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DEDUCTIONS AND ALLOWANCES
RENEWABLE ENERGY TAX INCENTIVES

PUBLIC BENEFIT ORGANISATIONS
FUNDING FOR COMMUNITY-BASED PROJECTS

TRANSFER PRICING
VALUE CHAIN ANALYSIS

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SELF-GENERATED GOODWILL

Self-generated goodwill has to be valued when a business is sold as a going concern, and if it commenced before 1 October 2001, the time-apportionment method of valuation can be used.

One of the assets to which a value is assigned when a business is sold as a going concern will often be self-generated goodwill. Several factors need to be considered when determining the base cost of such goodwill, particularly when it commenced before 1 October 2001.

The questions that are usually asked in relation to self-generated goodwill are the following:

- Is it an asset?
- Can time-apportionment be used to determine its valuation date value when it was acquired before 1 October 2001 and, if so, does it have a cost and when did it commence?

IS IT AN ASSET?

The word "goodwill" is not defined in the Income Tax Act, 1962 (the Act), although it is included in the definition of "intangible asset" in paragraph 16 of the Eighth Schedule to the Act.

In *Jacobs v Minister of Agriculture,* [1972], Colman J stated:

> "goodwill is an intangible asset pertaining to an established and profitable business, for which a purchaser of the business may be expected to pay, because it is an asset which generates, or helps to generate, turnover and, consequently, profits".

Paragraph *(a)* of the definition of "asset" in paragraph 1 of the Eighth Schedule includes:

> "property of whatever nature, whether movable or immovable, corporeal or incorporeal …"

In *Commissioner for Inland Revenue v Estate Crewe & Another,* [1943], in relation to the determination of estate duties, Watermeyer CJ said:

> "what is meant by property is all rights vested in him which have a pecuniary or economic value".

Since goodwill (whether self-generated or purchased) has pecuniary or economic value and comprises incorporeal property, it is an asset for purposes of the Eighth Schedule.

CAN TIME-APPORTIONMENT BE USED TO DETERMINE ITS VALUATION DATE VALUE WHEN IT WAS ACQUIRED BEFORE 1 OCTOBER 2001?

SARS notes in its *Comprehensive Guide to Capital Gains Tax* (Issue 9) (the CGT Guide) that time-apportionment may be used to determine the valuation date value of self-generated goodwill "in appropriate circumstances". The time-apportionment method is permitted under paragraph 26(1)*(c)* of the Eighth Schedule when the expenditure incurred on the asset before, on and after the valuation date is known. The various time-apportionment formulae are set out in paragraph 30 of the Eighth Schedule. The main formula is $Y = B + [(P - B) \times N]/(T + N)$ in which P is the proceeds, B is the expenditure allowable under paragraph 20 of the Eighth Schedule before valuation date, N is the number of years before valuation date and T is the number of years on or after the valuation date.

In simple terms, the formula adds the portion of the overall gain (P – B) that relates to the pre-valuation period (N/[T + N]) to the pre-CGT expenditure (B) to arrive at the valuation date value (Y). N in the formula is limited to 20 years if expenditure is incurred in more than one year of assessment before the valuation date. The value of B will normally be nil unless additional businesses were acquired and goodwill was purchased. Self-generated goodwill is a by-product of other expenditure such as staff salaries and marketing expenditure and of other assets such as a building located in a sought-after location, licences and trademarks. Expenditure deductible against income is excluded from base cost under paragraph 20(3)*(a)*, while expenditure on other assets relates to such assets and is not actually expenditure on goodwill (In the Australian case of *Federal Commissioner of Taxation v Murry* [1998] HCA 42 (*FCT v Murry*) the court stated that "goodwill does not inhere in the identifiable assets of a business".). Consequently, self-generated goodwill will usually have expenditure of nil for the pre-CGT period unless additional goodwill has been purchased during that period. Since goodwill is indivisible (*FCT v Murry* above), purchased goodwill must be regarded as a cost of improvement under paragraph 20(1)*(e)*.

It needs to be determined when self-generated goodwill was first acquired to determine "N" in the formula. SARS cites various foreign sources in its guide on this question but, unfortunately, they are either unhelpful or in conflict. For example, the UK revenue authority states that the date of creation of an asset is a question of fact based on the evidence available (true, but what evidence?). A United States case cited in the CGT Guide (*Erwin D Friedlaender v Commissioner of Internal Revenue* 26 TC 1005 1956 US Tax Ct LEXIS 97) applies the super profits methodology used for accounting purposes. Australia applies the legal concept of goodwill which recognises that goodwill can be present even in the absence of profits. SARS does not state which of these views it supports, and simply concludes that the onus rests on the taxpayer to prove the values of the various variables in the time-apportionment formulae.

It is submitted that both the accounting and legal concepts of goodwill have roles to play when it comes to time-apportionment.

Before 1982, South Africa had no guidance on the accounting treatment of goodwill. In 1982 the Accounting Practices Committee (APC) of SAICA issued Discussion Paper 3 "Accounting for Goodwill", which indicated that goodwill should be amortised over its estimated useful life, not exceeding 40 years, be reflected under Fixed Assets and written down immediately if it became irrecoverable. Currently, the position is that self-generated goodwill is not recognised as an asset because it is not an identifiable resource (see IAS 38 "Intangible Assets").

Purchased goodwill is dealt with in IFRS 3.

The relevance of the accounting concept of goodwill comes into play when it is necessary to determine the market value of goodwill on valuation date under paragraph 26(1) or (2) or when determining the proceeds on its disposal.

On the legal meaning of goodwill, in *Caterham Car Sales and Coachworks Ltd v Birkin Cars (Pty) Ltd & Another,* [1998], Harms JA (as he then was) stated the following:

"Goodwill is the totality of attributes that lure or entice clients or potential clients to support a particular business (cf *A C Becker and Co (Pty) Ltd v Becker and Others* 1981 (3) SA 406 (A) at 417A). The components of goodwill are many and diverse (*O'Kennedy v Smit* 1948 (2) SA 63 (C) at 66; *Jacobs v Minister of Agriculture* 1972 (4) SA 608 (W) at 624A–625F). Well recognised are the locality and the personality of the driving force behind the business (ibid), business licences (*Receiver of Revenue, Cape v Cavanagh* 1912 AD 459), agreements such as restraints of trade (*Botha and Another v Carapax Shadeports (Pty) Ltd* 1992 (1) SA 202 (A) at 211H–I) and reputation. These components are not necessarily all present in the goodwill of any particular business."

In the landmark Australian case of *FCT v Murry* the court observed that there was a difference between legal and accounting goodwill. The court noted that the accounting and business concepts of goodwill emphasise the necessity for the business to have some value over and above the value of the identifiable assets. A business may have goodwill for legal purposes even though its trading losses mean that its sale value would be no greater than its "break-up" value.

The court stated that the attraction of custom still remains central to the legal concept of goodwill and that courts will protect this source or element of goodwill irrespective of the profitability or value of the business.

It is considered that the legal concept of goodwill should be applied in determining whether goodwill has been held continuously throughout the period since its creation. It would be impractical to apply the accounting concept of goodwill throughout the holding period, since this would involve constantly valuing goodwill throughout the period to determine whether it has been extinguished. As stated in the *Murry* case:

> "The sources of the goodwill of a business may change and the part that various sources play in maintaining the goodwill may vary during the life of the business. But, as long as the business remains the 'same business', the goodwill acquired or created by a taxpayer is the same asset as that which is disposed of when the goodwill of the business is sold or otherwise transferred."

By regarding goodwill as an attractive force, there is no need to have regard to its value on a day-to-day basis.

It is also more appropriate to apply the legal concept of goodwill in determining the date when goodwill was first created.

In *Inland Revenue Commissioners v Muller & Co's Margarine Ltd* Lord Macnaghten said of goodwill [1901] AC 217 AT 223/224):

> "It is the attractive force which brings in custom. It is the one thing which distinguishes an old-established business from a new business at its first start."

It can take several years before a business becomes profitable, but that does not mean that goodwill in the form of an attractive force has not been created. It may well be, depending on the circumstances, that goodwill can commence relatively soon after a business has begun trading because that is the point at which the "attractive force" should begin to develop, even if it is initially in a small way. For example, it should be possible to determine fairly soon after a business opens its doors whether repeat custom is being generated or whether sales are on an upward trajectory.

"In the landmark Australian case of *FCT v Murry* the court observed that there was a difference between legal and accounting goodwill."

PITFALLS OF TIME-APPORTIONMENT

The time-apportionment method contains a proceeds formula in paragraph 30(2) which is triggered when allowable expenditure under paragraph 20, other than selling expenses, is incurred on or after the valuation date. The effect of the formula is that the more allowable expenditure incurred on or after the valuation date, the greater is the proportion of the overall gain or loss that will comprise a capital gain or loss. If no expenditure is incurred before valuation date and only ZAR 1 of expenditure (other than selling expenses) is incurred on or after the valuation date, the entire economic gain (proceeds less the ZAR 1 expenditure) will comprise a capital gain, with the result that the market value method (if available) or 20% of proceeds method will have to be used. Selling expenses set out in paragraph 20(1)*(c)*(i) to (iv) do not trigger the proceeds formula (paragraph 30(5)) but the cost of valuing goodwill for the purpose of determining a capital gain or loss will trigger the proceeds formula. The failure to treat the cost of a CGT valuation in the same way as selling expenses is inequitable and makes little sense. The purchase of goodwill on or after the valuation date may also trigger the proceeds formula, for example, when a company acquires a competitor's business and merges it with its pre-existing business.

Finally, SARS has a useful Excel-based "TAB Calculator" which can greatly speed up the complex task of determining the time-apportionment base cost of an asset. The TAB Calculator can be found on the SARS website under Types of Tax/Capital gains tax/Calculators)

CONCLUSION

Self-generated goodwill is an asset for CGT purposes. When it commences to be generated before 1 October 2001, the time-apportionment method can be used to determine its valuation date value. Factors which can make its use unattractive include whether goodwill was purchased in more than one year of assessment before valuation date ("N" will be limited to 20) and the extent to which the proceeds formula makes more of the overall gain a capital gain (for example, because of the cost of a CGT valuation or the purchase of goodwill).

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Acts and Bills

- Income Tax Act 58 of 1962: Eighth Schedule: Paragraphs 1 (definition of asset: paragraph *(a)*), 16(2) (definition of "intangible asset", which includes the word "goodwill"), 20(1)*(c)*(i)–(iv) & *(e)*, 26(1) & (2), 30(2) & (5).

Other documents

- *Comprehensive Guide to Capital Gains Tax* (Issue 9);
- Discussion Paper 3 "Accounting for Goodwill" (published by Accounting Practices Committee (APC) of SAICA in 1982);
- IAS 38 ("Intangible Assets");
- IFRS 3 Business Combinations (dealing with purchased goodwill).

Cases

- *Jacobs v Minister of Agriculture* [1972] (4) SA 608 (W) at 621 & 624A–625F);
- *Commissioner for Inland Revenue v Estate Crewe & Another* [1943] AD 656, 12 SATC 344 at 352;
- *Federal Commissioner of Taxation v Murry* [1998] HCA 42;
- *Erwin D Friedlaender v Commissioner of Internal Revenue* 26 TC 1005 1956 US Tax Ct LEXIS 97;
- *Caterham Car Sales and Coachworks Ltd v Birkin Cars (Pty) Ltd and Another* (393/95) [1998] ZASCA 44; [1998] (3) SA 938 (SCA); [1998] 3 All SA 175 (A) (27 May 1998);
- *A C Becker and Co (Pty) Ltd v Becker and Others* [1981] (3) SA 406 (A) (at 417A);
- *O'Kennedy v Smit* [1948] (2) SA 63 (C) (at 66);
- *Receiver of Revenue, Cape v Cavanagh* [1912] AD 459;
- *Botha and Another v Carapax Shadeports (Pty) Ltd* [1992] (1) SA 202 (A);
- *Inland Revenue Commissioners v Muller & Co's Margarine Limited* [1901] AC 217 (at 223/224).

Tags: self-generated goodwill; valuation date value; goodwill; time-apportionment; purchased goodwill.

CONTRIBUTIONS TO EMPLOYEE SHARE INCENTIVE TRUSTS

The contributions that companies make to employee share trusts should be tax deductible if they are made to incentivise employees but, if there are other benefits, there may be a capital gains liability.

