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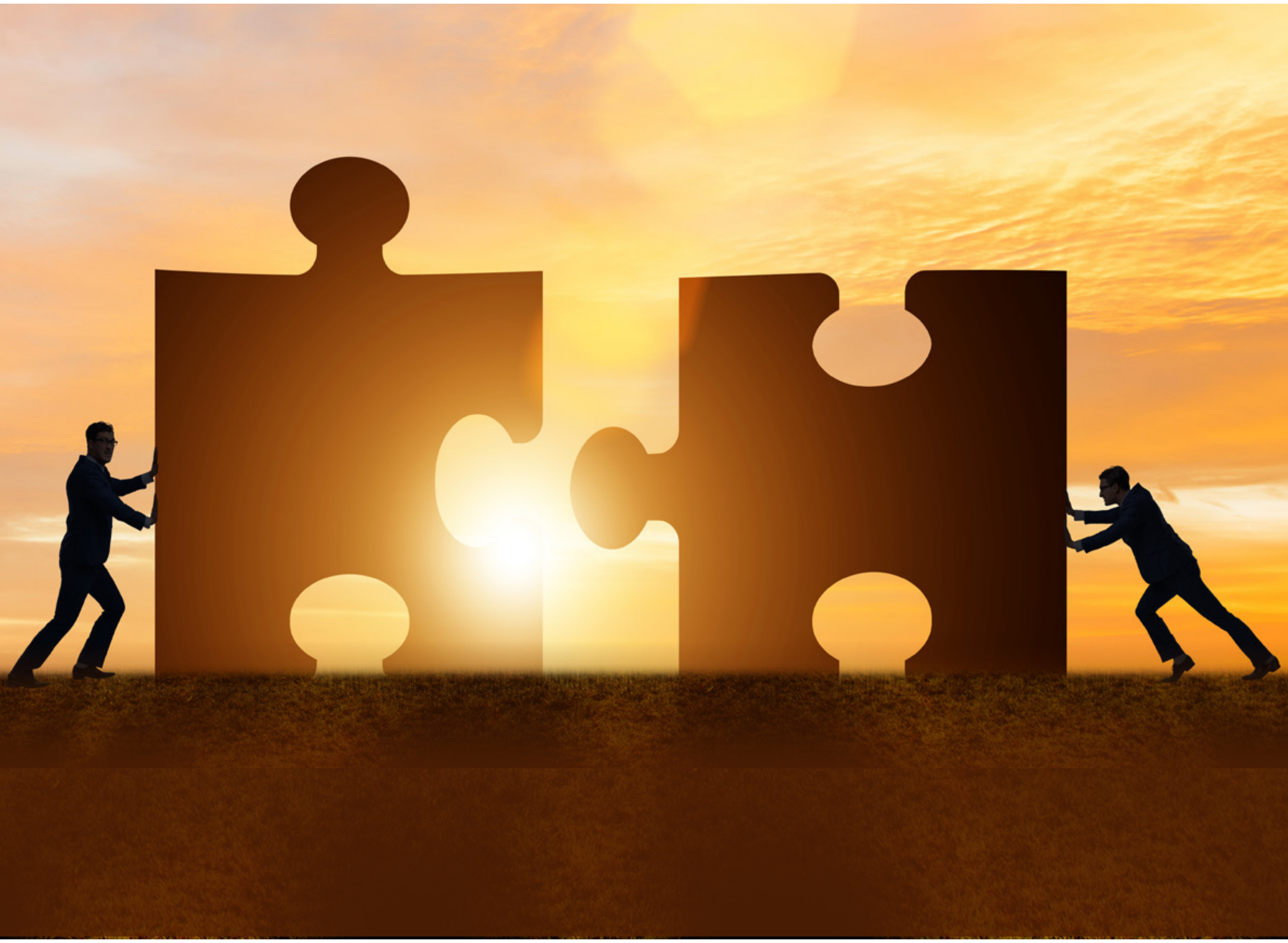
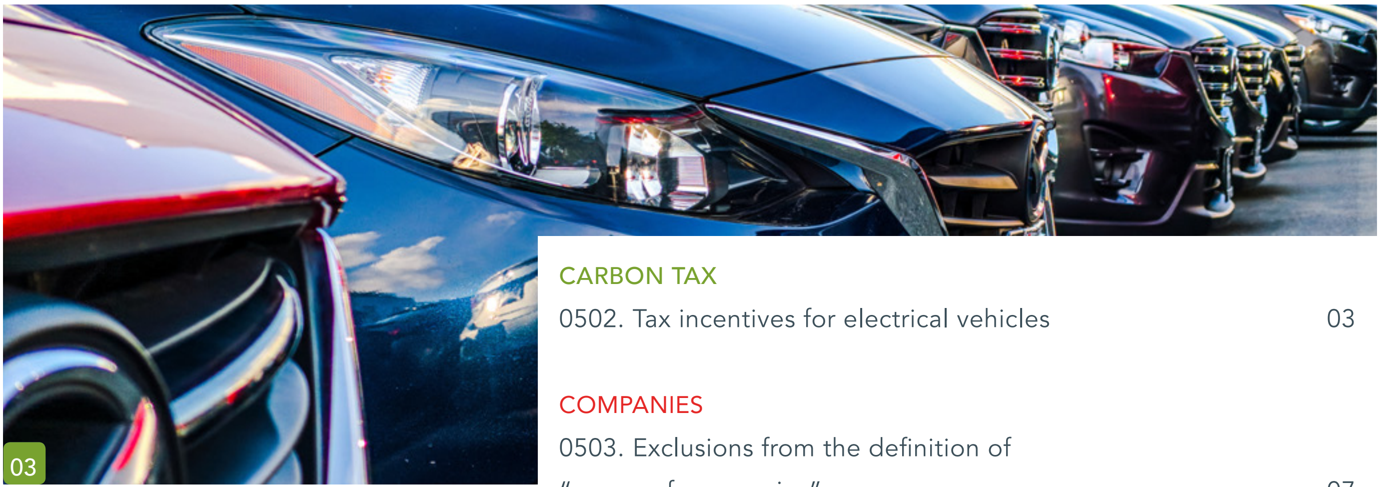
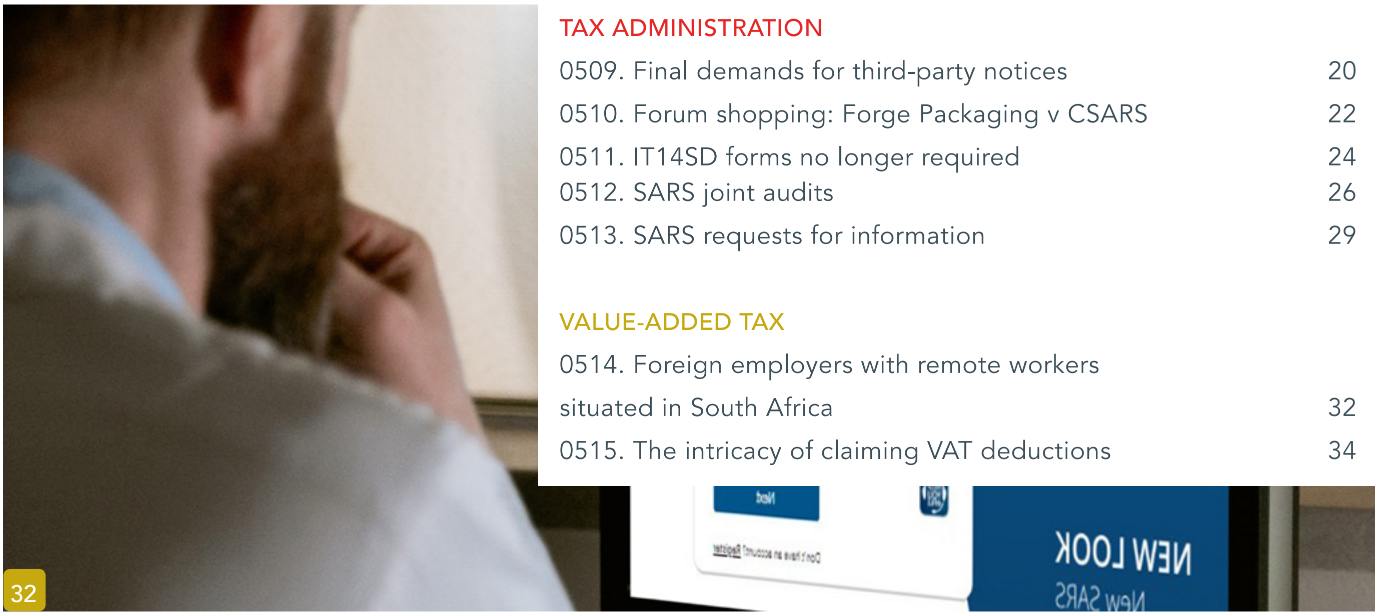


CARBON TAX
TAX INCENTIVES FOR ELECTRICAL VEHICLES

INTERNATIONAL TAX
OFFSHORE FOUNDATIONS

VALUE-ADDED TAX
THE INTRICACY OF CLAIMING VAT DEDUCTIONS





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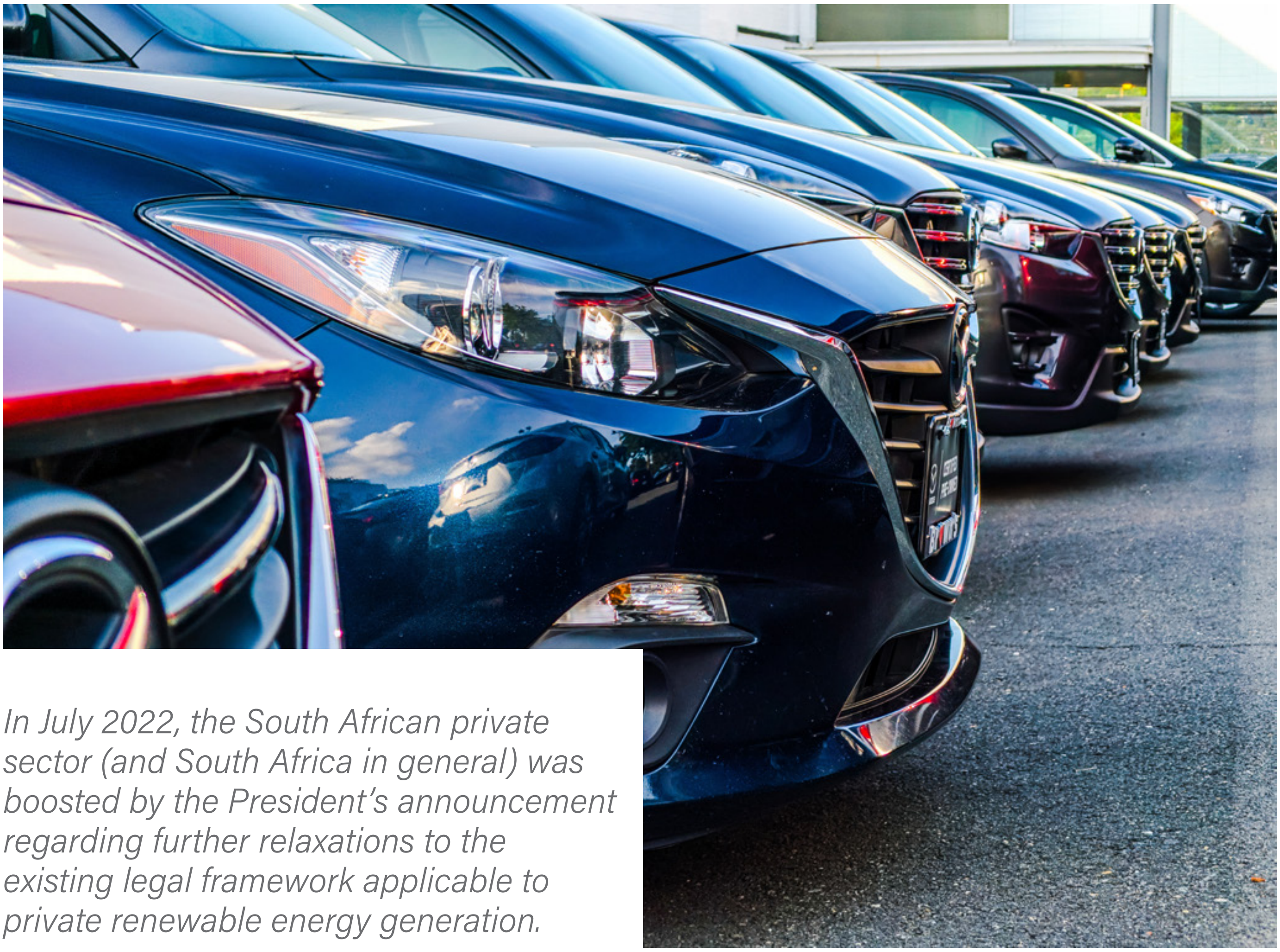
TAX INCENTIVES FOR ELECTRICAL VEHICLES



In July 2022, the South African private sector (and South Africa in general) was boosted by the President's announcement regarding further relaxations to the existing legal framework applicable to private renewable energy generation.

Aside from addressing the electricity supply shortfall, this will also hopefully assist in boosting South Africa's electric vehicle market, including the infrastructure needed to increase the roll-out of electric vehicles and charging stations, with the ultimate goal of this taking South Africa closer to its goal of getting to net zero carbon emissions. At the same time, it is important to understand how tax laws encourage or discourage the use and purchase of electric vehicles.

It is a well-accepted principle that taxes can achieve several different purposes, including increasing revenue for governments but also, importantly, encouraging or prohibiting certain behaviour. The Carbon Tax Policy Paper published for comment by National Treasury in May 2013 specifically recognised the important role that carbon taxes play in internalising the external costs of climate change and creating the correct incentives to stimulate changes in the behaviour of producers and consumers.

This article briefly discusses some of the taxes that one should consider with reference to potentially changing behaviour and pursuing e-mobility more vigorously in light of some of the existing environmental taxes imposed on vehicles that cause carbon emissions, such as those using petrol and diesel.

BRIEF OVERVIEW OF ENVIRONMENTAL TAXES ON PETROL AND DIESEL MOTOR VEHICLES

Environmental levy on CO2 emissions on newly manufactured motor vehicles

In terms of Schedule 1 Part 3D to the Customs and Excise Act, 1964 (the C&E Act), an environmental levy is payable on certain locally manufactured motor vehicles which are manufactured in a special *ad valorem* manufacturing warehouse. Specifically, the environmental levy is imposed on vehicles whose use results in CO2 emissions. The environmental levy is imposed based on the CO2 emission level of the locally manufactured vehicle. While the customs legislation classifies vehicles with reference to the environmental levy item number and tariff subheading in which the vehicle falls, there are broadly speaking two categories of vehicles that are affected by the levy:

- Vehicles described as "Other, double-cab, of a vehicle mass not exceeding 2 000 kg or a G.V.M. not exceeding 3 500 kg, or of a mass not exceeding 1 600 kg or a G.V.M. not exceeding 3 500 kg per chassis fitted". As of 1 April 2022, the environmental levy imposed on these vehicles is R176.00 per g/km CO2 emissions exceeding 175g/km. In other words, the environmental levy is only payable if the vehicle's CO2 emissions exceed 175g/km; and

- All vehicles falling under the general description "Other", which are subject to an environmental levy of R132.00 per g/km CO2 emissions exceeding 95g/km. In other words, the environmental levy is only payable if the vehicle's CO2 emissions exceed 95g/km.

