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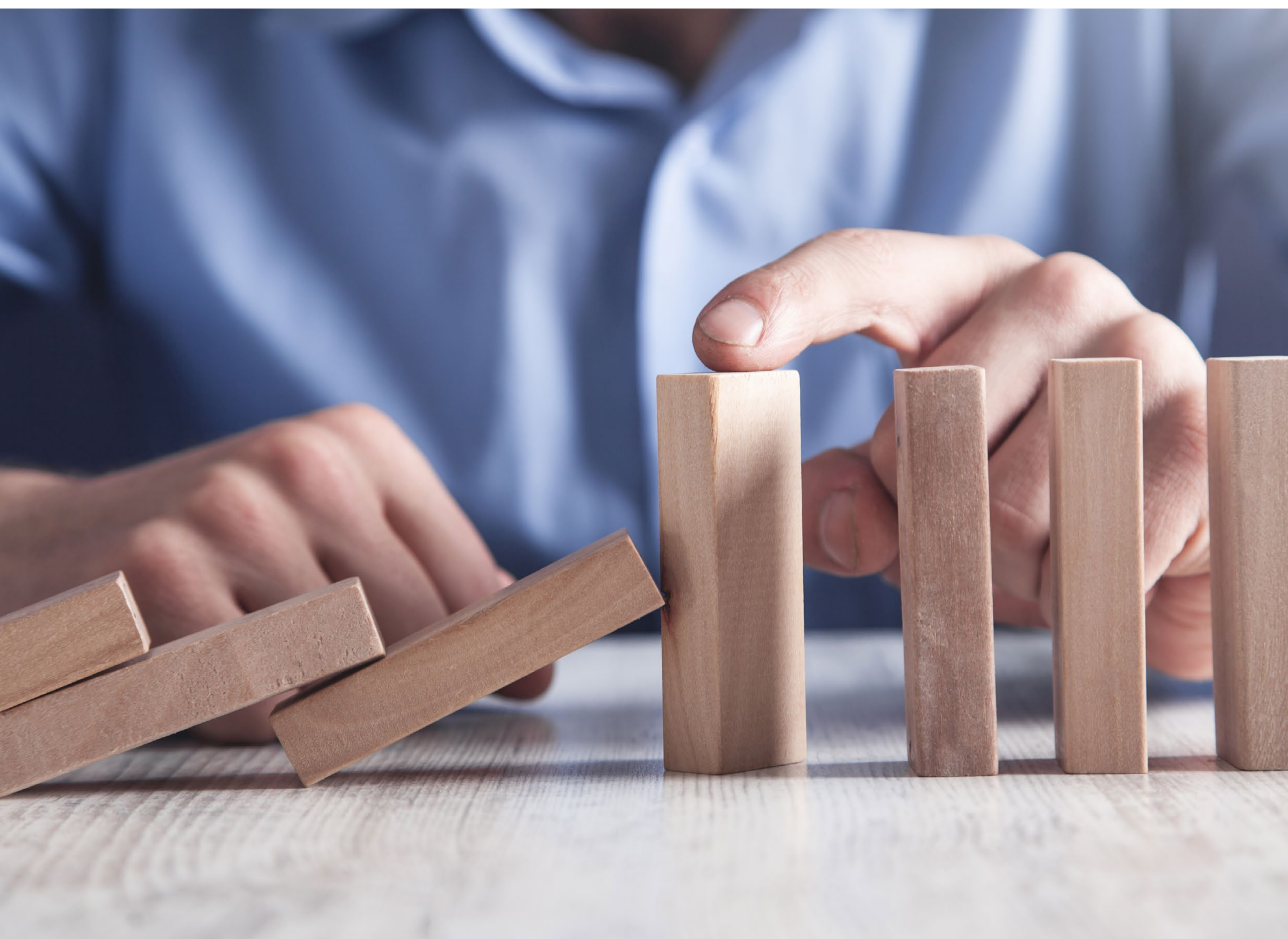

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WELCOME ADDITIONS TO THE PANEL

So as to strengthen the membership of the editorial panel, we are pleased to announce the appointment of three new members: Prof Deborah Tickle, Mr Ettiene Retief and Ms Di Hurworth

We welcome them and thank them for their willingness to join the team.

- Editorial Team

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

Tax Chronicles Monthly is published as a service to members of the tax community and includes items selected from the newsletters of firms in public practice and commerce and industry, as well as other contributors. The information contained herein is for general guidance only and should not be used as a basis for action without further research or specialist advice. The views of the authors are not necessarily the views of the editorial panel or the South African Institute of Taxation.

TIME OF DISPOSAL AND SUSPENSIVE CONDITIONS

In many instances, especially in the context of complex, high-value transactions, a taxpayer may adopt a robust interpretation of tax legislation. This often results in the deferral or mitigation of the tax liability emanating from such transactions for the taxpayer. In doing so, a taxpayer should make absolutely certain that there is a sound basis for the tax position adopted.

In *Mr A v The Commissioner for the South African Revenue Service*, [2021] (as yet unreported) *(Mr A v CSARS)*, a taxpayer failed to disclose to the South African Revenue Service (SARS) a disposal in circumstances in which he was undoubtedly under a legal obligation to do so. The taxpayer's justification for not making such disclosure, notably that he viewed the fact that the sale was subject to a number of suspensive conditions as an indication that the purchase price had not yet accrued, was held by the court to be "untenable". Fortunately for the taxpayer, the facts of the matter were favourable and did not result in materially adverse consequences due to a gross error by SARS in calculating the tax liability for the taxpayer.

BACKGROUND

During the 2009 year of assessment, the taxpayer had disposed of his shares in BCD (Pty) Limited (BCD SA), making him liable for capital gains tax in addition to interest and additional penalty taxes.

On 30 August 2012, SARS issued the taxpayer with a revised assessment to adjust the taxpayer's assessed income for the 2009 tax year to take into account the disposal mentioned above.

In terms of the revised assessment, the taxpayer was held liable for additional taxes and the total amount of his tax liability, including the additional taxes, amounted to R23,124,966, of which R10,618,223 related to a "capital gain on disposal of business interest[s]".

On 2 November 2012, the taxpayer objected to the revised assessment, which was disallowed by SARS in respect of the capital gains tax levied and the related interest imposed in terms of section 89*quat*(2) of the Income Tax Act, 1962 (the Act), and additional penalty taxes.

Importantly, in 2003 the taxpayer had used the amnesty available in terms of the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003, in order to repatriate his assets and wealth back to South Africa, which at that stage were residing offshore (amnesty application).

The taxpayer's assets included his shareholding in an offshore company, registered and incorporated in the British Virgin Islands (BCD Corporation) valued at R95,389,436 (as per the amnesty application – US$11,937,258 multiplied by the agreed US$/ZAR foreign exchange rate of 7,9909). Critically, this valuation was accepted by the South African Reserve Bank in the amnesty application.

"In this appeal, the tax court had to determine whether the taxpayer was liable for capital gains tax as a result of the sale of the BCD SA shares."

THE TRANSACTIONS UNDER THE SPOTLIGHT

On 29 January 2009, a sale of shares agreement was entered into between all the shareholders of BCD SA (including the taxpayer) and Sail Group Limited (the purchaser), in terms of which the purchaser would acquire 100% of the issued share capital of BCD SA, 53.1% of which was owned by the taxpayer at the time.

The aggregate purchase price due and payable to the taxpayer for the sale of his BCD SA shares was the sum of R66,364,587, payable as follows:

- R27,944,485 in cash on the implementation date – that being 8 January 2009 and seven days after fulfilment of all of the suspensive conditions of the agreement.
- R15,264,000 – by the allotment and issue to the taxpayer of the equivalent of shares to the value of R16,591,304 in the purchaser.
- R23,156,102 – on the third anniversary of the implementation date, being during January 2012, subject to certain warranty clauses and breach provisions in the agreement.

At the same time, and as part of the same agreement of sale dated 29 January 2009, the taxpayer also sold to the purchaser all of his shares in BCD Corporation.

ISSUES TO BE DETERMINED

In this appeal, the tax court had to determine whether the taxpayer was liable for capital gains tax as a result of the sale of the BCD SA shares.

If the taxpayer was found to have been liable for capital gains tax on the sale of the BCD SA shares, then the court had to determine how the capital gains tax should have been calculated, namely:

- What were the proceeds from the sale of the shares; and
- What was the base cost of the shares?

DID THE PROCEEDS ACCRUE TO THE TAXPAYER?