In 2021 two decisions were delivered by the SCA on contributions to employee share trusts, both of which went against the taxpayer, namely, *Massmart Holdings Limited v Commissioner for the South African Revenue Service,* [2021], and *Commissioner for the South African Revenue Service v Spur Group (Pty) Ltd,* [2021].

Both involved structures which resulted in the contributions not being deductible by the contributing company under section 11*(a)* of the Income Tax Act, 1962 (the Act), because the amounts were held to be not incurred in the production of income. In the *Massmart* case, the contributions were incurred by the holding company and, since the employees were in the operating subsidiaries, the expenditure was not considered by the taxpayer to be incurred in the production of the income of that company and it was claimed in the tax return as capital losses. The appellant was, however, unsuccessful in this claim. In the *Spur* case the SCA held that the contribution was not incurred directly in the production of income. The contribution facilitated the acquisition of shares by the employees but was ultimately distributed to the company's holding company. News reports indicate that Spur intends to appeal to the Constitutional Court.

But even with vanilla structures there are tax pitfalls and uncertainties.

THE COMPANY

In a typical structure, a company makes a non-refundable cash contribution to an employee share trust to enable it to acquire its shares on the open market, in order to award them to deserving employees of the company.

Applying the principle established in *Provider v Commissioner of Taxes,* [1950], such a contribution would be in the production of income on the basis that it was designed to encourage settled conditions of employment and promote a motivated workforce.

In BPR 050, dated 16 October 2009, a listed company made cash contributions to employee share trusts that the trusts would use to acquire shares in the company, either by issue or on the open market, which it would award to the qualifying employees. SARS ruled that the contributions were deductible under section 11*(a)* but the deduction had to be spread under section 23H of the Act.

A similar ruling was given in BPR 354, dated 29 September 2020, once again with the contributions being deductible but spread under section 23H.

SECTION 23H

The relevance of section 23H in the present context is that it applies when –

- a person has incurred expenditure during a year of assessment on services rendered under section 11*(a)*; and
- all those services will not be rendered to that person in that year of assessment.

Under these circumstances, the expenditure to be allowed in a year of assessment is equal to the expenditure incurred multiplied by the number of months in that year in which services were rendered, divided by the total number of months over which those services will be rendered. No apportionment is required if all the services will be rendered within six months of the end of the year of assessment or if all the expenditure does not exceed ZAR 100,000.

Employees acquiring shares under a share incentive scheme are normally restricted from disposing of them for a number of years. During this period, the employer would derive a benefit because the employees would be incentivised to remain in employment. Once the restriction comes to an end, the employee would be subject to tax on any gain under section 8C of the Act. Spreading the deduction over the period in which the employees are restricted seems a fair way of determining the period over which the services will be rendered, but the facts and circumstances of each situation will determine the period over which the deduction is spread. For example, sometimes the shares will be awarded in tranches over a period and this will need to be taken into account.

EXPENDITURE OF A CAPITAL NATURE

SARS seems to accept that the expenditure on the contribution is of a revenue nature when it relates to incentivising employees. There is no guarantee that individual employees will remain in the company's employ, which points to the absence of an enduring benefit. However, there are circumstances when such a contribution can be of a capital nature.

In BCR 072, dated 7 August 2020, the contributions to the trust were said to have a dual purpose, namely, to promote the B-BBEE status of the operating companies while incentivising the employees. SARS ruled that the portion of the contributions that related to the B-BBEE status was of a capital nature, presumably on the basis that it created an enduring benefit. Authority for the apportionment of expenditure or income between its capital and revenue elements can be found in a variety of cases. For example, in *Tuck v Commissioner for Inland Revenue* [1988], the court approved a 50% apportionment between a salary (income) and a payment for restraint of trade (capital at the time). The definition of "gross income" in section 1(1) of the Act now includes restraint of trade payments in paragraphs *(c*A) and *(c*B).

THE EMPLOYEE SHARE INCENTIVE TRUST

A question arises whether the trust will have a capital gain when it receives the cash contribution. In this regard, the argument in favour of such a gain is that the trust acquires a personal right to claim the contribution once it has been approved by the board of directors and that that right has a base cost of nil. When the contribution is deposited into its bank account, the trust disposes of the right in return for the amount of the contribution, resulting in proceeds and a capital gain of the same amount. The base cost of the amount deposited into its bank account is equal to the amount by which it has been impoverished in giving up the personal right. (*Note:* On the need for expenditure to involve the diminution or movement of assets, see *Commissioner, South African Revenue Service v Labat Africa Ltd,* [2013]). Some have contended that there is no such personal right because acceptance is not required but, if that is so, how does the trust's bank account acquire base cost?

"In BCR 072, dated 7 August 2020, the contributions to the trust were said to have a dual purpose, namely, to promote the B-BBEE status of the operating companies while incentivising the employees."

This problem has wider implications than employee share trusts, and applies, for example, to cash donations. In such a case, acceptance of the donation is definitely required under common law – see GB Bradfield *The Law of Contract in South Africa* 7 ed (2016) [online] (My LexisNexis: 31 December 2015) in paragraph 2.3. There can be no doubt that the personal right to claim the amount is an asset acquired for no consideration. An outcome that results in a capital gain every time funds are donated would clearly be absurd because CGT is not intended to be a capital transfer tax. So what is the solution to this enigma?

There seems to be an unwritten rule that, when the Act specifies how the base cost of an asset is to be determined, no regard is had to any underlying exchanges of personal rights. For example, the expenditure on a capitalisation share is deemed to be nil under section 40C of the Act and an heir is treated as having acquired an asset for the expenditure incurred by the deceased estate under section 25(3)*(b)* of the Act. It would be absurd if the receipt of a capitalisation share or an inheritance were to give rise to a capital gain.

The answer may lie in paragraph 38 of the Eighth Schedule to the Act, which treats disposals of assets by donation, or for a consideration not measurable in money or for a non-arm's length price between connected persons, to be acquired for expenditure equal to market value.

If it can be shown that paragraph 38 applies, the focus will be on the end asset and any exchanges of rights will be disregarded.

The benefits to a company from making a contribution to an employee share trust are not measurable in money because there would be no way of quantifying the exact impact individual employees will have on increasing the company's profits as a result of experiencing settled conditions of employment and being motivated. But a difficulty arises under paragraph 38 because the asset disposed of by the transferor must be the same asset that is acquired by the transferee. The reduction in the company's bank account results in an increase in the trust's bank account but the two bank accounts are not the same asset.

In *Trustees, Estate Whitehead v Dumas & Another,* [2013], the court stated the following in relation to a bank transfer:

> "Where, as in this case, A causes the transfer of money from his bank account to the account of B, no personal rights are transferred from A to B; what occurs is that A's personal claim to the funds that he held against his bank is extinguished upon the transfer and a new personal right is created between B and his bank. Ownership of the money – in so far as money *in specie* is involved – is transferred from the transferring bank to the collecting bank, which must account to B in accordance with their bank-customer contractual relationship."

The definition of "asset" in paragraph 1 of the Eighth Schedule excludes currency but the preamble to the definitions states "unless the context otherwise indicates". There are examples of the use of "cash or assets *in specie*" in paragraphs 76, 76B and 77. The word "cash" in these provisions probably refers to a transfer of funds by electronic transfer. It might be possible to read this meaning into the word "asset" in paragraph 38.

If the funds are regarded as the asset, the amount deposited into the trust's bank account will have a base cost equal to the amount deposited under paragraph 38 and the underlying exchanges of rights can be disregarded.

The same interpretation would need to be applied to donations effected by bank transfer.

From the company's perspective, the proceeds on the part-disposal of its bank account would be equal to the amount withdrawn, resulting in neither a capital gain nor a loss. It could be argued that the company has a liability to make the contribution, and, when it is discharged, there are proceeds equal to the debt discharged under paragraph 35(1)*(a)*, but in the circumstances paragraph 38 should be regarded as taking precedence in order to ensure a sensible outcome for the trust.

SARS accepts this approach in its *Comprehensive Guide to Capital Gains Tax* (Issue 9) in 24.13, Example 4.

CONCLUSION

A cash contribution to a share incentive trust should be deductible under section 11*(a)* if it is made to incentivise the company's own employees. When the services to be rendered as a result of the contribution extend beyond six months after the end of the year of assessment, they will have to be spread over the period in which the services will be rendered under section 23H. When there are long-term benefits other than those derived from incentivising employees, part of the contribution may be of a capital nature, requiring its apportionment between the capital and revenue elements.

Fortunately, SARS does seem to have accepted that the receipt of a capital contribution by the trust does not give rise to a capital gain, though this is a complex issue of some uncertainty, deserving legislative intervention.

[This article was first published in *ASA February 2022*.]

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Acts and Bills

- Income Tax Act 58 of 1962: Sections 1 (definition of "gross income": Paragraphs *(cA)* & *(cB)*), 11*(a)*, 23H, 25(3)*(b)* & 40C; Eighth Schedule: Paragraphs 1 (definition of "asset"), 35(1)*(a)*, 38, 76, 76B & 77;
- Tax Administration Act 28 of 2011.

Other documents

- *SARS Comprehensive Guide to Capital Gains Tax* (Issue 9): in 24.13, Example 4;
- *The Law of Contract in South Africa* (GB Bradfield) 7 ed (2016) [online] (My LexisNexis: 31 December 2015 in paragraph 2.3);
- Binding Class Ruling 072 (*Deductibility of employment related expenditure, incurred as part of a B-BBEE ownership transaction and the PAYE treatment of interest-free loan to a share trust*), dated 7 August 2020;
- Binding Private Ruling 354 (*Cash grants to an employee incentive trust and the transfer of share awards to qualifying employees*), dated 29 September 2020;
- Binding Private Ruling 050 (*Cash grants made by an employer to share-incentive scheme trusts and their deductibility for tax purposes*), dated 16 October 2009.

Cases

- *Massmart Holdings Limited v Commissioner for the South African Revenue Service* (84/2020) [2021] ZASCA 27 (26 March 2021); 83 SATC 333 (SCA);
- *Commissioner for the South African Revenue Service v Spur Group (Pty) Ltd* (320/2020) [2021] ZASCA 145; 84 SATC 1 (15 October 2021);
- *Provider v Commissioner of Taxes* [1950] (4) SA 289 (SR); 17 SATC 40;
- *Tuck v Commissioner for Inland Revenue* [1988] (3) SA 819 (A); 50 SATC 98;
- *Commissioner, South African Revenue Service v Labat Africa Ltd* [2013] (2) SA 33 (SCA); 74 SATC 1 (at 6));
- *Trustees, Estate Whitehead v Dumas & Another* [2013] (3) SA 331 (SCA) (at 335)).

Tags: employee share trusts; non-refundable cash contribution; share incentive trust.

RENEWABLE ENERGY TAX INCENTIVES

The draft Taxation Laws Amendment Bill, 2023 ("Initial batch"), which gives effect to the two renewable energy tax incentives announced in the 2023 Budget Speech, was published for comment on 21 April 2023.

"As an electrical certificate of compliance is a requirement for the credit, each and every individual claiming the credit should be issued such a certificate."

These proposals carry a degree of urgency due to the proposed effective dates for implementation, to assist in partially addressing the country's energy crisis and to enhance certainty for individuals and businesses whilst encouraging private investment in renewable energy.

As a consequence of the severe energy crisis currently experienced by South Africa, and Eskom's continued struggles to produce reliable electricity through the national grid, two renewable energy tax incentives to improve efficiency, lower the pressure on the grid and encourage greater investment in renewable energy, are proposed.

The legislation is in draft, and amendments to it can be expected before it will be issued in final form.

SOLAR ENERGY TAX CREDIT: INDIVIDUALS INSTALLING SOLAR PANELS AT HOME

A proposed new section 6C of the Income Tax Act, 1962, provides for a solar energy tax credit for natural persons installing solar panels at their homes. The credit reduces a person's tax and is not in the form of a deduction from income. In effect, thus, this credit can reduce a natural person's tax bill even if the tax results from salary income.

The solar energy tax credit is available in respect of the actual cost incurred for the acquisition of solar panels (which cost does not include installation costs or the costs of other necessary materials such as lithium batteries).

In order to be eligible for the tax credit, the solar panels must meet these further requirements:

- They must be new, unused and acquired and brought into use for the first time on or after 1 March 2023 and before 1 March 2024 (to encourage investment as soon as possible this incentive will only be available for one year);
- They must have a minimum generation capacity of at least 275W per panel;

- It is required that they form part of a system that is connected to the distribution board of a residence that is mainly used by an individual for domestic purposes; and

- An electrical certificate of compliance must be issued to the individual in terms of the Electrical Installation Regulations, 2009.