Carbon tax on petrol- and diesel-powered motor vehicles

When the Carbon Tax Act, 2019, came into operation in 2019, it made provision for the imposition of carbon tax on GHG (greenhouse gas) emissions arising from the use of petrol- and diesel-powered motor vehicles. However, in light of the fuel levy dispensation that already existed at the time under the C&E Act, it was decided that GHG emissions arising from the use of petrol and diesel in motor vehicles would be taxed through the fuel levy dispensation, by providing for a carbon fuel levy on petrol and diesel. This levy was increased to 9c/l for petrol and 10c/l for diesel from 6 April 2022 and is payable in addition to the general fuel levy and the road accident fund levy. In light of this approach, the formula in the Carbon Tax Act to calculate one's carbon tax liability (including from the use of petrol and diesel) was amended to prevent double taxation. In other words, carbon tax arising from the use of petrol and diesel in motor vehicles is only taxed under the fuel levy dispensation and not also under the Carbon Tax Act. To ensure fairness, the carbon fuel levy is also increased annually by the same percentage as the carbon tax rate at which GHG emissions are taxed under the Carbon Tax Act.

PETROL AND DIESEL MOTOR VEHICLES TO BE SCALED DOWN AND EVENTUALLY BANNED IN THE UK AND EU

South Africa's (and Africa's) largest trading partners (particularly for motor vehicles) include the United Kingdom (UK) and Europe (EU).

In April 2022, the UK Department of Transport published a paper titled: *"Outcome and government response to the green paper on a New Road Vehicle CO2 Emissions Regulatory Framework for the UK"* which, amongst others, confirmed that the UK Government will introduce a zero-emission vehicle mandate setting targets requiring a percentage of manufacturers' new car and van sales to be zero emission each year from 2024.

Furthermore, the UK Government announced that it will continue to regulate the CO2 emissions of new non-zero emission cars and vans to limit their emissions until all new sales are zero emission at the exhaust. It was stated that, if not fully zero emission, all new cars and vans sold between 2030 and 2035 must have significant zero emission capability. The European Commission has similarly implemented various regulations and intends cutting carbon emissions from motor vehicles by 55% by 2030 with a 100% target by 2035.

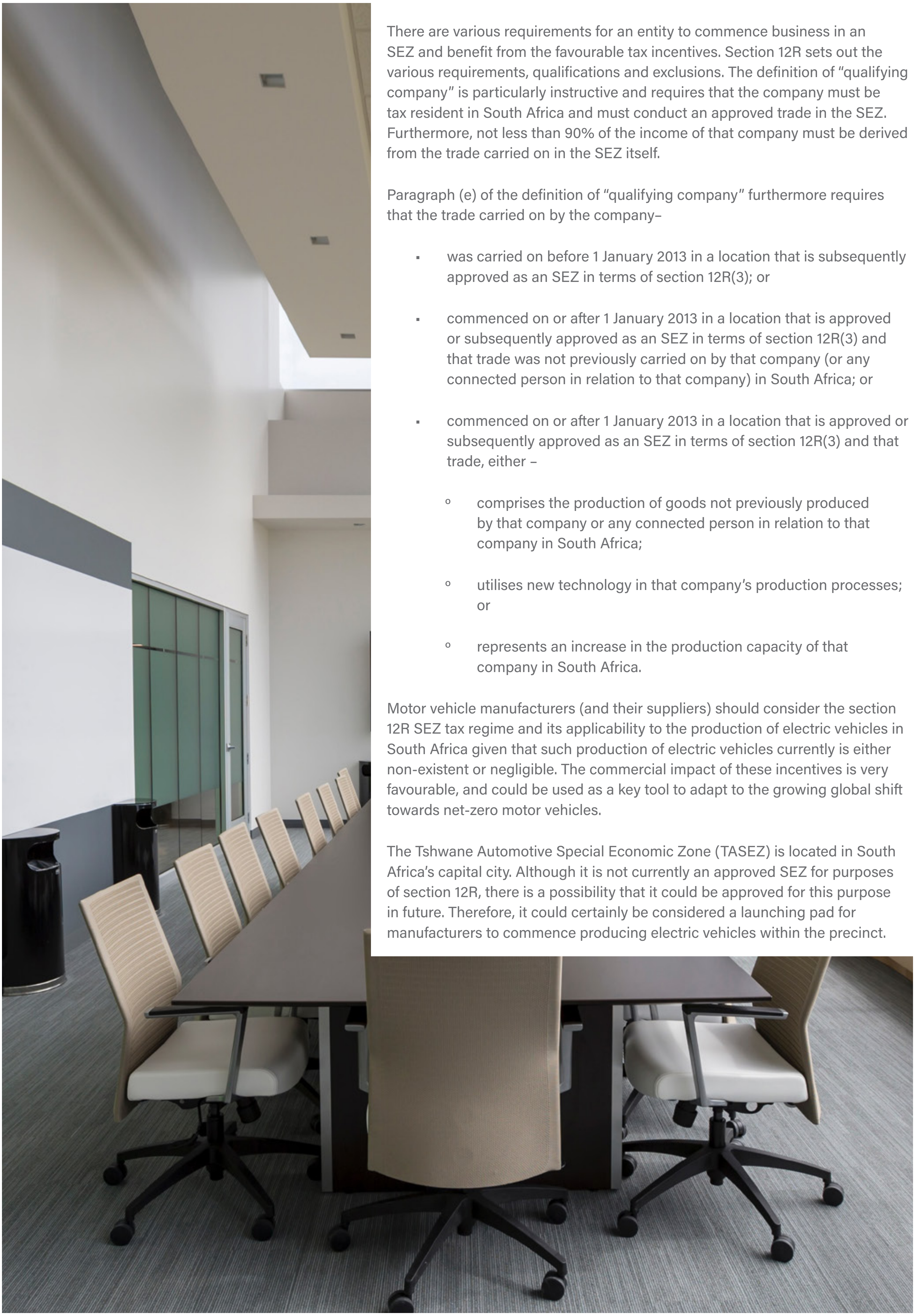
> " It is a well-accepted principle that taxes can achieve several different purposes, including increasing revenue for governments but also, importantly, encouraging or prohibiting certain behaviour."

These measures will have a profound influence on Africa and South Africa as exports to those markets will be significantly impacted unless the local market starts to embrace the move towards "net-zero" and commences producing electric vehicles.

SECTION 12R – SPECIAL ECONOMIC ZONE

In advancing its efforts towards promoting economic growth and industrial development, the South African government, via the Department of Trade and Industry, has established various special economic zones (SEZs) within designated areas in South Africa. Importantly there are a number of specific tax incentives including income tax, value-added tax (VAT), customs & excise and employees' tax incentives from which a "qualifying company" in an SEZ (as defined in section 12R(1) of the Income Tax Act, 1962 (the Act)), could potentially benefit.

One of the most beneficial tax incentives is that companies carrying on business within certain SEZs are subject to an annual income tax rate of 15%, which is a significant benefit compared to the ordinary corporate income tax rate of 27%. In addition, qualifying companies can claim a special capital allowance of 10% per year on the costs of any new or unused building or improvement to such building. These incentives are provided for in sections 12R and 12S of the Act. One should appreciate that only companies operating in an SEZ approved by the Minister of Finance for purposes of section 12R can benefit from the incentive. Currently, only some of South Africa's SEZs are approved for purposes of section 12R.



There are various requirements for an entity to commence business in an SEZ and benefit from the favourable tax incentives. Section 12R sets out the various requirements, qualifications and exclusions. The definition of "qualifying company" is particularly instructive and requires that the company must be tax resident in South Africa and must conduct an approved trade in the SEZ. Furthermore, not less than 90% of the income of that company must be derived from the trade carried on in the SEZ itself.

Paragraph (e) of the definition of "qualifying company" furthermore requires that the trade carried on by the company–

- was carried on before 1 January 2013 in a location that is subsequently approved as an SEZ in terms of section 12R(3); or
- commenced on or after 1 January 2013 in a location that is approved or subsequently approved as an SEZ in terms of section 12R(3) and that trade was not previously carried on by that company (or any connected person in relation to that company) in South Africa; or
- commenced on or after 1 January 2013 in a location that is approved or subsequently approved as an SEZ in terms of section 12R(3) and that trade, either –
    - comprises the production of goods not previously produced by that company or any connected person in relation to that company in South Africa;
    - utilises new technology in that company's production processes; or
    - represents an increase in the production capacity of that company in South Africa.

Motor vehicle manufacturers (and their suppliers) should consider the section 12R SEZ tax regime and its applicability to the production of electric vehicles in South Africa given that such production of electric vehicles currently is either non-existent or negligible. The commercial impact of these incentives is very favourable, and could be used as a key tool to adapt to the growing global shift towards net-zero motor vehicles.

The Tshwane Automotive Special Economic Zone (TASEZ) is located in South Africa's capital city. Although it is not currently an approved SEZ for purposes of section 12R, there is a possibility that it could be approved for this purpose in future. Therefore, it could certainly be considered a launching pad for manufacturers to commence producing electric vehicles within the precinct.

At the very least, manufacturers operating in TASEZ automatically benefit from the preferential value-added tax (VAT) provisions applicable to companies operating in SEZs, with the section 12R incentive also becoming available to them if the Minister of Finance approves TASEZ for purposes of section 12R. When the Taxation Laws Amendment Act, 2020, came into operation in January 2021, the sunset date for the section 12R incentive was extended to 31 December 2030.

SOUTH AFRICA'S POTENTIAL NEW "DRIVING TAX"

The South African National Department of Transport published the White Paper on National Transport Policy in May 2022; it proposed, among other things, further investigations into additional and innovative funding strategies for traffic management functions. It was announced that a traffic management levy to vehicle licence fees and fuel sales would be investigated. Interestingly, this potential new levy may not impact electric vehicles, especially if it is introduced with reference to fuel sales – this could further encourage the uptake of electric vehicles in South Africa.

"In terms of Schedule 1 Part 3D to the Customs and Excise Act, 1964 (the C&E Act), an environmental levy is payable on certain locally manufactured motor vehicles which are manufactured in a special ad valorem manufacturing warehouse."

FURTHER CARBON TAX PROPOSALS TO POTENTIALLY INCENTIVISE EV UPTAKE

In addition to the above, manufacturers and users of petrol and diesel vehicles must keep in mind that the taxes imposed as a result of the use of such vehicles is only likely to increase. This appears evident from the announcements in the 2022 Draft Taxation Laws Amendment Bill, published in July 2022, which proposes, amongst other things, substantial increases in the annual carbon tax rate going forward. The likely effect of this is that each person in the petrol/diesel vehicle manufacturing supply chain, including the end-user, will have to pay more for the vehicle and for the fuel necessary to use such a vehicle.

(This article is based on the South African section of CDH's *E-Mobility In Africa* publication.)

Louis Botha & Jerome Brink

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 12R(1) (definition of "qualifying company" – more specifically paragraph *(e)*) & (3) & 12S;
- Customs and Excise Act 91 of 1964: Schedule 1: Part 3D *(Environmental levy on carbon dioxide (CO2) emissions of motor vehicles)*;
- Carbon Tax Act 15 of 2019;
- Draft Taxation Laws Amendment Bill, 2022.

Other documents

- Carbon Tax Policy Paper (*"Reducing greenhouse gas emissions and facilitating the transmission to a green economy"*) – published by National Treasury in May 2013 for comment;
- *"Outcome and government response to the green paper on a New Road Vehicle CO2 Emissions Regulatory Framework for the UK"* (paper published by the UK Department of Transport in April 2022);
- White Paper on National Transport Policy (published by National Department of Transport in GG 46422 of 27 May 2022).

Tags: zero carbon emissions; environmental taxes; environmental levy; carbon fuel levy; qualifying company; traffic management levy.

EXCLUSIONS FROM THE DEFINITION OF "GROUP OF COMPANIES"

The ability of corporate groups to acquire businesses that fit their proposed models, divest in order to right-size or realise returns and introduce capital from various sources is of increasing importance in today's economic climate.

The corporate roll-over relief provisions contained in Part III of Chapter 2 of the Income Tax Act,1962 (the Act), provide corporate groups with the agility to reorganise to meet the exigencies of the prevailing economic realities. These provisions achieve this by allowing corporate groups to reorganise by deferring the otherwise immediate income tax and capital gains consequences associated with certain transactions.

The application of aspects of the corporate roll-over relief and several other provisions in the Act, in many instances, turns on whether the companies in question form part of the same "group of companies" as defined in the Act. In the context of these provisions, there are two sets of rules to be considered in determining whether a "group of companies" indeed exists. The first consideration is the general definition of "group of companies" contained in section 1(1) and the second consideration is the exclusions of certain companies and shares from the determination as provided for in the more limited definition of "group of companies" in section 41(1).

The South African Revenue Service (SARS), on 18 August 2022, issued an update (Issue 4) to Interpretation Note 75: *Exclusion of certain companies and shares from a "group of companies" as defined in section 41(1)* (IN75). This interpretation note provides updated guidance on how to determine whether companies indeed form part of the same "group of companies". No significant changes have been made to the guidance provided, but IN75 now caters for amendments which were made to the Act following promulgation of amendments introduced under the 2021 taxation laws and tax administration laws amendment process.

"GROUP OF COMPANIES" DEFINITIONS IN THE ACT

Section 1(1) provides that a group of companies exists where one company (the controlling group company) directly or indirectly holds shares in at least one other company (the controlled group company), where –

- at least 70% of the equity shares in each controlled group company are directly held by the controlling group company, one or more other controlled group company or any combination of the preceding; and
- the controlling group company directly holds at least 70% of the equity shares in at least one controlled group company.

This definition provides that a "group of companies" exists where there is a top holding company that holds at least 70% of the equity shares in one or more second level subsidiaries. It further includes in that group any other subsidiary company down the ownership chain, where either a group subsidiary or the top holding company, alone or together, holds at least 70% of the equity shares.

"Overall, an appreciation of the scope of the definition of "group of companies" in section 41(1) is critical to a proper understanding of the availability of corporate roll-over relief for a given set of companies"

It is important to note for the purposes of this definition, that "equity share" is defined in section 1(1) as "any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution".

