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TAX TAX ADMINISTRATION
SARS CAN ONLY LEVY TAX LEGALLY DUE

VALUE-ADDED TAX
APPORTIONMENT: THE *CAPITEC BANK* CASE

INTERNATIONAL TAX
TAX AND OTHER IMPLICATIONS FOR DIGITAL NOMAD VISA HOLDERS AND THEIR EMPLOYERS

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Editorial Panel:
Mr KG Karro (Chairman), Prof KI Mitchell, Prof JJ Roeleveld, Prof PG Surtees, Ms MC Foster, Prof DA Tickle, Ms D Hurworth.

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DEDUCTION OF INTEREST COSTS

The deduction of interest paid on borrowings has been the subject of a plethora of case law over the years, a soon to be removed Practice Note (31) (which is to be replaced with section 11G) and ongoing legislative changes designed to regulate when and how interest may or may not be deducted. The January 2024 Unitrans Holdings *judgment is a reminder of how complex this topic is.*

The *Unitrans Holdings* case [*Unitrans Holdings Limited v Commissioner for the South African Revenue Service* [2023]] deals with, yet another, holding and investment company that attempted to deduct its full interest costs (which amounted to almost double its interest income for the relevant tax year – 2011).

Unitrans Holdings conducted a "treasury function" for its group subsidiaries, through which the subsidiaries' bank balances were netted to nil each night. This was achieved by Unitrans Holdings either depositing the excess cash in its bank account or borrowing from the bank, and a corresponding loan being raised to or from the relevant subsidiary. The result was interest received and paid in Unitrans Holdings' books.

In addition, it seems that a portion of the funds in respect of which Unitrans Holdings attempted to deduct the interest cost, was used directly to acquire shares in a subsidiary. Since such shares would produce tax-free dividends, the interest could not be in the production of "income", as defined ("gross income less exempt income"). Section 23*(f)* of the Income Tax Act, 1962 (the Act), also prohibits the deduction of expenditure that produces only exempt income, and thus that portion of the interest merited only limited mention.

The crux of the dispute revolved around whether the interest Unitrans Holdings incurred complied with section 24J(2) of the Act, which permits the deduction of interest from any trade, provided the interest is incurred in the production of the income. (Section 24J does not require that the interest be "not of a capital nature").

The letter of findings of the South African Revenue Service (SARS) argued that the interest was not incurred in Unitrans Holdings' trade as a "moneylender". Case law [*Stone v Secretary for Inland Revenue* [1974]] which defines "moneylenders" generally deals with whether irrecoverable loan capital is deductible, and not with the deductibility of the interest incurred on funds raised to provide the loan capital. Thus, a finding based on such case law that a moneylending business is being conducted would clearly cover the interest aspect as well. To qualify as a moneylender, however, the taxpayer must lend funds to a broad body of public borrowers who satisfy prescribed criteria. Since Unitrans Holdings lent only to its own subsidiaries and deposited excess funds in its own bank, this clearly did not apply and it, wisely, did not pursue this argument in the High Court.

The first sentence of the judgment states that Unitrans Holdings "trades as an investment and holding company". Thus, the Judge (Adams (with Judge Strydom agreeing)) effectively, upfront, disposed of the question as to whether the company was in fact trading at all. However, the investment trade derived profits largely from dividends (not taxable). Although the Judge also determined that the company conducted a "second venture" – lending to its subsidiaries, but at 0% interest or lower than its borrowing cost – he advised that it did not appear to be further involved in the businesses of its subsidiaries.

The main focus of the judgment lay largely with the question of whether the interest costs were incurred in the production of Unitrans Holdings' income. The Judge notes that Unitrans Holdings did not lead any evidence specifically on this point nor challenge SARS' evidence.

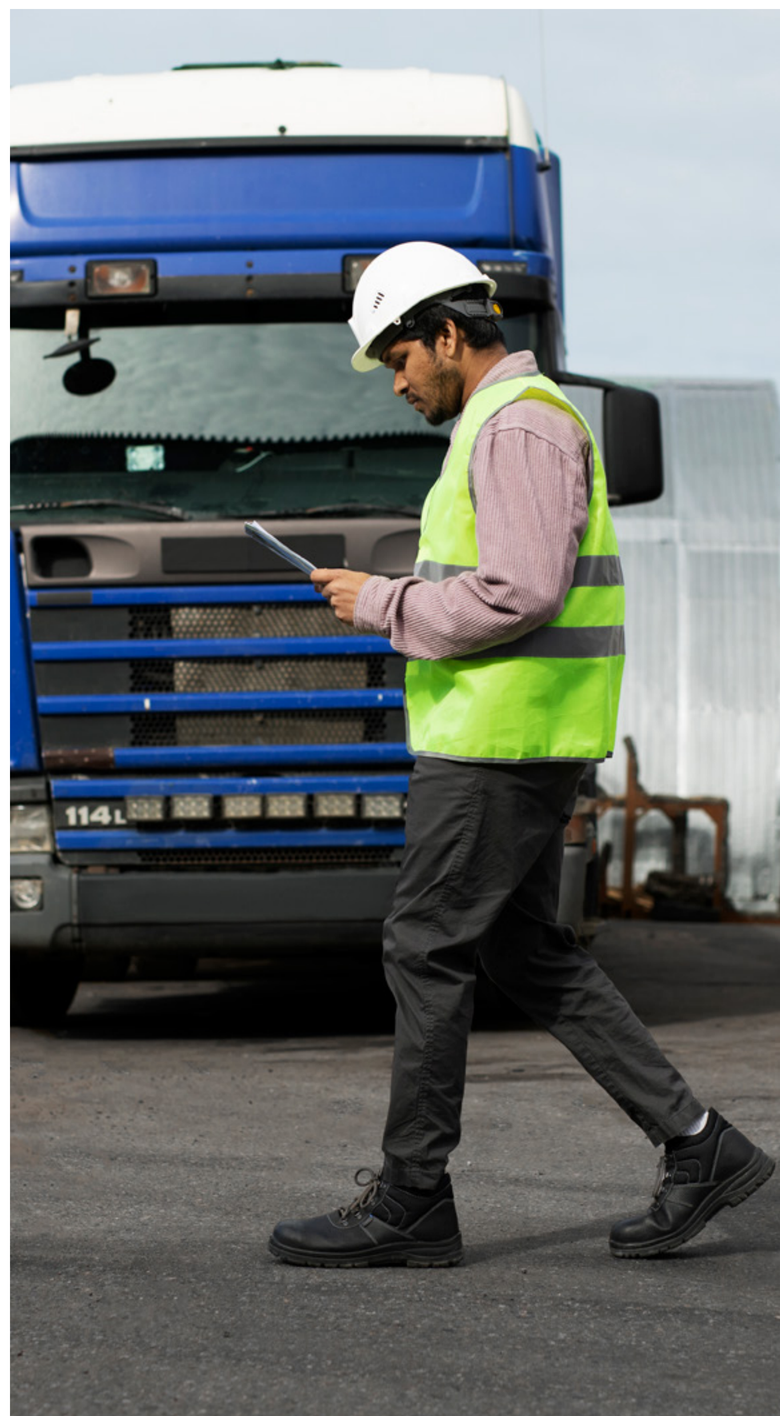
Unitrans Holdings argued that its dealings with its bank and subsidiaries amounted to the funds being "actively managed on a daily basis". It further argued that if its interest costs were incurred in the production of its income, they could be offset against *any* trade it conducted (ie, its trade as an investment and holding company).

Unitrans Holdings submitted rigorous arguments which attempted to liken its position to that of Tiger Oats in the Regional Establishment Levy case [*Commissioner for the South African Revenue Service v Tiger Oats Ltd* [2003]], and asserted that if one looked at the position of Unitrans Holdings over a number of years (many of which indicated net interest income) and also took dividends into account, the company clearly made profits and, since that was its purpose, it was not only trading but its interest incurred was in the production of the income from trading. However, the Judge focused on whether the interest incurred by Unitrans Holdings in fact *produced* the interest income it derived.

In the *Tiger Oats* case it was held that Tiger Oats was trading because it made loans to its subsidiaries and recovered interest *and* management fees, with a view to enhancing its own income.

Judge Adams pointed out that, unlike Tiger Oats, Unitrans Holdings did not perform any administrative, financial or secretarial services to group companies. It also did not get involved in the management of its subsidiaries. It merely invested in its subsidiaries and acted as a central depository for their funds. The *Solaglass* case [*Solaglass Finance Company (Pty) Ltd v Commissioner for Inland Revenue* [1991]] could be distinguished on similar grounds.

"Judge Adams pointed out that, unlike Tiger Oats, Unitrans Holdings did not perform any administrative, financial or secretarial services to group companies. It also did not get involved in the management of its subsidiaries."



Judge Adams reiterated the relevant and well-known rules that one must follow to determine whether an amount is in the production of the income, which originated from the old, but still relevant, *PE Tramways* [*Port Elizabeth Electric Tramway Company Ltd v Commissioner for Inland Revenue* [1936]] and *Joffe [Joffe & Co (Pty) Ltd v CIR* [1946]] cases, and which were more recently reconfirmed and refined in the *Spur* case [*Commissioner for the South African Revenue Service v Spur Group (Pty) Ltd* [2021]]. He stated that in the case of borrowings raised for a specific purpose, it is possible to identify specific income which arises from the application of the funds. But when borrowings are raised to generally fund a business

> "[i]t is trite that all expenses attached to the performance of a business operation *bona fide* performed to earn income are deductible whether such expenses are necessary for its performance or attached to it by chance or are *bona fide* incurred for the more efficient performance of such operation provided they are so closely connected with it that they may be regarded as part of the cost of performing it."

Judge Adams further emphasised that

> "The most important factor in that inquiry is the purpose of borrowing money. If the purpose is to apply the funding to produce taxable income, the interest expenditure incurred should be deductible. However, if the purpose is not to produce taxable income, then the interest expenditure is not deductible".

He made it clear that these rules apply equally for purposes of applying section 24J.

Despite the "actively managed" argument, in finding against Unitrans Holdings, Judge Adams advised that it had failed to demonstrate its "entitlement to" deduct its interest expenditure and concluded that Unitrans Holdings' activities were designed to "further the interest of its subsidiaries" (the pun seems apt) and thus the costs were not designed to be incurred in the production of Unitrans Holdings' own income.

He advised that the facts indicated that it was not Unitrans Holdings' purpose to make a profit of its own (in fact it was its intention not to make a profit from its interest – it lent at rates lower than it borrowed) but that it had borrowed funds to enable its group companies to improve *their* income-earning capabilities and it was "subjugating its own profitmaking potential to the interests of the group companies".

In reiterating the *Spur* case's narrowing of the principle, Judge Adams confirmed that the production of the income of the subsidiaries could not be regarded as "sufficiently close" to the production of the income in Unitrans Holdings.

Whether Unitrans Holdings will appeal the finding remains to be seen.

Even though Unitrans Holdings "lost" the case, it was permitted to deduct its interest paid to the extent of its interest received. This treatment aligns with the concession set out in Practice Note 31, in which SARS, since 1994, has allowed costs incurred by a taxpayer as a deduction to the extent of interest received by the taxpayer.

As is now widely known, SARS has proposed withdrawing PN 31, which will be replaced by section 11G. This section takes its current form after much input from taxpayers and practitioners and will become effective for years of assessment commencing on or after 1 January 2025. Section 11G allows a deduction for interest incurred even if it is not incurred for the purposes of trade. However, the deduction will be limited to interest that "is incurred *in the production of* interest that is included in the income of that person" *(own emphasis*).

The question that arises in relation to section 11G is: If the facts of the *Unitrans Holdings* case were to be presented to SARS for the purposes of applying the section, would it still allow a deduction for the interest incurred to the extent of interest received or would it disallow all the interest on the basis that the interest incurred is not sufficiently closely connected to the interest income, ie, that the interest was incurred to enhance the income of the subsidiaries and not Unitrans Holdings' own income? Is this something that was contemplated when the legislature drew up the wording of section 11G?

If not, there is still time to refine section 11G, but if the intention is correctly reflected in the current wording, a company like Unitrans Holdings (and many others like it) might find all its interest costs being disallowed in its years of assessment commencing after 1 January 2025 and would need to count itself to have been lucky to have been treated as tax neutral until then insofar as its net interest income is concerned.

Only time will tell.

First published in ASA: April 2024 Edition

Adjunct Associate Professor Deborah Tickle

Acts and Bills

- Income Tax Act 58 of 1962: Sections 11G, 23*(f)* & 24J(2).

Other documents

- Practice Note (31) (soon to be replaced by section 11G of the Income Tax Act).

