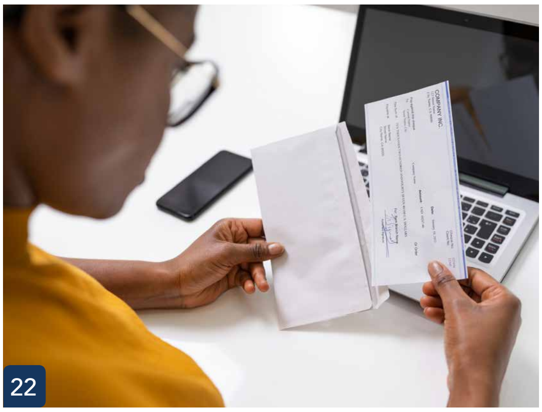

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Editorial panel:

Mr KG Karro (Chairman), Mr MA Khan, Prof KI Mitchell, Prof JJ Roeleveld, Prof PG Surtees, Ms MC Foster

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ASSESSED LOSSES - TRADE REQUIREMENT

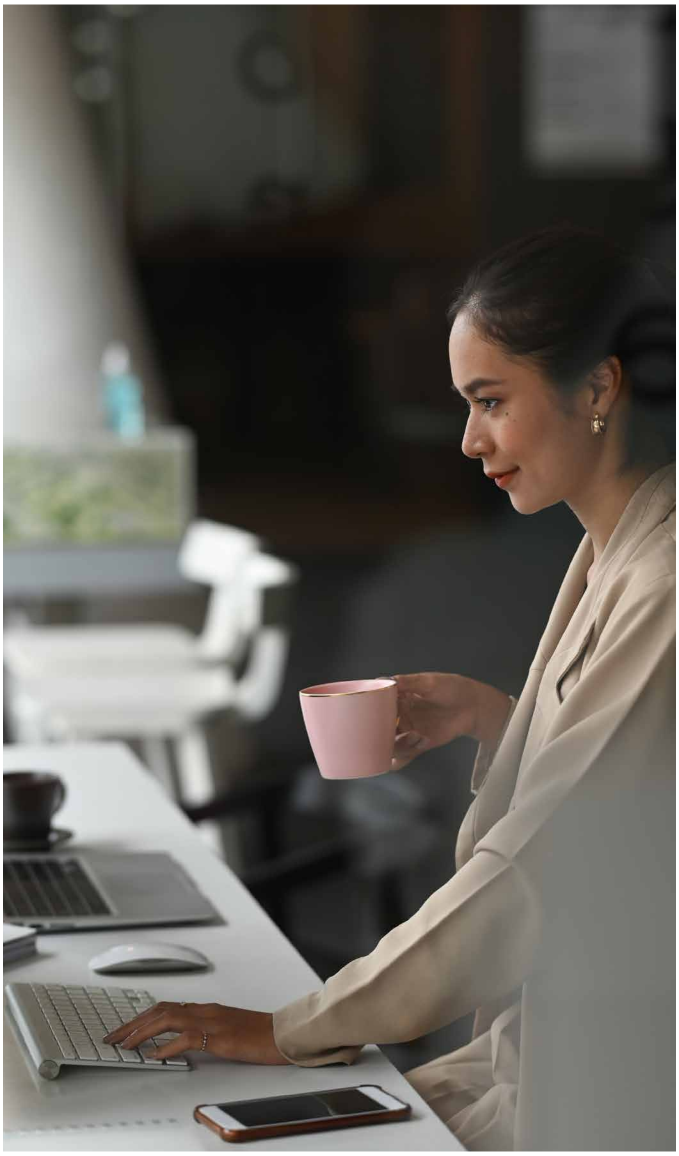
An assessed loss is incurred by a taxpayer (such as a company) when the deductions claimed by that company exceed its income for the relevant year of assessment (YOA). In terms of section 20 of the Income Tax Act, 1962 (the Act), in order to determine its taxable income from trade, a taxpayer is permitted to set off inter alia *any assessed loss (or balance of an assessed loss) brought forward from the previous YOA.*

In terms of section 20(1)*(a)*, before a company can carry forward its assessed loss from the immediately preceding YOA (balance of assessed loss), it must have carried on a trade during the current year of assessment. If it fails to do so, it will forfeit the right to carry forward its balance of assessed loss under section 20(1)*(a)*.

In addition to the trade requirement, a further question arises, namely whether a company that has traded during the current YOA but has derived no income from trade during that period is denied the opportunity to carry forward its assessed loss from the preceding YOA; ie, the taxpayer has genuinely attempted to trade, but has been unsuccessful in its endeavours. This is referred to as the "income from trade" requirement.

Taxpayers, when considering whether they are entitled to carry forward an assessed loss (and whether they have satisfied the "trade" and "income from trade" requirements), should have regard to established principles which emanate from case law over the years such as:

- a company which seeks to set off an assessed loss from a previous YOA cannot merely "keep itself alive" in the YOA in which it seeks to carry forward the assessed loss. Compliance with minimum regulatory obligations and the maintenance of a bank account will not constitute the carrying on of a trade even if the taxpayer intended to resume trading in the future;
- the holding of meetings, appointment of directors and/or arranging for financial statements to be prepared, will on its own be unlikely to constitute the carrying on of a "trade". Passive behaviour absent of any active endeavour to carry on a trade will not be sufficient to argue that a trade is being conducted;
- if a taxpayer does not have any assets with which it can engage in a trade, then it will be difficult to argue that it is actively carrying on a trade. For example, in circumstances where a taxpayer has no premises from which to trade, no equipment, no stock and no staff, it is likely that a court will deem this indicative of a company which is not trading. Accordingly, the absence of productive assets has been found to be an indicator of the absence of trading activity;
- in respect of the income from trade requirement, courts have found that an unsuccessful endeavour to trade can constitute trading even if no expenditure is outlaid (in certain circumstances) and no income is derived. The crux of the argument is that a company may retain its assessed loss even if its income so derived is nil, provided that there was some attempt to trade; and



- the discontinuation of a taxpayer's main business operations may not in itself be deemed to be the cessation of trading if the taxpayer undertook other activities such as the continued employment of staff to realise assets and collect trade receivables. However, where a taxpayer's only activities comprised the collection of trade receivables and it had no stock, employees, or fixed assets of any significance, it is likely that the taxpayer will not meet the "trade" requirement.

"Accordingly, taxpayers should be certain that they will satisfy the trade and income from trade requirements before relying on the provisions of section 20(1)*(a)* to carry forward an assessed loss from the previous YOA. "

Accordingly, taxpayers should be certain that they will satisfy the trade and income from trade requirements before relying on the provisions of section 20(1)*(a)* to carry forward an assessed loss from the previous YOA. An incorrect determination could result in the South African Revenue Service (SARS) disallowing the carry forward of the assessed loss resulting in significant adverse consequences for the taxpayer's business.

In addition to the requirements above, taxpayers should also be aware that SARS can still invoke section 103(2) of the Act to disallow the utilisation of an assessed loss notwithstanding compliance with the trade and income from trade requirements where SARS is of the view that:

- an agreement affecting any company has been concluded or a change of shareholding has occurred;
- the agreement or change of shareholding directly or indirectly results in the receipt or accrual of income or proceeds by that company; and
- such agreement or change of shareholding was mainly or solely entered into for the purpose of utilising any assessed loss incurred by that company in order to avoid, postpone or reduce liability for tax for any person.

Therefore, whilst it may be beneficial for taxpayers to try to utilise an assessed loss within a group of companies, taxpayers should be aware that if there is no robust commercial justification for the utilisation of the assessed loss where one of the above factors are present, then there is a real risk that SARS will invoke the provisions of section 103(2).

Similarly, robust commercial justification would also be applicable in the context of an acquisition of a company with an assessed loss. In this instance, SARS may disallow the utilisation of the assessed loss where it is of the view that the company was acquired solely or mainly for the purpose of using the assessed loss to avoid tax.

[*Editorial comment*: The views of SARS are clearly set out in Interpretation Note 33.]

Keshen Govindsamy

Cliffe Dekker Hofmeyr

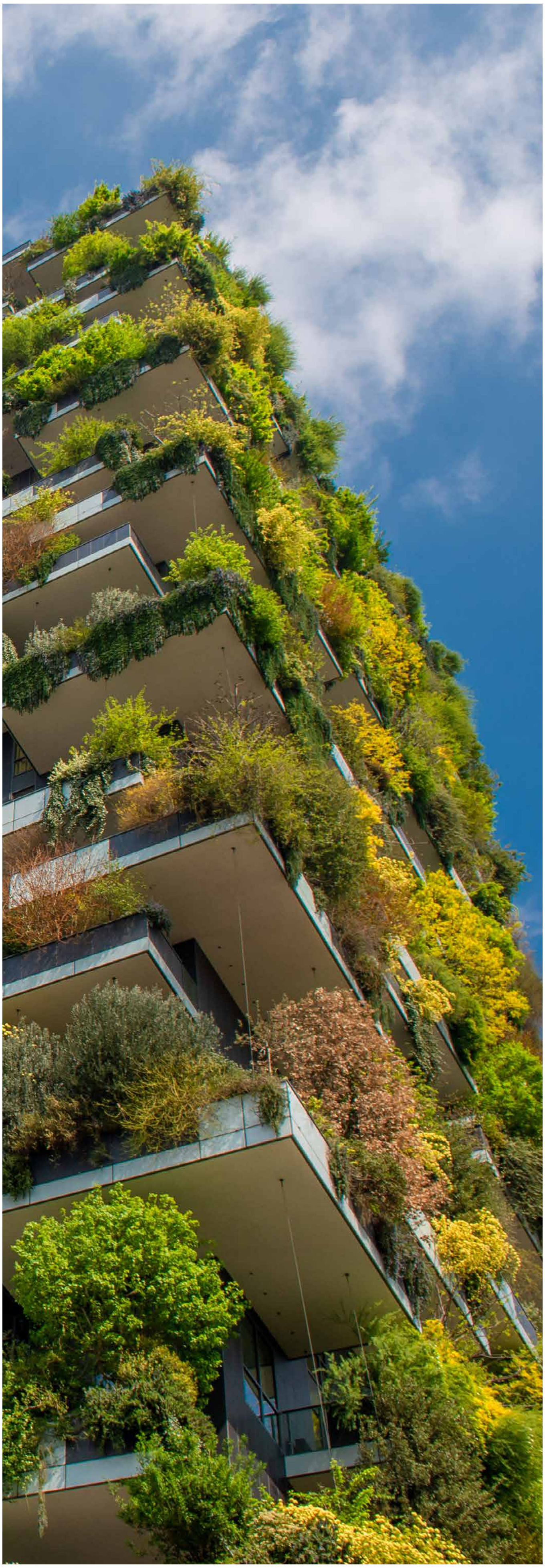
Acts and Bills

- Income Tax Act 58 of 1962: Sections 20 (more specifically subsection (1)*(a)*) and 103(2).

Other documents

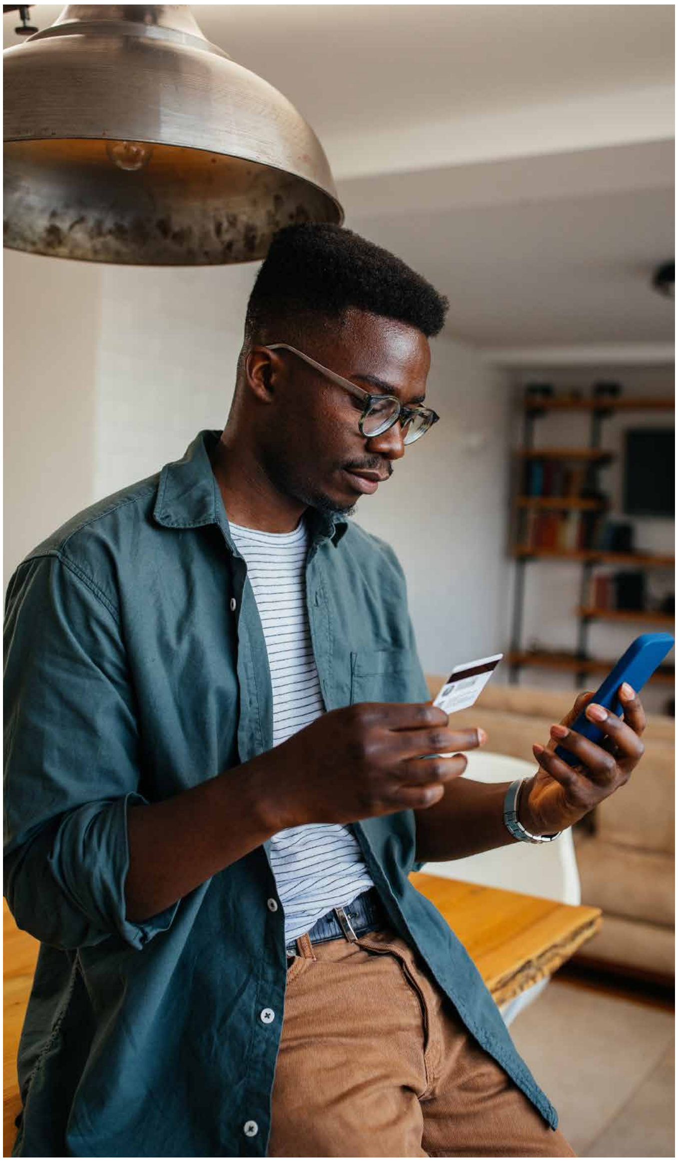
- Interpretation Note 33 (Issue 5) ("Assessed losses: Companies: The 'trade' and 'income from trade' requirements").