Section 41 defines a "group of companies" with reference to the definition in section 1(1) noted above, but contains a proviso excluding certain categories of companies from the determination as to whether such company forms part of such group and that deems equity shares held in certain circumstances to not be equity shares and therefore to be excluded from consideration in whether the 70% threshold is met.

The categories of companies to be excluded are:

- all co-operatives;
- associations formed in South Africa for a specific purpose, beneficial to the public or a section of the public;
- a portfolio of an investment scheme carried on outside of South Africa, comparable to a collective investment scheme, where members of the public are able to contribute and hold a participatory interest in such portfolio through shares, units or another form of participatory interest;
- non-profit companies as defined in section 1(1) of the Companies Act, 2008;
- companies where any amount constituting gross income of whatever nature would be exempt from tax under the provisions of section 10 of the Act; this would include government entities, and pension funds, pension preservation funds, provident funds, provident preservation funds and retirement annuity funds;
- public benefit organisations or recreational clubs approved by the Commissioner under the provisions of section 30 or 30A of the Act;
- foreign incorporated companies, unless effectively managed in South Africa; and
- locally incorporated companies that are effectively managed outside of South Africa.

The circumstances in which shares will be deemed to not constitute equity shares are where –

- the shares are held as trading stock; and
- any person is under a contractual obligation to sell or purchase the relevant share, or has an option to sell or purchase the relevant share, unless that obligation or option provides for the sale or purchase to take place at the market value of such share at the time of the sale or purchase.

HIGHLIGHTS OF THE IN75 GUIDANCE

IN75 emphasises that the exclusions contained in the proviso to the definition of "group of companies" in section 41(1) must be read together with the preceding wording which refers to the definition in section 1(1). This means that for the purposes of the section 41(1) definition, the exclusions must be read as applying to the definition of "group of companies" in section 1(1).

For example, where a company that is an approved public benefit organisation or a foreign incorporated company constitutes the controlling group company under the definition in section 1(1), such company must be excluded for the purposes of the section 41(1) definition. The exclusion of the controlling group company from the consideration could therefore possibly result in the group not constituting a "group of companies" as defined in section 41(1).

IN75 also considers the applicability of Article 24(5) of the Organisation for Economic Cooperation and Development's *Model Tax Convention on Income and on Capital*, which prohibits more burdensome tax treatment applying to resident subsidiaries held by non-resident holding companies, than to resident subsidiaries not held by non-resident holding companies, where the circumstances are similar.

The conclusion drawn by IN75 is that the proviso to the definition in section 41(1) does not treat foreign held subsidiaries in a more burdensome manner, because the policy basis for the exclusion is that the exclusions target companies that do not fall within the South African tax net. The exclusions therefore also target resident companies which are not subject to tax in South Africa, such as approved public benefit organisations and pension funds, pension preservation funds, provident funds, provident preservation funds and retirement annuity funds.

COMMENT

The policy rationale for the exclusion of certain categories of companies and shares from the definition of "group of companies" in section 41(1) is that the companies and shares targeted would erode the South African tax base in a manner not aligned to the policy imperatives of National Treasury.

It is therefore possible that, in future, further amendments may be made to the Act, seeking for the section 41(1) definition of a "group of companies" to be extended to prevent the provisions of the Act from applying in circumstances where base erosion is a policy consideration.

Overall, an appreciation of the scope of the definition of "group of companies" in section 41(1) is critical to a proper understanding of the availability of corporate roll-over relief for a given set of companies. It is also important for the correct application of several other provisions in the Act, for example, the debt concession or compromise provisions contained in section 19 and paragraph 12A of the Eighth Schedule to the Act.

[*Editorial comment*: Interpretation notes (which are "official publications" and thus create "practice generally prevailing" (PGP)) are intended to provide *guidelines* to stakeholders (both internal and external) on the SARS interpretation and application of the provisions of the legislation administered by the Commissioner. These notes are amended when necessary in line with policy developments and changes in legislation. An interpretation note is published for general information.

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Tsanga Mukumba

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definitions of "equity shares" & "group of companies"), 10, 19, 30, 30A & 41(1) (definition of "group of companies"); Chapter 2, Part III (sections 41 to 47); Eighth Schedule: paragraph 12A;
- Companies Act 71 of 2008: Section 1(1) (definition of "non-profit company").

Other documents

- Interpretation Note 75 (Issue 4): *Exclusion of certain companies and shares from a "group of companies" as defined in section 41(1)* (18 August 2022);
- Organisation for Economic Cooperation and Development Model Tax Convention on Income and on Capital: Article 24(5).

Tags: group of companies; controlling group company; controlled group company; collective investment scheme; non-profit companies.

INCOME TAX AND VAT – MINING OF CRYPTO ASSETS

The ability of corporate groups to acquire businesses that fit their proposed models, divest in order to right-size or realise returns and introduce capital from various sources is of increasing importance in today's economic climate.

The income tax and VAT consequences for crypto asset mining will vary, depending on the different ways that crypto assets are earned as rewards. These are:

1. proof of work (POW) mining, where –
    a. the miner owns the machines (Scenario 1a); or
    b. the miner rents computing power (Scenario 1b); and
2. proof of stake (POS) mining (Scenario 2).

POW mining is analogous to "mining for gold in the ground". The crypto miner solves a problem in order to validate a transaction to be added onto the distributed ledger. The likelihood of validating a transaction is in proportion to the crypto POW miner's computing power from machines owned or leased.

POS mining, however, is analogous to "having voting rights on the board of directors based on shares held". The crypto POS miner votes on the validity of a transaction to be added onto the distributed ledger. The voting power depends on the percentage of coins the POS crypto miner has staked as a proportion of total coins staked.

SCENARIO 1A: THE POW MINER OWNS THE ASIC MACHINES OR GRAPHICS CARDS

POW mining requires graphics cards or Application Specific Integrated Circuit (ASIC) machines. These are the machines used to solve the algorithms to validate a transaction. Some algorithms are designed to be ASIC-resistant (such as Monero), in which case a miner can only use graphics cards to solve them.

There is a fundamental difference between the functionality of graphics cards and ASIC machines in POW mining. Graphics cards used for POW mining are usually top-of-the-range gaming graphics cards. They have value even if they are not used for POW crypto mining, because they can be used elsewhere, or sold on Gumtree, where there is a thriving second-hand market for them.

ON THE OTHER HAND, AN ASIC MACHINE CAN ONLY BE USED FOR THAT SPECIFIC POW MINING AND NOTHING ELSE.

Section 11*(e)* of the Income Tax Act, 1962 (the Act), and Interpretation Note 47 (IN 47) will determine how to claim the costs of the ASIC machines or graphics cards. If the cost of an item is less than R7 000, a full write-off can be claimed in the year of acquisition. Where the cost of an item is R7 000 or more, the recommended write-off periods in IN 47 would apply.

We believe that ASIC machines and graphics cards should be considered as "personal computers". IN 47 generally provides for personal computers to be written off over three years.

We submit that the costs of graphics cards should be written off over three years in line with IN 47, as they can be used for other purposes. However, an ASIC machine is only used for a very specific proof of work. Its useful life is less than two years, based on Moore's law, an empirical law held since 1965 that says computing power doubles every two years. An ASIC machine has no alternative use or resale value after two years. For these

"POW mining requires graphics cards or Application Specific Integrated Circuit (ASIC) machines. These are the machines used to solve the algorithms to validate a transaction."

reasons, we submit that the costs of ASIC machines can be written off over two years. Other tax-deductible costs during POW mining include electricity, maintenance, rental of premises, salaries, and shipping. We submit that these costs are fully deductible in terms of section 11*(a)* of the Act.

As crypto mining is an exempt supply (section 2(1)*(o)* of the Value-Added Tax Act, 1991) (the VAT Act), VAT paid by the miner on expenses cannot be claimed back as input VAT. At the same time, there is no output VAT on the supply of cryptocurrencies by the POW miner.

If the miner in this scenario also has digital wallet management services, for which a fee is charged, this fee is not an exempt supply and normal VAT rules apply.

When does the miner account for the gains on the coins which appear in the wallets from the POW mining? We submit that the coins which appear in the wallets are "trading stock", as defined in section 1(1) of the Act. Gains or losses on these coins should, thus, only be accounted for by the miner on their actual disposal as ordinary revenue from a scheme of profit making. This interpretation leads to a sensible, businesslike result given the highly volatile nature of cryptocurrency markets.

SCENARIO 1B: THE POW MINER RENTS COMPUTING POWER FROM A SUPPLIER

In this scenario, the POW miner does not own the computing power used to solve the algorithms to validate a transaction but rents them from a supplier such as Nicehash.

The crypto produced is either paid into a wallet or Nicehash will liquidate the coins for USD. Nicehash then pays the USD to the POW miner, after deducting the rental for the computing power.

The supply of computing power falls into the category of "cloud computing" and is an electronic service in terms of the VAT Electronic Services Regulations, 2014, as updated.

Nicehash is carrying on "electronic services" (as defined in section 1(1) of the VAT Act, read with the VAT regulations) and may need to register as a VAT vendor if the supply to South African recipients is more than R1 million in 12 months. The POW miner will not be able to claim VAT paid on the rental as input VAT because the service was used in furtherance of an exempt supply, ie, cryptocurrency mining.

For income tax purposes, we submit that the POW miner renting the machine who earns coins from mining or USD is accumulating trading stock. and that gains or losses of a revenue nature should only be accounted for on the actual disposal of these coins by the miner. In the arrangement where these coins are sold by Nicehash for USD, the USD paid (less rental due) to the POW miner would be taxable income.

SCENARIO 2: THE POS MINER EARNS REWARDS FROM STAKING

POS mining generates rewards in the form of coins for locking away cryptocurrencies, ie, it "stakes the coins". This is done in order to verify transactions to be added onto the distributed ledger on the decentralised network. In our view, this is analogous to dividends in the form of capitalisation shares. However, these coins become taxable as income when they appear in the wallet.

BURDEN OF PROOF

Certain coins can only be mined using POW mining, such as Bitcoins, Litecoins, Bitcoin Cash, and Monero. Coins that can be mined using POS mining are Ripple and Cardano. POW miners that account for gains on disposal of the coins, not when the coins appear in their wallets, would find it easier to discharge their burden of proof if they mined coins which can only be minted using POW mining.

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Joon Chong

Webber Wentzel

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "trading stock") & 11*(a)* & *(e)*;
- Value-Added Tax Act 89 of 1991: Sections 1(1) (definition of "electronic services") & 2(1)*(o)*.

Other documents

- Interpretation Note 47 (Issue 5): Wear-and-tear or depreciation allowance;
- VAT Electronic Services Regulations, 2014 (as updated).

Tags: crypto asset mining; trading stock; electronic services; capitalisation shares.services; capitalisation shares.

CEASING TAX RESIDENCY

Section 9H of the Income Tax Act, 1962 (the Act), provides that a natural person's year of assessment is deemed to have ended on the date immediately before the day on which that person ceased to be a resident for South African tax purposes.

Furthermore, that person's subsequent tax year is deemed to commence on the day on which that person ceased to be a tax resident. This effectively creates two years of assessment during a single 12-month tax period which would ordinarily constitute a single year of assessment beginning on 1 March and ending at the end of February the following year.

In turn, section 10(1)*(i)* of the Act provides an exemption in respect of the aggregate interest earned by a natural person ("individual") during a year of assessment. As such, individuals 65 years and older on the last day of the year of assessment are afforded an interest exemption, currently in the amount of R34 500, while individuals younger than 65 on the last day of the year of assessment are afforded an interest exemption, currently in the amount of R23 800.

Further to the above, the Act allows an individual a capital gains tax (CGT) annual exclusion, currently in the amount of R40 000 per year of assessment (paragraph 5(1) of the Eighth Schedule to the Act).

Both the interest exemption and annual exclusion apply per year of assessment.

REASONS FOR THE PROPOSED LEGISLATIVE CHANGES

The issue at hand is the two years of assessment created during the single 12-month tax period during which a natural person ceases to be a South African tax resident. By way of illustration, when a natural person ceases to be tax resident on 1 June 2021, their year of assessment as tax resident would have begun on 1 March 2021 but would be deemed to have ended on 31 May 2021; this constitutes a 3-month year of assessment. Their year of assessment as a tax non-resident would thus have begun on 1 June 2021 and ended on 28 February 2022, constituting a 9-month year of assessment. Both periods (the three-month and the nine-month year) would fall within a single 12-month tax period.

As a result of the natural person having these two years of assessment in the single 12-month tax period, the natural person may double-up on the interest exemption as well as the CGT annual exclusion (as the exemption and yearly exclusion are available per year of assessment, and are currently not apportioned in instances where the year of assessment is less than 12 months). This is contrary to policy rationale. As such, an individual who is younger than 65 years on the last day of the year of assessment would have been able to claim an interest exemption of R47 600 (R23 800 for the 3-month period and another R23 800 for the 9-month period) as well as a CGT annual exclusion of R80 000 (R40 000 for the 3-month period and R40 000 for the 9-month period) for the full period 1 March 2021 to 28 February 2022.

WHAT WILL CHANGE?

To address this anomaly, Government proposes in clauses 5 and 22 of the Taxation Laws Amendment Bill, 2022, that changes be made to the Act to require an apportionment of the interest exemption under section 10(1)*(i)* and the CGT annual exclusion (under paragraph 5(1) of the Eighth Schedule) to cater for instances where the individual's year of assessment is less than 12 months. The proposed amendment will come into operation on 1 March 2023 and apply for years of assessment commencing on or after that date.

T Roos

Acts and Bills

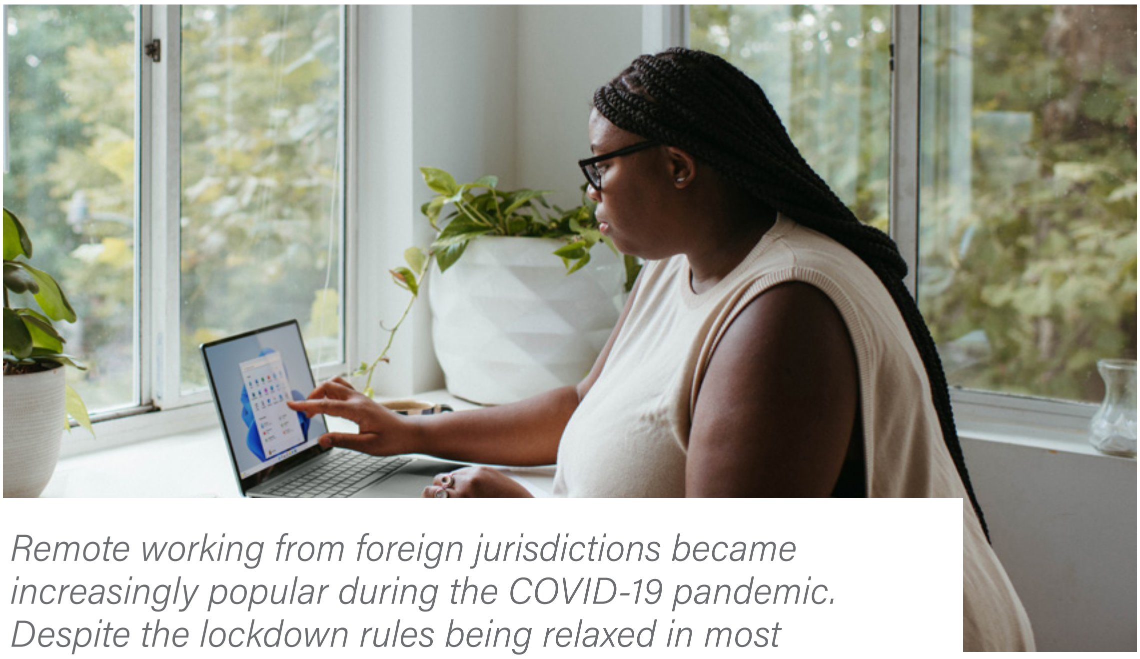
- Income Tax Act 58 of 1962: Sections 9H & 10(1)*(i)*; Eighth Schedule: Paragraph 5(1);
- Taxation Laws Amendment Bill 26 of 2022: Clauses 5 & 22.