Cases

- *Unitrans Holdings Limited v Commissioner for the South African Revenue Service* (A3094/2022) [2023] ZAGP JHC;
- *Stone v Secretary for Inland Revenue* [1974] (3) SA 584 (A), 36 SATC 117;
- *Commissioner for the South African Revenue Service v Tiger Oats Ltd* [2003] 2 All SA 604 (SCA), 65 SATC 281 [2003] ZASCA 43;
- *Solaglass Finance Company (Pty) Ltd v Commissioner for Inland Revenue* [1991] (2) SA 257 (A), 53 SATC 1;
- *Port Elizabeth Electric Tramway Company Ltd v Commissioner for Inland Revenue* [1936] CPD 241, 8 SATC 13;
- *Joffe & Co (Pty) Ltd v CIR* [1946] AD 157, 13 SATC 354;
- *Commissioner for the South African Revenue Service v Spur Group (Pty) Ltd* [2021] JDR 2530 (SCA), 84 SATC 1.

Tags: deduction of interest; tax-free dividends; actively managed.

INTEREST ON DEBT USED TO ACQUIRE SHARES

For expenditure (including interest) to be deductible in terms of section 11(a) *of the Income Tax Act, 1962 (the Act), one of the requirements is that the expenditure must be incurred "in the production of [the] income".*

The term "income" in this context takes its defined meaning in section 1(1) of the Income Tax Act, ie, "gross income" less amounts exempt from normal tax. The phrase "in the production of [the] income" has been held to mean that there must be a close connection between the expenditure and the taxpayer's income-earning operations, having regard both to the purpose of the expenditure and to what it actually effects (*Commissioner for Inland Revenue v Genn and Co (Pty) Ltd* [1955]). The dual enquiry into the taxpayer's purpose and to what the expenditure effects thus contains both a subjective test (the taxpayer's purpose) and an objective test (what the expenditure effects).

Given the wide definition of "instrument" in section 24J, in practice, interest is more often deductible in terms of section 24J than section 11*(a)*. However, section 24J(2) contains the same requirement regarding the production of income as section 11*(a)*.

Since shares generally produce dividends which are exempt from normal tax, the well-established position is that interest incurred on borrowings taken out to finance the acquisition of shares that are held to earn dividends is not incurred in the production of income and is therefore not deductible, since the interest is productive of exempt dividends. Even if shares are not specifically acquired to earn dividends, interest incurred to acquire shares which are held as assets of a capital nature is also not deductible for income tax purposes, since no "income" will be produced from the holding and disposal of such shares. On the other hand, if the shares are acquired with a revenue intention, ie, for purposes of resale at a profit, such that the shares constitute the taxpayer's "trading stock" (defined in section 1(1) of the Act), the interest on debt used to acquire the shares will be deductible.

Because of the non-deductibility of interest in situations in which the target company's shares will not be held as trading stock, corporate tax advisors often recommend that in a leveraged acquisition, instead of purchasing the shares in a target company, the acquirer should purchase the income-producing assets out of the target company. In such a case, there should be a sufficiently close connection between the interest expense and the income produced by the assets for the interest to be deductible.

"At the end of the date of the acquisition of the equity shares, the purchaser company, the 'operating company' and, if applicable, the 'controlling group company' in relation to the 'operating company', must form part of a South African 'group of companies'."

However, often one finds that the purchase of assets out of a target company instead of the shares in the target company does not suit the seller, who may face higher taxes in the target company in that case due to the inclusion of trading stock in gross income or recoupments on tax-depreciable assets. This compares unfavourably with capital gains tax that may arise on the disposal of the shares in the target company by the seller, at the lower inclusion rates for capital gains.

Various tax strategies have therefore emerged, which may, in appropriate circumstances, grant the purchaser company a deduction for the interest incurred on the acquisition of shares in a target company. This is particularly the case where the target and purchaser companies will form a "group of companies" for income tax purposes following the purchase transaction (among other requirements, the definition of "group of companies" in section 1(1) of the Act requires an equity shareholding of 70 per cent or more).

For example, the purchaser company may acquire 70 per cent or more of the equity shares in the target company by using interest-bearing debt, immediately whereafter the target company is liquidated and, in the process of liquidation, distributes the pro rata share of its assets to the purchaser. In these circumstances, section 47 of the Act may be utilised to ensure rollover relief applies to the target company upon the disposal of its assets in the liquidation distribution. The same provision ensures that the purchaser company assumes the tax cost of the various assets acquired in the hands of the target company. The purchaser's argument for the deduction of the interest on the borrowing to acquire the shares in the target company is that the purpose and effect of the borrowing was to acquire the underlying productive assets of the target company in the liquidation distribution rather than to acquire and hold the shares in the target *per se* – indeed, the shares are disposed of in the liquidation process – and that the interest should be deductible because the necessary close connection between the interest expenditure and the purchaser's income-earning operations exists. A similar strategy may be employed utilising the intra-group rollover provisions of section 45 of the Act to grant the purchasing company a deduction for interest incurred in acquiring 70 per cent or more of the equity shares in a target company by using interest-bearing debt.

Around 2011, concerns that the above strategies were leading to abuse arose within National Treasury, which culminated in the introduction of section 23K and later sections 24O and 23N into the Act. The concerns initially appeared to centre on interest mismatch cases in which the lender, either a non-resident or a tax-exempt person, would not be taxed on the interest income, while the purchaser (ie, the borrower) would enjoy a full deduction for the interest incurred by employing the above strategies. Section 23K effectively does not apply to "acquisition transactions" (defined in section 23K(1)), entered into on or after 1 April 2014, whereas section 24O applies to "acquisition transactions" (defined in section 24O(1)) entered into on or after 1 January 2013.

The aim of section 24O is to grant the purchaser company a deduction of interest incurred for the purpose of acquiring equity shares in a target "operating company" (or equity shares in the "controlling group company" – as defined in section 1(1) – in relation to a target "operating company") without the purchaser having to employ section 47 or 45 interest deduction strategies to acquire the underlying assets out of the target company. If it applies, the effect of section 24O is that the interest incurred on qualifying debt is deemed to be in the production of the purchaser company's income and laid out or expended for purposes of its trade. In practice, one often finds that if the purchaser company is a mere holding company with no income besides dividend income, the deduction afforded by section 24O is effectively useless. Therefore, the choice of purchaser company is an important one in the context of section 24O – the purchaser must have sufficient taxable income for the section 24O deduction to be of use to it. An "operating company" is defined in subsection (1) as a company of which "at least 80 per cent of the aggregate amount received by or that accrued to the company during a year of assessment constitutes income in the hands of that company". The income must be derived from a business carried on continuously by that company and in the course or furtherance of which, goods or services are provided or rendered by that company for consideration.

Section 24O is a complex provision with many requirements. The most important of these are:

- The target company must be an "operating company" or the controlling group company in relation to an "operating company" on the date of the acquisition of the equity shares by the purchaser;
- At the end of the date of the acquisition of the equity shares, the purchaser company, the "operating company" and, if applicable, the "controlling group company" in relation to the "operating company", must form part of a South African "group of companies";
- The shares must have been acquired from a person that was not part of the same "group of companies" as the purchaser company;
- A redetermination of whether or not the target company is still an "operating company" is required by the purchaser company on an annual basis; and
- Where the shares in a "controlling group company" in relation to an "operating company" are acquired, the purchaser is required (also on an annual basis) to determine to what extent the value of the shares in the "controlling group company" relates to the value of the equity shares held by the "controlling group company" in an "operating company" (or "operating companies"). If the value of the shares in the "controlling group company" are derived to the extent of less than 90 per cent from the value of the equity shares held in the "operating company" (or "operating companies"), then only a pro rata portion of the interest incurred will be allowed as a deduction.

Section 23N was introduced into the Act with effect from 1 April 2014. Where debt is utilised to acquire equity shares pursuant to a section 47 or section 45 transaction as described above, or to acquire equity shares in terms of which a deduction is claimed in terms of section 24O, the amount of interest that may be deducted in terms of such debt for the year in which the acquisition transaction occurs and the five immediately succeeding years of assessment is limited in terms of a formula contained in this section. This formula is complex but uses as a basis, a percentage applied to the "adjusted taxable income" (defined in subsection (1)) of the acquiring company, plus interest received by or that accrued to the acquiring company, reduced by interest incurred by the acquiring company on other debts.

In conclusion, many laypersons believe that interest incurred on debt that is used to acquire shares is not deductible under any circumstances. As discussed in this article, this belief is incorrect. However, careful planning is required to ensure compliance with the various complex provisions in terms of which a deduction may be available, including a possible limit on the quantum of the deduction.

Adjunct Associate Professor David Warneke

BDO

- Income Tax Act 58 of 1962: Sections 1(1) (definitions of "controlling group company", "group of companies" & "trading stock"), 11*(a)*, 23K (definition of "acquisition transaction" in subsection (1)), 23N (definition of "adjusted taxable income" in subsection (1)), 24J (definition of "instrument" in subsection (1)), 24N, 24O (definitions of "acquisition transaction" and "operating company" in subsection (1)), 45 & 47.

Cases

- *Commissioner for Inland Revenue v Genn and Co (Pty) Ltd* 20 SATC 113; [1955] (3) SA 293 (A).

Tags: in the production of income; income-producing assets; group of companies; interest-bearing debt; acquisition transactions; operating company; controlling group company.

SHARE LENDING AND COLLATERAL ARRANGEMENTS

The Income Tax Act, 1962 (the Act), in section 1(1), contains definitions of a "securities lending arrangement" and a "collateral arrangement" (in both definitions reference is made to the Securities Transfer Act, 2007, where definitions of those terms are found) which are relevant to determine the tax consequences in instances where, inter alia, *equity securities listed on a South African exchange (Listed Shares) are transferred in terms of a share loan or provided as security for an amount owed.*

To the extent that the transfer of the Listed Shares qualifies as a "securities lending arrangement" or a "collateral arrangement" (as defined), then the transfer is tax neutral for the lender and borrower or collateral provider and collateral receiver, and in some instances effectively disregarded. For example, for capital gains tax purposes the transfer of the Listed Shares is not regarded as a disposal (irrespective of the fact that beneficial ownership is transferred) in terms of paragraph 11(2)*(h)* and/or *(n)* of the Eighth Schedule to the Act. In addition, section 9C(4) of the Act deems an identical share returned by a borrower to a lender in terms of a "securities lending arrangement" to be one and the same in the hands of the lender. A similar provision applies to shares transferred in terms of a "collateral arrangement" in terms of section 9C(4A).

To the extent that financing for the acquisition of the Listed Shares was obtained by the lender/collateral provider (or another related company that indirectly funded the acquisition of the Listed Shares) by the issuance of preference shares, the provisions of *inter alia* section 8EA are relevant.

Section 8EA of the Act deals with the taxation of dividends and foreign dividends received by a taxpayer in respect of shares that qualify as "third-party backed shares". A "third-party backed share" is defined in section 8EA(1) and includes preference shares where the holder of the preference share has an enforcement right which may be exercised as a result of the holder not receiving a dividend or return of capital from the issuer. An enforcement right includes a right to require a person other than the issuer to acquire the shares from the holder or to make payments to the holder in terms of a guarantee, indemnity or similar instrument. Certain enforcement rights are excluded when determining whether a preference share constitutes a "third-party backed share" in instances where the preference shares were issued for a "qualifying purpose". A "qualifying purpose" is a further defined term and includes the direct or indirect acquisition of an equity share in a listed company. For example, the acquisition of Listed Shares referred to above could constitute a "qualifying purpose" if all the other requirements are complied with.

The Taxation Laws Amendment Act, 2023, amended section 8EA with effect from 1 January 2024. The amendment applies to any dividend or foreign dividend received or accrued during years of assessment commencing on or after 1 January 2024. The amendment provides that certain enforcement rights may not be disregarded if the shares referred to in the definition of "qualifying purpose" are no longer held by the person (the Exclusion).

The question is how the Exclusion impacts Listed Shares transferred in terms of a "securities lending arrangement" or a "collateral arrangement". Absent a specific provision in the Act, a company that issued preference shares to raise finance (Issuer) in order to acquire Listed Shares and transferred the Listed Shares in terms of a "securities lending arrangement" or "collateral arrangement", should not be the holder of the Listed Shares whilst the shares are held by the borrower/collateral receiver. This is because a "securities lending arrangement" or "collateral arrangement" results in the transfer of ownership of the Listed Shares.

Although section 22(9) of the Act deems a share held as trading stock to be held and not disposed of, this only applies in instances where the trading stock was lent in terms of a "securities lending arrangement" and an identical security has not been returned by the borrower in that year of assessment.