The solar energy tax credit that can reduce the person's tax is equal to the lower of R15,000 or 25% of the actual cost of the qualifying solar panels.

A few examples are below:

- If a natural person acquires 10 qualifying solar panels, at a cost of R4,000 per panel, and thus a total cost of R40,000, that person would be able to claim a tax credit of 25% of the total cost up to R15,000, which will be R10,000 (R40,000 x 25%) in this instance.

- If a natural person acquires 20 qualifying solar panels at a cost of R4,000 per panel and thus a total cost of R80,000, that person will be limited to claim R15,000 as 25% of the total costs amount to R20,000 (R80,000 x 25%).

- Where multiple individuals incur costs in respect of the acquisition of a qualifying solar panel, the solar energy tax credit per individual would be determined as an amount equal to 25 per cent of the total amount in respect of the acquisition of the solar panel multiplied by the same ratio as the amount of the cost incurred by that individual bears to the total amount of the costs incurred for that acquisition. This apportionment does not appear to apply to the same household, but rather to solar panels acquired jointly.

- For example, **individual A** and **individual B** jointly acquire 30 panels at a cost of R4,000 per panel (total cost of R120,000), **A** contributes R40,000 and **B** contributes R80,000.

    - **A** would be entitled to claim a tax credit of R10,000 ((25% x (R120,000 × R40,000/R120,000)),

    - **B** would be entitled to claim a tax credit of R20,000 ((25% x (R120,000 × R80,000/ R120,000)), however, **B**'s tax credit would be limited to R15,000.

The aggregate credit available will be R25,000 even though all 30 panels will be installed in one house. If A and B each contributed R60,000 the aggregate credit available would have been R30,000.

Where an individual sells a qualifying solar panel on or before 1 March 2025, any tax credit claimed in respect of that panel will be added to the person's tax payable in the tax year when the panel is sold. This claw-back rule does not apply where the residence is sold together with the solar panels affixed to it.

The tax credit is only available if the cost incurred on the solar panels does not qualify for any other tax allowances provided for in the Income Tax Act.

A few point-worthy aspects in respect of the solar tax credit are:

- The tax credit is only available to natural persons and the acquisition of solar panels by, say, a family trust which owns a family residence, will not qualify for the credit. However, there is no requirement that the natural person incurring the cost of the solar panels and claiming the credit, must own the residence, so that a natural person occupying a trust property can, in principle, qualify for the credit.

- As an electrical certificate of compliance is a requirement for the credit, each and every individual claiming the credit should be issued such a certificate. If multiple individuals acquire the solar panels, it would be wise to have the electrical certificate issued to each one of them.

- As the tax credit for natural persons only applies if none of the other capital allowances available for renewable energy is available, it should be noted that natural persons are not automatically entitled to the credit, nor are they automatically limited to this credit (noting that the other allowances may well be more meaningful to a taxpayer).

- A taxpayer can generally add the cost of improvements to the base cost for the asset. However, costs which benefited from a deduction in determining the taxable income of a person are not eligible to increase the base cost of an asset. The tax credit available to natural persons in respect of solar panels affixed for domestic residences, does not take the form of a deduction in determining the taxable income of the person, and therefore it is conceivable that the cost of solar panels which can form part of a natural person's base cost for a residence, can increase the base cost of the residence in addition to the benefit of the solar tax credit.

ENHANCED RENEWABLE ENERGY TAX ALLOWANCE: BUSINESS

The enhanced solar energy tax allowance for businesses differs from the tax credit available to natural persons in the following significant respects:

- It is available to all taxpayers, including but not limited to natural persons, as long as the qualifying assets are brought into use for trading purposes;

- It takes the form of a deduction against income, and not a credit against tax and therefore reduces taxable income, rather than tax;

- It is not limited to the cost of solar panels or even solar energy, but applies to the cost of all qualifying machinery, plant, implements, utensils and articles used in the production of renewable energy in the form of wind power, photovoltaic or concentrated solar energy, hydro-power or biomass comprising organic waste, landfill gas or plant material, and regardless of their energy-generation capacity;

- It is not subject to a cap, save that the cost cannot exceed arm's length third-party cost; and
- The allowance is available to lessors in limited circumstances.

The enhanced renewable energy tax incentive is calculated at 125% of the cost of the qualifying energy-producing assets, including mounting costs, and is available in full in the tax year during which the cost is incurred.

The enhanced renewable energy allowance is available only to "owners" who purchased the qualifying machinery, plant, etc, in terms of an "instalment credit agreement" as defined in paragraph *(a)* of that definition in section 1(1) of the Value-Added Tax Act, 1991, and is specifically not available if ownership of the energy-producing asset is retained by the taxpayer as a seller in terms of an "instalment credit agreement". The existing renewable energy tax allowance is available to all owners or purchasers under "instalment credit agreements" of qualifying energy-producing assets or purchasers in terms of an instalment credit agreement. It is, therefore, not clear why an owner who purchases qualifying energy-producing assets in terms of a cash sale cannot qualify for the enhanced allowance. The draft Explanatory Memorandum which was published with the draft legislation does not discuss this distinction and it may be a drafting oversight which will be rectified in the final batch of legislation.

The qualifying criteria for energy-producing assets and mounting structures are the same as the requirements for the existing capital allowance for these assets, save that it is required that the assets must be new and unused and must be brought into use for the first time during the window-period of 1 March 2023 to 28 February 2025. Similarly, eligible construction and mounting structures must be brought into use during the same window-period.

Where, before 1 March 2026, a taxpayer disposes of an energy-producing asset that qualified for the enhanced renewable energy allowance, 25% of the cost of the asset must be included in the taxpayer's income together with any other normal recoupments.

If the normal renewable energy allowance has already been granted (presumably in a prior tax year) in respect of the cost of energy-producing assets, the enhanced allowance is not available. The draft legislation does not, however, specify that the enhanced renewable energy allowance, if available, trumps the normal allowance. Consequently, it appears that a taxpayer may, if for whatever reason preferred, decide to claim the normal renewable energy allowance even if the enhanced allowance would have been available.

The interplay between the enhanced renewable energy allowance and the capital allowances for small business corporations is regulated in that it is specified that the enhanced renewable energy allowance, if available, must be claimed to the exclusion of the small business corporation allowances.

In summary, it appears that the draft legislation may require further work, but the publication of this draft legislation as a special early batch is commendable.

Doelie Lessing & Luke Magerman

Werksmans Attorneys

Acts and Bills

- Income Tax Act: Section 6C (proposed new section);
- Value-Added Tax Act 89 of 1991: Section 1(1) (definition of "instalment credit agreement": Paragraph *(a)*);
- Draft Taxation Laws Amendment Bill, 2023 ("Initial batch") (21 April 2023).

Other documents

- Electrical Installation Regulations, 2009 (published 6 March 2009 in *GG* 31975);
- Draft Explanatory Memorandum on the draft Taxation Laws Amendment Bill, 2023 (Initial batch) (21 April 2023).

Tags: solar energy tax credit; electrical certificate of compliance; qualifying solar panel; enhanced renewable energy allowance.

EXTERNALISING IP

Despite challenges faced in recent years with the global pandemic as well as political and economic instability, South Africa has a booming fintech and technology industry. In particular, we are seeing tremendous growth in interest and investment in South African technology businesses. These companies are all intellectual property (IP) rich, as IP underpins the technology assets on which their businesses are based.

Funding from non-resident investors is often a major stumbling block for start-ups. One of the reasons is that South Africa has exchange controls and restricts the externalisation of IP owned by South African exchange control residents to related non-resident parties. Non-resident investors are often reluctant to invest into a South African company where the primary asset, the IP, is subject to exchange control restrictions. Further, South African exchange controls previously prohibited so-called "loop structures".

Loop structures typically entailed the formation by a South African resident of an offshore structure, which by a reinvestment into South Africa acquires shares or some other interest in a South African resident company or a South African asset. To overcome this issue, parties often had to resort to complex structures such as mirrored shareholdings. On 1 January 2021, the Financial Surveillance Department of the South African Reserve Bank (the SARB) abolished its policy on loop structures to encourage inward investments into the country. However, loop structures set up before 1 January 2021 are still considered to be "unauthorised" and are required to be reported to the SARB and regularised.

Many South African companies are looking to externalise their South African IP to attract foreign investment and/or to grow their business in the international markets. There are three main areas to consider when dealing with South African-owned IP, namely:

- exchange controls;
- tax; and
- IP law.

Some of the key aspects of these areas of consideration are set out below, although they are not discussed in depth.

SO CAN YOU SELL YOUR SOUTH AFRICAN IP?

From an exchange control perspective, whilst the SARB has relaxed the exchange control rules applicable to IP, at present, authorised dealers are only permitted to approve the outright sale, transfer and assignment of intellectual property to *unrelated* non-resident parties if –

- the transaction is at an arm's length and the price represents a fair and market-related price;
- the authorised dealer views the sale, transfer or assignment agreement;

- the authorised dealer is provided with an auditor's letter or IP valuation certificate confirming the basis for calculating the sale price;
- the transaction is subject to appropriate tax treatment; and
- the assigned or transferred IP is not licensed back to a South African resident party.

Where a South African company undertakes IP development work for a non-resident party under a subcontract, any IP developed by the South African company would need to be assigned to the non-resident party for such non-resident party to legally own any IP developed under a subcontract. Any such assignment requires approval in terms of the South African Exchange Control Regulations.

The sale, assignment, cession and/or waiver of any IP rights in favour of a related non-resident party requires prior approval from the SARB.

WHAT ABOUT CROSS-BORDER LICENSING ARRANGEMENTS?

What is possible is the licensing of IP by South African residents from non-resident parties, both related and unrelated, provided it is done at a fair market-related price. Similar, to the case of the assignment or transfer of IP, the authorised dealer is required to view:

- a copy of the licence agreement; and
- an auditor's letter confirming the basis of the calculation of the royalty rate or licence fee.

What are some of the tax considerations?

From a tax perspective, it is important to understand that IP is considered to be an asset for capital gains tax (CGT) purposes and assuming such IP is held on a capital account, the disposal or sale of such IP will trigger CGT.

If South African companies are paying a royalty in respect of the use of the IP of a non-resident party, their tax deductions may be limited in terms of the Income Tax Act, 1962. This applies to licences for so-called "tainted IP". In this regard, the Income Tax Act contains anti-avoidance provisions which target IP sale-and-leaseback arrangements where certain parties are located outside of the tax net. IP will be "tainted" in situations where South African developed IP is sold to a non-resident or tax exempt entity (it applies to unrelated parties as well) and is then licensed back to the South African creator, or other South African end users who pay and claim as a tax deduction, the licence fees to use such IP.

Whilst there are ways in which to set up structures which may allow for the externalisation of South African-owned IP, the next issue that requires close focus is the ongoing management of such non-resident IP holding companies. Some important aspects to keep in mind in this regard include:

- the effective management and control of the foreign company (focussing on where the key management and commercial decisions that are necessary for the business are, in substance, made). If the effective management of the foreign company is deemed to be in South Africa, SARS has the right to tax the worldwide income of any such foreign company.

- whether such a foreign company constitutes a so-called controlled foreign company (CFC) (a foreign company will constitute a CFC if more than 50% of the participation rights in any such foreign company are held by South African residents). Where the foreign company constitutes a CFC, the profits of the foreign company may, in certain circumstances, be attributed to the resident shareholders and taxed in their hands; and

- transfer pricing.

From a transfer pricing perspective, the legal and economic ownership of the IP must be aligned to ensure that the legal owner is entitled to the benefits flowing from the exploitation of the IP. The alignment of legal and economic ownership is analysed with a focus on the performance of the so-called "DEMPE" functions, which refers to the "Development, Enhancement, Maintenance, Protection and Exploitation" of the IP. A functional analysis is required to be undertaken in this regard.

A functional analysis is factual in nature and takes place against the background of which role player acts as the central entrepreneur in the business, carries the financial and legal risk associated with the IP and is ultimately responsible for the value creation.

There are several complex tax, IP law and exchange control considerations to be kept in mind when considering the structuring of IP assets.

It is recommended that experts in the field are contacted if any assistance with IP structuring is required.

"From a tax perspective, it is important to understand that IP is considered to be an asset for capital gains tax (CGT) purposes and assuming such IP is held on a capital account, the disposal or sale of such IP will trigger CGT."

Waldo Steyn & Lavina Daya

ENSafrica

Acts and Bills

- Income Tax Act 58 of 1962.