Other documents

- Draft Explanatory Memorandum on the Taxation Laws Amendment Bill, 2022

Tags: natural person; interest exemption; tax resident.

CROSS-BORDER REMOTE WORKING



Remote working from foreign jurisdictions became increasingly popular during the COVID-19 pandemic. Despite the lockdown rules being relaxed in most jurisdictions, it appears that employers should not expect the workplace to return to the way it was before the pandemic.

For example, Microsoft 365 corporate vice-president Jared Spataro said early in 2022: "As organisations around the world make the definitive shift from remote to hybrid work, one thing is clear: the people who went home to work in 2020 are not the same people returning to the office in 2022".

For personal reasons, growing numbers of employees are choosing to relocate to other jurisdictions while remaining with their current employers. In many instances, the employers will go along with these arrangements; sometimes as a continuation of remote working during lockdown, and in other instances to attract valuable employees.

However, there are risks involved, and many South African employers may not be aware of these risks.

This is a different world from two years ago. In the past, employers would establish a presence in other jurisdictions; now it is employees who want to work from foreign jurisdictions. Often, these employees will argue that they can be as productive working remotely as from the office, and that this should make no difference to the employer. However, the situation may not be as straightforward as it seems.

"This is a different world from two years ago. In the past, employers would establish a presence in other jurisdictions; now it is employees who want to work from foreign jurisdictions."

WATCH OUT FOR CREATING A PERMANENT ESTABLISHMENT

The risks for South African employers include the possibility that an employee's presence in another country may amount to creating a permanent establishment for the employer, thus creating a tax presence for the employer in the foreign jurisdiction.

The interest of a foreign tax authority may be triggered by something as apparently harmless as the employee having business cards bearing the South African company's name and the address of his or her home office in the host country.

Although unusual, where the executives of a business work remotely, this could even create a risk of changing a company's place of effective management (POEM) and thus the company's corporate tax residence.

Other tax considerations include the risk that the South African employer may be obliged to register as an employer in the foreign jurisdiction and pay employees' tax and social security in the foreign jurisdiction. South African employers also sometimes fail to realise that they could still have an employees' tax-withholding obligation in South Africa.

IT ALL DEPENDS. . .

However, it is difficult to say definitively if and when such risks will actually materialise without taking the specific facts into account. It all depends; there is no one-size-fit-all answer. What works for the goose does not necessarily work for the gander. Thus, the best course of action for an employer considering an employee's request to work for the company from a foreign jurisdiction is to seek advice.

When doing so, some of the questions employers should be asking are: Is there a risk that the employee could create a taxable presence for the employer in the foreign jurisdiction? Which country has the right to tax the employee's remuneration? Would the employer still be obliged to withhold employees' tax in the country where the employer is tax resident and/or is there a risk that it would also have to register as an employer in the foreign jurisdiction?

> "While a remote working arrangement could offer exciting opportunities for employers and employees alike, it is crucial for employers to carefully consider the risks that a more permanent cross-border remote working arrangement could have for the employer, before agreeing there to."

RELAXED STANCE MAY NOT LAST

During April 2020, the Secretariat of the Organisation for Economic Cooperation and Development (OECD) issued guidance regarding the interpretation of tax treaty concepts such as POEM and permanent establishments during the COVID-19 pandemic, when people were literally stranded overseas.

However, employers should keep in mind that the relatively relaxed stance many foreign jurisdictions and regulators adopted to remote working during the COVID-19 pandemic will not last. A return to "normality" also means a return to normal tax rules. While there does seem to be a realisation that the world of work of today is very different to that of the pre-pandemic world, the tax rules are still the ones that were created for such "old" world.

While a remote working arrangement could offer exciting opportunities for employers and employees alike, it is crucial for employers to carefully consider the risks that a more permanent cross-border remote working arrangement could have for the employer, before agreeing thereto.

Aneria Bouwer

Bowmans

Tags: permanent establishment; place of effective management (POEM); tax-withholding obligation.

EXPATS TAX RESIDENCY

The South African Revenue Service's (SARS') focus on South Africans abroad was first revealed in the 2017 Budget Speech.

SARS' reasons were only revealed in the pursuant parliamentary debate, where in the Q&A session it was shared that National Treasury and SARS had been keeping a close eye on expatriate tax compliance. Statistics of SARS and the South African Reserve Bank (SARB) painted a compelling picture of widespread non-compliance among South Africans who had left the country with a permanent intention.

CEASING SOUTH AFRICAN TAX RESIDENCY PRE-2022

South Africa operates on the generally accepted worldwide best practice principle of a residency basis of taxation. The rule is very simple, when a person is tax resident, they have to disclose their worldwide income to SARS.

Furthermore, many of the assets in the estate of a person who is ordinarily resident on death are subject to estate duty, which is 20% on the first R30 million and 25% on the dutiable value of the estate above R30 million. The person is also liable for donations tax and is subject to deeming and anti-avoidance provisions contained in our tax law.

Where a person is non-resident for tax purposes, many of these rules no longer apply to them. The question is: how does one get SARS to acknowledge that a taxpayer is non-resident for tax purposes?

Previously there was an SARB process, which required that an Emigration Tax Clearance Certificate be obtained, which later was called an Emigration Tax Compliance Status (TCS) PIN. Late in the 2021 calendar year, SARS started to issue, or decline, a Certificate of Non-Residency as an additional step; this has become a golden ticket for anyone wanting to confirm their tax non-residency.

MISCHIEF RULE

There is, in tax law, the famous "mischief rule". This means that any new law or SARS action is typically explained by some mischief that the fiscus wants to address. Where SARS introduces a new step or verification, the prudent advisor will always have an understanding of the underlying reason for the change.

There appear to be at least two reasons why SARS has decided that expatriates require an additional step on ceasing their tax residency:

Abuse of the "tick box"

There appears to have been abuse of the SARS non-residency tick box, where the formal process of ceasing tax residency was ignored and expatriate tax returns were merely filed by ticking a box, declaring non-residency even where they had not factually done so.

SARS surprised tax practitioners and taxpayers with a move not seen before – they kept the "tick-box" declaration on the 2022 annual tax return form, but they do not allow the taxpayer on eFiling to tick the box!

Budget Speech warning

In the 2020 Budget Review, SARS directly addressed the increasing number of taxpayers ceasing residency and concerns around abuse of the system, confirming that they would be separating this process from the exchange control statuses of taxpayers, to allow for "strengthening the tax treatment" and in doing so creating a "more stringent verification process", "risk management test" with "certification of tax status".

This promise has certainly been met, and taxpayers applying for non-residency now must work through additional paperwork and a barrage of SARS status verification requests to cease their residency.

SARS AUTO ASSESSMENTS INTRODUCED A NEW STEP

As part of this project, SARS updated the income tax return forms, which we have seen is in certain cases to the detriment of compliant taxpayers. The cessation of tax residency "tick-box" now being greyed out on the return form, with additional new processing required to update the form, means that a taxpayer is no longer able to "simply tick the box" but rather needs to request an update to their SARS registered residency status on their Registration, Amendment and Verification (RAV01) form on eFiling. This is a process which must be followed and can result in a new audit of a person's tax affairs for residency confirmation.

Unfortunately, for the diligent taxpayer who previously underwent the "old" process to cease tax residency, their status has been reset as well. Thus, regardless of having ticked the box in prior returns or even acquiring a Tax Clearance Certificate for Emigration and SARB confirmation, it may still be necessary for a person to update their residency status to indicate their cessation date and file a non-resident tax return.

IN SUMMARY

The question which can be asked is whether the non-pulling through of a taxpayer's non-residency status is an IT glitch, the case of one hand not speaking to the other, or a deliberately planned step for enhanced compliance.

Nevertheless, it appears as though SARS has again shifted the goal posts on the formal declaration and updating of a taxpayer as a non-tax resident of South Africa. Fair warning was given in the 2020 Budget Review, in which a more stringent process was announced.

However, this unfortunately also impacts diligent taxpayers who may find themselves in a position where they need to again verify their non-resident position to submit annual tax returns, to ensure alignment with their factual status.

"South Africa operates on the generally accepted worldwide best practice principle of a residency basis of taxation. The rule is very simple, when a person is tax resident, they have to disclose their worldwide income to SARS."

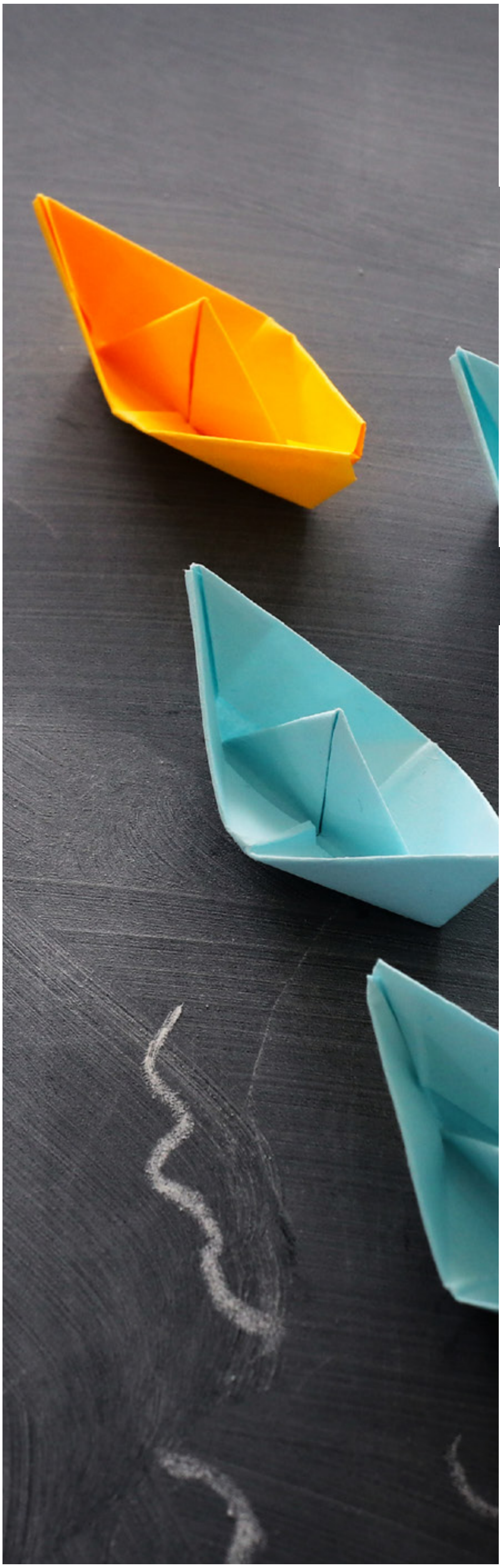
Nicolas Botha

Tax Consulting SA

Other documents

- *Emigration Tax Compliance Status PIN (Emigration Tax Clearance or Emigration Pin) (previously called: Emigration Tax Clearance Certificate);*
- *Certificate of Non-Residency.*

Tags: expatriate tax compliance; ordinarily resident; compliant taxpayers.



OFFSHORE FOUNDATIONS

A foundation is a specific entity type that has some of the characteristics of a trust and some of a company. It functions nearly the same as a trust but is administered like a company. Foundations exist as legal entities under various countries' regimes and are generally used to carry out charitable objectives."

We are seeing more and more instances where foundations are being used. This has raised the question as to how distributions from a foundation would be treated for South African tax purposes, and whether there are any potential tax benefits in using a foundation.

HOW IS A FOUNDATION TREATED FOR SA TAX PURPOSES?

As a foundation is not a concept dealt with in South African tax law, the first hurdle is to understand whether a foundation will be treated as a foreign company or a foreign trust for South African tax purposes.

The definition of a "company" in section 1(1) of the Income Tax Act, 1962, includes any association, corporation, or company incorporated under the law of any country other than South Africa.

A "trust", in contrast, is defined as "any trust fund consisting of cash or other assets which are administered and controlled by a person acting in a fiduciary capacity, where such person is appointed under a deed of trust or by agreement or under the will of a deceased person".

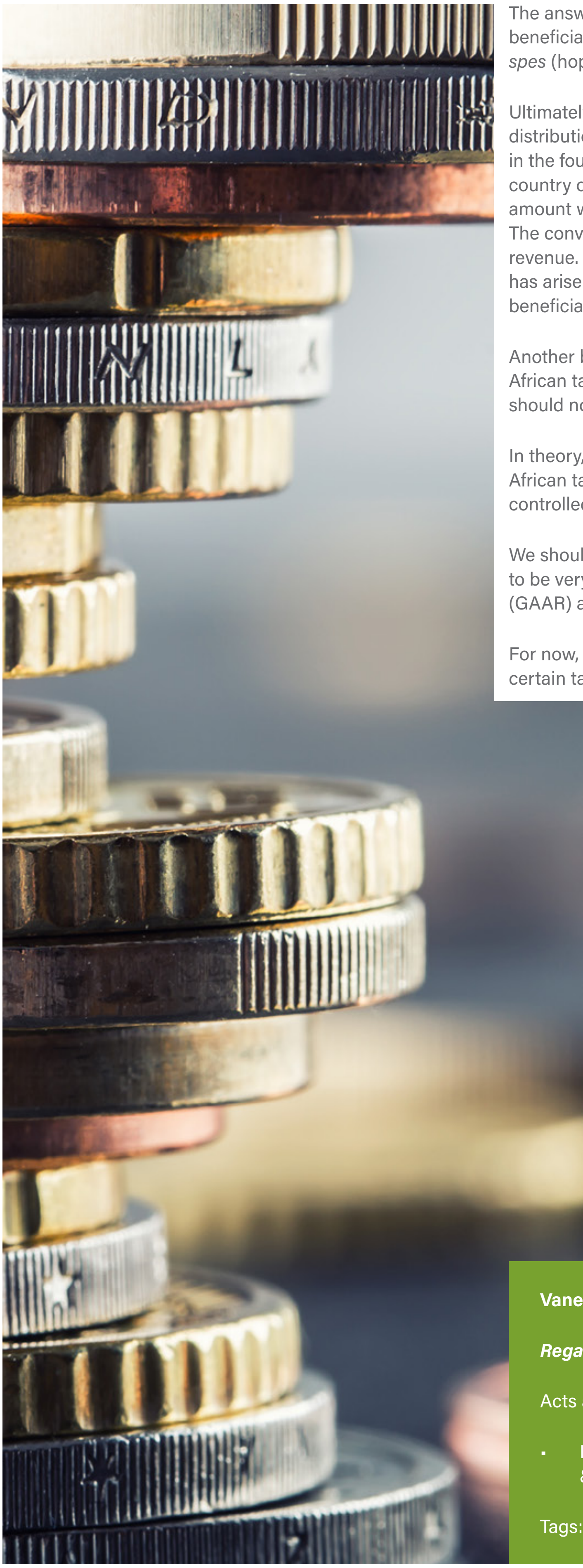
Based on the above definitions, the key distinguishing feature of a company is that it is incorporated, meaning that it is given legal status as a person. A trust is merely an arrangement, a non-person.