Therefore, in instances where an Issuer held Listed Shares as trading stock, lent them out in terms of a "securities lending arrangement" and the latter has not been closed out in the relevant year of assessment, section 22(9) should deem the Issuer to hold the shares and the Exclusion should not apply. However, the deeming provision does not apply if identical shares have been returned to the Issuer. In such an instance the question is whether the Exclusion may apply to the Issuer as the Issuer would not hold the shares referred to in the qualifying purposes definition because the Issuer holds identical shares returned to it. Is this sufficient for the Exclusion not to apply to the Issuer?

What if the Issuer held the Listed Shares as capital assets? Although the Issuer may be regarded as not having disposed of the Listed Shares in terms of paragraph 11(2)*(h)* of the Eighth Schedule to the Act, legally it does not own the Listed Shares. Would it be deemed to hold the Listed Shares if it is regarded as not having disposed of the Listed Shares?

For the reasons set out above, taxpayers that are funded by preference shares and have on-lent shares or provided shares as security should consider the impact of the "securities lending arrangement" and "collateral arrangement" provisions on the dividends it declares on the preference shares. This is because if an enforcement right is not disregarded for purposes of section 8EA, and the shares constitute third-party backed shares, then any dividend received by the holder of the preference shares would be included in the holder's income and be subject to income tax.

"Section 8EA of the Act deals with the taxation of dividends and foreign dividends received by a taxpayer in respect of shares that qualify as 'third-party backed shares.'"

Magda Snyckers

ENS

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definitions of "collateral arrangement" and "securities lending arrangement"), 8EA (definitions of "preference share", "qualifying purpose" and "third-party backed share" in subsection (1)), 9C(4) & (4A) & 22(9); Eighth Schedule: Paragraph 11(2)*(h)* & *(n)*;
- Securities Transfer Act 25 of 2007: Section 1 (definitions of "collateral arrangement" and "lending arrangement");
- Taxation Laws Amendment Act 17 of 2023: Section 5(1) (amending section 8EA of the Income Tax Act, 1962).

Tags: securities lending arrangement; collateral arrangement; third-party backed share; qualifying purpose.

SHAREHOLDER-NOMINATED NON-EXECUTIVE DIRECTORS

Section 69(7)(a) of the Companies Act, 2008, states that a company is "ineligible" to be appointed as a director of another company. In practice, however, non-executive directors (NEDs) are often nominated by the company's shareholders to represent that shareholder on the board and advance their interests in the company (nominated NED). In such instances, the nominating shareholder (as opposed to the NED) may also choose to recover the NED fees directly from the company.

This situation raises several noteworthy aspects from a value-added tax (VAT), income tax, and employees' tax (PAYE) perspective. While the South African Revenue Service (SARS), in Binding General Ruling 40 (BGR 40), provides clarity on the obligation to deduct PAYE on NED fees, BGR 40 does not address the income tax consequences of NED fees generally, and, in particular, the situation where the shareholder (as opposed to the shareholder-nominated NED) recovers such fees from the subsidiary company. Similarly, this situation is not explicitly addressed by SARS, from a VAT perspective, in Binding General Ruling 41 (BGR 41).

In this article, a closer look is taken at the tax position of shareholder-nominated NEDs, particularly those instances where NED fees are recovered by the nominating shareholder.

VAT

SARS confirms in BGR 41 that a NED is regarded as carrying on an "enterprise" for VAT purposes in respect of their NED activities. Therefore, a NED is required to register for VAT in their individual capacity (as an independent contractor, or sole proprietor) if the total value of their director fees exceeds the VAT registration threshold of R1 million in any consecutive 12-month period. Activities physically performed outside South Africa by the NED may qualify for zero-rating under certain conditions, but are still counted towards taxable supplies (these supplies are subject to VAT albeit at a VAT rate of 0%).

Further, SARS notes in its "*Frequently Asked Questions on BGRs (Binding General Rulings) 40 and 41*" that a shareholder-nominated NED must include in their taxable supplies calculation the NED fees paid directly by the company (on whose board they serve) to the shareholder, regardless of whether the shareholder retains some or all of these fees. This is because the fees are considered to be a consideration for services rendered by the NED in their individual capacity, not that of the nominating shareholder.

As a VAT vendor, a NED is not permitted to account for VAT on their director fees through another vendor, such as a company or other entity. The NED services are provided by them personally (as the contractual "supplier" for VAT purposes), notwithstanding the payment mechanism in place between the company, the shareholder and the NED in this regard. This also aligns with the legal stance that only natural persons can serve as NEDs. Therefore, the VAT treatment of NED fees should be carefully evaluated to ensure that the VAT has correctly been accounted for by the NED in their personal capacity (ie, the NED's own VAT returns).

Further, the VAT Act generally requires that vendors must provide VAT-inclusive pricing. Where a NED belatedly registers for VAT, the issue of pricing is thrust into the foreground. Unless VAT was taken into account when NED fees were agreed, a NED could risk forfeiting 15/115 (or approximately 13%) of its fees in the event that this component of an agreed fee is considered VAT "charged" in respect of its NED services.

INCOME TAX

Generally, NED fees derived from a South African company are included in the "gross income" of the resident NED. For non-resident NEDs, only South African-sourced income is taxable; the common law provides that the source of NED fees is the place where the company's head office is situated. Therefore, NED fees earned by non-resident NEDs would typically be taxable in South Africa if the company's head office is located here, barring any applicable double tax agreement between South Africa and the NED's country of residence.

Regarding NED fees recovered by nominating shareholders, paragraph *(c)*(ii) of the "gross income" definition in the Income Tax Act, 1962 (the Act), should be considered. According to this paragraph, an amount received by or accrued to a person (eg, the nominating shareholder) in respect of services rendered by another person (eg, the nominated NED) is deemed to have been received by or to have accrued to the service-rendering individual (eg, the nominated NED). This implies that NED fees may be subject to income tax in the hands of the nominated NED, regardless of the recovery of fees by the nominating shareholder. Possibly to mitigate potential adverse effects of this provision, SARS issued Practice Note 4 of 1985 (PN4), which specifically addresses this scenario, suggesting that under certain conditions, NED fees will not be subject to income tax in the hands of the nominated NED.

PAYE

As stated, BGR 40 clarifies that NED fees paid to a resident NED are not subject to PAYE deductions since NEDs are considered independent contractors (or sole proprietors). However, this exclusion does not extend to non-resident NEDs. Moreover, a PAYE-withholding obligation may arise on NED fees paid to a nominating shareholder if that entity is classified as a "personal service provider" (PSP) under paragraph 1 of the Fourth Schedule to the Act. Although the definition of PSP has various requirements, in this context, the nominating shareholder would likely be a PSP if the NED is a "connected person" to the nominating shareholder and if more than 80% of the nominating shareholder's income, during a year of assessment, is derived from one client.

WAY FORWARD

Navigating the tax consequences of shareholder-nominated NEDs, particularly when the nominating shareholder recovers the NED fees, can be a complex process. The VAT and income tax consequences require careful consideration of the relevant legislation and SARS pronouncements like PN4. A sound understanding of the relevant PAYE obligations in this regard is crucial too.

For companies and shareholders considering this type of director appointment structure, consulting with a qualified tax professional is highly recommended. If NED fees have been incorrectly treated in the past, a tax professional can advise on remedial steps, such as voluntary disclosures, to help achieve a compliant position going forward.

"In this article, a closer look is taken at the tax position of shareholder-nominated NEDs, particularly those instances where NED fees are recovered by the nominating shareholder."

Annelie Giles & Simon Weber

ENS

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "gross income": Paragraph *(c)*(ii)); Fourth Schedule: Paragraph 1 (definition of "personal service provider");
- Companies Act 71 of 2008: Section 69(7)*(a)*.

Other documents

- Binding General Ruling 40 ("Remuneration paid to non-executive directors");
- Binding General Ruling 41 ("VAT treatment of non-executive directors");
- *Frequently Asked Questions on BGRs (Binding General Rulings) 40 and 41* (accessible on SARS' website);
- Practice Note 4 of 1985 ("Nominee Directors: Directors Fees").

Tags: non-executive directors (NEDs); taxable supplies; South African-sourced income; connected person.

TAX REGISTRATION OBLIGATIONS

"Nothing is certain but death and taxes."

This infamous proverb confirms the obligation that we all have to pay tax – in some way or another. However, how many of us are actually aware of this obligation and how to go about discharging it?

As a starting point, it should be noted that different tax obligations arise in respect of the different types of taxes. This article considers the registration requirements for income tax, employees' tax (also known as PAYE), and value-added tax (VAT) for a business.

Where differences may exist between different forms of businesses, this article will only consider the differences between a sole proprietor and a company. However, the obligations noted for a sole proprietor will equally apply to partners in a partnership, freelancers, and independent contractors.

INCOME TAX

Irrespective of the type of business one chooses to operate, it will be liable for income tax if it has a taxable income (income less expenses) in a particular year of assessment, in terms of the Income Tax Act, 1962 (the Act). However, registration for income tax would only be required if the business is required to submit an income tax return for that year, in terms of the annual notice published by SARS in the *Government Gazette*. For example, for the 2024 year of assessment, any company with a gross income of more than R1,000 and any individual conducting a trade (like a sole proprietor), had to submit an income tax return and, therefore, also had to be registered for income tax.

As a sole proprietor, no formal registration is required *per se*. Given that a sole proprietorship is not taxed separately from the individual that operates it, the individual may already be registered with SARS as a taxpayer. If that is the case, the sole proprietor will be required to include all amounts earned through the operation of the business in their income and deduct all expenses incurred in the production of such income (as provided for in terms of the Act) in their annual personal income tax return (ITR12). Practically, the ITR12 provides for an individual to declare each business (trade) conducted as a sole proprietorship, including the income and permissible deductions attached to that business, separately. For example, if an individual carries on business as an accountant in their own name but is also a share trader in their spare time, they would likely have to declare the income derived from and expenses incurred in respect of each business (trade) separately.

A company, on the other hand, will automatically be registered with SARS as a taxpayer when it completes its registration with the Companies and Intellectual Property Commission (CIPC). As such, a separate registration with SARS is not required.

PAYE

Registration for PAYE is required when your business becomes an employer that pays remuneration to an employee. The terms "employer", "remuneration" and "employee" are defined in paragraph 1 of the Fourth Schedule to the Act, and it is only when all three of these elements are present in an employer-employee relationship that a business will be required to register for PAYE. It is, therefore, important to have an understanding of these terms to be able to determine whether there is an obligation for your business to register as an employer or not.

In this context, an "employer" is defined as: "any person… who pays or is liable to pay to any person any amount by way of remuneration".

The definition of "remuneration", on the other hand, can be divided into three parts:

1. The general definition, which defines "remuneration" to mean any amount of income that is paid or is payable to a person by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument, pension, superannuation allowance, retiring allowance or stipend, whether in cash or otherwise and whether or not for services rendered.

2. The extended definition, which expressly includes certain items into the definition, such as amounts referred to under specific paragraphs of the "gross income" definition in section 1(1) of the Act, including fringe benefits, allowances and advances, travelling allowances, and the like.

"This article considers the registration requirements for income tax, employees' tax (also known as PAYE), and value-added tax (VAT) for a business."

3. The excluding part of the definition, which expressly excludes certain amounts from the definition, such as income earned by independent contractors, or any annuity received under an order of divorce or agreement of separation.

An "employee" is:

- any person who receives remuneration or to whom remuneration accrues;
- any person who receives remuneration or to whom remuneration accrues by reason of any services rendered by such person to or on behalf of a labour broker;
- any labour broker; and
- any personal service provider.

In addition to the above persons/category of persons, the Minister of Finance may also, by notice in the *Government Gazette*, declare any person or class or category of persons to be an employee for purposes of the definition in the Fourth Schedule.

Therefore, to the extent that the above three elements are present, the business will be required to register with SARS as an employer within 21 business days of becoming an employer, unless none of the employees are liable for normal tax (ie, they earn below the minimum threshold for tax which is currently R95,750 for persons younger than 65, R148,217 for persons older than 65 and R165,689 for persons 75 and older for the 2025 year of assessment).

Registration for PAYE can be completed on SARS' eFiling system through the RAV01 form. Alternatively, a taxpayer can register through a SARS branch. It should be noted that where a business is required to register for PAYE, it may also be required to register for the Skills Development Levy (SDL) and the Unemployment Insurance Fund (UIF) contribution. Although registration for SDL and UIF takes place with SARS, the requirements for registration differ from those applicable to PAYE. A business should therefore take this into account when registering for PAYE and obtain the relevant advice in respect thereof.