The primary argument of the taxpayer in disputing the tax imposed by the revised assessment was that the purchase price was only payable upon the fulfilment of certain suspensive conditions. As a result, the taxpayer adopted the position that he would only include the sale proceeds in his taxable income in the year of assessment in which all the suspensive conditions had been fulfilled.

The court considered well-established jurisprudence in determining whether the proceeds had accrued to the taxpayer and stated that the words in the Act "has accrued to or in favour of any person", simply means "to which he has become entitled" as outlined in *Lategan v Commissioner for Inland Revenue*, [1926].

Similarly, in paragraph [24] of *Mr A v CSARS* it is stated "in *Mooi v SIR* 34 SATC 1, it was held that a contingent right conditional upon the fulfilment of certain conditions cannot be regarded as an 'amount' for the purposes of the definition of 'gross income' [in section 1(1) of the Act], even though such a right possesses a money value at the time it is acquired by a taxpayer. Such a contingent right does no more than 'set up the machinery for creating a benefit', and the benefit accrues only when all conditions attaching to the right are fulfilled."

The court, however, found this argument to be fatally flawed in that, on the taxpayer's own evidence, he received the first payment from the purchaser in February 2009. Accordingly, the court stated that "the ineluctable inference to be drawn is that all of the suspensive conditions were fulfilled. If not, there would not have been payment to him of the first instalment payable."

The court concluded that the purchase price of R66,364,578 had indeed "accrued" to the taxpayer when he sold his shares in BCD SA on 29 January 2009 and the amount represented "the proceeds received or accrued" in respect of the disposal of the BCD SA shares.

HOW WAS THE CAPITAL GAINS TAX LIABILITY CALCULATED?

Having found that the purchase price had accrued to the taxpayer and that he was liable for capital gains tax on the sale of the BCD SA shares, the court turned to the issue of the quantum of the capital gain that should have been included in the taxpayer's income. This enquiry required the court to establish the base cost of the BCD SA shares and entailed the considerations set out hereunder.

The taxpayer argued that the valuation done for the amnesty application of the BCD Corporation shares constituted a valuation which should be accepted and, as a result, there was a capital loss when the BCD Corporation shares were disposed of.

SARS argued that the base cost should simply be calculated on the basis that the taxpayer acquired the BCD Corporation shares at R1 par value, therefore R531, and that the capital gain should be assessed on that basis.

The court found that there was merit in the approach proposed by the taxpayer, being that all of the shares held by the taxpayer in the group of companies should, for purposes of the assessment of capital gains tax, be treated as one "asset" as defined in paragraph 1 of the Eighth Schedule to the Act.

Therefore, the base cost of that asset should be determined on the basis that it was acquired on the date on which the shares in BCD SA were issued to the taxpayer and, importantly, the market value of those shares should be established with reference to the amount declared to and accepted in the amnesty application. In terms of this declaration, the taxpayer had an 82% shareholding in the BCD Group of Companies – that being the BCD Corporation at that stage – valued at R95,389,436.60.

A key point in determining the base cost of the shares (both the BCD SA shares and the BCD Corporation shares) was that at 28 February 2003 the taxpayer owned 82% of the shares in BCD Corporation. On 29 January 2009 only a 53,1% shareholding in the group (consisting of BCD SA and BCD Corporation shares) was disposed of, meaning that the base cost of 53,1% of the shareholding should be determined by pro-rating the value, resulting in a 53,1% shareholding being valued at R61,763,519.70.

Taking into account the above, the court stated that this approach accorded with the letter and the spirit of the relevant provisions of the Eighth Schedule. It performed its own calculation, which resulted in tax payable by the taxpayer on the amount of R3,641,339.58 (being 25% of the gain less the annual exclusion of R16 000 at the time) being payable by the taxpayer.

ORDER

The court held that:

- The assessment did not correctly reflect the capital gain realised by the taxpayer and accordingly, SARS was ordered to alter the assessment.
- Interest would therefore need to be recalculated based on the correct tax liability amount.
- Additional tax imposed was reduced by the court from 200% to 25% on the basis that the court found extenuating circumstances to be present. This was premised on the fact that the assessment was in excess of what the court determined such liability to be (ie, the basis of SARS' calculation was grossly incorrect).

COMMENT

This judgment is an example to taxpayers of the importance of, firstly, obtaining good tax counsel when entering into material transactions, and, secondly, being able to justify and substantiate any tax position being adopted, especially where that position results in the mitigation or deferral of the taxpayer's tax liability.

The concept of accrual in the definition of gross income has been traversed extensively in our law and the position adopted by the taxpayer was plainly incorrect. In fact, the court took great exception to the taxpayer's failure to disclose to SARS that he disposed of an asset and realised a substantial sum of money running into tens of millions of rand – the court stated that there is no justification for this position.

In addition to the above, were it not for the gross error by SARS in calculating the taxpayer's liability, the court may well have confirmed the additional tax penalty of 200% as there would not have been any extenuating circumstances present to reduce the penalty.

Keshen Govindsamy

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "gross income") & 89*quat*(2); Eighth Schedule: Paragraph 1 (definition of "asset");
- Exchange Control Amnesty and Amendment of Taxation Laws Act 12 of 2003.

Cases

- *Mr A v The Commissioner for the South African Revenue Service* SARSTC 13395 (IT) [2021] (as yet unreported);
- *Lategan v Commissioner for Inland Revenue* [1926] CPD 203;
- *Mooi v Secretary for Inland Revenue* [1972] (1) SA 675 (A); 34 SATC 1.

Tags: tax liability; base cost; additional tax.

ACTIONS HAVING TAX CONSEQUENCES

SARS is tightening tax collection on crypto asset transactions, which makes it important to distinguish between events that will trigger income tax rates or capital gains tax (CGT) rates.

Have you (i) sold your crypto assets (crypto); (ii) exchanged one crypto for another crypto; (iii) purchased goods and services using crypto; (iv) mined or forked for crypto; (v) received staking rewards in crypto; (vi) then sold your staking rewards; (vii) received air-drops of crypto; or (viii) used crypto as collateral for loans? If you have answered yes to any of these questions, remember your taxes!

The South African Revenue Service (SARS) is increasingly auditing taxpayers' crypto holdings and trading activities. It has also requested information from certain South African crypto exchanges, including Luno, about users on the platform and their transactions.

SARS has not issued an interpretation note on the tax implications of crypto. A crypto asset is defined as a "financial instrument" in section 1(1) of the Income Tax Act, 1962 (the Act), as opposed to "currency", which would have excluded crypto gains from the ambit of CGT. This means that the intention of the taxpayer, supported by objective factors such as length of holding and frequency of trades, would determine whether the crypto gains are revenue (taxed at a maximum of 45%) or capital in nature (taxed at a maximum of 18%).

DISPOSAL OF CRYPTO

The disposal of crypto as a financial instrument is a taxable event. It may, however, be hard for taxpayers to prove that their crypto investment gains fall within the CGT net, as there are no capital deeming rules in the Act for crypto, such as the three-year rule for equity shares.

In determining the intention of the disposal, SARS may be guided by cases involving the disposal of Krugerrands. In ITC 1525, [1991], the taxpayer held Krugerrands for 12 years with the intention to provide funds for a rainy day. The Krugerrands were sold to inject capital into a new business. In ITC 1526, [1991], the taxpayer held Krugerrands from eight months to nine years to provide a store of wealth for the taxpayer's children and protection from inflation. They were sold for various reasons, including to make improvements to properties and to purchase properties. The tax court held in both these cases that the Krugerrands were held on revenue account and subject to income tax rates.

It may thus be practical to use different wallets for trading cryptos and holding cryptos for long-term gains.

BARTER TRANSACTIONS

The gain when one crypto (A) is exchanged for another (B) is the difference between the market value of B and the acquisition cost of A. If A was held or acquired on revenue account, the difference will be taxed as income (45%). Otherwise, if held on capital account, the difference will be subject to CGT (18%).

It can be difficult to determine the market value and acquisition cost of crypto in rands. The authors recommend that the spot rate should be used for the transactions. Schedules of rates and transactions should be compiled to reflect the calculated gains or losses in the tax return. [*Editorial comment*: In certain circumstances, section 25D of the Act and paragraph 43 of the Eighth Schedule to the Act allow for the use of the average exchange rate for the year.]

The same principles would apply where the taxpayer has purchased goods or services with crypto. The difference between the market value of the goods or services and the acquisition cost of the crypto would be subject to income tax (45%) or CGT (18%), depending on whether the crypto was held on revenue or capital account.

Assessed losses from trading in crypto may be ring-fenced. It might not be possible to offset these losses against other income of the taxpayer if the taxable income and losses of that taxpayer (adding back assessed losses from the current and prior year) are more than R1 656 601 for the 2022 tax year. There are, however, exceptions to this rule – see, for example, section 20A(2)*(b)*(ix) of the Act.