Other documents

- Exchange Control Regulations, 1961.

Tags: intellectual property (IP); loop structures; non-resident party; IP sale-and-leaseback arrangements.

FOREIGN EMPLOYERS TO REGISTER WITH SARS

National Treasury announced in the February 2023 Budget that it intends to align the obligations on South African and foreign employers, and this creates certain practical issues.

The global trend of remote working, which has surged since the Covid-19 lockdowns, allows employers at one end of the world to employ South Africans whom they may never have met face-to-face.

These arrangements benefit both employers (because they may be able to employ highly skilled workers more cheaply than in their own countries) and employees (who may broaden their opportunities to earn income).

FOREIGN EMPLOYERS TO BE REQUIRED TO REGISTER AS “EMPLOYERS” WITH SARS

There are currently some inconsistencies in the legislation covering the obligations of foreign employers. Annexure C of the Budget Review 2023 (the Budget) proposes to align the employer registration requirements for foreign employers to ensure that these rules are consistent for both resident and foreign employers.

"Notably, once the proposed alignment takes effect, a foreign entity registered as an 'employer' with SARS will be required to meet all payroll compliance obligations, including submission of all returns and tax certificates by the relevant deadlines."

At present, a foreign employer that does not have a "representative employer" in South Africa with the authority to pay remuneration need not deduct PAYE from the amounts it pays to South African (SA) employees and these individuals need to pay the income tax due as provisional taxpayers.

The Budget observed that as the foreign employer pays remuneration (even though not required to deduct PAYE), it still needs to pay the 1% skills development levy (SDL) and the Unemployment Insurance Fund (UIF) contributions, and many do.

A SA employer, however, is required to register as an employer, deduct PAYE from remuneration paid or payable to employees, and pay the SDL and UIF contributions to SARS.

The Budget proposes to align the provisions of the Fourth Schedule to the Income Tax Act, 1962, relating to foreign employers in order to ensure consistency between resident and foreign employers. It remains to be seen, around July 2023 when the draft Taxation Laws Amendment Bill for 2023 is usually circulated for comments, how the proposed amendment will be worded. In our view, the proposed amendment will likely result in foreign employers being required to register as "employers" with SARS, and be accountable for all PAYE, SDL and UIF due on remuneration paid or payable to "employees" and their related payroll compliance obligations.

PRACTICAL ISSUES FOR FOREIGN EMPLOYERS TO REGISTER WITH SARS

Currently, in order to register as an "employer" with SARS, a foreign employer will require, among others,

- a CIPC registration number;
- its SARS income tax registration number; and
- an SA bank account.

A foreign employer that is a foreign company may not have registered as an "external company" with the CIPC, although required to do so within 20 business days of being a party to an employment agreement. It will then not have a CIPC registration number.

The CIPC will automatically issue a SARS income tax registration number on completion of the external company registration of a foreign company. Unless the foreign employer registers for income tax separately, the foreign employer will then also not have a SARS income tax registration number if it does not register as an external company.

A foreign employer may also not have a CIPC number as it is not a company but a foreign trust, partnership or foundation. We anticipate that the foreign employer would then not be required to provide a CIPC number to SARS in this situation as it is not an external company.

The foreign employer may not have an SA bank account. SARS accepts foreign bank accounts when foreign suppliers and intermediaries of "electronic services" register for VAT. Perhaps a similar concession will be available for foreign employers in the proposed alignment and SARS will accept foreign bank accounts for a foreign entity to register as an "employer".

Another situation could arise where the foreign entity does not have employees but SA-resident individuals that provide services to it as independent contractors. The foreign entity is then not usually required to register as an external company with the CIPC as it has not entered into any employment agreements. In our view, the foreign entity should then also not be required to register with SARS as an "employer".

Notably, once the proposed alignment takes effect, a foreign entity registered as an "employer" with SARS will be required to meet all payroll compliance obligations, including submission of all returns and tax certificates by the relevant deadlines.

POSSIBLE SOLUTION

A possible solution for the foreign employer around the SA payroll compliance obligations is to engage a payroll company to be its employer of record (EOR) in South Africa. The payroll company usually has an international network of existing EOR companies in various jurisdictions, including in South Africa. Ideally, the network of existing EOR companies (including the EOR entity in South Africa) would be wholly owned by the EOR parent entity.

The SA employee will be co-employed by the foreign employer and the SA EOR company. The SA EOR company is the legal in-country employer responsible for complying with all SA employment legislation. The employee will be on the SA EOR company's payroll and this company will account for all payroll taxes due to SARS. The foreign employer, however, remains responsible for the day-to-day supervision and control of the employee. Any employment and work-related decisions will still be made by the foreign employer.

The EOR arrangement is useful for multinationals to contract and deploy individuals wherever necessary in a matter of days without needing to go through the process of registering a subsidiary or branch in the country of deployment and of any related registrations with revenue authorities in those countries. This arrangement may provide an efficient solution in light of the proposed amendments affecting foreign employers in the Budget.

Joon Chong

Webber Wentzel

Acts and Bills

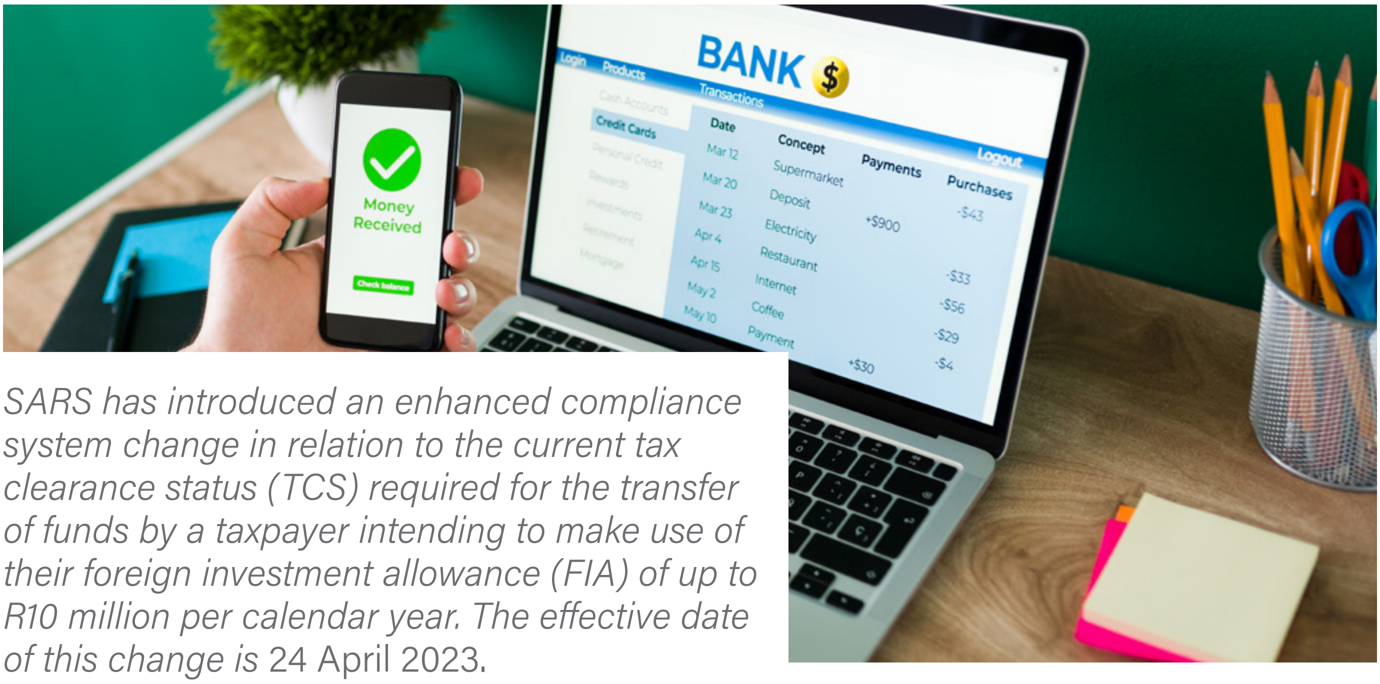
- Income Tax Act 58 of 1962: Fourth Schedule;
- Draft Taxation Laws Amendment Bill, 2023.

Other documents

- 2023 Budget Review: Annexure C.

Tags: foreign employer; representative employer; CIPC registration number; SARS income tax registration number

SARS DISCLOSURE REQUIREMENTS FOR TRANSFERRING FUNDS



SARS has introduced an enhanced compliance system change in relation to the current tax clearance status (TCS) required for the transfer of funds by a taxpayer intending to make use of their foreign investment allowance (FIA) of up to R10 million per calendar year. The effective date of this change is 24 April 2023.

The enhanced changes to the TCS system require additional information for the Approval for International Transfer (AIT) application, to aid SARS to ensure that all required tax payable has been duly accounted for by the taxpayer. It is further noted that this would only apply for amounts in excess of R1 million. No TCS is required for transfers up to R1 million per calendar year.

SUPPORTING DOCUMENTS REQUIRED FOR TAX RESIDENTS AND NON-TAX RESIDENT APPLICATIONS

When making an application for individual taxpayers, the following supporting documents must be submitted:

- Evidentiary documentation for the **source of the capital** to be invested (with each source having its own criteria).
- Statement of assets and liabilities for the previous three tax years (including disclosure of all investments, loan accounts and distributions from **local and foreign** companies and trusts).
- Power of attorney is required when the TCS application is submitted on behalf of the individual taxpayer.

NON-RESIDENT APPLICATIONS

In addition to the abovementioned supporting documentation the following is required:

- Proof that the individual taxpayer ceased to be tax resident in South Africa, including the date of tax residency cessation.
- Capital Gains Tax (CGT) calculation schedule, as determined at the time of ceasing of residency noting that the ceasing of tax residency gives rise to a deemed disposal of an individual's **world-wide assets** which may result in CGT.

Where the non-resident application is for a family unit and one or more of the members thereof are registered for tax purposes in South Africa, then the said members of the family unit must make a separate application to be issued a TCS Pin.

In respect of withdrawals from retirement funds, where a South African tax resident ceases residency, payment of the said benefit shall only be allowed where the individual remained non-tax resident for at the least three uninterrupted consecutive tax years.

SUPPORTING DOCUMENTS PER SOURCE CRITERIA

As discussed above the below evidentiary documentation is required to demonstrate the source of the funds. SARS has issued a comprehensive list of the evidentiary documents that are required per category depending on the source of income.

1. **Distributions from a trust**
   - Copy of trust deed;
   - Trustees' resolution for distribution;
   - Details of source of funds distributed by the trust;
   - Bank statement of the taxpayer issued on the date of the TCS application, reflecting the distribution from the trust;
   - Bank statement of the trust reflecting the distribution to the taxpayer, not older than a month;
   - Trust's latest portfolio statement (not older than a month), inclusive of the number of shares and current market value; and
   - Latest trust financial statements.
2. **Donations**
   - A declaration of the donation (IT144);
   - Bank statement of the donor (not older than a month) reflecting the donation paid;
   - Bank statement of the donee issued on the date of the TCS application, reflecting the donation received; and
   - Proof (copy of the receipt) of donations tax paid (not applicable to donation between spouses).
3. **Earnings**
   - Where a taxpayer has recurring foreign investments not exceeding R30 000 per annum a copy of a salary slip is needed once a year; and
   - The policy number noting that the institution (eg, Sanlam / Old Mutual) will apply on behalf of the taxpayer.
4. **Income from companies, local or foreign, where taxpayer holds direct or indirect beneficial interest**
   - The nature of relationship with the entity;
   - Proof of amounts/distribution received from such entities;
   - For an owner of any business, the company group structure, profile, and other group investments; and
   - If a director of company or member of a close corporation is a shareholder, a shareholder's agreement and share incentive scheme agreement.

"Where the non-resident application is for a family unit and one or more of the members thereof are registered for tax purposes in South Africa, then the said members of the family unit must make a separate application to be issued a TCS Pin."

5. **Inheritance**
   - A copy of the final liquidation & distribution account stamped and signed by the Master of the High Court; and
   - Bank statement issued on the date of the TCS application, reflecting the inheritance received.
6. **Investment income – local & foreign**
   - Schedules of the interest or dividends received indicating the source and amount of interest or dividends.
7. **Loan**
   - **Between individuals:**
   - The signed and complete loan agreement.
   - Bank statement of the lender, showing the loan amount, not older than a month.
   - Details of the source of capital of the lender.
   - Bank statement of the borrower issued on the date of the TCS application, showing the loan amount.
   - **Between trust and trustee or beneficiary:**
   - The signed and complete loan agreement.
   - Bank statement of trustee or beneficiary issued on the date of the TCS application, showing the loan amount.