Foundations are, in most cases, seen as incorporated legal entities in the country in which they are established. This is certainly the case with a Mauritian or Isle of Man foundation.

Therefore, logic follows that, in most instances, a foundation should be seen as a foreign company for South African tax purposes.

HOW ARE DISTRIBUTIONS FROM A FOREIGN FOUNDATION TAXED IN SOUTH AFRICA?

But does this mean that distributions from a foundation will be classified as "foreign dividends" and taxed as such?



The answer is no. A foundation generally has no "shares"; therefore the beneficiaries of the foundation do not "hold" any "shares" but merely have a *spes* (hope) of a discretionary distribution.

Ultimately, the answer to the South African tax implications of any distribution from the foundation will follow how the distribution is regarded in the foundation's country of residence. For example, if the foundation's country of residence views the distribution as a capital payment, the amount will be classified as a capital receipt for South African tax purposes. The converse will also apply in that a revenue payment will be treated as revenue. In most instances, the distribution should be seen as capital which has arisen fortuitously for the recipient, resulting in no tax in the hands of the beneficiaries.

Another benefit of a foundation is that, if no "shares" are held by South African tax residents, the South African-controlled foreign company rules should not apply.

In theory, a foundation could provide the best of both worlds from a South African tax perspective, not having shares and therefore not falling foul of the controlled foreign company rules … but also not being a foreign trust.

We should caution though that where a foundation is used, taxpayers need to be very careful of any potential risks in terms of the general anti avoidance (GAAR) and substance over form rules.

For now, it seems that a foundation may offer some tax-planning benefits for certain taxpayers.

"As a foundation is not a concept dealt with in South African tax law, the first hurdle is to understand whether a foundation will be treated as a foreign company or a foreign trust for South African tax purposes."

Vanessa Turnbull-Kemp

Regan van Rooy

Acts and Bills

- Income Tax Act 58 of 1962: Section 1(1) (definitions of "company" & "trust").

Tags: foundation; incorporated legal entities.

FINAL DEMANDS FOR THIRD-PARTY NOTICES

The power of the South African Revenue Service (SARS) to collect tax from a taxpayer by way of issuing a notice to a third party holding assets belonging to a taxpayer, such as a bank holding a taxpayer's funds, is provided for in section 179(1) of the Tax Administration Act, 2011 (the TAA).

SARS may only issue the notice if it complies with the requirement in section 179(5), which is that it must deliver to the tax debtor (the taxpayer) a final demand for payment, which must be delivered at least 10 business days before the notice is issued. Importantly, the demand must contain the following:

- It must set out the recovery steps that SARS may take if the tax debt is not paid and the available debt relief mechanisms under the TAA, including in respect of recovery steps that may be taken under section 179.
- If the tax debtor is a natural person, the demand must state that the tax debtor may, within five business days of receiving the demand, apply to SARS for a reduction of the amount to be paid to SARS under section 179(1), based on the basic living expenses of the tax debtor and his or her dependants.
- If the tax debtor is not a natural person, the demand must state that the tax debtor may, within five business days of receiving the demand, apply to SARS for a reduction of the amount to be paid to SARS under section 179(1), based on serious financial hardship.

However, section 179(6) states that SARS need not issue a final demand under section 179(5) if a senior SARS official is satisfied that to do so would prejudice the collection of the tax debt. This provision, which has not been the subject of much interpretation by our courts, had to be considered in the judgment in *CRRC E-Loco Supply (Pty) Ltd v Commissioner for the South African Revenue Service*, [2022], handed down on 18 July 2022.

"SARS issued the third-party notices and recovered the funds in question without first issuing a final demand, as it submitted that section 179(6) applied."

FACTS

CRRC E-Loco Supply (Pty) Ltd (the taxpayer) was the subject of a tax audit conducted by a specialist unit of SARS that concluded there was *prima facie* evidence that the taxpayer had overstated the price of locomotives sold to Transnet as part of what has since become known as "State capture". As a result of the audit, the taxpayer had an assessed tax debt exceeding R3,6 billion, which had not been satisfied and only partial payment was achieved by SARS through the recovery of funds pursuant to the third-party notices issued by SARS in terms of section 179.

SARS issued the third-party notices and recovered the funds in question without first issuing a final demand, as it submitted that section 179(6) applied. This was done pursuant to a decision made by the head of SARS' Criminal and Illicit Economic Activities Division, who is a senior SARS official. He did this after considering a memorandum from SARS' Illicit Economy Unit. The total amount paid over to SARS in terms of the notices was in excess of R630 million.

The taxpayer brought a review application before the High Court, seeking to have SARS' decision to issue the third-party notices set aside on the basis that SARS did not comply with section 179(5) and was not entitled to rely on section 179(6) in the current instance.

PARTIES' ARGUMENTS AND JUDGMENT

SARS gave a number of reasons for its decision to issue a third-party notice in terms of section 179(6), that is, without first issuing a final demand, which the court considered.

SARS submitted that it was dealing with a dishonest taxpayer, relying on the *prima facie* evidence of large-scale corruption committed by the taxpayer in its dealings with Transnet as part of the reasons for its conclusion. SARS also alleged that there was *prima facie* evidence of tax fraud in excess of R4 billion on the part of the taxpayer based on the taxpayer substantially understating its tax liability in its returns for the 2013 to 2018 tax years, with the taxpayer also allegedly not giving adequate responses when information was requested in the course of the tax audit. SARS further alleged that the taxpayer reneged on its commitment to issue guarantees. Specifically, this relates to a blocking order by the South African Reserve Bank that was lifted and SARS obtained a preservation order in respect of the blocked funds, but for them to be released if the agreed guarantees were furnished.

SARS further alleged that the taxpayer was not prejudiced by the recovery of funds in light of the preservation order as the taxpayer was not trading. Furthermore, it argued that it had a duty to recover taxes and that the taxpayer had an opportunity to be heard in accordance with the *audi alteram partem* principle, in light of the ongoing correspondence between the parties.

In response, the taxpayer's attorneys argued in an affidavit that the reasons for SARS' decision in this instance did not constitute reasonable grounds and that without such grounds the decision was not rational and open to review. The court noted that the taxpayer did not provide any direct evidence in support of its application, but only by way of its attorneys' affidavit.

In the court's view, SARS' allegations regarding dishonesty, tax fraud and breach of guarantee commitments were largely left uncontroverted and the taxpayer failed to demonstrate a *bona fide* dispute in respect of these allegations. The court found that the risk or jeopardy of a tax debt by a delinquent taxpayer who might transfer the funds abroad creates such a reasonable fear that it justifies an avoidance of the risk by having the third party's banks pay the funds over to SARS.

The court found that SARS' reliance on specific parts of the judgment in *Hindry v Nedcor Bank Ltd and Another*, [1999], was correct, as they were relevant to the current dispute, despite the fact that that decision dealt with section 179 of the TAA's predecessor. As such, the court found that the taxpayer's complaint of unfairness and alleged non-application of the *audi alteram partem* principle was not justified.

In conclusion, the court found that the senior SARS official authorising the third-party notices had sufficient grounds to justify the decision to issue the notices without a final demand as contemplated in section 179(6).

COMMENT

The judgment is important as it gives valuable insight into the interpretation of section 179(6). Considering the facts of the case, it is clear that the alleged conduct of the taxpayer was serious enough to justify SARS' decision and for the court to find that it complied with section 179(6). It seems reasonable for the section to be applicable in the face of such serious alleged unlawful conduct on the part of a taxpayer.

While it is understandable that SARS has the power to issue a third-party notice under section 179(1), generally speaking, the power to issue one under section 179(6) without a final demand (and collect tax) is arguably a power that should not be too easily exercisable, considering the potentially devastating impact it can have on a taxpayer's business. The judgment seems to suggest that it must be clear that issuing a final demand first would prejudice the collection of a tax debt, so that it would lead the taxpayer to, for example, attempt to withdraw funds from his bank account or transfer them to avoid implementation of the subsequent third-party notice issued.

The case under discussion is an exception in that most of the reported judgments on section 179 have dealt with SARS' failure to adhere to the final demand requirement in section 179(5). There have been a number of judgments which have been decided in favour of taxpayers where SARS has not fully complied with the requirements of section 179.

> "SARS issued the third-party notices and recovered the funds in question without first issuing a final demand, as it submitted that section 179(6) applied."

Louis Botha

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: section 179 (more specifically subsections (1), (5) & (6)).

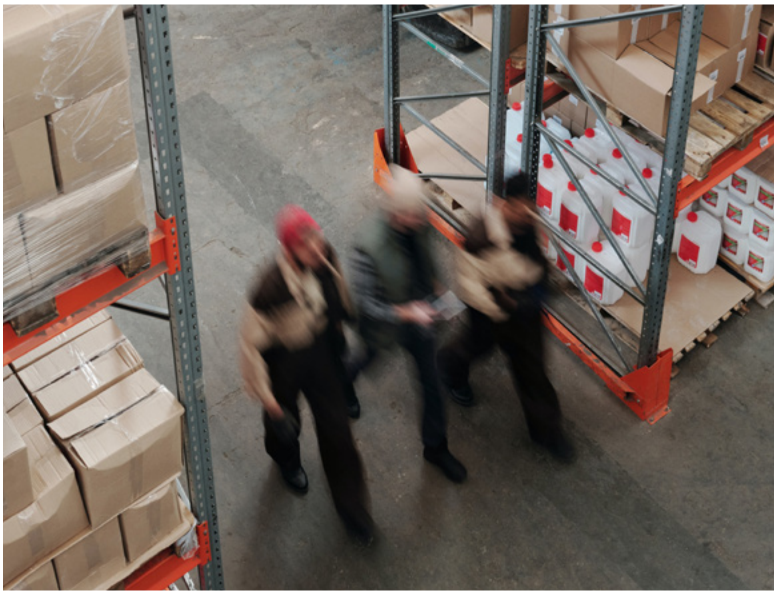
Cases

- *CRRC E-Loco Supply (Pty) Ltd v Commissioner for the South African Revenue Service* (37766/2021) [2022] ZAGPPHC 527 (18 July 2022);
- *Hindry v Nedcor Bank Ltd and Another* [1999] (2) SA 757 (W).

Tags: debt relief mechanisms; tax debtor; assessed tax debt; third-party notices; audi alteram partem principle.

FORUM SHOPPING: *FORGE PACKAGING V CSARS*

There are various rules and procedures in place to ensure a streamlined approach to disputing assessments issued by the South African Revenue Service (SARS). One such rule can be found in section 105 of the Tax Administration Act, 2011 (the TAA), which provides that where a person intends to dispute an assessment, the assessment may not be disputed in any court or other proceedings except in terms of Chapter 9 of the TAA and the Tax Court Rules (promulgated under section 103 of the TAA), unless the High Court otherwise directs.



Practically, this means that an appeal against an assessment must be heard by the tax court, if it is not resolved at the objection phase or in terms of the ADR process provided for in the Tax Court Rules.

However, the section does not prohibit a taxpayer from reviewing in the High Court a decision made by SARS or an assessment issued by SARS. The interpretation of this section is important as the simultaneous consideration of the dispute in the tax court and the High Court could potentially give rise to unwanted delays or the unnecessary fragmentation of a matter.

This was a focal issue in the matter of *Forge Packaging Proprietary Limited v The Commissioner for the South African Revenue Service,* [2022]. In this case, the High Court had to determine, amongst other things, whether it was appropriate for Forge Packaging Limited (the applicant) to seek a review in the High Court without relying on the provisions of section 105 of the TAA.

BACKGROUND

On 31 June 2018, SARS issued the applicant with a letter indicating that its return of income for the 2016 tax year had been selected for verification. The verification procedure involved requesting that the applicant verify the information provided in the return against the information the applicant already had to ensure that the return was an accurate reflection of the applicant's tax position.

Following the applicant's confirmation of the information provided, SARS issued an additional assessment for the 2016 tax year, which led to an additional revision of the assessments for the 2014 and 2015 tax years. Ultimately, SARS' adjustments to these assessments led to the imposition of hefty understatement penalties.

The applicant disputed the additional assessments on the grounds that no adequate reasoning was provided for issuing them. A notice of appeal was submitted by the applicant, after which SARS furnished its statement of grounds of assessment and opposing appeal in terms of Rule 31 of the Tax Court Rules.

The applicant failed to submit its statement of grounds of appeal, in terms of Rule 32, and instead brought an application in the tax court for the judicial review and setting aside of the additional assessments. SARS in response made an application in terms of rule 42 of the Tax Court Rules to strike out the review application as an irregular step.

Cloete J presided over the matter in the tax court and found in favour of SARS, that the review application was an irregular step. In addition, Cloete J granted an order to stay the appeal pending the determination of equivalent review proceedings to be instituted by the applicant in the High Court within 30 calendar days of the date on which the stay was granted. The High Court explained that the applicant accordingly was prosecuting the current application in the High Court parallel to the appeal in the tax court with the same aim to set aside the additional assessments.

SARS opposed the applicant's review application on the following grounds:

1. It was instituted outside the timeframe provided in terms of the order by Cloete J in the tax court.
2. There was an unreasonable delay in the institution of the review proceedings as the proceedings were brought outside the 180-day limit provided for in section 7 of the Promotion of Administration of Justice Act, 2000.

"The High Court held that even if the issues for determination were solely issues of law, hearing the review application would lead to an unnecessary fragmentation of this matter."

3. The review was based on the misguided premise that the applicant was subject to an audit in terms of section 42 of the TAA when SARS alleged that it conducted an income tax verification as opposed to an audit.