STAKING / MINING / FORKING / AIRDROPS

If a taxpayer has derived crypto from mining or forking, then the gains would be subject to income tax (45%), since they are derived from conducting a trade. If the taxpayer's intention was to hold the crypto as a long-term investment, then any gains will be subject to CGT (18%).

Staking rewards are also taxed at income tax rates, and are, for now, unlikely to meet the definition of "interest" in section 24J(1) of the Act. This means that the annual interest exemption for individuals will not apply to staking rewards.

Further complexities arise when staking rewards are sold. For example, assume a taxpayer received staking rewards with a market value of 80 at the time of receipt. That 80 would be subject to income tax as it is akin to interest (without the annual interest exemption). Assume next that the staking reward is sold for 450 after five years. The difference between 450 and 80 is the gain on the disposal. This gain may be taxed at CGT rates (18%), not income tax rates (45%), again depending on the intention of the taxpayer at disposal.

If the taxpayer receives new crypto through airdrops on existing crypto held, this is akin to a distribution of new financial instruments based on existing financial instruments held. Once again, the taxpayer's intention in holding the existing crypto, frequency of trading, how long they were held, and other indicators would be taken into account to determine whether the new airdropped crypto would be held on revenue or capital account. If held on revenue account, the market value of the new airdropped crypto would be subject to income tax (45%) and, if on capital account, to CGT (18%). It is irrelevant that the value of the crypto airdropped was not converted to rands. Income is subject to tax when received or accrued, and there is accrual when there is an unconditional entitlement to the crypto / income.

CRYPTO USED AS COLLATERAL

In our view, when crypto is used as collateral for a loan, there is no disposal of the crypto and no taxing event. Where the taxpayer is the lender and receives interest in crypto, then the market value of the crypto received as such interest would be subject to income tax (45%). In this situation, we would argue that the annual interest exemption should apply.

We recommend that taxpayers seek advice to ensure that their crypto gains are reported correctly in their tax returns. The volatility and high-risk nature of this asset class should not be compounded by an unexpected tax liability!

Joon Chong & Lumen Moolman

Webber Wentzel

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "financial instrument"), 20A(2)*(b)*(ix), 24J(1) (definition of "interest") & 25D; Eighth Schedule: Paragraph 43.

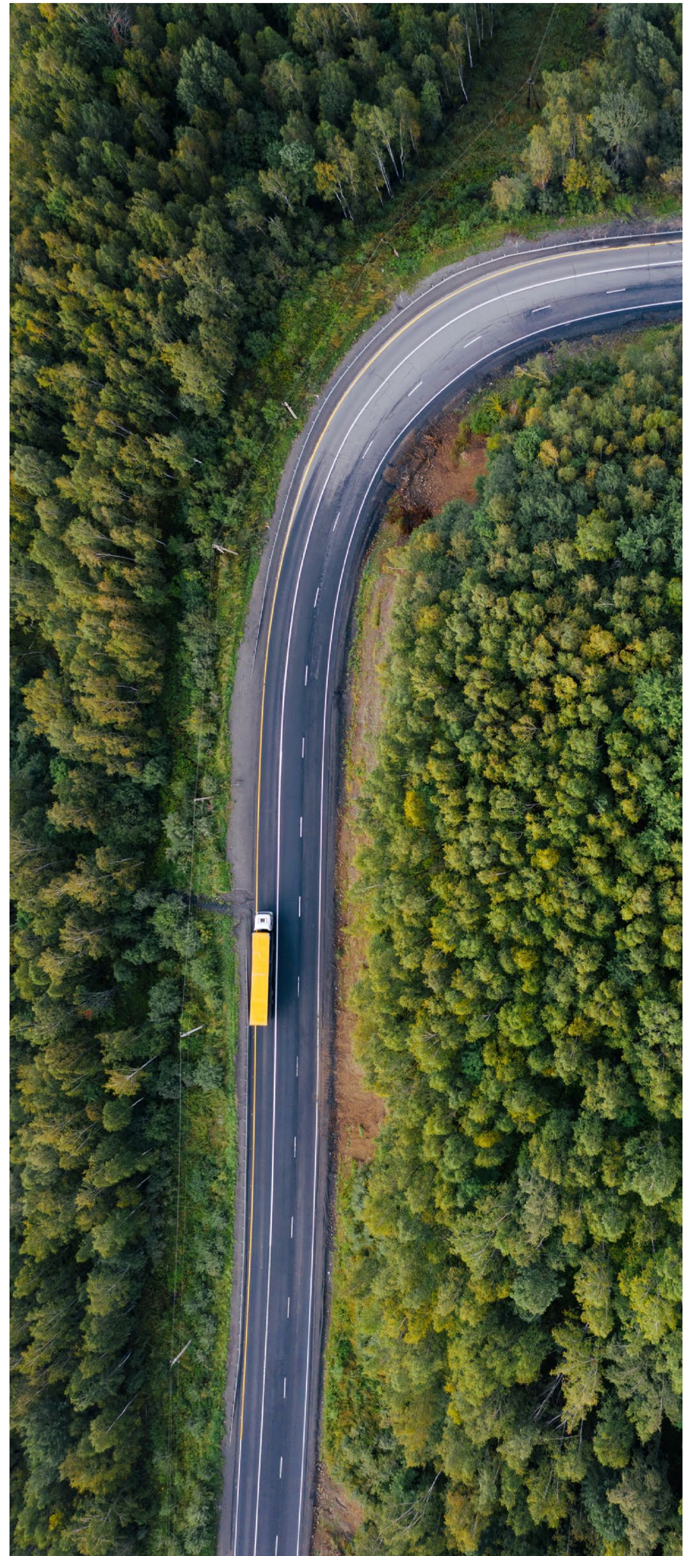
Cases

- ITC 1525 (1991) 54 SATC 209 (C);
- ITC 1526 (1991) 54 SATC 216 (T).

Tags: crypto assets; financial instrument; assessed losses; staking rewards.

DIESEL REFUNDS FOR MINERS

Judgment was handed down by the Supreme Court of Appeal (the SCA) on 10 August 2021 in Commissioner, South African Revenue Service v Glencore Operations SA (Pty) Ltd*, [2021].*



Glencore Operations SA (Pty) Ltd (Glencore) claimed refunds for diesel fuel levies used for primary production in mining in terms of the provisions of Note 6(f)(iii), Item 670.04 in Part 3 of Schedule 6 to the Customs and Excise Act, 1964 (the CE Act).

The claim by Glencore was originally disallowed by SARS on the ground that the activities in respect of which the claim was submitted did not constitute primary production activities in mining within the ambit of Note 6(f)(iii), but rather that such activities related to secondary activities in mining. During 2020, the High Court overturned the decision by SARS and held that Glencore was entitled to a refund for diesel levies. The Commissioner for SARS' request for leave to appeal was granted during June 2020.

The SCA primarily had to consider whether the mining operations in relation to which diesel refunds were claimed by Glencore had been carried on for own primary production in mining. Also, whether the list of activities set out in the said Note 6(f)(iii) is exhaustive.

Glencore argued that its "own primary production in mining" does not mean that its primary mining activities cease once the ore is extracted from the ground. Glencore further argued that the list of activities in Note 6(f)(iii) is not exhaustive.

The SCA criticised the High Court order made, and the following was specifically noted:

- The list of activities set out in Note 6(f)(iii) is exhaustive as the Commissioner intended. The list covers activities that are inextricably linked to primary mining, therefore the extraction of minerals from the ground. A non-exhaustive list would lead to an unbusinesslike or insensible result;

- All mining activities were not intended to benefit from the diesel rebate scheme, only "own primary production activities";

- "Primary production activities" means mining activities associated with extracting minerals from the ground, which is distinct from activities which occur after minerals have been extracted from the ground, with such latter activities being "secondary";

- Operations, which in the case of Glencore were comprised of mining for coal, would involve various activities, such as crushing, screening, washing and stockpiling to take place after the mineral (being the coal) has been extracted from the ground – such activities are therefore not within the ordinary meaning of "own primary production activities"; and

- The main purpose of the list in Note 6(f)(iii) is to identify those activities directly associated with the extraction of minerals from the ground, which are to be included in the rebate scheme.

"While the SCA judgment signals bad news to mining entities, the situation may not be as severe where the mineral being mined requires further processing in order to extract this from the ore."