- Latest trust financial statements.
- Bank statement of the trust showing the loan amount, not older than a month; or
- Trust's latest share portfolio statement (not older than a month), this statement will include the number of shares and current market value.
- **Between company and director or employee:**
- The signed and complete loan agreement.
- Bank statement of the borrower issued on the date of the TCS application, showing the loan amount.
- Company's latest annual financial statements.

8. Other

- Documentary proof and explanation.

9. Royalty income

- Source of royalty income; and
- Proof of royalty payment.

10. Sale of crypto assets

- Trading account statement reflecting the trade of the crypto asset;
- Bank statement, issued on date of the TCS application, reflecting the amount available for transfer.

11. Sale of property

- Original letter of the conveyancers to confirm the transfer of the property and that the money will be transferred from the trust account; or
- Proof of receipt of the proceeds in the applicant's bank statement not older than a month;
- Where the property was jointly owned, the proceeds of the sale to be clearly split as per source document; and
- CGT calculation on the sale of property.

12. Sale of shares & other securities

- CGT calculation on the disposal of the shares;
- Portfolio statement reflecting the sale of shares, not older than a month. This statement will also include the number of shares and current market value.
- The SARS webpage states: "Do not insist that the taxpayer transfer shares, investments, unit trusts, fixed deposits over to a savings account." [*Note: It is not clear what SARS means by this?*]

13. Savings/cash

- Bank statement issued on the date of the TCS application, reflecting the cash/savings value;
- Supporting documents that demonstrate and/or prove where the cash/savings originated from.
- It is advised by SARS that, should the taxpayer claim that the source of the funds to be invested is annual income / salary, then the administrator must review the past three year's taxable income on the income tax system to ascertain the reasonableness of the statement.

14. Transfer of listed securities

- Details of the locally listed securities that the taxpayer will be transferring to an exchange that is outside South Africa.
- CGT calculation on the transfer of the shares.

CONCLUSION

These changes, identified above, have placed a significant and higher burden of proof on the taxpayer intending to invest funds abroad whilst obtaining the TCS. This information is imperative for the transfer of funds out of the country. It is therefore critical that the TCS application is formulated correctly to ensure compliance with the required supporting documentation.

Frank Sebatana

PKF Durban

Other documents

- A declaration of the donation (IT144);
- International Transfer (AIT) Application;
- Capital Gains Tax (CGT) Calculation Schedule.

Tags: tax clearance status (TCS); foreign investment allowance (FIA); Approval for International Transfer (AIT) application; Statement of assets and liabilities; Capital Gains Tax (CGT) Calculation schedule; declaration of the donation (IT144); final liquidation & distribution account.

FUNDING FOR COMMUNITY-BASED PROJECTS

It is recognised in the Tax Exemption Guide for Public Benefit Organisations in South Africa *issued by the South African Revenue Service (SARS) (the PBO Guide) that non-profit organisations play a significant role in society by undertaking shared responsibility for the social and developmental needs of the country.*

This relieves the financial burden that would otherwise fall on the state. It is on this basis that public benefit organisations (PBOs) are granted preferential tax treatment. PBOs can either carry out public benefit activities (PBAs) or provide funds to other PBOs that carry out PBAs outlined in the Ninth Schedule to the Income Tax Act,1962 (the Act).

Section 30(1) of the Act, particularly paragraph *(c)*(i) of the definition of "public benefit organisation", requires each activity carried on by a PBO to be for the benefit of or to be widely accessible to the public at large, including any sector thereof (other than small and exclusive groups).

In terms of paragraph 1*(p)* of Part I of the Ninth Schedule to the Act, PBOs are empowered to engage with the community development for poor and needy persons and anti-poverty initiatives, including, *inter alia*, the promotion of community-based projects relating to self-help, empowerment, capacity building and skills development and of the provision of training, support or assistance to emerging micro-enterprises to improve capacity to start and manage businesses. However, it was not clear which community-based projects would meet the requirements of paragraph *(c)*(i) of the PBO definition in section 30(1) and there was uncertainty on this issue for PBOs.

In May 2022, SARS issued Binding Private Ruling (BPR) 371 where it determined whether the proposed operating model of a PBO was in line with the provisions of the said paragraph*(c)*(i). It should, of course, be noted that any BPR only has binding effect as between SARS and the applicant.

In BPR 371, the applicant (a PBO trust) was required, by agreement with a third-party donor, to make quarterly contributions to socio-economic and enterprise development initiatives in neighbouring communities. The PBO proposed an operating model, where the general public would submit proposals through established community forums and undergo a certain evaluation process. Initiatives aligned with the applicant's objectives and PBAs would then be granted funding.

The proposed transaction in this case involved the funding of four projects namely;

- a bakery;
- vegetable tunnels;
- a poultry project; and
- a small manufacturing concern.

The applicant sustained the view that the projects were to benefit the local community as contributions awarded will result in the creation of employment, skills development, and the enhancement of local enterprise. SARS affirmed the applicant's position and held that the applicant's initiatives being limited to a specific geographical region was consistent with the requirement that a PBO's PBA be carried on for the benefit of, or be widely accessible to, the general public at large, including any sector thereof (other than small and exclusive groups).

On face value, these projects that received funding, as indicated in BPR 371, do not appear to perform any qualifying altruistic function accessible to members of the general public as required by the abovementioned paragraph *(c)*(i). However, SARS' confirmation reveals that, in certain instances, SARS may adopt a purposive approach to the interpretation of paragraph *(b)*(i) of the PBO definition, giving recognition to the importance of socio-economic development.

"Although the issuing of donations or grants to projects has been clarified, there remains uncertainty concerning provision of loans to projects and/or microenterprises."

BPR 371 solidifies the position that projects, unlike previously, can now be afforded donations or grants by carrying out activities which are in line with those of the PBO. The BPR also shines a light on the fact that there is a route through which PBOs can be utilised to fund non-PBO initiatives as long as there is a PBA, recognised under the Ninth Schedule, which is being carried out and the requirements of section 30(1) are adhered to by the PBO.

Although the issuing of donations or grants to projects has been clarified, there remains uncertainty concerning provision of loans to projects and/or microenterprises. In terms of paragraph 1*(p)*(iii) of Part I of the Ninth Schedule, PBOs have been empowered to offer support to microenterprises; however, the required guidance to carry out this PBA is yet to be provided.

The Minister's guidance on the provision of loans to microenterprises by PBOs has the potential to change the economic fabric of South Africa, as the core struggle of emerging microenterprises is to obtain resources. The guidance is crucial at this stage on the basis that paragraph 1(p) serves as an adequate pathway for supporting persons and/or enterprises that can contribute towards the creation of employment, skills development, and the enhancement of local enterprise in the long run.

BPR 371 is of significant importance because it highlights how projects can be used as vehicles through which PBOs can perform the PBAs. It should encourage other PBOs to adopt progressive methods of executing their objects. As the realm of funding of projects has been clarified, we hope to see progress in terms of loans being granted to microenterprises with the potential to bear positive societal effects that mirror PBAs.

Mmangaliso Nzimande & Lerato Rankhumise

ENSafrica

Acts and Bills

- Income Tax Act 58 of 1962: Section 30(1) (particularly paragraphs *(b)*(i) & *(c)*(i) of the definition of "public benefit organisation"); Ninth Schedule: Part I: Paragraph 1*(p)*.

Other documents

- *Tax Exemption Guide for Public Benefit Organisations in South Africa* (SARS);
- Binding Private Ruling 371 (*"Public benefit activities carried on for the benefit of the general public"*).

Tags: preferential tax treatment; community-based projects.

IT IS CONSTITUTIONALLY PERMISSIBLE TO DISCLOSE TAX RECORDS WHERE SUCH A DISCLOSURE IS IN THE PUBLIC INTEREST

On 30 May 2023, the Constitutional Court in the case of Arena Holdings (Pty) Ltd t/a Financial Mail and Others v South African Revenue Service and Others, *[2023], ruled that it is constitutionally permissible to disclose a taxpayer's information held by the South African Revenue Service (SARS) where such a disclosure is in the public interest.*

This follows a four-year battle by financial journalist Warren Thompson (Thompson) to gain access to former President Jacob Zuma (Zuma)'s tax returns that were filed during the time that he was the President of South Africa. The request for access to Zuma's tax records was premised on the allegations that were made in the book written by Jacques Pauw (titled *"The President's Keepers: Those Keeping Zuma in Power and out of Prison"*) that Zuma was not tax compliant during the time that he was President. The basis for the request was therefore that there was a clear public interest in disclosing the tax records under the Promotion of Access to Information Act, 2000 (PAIA).

Thompson initially made a request to SARS for access to Zuma's tax records, which was refused by SARS on the basis that Zuma was entitled to confidentiality under sections 34(1) and 35(1) of PAIA as well as section 69(1) of the Tax Administration Act, 2011 (the TAA).

Briefly, the sections on which SARS relied for the refusal of Thompson's request provided as follows:

- Section 34(1) of PAIA: the information officer of a public body *must refuse a request for access to a record* of the body if its disclosure would involve the unreasonable disclosure of personal information about a third party, including a deceased individual.
- Section 35(1) of PAIA: the information officer of SARS *must refuse a request for access to a record* if such record contains information that was obtained or is held by SARS for purposes of enforcing legislation concerning the collection of revenue.
- Section 69(1) of the TAA: a SARS official (current or former) must preserve the secrecy of taxpayer information and *may not disclose* taxpayer information to a person who is not a SARS official.

DECISION OF THE HIGH COURT

Thompson, together with the *Financial Mail* and Amabhungane Centre for Investigative Journalism (collectively referred to as the Applicants), approached the High Court to request the court to determine whether tax information held by the State receives absolute protection from disclosure under PAIA. They also challenged the constitutional validity of the statutory prohibition of the disclosure of a taxpayer's information held by SARS, in circumstances where the disclosure would reveal evidence of a substantial contravention of the law and would be in the public interest.

The High Court's findings were that the argument that public interest overrides the limitation of taxpayer confidentiality was justified, that the blanket prohibitions of disclosure of taxpayer information contained in section 35 of PAIA and section 69 of the TAA unjustifiably limit the right of access to information provided for in section 32 of the Constitution of the Republic of South Africa, 1996 (the Constitution), and that a "reading-in" of the "public–interest override" provisions contained in section 46 of PAIA was justified and competent. The High Court thus declared the sections 34(1) and 35(1) of PAIA, as well as section 69(1) of the TAA, invalid and unconstitutional and ordered an interim reading-in. Following the declaration of invalidity, the High Court granted the application for the release of Zuma's tax records.

MAJORITY DECISION IN THE CONSTITUTIONAL COURT

The Applicants approached the Constitutional Court to confirm the declaration of invalidity made by the High Court.

The court found that section 69 of the TAA limits the rights to access to information provided for in section 32 of the Constitution and accordingly declared section 67 and section 69 of the TAA unconstitutional to the extent that they preclude –

- access to information being granted to a requester in respect of tax records where the requirements set out in section 46 of PAIA are met; and
- a requester from further disseminating information obtained as a result of a PAIA request.

> "SARS has been ordered to freshly consider Thompson's request under PAIA for access to Zuma's individual tax returns for the 2010–2018 tax years in light of the Constitutional Court's order."

As regards PAIA, the court's view is that the effect of section 35(1) of PAIA is that it elevates "… taxpayer confidentiality to some sacrosanct place where no exception to enable public access to it is possible", and the court cautioned against this elevation. The court found that there is no reasonable basis to hold that taxpayer information cannot be subject to the "public-interest override" in section 46 of PAIA in circumstances where the override is potentially available to justify the disclosure of information that may relate to the life and the safety of an individual, the defence or the security interest of the country or the private information of a third party (including their medical records), all of which can happen in terms of section 46. For this reason, the court found that section 35(1) cannot survive constitutional scrutiny.

Accordingly, the Constitutional Court declared section 35(1) of PAIA, read with section 46, unconstitutional to the extent that they preclude access to tax records by a person other than the taxpayer (a requester) even in circumstances where the requirements set out in terms of section 46 are met.