VAT

The registration requirements for VAT are contained in section 23 of the Value-Added Tax Act, 1991 (the VAT Act). Section 23(1) provides that any person who carries on any enterprise will become liable to register for VAT where the total value of taxable supplies made by that person exceeds (or will, in terms of a contractual obligation in writing, exceed) R1 million in a 12-month period. This is commonly referred to as the compulsory registration requirement.

However, the VAT Act contains a proviso which states that where the threshold for registration is met (ie, R1 million) solely as a consequence of –

"The VAT Act also makes provision for voluntary registration. In other words, the business will be able to deduct an amount of input tax on supplies purchased in the making of its own taxable supplies."

- any cessation of, or any substantial and permanent reduction in the size or scale of, any enterprise carried on by that person; or
- the replacement of any plant or other capital asset used in any enterprise carried on by that person; or
- abnormal circumstances of a temporary nature,

then registration will not be required.

The VAT Act also makes provision for voluntary registration. In other words, the business will be able to deduct an amount of input tax on supplies purchased in the making of its own taxable supplies. It would then raise output VAT on its taxable supplies and in this way pass on the cost to its customers.

The voluntary registration requirement states that a person may register for VAT where the total value of taxable supplies made by that person exceeds R50,000 in a 12-month period.

Like PAYE, registration for VAT will, therefore, be required (or possible, in the case of voluntary registration) if the following elements are present:

- the person is carrying on an "enterprise";
- the enterprise makes "taxable supplies"; and
- the total value of the supplies exceeds R1 million in a 12-month period, in the case of compulsory registration, or R50,000 in a 12-month period, in the case of voluntary registration.

An "enterprise" is widely defined in section 1(1) of the VAT Act and the definition contains several provisos and exceptions. However, generally, an enterprise is:

- any activity;
- carried on continuously or regularly by any person;
- in or partly in South Africa;
- in the course or furtherance of which;
- goods or services;
- are supplied;
- to any other person for consideration, whether or not for profit.

The above definition contains several elements that are in and of themselves defined and require careful consideration, especially given that South Africa's VAT system does not have any place of supply rules. As such, it can get tricky trying to determine whether a business is indeed carrying on an enterprise and required to register.

In addition to carrying on an enterprise, the business needs to be making "taxable supplies". A "taxable supply", as defined in section 1(1) of the VAT Act, is any supply of goods or services that is subject to tax as contemplated in sections 7 and 11 of the VAT Act – ie, goods or services that are subject to VAT at the standard rate (currently 15%) or zero rate. Therefore, where a business only makes exempt supplies (supplies not subject to VAT, such as the service of caring for children by a crèche or an after-school centre), the business will not be able to register for VAT and no input tax may be claimed.

Registration for VAT can also be completed through the eFiling system; alternatively, an appointment can be made at a SARS branch.

OVERALL COMPLIANCE IS IMPORTANT

Over and above the registration requirements noted in this article, the various tax Acts also impose ongoing obligations on taxpayers which need to be adhered to, to ensure compliance. It should also be noted that the above does not consider the obligations that may arise in respect of other taxes that may be applicable to a business, depending on the type of industry the business operates in – for example, carbon tax.

It is therefore important that taxpayers familiarise themselves with all of their tax obligations as failure to do so may lead to the imposition of serious penalties, interest, and, in extreme cases, criminal sanctions. Employing the services of a professional in this regard is therefore prudent and advisable.

Puleng Mothabeng

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Section 1(1) (definition of "gross income"); Fourth Schedule: Paragraph 1 (definitions of "employer", "remuneration" and "employee");
- Value-Added Tax Act 89 of 1991: Sections 1(1) (definitions of "enterprise" and "taxable supply"), 7, 11 & 23.

Other documents

- RAV01 form (SARS document for registration for PAYE);
- Annual personal income tax return (ITR12).

Tags: taxable income; personal income tax return (ITR12); employer; remuneration; employee; taxable supplies; enterprise.

DIESEL REFUNDS VIA VAT SYSTEM

There was a collective sigh of relief on 21 February 2024 when the Minister of Finance announced that there will be no increase in the general fuel levy for 2024/25. However, the Minister seems to have forgotten about a certain group of taxpayers – primary activity users.

In this article insights are shared on the distillate fuel refund system (the diesel refund scheme), on whether it has the impact that was intended, and on the impact being felt by primary producers as they continue to wait for a further dispensation that was promised by government, but has yet to materialise.

Government implemented the diesel refund scheme in an attempt to support primary production in certain primary activities such as agriculture, mining, forestry, and fishing. The diesel refund scheme did not extend to secondary activities such as the processing of goods or manufacturing.

Over the past nine years, there have been various discussions between SARS, the National Treasury, and stakeholders from various industries regarding the reform of the diesel refund system.

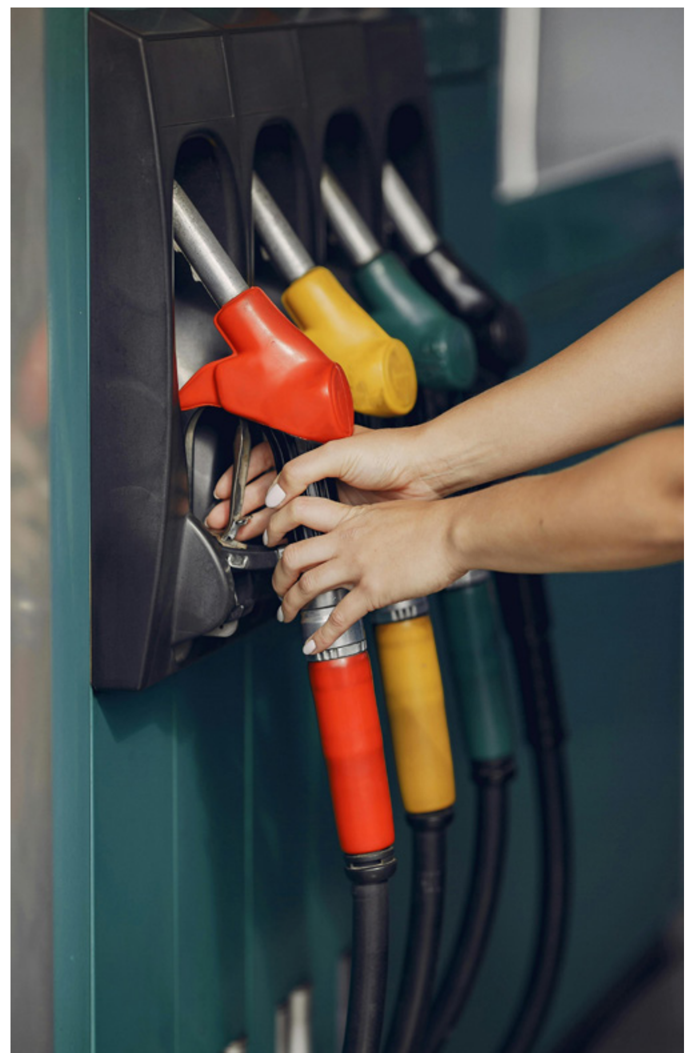
In 2023, the scheme was extended to manufacturers of food products, with the extension being granted for a limited period, from 1 April 2023 to 31 March 2025.

While all of the above is excellent news, the process of keeping storage and usage logbooks is extremely arduous. Additionally, the time limit for food manufacturers is so short that many producers and manufacturers from various sectors are simply not prepared to comply with the multiple administrative requirements needed to effectively make use of the dispensation. This therefore defeats the purpose of extending the scheme.

GETTING LOST IN THE MINUTIAE – AN ONGOING BATTLE FOR PRIMARY PRODUCERS

The diesel refund scheme is governed by section 75 of the Customs and Excise Act, 1964, but administered through the value-added tax (VAT) system. Schedule No 6, Part 3, Note 6 of the Customs and Excise Act (Schedule 6) prescribes the requirements of the system. The main requirement when claiming the diesel refund is that the user must have purchased the diesel for use in their "own primary production activities" in that specific industry.

On 18 March 2022, the Deputy Minister of Finance published amendments under *Government Gazette* 45056 (Notices R.1892 and R.1893). These amendments were meant to address the various issues that primary activity users faced with the requirements contained in Schedule 6.



Some significant amendments were in respect of the relaxation of the burden on users of keeping storage and usage logbooks.

The lists of equipment and vehicles regarded as dedicated to the performance of predominantly qualifying activities were amended. When such equipment and vehicles are directly powered by diesel, a detailed usage logbook is not required in respect of the usage of such vehicles. The user would only be required to substantiate the receipt of the diesel and the dispensing thereof.

It was stated that the effective date of the amendments was going to be determined.

Unfortunately, to date, there has been no progress regarding the effective date. The concerning issue is that users in the primary sectors are in constant disputes with SARS regarding the requirements of the current legislation, resulting in lengthy and expensive court battles.

One wonders whether there will ever be progress. The announcement to review the diesel refund administration to address anomalies was made in the 2015 budget speech. One would have hoped that by now progress would have been made and the weighty administrative requirements would be a thing of the past.

While relief is always welcome, any measures that are rejected by the very people who were meant to benefit from the relief, should be reassessed. If the government is truly trying to find ways to bolster support for the production and manufacturing sectors to promote sustainability and long-term economic growth, why is the burden of claiming dispensation so incredibly difficult and short-sighted?

Foodstuff manufacturers who wish to register as users can still do so. Approved registration applications have been effective since 1 April 2023, the date on which users became eligible for claiming refunds. Just as with the current primary production dispensation, the requirements are onerous. Therefore, it is important to consult a tax advisor in order to determine whether one would be eligible, and what documentation must be obtained and retained to prove the eligibility of refund claims.

"The diesel refund scheme is governed by section 75 of the Customs and Excise Act, 1964, but administered through the value-added tax (VAT) system."

A SHIFT IN FOCUS WITH AN UNREALISTIC TIME LIMIT

The focus seems to have shifted to foodstuff manufacturers in 2023 with the extension of the diesel refund scheme. However, as claiming for dispensation would require these manufacturers to spend large amounts to ensure that their premises are adequately set up to clearly prove the quantity of diesel used for activities such as manufacturing, packaging, and distribution, most stakeholders have expressed little to no interest. Essentially, claiming is a very costly exercise for a dispensation that is only in place for two years (1 April 2023 to 31 March 2025).

Would it not perhaps have been more prudent for the Minister of Finance, in his budget speech earlier in 2024, to have extended this period? The energy crisis is still an issue, loadshedding is not a thing of the past and may be an issue for a few more years to come, and the global recession and increased food prices remain ongoing. There certainly seems to be no end in sight for the challenges that these manufacturers have to face.

Kagiso Nonyane

BDO

Acts and Bills

- Customs and Excise Act 91 of 1964: Section 75; Schedule 6, Part 3, Note 6;
- Value-Added Tax Act 89 of 1991.

Other documents

- *Government Gazette* 45056 (Notices R.1892 and R.1893).

Tags: distillate fuel refund system; own primary production activities.

TAX AND OTHER IMPLICATIONS FOR DIGITAL NOMAD VISA HOLDERS AND THEIR EMPLOYERS

South Africa may soon see its first batch of remote workers entering the country on the newly created species of visitor's visa aimed at foreign employees.

Following the draft published in the *Government Gazette* on **8 February 2024** (the "Draft Second Amendment of the Immigration Regulations, 2014"), and a short-lived formal introduction in March 2024, the amendments to the Immigration Regulations which, among other things, introduce the new "digital nomad visa" in South Africa, came into operation with effect from **20 May 2024.**

The initial promulgation of the Second Amendment of the Immigration Regulations, 2014 (**Second Amendment**) in the *Government Gazette* on **28 March 2024** came as a surprise, one day before the closing date for public comments on the draft version. The timing, coupled with the fact that the Second Amendment was identical to the draft released in February, raised the question whether any comments were considered by the Minister of Home Affairs, who afforded the public until **29 March 2024** to make written submissions.

Acknowledging that he had been "ill-advised" in publishing the amendments before the conclusion of the period for public comment, the Minister subsequently withdrew the regulations. The "second take" of the Second Amendment was then republished in May, hereinafter referred to as the **Nomad Regulations**.

ELIGIBILITY FOR THE VISA

The so-called "remote working visa" or "digital nomad visa" may be issued for up to three years in circumstances where a foreigner conducts work "for a foreign employer or derives foreign source income on a remote basis" and earns not less than the equivalent of ZAR 1 million per annum.

The initial draft simply referred to work conducted for a foreign employer on a remote basis and the intention behind the "foreign source" insertion is not clear. Based on the use of the word "or", it may be to extend the application of the digital nomad visa to foreign entrepreneurs or individual consultants who work for themselves, remotely. They would not work for a foreign employer but would presumably receive payment from foreign clients.