The SCA (and SARS) further placed heavy reliance on the unreported case of *Graspan Colliery (Pty) Ltd v Commissioner for the South African Revenue Service* (Gauteng Division of the High Court, Pretoria), [2020], where it was also held that the list in Note 6(f)(iii) is an exhaustive list.

The SCA ruled that the activities in which Glencore used the diesel do not fall within the scope of any of the items listed in Note 6(f)(iii) and therefore the High Court came to an erroneous conclusion. The Commissioner's determination should hence be reinstated.

While the SCA judgment signals bad news to mining entities, the situation may not be as severe where the mineral being mined requires further processing in order to extract this from the ore. The minority assenting judgment differentiated between circumstances where the mineral itself is extracted from the ground, and circumstances where ore is extracted from the ground and further primary production activities in mining are necessary in order to extract the relevant mineral from the ore.

It is also worthwhile noting that the SCA was quite critical regarding the lack of evidence led by Glencore as to the detailed mining processes involved, and noted that this harmed Glencore's case. This indicates that significant detail regarding processes is necessary in litigation on these types of matters.

The implications of the SCA judgment for the mining industry and the relief sought by mining companies through the diesel rebate scheme may be detrimental in an economy already under pressure.

Adele de Jager & Patricia Williams

Bowmans

Acts and Bills

- Customs and Excise Act 91 of 1964: Schedule 6, Part 3, Item 670.04, Note 6(f)(iii).

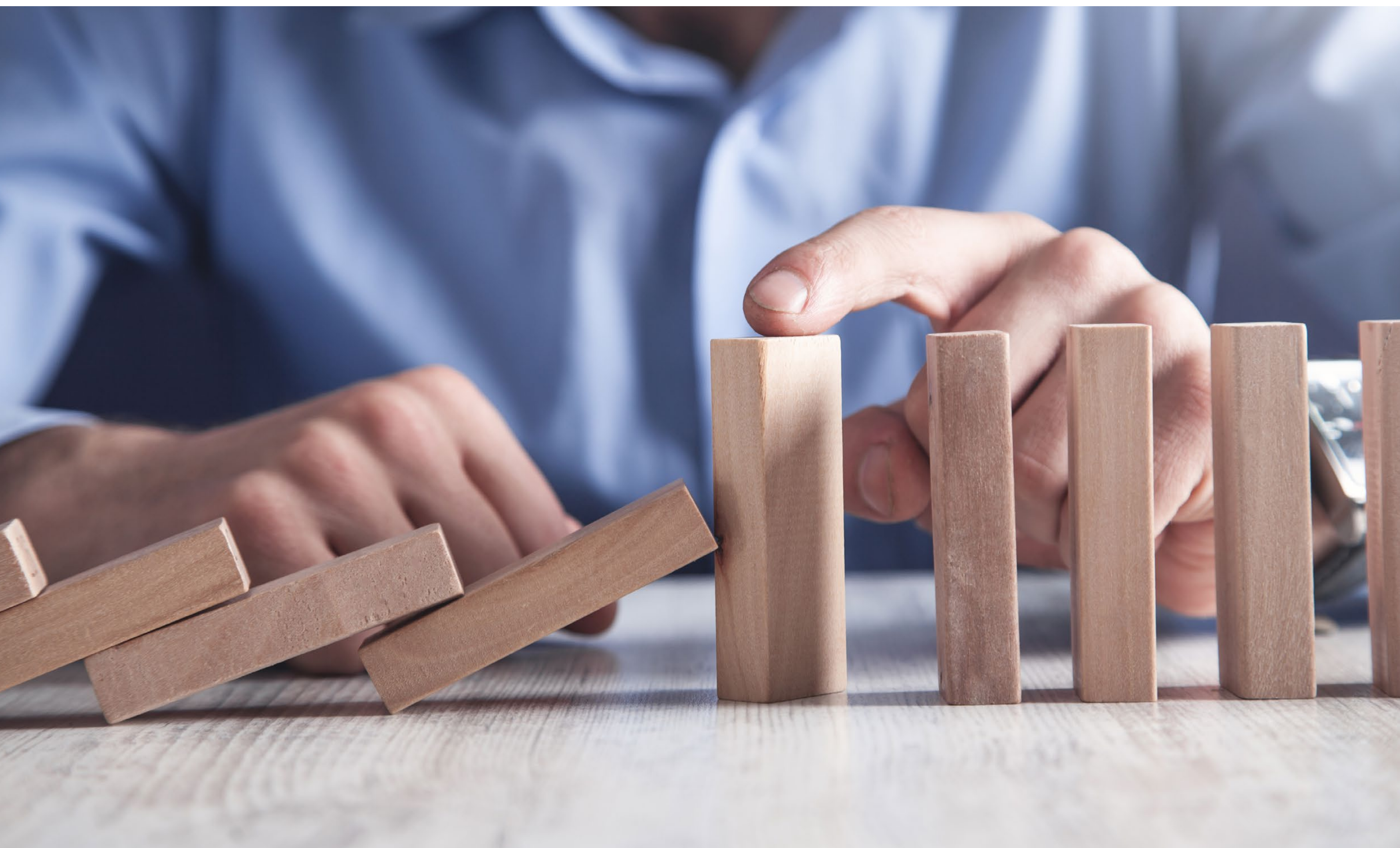
Cases

- *Commissioner, South African Revenue Service v Glencore Operations SA (Pty) Ltd* (Case no 462/2020) [2021] ZASCA 111 (10 August 2021);
- *Graspan Colliery (Pty) Ltd v Commissioner for the South African Revenue Service* (Gauteng Division of the High Court, Pretoria, case no 8420/2018, delivered on 20 September 2020) (unreported).

Tags: diesel fuel levies; primary production activities; diesel rebate scheme.

EMPLOYERS' OBLIGATIONS IN TIME OF DISASTER

The looting and damage to businesses in KwaZulu-Natal and Gauteng in July 2021 has had a devastating impact on many businesses, both small and large. In some cases, the damage is so severe that the business cannot continue to produce or sell, and valuable data may have been lost, including employee and tax records.



In this article, we deal with some of the possible implications for affected employers and employees.

NO MONEY FOR PAYROLL

If an employer's premises are so severely damaged that employees cannot work and there is no work-from-home alternative, the "no work no pay" principle with no accrual of benefits would likely apply, as the employer is not able to perform in terms of the employment contract due to supervening impossibility.

Where employers are severely cash constrained, they may not be able to pay their employees at all. Ideally, the employer and employee would consult and agree to a temporary lay-off while the business is rebuilt. The employees may receive no or minimal remuneration during this period. In this case, employees would qualify to receive reduced work time (RWT) benefits from the Unemployment Insurance Fund (UIF).

The UIF recently enabled a bulk application process for Covid-19 affected employers to apply for the RWT benefits for their employees. RWT benefits will be paid by the UIF directly to the employees. These payments are conditional on the employees being contributors to the UIF and having sufficient UIF credits; and on employers being up-to-date with their UIF compliance obligations, including the submission of monthly reports to the UIF.

There are industry discussions to provide for the normal RWT benefit to be calculated in the same manner as the RWT benefit is calculated in the Covid-19 Temporary Employer / Employee Relief Scheme (TERS) directive. This is more beneficial as it provides for an employee to be paid the full value calculated in terms of the formula referred to in section 13 of the Unemployment Insurance Act, 2001. Any amount paid by the employer to top up the payments will not reduce the benefit calculated in terms of the formula as long as, in total, employees do not receive more than their normal remuneration. These discussions further hope to provide for an efficient process for employers with destroyed businesses to apply for relief for their employees as well.

IMPOSSIBILITY OF MEETING TAX DEADLINES

The employer's monthly EMP 201 and the related payroll taxes are usually due by the 7th of the following month. Late payments of payroll taxes after the due dates result in a 10% late payment penalty and interest calculated from the 1st of the following month at the current rate of 7% per annum.

President Cyril Ramaphosa announced, in his Address to the Nation on 25 July 2021, the deferral of "PAYE taxes" for three months to provide businesses with additional cash flow, and an automatic deferral of 35% of "PAYE liabilities" for employers with revenue below R100 million. The employment tax incentive (ETI) is also to be expanded to include any employees earning below R6 500 and the incentive amount increased by up to R750 a month.

National Treasury in the media briefing on 28 July 2021 confirmed that the deferral of the PAYE liabilities and ETI amendments would start on 1 August 2021 and last for four months.

Employers who are still unable to meet their payment obligations after the four months of relief should apply to SARS for deferral of these obligations or a compromise / waiver of tax debts, to avoid collection measures. Those collection measures could include debiting the taxpayer's bank account for the amounts due. The SARS website contains email addresses for the various regions that taxpayers can use to apply for deferral of payment obligations.