So, what are these "requirements" set out in section 46, one may ask? Briefly, section 46 provides for the mandatory disclosure of certain records, despite any other provision in Chapter 4 of PAIA (which covers sections 33 to 45 and the grounds on which access to information can be denied), if the following requirements are met:

- The disclosure of the record must reveal evidence of a substantial contravention of, or failure to comply with, the law OR an imminent and serious public safety or environmental risk; and
- The public interest in the disclosure of the record must clearly outweigh the harm contemplated in the relevant provisions in PAIA.

Where to from here?

The Constitutional Court has granted Parliament a period of 24 months (from 30 May 2023) to address the constitutional invalidity. Meanwhile, the court has "read in" words to sections 46 of PAIA and 69(2) and 67(4) of the TAA pending any measures to be taken by Parliament to address the constitutional invalidity. In terms of the current reading (which includes the Constitutional Court's reading-in):

- SARS officials (current or former) are not prohibited from disclosing taxpayer information to a person who is not a SARS official where access has been granted for the disclosure of the information in terms of PAIA.
- A person who receives information under sections 68–71 of the TAA as a result of a PAIA request may further disseminate the information.

SARS has been ordered to freshly consider Thompson's request under PAIA for access to Zuma's individual tax returns for the 2010–2018 tax years in light of the Constitutional Court's order.

Thompson has been afforded one month (from 30 May 2023) to supplement his request for access to Jacob Zuma's 2010–2018 tax returns.

Lebo Motsumi Nkoloti

Bowmans

Acts and Bills

- Promotion of Access to Information Act 2 of 2000: Sections 34(1), 35(1), 46; Chapter 4 (sections 33–45);
- Tax Administration Act 28 of 2011: Sections 67, 68, 69(1), 70 & 71;
- Constitution of the Republic of South Africa, 1996: Section 32.

Other documents

- *The President's Keepers: Those Keeping Zuma in Power and out of Prison* (Jacques Pauw).

Cases

- *Arena Holdings (Pty) Ltd t/a Financial Mail and Others v South African Revenue Service and Others* [2023] ZACC 13.

Tags: public interest; tax records; tax compliant; disclosure of a taxpayer's information.

JURISDICTION IN TAX DISPUTES

"Jurisdiction is not given for the sake of the judge, but for that of the litigant." These words spoken by the famous French mathematician, Blaise Pascal, might resonate with many. For the average person, the question as to whether someone has "jurisdiction" to hear a matter is something highly technical with which only lawyers need to concern themselves.

In the same vein, many people may also feel that the effect of jurisdiction is something that can often exclude a litigant's or aggrieved person's access to justice and a just outcome, as opposed to promoting it.

In the tax context, the question of jurisdiction has become a hotly debated one, as a number of cases have made their way through our courts culminating with the Supreme Court of Appeal (SCA) handing down three judgments relating to the question of jurisdiction. As things stand there, the judgment in *Absa Bank Limited and Another v Commissioner for the South African Revenue Service,* [2021] ZAGPPHC 127, was appealed to the SCA, where it was heard in March 2023. It is anticipated that this judgment will also deal with the question of jurisdiction. In this article, we briefly touch on some of the judgments that have been handed down and the concomitant issues arising, without dissecting the issues at this stage.

THE MAIN HURDLE: SECTION 105 OF THE TAA

Section 105 of the Tax Administration Act, 2011 (the TAA), states that, unless a High Court directs otherwise, a taxpayer may only dispute an assessment or "decision" as described in section 104 in proceedings under Chapter 9 of the TAA. In *Commissioner for the South African Revenue Service v Rappa Resources (Pty) Ltd,* [2023] ZASCA 28, the taxpayer launched an urgent review application in the High Court requesting the review and setting aside of additional value-added tax (VAT) assessments, instead of objecting to the assessments in the ordinary course in terms of section 104 of the TAA. The question of High Court jurisdiction was decided by the High Court in the taxpayer's favour, and the South African Revenue Service (SARS) appealed this decision. The SCA ultimately held that, in terms of this section, it is required that a taxpayer must first apply for the High Court to direct that it has jurisdiction to hear the application, before it can actually be heard. In *United Manganese of Kalahari v Commissioner for the South African Revenue Service,* [2023] ZASCA 29, which was decided by the SCA on the same day (24 March 2023), it reached the same conclusion, albeit that the dispute in that case related to transfer pricing and had slightly different facts. Both judgments were thus decided in SARS' favour.

REVIEW AND JURISDICTION IN THE CUSTOMS AND EXCISE CONTEXT

In *Commissioner for the South African Revenue Service and Another v Richards Bay Coal Terminal (Pty) Ltd,* [2023] ZASCA 39, heard by the SCA just a week later, the issue of jurisdiction also arose. In short, the issue here was whether the taxpayer could, in terms of section 47(9)*(e)* of the Customs and Excise Act, 1964 (the CEA), appeal and review a tariff determination under the Promotion of Administrative Justice Act, 2000 (PAJA), alternatively the principle of legality.

In this case, the SCA stated, amongst other things, that "nothing in the CEA expressly ousts the jurisdiction of the High Court to review a tariff determination decision". The SCA thus held that the High Court has the jurisdiction to hear a review application for a tariff determination, where the review is based on PAJA or the principle of legality.

"In the tax context, the question of jurisdiction has become a hotly debated one, as a number of cases have made their way through our courts culminating with the Supreme Court of Appeal (SCA) handing down three judgments relating to the question of jurisdiction."

CONFLICTING APPROACHES? WHAT'S NEXT?

While on the face of it, it may seem strange that the same court held that a High Court has jurisdiction (automatically) to hear a review of a SARS decision in the customs and excise context, but not in the context of reviewing a VAT assessment, one should appreciate that section 105 of the TAA does not apply in the customs and excise context. Whether any of the decisions we refer to are correct is not at issue, but rather, whether the SCA's approach is inconsistent. While the different outcomes are likely based on the different pieces of legislation underpinning the matters, it is possible that the parties will appeal the judgments to the Constitutional Court. It will also be interesting to see whether the SCA will, in *Absa Bank Limited*, follow the same approach it did in *Rappa Resources* and *United Manganese of Kalahari.*

While the debate regarding jurisdiction in tax disputes might seem academic to some, it has great practical importance, as it impacts on the constitutional right to fair administrative action. It is hoped that, once all is said and done, the result will not be that taxpayers are unfairly limited in the way they dispute tax assessments and in exercising their right to fair administrative action.

Louis Botha

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 104 & 105;
- Customs and Excise Act 91 of 1964: section 47(9)*(e)*;
- Promotion of Administrative Justice Act 3 of 2000.

Cases

- *Absa Bank Limited and Another v Commissioner for the South African Revenue Service* (2019/21825) [2021] ZAGPPHC 127; 2021 (3) SA 513 (GP) (11 March 2021);
- *Commissioner for the South African Revenue Service v Rappa Resources (Pty) Ltd* (1205/2021) [2023] ZASCA 28 (24 March 2023);
- *United Manganese of Kalahari v Commissioner for the South African Revenue Service* (1231/2021) [2023] ZASCA 29 (24 March 2023);
- *Commissioner for the South African Revenue Service and Another v Richards Bay Coal Terminal (Pty) Ltd* (1299/2021) [2023] ZASCA 39 (31 March 2023).

Tags: jurisdiction; fair administrative action.

VALUE CHAIN ANALYSIS

CLASSICAL TRANSACTIONAL TRANSFER PRICING

As contentious as transfer pricing can be in many respects, there is an established set of principles generally agreed upon under the *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, which is issued by the Organisation for Economic Cooperation and Development (the OECD Guidelines) and is accepted by most regimes.

Most of the debate is around interpreting the facts and the application of suitable methods based on third-party data. Typically, only the prices of individual transactions and the simplest sides of transactions are looked at, while the entrepreneurial entities and the full value chain receive limited focus.

THE BASE EROSION AND PROFIT SHIFTING (BEPS) INITIATIVE

The changes brought in by the OECD's BEPS Action Plan have the potential to radically change tax outcomes for many taxpayers. The realignment of taxing rights with economic substance is at the heart of the initiative. The OECD defines this as the need for aligning transfer pricing outcomes with value creation.

Two key pillars of the BEPS Action Plan are –

- ensuring that substance and value creation are consistent with the location of taxable profits (Actions 8 and 10); and
- requiring transparency in the profitability, tax outcomes and global business value chain of a Multinational Enterprise (MNE) (through the country-by-country reporting and the Master File, as per Action 13).

This means that companies require a coherent and holistic picture of their business, which articulates how and where value is created, as well as helps to identify and explain profit and tax outcomes.

THE VALUE CHAIN ANALYSIS (VCA) APPROACH

A VCA can be an important tool in demonstrating that the location of a company's taxable profits is consistent with the location of key substances.

A VCA considers an end-to-end view of a company's activities, enabling a better perspective on the way a business works and how each component contributes value.

Classical transfer pricing and the arm's length standard are still the prevailing principles of transfer pricing; however, the requirements for supporting a company's transfer pricing system are rapidly evolving and are demanding a more complete review of the entire value chain. Therefore, a VCA should be performed in addition to the classical transactional transfer pricing analysis.

Each VCA should start with identifying the value chain within the industry and the result of the VCA provides a fair and accurate view of the actual allocation of the group's profit in the global value chain.

The VCA approach looks at the consolidated totality of the MNE and its peers and involves an investigation into the functions, assets and risks of the group as a whole, and an evaluation of how they integrate with the group's key value drivers. The conclusions from these analyses are often used to attribute group profits to key functions, assets and risks, and value drivers of the business.

ISSUES ADDRESSED THROUGH VCA

In contrast to a local file, master file, or country-by-country report, the VCA is not a compliance requirement, ie, in most countries, taxpayers are not obligated to prepare it. Nevertheless, many MNEs are very interested in performing a VCA as it provides so many benefits:

- Assessing your transfer pricing model's alignment with the OECD BEPS principles:
  - A VCA can help assess the risk of a transfer pricing model for MNEs and test whether the location of key value drivers and business substance is appropriately connected with the location of taxable profits.
- Supporting your master file and country-by-country reporting:
  - Although the VCA is not explicitly required in most countries, it is a beneficial addition to the standard transfer pricing documentation package. A VCA can help explain the drivers of business profit and principal contributions of value creation, as required under the master file requirements as well as explain your country-by-country reports and the location of taxable profits.
- Deepening your understanding of how your business functions:
  - A well-executed VCA can help you align your operating model to reality, and enable you to articulate this simply and objectively. As businesses evolve, change and restructure, a VCA can ensure that the tax outcomes continue to align with the new operating model. It can then be used to develop the most appropriate transfer pricing approach to apply.
- Developing a more sustainable model:
  - A VCA can identify a fundamental change in the way a company operates, or may simply reinforce the validity of its existing model.
- Preparing for discussions with tax authorities and stakeholders:
  - A VCA can help you clearly and transparently demonstrate to tax authorities and other stakeholders how a legal entity's share of the total business profit correlates with its role in the value chain. In APA (Advanced Pricing Agreement) discussions or audits, tax authorities often want to know how the organisation operates and where the value is created. Presenting the VCA is usually a great way to answer most of their questions.

A VCA creates a context for pricing transactions between entities by assessing the relative contributions made by each entity to the overall business.

"Each VCA should start with identifying the value chain within the industry and the result of the VCA provides a fair and accurate view of the actual allocation of the group's profit in the global value chain."

Robyn Kantor

ENSafrica

Other documents

- *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (issued by the Organisation for Economic Cooperation and Development (OECD));
- Base Erosion and Profit Shifting (BEPS) Action Plan: Actions 8, 10 & 13.

Tags: Base Erosion and Profit Shifting (BEPS); BEPS Action Plan; value chain analysis (VCA); country-by-country report.

REPORTING REQUIREMENTS REGARDING BENEFICIAL OWNERSHIP

South Africa is introducing new rules regarding the disclosure of beneficial ownership of assets as part of the measures to address its laws regarding anti-money laundering and the combating of terrorism financing.

The rules applicable to trusts and companies are not identical and persons who act as trustees of trust/s and as directors of company/ies, must ensure that they are familiar with both sets of rules.

The rules regarding trust assets, which came into effect from 1 April 2023, are outlined below.

The measures were introduced in a new section 11A in the Trust Property Control Act, 1988 (TPCA), read with the Regulations issued in terms thereof (the Regulations).

In terms of section 11A(1) of the TPCA, a trustee must –

"*(a)* establish and record the beneficial ownership of the trust;

(b) keep a record of the prescribed information relating to the beneficial owners of the trust;

(c) lodge a register of the prescribed information on the beneficial owners of the trust with the Master's Office; and

(d) ensure that the prescribed information referred to in paragraphs *(a)* to *(c)* is kept up to date."