The use of the term "foreign source income" is bound to cause confusion, though. In the context of tax, "source" refers to the originating cause of income. If such originating cause (eg, the rendering of services) is situated in South Africa, the income would be from a local source – even if payment is received from foreign clients. This results in some uncertainty regarding how this concept will be interpreted and implemented.

TAX CONSIDERATIONS

A remote working arrangement has potential tax implications both for the employee (the digital nomad in this scenario) and for the foreign employer. The Nomad Regulations do not deal with the tax risks for the foreign employer but they do, to some extent, provide tax relief for the employee.

Employer tax risks

Foreign employers are generally concerned that a cross-border remote working arrangement could not only trigger a corporate tax liability for the employer in the foreign jurisdiction, but that the foreign employer may also have to register as an employer with the South African Revenue Service (SARS).

The most notable consequence is the risk that employees who work remotely could create a permanent establishment (PE) for the foreign employer in South Africa. This could trigger an obligation for the foreign employer to register as a taxpayer and as an employer with SARS.

The Nomad Regulations do not address these risks for the foreign employer. Many foreign employers will remain reluctant to permit employees to work remotely in terms of the digital nomad scheme, until the tax risks for the employer have been addressed.

Employee tax risks

In terms of the Income Tax Act, 1962 (the Act), an employee who is tax non-resident (which "digital nomads" would generally be) would be subject to income tax on their income from a South African source. It is generally accepted that the source of remuneration would be where the services are rendered. The employees would thus, in principle, be subject to income tax on their remuneration to the extent that it relates to services rendered in South Africa.

The Act does not provide an exemption for remuneration if the person is in South Africa for less than six months. However, in terms of most double taxation agreements (**DTAs**), South Africa would not be entitled to tax the remuneration earned by a non-resident employee if (a) the person works for a non-resident employer; (b) the person is present in South Africa for less than 183 days in a 12-month period; and (c) the costs of the remuneration are not borne by a permanent establishment which the employer has in South Africa.

Accordingly, while South Africa would not be entitled to tax digital nomads who comply with the conditions for DTA relief, the same does not apply to employees who are tax resident in a country which has not concluded a DTA with South Africa. Currently, digital nomads who are present in South Africa for less than six months but who cannot rely on DTA relief would thus in principle still be liable to pay income tax on their remuneration.

"Unless the Act is amended to provide for such an exemption, the Nomad Regulations would create the conundrum that a digital nomad may be liable to pay income tax in South Africa but is exempted from submitting income tax returns."

The previous version of the regulations exempted foreign employees from registering as taxpayers if their visa was issued for a period of less than six months in a 12-month period. This cut-off has been tightened in the final version and the "exemption" will only be available if the foreign employee spends less than six months in a 36-month period in South Africa. Also, the "exemption" is no longer available automatically, but the employee must apply to be exempted by SARS from registering as a taxpayer.

Although this exemption only deals with the tax compliance obligation to register as a taxpayer and submit income tax returns, this effectively provides an income tax exemption for these individuals. Unless the Act is amended to provide for such an exemption, the Nomad Regulations would create the conundrum that a digital nomad may be liable to pay income tax in South Africa but is exempted from submitting income tax returns.

RISKS FOR THE FOREIGN EMPLOYER

While the digital nomad visa is a step in the right direction in the implementation of an effective remote working scheme in South Africa, there are still potential obstacles, and employers should consider the potential tax, corporate and employment law consequences before permitting employees to work in South Africa on the new visa.

As mentioned, from a tax perspective the corporate tax risk for the employer is not addressed by the Nomad Regulations, nor do the regulations deal with the risk that the foreign employer would have to register as an employer with SARS and withhold and/or pay employees' tax, skills development levies and unemployment insurance fund contributions.

Another question is whether an external company registration obligation will be triggered for the foreign employer in terms of the Companies Act, 2008, where foreign employees work in South Africa on digital nomad visas. Consideration should be given to whether the foreign employer may be considered to be "conducting business" in South Africa in such circumstances, for purposes of section 23 of the Companies Act.

From an employment law perspective, a careful analysis should be undertaken of the circumstances surrounding the remote working arrangement to determine whether our South African employment laws will apply to remote workers while they are working in the country.

In this regard, an additional *proviso* has been added to the final regulations requiring compliance with legislation governing employment of workers in the Republic, "if applicable". It is not entirely clear from the wording whether it is the foreign employee or the foreign employer who is required to comply with this legislation and which employment legislation is contemplated here. It may be that the intention is to ensure, for example, that foreign employees are subject to terms and conditions of employment (such as leave entitlements) that are not less favourable than those prescribed by our Basic Conditions of Employment Act, 1997, while they are working in South Africa.

CONCLUDING THOUGHTS

While the digital nomad visa is being lauded as a substantial boost for our economy, further reforms are required. In particular, many foreign employers will most probably remain reluctant to permit their employees to work in South Africa, until the corporate tax, employment law and company law risks are addressed. Without the removal of these risks, the digital nomad visa will not bring the economic boost our country so desperately needs.

Chloë Loubser, Aneria Bouwer & Sian Gaffney

Bowmans

Acts and Bills

- Income Tax Act 58 of 1962;
- Companies Act 71 of 2008: Section 23;
- Basic Conditions of Employment Act 75 of 1997.

Other documents

- Draft Second Amendment of the Immigration Regulations, 2014 (published in the *Government Gazette* 50098 (Notice 4344) on 8 February 2024);
- Second Amendment of the Immigration Regulations, 2014 – initial promulgation (published in the *Government Gazette* 50419 (Notice R4588) on 28 March 2024) – withdrawn by Minister in *Government Gazette* 50485 (Notice R4723) on 12 April 2024;
- Second Amendment of the Immigration Regulations, 2014 (Second Amendment (as revised) republished in the *Government Gazette* 50575 (Notice R4847) on 20 May 2024).

Tags: digital nomad visa; foreign source income; cross-border remote working arrangement; permanent establishment (PE); foreign employers; skills development levies; unemployment insurance fund contributions.

MINERAL ROYALTY REFUNDS

Promulgated in November 2009, the Mineral and Petroleum Resources Royalty Act, 2008 (the Royalty Act), has been in effect for more than 14 years. But, despite the perceived familiarity with its provisions, challenges continue to emerge within this regime.

The South African Revenue Service (SARS) is currently in the process of implementing a new system aimed at streamlining the mineral royalty process, although implementation is still a work in progress. One notable inconvenience is that SARS' mineral royalty statements of account may only reflect the transactional data (ie, returns, payments, and refunds) that has been captured by SARS on the new online system. As SARS is uploading this data in batches, mineral royalty statements of account are often incomplete and inaccurate.

The mineral royalty regime operates on estimates. An extractor must **estimate** its mineral royalty liability and submit a first provisional return not later than six months after the start of the tax year. A second provisional return, also based on an **estimate**, is due by the last day of the tax year. Then, if the final royalty liability is higher than the provisional payments, the extractor must submit a return of excess within six months of the end of the tax year. The final return is only due by the end of the subsequent tax year.

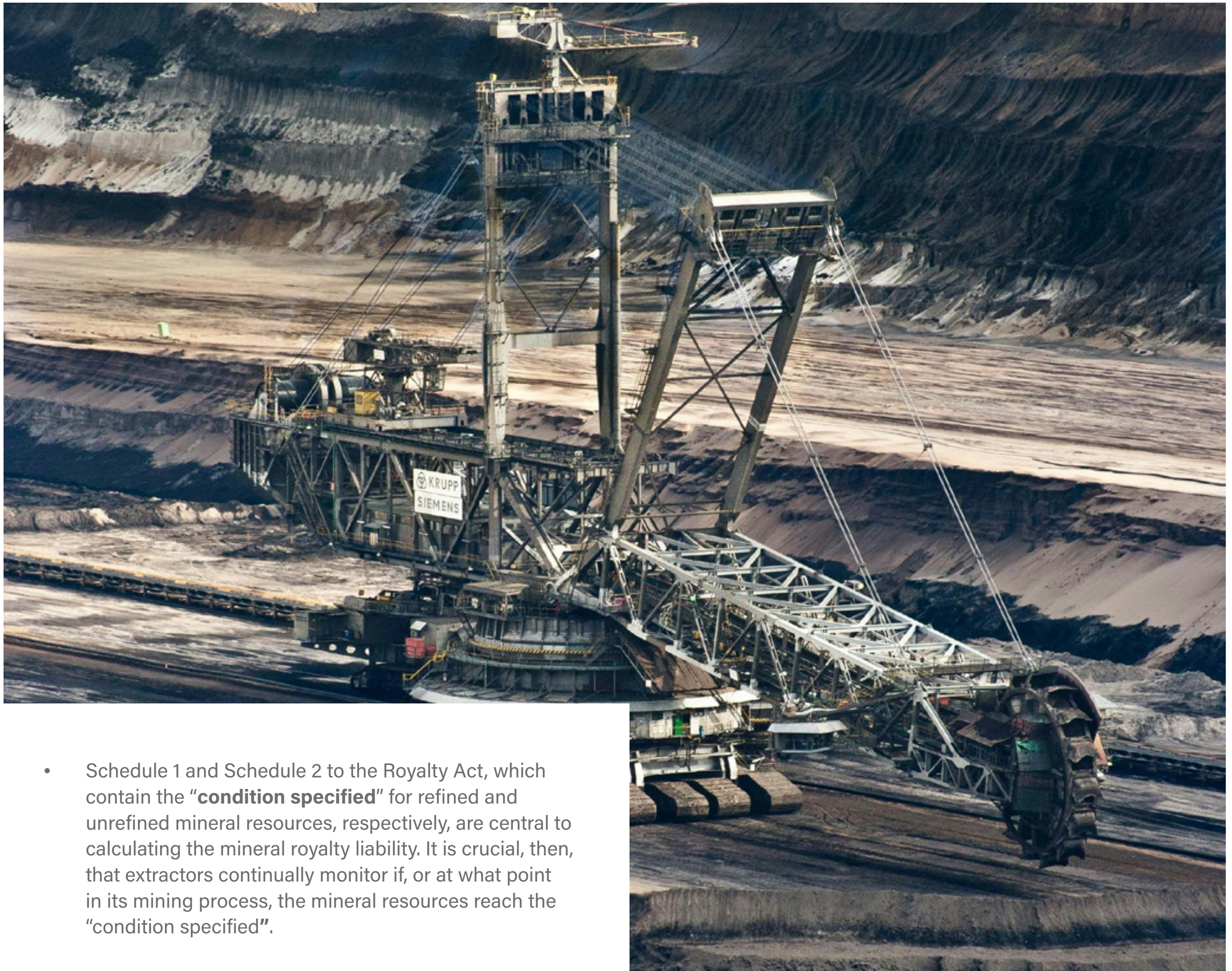
So, it is not uncommon for the final (annual) royalty liability to be less than the payments made pursuant to the first and second provisional mineral royalty returns. In such cases, SARS may owe the extractor a **refund**. However, given that accurate mineral royalty statements of account are not readily available, extractors are often not aware that they have overpaid mineral royalties.

Moreover, the Royalty Act is complex, often resulting in ambiguity. In this respect, the following serve as examples of possible pitfalls that warrant proper consideration:

- The mineral royalty is only imposed in respect of the "**transfer**" of a "**mineral resource**" "**extracted**" from within South Africa. So, for example, where the extractor transfers a mineral that does not fall within the ambit of the definition of "mineral resource", then the royalty liability will not be imposed in respect of that mineral. Relevant here, is that the term "mineral resource" is defined in section 1 of the Royalty Act with reference to the Mineral and Petroleum Resources Development Act, 2002. A question that arises, then, is whether minerals extracted from **tailing dumps** that were created pursuant to "**old order**" mining rights are "mineral resources" for royalty purposes.

"It should be kept in mind that royalty amounts due, either to an extractor, or to SARS, will attract interest in terms of the Mineral and Petroleum Resources Royalty (Administration) Act, 2008, read with Chapter 12 of the Tax Administration Act, 2011."

- Generally speaking, an extractor may, in calculating its "earnings before interest and taxes" (**EBIT**), deduct "**capital expenditure**" (as per section 36(11) of the Income Tax Act, 1962 (the Act)) that was incurred to win, recover and develop the mineral resource to the "condition specified". But, for instance, do the so-called "**capex per mine ring-fence**" provisions in section 36(7F) of the Act, read with section 36(10), impact the calculation of EBIT for mineral royalty purposes?



- Schedule 1 and Schedule 2 to the Royalty Act, which contain the "**condition specified**" for refined and unrefined mineral resources, respectively, are central to calculating the mineral royalty liability. It is crucial, then, that extractors continually monitor if, or at what point in its mining process, the mineral resources reach the "condition specified**"**.