Where the 10% late payment penalty has been triggered, it may be possible for the employer to justify the late payment on the basis of exceptional circumstances. The Tax Administration Act, 2011 (the TAA), in section 218, provides for SARS to remit the late payment penalty if SARS is satisfied that one of the following exceptional circumstances prevented the taxpayer from complying with its payment obligations:

1. human-made disaster;
2. civil disturbance or disruption in services;
3. serious emotional or mental distress;
4. serious financial hardship in the case of a business, which is an immediate danger that the continuity of business operations and the continued employment of its employees are jeopardised;
5. any other circumstance of similar severity.

It is submitted that the violence, looting and destruction of an employer's business should fall within one of the exceptional circumstances above. In applying for the deferral or write-off of tax obligations, the employer should submit supporting documents such as photos, insurance or police reports, and bank statements to SARS, demonstrating the direct link between these circumstances and the late payment.

"In applying for the deferral or write-off of tax obligations, the employer should submit supporting documents such as photos, insurance or police reports, and bank statements to SARS, demonstrating the direct link between these circumstances and the late payment. "

In terms of section 187(6) and (7) of the TAA, interest can also be remitted on the basis of circumstances beyond the taxpayer's control, and these circumstances are limited to:

1. a natural or human-made disaster;
2. a civil disturbance or disruption in services; or
3. a serious illness or accident.

SARS is likely to adopt a case-by-case consideration of whether to remit the penalties and interest and we hope that SARS will adopt a sympathetic approach.

NO MACHINES TO SUBMIT PAYROLL RETURNS

As SARS officials continue to work remotely and various compliance services are available online, such as eFiling, e@syfile, online self-help services, and SARS' MobiApp, it is unlikely that SARS will accept the destruction of an employer's computers as the sole reason for non-compliance or late compliance of payroll obligations.

Some employers would already be using an external payroll provider or a laptop at home, which would not have been affected by the damage at the business premises.

SARS is also unlikely to accept the destruction of records as a reason for non-compliance with tax obligations and inability to discharge the onus of proof, as cloud backup services are readily and efficiently available.

"Unfortunately, some employers who were already on their last cash reserves before the destruction of their businesses due to the looting, will be unable to recover without government support."

If the employer's records and computers are destroyed and the employer has no off-site or cloud backup, then it may not be in a position to issue IRP5 certificates to employees for the 2021 year of assessment, for which the filing season opened in mid-2021. Again, SARS is unlikely to accept damage of computers as the sole reason for non-compliance. The employer should possibly reconstruct the payroll using best estimates and submit the IRP5 for the 2021 year of assessment. This is to prevent the employees having to submit their ITR12 tax returns without SARS having records that the PAYE had been withheld and paid to SARS on their behalf.

BUSINESS CLOSURES

Unfortunately, some employers who were already on their last cash reserves before the destruction of their businesses due to the looting, will be unable to recover without government support. These employers should commence the retrenchment process in terms of section 189 or 189A of the Labour Relations Act, 1995. If it is necessary to retrench employees, any statutory payment as a result of termination of employment (excluding notice and leave pay) would qualify as a severance benefit.

Employees that have not made a lump sum retirement withdrawal or have not previously received severance benefits will be able to take up to R500 000 as exempt from income tax. The employer would need to apply for a directive before making the severance payment.

Joon Chong & Nina Keyser

Webber Wentzel

Acts and Bills

- Unemployment Insurance Act 63 of 2001: Section 13;
- Tax Administration Act 28 of 2011: Sections 186(6) & (7) & 218;
- Labour Relations Act 66 of 1995: Sections 189 & 189A.

Other documents

- Covid-19 Temporary Employer / Employee Relief Scheme (TERS) directive;
- EMP 201 form of the employer;
- IRP5 certificates;
- ITR12 tax returns.

Tags: Covid-19 Temporary Employer / Employee Relief Scheme (TERS); PAYE liabilities; late payment penalty; deferral or write-off of tax obligations.

DOUBLE TAX TREATIES: THE PRINCIPAL PURPOSE TEST

A new test is in play in a cross-border tax context which, on the face of it, makes organising a transaction or a series of transactions to take advantage of bilateral tax treaties much more challenging. It is the so-called "Principal Purpose Test" (PPT). Taxpayers are used to the idea that they are perfectly entitled to arrange their tax affairs in a manner which enables them to take maximum advantage of existing tax laws. This is, in general, perfectly legal, provided the arrangements entered into by the taxpayer are genuine (ie, not simulated to disguise the true intention behind that arrangement) or provided the sole or main purpose behind the arrangement was not to obtain a tax benefit.

"Treaty shopping" is the target. That is, where the main reason behind a series of transactions was merely to obtain a benefit under a bilateral tax treaty (eg, a reduced withholding tax). Generally, however, provided a taxpayer was able to demonstrate a commercial rationale for entering into the transaction, the taxpayer was perfectly entitled to take advantage of the tax treaty. The PPT now makes this more difficult.

The PPT has been widely adopted through the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). This effectively modifies the application of thousands of existing bilateral tax treaties of most countries.

Article 7 of the MLI contains the PPT which most countries have adopted. The PPT provides that a benefit under a tax treaty will not be granted if it is reasonable to conclude that obtaining the benefit was *one of the* principal purposes of the arrangement or transaction that resulted directly or indirectly in that benefit. This is unless the granting of the benefit was in accordance with the object and purpose of the treaty. This means that any arrangement that was made for purposes which include a principal purpose of obtaining a tax benefit under a treaty, which amounts to an abuse of that treaty, may infringe upon the PPT and will probably result in a cancellation of that treaty benefit.

Tax treaties have been the cornerstone of the tax-planning arrangements of many companies. The gravity of the impact of the PPT on global tax planning will turn on what "principal purpose", "tax benefit" and "object and purpose" mean. While the OECD has given some guidance in its explanatory materials to the MLI and its Guidelines, it will ultimately be up to the tax and judicial authorities in each participating jurisdiction to construe what these terms mean for the purposes of their tax treaties. Nevertheless, some lessons can be learnt from Australia. Australia's tax regulator – the Australian Tax Office (ATO) – has issued a Practice Statement outlining its view of the PPT. The ATO's guidance is useful in South Africa given that Australian tax law is often considered by South African courts and has, in the past, formed the basis of the design of some of South Africa's tax laws.

"This means an arrangement may fall foul of the PPT even it was entered into by a company for commercial objectives consistent with commercial gain but was implemented in a particular way so as to obtain a treaty benefit."

The ATO says that "tax benefit" is wide and could include a limitation on the taxing rights of a source jurisdiction (such as a tax reduction, exemption, deferral, or refund) or relief from double taxation provided to residents. An arrangement may have more than one "principal purpose" and it is sufficient if *at least one purpose* was to obtain the benefit, even if it was not the dominant purpose. The test is an objective one. What a company says is the purpose of a transaction is irrelevant if, based on an objective analysis of all the facts and circumstances, one of the principal purposes of the arrangement was to obtain a tax benefit. This means an arrangement may fall foul of the PPT even it was entered into by a company for commercial objectives consistent with commercial gain but was implemented in a particular way so as to obtain a treaty benefit. The general comfort previously relied upon by taxpayers – namely that an arrangement can be justified on commercial grounds – cannot be relied upon so easily.

However, the ATO recognises that a distinction must be made. Arrangements used to secure treaty benefits that amount to an improper use of the treaty or treaty abuse must be distinguished from arrangements that are entered into or carried out for the purpose of obtaining treaty benefits that are consistent with the object of the treaty. The MLI PPT will not apply where an arrangement has been adopted merely with an eye to its tax advantages unless it amounts to an abuse of the treaty. It is difficult to fully understand when this will or will not be the case. Some case law, which hopefully will be forthcoming as the impact of the PPT starts to be felt, will prove helpful.

Nevertheless, there is some OECD commentary on the question: Where the arrangement is inextricably linked to a core commercial activity and the particular form in which the scheme is implemented is conventional and straightforward and not driven by such tax benefit considerations, it is unlikely that one of its principal purposes was to obtain the tax benefit.

Justifying the commercial rationality of cross-border transactions has always been relevant. However, the PPT seems to put far more scrutiny on the degree to which the stated commercial objectives of the taxpayer can reasonably be relied upon; a much more difficult task.

Rebecca James

Regan van Rooy

Other documents

- Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI);
- Principal Purpose Test (PPT – contained in Article 7 of the MLI);
- Law Administration Practice Statement (issued by the Australian Tax Authority, outlining its view of the PPT).

Tags: Principal Purpose Test; treaty shopping; tax benefit.