4. The applicant had failed to obtain the necessary direction from this court in terms of section 105 of the TAA permitting it to bring this application.

SECTION 105 OF THE TAA

The High Court interpreted section 105 as requiring the applicant to first pursue the ordinary course, that being the proceedings available under Chapter 9 of the TAA and the Tax Court Rules, unless this default route would be less appropriate. The High Court noted that one of the well-recognised situations in which it would exercise its jurisdiction in tax matters is where the question before the court relies wholly on a point of law. In this regard, the High Court relied on the judgment in *Absa Bank Ltd and Another v Commissioner, South African Revenue Service,* [2021].

In trying to decipher whether a question of law was before the court, the applicant alleged that SARS' non-compliance with section 42 was a matter of law. This concerned whether the information-gathering exercise SARS conducted was a verification, as SARS alleged, or an audit. The High Court disagreed as SARS' alleged non-compliance with section 42 was only one of the issues in the applicant's appeal pending before the tax court. Though SARS alleged it to be a verification, while making the necessary exchanges of statements in preparation for the appeal in the tax court, in its statement of grounds of assessment and opposing appeal, the terminology used by SARS was that of "audit". Evidence in this case would be required to determine which specific exercise SARS was engaging in. The High Court held that even if the issues for determination were solely issues of law, hearing the review application would lead to an unnecessary fragmentation of this matter. It explained that should it rule unfavourably for the applicant on a point that is also subject to a pending appeal in the tax court, uncertainty would arise on whether the tax court should follow suit with the High Court's finding or proceed to make its own finding, which would lead to further uncertainty amongst the parties.

Importantly, the High Court found that the applicant would be entitled to rely on SARS' alleged non-compliance with section 42 in its tax court appeal, provided it is able to provide proof of this non-compliance, by way of a defensive or collateral challenge to the legality of SARS' decision. In making this finding, it relied on the well-known *Oudekraal Estates decision,* [2010], and the High Court's finding in *South Atlantic Jazz Festival (Pty) Ltd v Commissioner, South African Revenue Service*, [2015], where it was held that the tax court is competent to decide such a collateral challenge as an incident of the appeal.

COMMENTS

In understanding the Legislature's intention behind section 105, one should keep in mind the decision in *Rossi and Others v the Commissioner for the South African Revenue Service,* [2011],, where the court considered the predecessor provisions to section 105 of the TAA and held that it was never the intention for the Legislature to create competing and concurrent forums for a resolution of tax disputes. Rather, it is to have various forums that operate in tandem with one another to ensure the efficiency of the judicial system and service delivery. As noted by the High Court in the case at hand, instituting a review application in the High Court while a parallel proceeding is underway at the tax court, both of which aim to set aside the same additional assessments, would not only undermine court procedure but create unreasonable delay to the resolution of tax disputes for the parties involved.

The High Court's judgment is also helpful in providing further assistance regarding the practical application of section 105 and making it clear that taxpayers can rely on section 42 to challenge the validity of an assessment before the tax court.

Esther Ooko & Louis Botha

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 42, 103 & 105; Chapter 9 (sections 101–103);
- Promotion of Administration of Justice Act 3 of 2000: Section 7.

Other documents

- Tax Court Rules (promulgated under section 103 of the TAA): Rules 31, 32 & 42.

Cases

- *Forge Packaging Proprietary Limited v The Commissioner for the South African Revenue Service* (21634/2021) [2022] ZAWCHC 119 (13 June 2022);
- *Absa Bank Ltd and Another v Commissioner, South African Revenue Service* [2021] (3) SA 513 (GP);
- *Oudekraal Estates (Pty) Ltd v City of Cape Town and Others* [2009] ZASCA 85; [2010] (1) SA 333 (SCA);
- *South Atlantic Jazz Festival (Pty) Ltd v Commissioner, South African Revenue Service* [2015] (6) SA 78 (WCC);
- *Rossi and Others v the Commissioner for the South African Revenue Service* [2011] 74 SATC 387.

Tags: understatement penalties; statement of grounds of appeal; income tax verification.

IT14SD FORMS NO LONGER REQUIRED

The South African Revenue Service's (SARS') core function is the efficient and effective administration of tax Acts.

This necessarily includes the collection of the proper amount of tax from various taxpayers. Part of the means at SARS' disposal to ensure that this is achieved, is requiring taxpayers to submit relevant information, augmented by data collected from third-party entities. A further mechanism at SARS' disposal to ensure that the information received is complete and correct, is the investigatory powers granted to SARS under Chapter 5 of the Tax Administration Act, 2011 (TAA).

A familiar part of the tax administration process for corporate taxpayers is the preparation and submission of a corporate income tax supplementary declaration form titled IT14SD (IT14SD). In this form, companies selected for verification by SARS are required to reconcile income tax, value-added tax (VAT), Pay-As-You-Earn (PAYE) and customs declarations after the submission of their corporate income tax returns.

With effect from 16 September 2022, SARS is no longer issuing or accepting IT14SD forms. This includes IT14SD forms outstanding at that date, in which case the verification process will proceed under the new regime.

WHAT IS VERIFICATION?

SARS' verification procedure entails a face value assessment of what has been declared by the taxpayer in their tax returns, against other sources of information such as the supporting documents submitted by the taxpayer and third-party information collected by SARS. The overall intention is to ensure that the return accurately reflects the tax position, as evidenced by such supporting documents or third-party information.

SARS' authority to conduct verifications of income tax returns is rooted in section 40 of the TAA, which empowers SARS to "select a person for inspection, verification or audit on the basis of any consideration relevant for the proper administration of a tax Act, including on a random or a risk assessment basis".

EFFECT OF THE CHANGE

Previously, SARS would initiate the verification procedure by issuing a notice of verification of income tax return (Verification Notice) identifying the return which is subject to verification. This letter would set out the information sought for verification and the timeframes envisaged for the verification process.

A taxpayer that received a Verification Notice could opt to submit a revised income tax return for the relevant period (provided the specific requirements for such a resubmission were met) or to submit an IT14SD, along with any relevant supporting material requested.

The IT14SD would require the taxpayer to complete the schedules relating to the various tax types, indicating the items of tax information required. For example, with corporate income tax, taxpayers would be required to indicate the net profit/loss and calculated profit/loss for the year of assessment, as well as the applicable debit and credit adjustments,

"The verification process, now that SARS will no longer utilise the IT14SD, remains largely unchanged in the other respects."

and thereafter where the reconciling differences exceed 1% of taxable profit/loss or R1,000, to provide details explaining the basis for such differences.

If the taxpayer fails to co-operate with the verification process, SARS could potentially issue a revised assessment based on the information at its disposal, which could in some instances result in the imposition of penalties.

The result following the completion of the verification process would depend on the outcomes of the process. Where no risks were identified a notice of finalisation of verification would be issued. If grounds for a revised assessment were uncovered during the verification, SARS could potentially issue a revised assessment. Alternatively, if additional risks were identified SARS could pursue an audit process.

The verification process, now that SARS will no longer utilise the IT14SD, remains largely unchanged in the other respects. SARS will continue to issue a Verification Notice setting out the timelines. The taxpayer retains the ability to submit a request for correction, allowing the submission of a revised tax return. Similarly, the failure to comply with the process and potential outcomes of the verification remain the same.

The principal difference under the new verification regime is that in the Verification Notice SARS will now request specific supporting documents targeted at addressing the particular risks which were the underlying reason for the taxpayer being selected for verification.

Although only a streamlined set of documentation will now be requested from the taxpayer, it is worth noting that the verification process will require the submission of a signed set of annual financial statements, and a detailed tax computation, accompanied by the underlying supporting documentation/schedules.

Taxpayers are able to submit the documents requested in the same manner which the IT14SD and any required supporting documents would have been submitted, being at a SARS branch, through the taxpayer's SARS eFiling profile, or through the online query portal on the SARS website.

COMMENT

SARS has indicated in its strategic plan for the 2023 tax year that a continuing part of its strategic vision as a revenue authority is to make tax compliance easy and streamlined. The jettisoning of the IT14SD as part of the verification process is in line with these objectives.

Taxpayers will now have to deal with a risk-based and targeted verification process, where they will be required to submit specified documentation. This means that taxpayers will not have to bear the administrative burden of completing the IT14SD form, which could require information regarding all the tax types for which a corporate taxpayer was registered. This reduction in the tax compliance burden should be a welcome development for corporate taxpayers.

[*Editorial comment*: The reconciliation that the IT14SD required a taxpayer to perform was nevertheless a useful mechanism to enable the taxpayer to reconcile its different taxes based on the same information. Taxpayers would be wise to continue to monitor that such reconciliations make sense.]

Tsanga Mukumba

Cliffe Dekker Hofmeyr

Acts and Bills

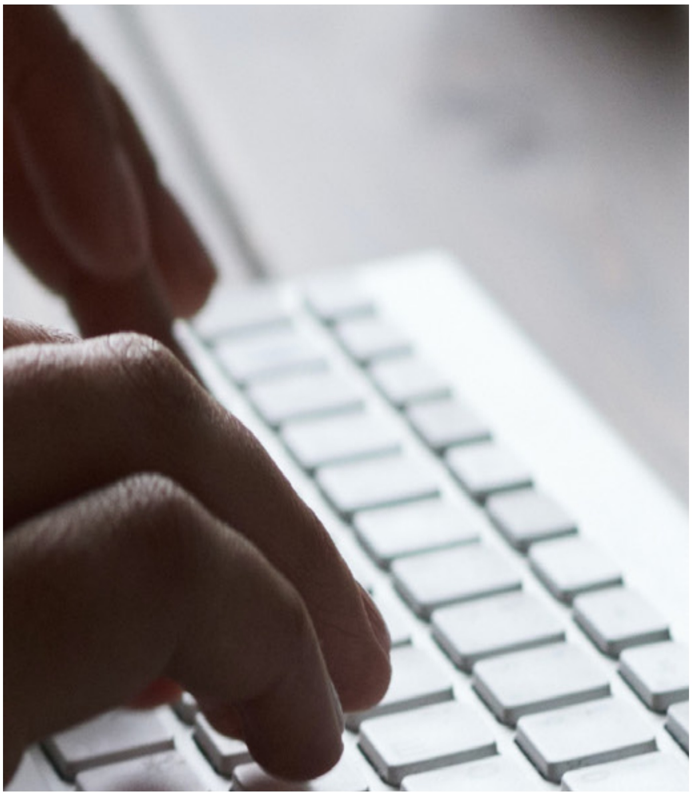
- Tax Administration Act 28 of 2011: Chapter 5 (sections 40–66 – more specifically section 40).

Other documents

- Corporate income tax supplementary declaration form titled IT14SD.

Tags: IT14SD forms; third-party information; notice of verification of income tax return.

SARS JOINT AUDITS



CROSS-BORDER TRANSACTIONS

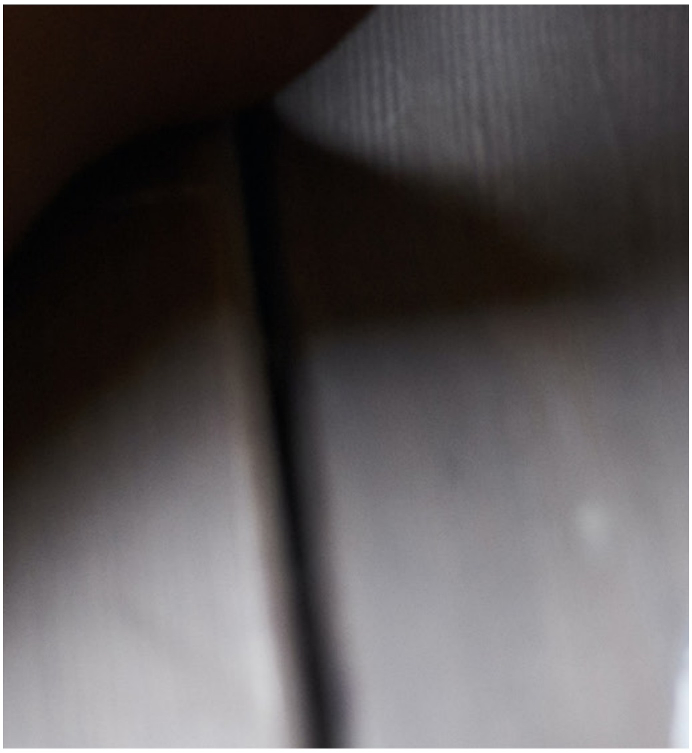
As a result of globalisation and the digitalisation of the economy, the number of South African taxpayers who engage in cross-border transactions and tax planning is on the rise. The South African Revenue Service (SARS) is forever on the lookout for ways in which it can limit or counter **cross-border tax avoidance** to protect South Africa's tax base.

During the 2022 Budget Speech, the Minister of Finance announced that National Treasury intends to introduce rules to enable SARS to conduct "joint audits" with foreign tax administrations. The aim is to improve the exchange of information to enhance co-operation between foreign governments in collecting tax to counter cross-border tax avoidance.

This article considers the exchange of information and reciprocal assistance measures in place under domestic and international tax law. It further explores possible amendments that could be expected to align our domestic framework for joint audits with international best practice.

MUTUAL ASSISTANCE MEASURES IN PLACE UNDER DOMESTIC LAW

South Africa's domestic legislation is limited to the exchange of information and reciprocal assistance provided for in international tax agreements, to enable SARS or its foreign counterparts to conduct unilateral tax investigations.



Upon request, SARS is obliged to co-operate with a foreign tax authority in respect of the exchange of information and/or the recovery of taxes if the foreign jurisdiction has concluded a double tax treaty or other form of international tax agreement with South Africa.

Although these measures currently enable SARS and foreign tax authorities to exchange information, only SARS officials are empowered to conduct unilateral tax investigations or audits in South Africa, once the information has been obtained from a foreign tax administration. There is no regulatory framework in place which enables SARS and a foreign tax administration to work together to conduct a joint audit into the tax affairs of South African taxpayers.

JOINT AUDITS

According to the Organisation for Economic Co-operation and Development's (OECD) *"Joint Audit 2019 Report – enhancing tax co-operation and improving tax certainty"* , a joint audit is understood as:

> "two or more tax administrations joining together to examine an issue(s)/transaction(s) of one or more related taxable persons (both legal entities and individuals) with cross-border business activities, perhaps including cross-border transactions involving related affiliated companies organised in the participating jurisdictions, and in which the tax administrations have a common or complementary interest, while proceeding in a pre-agreed and co-ordinated manner guaranteeing a high level of integration in the process and including the presence of officials from the other tax administration where the tax administrations jointly engage with the taxpayer, enabling the taxpayer to share information with them jointly and having Competent Authority representatives from each tax administration for the exchange of information included in each team".