The aim of the new rules is to provide some form of transparency regarding the ownership of trust assets *before* such assets, or the income of such assets, are vested in the beneficiaries.

It is important for trustees of all trusts (including family trusts, investment vehicles, share schemes and charitable trusts) to assess to what extent the record-keeping and reporting requirements would apply to them and to ensure that they comply with their obligations in this regard.

WHAT IS A "BENEFICIAL OWNER"?

There is no standard definition of beneficial ownership in South Africa. When considering the concept in the context of trusts, the definition in section 1 of the TPCA will apply. It includes:

(a) a natural person who directly or indirectly ultimately owns the trust property;

(b) a natural person who exercises effective control of the administration of the trust;

(c) each founder of the trust;

(d) each trustee of the trust; and

(e) each beneficiary referred to by name in the founding documents of the trust.

Paragraphs *(c)* to *(e)* above are subject to special rules where the founder, trustee or the beneficiary is a legal person or a partnership.

The concept of beneficial ownership for purposes of TPCA reporting would have to be interpreted based on the context and on the specific set of facts. For example, in the context of a share scheme, a beneficiary who is not specifically named and who does not have a vested right to trust assets but who receives income derived from trust assets, would arguably not qualify as a beneficial owner as defined, although each case would have to be assessed based on the specific facts.

INFORMATION AND DOCUMENTATION TO BE RETAINED BY TRUSTEES

The trustees must keep detailed information of the beneficial owners of trust assets, including full name, date of birth, nationality, an official identity document number or passport number, citizenship, residential address, address for notices, other means of contact, tax number (if applicable), class or category of beneficial ownership, the date on which the person became a beneficial owner, and the date on which the person ceased to be a beneficial owner.

Where the beneficial owner is a minor, the same information must be provided for the legal guardian of the minor. The trustee must keep a certified or verified copy of the official identity document or passport of each identified beneficial owner of the trust.

ELECTRONIC REGISTER BY THE MASTER OF THE HIGH COURT

The Master must keep an electronic register of beneficial owners. Trustees must be able to submit the beneficial ownership information (see above) to such electronic register. The register must be electronic and provide for access to registered users; and access for trustees to lodge and update information, upload documents and sign off on the information. It appears that this register is already available on the website of the Master of the High Court.

The trustees are, in terms of section 11A (see above), obliged to lodge a register of the beneficial owner information with the Master's Office, ie, on the electronic register and to ensure that such information is kept up to date.

ACCESS TO THE INFORMATION REGARDING BENEFICIAL OWNERSHIP

This is likely to be the biggest concern for trustees: Which persons or entities will have access to the information and is there a risk that third parties could also obtain access to the information?

In terms of the Regulations, access to such information is restricted to various government bodies such as the National Prosecuting Authority, the Independent Police Investigative Directorate, the State Security Agency, the Intelligence Division of the National Defence Force, a Special Investigating Unit, the South African Revenue Service, the Financial Intelligence Centre and such other bodies as are named in the Regulations.

Access could also be granted to *a person who is entitled to receive such information in terms of other national legislation*. Regulation 3E sets out the list of entities as well as the process to obtain access to such information.

These entities must request access in writing, providing proof that they qualify and designate officials who will have access. The Master must then grant access to the designated officials. The Regulations do not provide for the Master to request feedback or input from the trustees in question, before providing such access.

OTHER REQUIREMENTS OF THE REGULATIONS

The Regulations also provide for the Master to establish and maintain a public register of persons disqualified from serving as trustees, and for trustees to record the details of accountable institutions as contemplated in section 11(1)*(e)* of the TPCA. These include any accountable institution listed in Schedule 1 to the Financial Intelligence Centre Act, 2001, used by the trustees to perform any of the trustees' functions relating to trust property.

"There is no standard definition of beneficial ownership in South Africa. When considering the concept in the context of trusts, the definition in section 1 of the TPCA will apply."

Aneria Bouwer & Wally Horak

Bowmans

Acts and Bills

- Trust Property Control Act 57 of 1988: Sections 1 (definition of "beneficial owner"), 11(1)*(e)* & 11A (in particular subsection (1);
- Financial Intelligence Centre Act 38 of 2001: Schedule 1.

Other documents

- Regulations issued in terms of Trust Property Control Act 57 of 1988: Regulation 3E.

Tags: beneficial ownership; accountable institutions.

TRUST INCOME VESTED IN NON-RESIDENT BENEFICIARIES

A significant change to the tax treatment of income which is vested by a South African trust in non-resident beneficiaries has been proposed in Annexure C of the 2023 Budget Review (the Review*), which sets out additional tax amendments for the upcoming legislative cycle.*

Under current South African statute and common law, a trust is regarded as a "conduit" or flow-through vehicle in relation to receipts and accruals of income by trustees where such amounts are vested in a beneficiary in the same year of assessment as the income is received by or accrues to the trustees. In this instance, the income is taxable in the hands of the beneficiary in whom the amount has been vested, regardless of whether the beneficiary is a resident or a non-resident for tax purposes.

This differs from the tax treatment of capital gains arising in respect of the disposal of capital assets by a South African trust and which are vested in a beneficiary in the same year of assessment. In the case of a capital gain which is vested in a beneficiary, the attribution of the capital gain to the beneficiary only applies if the beneficiary is a South African tax resident. Where the beneficiary is a non-resident, the capital gain is subject to capital gains tax in the hands of the South African tax resident trust and not in the hands of the beneficiary.

The proposed amendment will change the taxation of income distributions by a South African trust to align this with the taxation of capital gains vested in a beneficiary. In other words, income which is vested in a South African resident beneficiary in the same year of assessment will continue to be taxable in the beneficiary's hands on the current flow-through basis. However, any income which is vested in a non-resident beneficiary will be taxable in the trust at an income tax rate of 45%.

Presumably, where income is vested in a non-resident beneficiary and taxed in a trust, there should be no South African tax implications for the non-resident beneficiary.

The reason given for this change is the gradual relaxation of exchange control regulations which, according to the *Review*, has led to an increase in applications to SARS for confirmation of the tax compliance status of individuals for purposes of transferring funds offshore. The *Review* states that government is concerned about the difference between the rules governing the tax treatment of income and capital gains distributed to beneficiaries, in terms of which capital gains can only be attributed to beneficiaries who are South African tax residents and cannot flow through to non-resident beneficiaries.

The *Review* also states that the flow-through of amounts from South African tax resident trusts to non-resident beneficiaries makes it difficult for SARS to collect income tax from those non-resident beneficiaries as it is more complicated to enforce recovery actions against non-residents.

When this change is introduced, the potential impact on the tax liability of South African trusts will have to be considered. It will also be important to consider the interplay of the amended tax provision with the donor attribution rules (SARS' views on this are set out in Interpretation Note 114), as well as the withholding tax regime for interest and dividends.

"The proposed amendment will change the taxation of income distributions by a South African trust to align this with the taxation of capital gains vested in a beneficiary."

The exchange control implications of distributions by a South African trust to a non-resident beneficiary should also be considered. In this regard, where the non-resident beneficiary is a foreign trust, SARS has confirmed that they would consider approval for the transfer of funds vested in the non-resident trust, provided that a manual letter of compliance is obtained from SARS.

Jenny Klein

ENSafrica

Other documents

- 2023 Budget Review: Annexure C.

Tags: taxation of income distributions; non-resident beneficiary; exchange control regulations; tax compliance status.

VAT REGISTRATIONS: MORE STRINGENT REQUIREMENTS

An important objective and design principle of SARS' administrative platform is to balance the ease of VAT registration with the potential risk of abuse to which this could give rise when persons are merely seeking to obtain a VAT number in order to claim fraudulent VAT refunds.

In a media release issued by SARS on 11 May 2023, it noted concern following a trend of suspicious VAT registrations during the month of April. In particular, SARS noted that its sophisticated risk system indicated that there was a significant increase in the number of VAT registrations during April. Upon further analysis by SARS it appears that a large number of such VAT registrations were, in their view, created with the intention of defrauding SARS.

Since COVID-19, VAT registration applications were electronically submitted to SARS and approved with relative ease. Over time, it appears that this ease of registration has led to abuse.

In order to address the potential for fraud and further illegitimate VAT registrations, SARS **implemented** the following **with effect from the date of the media release:**

A more stringent process will apply to all new VAT registration applications which could include the requirement that applicants present themselves, in person, to their closest SARS branch office for validation and accreditation.

- Should an applicant be expected to visit a SARS branch office, such appointment must be pre-booked on the SARS website.
- All supporting documents required for the validation of registration must be submitted at the SARS branch on the day of the appointment.
- SARS will only register a person for VAT if it is satisfied that the application is lawful.

Although SARS notes that more stringent registration requirements may give rise to inconvenience for honest taxpayers, such inconvenience is necessary to address perpetrators who effectively steal from the fiscus leading to an increase in the overall tax burden for honest taxpayers.

SARS reaffirmed that it is committed to paying legitimate VAT refunds to qualifying taxpayers, but made it clear that it will pursue criminal charges against perpetrators falsely registering for VAT and/or fraudulently claiming refunds.

In our view, the critical aspect on which SARS should focus to address this abuse should be to suitably audit VAT refunds as opposed to implementing measures that may delay a VAT registration process. Historically, when the registration process was more complex, this gave rise to delays in VAT registrations which impacted on business growth, but fraudulent VAT refund claims remained an issue. The balance sought to be achieved by SARS may, in our view, be better achieved in the interest of economic growth if the focus was more on the audit of a VAT refund rather than the VAT registration process.

PKF Cape Town

Acts and Bills

- Value-Added Tax Act 89 of 1991

Tags: more stringent registration requirements; VAT registration.

WHEN IS A TAX DEBT ESTABLISHED?

Can the Commissioner for the South African Revenue Service (SARS) set off a company's income tax liability against the VAT refunds that are due to that company, in circumstances where the tax liability concerns a period prior to the company entering business rescue, but was only determined or quantified after the company had already entered into business rescue?

This was the question that was before the High Court in Johannesburg in the matter of *Henque 3935 CC t/a PQ Clothing Outlet v Commissioner for SARS,* [2023].

In this article, the case and the court's interesting findings are discussed. However, before that is done, context is provided by setting out some background regarding the business rescue process in South Africa as it had an impact on the court's determination of the issues.

WHAT IS BUSINESS RESCUE?

In terms of section 128(1)*(b)* of the Companies Act, 2008 business rescue is a legal process that is designed to "facilitate the rehabilitation" of an entity that is financially distressed by –

- temporarily appointing a business rescue practitioner (BRP) who supervises and manages the affairs of the entity;
- placing a temporary moratorium on the rights of claimants against the entity or against any property in the possession of the entity; and
- allowing for a business rescue plan to be developed.

By placing a temporary moratorium on the rights of claimants, the Companies Act effectively ring-fences the debts of the entity that have accrued prior to the commencement of business rescue. It is these debts on which the plan focuses to "rehabilitate" or "rescue" the entity.

In terms of section 154(2) of the Companies Act, no creditor, including SARS, if owed unpaid taxes which were due and payable prior to the commencement of business rescue, can enforce the debt except in terms of the business rescue plan. Post-commencement debts (referred to as post-commencement finance in the Companies Act), however, are dealt with in terms of section 135 of the Companies Act and are not affected or compromised by the business rescue plan. Section 135 creates preferent claims in respect of post-commencement finance obtained by the company and specifies the ranking of these claims.

It should therefore be noted that SARS would typically prefer that its tax debts and claims against the entity in business rescue constitute "post-commencement finance" as opposed to pre-business rescue claims. This would place SARS in a better position to recover taxes due to it from the entity under business rescue. This formed the crux of the issue in this matter.

THE FACTS

Henque (the applicant), a South African tax resident close corporation, submitted its 2017 tax return in terms of which it claimed to have made a loss of R46,000. At the same time, it had accumulated tax credits for VAT, in the amount of R1,018,820.80, for which it was entitled to a refund.

On 29 November 2017 SARS issued a notice of assessment to Henque in which it recognised that an income tax refund was due to Henque. The assessment was based solely on the claims made by Henque in its 2017 income tax return. In the same notice, SARS informed Henque that it was to be subjected to an audit in respect of its 2017 tax year.

On 31 January 2018, Henque placed itself into voluntary business rescue. The first meeting of creditors and employees was held on 12 February 2018.