Tags: assessed loss; taxable income.



REMUNERATION REFUNDED

It often happens that a person receives remuneration and other similar amounts (for services rendered or to be rendered, or by virtue of employment or the holding of any office), which subsequently have to be refunded, often because of contractual obligations not having been fulfilled, or due to an overpayment which was previously subject to tax. These amounts can include, for example, paid maternity or sick leave benefits, or retention bonuses, which are often refunded by the person in a subsequent year of assessment. The amounts refunded may qualify for an income tax deduction in the hands of the person under section 11(nA) *of the Income Tax Act, 1962.*



Section 11(*n*A*)* will apply where any amount (including any voluntary award) received or accrued –

- in respect of services rendered or to be rendered, or by virtue of any employment or holding of any office;
- as was included in the taxable income of that person,

is refunded by that person.

Section 11(*n*A) permits a person to claim, as a deduction, any amount refunded by them in the year of assessment that the amount is refunded, but only if that amount was previously included in their taxable income. The amount that would have been used to determine that person's taxable income on receipt thereof would have been the gross remuneration and not the net amount received from the employer (namely, the after-tax amount). The deduction will be limited to the amount that has been refunded (be it the gross or net amount or even a partial refund) under terms laid down in the contract between, for example, the employer and the employee.

The deduction allowed under section 11(*n*A*)* is limited to amounts previously included in taxable income. If, for example, an amount of R100 000 (in the form of a sign-on bonus) was included in taxable income, but an employee is required to refund that amount and R12 000 interest charged by the employer, the amount of R12 000 will not qualify for deduction under section 11*(n*A*)*. The deduction would thus be limited to R100 000. The deduction can only be claimed in the year in which it is actually refunded. It can create or increase an assessed loss, and will not be ring-fenced.

Documentation required to prove that an amount was refunded

To claim a deduction under section 11*(n*A*)*, satisfactory proof must be provided to show that the amount was previously included in taxable income and subsequently refunded. All relevant information and documentation are required in the event that SARS conducts a compliance verification or audit. SARS will also take into consideration documentation such as bank statements and payslips when assessing whether an amount was refunded. The onus of proving that an amount was included in taxable income and then refunded lies with the claimant.

A person who wishes to claim the deduction on assessment must record the amount in the applicable field on the ITR12 (which is the annual income tax return for individuals) dealing with deductions.

T Roos

Acts and Bills

- Income Tax Act 58 of 1962: Section 11*(n*A*)*.

Other documents

- ITR12 (the annual income tax return for individuals).

Tags: voluntary award; compliance verification.

DONATIONS TO A FOREIGN TRUST

Historically, South African resident individuals have made use of trusts, both local and offshore, as part of their estate planning. In practice and in the context of a local trust, South African residents can transfer assets to such a trust in different ways.

Two of the ways in which this could potentially be done are the following:

- The resident individual could transfer the assets to the trust by selling them to the trust on loan account. In such an instance and depending on the type of assets involved, such sale could potentially be subject to various taxes, including capital gains tax, transfer duty (if the asset is immovable property) and/or securities transfer tax (if the asset is a share). Furthermore, one would have to ensure compliance with section 7C of the Income Tax Act, 1962 (the Act), which states that interest must be charged on certain loans made to trusts.

  [*Editorial comment*: Failure to charge interest could result in an annual donations tax liability.]

- Alternatively, the resident individual could transfer the assets to the trust by way of donation. In this instance and depending on the nature and value of the assets donated, the donation would be subject to donations tax, in addition to capital gains tax, transfer duty and/or securities transfer tax. However, section 7C would not need to be considered as no loan account is created.

In the context of transferring assets to a foreign trust, the South African resident would need to consider what is stated above but would also need to ensure compliance with South Africa's exchange control rules.

DONATIONS OF CERTAIN OFFSHORE ASSETS NOT EXEMPT FROM DONATIONS TAX

One should note that there are certain donations listed in section 56(1) of the Act which are exempt from donations tax. One of these exemptions is contained in section 56(1)*(g)*, which states that a donation will be exempt from donations tax if the property or the right to property donated is situated outside South Africa and was acquired by the donor –

- before the donor became a South African resident for the first time (section 56(1)*(g)*(i));
- by inheritance from a person who at the date of the person's death was not ordinarily resident in South Africa or by a donation if at the date of the donation the donor was a person (other than a company) not ordinarily resident in South Africa (section 56(1)*(g)*(ii)); or
- out of funds derived by the donor from the disposal of any property referred to in section 56(1)*(g)*(i) or (ii), if the donor disposed of such last-mentioned property and replaced it successively with other properties (all situated outside South Africa and acquired by the donor out of funds derived by him from the disposal of any of the said properties), out of funds derived by him from the disposal of, or from revenue from, any of those properties (section 56(1)*(g)*(iii)).

On 15 March 2021, SARS issued Binding Private Ruling 357 (BPR 357), which dealt with the question whether the above-mentioned exemption applied in a specific set of circumstances.

FACTS OF BPR 357

The applicant and the co-applicant are resident natural persons married to each other in community of property.

- Together with some of the applicant's siblings, who have never been residents of South Africa, the applicants entered into an agreement with a foreign seller.
- In terms of the agreement, the foreign seller would sell all of the shares of two foreign companies, each holding a number of shares in a third foreign company.
- The purchase was finalised in November 2009, with the price payable in instalments from December 2013.

- Over the years the applicants received distributions from Trust A, a foreign discretionary trust settled by the applicant. The applicants, amongst others, are beneficiaries of Trust A. The applicants used the distributions from Trust A to partially settle the applicants' share of the purchase price.

- Trust A was funded by shares donated by the applicant, which were received from the applicant's parents who have never been residents of South Africa.

- Disputes arose between some of the siblings that were related to the share transaction, and legal proceedings ensued as a result of the disputes. Following extensive negotiations, a settlement was reached between the parties that will be made an order of the relevant foreign court.

- The settlement includes what is termed a "partial liquidation" of the two foreign companies acquired in November 2009. As a result, the applicants will receive cash as well as shares in the third foreign company, with the cash being deposited into the foreign bank account(s) of the applicants.

- The applicants will dispose of the cash as well as the shares in the third foreign company to a fourth foreign company on loan account, and then donate their loan accounts to Trust B.

- Trust B is a foreign discretionary trust settled by the applicant of which the applicants and their three children are the beneficiaries.

RULING IN BPR 357

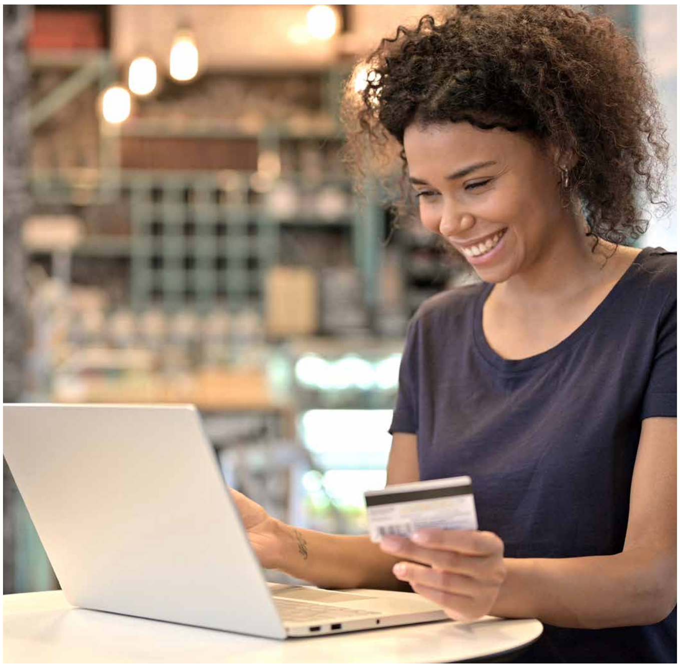
SARS ruled that the donation by the applicant and the co-applicant, jointly, to Trust B will be exempt from donations tax under section 56(1)*(g)*(iii).

COMMENT

The application of section 56(1)*(g)* has been considered by SARS on a number of occasions, including in Binding Private Ruling 157 (issued on 18 November 2013) and Binding Private Ruling 197 (issued on 1 July 2015). Whereas these two rulings dealt with the application of section 56(1)*(g)*(ii) of the Act, BPR 357 deals with section 56(1)*(g)*(iii) of the Act.

In the 2021 Budget Speech it was announced that SARS would set up a dedicated unit to improve compliance of individuals with wealth and complex financial arrangements. It is mostly high net worth individuals that make use of complex financial structures, including trust structures that may be located locally and abroad.

Considering the announcement in the 2021 Budget, taxpayers with offshore structures would be well advised to ensure that any transactions that they conclude in respect of such structures are concluded pursuant to professional advice received from their tax advisors. Where a taxpayer is uncertain of the tax consequences that may arise from a transaction related to his offshore structure, the taxpayer can apply to SARS for an advance tax ruling under chapter 7 of the Tax Administration Act, 2011. If SARS finds that the application meets all the requirements in section 79 of the Tax Administration Act and should not be rejected in terms of section 80 thereof, it will consider the merits of the application and issue a binding private ruling.



Louis Botha

Cliffe Dekker Hofmeyr

Editorial comment: Published SARS rulings are necessarily redacted summaries of the facts and circumstances. Consequently, they and articles discussing them should be treated with care and not simply relied on as they appear. Furthermore, a *binding private ruling* has a binding effect *between SARS and the applicant only*, and is published for general information. It does not constitute a practice generally prevailing. A third party may not rely upon a binding private ruling under any circumstances. In addition, published binding private rulings may not be cited in any dispute with SARS, other than a dispute involving the applicant or any co-applicant(s) identified therein.

Acts and Bills

- Income Tax Act 58 of 1962: Sections 7C and 56(1)*(g)*(i), (ii) & (iii);

- Tax Administration Act 28 of 2011: Chapter 7 (sections 75 to 90) – specifically sections 79 & 80.

Other documents

- Binding Private Ruling 357 (issued on 15 March 2021) (deals with the application of section 56(1)*(g)*(iii) of the Act);

- Binding Private Ruling 157 (issued on 18 November 2013) (deals with the application of section 56(1)*(g)*(ii) of the Act);

- Binding Private Ruling 197 (issued on 1 July 2015) (deals with the application of section 56(1)*(g)*(ii) of the Act).

Tags: securities transfer tax; donations tax; foreign discretionary trust.

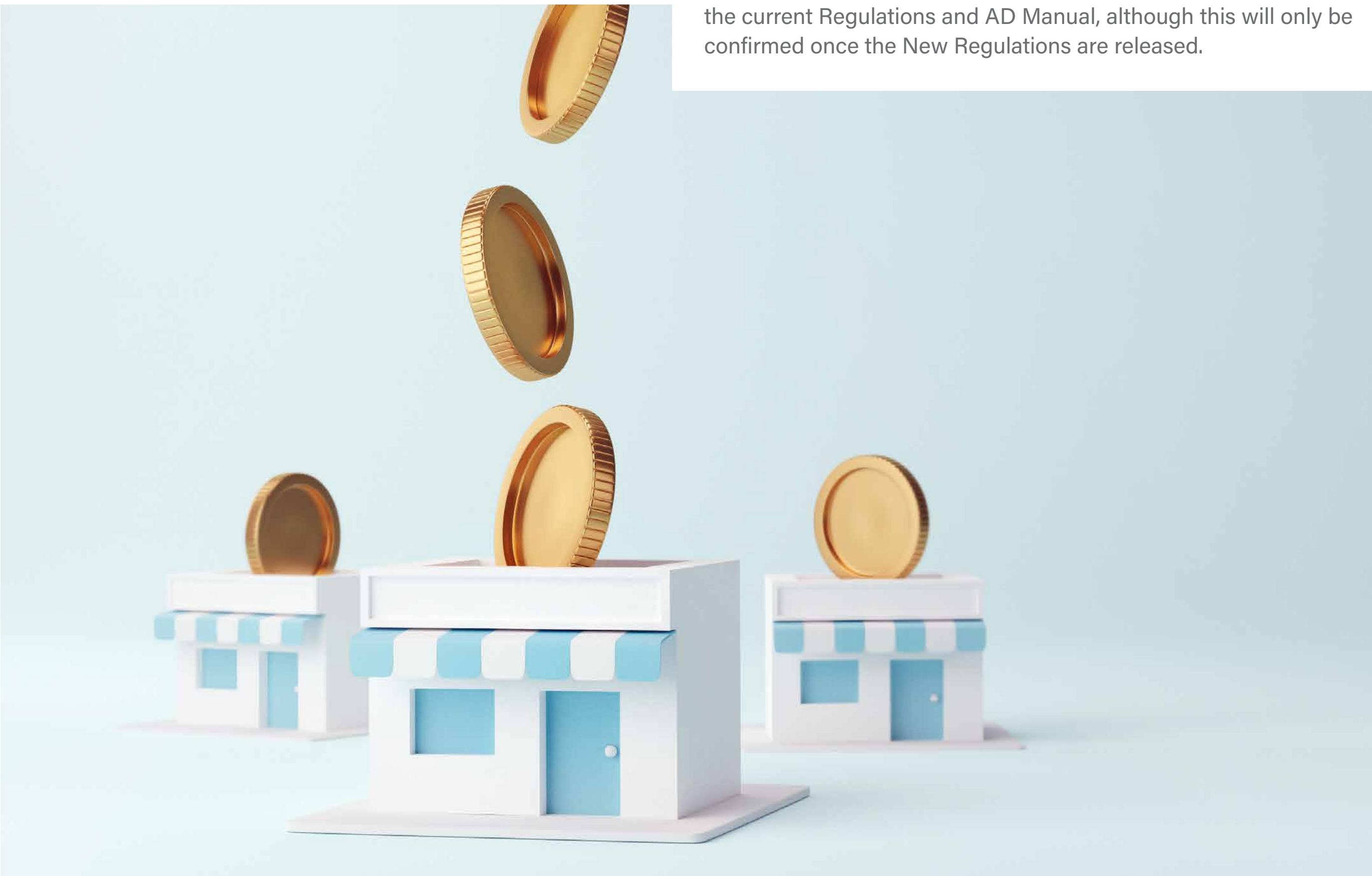
FOREIGN DIRECT INVESTMENT INTO SOUTH AFRICA