In light of this, extractors should conduct a review of their mineral royalty positions and in doing so, consider if the Royalty Act has been interpreted and applied correctly. Are the assumptions underlying the calculations still valid 14 years after the Royalty Act was first introduced? Or has there been a change in mining processes or output? At the very least, extractors should compile a manual statement of account based on historic returns and payments.

It should be kept in mind that royalty amounts due, either to an extractor, or to SARS, will attract interest in terms of the Mineral and Petroleum Resources Royalty (Administration) Act, 2008, read with Chapter 12 of the Tax Administration Act, 2011. So, a manually prepared statement of account should account for interest too.

If an extractor has established that a refund is due, it is necessary to formally request SARS to pay such a refund. This request should be made keeping in mind the legislative framework applicable to royalty refunds.

Given these practical challenges and legal complexities, extractors should obtain professional legal advice.

In the current economic climate, coupled with the challenges presented by a downturn in the commodity price cycle, a refund from SARS can prove to be a handy windfall for many businesses.

Kristel van Rensburg & Simon Weber

ENS

Acts and Bills

- Income Tax Act 58 of 1962: Section 36(7F), (10) & (11) (definition of "capital expenditure");
- Tax Administration Act 28 of 2011: Sections 1 (definition of "relevant material"), 46 & 187-189 (Chapter 12);
- Mineral and Petroleum Resources Royalty Act 28 of 2008: Section 1 (definitions of "mineral resource" and "transfer");
- Mineral and Petroleum Resources Development Act 28 of 2002;
- Mineral and Petroleum Resources Royalty (Administration) Act 29 of 2008.

Tags: mineral royalty statements of account; mineral resource; capital expenditure.

SARS CAN ONLY LEVY TAX LEGALLY DUE

The process of defining issues in a dispute, and the grounds in support thereof, has always been of immense value – the documents containing these are the pleadings, and they are the foundation of the case, identifying the issues and informing the other party of the case they must meet.

In *Commissioner, South African Revenue Service v Free State Development Corporation* [2023], the Supreme Court of Appeal (SCA) decided in which circumstances it is permissible to amend the grounds of appeal and delivered its judgment on 31 May 2023. The matter was revisited, due to the Commissioner for the South African Revenue Service (SARS) having noted an appeal to the Constitutional Court which was dismissed without a hearing on 12 February 2024.

The taxpayer, The Free State Development Corporation, a registered VAT vendor, rendered its VAT returns declaring zero-rated taxable supplies. SARS disagreed and subjected the supplies to VAT at the standard rate.

The taxpayer filed an objection contending that there were no actual supplies, only deemed supplies, which were zero-rated. SARS disallowed the objection. In its appeal, the taxpayer maintained that the supplies were zero-rated. The matter proceeded to the tax court:

- SARS delivered its Rule 31 statement, and the grounds of assessment were that in terms of section 7(1)*(a)* of the VAT Act and the definition of "supply" in section 1(1) of that Act, the taxpayer must levy and pay over VAT at the standard rate.
- In its Rule 32 statement the taxpayer stated that it supplied services under two funding arrangements (managing and monitoring the funding). However, it derived no financial benefit and was a mere conduit.
- SARS, responding in its Rule 33 statement, submitted that the taxpayer did not enjoy the zero rate.

The parties may agree to an amendment to a Rule 31, 32 or 33 statement and if unable to agree, the party requiring the amendment may apply to the tax court to grant an amendment (Rule 35, read with Rule 52). However, it should be noted that a taxpayer may appeal on a new ground not raised in an objection unless it constitutes a new objection against a part or amount not objected to (Rule 10(3)). The taxpayer requested to withdraw its original grounds of appeal claiming that the supplies were zero-rated and wished to file an amended version now claiming that there was no actual or deemed supply. The Taxpayer argued that:

- The issue in the amended grounds was covered by the substance of the objection, and it was therefore permitted by the Rules.
- The amendment is based on the same facts but reaches the correct legal conclusion.

SARS opposed the amendment by –

- stating that it introduced grounds of appeal against a part of the assessments not previously objected to;
- stating that the ground of objection was a taxable supply subject to the zero rate and it was not a ground of objection that the supplies do not constitute taxable supplies; and
- also submitting that a taxpayer is bound by its own declarations in a return and did not indicate that this was incorrect prior to the amendment (section 25 of the Tax Administration Act, 2011 (the TAA)).

The court (SCA) held that:

- The amendment was based on the same facts but reached the correct legal conclusion.
- The amendment claimed that the transactions were not subject to VAT because there was no supply. The basis of the objection claiming the zero-rating was likewise based on the nature of the transactions, and that it had no relation to an actual supply.
- The amended grounds of appeal were clearly foreshadowed in the objection.
- The nature of the taxpayer's objection to the whole of SARS' assessment was always, and continued to be, whether VAT was lawfully imposed on these transactions.
- On a proper interpretation, the taxpayer was not precluded from raising a new ground of appeal in its amended statement, in particular when the grounds were, in substance, the same as those stated in its initial objection.

The judicial wisdom with which the court expressed itself may be applauded. It stated in paragraph 47 that:

> "The amendment will permit the true issue between the parties to be ventilated. This basic principle of tax law is underscored by section 143(1) of the TAA, which provides that SARS has a duty 'to assess and collect tax according to the laws enacted by Parliament and not to forgo a tax which is properly chargeable and payable.' This principle must also relate to the corollary – SARS' obligation not to levy taxes which are not payable in terms of the law. This could be the situation if the amendment was not granted."

"The nature of the taxpayer's objection to the whole of SARS' assessment was always, and continued to be, whether VAT was lawfully imposed on these transactions."

The suggestion by SARS that because section 25 regards a return to be full and true, a taxpayer is bound by its own prior declarations in the return, is surprising for two reasons:

- It is settled law that a taxpayer can object against its own assessment (see paragraph 25 of the SCA decision in *GB Mining and Exploration SA (Pty) Ltd v Commissioner, South African Revenue Service*, [2014]); and
- an assessment only becomes final after a period of three years, where assessed by SARS, or five years where self-assessed (section 99 of the TAA), permitting taxpayers to revise a self-assessment any number of times within that period unless SARS has issued a notice of assessment which must be addressed through the chapter 9 dispute process.

Section 25 requires that a return must be full and true, but clearly this does not mean that returns are necessarily free from errors. Section 222 of the TAA clearly envisages that *bona fide* inadvertent errors can arise. The resubmission of returns may thus be required.

The purpose of Tax Court Rules governing the exchange of pleadings is to ensure that fairness is achieved and that neither party is procedurally or substantively "ambushed". Its purpose is not to prevent the true issues from being adjudicated if they are foreshadowed in the taxpayer's objection. However, it is unclear what degree of foreshadowing would be sufficient for the taxpayer to be permitted to amend its pleadings. It appears to have been important that both sets of grounds relied on the same factual basis.

Was the permission to amend the pleadings granted because the original objection was based on there being a deemed supply and not an actual supply? It is trite that a deeming provision recognises that something is in fact not what it is deemed to be and a legal "fiction" is thus created. The weight of this finding is difficult to assess because the court also held that both the objection and the amendment to the pleadings were concerned with whether VAT was lawfully imposed on the transactions.

In the tax court decision of *ITC 45710*, [2022], argued and decided before *Free State Development Corporation*, the taxpayer introduced a new ground of appeal. Its ground of objection had been that an amount was an allowable deduction in terms of section 11*(a)* read with 23*(g)* of the Income Tax Act, 1962 (the Act), but in its Rule 32 statement the taxpayer presented a new ground, namely that the amount was not received or accrued within the meaning of the "gross income" definition in section 1(1) of the Act. The tax court held that this was not a permissible new ground because:

- It constituted an entirely new case on appeal, aimed at the reduction of an amount not previously objected to.
- The new ground was not merely a "re-packaging" of the legal basis upon which the taxpayer disputed the amount for the purposes of determining its income tax liability.
- It was incorrect to say that an objection against an expense amount is equivalent to an objection against the gross income amount.

If this tax court decision is evaluated against the subsequent findings of the SCA in *Free State Development Corporation*, it is difficult to say if the outcome would be different. The degree of foreshadowing would have to be assessed, and there are legitimate differences between this case and that of *Free State Development Corporation*.

On the basis that SARS has an obligation to assess and collect tax according to the law and must not forgo a tax which is properly chargeable and payable, it may likewise also introduce new grounds of assessment at the appeal stage provided it is not a novation of the entire factual or legal basis of the disputed assessment (see Rule 31(3)).

Taxpayers should always seek advice at the earliest stage of a dispute to ensure that the objection is based on the proper grounds and that the correct part or amount is objected against. Those taxpayers who have already lodged objections should be aware that they may introduce new grounds of appeal in the circumstances envisaged in the *Free State Development Corporation* case.

[*Editorial note*: The tax court decision of *ITC 45710* [2022] was taken on appeal to the Full Bench of the High Court and is cited as *Baseline Civil Contractors (Pty) Ltd v Commissioner for the South African Revenue Service* [2024] ZAWCHC 113 (26 April 2024). This decision could not be considered by the author since it had not been decided at the time of writing, but became available prior to publication in *Tax Chronicles Monthly* in August 2024.]

Edlan Jacobs

BDO

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "gross income"), 11*(a)* & 23*(g)*;
- Tax Administration Act 28 of 2011: Sections 25, 99, 103, 143(1) & 222;
- Value-Added Tax Act: Sections 1(1) (definition of "supply") & 7(1)*(a)*.

Other documents

- Rule 31 statement;
- Rule 32 statement;
- Rule 33 statement;
- Rules in terms of section 103 of the Tax Administration Act 28 of 2011: Rules 10(3), 31(3), 35 & 52;
- Tax Court Rules.

Cases

- *GB Mining and Exploration SA (Pty) Ltd v Commissioner, South African Revenue Service* (903/2012) [2014] ZASCA 29; [2015] (4) SA 605 (SCA) (28 March 2014) [paragraph 25];
- *Commissioner, South African Revenue Service v Free State Development Corporation* (1222/21) [2023] ZASCA 84; [2024] (2) SA 282 (SCA) (31 May 2023) (specific reference to paragraph 47);
- *ITC 45710* [2022];
- *Baseline Civil Contractors (Pty) Ltd v Commissioner for the South African Revenue Service* [2024] ZAWCHC 113 (26 April 2024).

Tags: zero-rated taxable supplies; grounds of assessment; supply; Rule 31 statement; Rule 32 statement; Rule 33 statement; *bona fide* inadvertent errors.

THE STATUS OF TAX COURTS AS COURTS OF LAW

The South African legal system is host to a number of quasi-judicial decision-making bodies which, while having the power to make decisions which are authoritative and may be binding on parties and while conducting proceedings in a judicial manner, cannot be described as courts of law in the proper sense.

The High Court in the case of *Poulter v The Commissioner for the South African Revenue Service* [2024] had to determine whether the tax court was a court of law for the purposes of deciding whether a taxpayer could be represented by a layperson in the tax court. It should be noted that the tax court first considered the issue of a layperson's right of appearance before it in 2016 in the *RTCC* case, to which reference is made below.

BACKGROUND

The matter concerns an appeal to the Western Cape High Court (the High Court) against an order of the tax court confirming a taxpayer's assessment by the Commissioner for the South African Revenue Service (SARS), which was made without hearing the taxpayer's representative on account of the representative not being a legal practitioner. Despite the representative possessing a power of attorney from the taxpayer, the tax court invoked Rule 44(7) of the Tax Court Rules. This rule provides that if a party or person authorised to appear on their behalf fails to appear at the hearing, the tax court may decide the appeal upon the request of the party that does appear and proof that the absent party or their representative had been notified of the hearing. Because the representative was not a legal representative (legal practitioner), the tax court did not consider him authorised to appear for the taxpayer.

The question therefore arose as to whether the tax court was correct in finding that the taxpayer's representative had to be a legal practitioner.

THE LEGISLATIVE FRAMEWORK

In laying the foundations for its decision, the High Court first dealt with the Legal Practice Act, 2014 (the LPA). Section 25 provides that any person who has been admitted and enrolled to practice as a legal practitioner has the right to do so throughout South Africa and can appear on behalf of any person in any court or before any board, tribunal or similar institution in South Africa. Section 33 of the LPA prohibits any person who is **not a legal practitioner** from appearing in any **court of law**, board, tribunal or similar institution at which only legal practitioners may appear in expectation of a fee, commission, gain or reward.

The High Court also considered section 125(1) of the Tax Administration Act, 2011 (the TAA), which when read together with section 12, provides for a senior SARS official to appear before the tax court. Pursuant to amendment in 2017, section 125 did not expressly address who could appear on a taxpayer's behalf.