NEW GLOBAL TAX DEAL: EFFECT ON AFRICA

African nations will be able to claw back some tax on highly digitalised businesses, but more needs to be done to ensure equitable tax allocation.

Africa will have to rebuild its economies post the Covid-19 pandemic and efficient fiscal policies will be vital in ensuring that revenue is not lost through aggressive tax avoidance schemes, illicit financial flows and the inability to tax business operations provided by offshore digitised multinationals.

According to the African Tax Administration Forum (ATAF), corporate income tax represents a higher share of tax revenues and GDP in developing countries than in rich countries.

Tax levies are also higher – on average 16% of total tax revenue, compared to 9% in Organisation for Economic Co-operation and Development (OECD) countries.

GLOBAL TAX REFORM

On 1 July 2021 130 countries and jurisdictions signed a statement agreeing with the Inclusive Framework two-pillar plan to reform international taxation rules and ensure that multinational enterprises pay a "fair share" of tax wherever they operate. These countries represent more than 90% of global GDP.

The two-pillar plan has been being developed by the OECD and its members over the last six years. ATAF, with 38 member countries, was invited to participate and to strengthen the participation of Africa in the process.

ATAF views the work being carried out by the OECD and the Inclusive Framework on the Pillar One and Pillar Two rules to be of vital importance to African countries.

Pillar One will ensure a fairer distribution of profits and taxing rights among countries in regard to large multinationals, including digital companies. It is designed to reallocate taxing rights to the markets where they carry out business activities and earn profits without necessarily having a physical presence in those markets.

Pillar Two introduces a 15% global minimum corporate tax rate.

THE BIGGEST TAX OVERHAUL IN 100 YEARS

After nearly a decade, it is a big deal that some 130 countries have agreed to the Inclusive Framework. But who will lose, and who will gain?

- When powerful countries are driving (or curtailing) proposed reform, how strong is Africa's voice?
- Africa is resource-rich, and most African countries struggle with an imbalance in the allocation of taxing rights between source and residence countries.
- African countries are also in need of foreign direct investment, which can be a disadvantage when negotiating or renegotiating a double taxation treaty.

For nearly a hundred years, countries have levied taxes based on the location of a business. However, with the digitisation of the economy, companies are able to sell digital services into countries where they have no physical presence.

When the OECD published the blueprint of the Inclusive Framework, ATAF published a press release stating that it "welcomes the achievement of this new milestone as, in our view, a global consensus on the tax challenges arising from the digitalisation of the economy is of paramount importance as now more than ever, cooperation and multilateralism are required in developing solutions that will assist all countries in rebuilding their economies in a post-Covid-19 environment".

ATAF'S COMMENTS ON PILLAR ONE RULES

The Pillar One Rules incorporate some of ATAF's suggestions, but more needs to be done to address the imbalance in the allocation of taxing rights between source and residence countries.

In partnership with the African Union, ATAF is calling upon the Inclusive Framework to undertake further work on the tax allocation issue.

ATAF also notes that the profit allocation, namely that 20% of the residual profit can be reallocated to countries where the multinational operated and earned profits, but only where that multinational has a minimum profit margin of 10%, "appears to lead to only a low level of profit reallocation, in particular, to smaller markets jurisdictions".

ATAF is of the view that many digital businesses have no taxable nexus presence in a market jurisdiction, and therefore none of the routine profit will be allocated to that jurisdiction. "This does not seem like an equitable outcome," it says.

The Inclusive Framework provides an allocation of between 20% and 30% of residual profit, in excess of a 10% minimum profit margin, to market jurisdictions. ATAF would prefer to see at least 35% of residual profit being allocated to market jurisdictions.

The Inclusive Framework proposed an elective binding dispute resolution mechanism to resolve any issues and ATAF managed to get agreement that any binding arbitration would be consensual, as dispute resolution is a demanding and complex process.

"ATAF anticipates that the Pillar Two rules will help stem illicit financial flows out of Africa by multinational enterprises through artificial profit shifting."

ATAF'S COMMENTS ON PILLAR TWO RULES

ATAF anticipates that the Pillar Two rules will help stem illicit financial flows out of Africa by multinational enterprises through artificial profit shifting. It also welcomes a minimum effective tax rate, but would prefer this to be 20% and not the agreed 15%.

Developed countries opposed ATAF's proposal for a source-based rule – such as the so-called Undertaxed Payments Rule (UTPR) or Subject to Tax Rule (STTR) – to be applied in priority to the so-called Income Inclusion Rule (IIR).

The STTR can, however, be included in bilateral tax treaties with Inclusive Framework members that apply nominal corporate income tax rates below the STTR minimum rate.

ATAF called for the STTR to be broad in scope to cover payments of interest, royalties, all service payments, and capital gains. However, the Inclusive Framework agreed that the STTR will cover interest, royalties and only a defined set of payments.

ATAF has indicated that its members have found that service payments are a notable profit shifting risk.

RESTORING STABILITY TO THE INTERNATIONAL TAX SYSTEM

ATAF holds the view that the work of the Inclusive Framework will restore stability to the international tax system.

- African countries have been introducing new measures to curtail aggressive transfer pricing schemes by multinational enterprises. Mining regimes will be strengthened and tax incentives will be evaluated.
- The Pillar One and Pillar Two rules will enable African countries to claw back some tax on highly digitalised businesses. The development of global tax rules is a key part of the tax policy considerations for Africa in the post-Covid era.
- More work, however, needs to be done to ensure a more equitable tax allocation and to stem illicit financial flows from Africa. ATAF has advised that developed countries should not exert political pressure on developing countries if an equitable outcome is to be attained.
- Compromises have been made. Extractives and financial services have been excluded.
- Countries that had already introduced digital services taxation, such as the UK and France, have agreed to dispense with this following implementation of Pillar 1 and Pillar 2.
- ATAF executive secretary Logan Wort says the carve-out for financial services was contentious, but at least a compromise was reached on mandatory binding arbitration (that countries would participate in binding dispute resolution on consensual basis). Wort also notes that even though 130 countries agreed with the Inclusive Framework plan, some agreed with reservations.

Barbara Curson

[*Editor's comment*: The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF) has agreed a two-pillar solution to address the tax challenges arising from the digitalisation of the economy. The IF marks agreement by more than 130 countries to implementing a truly multinational plan to tax in market/user jurisdictions (Pillar One) and implementing or accepting implementation by other states of a global minimum tax (Pillar Two), with a commitment to implement these tax reforms by 2022 (with effect from 2023).]

Other documents

- Inclusive Framework on the Pillar One and Pillar Two rules;
- Undertaxed Payments Rule (UTPR);
- Subject to Tax Rule (STTR);
- Income Inclusion Rule (IIR).

Tags: corporate income tax; Undertaxed Payments Rule (UTPR); Subject to Tax Rule (STTR); Income Inclusion Rule (IIR).

ADVICE FROM AUDITOR NOT A SOLID DEFENCE

The tax court has again confirmed that there is no safety-net for taxpayers in relying on their auditors' views to justify a tax position adopted. To the contrary, where a taxpayer infers that their tax position is justified "because my auditor said so", it can actually result in a larger tax penalty. In June 2021, the tax court again sent a clear message on the misconception that taxpayers may delegate their tax obligations to their auditors or may rely on their auditors' advice blindly.

In the case of *LDC Taxpayer v The Commissioner for the South African Revenue Service*, [2021] (the *LDC* case), the tax court was again forced to deal with this matter. The court remarked that the taxpayer's "failure to disclose the capital gain was the result of a tax position adopted on advice of its auditors". This was found to provide no defence and, had SARS not made a "mistake" in raising the penalty, the tax court was of the view that a higher penalty could have been raised.

The matter of professional negligence of auditors is also highlighted by the *LDC* case. It will be interesting to see what action the Independent Regulatory Board for Auditors will take to protect the reputation of the profession and whether the taxpayer will seek damages from the auditor concerned.

TAX COURT ORDERED TAXPAYER TO PAY UNDERSTATEMENT PENALTY

In the *LDC* case, the taxpayer sold and transferred ownership of an immovable property during the 2017 year of assessment. Attached to the property were development rights to subdivide it into 72 erven. The purchase price of R25,200,000 was payable in tranches of R350,000 as and when the purchaser transferred each erf to a further third-party end-user.

The taxpayer adopted the tax position that the sale proceeds did not accrue to it during the 2017 year of assessment. Rather, the taxpayer argued, the capital gain only accrued to it on the transfer of each individual erf from the purchaser to the respective third-party end-users. The taxpayer thus did not declare this capital gain in its 2017 income tax return.