Under the regime of President Cyril Ramaphosa, one of South Africa's stated goals has been to increase foreign direct investment (FDI) into the country. According to a recent report by the United Nations Conference on Trade and Development, FDI into South Africa decreased by about 42% in 2020, in line with international trends. At the same time, however, South Africa was the top-ranked African country in the inaugural 2021/22 fDi African Tech Ecosystems of the Future *ranking; of particular interest is that South Africa received the largest number of FDI projects in the software and IT services sector of any African country.*

Where a foreign person or entity invests into South Africa by, for example, acquiring shares in a South African entity, the foreign investor would need to consider a number of commercial and legal issues. This would include the tax considerations that may be applicable to investing into and doing business in South Africa, along with any other regulatory requirements that may apply. While the tax considerations are often front of mind, a legal consideration that sometimes does not receive attention is compliance with South Africa's exchange control (Excon) rules, which also apply to FDIs received. In this article we discuss some of the Excon considerations that foreign investors should bear in mind when investing.

EXCON LEGAL FRAMEWORK

South Africa's Excon regime is governed mainly by the Exchange Control Regulations, 1961 (the Regulations), read with the Currency and Exchanges Manual for Authorised Dealers (AD Manual). The Regulations were published under the Currency and Exchanges Act, 1933, and it was announced in the Minister of Finance's 2021 Budget that the Regulations would be repealed and replaced by a capital flow management framework (the New Regulations). It is anticipated that the New Regulations may be less onerous than the current Regulations and AD Manual, although this will only be confirmed once the New Regulations are released.



The Regulations are enforced by the South African Reserve Bank (SARB), which also delegates to authorised dealers, that is, South African banks, the authority to approve certain transactions under the Regulations read with the AD Manual. Transactions that can be approved by an authorised dealer are detailed in the AD Manual; for any other transaction, SARB approval needs to be obtained.

ACQUIRING SHARES

When a foreign investor acquires shares in a South African company, it is a requirement that the shares be endorsed "non-resident". Under the Regulations, shares held by a foreign investor in a South African company are called "controlled securities". In practice, the physical endorsement will only take place in respect of shares acquired in a private company not listed on a South African exchange. The endorsement must be done by an authorised dealer (AD), that is, a South African bank. In order for the AD to endorse the shares, the AD will require that certain supporting documentation and information be provided, along with the relevant share certificates.

In practice, it may appear that the endorsement is merely a formal requirement that needs to be met. However, it has important practical implications. For example, in the event that the South African company declares dividends to its foreign shareholder, those dividends may only be paid if the shares of the foreign investor are endorsed "non-resident". If not, the investor would first have to obtain the endorsement. Furthermore, the AD may be of the view that the failure to endorse the share certificate earlier constituted a contravention of South Africa's Excon laws, which contravention would then need to be regularised before endorsement can take place.

Where a foreign investor disposes of its shares in a South African company, it is also necessary that the shares be endorsed, to avoid complications arising pursuant to the transfer of shares to the new shareholder.

FUNDING OF THE SHARE ACQUISITION

Another practical issue to consider is how the foreign investor will fund the shares to be acquired. Under South Africa's Excon laws, so-called "financial transactions", which include the purchase and sale of unlisted and listed shares, are subject to the so-called 1:1 rule. In essence, the effect of this rule is that the foreign investor may only borrow funds in the South African market to the extent that it introduces an equivalent amount. For example, if a foreign investor introduces R100 000 into South Africa, it may borrow no more than R100 000 in the South African market to fund the share purchase. The 1:1 rule also applies to South African companies where 75% or more of the voting rights in such companies are held directly or indirectly by foreign persons. Such companies are known as affected persons.

A situation may also arise where a foreign company seeks to acquire the shareholding through alternative means, for example, by offering the existing shareholders in the South African company shares in the foreign company, in exchange for their shares in the South African company. Colloquially, this may be called a share swap. Under South Africa's Excon rules, the foreign entity is required to fund the purchase in one of the following ways:

- Through the introduction of foreign currency;
- By using rand from a non-resident rand account held in its name;
- By using rand from a vostro account held in the books of the authorised dealer; and/or
- By borrowing the funds in the local market, subject to the application of the 1:1 rule discussed above.

As such, if a foreign company seeks to acquire the shares in the South African company by means of a share swap, this can only be done if prior approval is obtained from the SARB. If the share swap takes place without SARB approval, the foreign company will have to regularise the contravention, subject to the payment of an exchange control levy of up to 40%.

A FINAL THOUGHT

When making an FDI into South Africa, including through the acquisition of shares in a South African company, a foreign investor must consider all relevant regulatory requirements, including any Excon rules that may apply. While the Excon rules may appear onerous, South Africa's Excon rules also make it possible for South African companies, including companies majority-owned by foreign investors, to invest and expand their operations into Africa, through the domestic treasury management company regime.

Louis Botha

Cliffe Dekker Hofmeyr

Acts and Bills

- Currency and Exchanges Act 9 of 1933.

Other documents

- Report by the United Nations Conference on Trade and Development, FDI (Foreign Direct Investment);
- 2021/22 *fDi African Tech Ecosystems of the Future* rankings document (overview document);
- Exchange Control Regulations, 1961;
- Currency and Exchanges Manual for Authorised Dealers (AD Manual).

Tags: authorised dealers; foreign investor; foreign shareholder.

PROPERTY RENTAL INCOME

Many individuals who own residential property located in South Africa, for various reasons, consider leasing out their property and in return receive rental income from their tenants. Private property rentals are a common consideration for individuals seeking to generate income from a pastime activity to supplement their main income streams and, in some cases, can be a profitable way of doing business.

It is widely known, from a South African tax perspective, that the rental income received by or accruing to a South African property-owner letting out their property (whether short-term or long-term) located in South Africa or abroad, must be included as part of the gross income (as defined in section 1(1) of the Income Tax Act, 1962 (the Act)), of that person and is subject to income tax. This would be the case unless it can be proved that the receipt or accrual of that rental income is of a capital nature and stands to be excluded.

Therefore, this principle applies to resident taxpayers on their worldwide income, as well as non-residents specifically in relation to any residential property located in South Africa and from which rental income is derived.

On 11 March 2021, the South African Revenue Service (SARS) published a statement urging property owners whose properties are located in South Africa and who derive rental income from hosting fee-paying guests to declare the rental income which they receive, in their income tax returns (the Statement). SARS emphasised that property owners who host fee-paying guests and receive rental income have the same obligation to declare such income to SARS, just as homeowners letting out their property. Although the legal position is fairly clear, it appears that SARS may have identified the need to focus on improving taxpayer compliance in the property sector. In particular, the focus is on property owners who derive rental income from hosting fee-paying guests, that is on an ad hoc basis, rather than on property owners who enter into lease agreements for longer periods of time, retaining the same lessees in many such instances.

PRACTICAL CONSIDERATIONS AND CERTAIN ALLOWABLE EXPENDITURE

In practice, the rental income received by the property owner should be added to any other income which that person may have received or accrued. However, such person's tax liability on the rental income can be reduced by claiming a deduction in respect of certain expenses which have been incurred during the period in which that person rented out the property, provided that those expenses meet the requirements of the general deduction formula in section 11 of the Act. In this regard, private expenses or expenses of a capital nature cannot be claimed as an expense and will therefore not be allowed as a deduction.

"When considering letting out residential property, taxpayers must be cognisant of the tax obligations arising from their trading activities, as well as the tax benefits available to them in the short and long term."

The Act also permits the deduction of expenditure actually incurred in relation to the repairs of property which is occupied for trade purposes. At this stage, it will become crucial for the property owner to distinguish between repairs and maintenance costs, as well as costs pertaining to the improvement of the property. SARS generally regards a repair and maintenance cost as a cost relating to the upkeep of an asset, while improvement costs are generally regarded as those costs relating to the enhancement of an asset which are differentiated from the costs associated with ordinary upkeep. Based on guidance documents published by SARS, it appears that in the property rental context, the list of expenses that can be claimed as a deduction includes the following:

- rates and taxes;
- bond interest;
- advertisements;
- agency fees of estate agents;
- homeowner's insurance;
- garden services;
- repairs in respect of the area rented out; and
- security and property levies.

OPTIONS FOR NON-COMPLIANT TAXPAYERS

In the Statement, SARS encourages property owners who, to date, have not declared their rental income to regularise their affairs with immediate effect, which can be done in terms of SARS' voluntary disclosure programme (VDP), failing which, non-compliant taxpayers may be selected by SARS for an audit and more stringent processes will be adopted. The potential downside of an audit is also that, pursuant to its finalisation, SARS could issue additional assessments in terms of which additional tax, interest and penalties of up to 200% on the additional tax could be imposed. Under the VDP, only additional tax and interest will be imposed if the VDP application is approved. SARS has expressed their enthusiasm to provide clarity and certainty for taxpayers to enable them to meet their obligations effortlessly; however, it is not clear what measures SARS will adopt (and what the severity of such measures will be) to ensure taxpayer compliance in addition to current processes.

When considering letting out residential property, taxpayers must be cognisant of the tax obligations arising from their trading activities, as well as the tax benefits available to them in the short and long term. As it remains to be seen how SARS will ensure compliance with tax obligations in the property sector, taxpayers are encouraged in the meantime, to take active steps and seek professional advice to regularise their tax affairs and utilise the VDP availed to them to avoid the payment of penalties.

Ursula Diale-Ali

Cliffe Dekker Hofmeyr

[*Editorial comment*: See also SARS Interpretation Note 74.]

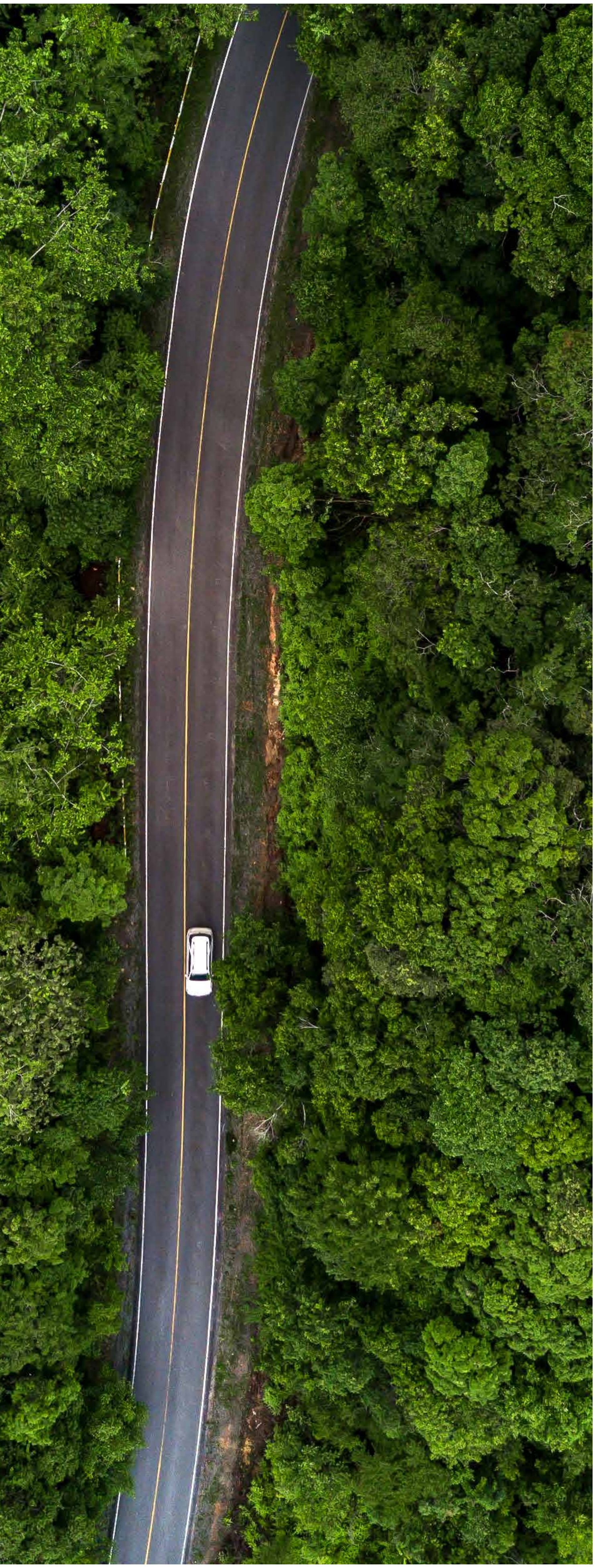
Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "gross income") & 11.