The OECD's Joint Audit Report proposes recommendations in respect of a legal framework for joint audits in terms of a jurisdiction's domestic laws. Even though South Africa is not a member of the OECD, it actively participates in the various OECD initiatives and adheres to several OECD instruments in respect of cross-border transactions.

The recommendations in the OECD's Joint Audit Report would be a good starting point to expand South Africa's legal framework to enable joint audits in accordance with international best practices.

Considering the above, some of the key recommendations highlighted in the OECD's Joint Audit Report are briefly considered.

Case selection criteria: Clear guidance on the domestic case selection criteria for joint audits should be provided. It would not be appropriate to conduct joint audits in respect of all cross-border matters. The legislation should define the criteria that a case should meet to be suggested for a joint audit.

Reaction to joint audit requests: The legislation should provide for a procedure in terms of which joint audit requests are effectively communicated to all parties, especially in relation to the time periods of, and the reasons for, any decision taken by the tax authorities. The OECD recommends that a request for a joint audit may be declined if the requesting tax authority has not exhausted all domestic means of obtaining the required information.

Involvement of the taxpayer: The taxpayer must be involved in the joint audit process, and must be notified of a pending joint audit, the selection criteria applied, any face-to-face meetings, requests for information and the timeframes for providing information.

"South Africa's domestic legislation is limited to the exchange of information and reciprocal assistance provided for in international tax agreements, to enable SARS or its foreign counterparts to conduct unilateral tax investigations."

Taxpayers should receive regular progress reports and must have the right to be informed of the outcome of the joint audit. They should be given an opportunity to make representations before the joint audit is finalised.

Preparation for the audit process: Criteria for the composition of the joint audit team should be set. According to the OECD the team should at least consist of an assigned responsible joint audit co-ordinator acting as a single point of contact, a designated person to secure the exchange of information and audit team members from all participating tax jurisdictions (including subject matter experts if necessary).

Initial joint audit meetings must take place between the tax authorities to prepare a joint audit plan.

Conducting the audit: The tax officials involved in the joint audit must be authorised to issue collective requests for information. Foreign tax officials should be authorised to effectively participate within South Africa in the investigations or audits in conjunction with SARS officials.

In this sense clear provision should be made in respect of which activities may only be carried out by SARS officials, and which activities may also be carried out by foreign tax officials who form part of the audit team.

Completion of audit: Upon completion of a joint audit a final audit meeting should be arranged between the participating tax authorities and taxpayers. All aspects of the joint audit should be discussed at such meeting before the finalisation of a joint audit report, which should be shared with all interested parties.

CONCLUSION

Although the Minister of Finance, in his 2022 Budget Speech, announced that National Treasury intends to expand the domestic legal framework to enable SARS to participate in joint audits, no such amendments were proposed in the 2022 draft tax Bills which were published on 29 July 2022.

With the rising number of South African taxpayers engaging in cross-border transactions, it is expected that appropriate rules will eventually be introduced in future legislative cycles and when they are so introduced, they will most likely be in accordance with the OECD's recommendations.

"The tax officials involved in the joint audit must be authorised to issue collective requests for information."

Nicholas Fairbairn & Kelly Sease (reviewed by **Doelie Lessing**)

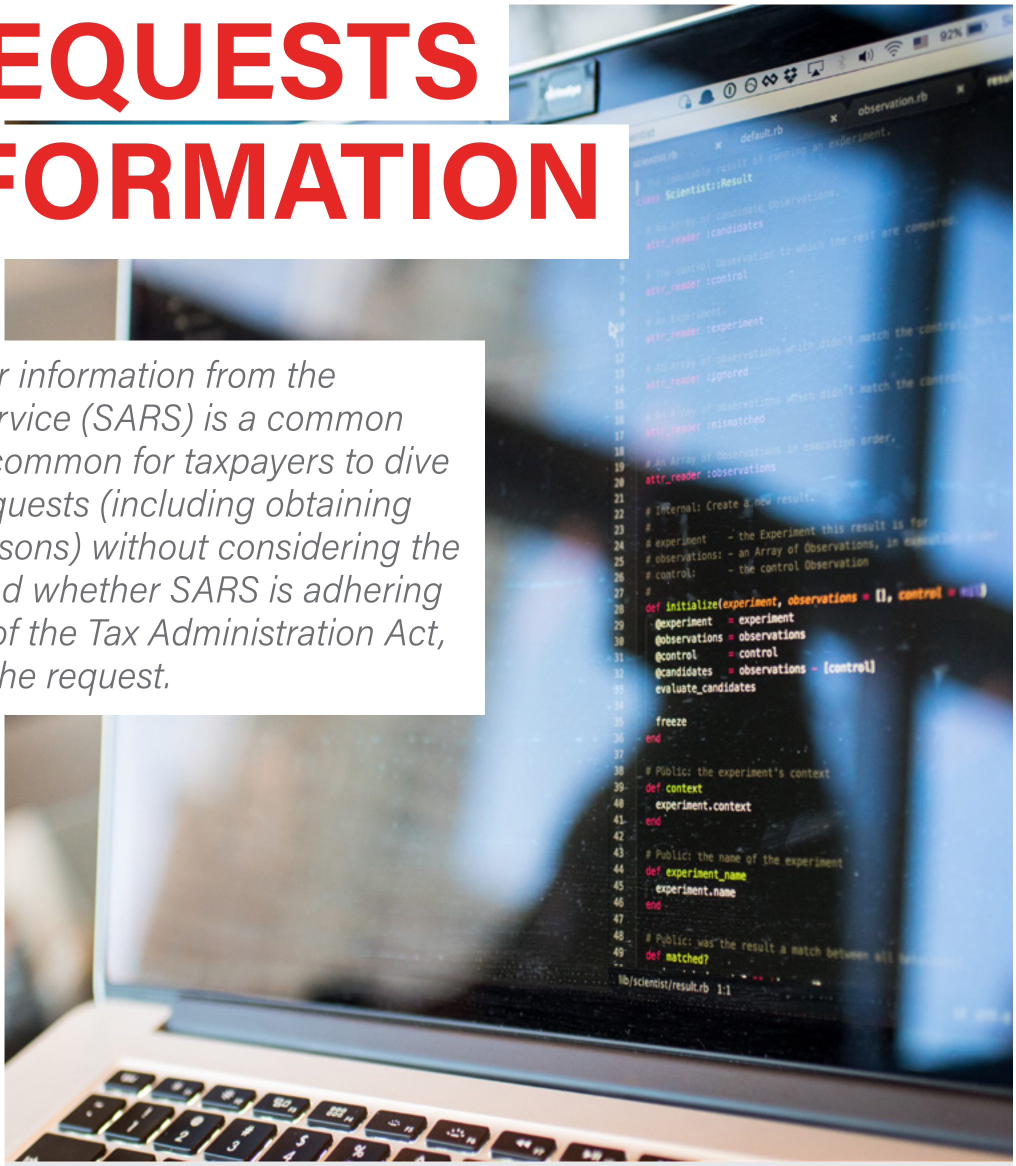
Werksmans Attorneys

Other documents

- *"Joint Audit 2019 Report – enhancing tax co-operation and improving tax certainty"* of the Organisation for Economic Co-operation and Development

Tags: cross-border tax avoidance; joint audits; international tax agreements.

SARS REQUESTS FOR INFORMATION



The receipt of a request for information from the South African Revenue Service (SARS) is a common occurrence, and it is also common for taxpayers to dive in and respond to such requests (including obtaining information from other persons) without considering the context of the response and whether SARS is adhering to the relevant provisions of the Tax Administration Act, 2011 (the TAA), in making the request.

Whilst it is true that SARS has very wide powers in fulfilling its mandate to collect tax, and that taxpayers should provide information to SARS and should not be obstructive in any way, the TAA sets out the parameters for requests for relevant material by SARS. Cognisance should be taken of these parameters before collating documents and information and preparing a response.

As a starting point, SARS may, for the purposes of the administration of a tax Act in relation to a taxpayer, whether identified by name or otherwise objectively identifiable, require the taxpayer (or another person) to, within a reasonable period, submit relevant material (whether orally or in writing) that SARS requires. They may also require that the relevant material be provided under oath or solemn declaration.

The definition of "relevant material" is contained in section 1 of the TAA as "any information, document or thing that in the opinion of SARS is foreseeably relevant for the administration of a tax Act…". SARS' subjective view therefore determines the relevance of material and it may be difficult for a taxpayer to argue otherwise. In this context, SARS' *Short Guide to the TAA* states that the purpose of this construction is to avoid protracted debates as to SARS' entitlement to information.

The term "administration of a tax Act" has a lengthy and broad definition in section 3(2) of the TAA which includes, among other things, to obtain full information in relation to anything that may affect the liability of a person for tax in respect of a previous, current or future tax period, a taxable event or the obligation of a person (whether personally or on behalf of another person) to comply with a tax Act, to ascertain whether a person has filed or submitted correct returns, information or documents in compliance with the provisions of a tax Act and to determine the liability of a person for tax. The ambit is thus wide and is not limited to the conduct of an audit or investigation. This process is usually a precursor to an audit or investigation.

A person or taxpayer that receives a request for information must provide the relevant material to SARS at the place and in the format (which must be reasonably accessible to the person or taxpayer) within the time period specified in the request. However, as set out above, such a time period must constitute a reasonable period, and if the period stipulated by SARS in the information request is not reasonable, the recipient of the request may provide reasons to SARS why the period is not reasonable and indicate to SARS what it considers to be reasonable. In practice, SARS typically regards such a communication to be a request for an extension of the time period in terms of section 46(5) of the TAA, which provides that SARS may extend the time period for the submission of the relevant material if reasonable grounds for an extension exist.

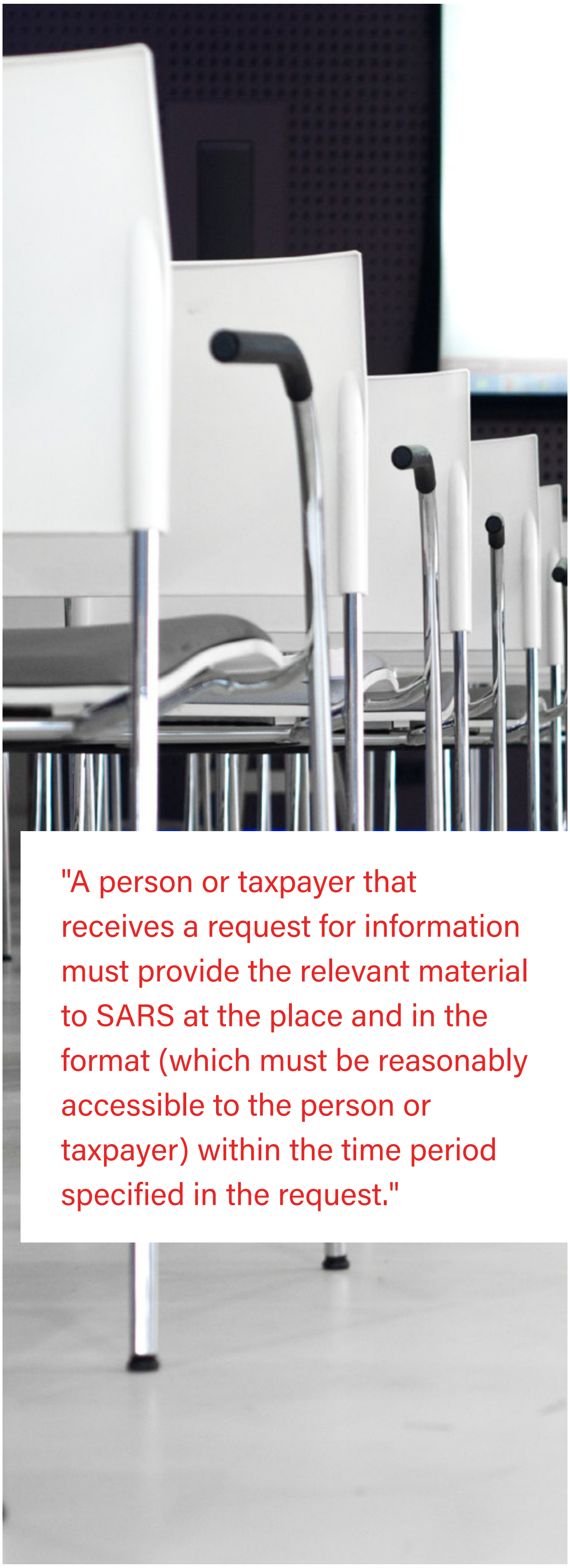
There is a difference between questioning the reasonability of the period stipulated by SARS in the request as opposed to requesting an extension in terms of section 46(5), but in our experience this nuance does not have a significant impact. In particular, in practice, SARS is usually amenable to granting an extension if a reasonable motivation is provided and where the volume of the information requested justifies this, even granting a further extension if properly motivated. The *Short Guide to the TAA* states that "…reasonable circumstances will depend on the facts and circumstances of the specific matter, such as the extent and availability of the relevant material required".

It is thus evident that SARS has wide powers to request information and, importantly, it must be noted that SARS may direct the request for information to the taxpayer or a person other than the taxpayer. However, the TAA provides that a request for information from a person other than the taxpayer is limited to material maintained or kept or that should reasonably be maintained or kept by the person in relation to the taxpayer. Accordingly, if the person that received the request does not have the information requested and it is unreasonable to expect such person to have the information (for example if the material is older than five years and has been destroyed in terms of document retention policies), that person is not obliged to obtain or gather information to comply with the request for relevant material.

A further qualification of the wide powers that SARS has in this regard is contained in section 46(6) of the TAA, which provides that the relevant material requested by SARS must be referred to with reasonable specificity. It is thus not sufficient for SARS to request information in a vague manner or to essentially embark on a "fishing expedition".

Another aspect that must be carefully considered is whether any of the material requested by SARS is subject to legal professional privilege, since, if this is the case, the person or taxpayer can assert that privilege applies and that they are not required to provide the material. This will typically arise in the context of legal advice such as tax opinions obtained from tax lawyers. However, section 42A of the TAA comes into play where legal professional privilege is asserted. It sets out the information that the person asserting privilege must provide to SARS, which is described by SARS as "…a basic set of information to enable it to determine whether a document is subject to legal professional privilege". It also provides for a procedure where SARS disputes the assertion of legal professional privilege. The Short Guide to the TAA states that the first objective of section 42A is to resolve the matter between SARS and the taxpayer, as opposed to starting with an adjudicative and generally more protracted process.

Taxpayers are also reminded of their right to administrative justice under the Constitution of the Republic of South Africa, 1996, which is given effect to in the Promotion of Administrative Justice Act, 2000 (PAJA). PAJA applies to administrative actions and decisions made by organs of state, including SARS, and broadly speaking requires that administrative actions that materially and adversely affect the rights of a taxpayer must, in the absence of exceptions provided for in PAJA, adhere to various fairness requirements. In enforcing the provisions of the TAA, SARS officials must act in a manner that is fair and reasonable, as PAJA applies to such actions, unless an exception applies or if the provisions of the TAA in question are inconsistent with PAJA. An unreasonable exercise of a power or performance of a function is a ground for review.