SARS disagreed, maintaining that the taxpayer should have declared the gain in the 2017 tax year. As there was no suspensive condition in the sale agreement, SARS insisted that the capital gain accrued to the taxpayer on the date of disposal, being the date of conclusion of the agreement. SARS classified the taxpayer's behaviour as "reasonable care not taken in completing a return" when it raised an additional assessment, and it imposed a 25% understatement penalty.

"In *Commissioner for Inland Revenue v People's Stores (Pty) Ltd*, [1990], it was confirmed that 'income' need not be an actual amount of money but includes every form of property earned by a taxpayer, including any debt or right to which a money value can be attached."

The taxpayer appealed to the tax court, continuing with its argument that the capital gain only accrued to it at a later stage. The taxpayer further argued that, even if the capital gain accrued to it, SARS did not suffer any prejudice as the same tax amount would ultimately have been paid to it. SARS was victorious and the taxpayer was ordered to pay the 25% understatement penalty of R798,372. In handing down its judgment, the tax court referred to the following two well-known Supreme Court of Appeal cases:

- In *Commissioner for Inland Revenue v People's Stores (Pty) Ltd*, [1990], it was confirmed that "income" need not be an actual amount of money but includes every form of property earned by a taxpayer, including any debt or right to which a money value can be attached. The capital gain thus accrued to the taxpayer during the 2017 year of assessment and had to be declared in its income tax return.
- The taxpayer itself relied on the prominent case of *Purlish Holdings (Proprietary) Limited v Commissioner for the South African Revenue Service*, [2019] (*Purlish*), contending that "prejudice" must amount to more than mere financial loss to the *fiscus*. The tax court correctly disagreed with the taxpayer's line of argument and interpretation of *Purlish*. The court held that not only was there financial prejudice to SARS, but the audit entailed a resource allocation in the form of additional time and human capital.

THE TAXPAYER'S CASE WAS PATENTLY UNREASONABLE

Considering the well-known cases referred to by the tax court, the taxpayer's tax position taken was patently unreasonable and had very little chances of success. Although SARS categorised the taxpayer's behaviour as "reasonable care not taken in completing a return", SARS conceded to the tax court that "this was, in hindsight, incorrect" and that the penalty should rather have been based on "no reasonable grounds 'for tax position' taken". The latter attracts an understatement penalty of 50% and SARS admitted that it had "lost an opportunity in using that 50%". Since SARS did not raise this as an item for adjudication, fortunately for the taxpayer, the tax court did not have the discretion to increase the penalty.

WAS THE TAXPAYER IN POSSESSION OF A COMPLIANT SECTION 223(3) OPINION?

SARS must remit an understatement penalty if a taxpayer complies with section 223(3) of the Tax Administration Act, 2011 (the TAA). This section requires that full disclosure be made to SARS of the arrangement that gave rise to the prejudice to SARS by no later than the date that the relevant return was due and that the contested tax constitutes a "substantial understatement" (greater of 5% of total tax or R1 million). The taxpayer must also be in possession of an opinion by an independent registered tax practitioner that –

- was issued by no later than the date that the relevant return was due;
- was based upon full disclosure of the specific facts and circumstances of the arrangement; and
- confirmed that the taxpayer's position is more likely than not to be upheld if the matter proceeds to court.

We doubt that the taxpayer was in possession of a section 223(3) opinion, as the facts would not support the legal issuance thereof. Taxpayers should note that their only legal refuge, when acting on their auditor's advice, is to obtain a section 223(3) opinion.

WHAT DOES THIS MEAN FOR TAXPAYERS?

To date, auditors have been very successful in claiming that they are not liable for mistakes in financial statements. However, such a privilege of non-liability would not apply to a tax case. If the taxpayer in the *LDC* case decides to pursue a claim for professional negligence, the auditor may have its work cut out for it.

SARS may also look at the *LDC* case and realise that it is not fully utilising the understatement penalty provisions available to them in the TAA.

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Acts and Bills

- Tax Administration Act 28 of 2011: Section 223(3).

Cases

- *LDC Taxpayer v The Commissioner for the South African Revenue Service* (IT 24888) [2021] ZATC 6 (18 June 2021);
- *Commissioner for Inland Revenue v People's Stores (Pty) Ltd* 52 SATC 9; [1990] (2) SA 353 (A);
- *Purlish Holdings (Proprietary) Limited v Commissioner for the South African Revenue Service* (76/18) [2019] ZASCA 04; 2019 JDR 0301 (SCA).

Tags: additional assessment; understatement penalty; professional negligence.

TAX CONSIDERATIONS WHEN LIQUIDATING

In terms of the Statistical Release on liquidations and insolvencies published by Statistics South Africa in July 2021, there was a 21.5% increase in the number of liquidations in the first seven months of 2021 compared to the first seven months of 2020. This has not deterred SARS from collecting outstanding tax debts from defaulting taxpayers.

Generally, when a business is in financial distress, it is not uncommon that the first financial obligations that fall by the wayside are the business' tax obligations. This is unsurprising as business owners likely prioritise payments to employees, suppliers and other creditors in order to keep their operations afloat. However, this is not an advisable strategy, as debts to SARS accumulate interest and, where applicable, administrative non-compliance penalties accumulate monthly. In addition, where a taxpayer understates its tax liabilities, SARS may impose understatement penalties that range from 10% of the tax debt in a standard case, and up to 200% where there is intentional tax evasion on the part of the taxpayer.

There are several tax considerations which need to be kept in mind by taxpayers where the business is in financial distress and is no longer able to operate, or once liquidation proceedings have commenced and compromises are entered into with creditors.

CESSATION OF TRADE

In the case of a taxpayer that is a company whose business is in distress and is no longer able to operate, and where such a taxpayer has an accumulated assessed loss which would otherwise be available to be carried forward to subsequent years of assessment and be offset against taxable income, the accumulated assessed loss would be forfeited in the event that the business does not trade for a full tax year. Should a taxpayer fall upon hard times and be unable to carry on its trade for a tax year, the taxpayer would forfeit its accumulated tax losses.

SARS' RIGHTS IN A LIQUIDATION

Once a taxpayer undergoes compulsory liquidation or a voluntary liquidation, SARS would be a preferent creditor in the liquidation proceedings and would be entitled to receive distributions equivalent to other concurrent creditors.

TAX IMPLICATIONS OF DEBT COMPROMISE

The process of liquidation itself may trigger adverse tax implications for the taxpayer undergoing liquidation. It is highly likely that most, if not all, of the debts of the taxpayer undergoing liquidation would be compromised and creditors would only receive a portion of the amounts owing to them. The compromise of the debts would trigger the debt concession or compromise provisions set out in section 19 of the Income Tax Act, 1962 (the Act), and paragraph 12A of the Eighth Schedule to the Act. Section 19 provides for the tax implications which would arise for a taxpayer where a debt owed by such taxpayer is cancelled, waived, extinguished or capitalised, and such debt funding was utilised by the taxpayer to fund tax-deductible expenditure (ie, operational expenditure). Where a taxpayer is released from the obligation to make payment of a debt (or part of such debt) that was utilised to fund tax-deductible expenditure [*Editorial comment*: including the purchase of trading stock], the amount of the debt in respect of which the taxpayer has been relieved of the obligation to make payment, would constitute a recoupment in the taxpayer's hands. This would give rise to a tax obligation in the taxpayer's hands where the taxpayer does not have an accumulated assessed loss.

Similarly, paragraph 12A provides for the tax implications in the instance where a taxpayer is relieved of the obligation to make payment of a debt or part of a debt, and the debt funding was utilised to acquire capital assets. The amount of such reduced or forgiven debt is to be applied first to reduce the base cost of the capital asset or allowance asset and, once such base cost has been reduced to nil, CGT is triggered.

There are several exemptions to the application of section 19 and paragraph 12A that are set out in section 19(8) and paragraph 12A(6). These exemptions (which are not exactly the same for the two provisions) should be kept in mind by a taxpayer who embarks on liquidation proceedings, whether voluntarily or compulsorily.

Where the debt concession or compromise provisions set out in section 19 and paragraph 12A are applicable to debts that are compromised as part of the liquidation process, any additional tax obligations that arise as a result of such liquidation would be triggered on the date of confirmation of the final liquidation and distribution account. This is confirmed in Interpretation Note 91, published by SARS.