Other documents

- Statement (issued by SARS, published on 11 March 2021) urging property owners whose properties are located in South Africa and who derive rental income from hosting fee-paying guests to declare the rental income which they receive, in their income tax returns;
- SARS Interpretation Note 74 (Issue 2) ("Deduction and recoupment of expenditure incurred on repairs").

Tags: fee-paying guests; expenses of a capital nature; repairs; maintenance costs.



EXIT TAX ON CEASING TO BE A RESIDENT

For the benefit of individuals planning to emigrate from South Africa, this article outlines the complexities of the procedures introduced through new regulations. "Financial emigration" has been replaced with a stringent new verification process. And in a post-2021-Budget development, there is the looming proposal that SARS may impose a deemed withdrawal tax on your retirement fund upon cessation of SA tax residency.

INTRODUCTION OF A TAX VERIFICATION PROCESS

The concept of financial emigration from South Africa was phased out with effect from 1 March 2021 and replaced by a tax verification process. All new emigration applications from 1 March onwards must be processed by the South African Revenue Service (SARS) in terms of a new procedure which will focus on the cessation of tax residence by a South African resident. There are also new restrictions in respect of your retirement funds regarding when and how you may withdraw and externalise those funds. In this respect, a further tax proposal has been announced by the National Treasury which, if implemented, could have a negative tax impact in some cases for individuals ceasing their SA tax residence.

THE NEW VERIFICATION PROCESS ON CESSATION OF TAX RESIDENCE

This procedure will apply regardless of whether any of a person's funds are transferred abroad when that person ceases to be a South African tax resident.

When ceasing South African tax residence, a person is required to apply for an "emigration" tax compliance status (TCS) PIN on e-filing. The generated form (TCR01) requires you to disclose assets and liabilities and their market values as at date of departure.

The submission of the application will require certain supporting documents to be submitted and triggers an audit by SARS into your tax compliance. An appointed auditor from SARS will respond to the application with further queries which may involve providing further documentation. The audit will focus more in depth on the source of funds an emigrant wishes to externalise from South Africa and may in certain cases trigger a lifestyle audit.

Once you have cleared the audit, you will be provided with a TCS PIN letter setting out your tax compliance. Should you wish to take funds or assets offshore, this TCS PIN needs to be provided to an authorised dealer approved by the Financial Surveillance Department of the South African Reserve Bank (Finsurv).

"Emigrants and residents are treated identically when it comes to externalising funds or assets offshore."

TRANSFERRING FUNDS OR ASSETS OFFSHORE

Emigrants and residents are treated identically when it comes to externalising funds or assets offshore.

On cessation of tax residency, a person is allowed to transfer assets abroad, subject to obtaining a TCS PIN which verifies that they are tax compliant. Additionally, they can transfer up to R10 million (the foreign capital allowance) of funds or assets in the year that they cease to be a tax resident, again subject to obtaining the necessary TCS PIN.

For any future externalisations, a non-resident and resident will be able to remit funds up to R1 million without having to obtain a tax clearance.

The externalisation of unlisted and listed securities will be treated like cash and will form part of the foreign capital allowance.

If you want to transfer funds or assets in excess of the R10 million, as a resident or non-resident:

- you will initially be subject to a more stringent tax audit by SARS; and
- Finsurv will, after receiving your TCS PIN letter, have to approve the transfer, which involves subjecting you to a risk assessment test (with a specific focus on anti-money laundering and countering terror financing requirements as set out in the Financial Intelligence Centre Act, 2001).

  Once Finsurv has approved the request, the authorised dealer will be allowed to transfer the funds offshore.

PLAN WELL AHEAD OF EMIGRATION

When contemplating emigration, it is important to review your tax affairs to ensure compliance and that you have the correct supporting documentation before applying for the TCS PIN.

The audit which ensues on submitting the TCS PIN application can be extensive and difficult to navigate considering the various potential queries which could be raised by SARS. We advise that professional advice be sought to assist with the response to the audit queries.

RETIREMENT FUNDS UNDER THE NEW DISPENSATION

From 1 March 2021 onwards, non-SA tax residents will be able to access any lump sum benefits on withdrawal from their retirement funds provided they can prove to the retirement fund that they have been non-resident for tax purposes for an uninterrupted period of three years. This change does not apply in respect of emigration applications filed under the previous exchange control regime on or before 28 February 2021.

The bombshell released by the National Treasury in the Budget Review 2021 is their proposal to impose a deemed withdrawal tax on retirement funds on cessation of tax residence. Currently, retirement funds are not subject to the section 9H exit charge applicable on cessation of tax residence due to the fact that these funds would be taxed in SA on the eventual lump sum withdrawal.

The proposal's objective is to address a potential benefit which an emigrant could obtain on withdrawing from their retirement funds in terms of an applicable double tax agreement (DTA). Certain DTAs, such as the SA/UK one, grant sole taxing rights to the UK on the SA pensions and annuities of an emigrant. Therefore, SARS would not be able to tax the withdrawal should such a provision apply, resulting in a loss to the fiscus.

The proposal provides for a deemed withdrawal from a retirement fund on the day before a person ceases to be a South African tax resident. This deemed withdrawal will result in a deemed retirement withdrawal tax.

If the funds are left in a South African retirement fund until retirement or death, there is an option to defer the deemed withdrawal tax (including associated interest) until payments are received from the fund. On the eventual withdrawal, the tax charge will be calculated based on the prevailing lump sum tables with a tax credit being provided for the deemed retirement withdrawal tax as calculated on the date of cessation of South African tax residency. The wording of the proposal is unclear and no definitive date for implementation of the proposal is provided. Clarity and advice on the proposal can only be provided once the Draft Taxation Laws Amendment Bill, 2021, is released.

In the meantime, the possibility of this proposed change should be kept in mind and anyone looking to relocate should be mindful of this proposal and should seek tax advice as soon as more clarity is provided.

Jaco van Zyl, Adelle du Plessis and Anje van Wyk

Maitland Group

Acts and Bills

- Income Tax Act 58 of 1962: Section 9H;
- Draft Taxation Laws Amendment Bill, 2021;
- Financial Intelligence Centre Act 38 of 2001.

Other documents

- Double tax agreement (DTA) between South Africa and the United Kingdom (effective from 1 January 2003 (SA) and 1 and 6 April 2003 (UK));
- Form TCR01 (to be filled in when one ceases to be a South African tax resident and applies for "emigration" tax compliance status (TCS); assets and liabilities and their market value as at date of departure have to be disclosed);
- TCS PIN letter.

Tags: tax residence; authorised dealer; deemed retirement withdrawal tax.

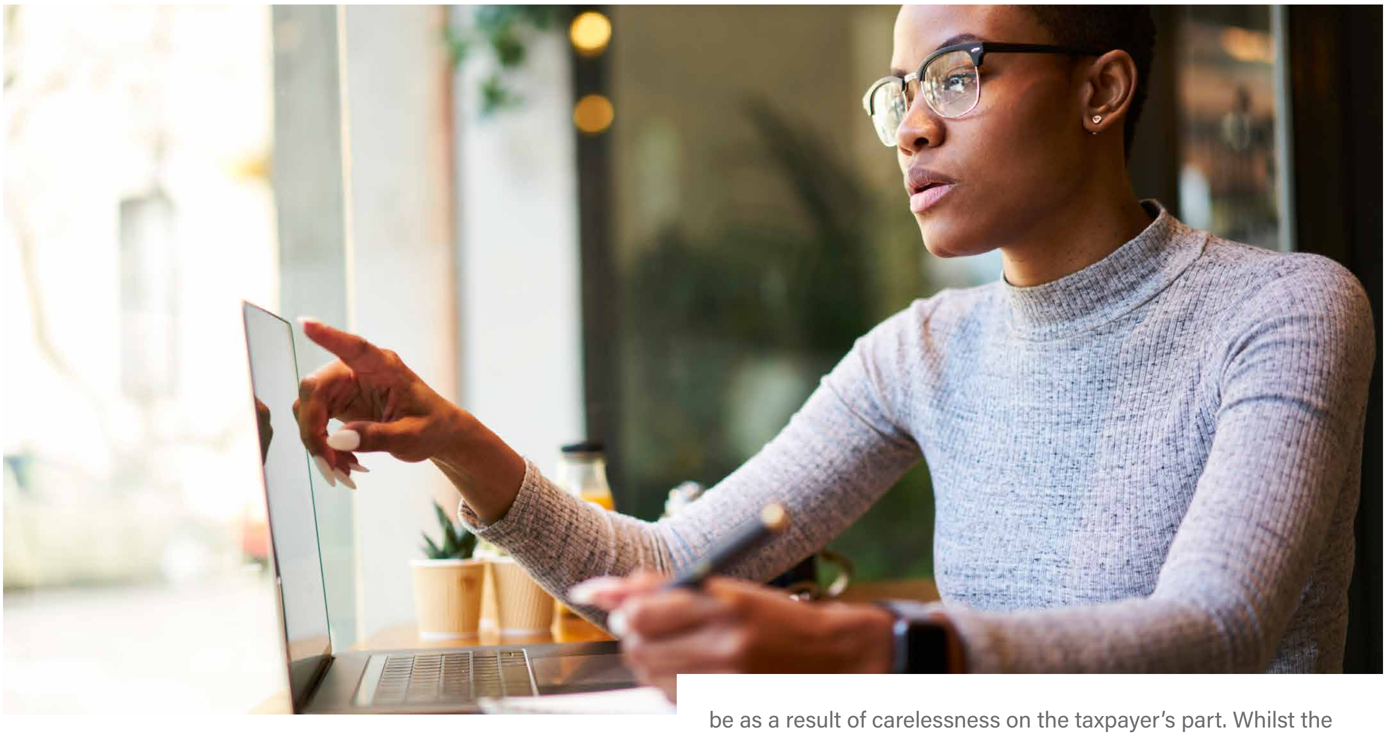
CRIMINAL NON-COMPLIANCE

With the legislature rapidly clamping down on taxpayers through the South African Revenue Service (SARS) and the National Prosecuting Authority (the NPA), it is not surprising that new regulations would be imposed to mitigate tax non-compliance. But amidst all the strategic "re-structuring", taxpayers may inadvertently be exposed to a concerning amendment to taxation legislation – the feared new section 234 of the Tax Administration Act, 2011 (section 234).

According to section 234, non-compliant taxpayers may be subject to criminal sanctions. In this regard, the list of criminal offences is set out extensively in section 234 and upon being found guilty, taxpayers face prosecution, conviction, and subsequent imprisonment (of up to two years) or a fine. Owing to the range of criminal offences envisaged in section 234, there is little to no leeway for taxpayers, even in the instance of unintentional non-compliance.

In this regard, both wilful and negligent conduct may result in taxpayers being found guilty of an offence and held criminally liable. This means that whether taxpayers intend to commit the listed offences or not, is irrelevant. Examples of serious offences which may result in criminal liability under section 234 include the wilful submission of false certificates or statements, the wilful issuing of erroneous, incomplete or false documentation and the wilful obstruction of a SARS official in the discharge of their duties. Examples of wilful criminal conduct as listed above are serious offences which may cause prejudice to SARS or the *fiscus*.

"What is concerning is not the fact that SARS and the NPA intend to mitigate tax non-compliance through section 234, but the fact that in doing so, the scope of criminal offences has widened so far that inadvertent human error coupled with the levels of severity of the listed offences have seemingly not been taken into consideration in conjunction with the potential result of criminal prosecution. "



On the other hand, examples of less severe conduct that may result in criminal prosecution include, *inter alia*: the failure of taxpayers to register or notify SARS of a change in their registered particulars (as required when registering for tax), the failure of taxpayers to appoint a representative taxpayer or notify SARS of such appointment or change of that representative and the failure of taxpayers to submit returns to SARS or furnish any information which SARS requires. In a practical sense, the success of the criminal sanctions to be potentially imposed on taxpayers as a result of the offences listed above will largely depend on how section 234 is applied by SARS in light of the administrative realities pertaining to the taxpayer's tax affairs. Since the particular circumstances of the taxpayer's position in relation to the offence or the severity of the offence are not to be considered (by virtue of the fact that both wilful and negligent conduct are punishable), the question arises as to how section 234 will be administered.