The audit into Henque's tax affairs for the 2017 tax year was completed by SARS on 4 April 2018. In terms of the audit findings, Henque was found to have actually produced taxable income of R16,793,724 for the 2017 tax year as opposed to having realised a loss of R46,000, as claimed in its income tax return. The additional assessment, which reflected an amount payable by Henque of R5,620,571.03, was issued by SARS on 1 May 2018. Notably, the "due date" in the additional assessment was 1 May 2018, whereas the "second date" (being the date when the amount owing was to be paid) was 31 May 2018.

In relation to the business rescue proceedings, the BRP published Henque's business rescue plan on 31 May 2018 (ie, subsequent to the issue of the additional assessment). The business rescue plan recognised a tax liability for VAT (R2,467,810) and for pay-as-you-earn tax (PAYE) (R568,728). Therefore, the total tax liability owed to SARS pre-commencement of business rescue proceedings was R3,036,538 according to the business rescue plan. The business rescue plan did not include the income tax liability for 2017, despite it having been issued to Henque as an additional assessment by the time the business rescue plan was published. According to the plan, SARS would receive only 15% of its claim.

The business rescue plan was adopted by the creditors at a meeting that was held on 13 June 2018. SARS was not present at the creditors' meeting (there was a dispute between the parties as to whether SARS was adequately notified of the meeting and provided with a copy of the business rescue plan). The creditors whose claims were accepted by the BRP, excluding SARS, were paid.

On 2 August 2018, a SARS employee addressed a letter to the BRP stating that SARS was not kept informed of the business rescue proceedings and would therefore approach the court for an order setting aside the business rescue proceedings. The BRP responded to SARS' letter on the same day, requesting that SARS send a copy of its claim against Henque for adjudication.

Ultimately SARS claimed R8,131,225.67 from Henque. The claim consisted of: (i) a VAT claim of R2,840,005.05; (ii) a PAYE claim of R20,705.86; (iii) an Unemployment Insurance Fund claim of R104,819.02; (iv) a skills development levy claim of R64,334.60; and (v) an income tax claim of R5,101,361.14 (the figure claimed was different from the amount reflected in the additional assessment). However, SARS acknowledged that the claim for income tax (R5,101,361.14), although raised on 4 April 2018 (alternatively 1 May 2018), was a pre-commencement of business rescue debt. As such, SARS would have to recover this debt in terms of the business rescue plan. As for the rest, SARS adopted the view that these were post-commencement debts. Therefore, in SARS' view, Henque owed it R3,029,894.53. At the same time, SARS owed Henque a VAT refund of R1,018,820.80.

Initially, SARS had conceded to the fact that the VAT refund could not be set off against the amount owed by Henque and that the refund was due and payable to Henque. However, in an email transmitted on 13 May 2019, SARS appeared to have changed its tune. Not only did it back-track on its concession regarding the offsetting of the VAT refund, SARS claimed that the income tax for the 2017 tax year had only become due and payable on 31 May 2018 when the additional assessment was completed. In other words, it alleged that the tax debt only arose when the amount owing under the additional assessment was due and payable, being the "second date" which was 31 May 2018. On that basis, SARS argued that it constituted a post-commencement debt.

Henque objected to SARS' decision to set off the VAT refund against the income tax liability for the 2017 tax year. The court was therefore asked to determine whether (i) the 2017 additional assessment constituted a pre-commencement debt; and (ii) SARS was permitted to set off the VAT refund due to Henque against the 2017 additional assessment.

"In terms of the Act (similar to the Namibian ordinance regarding taxation), normal tax is imposed in terms of section 5(1) in respect of taxable income received by or accrued to a taxpayer."

WHAT CONSTITUTES A TAX DEBT?

A "tax debt" is defined in section 1 of the Tax Administration Act, 2011 (the TAA), as an amount referred to in section 169(1). Section 169(1) in turn defines a "tax debt" as an amount of tax "due and payable" in terms of a tax Act. The key issue before the court was therefore whether the income tax liability was "due and payable" before or after the commencement of the business rescue proceedings.

KEY ARGUMENTS RAISED BY THE APPLICANT AND SARS

Notwithstanding the fact that SARS had initially acknowledged that the claim for income tax was a pre-commencement debt, in terms of its pleadings before the court it claimed that the income tax for the 2017 tax year had only become "due and payable" on 31 May 2018 when the additional assessment was completed and, therefore, constituted a post-commencement debt. SARS was further of the view that the refund owed to Henque could be set off against the tax debt owed. SARS, therefore, withheld the VAT refund due despite requests from Henque for the refund to be paid out and SARS' own initial concession that the refunds were payable (and would be paid) to Henque.

Henque, on the other hand, was of the view that although the income tax additional assessment was completed post the commencement of the business rescue proceedings, this did not change the fact that the liability for the 2017 income tax arose and was due on 28 February 2017, being its financial and tax year-end. In this regard, Henque submitted that an assessment, including an additional assessment, of the liability subsequent to 28 February 2017 only quantified the liability. It did not create the liability.

Henque's submission was anchored on the fact that income tax is assessed under the Income Tax Act, 1962 (the Act), on an annual basis, and is based on the total taxable income received by or accrued to any person during the year of assessment as determined under the provisions of the Act, with due regard to the exemptions, deductions and allowances prescribed in the Act and applicable during that period. Henque specifically relied on section 5(1)*(d)* of the Act, which states that income tax shall be paid annually in respect of income received by or accrued to or in favour of any company during every financial year of such company.

Therefore, it was Henque's view that the amount assessed in terms of the additional assessment was a pre-commencement debt to be dealt with in terms of the business rescue plan. Henque was further of the view that the VAT refund of R1,018,820.80, which related to the February 2018 tax period, could not be set off against the assessed amount.

JUDGMENT

In arriving at its judgment, the court referred to and relied on a Namibian Supreme Court case (*Esselman v Secretary of Finance,* [1991]) which considered whether a liability arises for the payment of taxes in circumstances where a proper income tax assessment has yet to be made and served on the person upon whom the liability rests. In this regard, the court quoted a dictum from the Namibian case which, according to the court, succinctly sums up the legal position in a single sentence:

> "In my view, section 5 merely established generally the liability to pay tax, but does not make tax payable before it has been assessed."

In terms of the Act (similar to the Namibian ordinance regarding taxation), normal tax is imposed in terms of section 5(1) in respect of taxable income received by or accrued to a taxpayer. As noted above, taxable income must be determined by the taxpayer on an annual basis and in that respect, it is arguable that the tax liability arises at the end of each financial year and not necessarily when the actual assessment is raised.

The court noted that when SARS issues a notice of assessment it has to specify the amount to be paid as well as the date when payment is to be made. According to the court's reading of section 5(1)*(d)* in the context of sections 1, 92 and 96 of the TAA it is "unquestionably clear" that income tax only becomes due and payable when the assessment or additional assessment is made and issued to the taxpayer.

"A 'tax debt' is defined in section 1 of the Tax Administration Act, 2011 (the TAA), as an amount referred to in section 169(1). Section 169(1) in turn defines a 'tax debt' as an amount of tax 'due and payable' in terms of a tax Act."

The original notice of assessment was issued by SARS on 29 November 2017 and the additional assessment was made on 4 April 2018 and issued to Henque on 1 May 2018. The notice of the additional assessment identified the "due date" to be 1 May 2018 and the "second date" to be 31 May 2018, which is the date by when the assessed amount is to be paid to SARS before interest starts running.

The court held that the amount assessed only became due and payable on 31 May 2018 – ie, this is when it became a "tax debt" as defined.

The court further held that:

> "… section 5(1) of the Income Tax Act only establishes 'generally the liability' but that in terms of the relevant provisions of the TAA … the tax became due and payable when the additional assessment was made. Only when it was quantified and became due and payable did it become a debt. The additional assessment constitutes the important event that transforms a general liability into an actual one."

The court, therefore, concluded that the 2017 additional assessment was not a pre-commencement debt. The question whether SARS can set off a company's tax liability against the VAT refunds due to that company where the tax liability concerns a period prior to the company entering into business rescue, but was only determined or quantified after the company had already entered into business rescue, was therefore answered in the affirmative.

OBSERVATIONS

While the court made use of the phrase "unquestionably clear" in its judgment, there are a few issues that warrant further interrogation and discussion. For example, it is unclear why the court referred to and relied solely on foreign case law, which merely has persuasive value, when South Africa has several cases that deal with the specific issues before the court.

In this context, the court's judgment does not address the findings handed down in the recent case of the *Commissioner, South African Revenue Service v Wiese and Others*, [2023], and the Supreme Court of Appeal judgment in *Singh v Commissioner, South African Revenue Service,* [2003].

The court in *Wiese* held that it would be "unbusinesslike but will also emasculate the very purpose of the TAA as a whole" to require an assessment to first be issued before there is a "tax debt" for purposes of section 183 of the TAA.

Although the court in *Wiese* had to determine the meaning of what constitutes a tax debt within the context of section 183 of the TAA, the court made it clear that SARS did not have to issue an assessment to establish a tax debt under those circumstances. The court in *Wiese* noted that the debt exists irrespective of whether the taxpayer or SARS made an assessment. Based on this interpretation of what constitutes a tax debt, Henque's contention that the liability for the 2017 income tax arose and was due on 28 February 2017 could well have been upheld. Although the court in *Wiese* took a broad approach to the meaning of what constitutes a "tax debt", the court in the *Henque* case seems to have gone in the opposite direction, which creates much jurisprudential uncertainty.

It may be that the *Wiese* case can be distinguished from the *Henque* case on the basis that, inter alia, the *Wiese* case involved the application of the General Anti-Avoidance Rules (GAAR) and hence its interpretation of what constituted a "tax debt" was informed by this context. It is therefore a pity that the court in *Henque* did not address the *Wiese* case, which it could have done as *Wiese* was handed down a few months before the *Henque* case was heard.

The *Singh* case, on the other hand, related to a VAT assessment in terms of which SARS had obtained judgment for the amount payable before it had issued the assessment to the taxpayer. This case is distinguishable from the other two cases in that SARS did not follow the correct procedure insofar as notifying the taxpayer of the tax debt prior to obtaining judgment in respect thereof. However, the court still held that the assessing of a taxpayer to tax is to retrospectively render the tax due and payable when it ought to have been paid, ie, a tax debt exists irrespective of whether the taxpayer or SARS has made an assessment. In this regard, the court noted:

> "… an amount is due when the correctness of the amount has been ascertained either because it is reflected as due in the taxpayer's return or because the circumstances set out in section 32(5) had been applicable (in both of which cases it is both due and payable) or if there is a dispute after the procedures relating to objection and appeal have been exhausted (in which case the amount so ascertained was due and payable with the return)."

Based on the *Singh* case, one would have thought that the court in the *Henque* case might have found that the debt arose on 29 November 2017 when SARS issued the original notice of assessment based on Henque's income tax return and not when the additional assessment was issued. Although the *Singh* case dealt with VAT and not income tax, and these taxes have different assessment mechanisms, it would have been helpful if the court in this case had dealt with *Singh* and commented on whether different types of taxes have an impact on the interpretation of the meaning of a "tax debt" and when it becomes due and payable.

Furthermore, it could be argued that the court may have come to a different finding *in casu* because in terms of the original notice of assessment a refund was due to Henque as opposed to there being an amount due "and payable" by Henque. The question therefore arises as to whether the court could have come to a different finding if the original notice of assessment recognised an amount payable by Henque.

Whatever the outcome may have been there is much uncertainty now as to what constitutes a "tax debt" and in what context. It will be interesting to see if the *Henque* case goes on appeal to the higher courts in circumstances where much needed clarity in this area of tax law is sought.

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Acts and Bills

- Companies Act 71 of 2008: Sections 128(1)*(b)*, 135 & 154(2);
- Income Tax Act 58 of 1962: Sections 5 (in particular subsection (1)*(d)*) & 32(5);
- Tax Administration Act 28 of 2011: Sections 1 (read with section 169(1): definition of "tax debt"), 92, 96 & 183.

Cases

- *Henque 3935 CC t/a PQ Clothing Outlet v Commissioner for SARS* (2020/35790) [2023] ZAGPJHC 186;
- *Esselman v Secretary of Finance* [1991] (3) SA 681 (NmS);
- *Commissioner, South African Revenue Service v Wiese and Others* [2023] (1) SA 119 (WCC); (15065/17);
- *Singh v Commissioner, South African Revenue Service* [2003] (4) SA 520 (SCA); 65 SATC 203.

Tags: tax liability; business rescue; preferent claims; pre-commencement of business rescue debt; tax debt.

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