SARS' RIGHTS IN TERMS OF THE TAA

SARS has powers in terms of section 177 of the Tax Administration Act, 2011 (the TAA), which provides that a senior SARS official may authorise the institution of proceedings for the sequestration, liquidation or winding up of a person for an outstanding tax debt. The provisions of section 177 were invoked by SARS against a taxpayer in the case of *Commissioner for the South African Revenue Service v Zikhulise Cleaning Maintenance and Transport Services and a related matter*, [2020]. In this case, the taxpayer was indebted to SARS in an amount in excess of R122 million, and had repeatedly failed to honour its commitments to make payment of its outstanding tax debts, despite submitting returns reflecting its tax obligations and undertaking to make payment. SARS was granted leave to institute liquidation proceedings against the taxpayer in terms of section 177 of the TAA. In a media release dated 16 October 2020, SARS commented that the judgment is precedent-setting and empowers SARS to act decisively against taxpayers who attempt to circumvent their fiscal obligations by using court processes to restrict SARS' ability to collect outstanding debt. SARS Commissioner Edward Kieswetter commented that "SARS will act within the law and will pursue without fear or favour any taxpayer who is bent on evading their legal obligations".

SARS is committed to collecting outstanding tax debts, and will not be deterred from collecting such tax debts and will institute liquidation proceedings against defaulting taxpayers. Taxpayers should keep in mind the applicable tax considerations upon experiencing financial constraints, and upon embarking on liquidation proceedings.

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Acts and Bills

- Income Tax Act 58 of 1962: Section 19 (more specifically subsection (8)); Eighth Schedule: Paragraph 12A (more specifically subparagraph (6));
- Tax Administration Act 28 of 2011: Section 177.

Other documents

- Interpretation Note 91 ("Reduction of debt" – published by SARS on 21 October 2016);
- Statistical Release on liquidations and insolvencies (published by Statistics South Africa in July 2021);
- SARS Media Statement, dated on 16 October 2020 (https://www.sars.gov.za/media-release/sars-right-to-liquidate-a-taxpayer-to-recover-debt/).

Cases

- *Commissioner for the South African Revenue Service v Zikhulise Cleaning Maintenance and Transport Services and a related matter (Application for Final Winding Up)* [2020] JOL 48758 (GP) (judgment delivered on 14 October; leave to appeal dismissed on 4 December 2020).

Tags: compulsory liquidation; voluntary liquidation; tax-deductible expenditure; capital assets.

VAT REFUNDS: DOES SARS HAVE POWER TO ABUSE?

The South African Revenue Service (SARS) has set its sights on non-compliant taxpayers through a very active and focused compliance programme. It seems that SARS has realised the enormous powers it enjoys under the Tax Administration Act, 2011 (the TAA), to administer tax laws and enforce compliance and it has been going from strength to strength ever since. This is particularly evident when it comes to the audit and verification of value-added tax (VAT) refunds. But is the law allowing SARS perhaps too much power when viewed against vendors' rights to conduct business?

ENTITLEMENT VS ENFORCEMENT

The design of the South African VAT system is such that it entitles a vendor to claim VAT on expenses that have been incurred in the course or furtherance of its taxable enterprise. A vendor's entitlement to a VAT refund claim is subject to certain requirements and the vendor bears the burden of proof. On the other hand, SARS' right to conduct an audit of a vendor's tax affairs is embedded in Chapter 5 of the TAA, which contains various enforcement tools ranging from verification to audit to criminal investigation. In practice, however, there seems to be difficulty in distinguishing between errant compliant vendors and errant criminal vendors. The result is that a broad brush approach to enforcement is emerging which is impacting the timing of VAT refund payments with trends reminiscent of the findings from the erstwhile Nugent Commission.

MUSTS VS NEED NOTS

Section 190(1) of the TAA requires that SARS "*must*" pay a refund if a person is entitled to it together with interest thereon. However, section 190(2) provides that SARS "*need not*" authorise a refund until such time that a verification, inspection, audit or criminal investigation of the refund has been finalised. In other words, the subsection preserves SARS' right to initiate and finalise an audit of a refund before the refund is paid out. The trouble is that there is no prescribed time period within which SARS is required to finalise any such audit activities. The TAA is silent on this aspect and the Value-Added Tax Act, 1991 (the VAT Act), in section 45, merely provides that interest starts accruing on the outstanding refund if it is not paid within 21 business days from the date on which the particular VAT return was received by SARS. Even so, interest may be suspended in certain prescribed instances (eg, if a vendor has any outstanding tax returns, or has not furnished its banking details to SARS, etc).

GENERAL AUDIT VS AUDIT OF THE REFUND

Notwithstanding that the audit must be "of the refund" before SARS is entitled to withhold payment thereof, section 190(2) is often (erroneously) interpreted to mean that SARS is not required to pay a VAT refund if any aspect of that person's tax affairs is under audit, until such time that the audit has been finalised. This practice has coincided with a recent increase in the use of special "stoppers" on the SARS system which block the payment of any VAT refund claims made by the vendor after the date on which an audit has been initiated, even if such subsequent VAT refund claims fall outside the period that is under audit. This notion has also had the effect that VAT refunds are being withheld on a large scale where SARS is conducting an industry-wide audit as opposed to an audit "of the refund".

"It seems then that a vendor's only option is to seek recourse from the courts to either compel SARS to finalise its audit within a reasonable period of time or to pay out any VAT refunds that do not fall within the scope of the audit."

Recent trends noted that support for this notion includes:

- Vendors whose VAT returns are frequently in a net VAT refund position will receive a verification request each and every time they submit a VAT return to SARS. The VAT refund will not be paid out until the verification is finalised. This carries on for multiple tax periods without any indication that the vendor is able to build up a good compliance history which could relieve it from constant SARS scrutiny.

- The initiation of a VAT refund audit will in all likelihood mean that payment of any subsequent VAT refund claims will automatically be withheld until the audit of the initial VAT refund is finalised. When a vendor enquires with the SARS call centre, it is usually informed that a stopper has been placed on the system with no indication as to when the stopper will be lifted or when the audit will be finalised.

- It has also been noted that a vendor will receive a notification of audit and related request for relevant material in respect of the same VAT returns that were previously subjected to verification requests, even though the verifications were finalised and no adjustments were made.

- In some instances an audit will be continuously extended to include an additional tax period each time the vendor submits a VAT return to SARS (eg, an audit may start off as relating to VAT refund "A to E" but will be extended to include VAT refund "F" the moment this VAT return is submitted to SARS and so forth).

DELAYED VAT REFUND CLAIMS

But VAT is a tax on the final consumer. By design, VAT is not intended to be a cost to business. It merely has a cash flow impact where goods or services are acquired by the vendor for taxable business purposes as the vendor is entitled to claim the VAT back from SARS. VAT refund payments are needed to stimulate business activity, but where VAT refunds are continuously locked up in audit activities the much needed cash flow to business is delayed, sometimes for months on end. It is not surprising that vendor frustration is mounting where VAT refund claims are constantly met with suspicion and intensely scrutinised at length.

The current lack of timeframes within which an audit must be concluded creates the impression of a lack of commitment to finalise audits, even where no indication of wrongdoing has been advanced (audits can be kept in abeyance seemingly for years without progression to any kind of end). It seems then that a vendor's only option is to seek recourse from the courts to either compel SARS to finalise its audit within a reasonable period of time or to pay out any VAT refunds that do not fall within the scope of the audit. In the recent matter of *Rappa Resources (Pty) Ltd v Commissioner for the South African Revenue Service* [2020] the Gauteng High Court cautioned that "SARS cannot be allowed an indefinite time to complete an audit" and, accordingly, the court directed SARS to conclude the audits by no later than a particular date. The Supreme Court of Appeal reinforced this judgment by declining SARS' application for leave to appeal.

BALANCE OF AUDITS AND BUSINESS

The vendor may have won this round, but litigation is costly, lengthy and not without risk. It simply is not a feasible option available to all and, in some instances, vendors may not emerge intact on the other side. What is needed instead is a balance, in law, between SARS' right to conduct an audit and a vendor's constitutional right to conduct business. Clear and reasonable timeframes need to be outlined and extensions should be the exception and only invoked when warranted in limited circumstances.

It is welcoming to note that various stakeholders are engaging with National Treasury and SARS in this regard. But until SARS' powers in this area are curtailed and the balance restored, there will continue to be a tug of war between SARS and vendors on the payment of VAT refunds with the vendor at a distinct disadvantage.

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Acts and Bills

- Tax Administration Act 28 of 2011: Chapter 5 (sections 40 to 66); section 190(1) & (2);

- Value-Added Tax Act 89 of 1991: Section 45.

Cases

- *Rappa Resources (Pty) Ltd v Commissioner for the South African Revenue Service* [2020], Case No 20/18875.

Tags: taxable enterprise; VAT refund; notification of audit.