What is concerning is not the fact that SARS and the NPA intend to mitigate tax non-compliance through section 234, but the fact that in doing so, the scope of criminal offences has widened so far that inadvertent human error coupled with the levels of severity of the listed offences have seemingly not been taken into consideration in conjunction with the potential result of criminal prosecution. Colloquially, it can be said that *the punishment does not fit the crime* in terms of retributive justice and in consideration of tax administration.

It is widely accepted that when dealing with tax administration, many taxpayers make errors which are not deliberate, or fail to comply with certain requirements as a result of a mere oversight. Through section 234, the scope of criminal prosecution has been broadened to include conduct which is not only wilful but may be as a result of carelessness on the taxpayer's part. Whilst the maladministration of a taxpayer's tax affairs due to carelessness is not to be taken lightly and is indicative of conduct which may cause a certain level of prejudice or be an inconvenience to SARS or the *fiscus*, imposing criminal sanctions in this regard is not retributive and will have far-reaching consequences for taxpayers who find themselves exposed to criminal prosecution.

However, irrespective of the sentiment of taxpayers towards section 234, the fact remains that they ought to be wary of the provisions which set out conduct that may be subject to criminal prosecution. In this regard, we strongly recommend that taxpayers take heed of the list of offences which are punishable and conduct their tax affairs in a diligent and disciplined manner so as to avoid attention by SARS and potential prosecution. Whilst the parameters of tax non-compliance have become a point of contention, taxpayers must take cognisance of the realities of tax administration and rather than potentially unintentionally subjecting themselves to criminal prosecution, take purposeful and careful steps to order their tax affairs and seek the guidance of skilled practitioners where necessary.

Pratista Singh

Shepstone & Wylie

Acts and Bills

- Tax Administration Act 28 of 2011: Section 234.

Tags: negligent conduct; wilful criminal conduct.

DISCLOSURE AND VDP

Automatic exchange of information between various revenue authorities worldwide is now a reality. As a result, the South African Revenue Service (SARS) is able to obtain financial information on any South African tax resident from various countries. This allows SARS to verify whether taxpayers have accurately reported their taxable income. Based on these information-gathering abilities, SARS has started to notify taxpayers that it intends to review their tax affairs, specifically in relation to taxpayers' offshore holdings.

In the 2021 Budget Speech, the Minister of Finance, Tito Mboweni, announced that the National Treasury and SARS intend to tackle tax avoidance more vigorously. The additional R3 billion that has been allocated to SARS – to aid in both the identification of non-compliance and increased collections – suggests that the Minister is willing to walk the talk.

SARS has been very vocal on its intended focus, too. Corporates, mining companies, high net worth individuals, complex tax structures, and transfer pricing are all in the firing line. SARS' enforcement and collection drive will be made possible by expanding its specialised audit and investigative skills, and modernising its IT infrastructure.

The introduction of the automatic exchange of information model, together with the bolstering of SARS' capacity, may be particularly problematic for taxpayers with undisclosed foreign assets. It is of course so that South African taxpayers are taxed on their worldwide income. A failure to pay income tax on worldwide income may attract understatement penalties of up to 200%. Perhaps more pressing than this, is that it may lead to a criminal investigation.

THE VOLUNTARY DISCLOSURE PROGRAMME

Certain taxpayers who have not complied with their legal obligations may make a voluntary disclosure to SARS in terms of the voluntary disclosure programme (VDP), as provided for in Part B of Chapter 16 of the Tax Administration Act, 2011.

Under a successful VDP application, all administrative non-compliance and understatement penalties that would otherwise have been imposed will be waived (unless gross negligence or intentional tax evasion is involved). Criminal prosecution for a tax offence may also be avoided. However, the taxpayer would still be liable to pay the tax and the interest thereon.

In order to qualify for such relief, the VDP application must:

- be voluntary;
- involve a default that has not occurred within five years of the disclosure of a similar default by the applicant;
- be full and complete in all material respects;
- involve the potential imposition of an understatement penalty in respect of the default;
- not result in a refund due by SARS; and
- be made in the prescribed form and manner.

THE *PURVEYORS* JUDGMENT: A POSSIBLE HURDLE

The requirements for a valid VDP application appear misleadingly straightforward. A recent example is the case of *Purveyors South Africa Mine Services (Pty) Ltd v The Commissioner for the South African Revenue Service*, [2020]. In that case, the court dealt with the meaning of the "voluntary" and "disclosure" requirements of a VDP. The facts were that the applicant had approached SARS to obtain a view on its tax liability. SARS informally advised the applicant that it was indeed liable and that, as a consequence for not paying this tax, certain penalties may be imposed. Consequently, the applicant made a VDP application to SARS. SARS, however, declined to grant relief on the basis that the application was neither "voluntary", nor constituted "disclosure", and thus failed to comply with the requirements for a VDP.

The term "voluntary" is not defined in the VDP provisions. In the *Purveyors* case, Fabricius J held that "a disclosure is not made [voluntarily] where an application has been made after the taxpayer has been warned that it would be liable for penalties and interest owing from its mentioned default." The judge went on to explain that, because the applicant had submitted its application in fear of being penalised, there was an element of compulsion. On that basis, the application could not have been made voluntarily.

In the same case, Fabricius J opined that when the applicant made the VDP application, SARS already knew of the default because it had previously informed SARS when clarifying its liability. As such, the court ruled that "there can be no disclosure to a person if the other already has knowledge thereof."

In recent interviews with the Commissioner for SARS, Edward Kieswetter, and retired Judge Dennis Davis, taxpayers were encouraged to make use of the VDP. However, in light of the *Purveyors* case, certain VDPs may not be "voluntary".

In addition, it may be the position that, should SARS reject the taxpayer's VDP application, the taxpayer is not in a position to rectify the application and resubmit it. This is because SARS would already be aware of the default; it would no longer constitute "disclosure" according to the *Purveyors* case.

The Supreme Court of Appeal has granted the taxpayer special leave to appeal the judgment in the *Purveyors* case.

ADDITIONAL ISSUES WITH A VDP APPLICATION

There are also other issues that plague the VDP process. For example, it takes a significant amount of time for a VDP application to be finalised. There is also a lack of clear guidance on the interpretation of the VDP requirements. As a result, failing to navigate through the requirements successfully will lead to a rejection of the VDP application and, as noted above, the taxpayer would arguably not be able to correct the application and resubmit it (unless the appeal of the judgment in the *Purveyors* case is successful).

THINK YOU MAY HAVE SOMETHING TO DISCLOSE?

While the VDP application procedure may look deceptively simple, it is evidently a complex, yet critical process for taxpayers with undisclosed assets, income and other tax defaults. We recommend that any taxpayer who may think it has anything to disclose to SARS should first consult with an experienced tax advisor to confirm whether there is in fact a default and, if so, advise on the remedies available to make the necessary disclosures and rectify the default.

Kristel van Rensburg and Simon Weber

ENSafrica

Acts and Bills

- Tax Administration Act 28 of 2011: Chapter 16: Part B (sections 225 to 233).

Cases

- *Purveyors South Africa Mine Services (Pty) Ltd v The Commissioner for the South African Revenue Service* [2020] ZAGPPHC 409; 2020 JDR 1830 (GP).

Tags: automatic exchange of information model; voluntary disclosure programme; understatement penalties.

EXPATRIATES

In 2021, the world is an entirely different place to live in as compared to the past, and many South African expatriates face more uncertainty than ever before due to the Covid-19 pandemic. Unfortunately, coinciding with the significant mobility and financial security concerns felt by expatriates was the commencement of the R1,25 million limitation on the exemption provided to tax resident employees on their foreign employment income from 1 March 2020 onwards.

One thing, however, is evident – SARS is already looking at expatriate tax compliance specifically as a key aspect of tax collection and compliance enforcement. This has led to much introspection for taxpayers, with many now considering whether they are seen as South African tax residents, whether they have been compliant in their affairs and whether the tax position they are taking is correct.

This is an especially relevant concern for expatriates abroad who –

- intend returning to South Africa at some point within the foreseeable future;
- do not intend to return to South Africa but cannot objectively prove this; or
- are completely uncertain as to whether they will return.

In practice, the pitfalls seen most often from an expat tax perspective have to do with taxpayers who have been incorrectly relying on the application of a DTA, the foreign employment income exemption (limited to R1,25 million), or taxpayers who are simply not disclosing their foreign income in their returns to SARS. These issues are alarmingly prevalent and pose a prominent non-compliance risk.

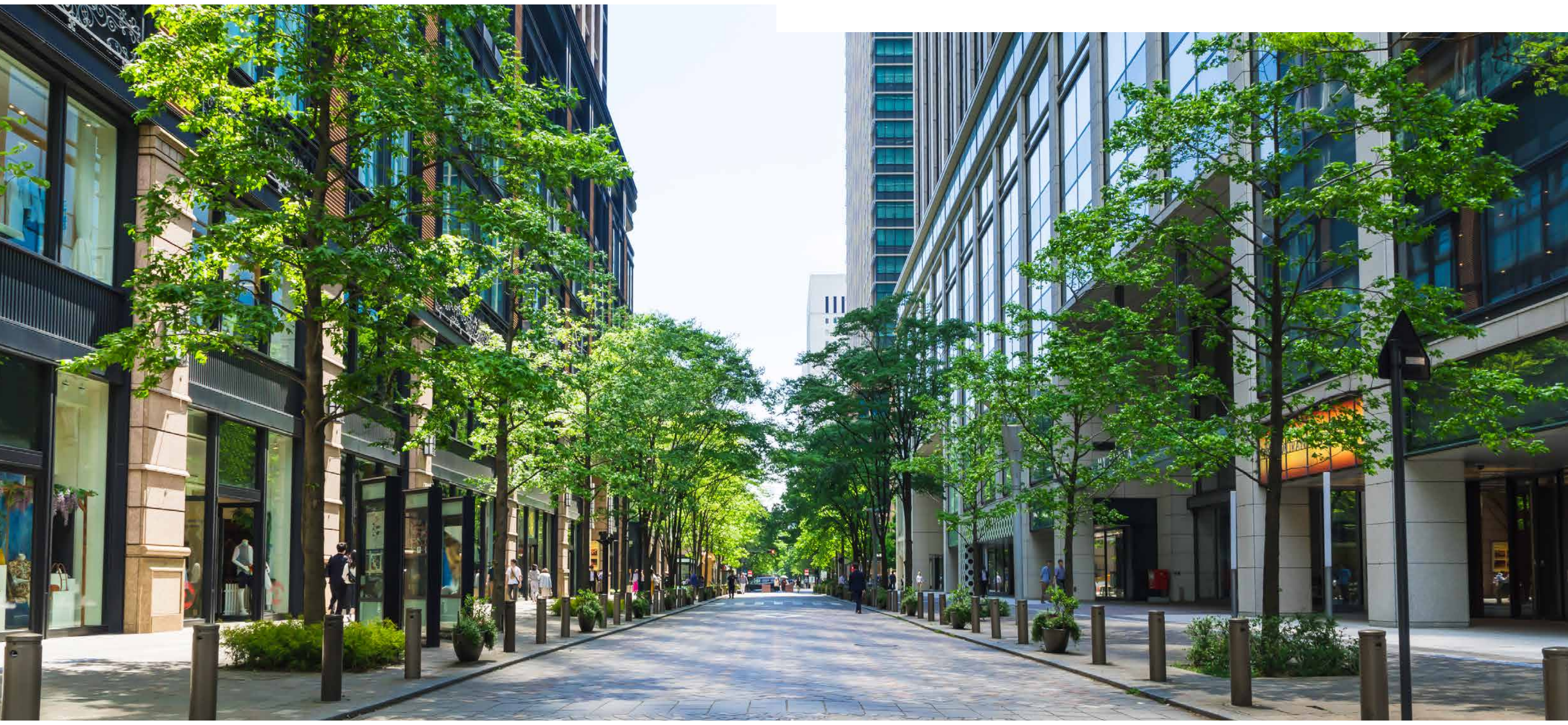
"In 2018, the Constitutional Court stated, with reference to a taxpayer's reliance on SARS' unilateral interpretation of South Africa's tax laws, that doing so 'is best avoided'."

EASY ANSWERS, WITH A PINCH OF SALT

With so much uncertainty around, many taxpayers have been heading to SARS for clarity on where they stand. For example, a common question asked is whether a taxpayer would be considered a resident or non-resident for tax purposes, and how this will affect their filing position.

Something that must be made abundantly clear, however, is that this is generally best avoided. It is also a legitimate cause for concern, given that the answers provided to these taxpayers have ranged from the absurd to downright reckless.