"A person or taxpayer that receives a request for information must provide the relevant material to SARS at the place and in the format (which must be reasonably accessible to the person or taxpayer) within the time period specified in the request."

Depending on the circumstances, a review application under PAJA is a course of action that may be considered.

Finally, it is a criminal offence if a person wilfully or negligently fails to furnish, produce or make available any information, document or thing as and when required under the TAA or if a person wilfully fails to reply to or answer truly and fully any questions put to the person by a SARS official as and when required in terms of the TAA. Therefore, while the recipient of a request for relevant material must ensure that they comply with their obligations in terms of the TAA in relation to the request, it is important for the recipient to first carefully consider the aspects highlighted above before penning a response to SARS.

"Finally, it is a criminal offence if a person wilfully or negligently fails to furnish, produce or make available any information, document or thing as and when required under the TAA or if a person wilfully fails to reply to or answer truly and fully any questions put to the person by a SARS official as and when required in terms of the TAA."

Nicolette Smit

ENSafrica

Acts and Bills

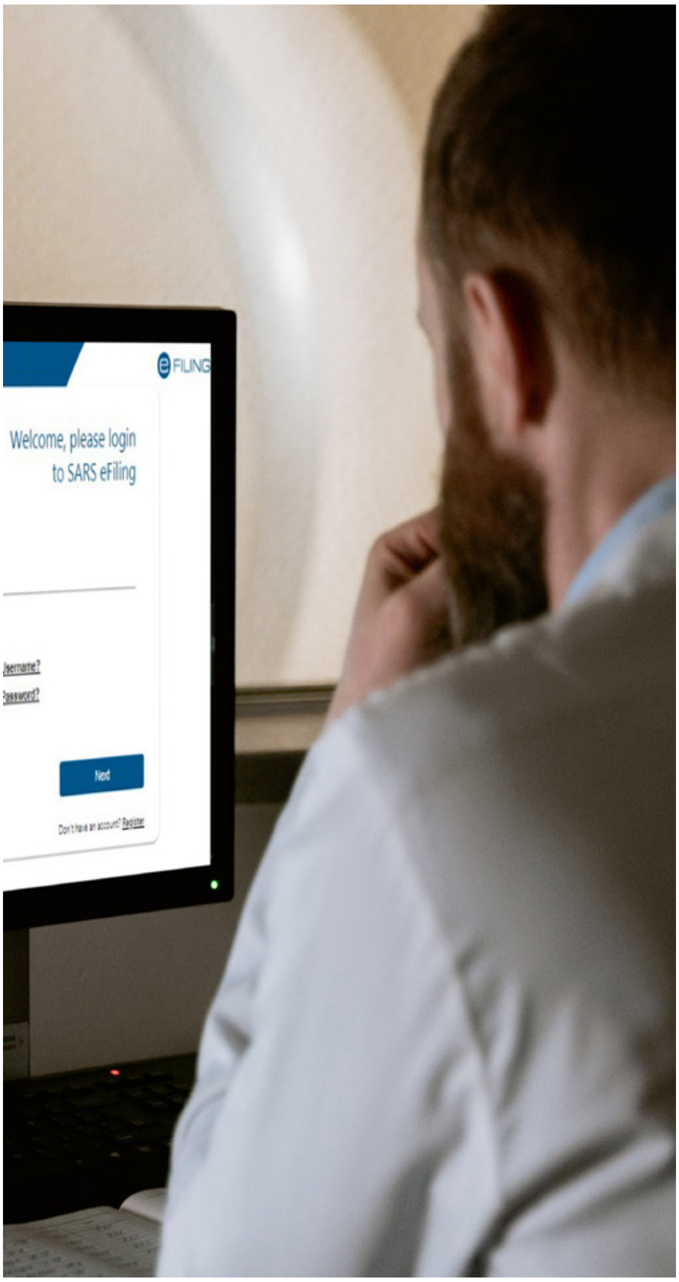
- Tax Administration Act 28 of 2011: Sections 1 (definition of "relevant material"), 3(2) (definition of "administration of a tax Act"), 42A & 46(5) & (6);
- Promotion of Administrative Justice Act 3 of 2000;
- Constitution of the Republic of South Africa, 1996.

Other documents

- *SARS Short Guide to the Tax Administration Act, 2011.*

Tags: relevant material; administration of a tax Act; taxable event.

FOREIGN EMPLOYERS WITH REMOTE WORKERS SITUATED IN SOUTH AFRICA



While many of us are still grappling with the aftermath of the global COVID-19 pandemic, some good things have emerged from a society placed under pressure. For one, remote and hybrid working arrangements became a new norm thanks to the fast-tracking of digital advances, making these types of arrangements increasingly viable.

When the tax implications of employing staff in a foreign country are explored, much attention is usually given to the income tax and employees' tax implications for the employer. However, the VAT implications are often overlooked. From a South African viewpoint, foreign employers of South African based employees should be mindful of the risk of creating a VAT enterprise in South Africa which could result in the foreign business having to register as a VAT vendor and submit VAT returns to the South African Revenue Service.

South Africa's VAT system largely follows the international norm of the destination principle, ie, to tax goods or services that are consumed within the borders of South Africa. Under the destination principle, exports are free of VAT and imports are taxed on the same basis and at the same rate as domestic supplies. That being said, the trigger for any business to register as a VAT vendor rests on the very broad definition, in section 1(1) of the Value-Added Tax Act, 1991, of what constitutes an "enterprise". An entity is regarded as carrying on an enterprise in South Africa if it carries on activities in or partly in South Africa, on a continuous or regular basis and in the course or furtherance of which goods or services are supplied for a consideration. Such an entity would be required to register as a VAT vendor if the total value of its goods and / or services supplied in South Africa exceeds, or will, in terms of a contractual obligation in writing, exceed, R1 million in any consecutive 12-month period.

The definition of what constitutes an "enterprise" is extremely wide. However, no clear guidance exists on how it should be interpreted. Much of it rests on how the terms "in or partly in South Africa" and "continuous or regular basis" are interpreted. Specific rules have been introduced which apply to foreign suppliers of electronic services, bringing such foreign suppliers into the South African VAT net.

These rules deem a foreign supplier of electronic services to be carrying on an enterprise in South Africa if two out of three criteria are met, being that –

- the recipient of the services is a resident of South Africa;
- payment for the service originates from a South African bank; or
- the recipient has a business or residential or postal address in South Africa.

The concept of "electronic services" is widely defined and includes any services supplied for a consideration by means of an electronic agent, electronic communication, or the internet.

In the digital world in which we live, the rules around foreign electronic service providers will apply to most instances where foreign entities are rendering services to South African customers.

However, there will be instances where these rules will not be applicable as the service itself may not be an "electronic service" as defined, but rather a service physically rendered by an employee stationed in South Africa. It is in these circumstances that we need to carefully consider whether such an employee's presence creates a VAT enterprise for the foreign employer entity. The mere presence of an entity's employees in South Africa by itself is not sufficient to create a VAT enterprise. The facts of each case should be considered and, in particular, also the role and function of such employees. In considering the facts of each case, we should keep in mind that the broad aim of South Africa's VAT legislation is to tax goods and services that are consumed within the country.

The actual activities performed by the employees are therefore far more important than considering whether such employees are working from a branch or office of the foreign entity, or from their home office. Typically, employees that are tasked mainly with administrative or support functions would not create a VAT enterprise for the foreign entity as it is unlikely that such employees are rendering services which are being consumed by South African customers. However, activities of client facing staff based in South Africa pose a significant risk, as such employees are likely providing services to customers located within South Africa, meaning that consumption of services is taking place in South Africa. If the consideration received by the entity from such services rendered by employees stationed in South Africa exceeds, or is expected to exceed, R1 million in any consecutive 12-month period, the foreign entity would be required to register as a VAT vendor.

"From a South African viewpoint, foreign employers of South African based employees should be mindful of the risk of creating a VAT enterprise in South Africa which could result in the foreign business having to register as a VAT vendor and submit VAT returns to the South African Revenue Service."

Reinette Theart

Crowe

Acts and Bills

- Value-Added Tax Act 89 of 1991: Section 1(1) (definitions of "electronic services" & "enterprise").

Tags: VAT enterprise; VAT vendor; enterprise; electronic services.

THE INTRICACY OF CLAIMING VAT DEDUCTIONS

The entitlement of a vendor to claim a deduction of input tax or to claim a deduction of a notional amount is a central feature of the South African VAT system.

In order for an amount to comprise "input tax", the amount must meet the following requirements:

- The supplier who supplied the goods or services must have charged VAT in terms of section 7 of the Value-Added Tax Act, 1991 (the VAT Act);
- the goods or services must have been supplied to the vendor claiming the amount as input tax;
- the goods or services concerned must have been acquired by the vendor (ie, the recipient); and
- the goods or services must have been acquired wholly or partly for the purpose of consumption, use or supply in the course of making taxable supplies.

This article briefly explores some of the landmark judgments that have been handed down by the Supreme Court of Appeal (the SCA) pertaining to the claiming of an input tax deduction or a deduction of a notional amount by a vendor. What is manifest is that the judgments have put paid to the maxim that all VAT incurred on goods or services acquired is claimable in full as an input tax deduction, even in cases where a business is a fully taxable vendor; in a similar vein, even in businesses that are not fully taxable, the issue of claiming an input tax deduction or claiming a deduction of a notional amount, has received closer scrutiny from the SCA.

In *Commissioner for South African Revenue Service v De Beers Consolidated Mines Ltd,* [2012], the SCA took a practical approach and effectively looked at the "effect" that certain local and foreign services acquired by De Beers had on the enterprise of De Beers (which was the mining, marketing and selling of diamonds). The SCA ruled against De Beers and stated that the diamond business of De Beers was not enhanced and that the enterprise was not in the least affected by whether or not De Beers acquired the foreign services and that the local services acquired, simply enabled De Beers to comply with its legal/statutory obligations. It followed that the services were not acquired for the purpose of making taxable supplies by an enterprise that mines, markets and sells diamonds. Southwood AJA, in paragraph 51, said the following regarding the definition of "enterprise": "The primary question requires that there be clarity as to the nature of the 'enterprise' because the purpose of acquiring the services and whether they are consumed or utilised in making 'taxable supplies' can only be determined in relation to a particular 'enterprise'. What the 'enterprise' consists of is a factual question...."

In *Consol Glass (Pty) Ltd v The Commissioner for the South African Revenue Service,* [2020], the SCA endorsed the views of Southwood AJA by stating that it is essential in any VAT enquiry (when determining the deductibility of input tax) to identify at the outset the enterprise that the vendor is conducting. In the *Consol case*, the South African Revenue Service was able to convince the SCA that certain local and foreign services received by the vendor were not related to the vendor's taxable business (ie, its enterprise which was fully taxable).

In that matter, Consol sought to substitute its foreign funding for local funding in order to mitigate its financial exposure to the volatility of the rand. In short, Consol restructured its debt to more favourable terms and the SCA viewed the concomitant service provider fees incurred, to be otherwise than for the purpose of making taxable supplies; stated differently, the SCA denied the deduction of the VAT incurred by the vendor on local service provider fees, etc, as it considered that the refinancing of the debt did not have a functional link to the making of taxable supplies by Consol, ie, the manufacture of glass containers – the refinancing of debt was undertaken to reduce Consol's debt servicing costs and was not in the course or furtherance of its enterprise.

In the judgment of *Commissioner for the South African Revenue Service v Capitec Bank Limited*, on 21 June 2022, the issue before the SCA was whether Capitec was entitled to a deduction of a notional amount based on the tax fraction (ie, 15/115) of amounts paid in respect of loan cover provided to its customers in terms of section 16(3)*(c)* of the VAT Act (which it had received from its insurer and which were used to settle its customer's outstanding loan obligations due to the death or retrenchment of the affected customers). The determination of this issue was largely dependent on whether the loan cover that was provided to its customers by Capitec was a taxable supply, ie, whether it was supplied in the course or furtherance of Capitec's enterprise. The SCA held, among other things, that Capitec was not entitled to the deduction as the loan cover did not qualify as a taxable supply because no consideration was charged and the loan cover was linked to the unsecured lending business, which is an exempt supply, supplied in the course of providing credit (which did not form part of Capitec's enterprise).

While the factual matrix applicable to the said cases was very specific, the claiming of input tax deductions or the claiming of a deduction of a notional amount has become a challenging and often contentious issue. Legislatively, the vendor claiming such a deduction bears the burden of proving that the amount is deductible.

It is evident that the *Consol* case aligns itself with the *De Beers* case in that the SCA in both cases, when considering the deductibility of input tax on local services, etc, evaluated the totality of the transaction that gave rise to the acquisition of the said services; ie, was the enterprise impacted before and after the transaction and can it be said that there is a functional link between the expenditure incurred and the making of taxable supplies?

Furthermore, it is inferred that a vendor needs to look at the purpose as well as the effect of the services acquired to determine if there is a functional link to the making of taxable supplies (in other words, the "effect" must be demonstrable). Contentious areas associated with the claiming of input tax or a notional amount may include, but are not limited to –

- the raising of finance to effect company reorganisation transactions;
- the subsequent refinancing/restructuring of the initial debt;
- the financing of capital expenditure by the raising of debt;
- legal fees to institute or defend any judicial action; and
- payments made in terms of any indemnification provided to a counterparty.

Vendors need to take heed of the stance of the SCA regarding the, seemingly, parochial determination of whether a vendor has incurred a particular amount in the course or furtherance of that vendor's enterprise before a deduction is warranted, in the circumstances – vendors need to prepare for more scrutiny by SARS in this regard.

"This article briefly explores some of the landmark judgments that have been handed down by the Supreme Court of Appeal (the SCA) pertaining to the claiming of an input tax deduction or a deduction of a notional amount by a vendor."

Seelan Moonsamy & Charles de Wet

ENSafrica

Acts and Bills

- Value-Added Tax Act 89 of 1991: Sections 7 & 16(3)*(c)*.

Other documents

- Uniform Court Rules.

Cases

- *Commissioner for South African Revenue Services v De Beers Consolidated Mines Ltd (503/11)* [2012] ZASCA 103; [2012] (5) SA 344 (SCA) (1 June 2012) (a reference to paragraph 51);
- *Consol Glass (Pty) Ltd v Commissioner for the South African Revenue Service* (1010/2019) [2020] ZASCA 175 (18 December 2020);
- *Commissioner for the South African Revenue Service v Capitec Bank Limited* (94/2021) [2022] ZASCA 97; [2022] 3 All SA 641 (SCA) (21 June 2022).

Tags: input tax; notional amount; taxable supplies; loan cover.

sait South African Institute of Taxation