The taxpayer's principal argument was that the taxpayer's representative before the tax court, being her father, was authorised to act on her behalf before the tax court in terms of a power of attorney that had been issued to him. In the context of section 25 of the LPA, the taxpayer's argument was that it supported the taxpayer's representative appearing on her behalf in the tax court as he did not expect a reward for doing so. SARS' argument in this context was that the taxpayer's representative was not entitled to appear in the tax court, as it is a "court of law" and only legal practitioners may appear in courts of law.

As a result, the main issue to be decided was whether the tax court is a court of law in the requisite sense to bar the taxpayer's father from representing her.

THE MEANING OF "COURT OF LAW"

The High Court considered several factors in determining whether the tax court constitutes a court of law, the most pertinent of which are discussed below.

Firstly, it looked at the inherent power of superior courts to regulate their own proceedings in terms of section 173 of the Constitution of the Republic of South Africa, 1996. In this regard, the High Court held that the tax court is not a superior court in that it does not possess this power, which is reserved only for the High Court, Supreme Court of Appeal and Constitutional Court.

Secondly, the High Court looked to foreign case law dealing with so-called local courts of valuation in the United Kingdom, which were not courts of law and whose decisions, amongst other things, did not create binding precedent. The High Court stated that the position of the tax court was similar in that its jurisdiction is limited to determining a taxpayer's tax liability in the case before it and thus it cannot decide general points of law or create binding precedent.

Thirdly, section 166 of the Constitution lists the courts that form part of the South African judicial system, being the superior courts listed above, the Magistrates' Court and any court of similar status to the High Court established by an Act of Parliament. It was held that the tax court is none of these as Parliament could not have intended to elevate a body performing an administrative function to that of a court, despite acting judicially. Furthermore, considering the provisions of the TAA, the High Court held that the tax court is established by a proclamation by the President, not an Act of Parliament. Accordingly, because the tax court does not form part of the constitutionally created judicial system, it cannot be properly characterised as a court of law.

THE COURT'S FINDING

Ultimately, it was held that although the tax court has the trappings of a court, it is an administrative decision-maker and ought to be conceived of as a "court of revision" and not a court of law. This finding was largely based on the fact that this was how the tax court's predecessor, the special tax court, was described. Accordingly, a tax court's functions are essentially those of an administrative tribunal.

Additionally, the High Court considered the language employed in the TAA, which mentions the taxpayer's "authorised representative" but does not say legal representative (or legal practitioner). The court held that this comes from an understanding that there is no limitation on who can appear, meaning that laypersons are entitled to represent natural persons in the tax court.

A critical aspect that the High Court considered is the impact of an amendment to section 125 of the TAA. As noted above, section 125, read with section 12, expressly provides for a senior SARS official to appear before the tax court. The High Court acknowledged that prior to its deletion, with effect from 18 December 2017, section 125(2) of the TAA stated that

> "the appellant or the appellant's authorised representative may appear at the hearing of an appeal in support of the appeal".

There was no limitation on whom the appellant (taxpayer) might appoint as its representative. Although section 125(2) was repealed, it was significant that the High Court held that:

> "[T]he mere deletion of the provision cannot tacitly imply an indication that an appellant is not entitled to representation before a tax court. A provision excluding any right of representation for an appellant would, in any event, probably be unconstitutional on grounds of unfairness, which is a further reason to discount the deletion of s125(2) as having such an effect."

The reason for the repeal of this section was reflected in the explanatory memorandum to the amendment Act as a technical correction, which in the High Court's view supported this interpretation. While it is unclear whether the tax court's judgment that is the subject of this appeal dealt with the now repealed section 125(2) of the TAA, it appears that the High Court addressed this issue, as in a related interlocutory application before the tax court (presided over by another judge), the repeal of this section was the reason for disqualifying the taxpayer's representative from appearing on her behalf.

What follows is that because the tax court is not a court of law and representation is not limited to legal practitioners, the prohibition restricting rights of appearance to legal practitioners did not apply and the taxpayer was entitled to be represented by her father in the tax court. Accordingly, the High Court overturned the tax court's finding that the appellant had to be represented by a person with a right of appearance in the High Court as an attorney or an advocate and remitted the matter to the tax court for hearing *de novo*.

COMMENT

As noted previously, the tax court stated in *RTCC v Commissioner for the South African Revenue Service* [2016], seemingly as an *obiter* statement, that given the wording of section 125(2) of the TAA, which had not yet been repealed at the time, a potential inequality of arms between the taxpayer and SARS was created. However, the tax court in that case held that any amendment should be "to ensure that the representatives have some expertise in the field of tax law". While the explanatory memorandum that addressed the reason for section 125(2)'s repeal did not refer to this judgment, it seems that this statement by the tax court may have been part of the reason for the repeal of section 125(2).

> "Considering the judgment in *RTCC*, the repeal of section 125(2) of the TAA and the subsequent commencement of the LPA, the High Court's judgment has provided welcome certainty."

This is important because although the LPA came into effect in 2018 to alter some of the rules regulating the legal profession, it appears that the repeal of section 125(2) of the TAA was the main reason for the *Poulter* matter ending up before the High Court. While the judgment in *RTCC* expressed concern around the potential inequality in representation of the parties before the tax court, one is inclined to agree with the High Court's finding that expressly disallowing a taxpayer from appointing an authorised representative who is not an admitted attorney, would have potentially been unconstitutional.

Considering the judgment in *RTCC*, the repeal of section 125(2) of the TAA and the subsequent commencement of the LPA, the High Court's judgment has provided welcome certainty. In addition to setting out the characteristics of what constitutes a court of law, this judgment also highlights that taxpayers appearing before the tax court can appoint someone to appear on their behalf who may not necessarily be a legal practitioner.

While it is important to appreciate that most tax disputes are resolved prior to reaching the tax court, it would likely be unfair for a taxpayer that may have limited resources, to have to incur costs to appoint a legal representative if the dispute is not resolved earlier. While it is acknowledged that SARS has been in the process of rebuilding its capacity in recent years, it generally has more resources, such as in-house admitted legal practitioners and the capability to brief external legal counsel. One should take into account that even if taxpayers decide to represent themselves in the tax court or to appoint someone other than an admitted legal practitioner, it is not without risk. This is evident from the 2023 judgment in *U Taxpayer v Commissioner for the South African Revenue Service* [2023], where the tax court allowed the taxpayer to represent himself in an interlocutory application, but still awarded a cost order in SARS' favour.

Corné Lewis, Louis Botha, Claudia Moser & Denzil Mhlongo

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 12 & 125;
- Legal Practice Act 28 of 2014: Sections 25 & 33;
- Constitution of the Republic of South Africa, 1996: Sections 166 & 173.

Other documents

- Tax Court Rules: Rule 44(7).

Cases

- *Poulter v The Commissioner for the South African Revenue Service* (A88/2023) [2024] ZAWCHC 97;
- *RTCC v Commissioner for the South African Revenue Service* [2016] (VAT 1345) ZATC 5;
- *U Taxpayer v Commissioner for the South African Revenue Service* (IT24502) [2023] ZATC 7.

Tags: senior SARS official; taxpayer's representative; court of law; local courts of valuation; authorised representative.

UNREDACTED DOCUMENTS REQUIRED BY SARS

Section 46 of the Tax Administration Act, 2011 (the TAA), allows SARS to request "relevant material" in relation to a taxpayer for the purposes of administering a tax Act. In the case of Commissioner for the South African Revenue Service v J Company *[2024] the High Court had to evaluate the oft-debated issue of what material is considered relevant.*

The taxpayer was a South African company which procured and provided advice and project management services to clients undertaking various corporate and commercial transactions. The taxpayer charges a fee to clients for its services and recharges to the client any amounts it pays to specialist advisors engaged on behalf of the client.

SARS issued the taxpayer with a request in terms of section 46 to provide copies of specified relevant material, including an explanation of the nature of each amount comprising the sales and other expenses reflected in the ITR14 together with supporting documentation and relevant invoices. The taxpayer provided SARS with schedules reflecting each item of income and expenditure but omitted the identity of the supplier or recipient of the service. Supporting invoices relating to the income statement analysis were also provided, but some were redacted to conceal the identities of the counterparties and the nature of the services rendered. The redacted invoices specifically related to advisory fees and expenses incurred by the taxpayer for instructing attorneys and procuring a consulting service.

SARS contended that the taxpayer was non-compliant with section 46 and approached the High Court for an order forcing the taxpayer to provide unredacted documents. The taxpayer's primary submission was that the request for relevant material was only in respect of the taxpayer and the redacted information on the invoices related to the identity of the taxpayer's clients and suppliers, in other words, parties other than the taxpayer, and thus was not "relevant material".

Section 1 of the TAA defines "relevant material" as any information, document or thing that "in the opinion of SARS is foreseeably relevant for the administration of a tax Act". The taxpayer contended that SARS had failed to demonstrate why the redacted information was "foreseeably relevant" for the administration of a tax Act.

The court's response to this was that in most cases, SARS is not aware of what information or documentation is available in order for it to fully discharge its function of assessing a taxpayer's liability and that it is not for the taxpayer to say that SARS has failed to include the reasons to prove that the documents may be "foreseeably relevant" when the taxpayer obstructs the very production of the material in order for the decisionmaker to make a decision.

The court confirmed that section 46 is clear in that when determining what material is "relevant" it is the opinion of SARS that matters and not the opinion of the taxpayer.

It is accepted that information is the lifeblood of a revenue authority's taxpayer audit function and the rationale of taxation would break down if a revenue authority had no effective powers to obtain confidential information about taxpayers who may be negligent or dishonest, resulting in the whole burden of taxation falling on diligent and honest taxpayers.

The court held that SARS has a duty to ensure that income is not derived from illegal sources or from illegal activities. The clients whose information was contained in the invoices would have a reciprocal duty or obligation to declare their income or expenses *vis-à-vis* the taxpayer in their financial statements and there is an obligation on SARS in the administration of a tax Act to be able to see a reciprocal entry in the receiving person's bank account.

The court agreed with SARS that the nature of the taxpayer's business and the parties with whom it conducts business in order to generate taxable income and claim allowable deductions is a matter by its very nature relevant to the tax affairs of the company. The court therefore ordered that the unredacted invoices be provided to SARS.

Interestingly, in relation to the invoices concerning services provided by attorneys, the taxpayer did not claim legal privilege as the basis for its refusal to provide unredacted versions (although the court noted that the information which had been redacted "could hardly amount to privilege", had that argument been put forward).

Robyn Armstrong

Werksmans Attorneys

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 1 (definition of "relevant material") & 46.

Other documents

- ITR14 (company income tax return).

Cases

- *Commissioner for the South African Revenue Service v J Company* (14944/19) [2024] ZAWCHC 63 (29 February 2024).

Tags: relevant material; redacted invoices; legal privilege.

TRUSTS AND BENEFICIAL OWNERSHIP

The General Laws (Anti-Money Laundering and Combating Terrorism Financing) Amendment Act, 2022 (the Amendment Act), promulgated as part of legislative framework changes by South Africa to curb money laundering, introduced key changes to the trust environment, requiring extensive beneficial ownership and other reporting by trusts.

SARS is also aligning its tax and data collection imperative with these changes by requiring similar reporting as part of trust tax submissions. In this article, the impact of these changes on trusts is reviewed.

The Amendment Act came into effect on 1 April 2023 and introduced interesting changes relating to trusts in South Africa by amending, amongst other things, the Trust Property Control Act, 1988 (the Trust Act). This now makes it a requirement for trusts to draw up a beneficial ownership register which contains all essential beneficial ownership information of the warm bodies behind each trust that receive benefits from the trust.

The Amendment Act also permits the sharing of information between authorities both domestically and internationally. This requires that beneficial ownership registers must correctly and accurately, according to required reporting standards, disclose all information to relevant authorities regarding trust beneficial owners and avoid discrepancies in the reporting thereof between different authorities.

SARS has likewise implemented the reporting of beneficial ownership information for trusts. It no longer only requires the submissions of annual financial statements or annual returns of trusts, but now also requires as much information as possible to ensure that it is dealing with everything as efficiently as possible. The beneficial ownership registers are one of the new requirements that SARS has implemented.

As of 1 April 2024, SARS requires proof of the beneficial ownership submission with the Master of the High Court prior to a trust submitting its annual returns. Should the beneficial ownership information not be submitted to the relevant regulatory body, SARS prohibits entities from submitting their annual returns. Failure to submit in accordance with the timelines stipulated by SARS may result in penalties for these late submissions. This new requirement of SARS took effect on 1 April 2024.