In 2018, the Constitutional Court stated, with reference to a taxpayer's reliance on SARS' unilateral interpretation of South Africa's tax laws, that doing so "is best avoided". This is the case for many reasons, not the least of which being that the role of SARS is to collect tax revenue, not to help taxpayers avoid tax liability.

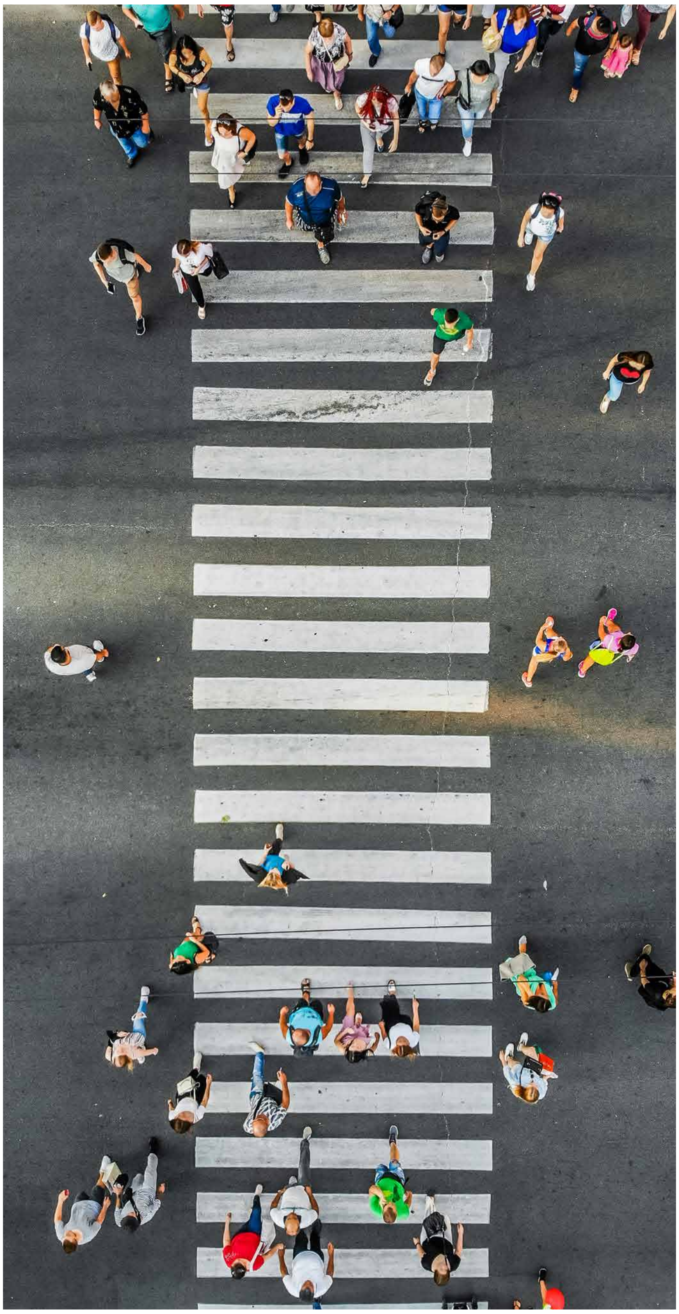


BEWARE OF PIE-IN-THE-SKY ADVICE

Aside from SARS, another avenue available to taxpayers is to seek advice from a tax practitioner. This is without a doubt the most appropriate route to follow to get the answers you seek regarding remaining (or becoming) compliant with your tax affairs.

However, one should be wary of one-size-fits-all approaches or off-the-cuff advice that is usually too good to be true. The simple fact of the matter is that not every player on the field will have their eye on the ball with regard to expatriate tax compliance or SARS' practices in this regard.

The truth is that the determination of one's tax residency is an exhaustive, fact-driven process that involves the consideration of various factors in relation to the taxpayer concerned, including whether this should be determined solely with reference to South Africa's domestic tax laws or by applying the provisions of a DTA. In most cases, this is simply not correctly done.



"For taxpayers with a foreseen tax liability in South Africa on their foreign income, now is the time (if not already passed due) to ensure that they take the requisite steps to remain tax compliant."

This means that, in the first instance, one should take professional advice to ensure that the advice provided is drawn from a proper interpretation of the laws concerned. An incorrect interpretation of the law can lead to very damaging consequences for a taxpayer, especially where it concerns one's tax residency or claiming tax relief in terms of a DTA.

PINPOINTING YOUR POSITION

Filing season for the year of assessment ending February 2021 has arrived. During this time, all South Africans who are required to file returns are subject to a new and improved SARS. This includes South African expatriates who, whether they know it yet or not, will be a particular focus on SARS' radar with regard to the disclosure of their foreign income.

Small details, such as whether one is an employee or an independent contractor, may completely erode one's eligibility for exemption – in such a case, a DTA or formalisation of the termination of their tax residency in South Africa would be a "must" from a tax mitigation perspective. The alternative to this is a potential shock for the taxpayer when an assessment is raised and SARS comes knocking.

There is no legitimate way out of it – foreign income earned by a South African resident expatriate is taxable in South Africa, and leaving these amounts off one's return is simply not correct – in fact, this is a prime example of non-compliance that (when found by SARS) may very well open a proverbial Pandora's box for the taxpayer concerned.

NOSEDIVE INTO OBLIVION

For taxpayers with a foreseen tax liability in South Africa on their foreign income, now is the time (if not already passed due) to ensure that they take the requisite steps to remain tax compliant. Taking action now, ahead of the relevant return, is not just highly recommended but most often absolutely necessary where action is needed to mitigate South African tax liability.

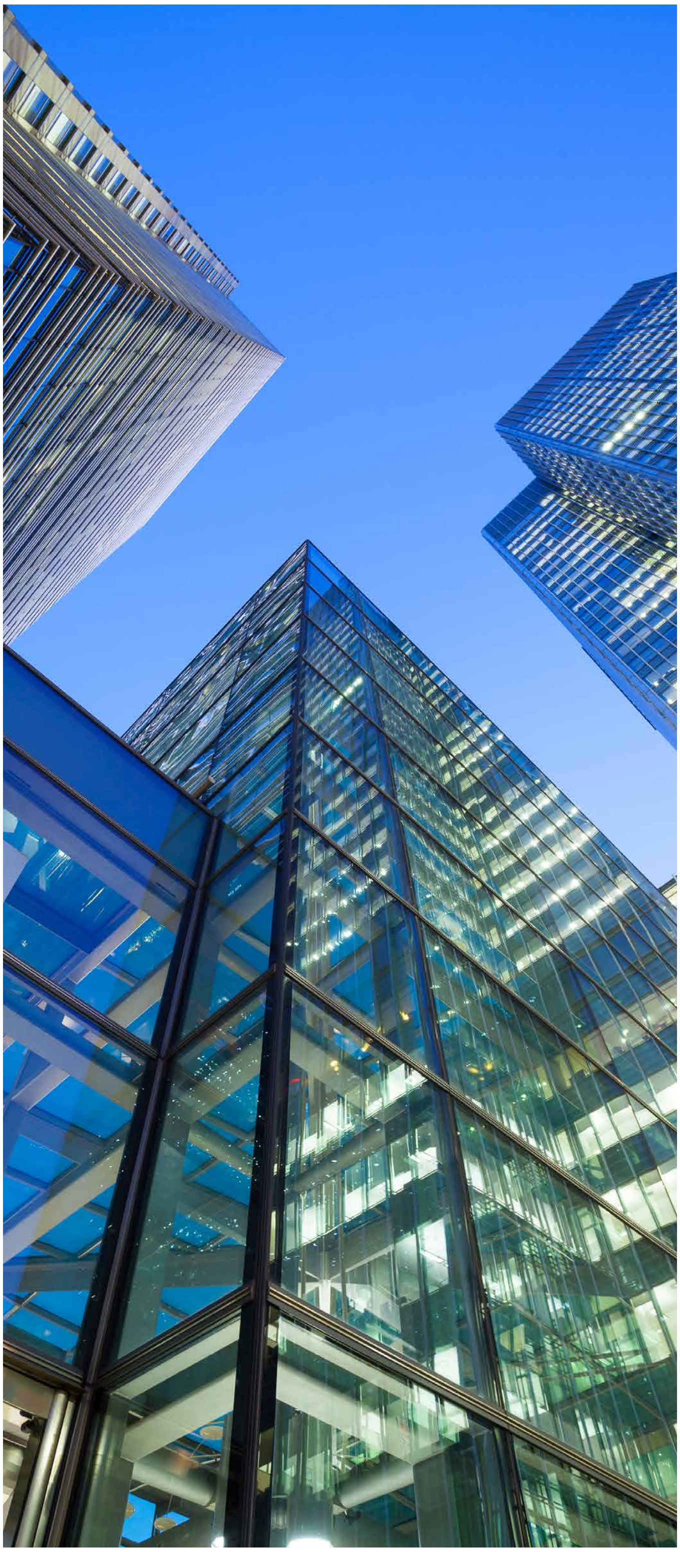
Expatriate tax continues to be one of the more contentious issues in recent memory and it is clear that SARS and National Treasury are not letting up. What this means is that South Africans need to make sure that they have the correct advisor to assist them in their circumstances, and take the correct tax position based on a proper interpretation of the law.

Thomas Lobban

Tax Consulting SA

Tags: expatriate tax compliance; domestic tax laws; tax residency

UNDERSTATEMENT PENALTIES WHEN IN A LOSS POSITION



INTRODUCTION

Taxpayers who find themselves in a loss-making position often intuitively assume that as long as they are not liable to pay tax due to the fact that they have an assessed loss, they would not be exposed to understatement penalties (USPs).

This is not the case if one considers the detail of the provisions of the Tax Administration Act, 2011 (the TAA), that deal with USPs. These provisions were the subject of a tax court case heard in the Gauteng Tax Court in November 2020 (Case No 24674). This article briefly considers the relevant provisions of the TAA that underpin USPs. This is followed by an analysis of the views expressed in the tax court in the context of the imposition of USPs where a taxpayer is in an assessed loss position.

THE LAW

SARS must impose a USP in the event of an understatement by a taxpayer, except if it results from a *bona fide* inadvertent error. An understatement is defined as any prejudice to SARS or the fiscus as a result of, amongst others, failure to submit a return or an omission from or incorrect statement in a return.

The USP is calculated as the highest percentage from the understatement penalty percentage table in section 223(1) of the TAA multiplied by the shortfall. In the case of a taxpayer who finds itself in an assessed loss position, the shortfall is calculated as the difference between the amount of an assessed loss properly carried forward from the tax period to a succeeding tax period and the amount that would have been carried forward if the understatement were accepted, multiplied by the maximum tax rate that would have applied ignoring the assessed loss.

CASE NO 24674

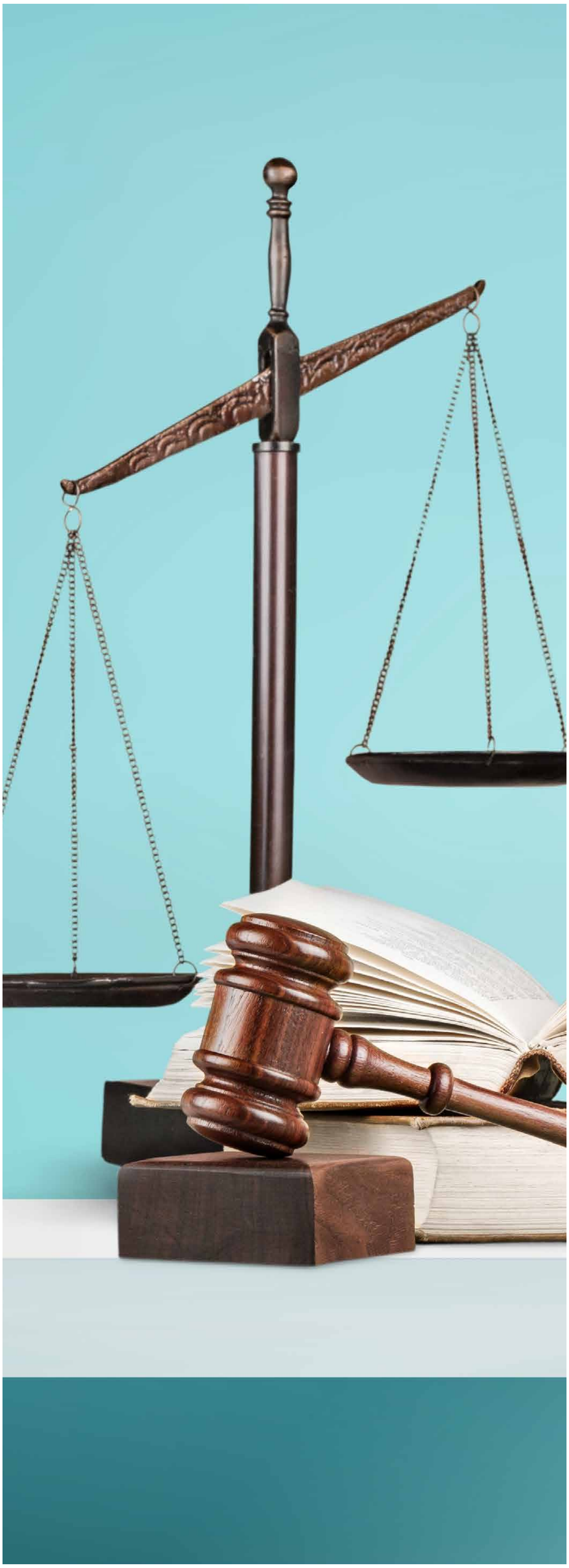
Background to the dispute

The taxpayer claimed less wear-and-tear (W&T) allowances than it was entitled to in years of assessment prior to 2016. When it became aware of this fact, it claimed the W&T allowances that it failed to deduct in prior years as "catch-up" in the 2016 year of assessment. SARS disallowed this deduction on the basis that tax is an annual event and the taxpayer accepted this. The taxpayer disputed the USP that SARS imposed at a rate of 50%.

Judgment and analysis

The judgment deals with a number of arguments raised by the taxpayer that are not dealt with in this article. The argument raised that is relevant to the focus of this article is that no USP can be levied unless there is prejudice to SARS or the *fiscus*. There

"A peculiar aspect of this case is that, unlike the case of a taxpayer who deducted an amount that should never have been deducted, this taxpayer did not deduct more W&T allowances than it is entitled to on a cumulative basis (although on a year-by-year basis, it claimed the W&T allowances in the incorrect periods)."



would be harm to SARS if it were out of pocket. It appears from paragraphs 16 and 17 of the judgment as if it was contended that SARS was not out of pocket and that there was no loss to the fiscus, since the taxpayer was in an assessed loss position, and remained so after the adjustment by SARS.

Counsel for SARS argued that prejudice does not only refer to actual prejudice, but also includes prospective or potential prejudice. It based this on *Wavelengths Construction CC v The Commissioner for the South African Revenue Service*, [2020] (Case No 24622), where the court stated that "[a]ny prejudice is, in our view, wide enough to include the existence of a realisable that the mistake will hamper the ability of the Respondent to effectively and efficiently administer the provisions of the tax legislation and to perform in terms thereof by assessing and collecting taxes which are due". Mabuse J agreed that the prejudice requirement was met in this case.

A peculiar aspect of this case is that, unlike the case of a taxpayer who deducted an amount that should never have been deducted, this taxpayer did not deduct more W&T allowances than it is entitled to on a cumulative basis (although on a year-by-year basis, it claimed the W&T allowances in the incorrect periods). There could possibly have been an argument that, since the balance of the assessed loss carried forward reflected the correct cumulative amount of W&T allowances, SARS suffered no prejudice. It is not clear whether counsel for the taxpayer pursued this argument.

Pieter van der Zwan

Acts and Bills

- Tax Administration Act 28 of 2011: Section 223(1).

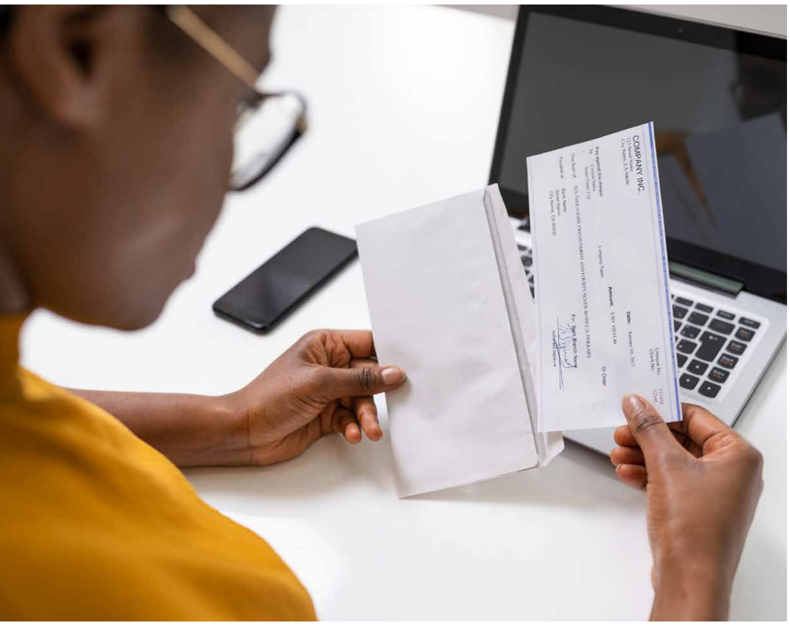
Cases

- *CBA (Pty) Ltd v Commissioner for the South African Revenue Service* (Case No 24674) [2020] ZATC 21 (25 November 2020);

- *Wavelengths Construction CC v The Commissioner for the South African Revenue Service* [2021] (Case No 24622).

Tags: assessed loss; wear-and-tear (W&T) allowances.

UNDISCLOSED FOREIGN INCOME



SARS SHINES THE TORCH ON WEALTHY INDIVIDUALS

One of the biggest highlights of the 2021 budget speech revealed SARS' latest ammunition. Following the recommendations made by the Davis Tax Committee, SARS established the High Wealth Individual Taxpayer Segment (HWI), a specialised unit with an allocated budget of R3 billion, to investigate and conduct specialised audits on high net worth individuals (HNWI), which may then lead to lifestyle audits and a review of social media accounts.

Finance Minister Tito Mboweni announced that the first group of HNWI taxpayers has been identified, and they would have received SARS correspondence from April 2021, informing them that the HWI unit will be handling their tax affairs.

OFFSHORE HOLDINGS IN THE SPOTLIGHT

The HWI unit focuses particularly on foreign income and assets held and complex arrangements. SARS Commissioner, Edward Kieswetter, mentioned in a statement that "SARS is aware of the increasing number of South Africans who have financial assets offshore, they have more than R400 billion rand in offshore accounts. We've identified around 10% of that, but we believe there's still a lot to be explained". He added that "in certain cases, a civil investigation into an individual who is not declaring an income, turns into a criminal investigation as the person's illicit dealings become clear."

As an early adopter of the international standard for the Automatic Exchange of Financial Account Information, SARS has at its disposal information relating to offshore account holdings of South African taxpayers, some of which seem not to have been declared. SARS is clamping down on tax avoidance and has made it clear that they are aware of certain individuals and businesses that are "dodging tax" due to undeclared offshore financial arrangements and undeclared offshore holdings.

TAX ADVISORS LEFT IN THE DARK

The problem with taxpayers' attempts at "dodging tax" often lies in their non-disclosures to their tax advisors. Taxpayers are failing to disclose their offshore financial arrangements and offshore holdings for fear of the possible tax implications. Tax advisors are handed selective information by their clients, preventing them from adequately assisting with their clients' tax non-compliance.

It is imperative to understand that taxpayers are obligated to disclose their offshore holdings to their tax advisors, and that there truly is no place to hide if your affairs are now handled by the HWI unit.

Following the announcement of the HWI unit's enforcement, we are seeing taxpayers coming out of the shadows, desperately trying to rectify their past non-compliance. Coming forward only after SARS has sent you a letter is risky, but there are still several avenues at the taxpayer's disposal which will allow them to regularise their tax affairs and keep their penalties and interests to a minimum. These avenues are best navigated by acting swiftly with the careful guidance of their tax advisors.

NOWHERE LEFT TO HIDE

The HWI unit will obtain taxpayers' information by means of the Common Reporting Standards (CRS), whereby financial institutions and tax authorities across the globe share financial information which will assist SARS in identifying any non-compliance or non-disclosures by taxpayers. This information will be compared to that which HNWI submitted to SARS; any discrepancies may lead to criminal prosecution under section 234 of the Tax Administration Act, 2011, as amended by section 35 of the Tax Administration Laws Amendment Act, 2020.

HNWI who were not informed in April must keep in mind that the moment this is flagged at SARS, their affairs will be handled by the HWI unit and which may indeed come with an audit in tow. Make sure that your affairs are in order, so when SARS hits the lights, you are not caught red-handed.

Roxanna Naidoo

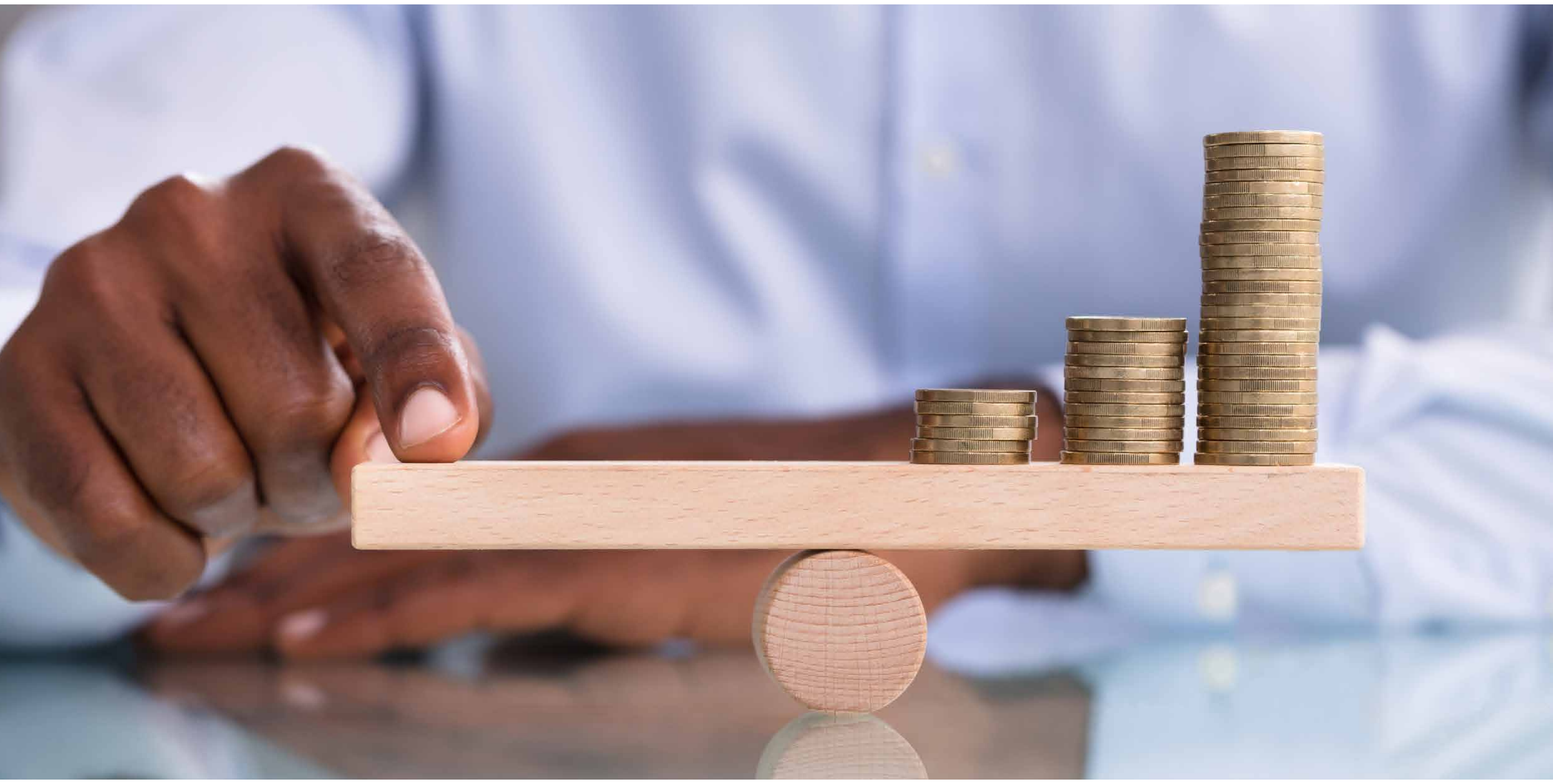
Tax Consulting SA

Acts and Bills

- Tax Administration Act 28 of 2011: Section 234;
- Tax Administration Laws Amendment Act 24 of 2020: Section 35.

Tags: High Wealth Individual Taxpayer Segment (HWI); high net worth individuals (HNWI); offshore financial arrangements.

SOUTH AFRICA'S LATEST TRANSFER PRICING CASE



On 6 January 2021, the tax court delivered judgment in the case referred to as ABC (Pty) Ltd v The Commissioner for the South African Revenue Service IT 14305*. The court, which ruled in favour of SARS, considered a number of important transfer pricing principles. The case, and some of the key findings, are briefly summarised below.*

The court considered, *inter alia*, whether SARS is permitted to adjust the profits of a taxpayer where a related-party transaction did not comply with the arm's length principle. The taxpayer contended that SARS is only allowed to adjust the consideration in respect of transactions with related parties and not its overall business profits resulting from sales to third parties.

The taxpayer's argument was based on the wording of section 31(2), prior to the substitution of section 31 by section 57(1) of the Taxation Laws Amendment Act. 2011, with effect from 1 April 2012. The section previously provided that the Commissioner for SARS may "adjust the consideration in respect of the transaction to reflect an arm's length price for the goods or services".