SARS now also requires trusts to submit resolutions two-fold in respect of trust distributions. The first resolution must be submitted at the end of the financial year reflecting the estimated distribution that a trust will declare to its beneficiaries. The second resolution must be submitted before the end of September of each year stipulating the actual distributions made to beneficiaries. Whilst these resolutions were previously only requested by SARS, they have now become a mandatory requirement. The suspicion is that these resolutions are aimed at establishing the flow of funds from a trust to beneficial owners in light of the Amendment Act and to identify the recipients of benefits from trusts and cross-refer such to beneficial ownership information.

One can expect further collaboration in future between the Master of the High Court, SARS and other regulatory bodies, with information sharing as the backbone of such collaboration. The purpose is not only to identify owners and cashflows, but also to identify reporting discrepancies and the imposition of sanctions for non-compliance. Recent statistics have shown that many South African trusts are not registered as taxpayers with SARS, suggesting the presence of either tax ignorance or tax evasion. Either way, the expectation is that SARS will increase its focus on compliance with these requirements and zoom in on these unregistered trusts.

Despite the additional scrutiny and administrative obligations imposed on trusts, trusts remain an important tool in South African estate and corporate planning and structuring if used correctly. However, the trust administration and reporting must be done correctly and in line with the new requirements in respect of trusts or run the risk of fines, imprisonment and the attention of SARS.

If anyone is concerned about complying with the latest trust compliance requirements, do not hesitate to contact experts in the field for assistance.

Dr Candice Reynders & Elani van Coller

PH Attorneys

Acts and Bills

- General Laws (Anti-Money Laundering and Combating Terrorism Financing) Amendment Act 22 of 2022;
- Trust Property Control Act 57 of 1988.

Tags: beneficial ownership registers; sanctions for non-compliance.

APPORTIONMENT: THE *CAPITEC BANK* CASE

On 12 April 2024 the Constitutional Court (Court) delivered its judgment in Capitec Bank Limited v Commissioner for the South African Revenue Service, *[2024]. In summary, Capitec Bank Ltd (Capitec) conducted a transactional banking and unsecured lending business which was its enterprise for VAT purposes, to the extent that it charged fees (a taxable supply).*

The standard loan agreements concluded with customers contained loan cover, which enabled the borrowers who defaulted in settling their obligation to be settled via the loan cover, up to a specified amount. The payout was dependent on the occurrence of either of two insured events, death or retrenchment. This loan cover was provided free of charge (ie, for no consideration).

During November 2017, due to the satisfaction of the conditions of the loan cover, Capitec settled borrowers' outstanding loan obligations to the total amount of R582 383 753. Capitec claimed a deduction of R71 520 811 in terms of section 16(3)*(c)* of the Value-Added Tax Act, 1991 (the VAT Act). Section 16(3)*(c)* permits a deduction equal to the tax fraction of any payment made by a vendor to indemnify another person under a contract of insurance, provided that the contract of insurance is a "taxable supply". The amount claimed represented the tax fraction of the amount settled in relation to the 14% VAT rate that applied at the time of the claim.

On 15 February 2018, SARS issued an additional assessment disallowing the deduction and imposing a late payment penalty.

The tax court found in favour of Capitec and upheld the appeal, concluding that it was allowed to make the deduction in full.

However, the Supreme Court of Appeal (SCA) found in favour of SARS and held that Capitec was not entitled to make any deduction in terms of section 16(3)*(c)* of the VAT Act (*Commissioner, South African Revenue Service v Capitec Bank Ltd,* [2022]).

Capitec appealed to the Constitutional Court, which provided clarity in three primary respects. It confirmed that:

- The VAT Act contemplates supplies made for zero consideration;
- A supply made for zero consideration may constitute a "taxable supply", as defined in section 1(1) of the VAT Act; and
- A supply does not lose its character once the amount relating to the supply has been capitalised (ie, debited to the recipient's account).

The Constitutional Court held that:

- The interest and fees were expected to cover the premium and leave a satisfactory return on Capitec's capital. Therefore, in economic terms, the supply of the cover was not free. However, Capitec's contracts with its customers explicitly stated that the cover was granted for no charge, and the case was approached on that basis;

- The definition of "enterprise" in section 1(1) does not require all supplies to be made for a consideration;

- A supply, taxable or otherwise, may be made for no consideration and assigned a value of nil for any purpose relevant to the VAT Act;

- Capitec's supply of the loan cover was not disqualified from being a "taxable supply" merely because it was supplied free of charge, and the SCA erred by disqualifying it;

- The *Tesco Freetime* case of the United Kingdom Upper Tribunal (*Commissioners for HM Revenue and Customs v Tesco Freetime Ltd* [2019]) reflected the economic reality when supplies were made free of charge to promote the vendor's business. Any expenses incurred by the vendor to further its enterprise, whether it charges a consideration or offers a good or service for free, will be factored into the vendor's charge to its customers. VAT is accounted for on the totality of the payments received from customers as consideration for all the goods and services supplied to its customers;

- The loan cover was a mixed supply made in the course or furtherance of Capitec's exempt activity of lending money at interest as well as its enterprise activity of charging fees to clients. Stated differently, the loan cover was a mixed supply that could be linked to Capitec's enterprise of lending money and earning both interest from exempt supplies and fees from taxable supplies;

- The unpaid fees debited by Capitec to borrowers' accounts do not lose their character when capitalised, any more than the interest, when debited, loses its character as interest;

- Section 2(1) of the VAT Act lists financial services which are all exempt supplies in terms of section 12*(a)* of the VAT Act, and the proviso to section 2(1) ensures that any fee or commission charged is taxable. The section requires one to view the supply of the contract of insurance as partly taxable and partly exempt. The scheme of the VAT Act, in the present circumstances, itself suggests an apportionment; and

- In the income tax cases of *Rand Selections (Commissioner for Inland Revenue v Rand Selections Corporation Ltd* [1956]) and *Nemojim (Commissioner for Inland Revenue v Nemojim (Pty) Ltd* [1983]), in dealing with the question whether expenditure had been incurred in the production of income, both courts found a practical solution in finding that the deduction was subject to apportionment, despite the legislation containing no apportionment provision. A similar approach is mandated in the context of section 16(3)*(c)* where the insurance contract is supplied only partly as a taxable supply.

The clarity provided by the court is welcomed, and the judgment is impeccable in many respects. However, with respect, the approach to apportionment taken by the court is questionable.

The court correctly concluded that the deduction afforded by section 16(3)*(c)* is not subject to the apportionment provisions of section 17(1) because it is not "input tax" (as defined in section 1(1)), but a deduction in a class of its own (*sui generis*).

Despite this finding, the court found that apportionment should apply. The court reasoned that a deduction in full was "instinctively unattractive", which was made more so by the fact that the taxable fee-earning component of Capitec's enterprise was 5%-13% and the rest an exempt activity (interest-earning). The court's solution was to apportion the deduction.

It appears that the court did not have proper regard to the purpose of section 16(3)*(c)*, and specifically, to why this unique deduction exists. The purpose is set out in the VATCOM Report, which states that a portion of the premium paid is for a service (managing the funds), and the rest is a capital contribution to pay future insurance claims. To avoid the difficulty of identifying which portion of the premium relates to managing funds and the capital contribution, the principle is that the full premium is subject to VAT, but the insurer is allowed an input credit for claims paid. The value added by a short-term insurer is represented by its gross margin (broadly speaking, the difference between premiums collected and claims paid).

This means that where insurance is supplied for no consideration the gross margin would be negative, and any claims arising would result in a VAT refund, provided the contract of insurance is a taxable supply.

The loan cover offered by Capitec was accepted by the court to be a contract of insurance. The deduction rests on the contract of insurance being a taxable supply. This only requires that it is made in the course or furtherance of the "enterprise" and not the extent to which it furthers the enterprise. Short-term insurance is wholly a taxable supply if made in the course or furtherance of an enterprise and cannot be a partially taxable supply. If Capitec had charged a premium for the insurance, it would have had to levy VAT on the entire amount, not part of it. The contract of insurance is fully taxable, unless it is a supply covered by an exemption (ie, an exempt supply). The court's reasoning means that any premium charged by Capitec should be a taxable supply only to an extent (only taxable to 5%-13%), and VAT should only be charged on this portion of the premium, since the supply is in the furtherance of the exact same enterprise, only the value has changed.

Taking into account the apparent purpose of section 16(3)*(c)*, the contract of insurance should be entirely taxable but assigned a value of zero (nil), and the deduction in respect of claims paid out should be deductible in full. Once it had been established that the insurance was in the furtherance of an enterprise and not itself an exempt supply, the deduction should have been allowed in full. If it is acknowledged that Capitec settled R582 383 753 in loans owed to it, the instinct to find this outcome unattractive is reduced (the fact that Capitec had insurance of its own does not change this).

A statute must apply to all subjects equally and its interpretation cannot vary from one factual matrix to the next (*Telkom SA SOC Limited v Commissioner for South African Revenue Service* [2020] paragraph 15). Section 16(3)*(c)* cannot mean one thing in the context where the consideration is nil, but then mean another where the consideration is more.

The income tax cases cited by the court were interpreting provisions that required one to determine the purpose for which the expenditure had been incurred. However, the VAT deduction for payments under a contract of insurance only requires the contract of insurance to be a taxable supply.

The court stated that the contract of insurance was a mixed supply made in the course or furtherance simultaneously of an exempt activity and an "enterprise" activity, requiring one to view the supply of the contract of insurance as partly taxable and partly exempt, which is contemplated by the proviso to section 2(1).

The difficulty with this finding is that section 2(1) of the VAT Act only exempts a life insurance policy as defined, which was not the cover Capitec provided. A distinction must be established between the supply of the loan agreement and loan cover. The provision of credit, although an exempt supply, was a supply made in terms of the loan agreement, it was not the supply made under the contract of insurance. The court's conclusion may be premised on the fact that the insurance and the exempt supply of credit all formed part of a single contract without proper regard to each being a separate supply.

"The clarity provided by the court is welcomed, and the judgment is impeccable in many respects. However, with respect, the approach to apportionment taken by the court is questionable."

The court concluding that the deduction requires apportionment without applying section 17(1), means that any apportionment on this basis could never benefit from the *de minimis* rule found in section 17, which provides that if the intended taxable use is at least 95%, it is regarded as being acquired wholly for taxable purposes (100%).

In conclusion, the case highlights the following key issues:

- Whether or not the contract of insurance was a taxable supply made for no consideration; and
- That the input tax deduction should be subject to apportionment.

Although the case clarifies various important issues, it is important to emphasise that the case did not deal with the following:

- Whether the loan cover was short-term or long-term insurance – it was merely accepted that it was short-term insurance;
- Whether settling amounts owed to oneself constitute payments made to indemnify; and
- What constitutes a contract of insurance and the essentialia of such a contract. The loan cover was accepted to be a contract of insurance, and no argument was advanced against this.

It is understood that whenever a customer takes up a loan with Capitec, the customer is also required to open a transactional account – the free loan cover is therefore also in the furtherance of Capitec's transactional banking business, which earns further fees (a taxable supply), potentially significantly increasing the proportion of its taxable supplies to total supplies.

In terms of section 129(4) of the Tax Administration Act, 2011, an altered assessment which arises from referral back to SARS for examination is subject to objection and appeal. It will be interesting to see the method of apportionment and whether Capitec will object or appeal against the altered assessments issued by SARS.

Edlan Jacobs & Elaina Silby

BDO

Acts and Bills

- Value-Added Tax Act 89 of 1991: Sections 1(1) (definitions of "enterprise", "input tax" & "taxable supply"), 2(1), 16(3)*(c)* & 17(1);
- Tax Administration Act 28 of 2011: Section 129(4).

Other documents

- VATCOM Report.

Cases

- *Capitec Bank Limited v Commissioner for the South African Revenue Service* (CCT 209/22) [2024] ZACC 1 (12 April 2024);
- *Commissioner, South African Revenue Service v Capitec Bank Ltd* (94/2021) [2022] ZASCA 97; [2022] (6) SA 76 (SCA);
- *Commissioners for HM Revenue and Customs v Tesco Freetime Ltd* [2019] UKUT 18 (TCC); [2019] STC 1188;
- *Commissioner for Inland Revenue v Rand Selections Corporation Ltd* [1956] (3) SA 124 (A);
- *Commissioner for Inland Revenue v Nemojim (Pty) Ltd* [1983] (3) SA 935 (A);
- *Telkom SA SOC Lt v Commissioner, South African Revenue Service* [2020] ZASCA 19; [2020] (4) SA 480 (SCA): Paragraph 15.

Tags: taxable supply; enterprise; no consideration; subject to apportionment.

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