The applicant in the case is an SA company that produces and sells catalysts to third parties. To produce the catalysts, the applicant purchases metals from a cross-border related party in Switzerland (the Swiss Entity). SARS carried out an audit in respect of the applicant's 2011 year of assessment and raised an additional assessment which resulted in an increase of the applicant's taxable income by an amount of R114 million. The SARS Letter of Audit Findings noted that the purchases made by the taxpayer from the Swiss entity did not comply with the arm's length standard.

The SA transfer pricing regime provides for a number of methods which can be used to assess the arm's length nature of a transaction. One such method is the Transactional Net Margin Method (the TNMM), which considers the net margins realised by independent entities performing comparable functions. Another well-known method is the Comparable Uncontrolled Prices (CUP) method, which considers the prices set between third parties in agreements which are comparable.

"The SA transfer pricing regime provides for a number of methods which can be used to assess the arm's length nature of a transaction."

The taxpayer in the case advocated the use of the CUP method and noted that if this method was applied to consider the arm's length nature of the transaction, there would have been no need for an adjustment. Unfortunately for the taxpayer it had not conducted any transfer pricing analysis to test the arm's length nature of the purchases it made from its related party. As a result, the taxpayer could not provide any evidence to illustrate the latter.

SARS consequently conducted a benchmark analysis based on the TNMM, using external companies it considered comparable to the taxpayer's business. The full cost mark-up, realised by the taxpayer on its catalyst sales to third parties, was considered by SARS. A conclusion was drawn that as the taxpayer's margin of 1% falls between the minimum and lower quartile of the range determined in terms of the benchmark, the margin realised by the taxpayer had to be adjusted to the median of the range. This adjustment resulted in an increase in the taxpayer's taxable income and the additional assessment.

The application to the court dealt with whether section 31(2) permits SARS to adjust the overall business profits and whether this issue could be separated from the factual question regarding the arm's length nature of the transactions. The court ruled that the issues could not be separated as the establishment of the arm's length nature, which is regarded as an overriding principle in transfer pricing matters, is the first step to consider and involves a factual inquiry that cannot be determined without reference to the merits of the case. The judge concluded that separating the legal and factual question would result in piecemeal litigation, increased costs and a delay in finalisation of the matter. Dependent on the taxpayer's stance, we may therefore see the matter being considered holistically by a court in due course, as the legal and factual questions before the court remained unanswered.

Although the legal and factual questions remained unanswered, the case leaves us with a number of important lessons. A key lesson from this case is the importance of having proper documentation in place, evidencing the arm's length nature of related-party transactions. It is clear from the case that courts are unlikely to entertain arguments regarding comparable agreements, where a proper study has not been conducted to analyse the comparability of such agreements in terms of the CUP method.

The case also illustrates the importance of understanding and appropriately applying the transfer pricing methods. Had the taxpayer conducted the necessary analysis in respect of its purchase transactions, it may have had success in arguing against the appropriateness of the TNMM and the use of the full cost mark-up realised by it as the margin to test.

As transfer pricing is not an exact science, each transaction has to be considered and analysed on a case by case basis to determine and confirm the arm's length nature thereof. It is consequently recommended that taxpayers with cross-border related-party transactions take note of this court case and allocate the necessary resources to having these transactions properly analysed.

Malan du Toit

Mazars

Acts and Bills

- Income Tax Act 58 of 1962: Section 31(2) (prelex text before 2011 amendment);
- Taxation Laws Amendment Act 24 of 2011: Section 57(1).

Other documents

- SARS Letter of Audit Findings (to taxpayer in *IT 14305* case).

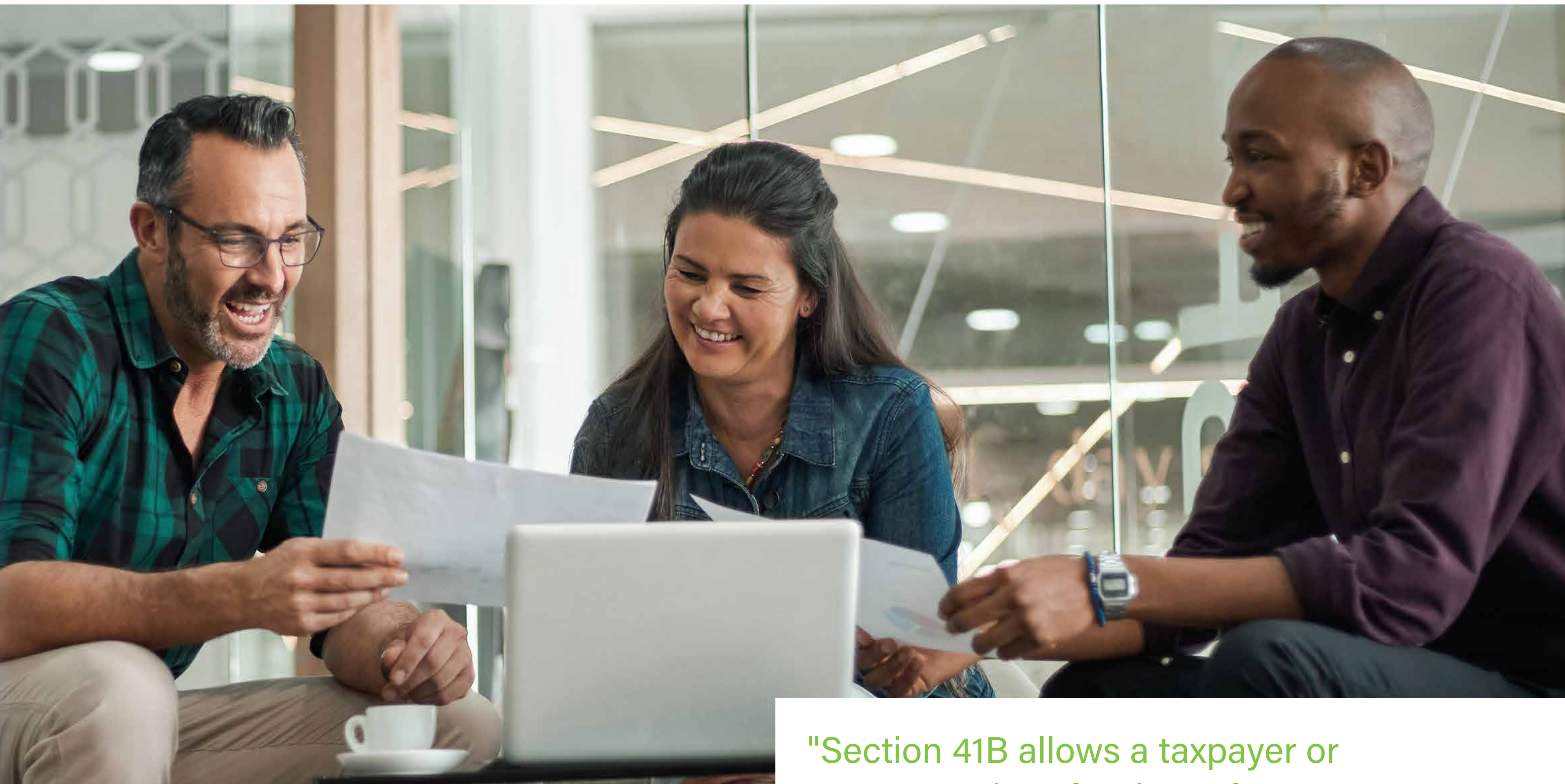
Cases

- *ABC (Pty) Ltd v The Commissioner for the South African Revenue Service IT 14305.*

Tags: additional assessment; benchmark analysis; transfer pricing methods.

ADVANCE VAT RULINGS AND COSTS

Advance tax rulings (ATRs) present an opportunity for taxpayers to gain certainty about how the South African Revenue Service (SARS) will treat a transaction or decision by a business. Armed with an ATR, a taxpayer can move forward confident that the often-complex variable of the tax cost of the business decision or transaction is known.



ATRs are generally governed by the procedural provisions set out in Chapter 7 of the Tax Administration Act, 2011 (the TAA). The Value-Added Tax Act, 1991 (the VAT Act), provides for an ATR system specific to value-added tax. It provides for two categories of rulings:

- Section 41B VAT rulings and VAT class rulings (VAT rulings), which mirror the Binding Private Rulings (BPR) and Binding Class Rulings (BCR) available regarding the other tax Acts administered by the Commissioner; and

- Section 72, which allows VAT vendors or classes of VAT vendors to approach SARS for a ruling to alleviate the difficulties, anomalies or incongruities which would be caused by the application of the provisions in the VAT Act to their business model.

On 1 April 2021 the Commissioner for SARS signed Public Notice 299 under section 81 of the TAA setting the fees to be charged for ATRs (PN 299). This public notice has not altered the cost scale in respect of fees charged by SARS but has rather provided clarity on the costs for determinations under section 72 of the VAT Act.

"Section 41B allows a taxpayer or representative of a class of taxpayers to approach SARS for a determination of the application of the provisions of the VAT Act to such taxpayer or class."

SECTION 41B

Section 41B allows a taxpayer or representative of a class of taxpayers to approach SARS for a determination of the application of the provisions of the VAT Act to such taxpayer or class. It further provides that the provisions of Chapter 7 of the TAA apply to rulings under section 41B. This means that the procedure for applying for a VAT ruling, and the bases for rejection of an application, are the same as for a BPR and BCR.

However, under section 41B(1)*(a)*, certain provisions of Chapter 7 of the TAA do not apply to VAT rulings. Notably, in the application process for a VAT ruling a proposed ruling does not have to be submitted, nor does a statement that the ruling does not fall within section 80 of the TAA. Section 81(1)*(b)* of the TAA, which provides for the payment of cost recovery fees for VAT rulings, also does not apply to VAT rulings.

SECTION 72

Where satisfied that as a consequence of the way in which a VAT vendor conducts their income-earning activity, the application of the provisions of the VAT Act has or may result in difficulties, anomalies or incongruities, section 72 empowers the Commissioner for SARS to make a ruling to overcome such difficulties, anomalies or incongruities. The ruling is to alleviate the concerns by determining:

- how the provisions of the VAT Act will apply to that particular VAT vendor or class of VAT vendors; or
- the calculation or payment of VAT by that VAT vendor, class of VAT vendors, or persons transacting with the VAT vendor or class.

Section 72(2) makes the procedural provisions regarding ATRs in the TAA applicable to VAT rulings. Specifically, it provides that sections 75, 81, 83, 84, 85, 86, 87, 89 and 90 of the TAA are applicable (with the necessary changes) to section 72 rulings.

Notable provisions of Chapter 7 of the TAA which are not applicable to section 72 rulings include:

- section 76: sets out the policy purpose underlying ATRs;
- section 79: sets out the requirements for an application for an ATR;
- section 80: deals with the prescribed grounds upon which SARS may reject an application for an ATR; and
- section 82: deals with the binding effect of ATRs.

The details about how a VAT vendor applies for a section 72 determination are contained in the VAT404 Guide for Vendors, published by SARS.

PUBLIC NOTICE 299

PN 299 was promulgated on 1 April 2021 and as stated above, states the fees to be paid in respect of ATRs, including applications under section 72. PN 299 replaces Public Notice 102 of 8 February 2013, which previously set the applicable fees for ATRs.

The application fees provided for under section 81(1)*(a)* of the TAA for BPRs and BCRs, under PN 299, remain differentiated between small, medium and micro enterprises (SMMEs), and any other taxpayer. The application fee for SMMEs to obtain a BCR or BPR is R2,500, while other taxpayers must pay a fee of R14,000.

The cost recovery fees under section 81(1)*(b)* of the TAA similarly remain differentiated between urgent applications and non-urgent applications. Non-urgent applications will carry a cost of R650 per hour and urgent applications will carry a cost of R1,000 per hour.

The most notable aspect covered by PN 299 is the introduction of provisions dealing with the costs of applications for a ruling under section 72. For such applications the application fee is capped at R2,500, regardless of the type of taxpayer. Following the track of VAT rulings, no cost recovery fees are payable for a section 72 ruling.

COMMENT

SARS has embarked on a process to improve the ATR system. Ensuring that taxpayers can easily determine the costs of an ATR is key to the good functioning of the system.

With the promulgation of PN 299, VAT vendors who find themselves facing difficulties, anomalies or incongruities are now able to more easily understand a critical requirement for making an application under section 72 – the expected cost.

Tsanga Mukumba

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Chapter 7 (sections 75, 76, 79, 80, 81 (more specifically subsection (1)*(a)* & *(b)*), 82, 83, 84, 85, 86, 87, 89 and 90);
- Value-Added Tax Act 89 of 1991: Section 41B (more specifically subsection (1)*(b)*), 72.

Other documents

- Public Notice 102 of 8 February 2013;
- Public Notice 299 (published in GG 44383 of 1 April 2021 under section 81 of the TAA);
- VAT404 Guide for Vendors.

Tags: VAT vendor; cost recovery fees.