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B-BBEE EXPENDITURE

On 7 August 2020 SARS issued Binding Class Ruling 72 (BCR 72), in which it ruled on the tax deductibility of contributions by a group of employer companies to fund an employees' ownership trust to enable the trust to participate as a part shareholder of a newly established black-owned and -controlled property entity. It appears from the ruling that the taxpayer accepted that the transaction had a dual purpose – to obtain a favourable broad-based black economic empowerment (B-BBEE) status, and to incentivise employees.

The ruling is novel as SARS has ruled that 50% of the employer contribution by each group company is not tax deductible because it is of a capital nature. Taxpayers who claim that expenditure incurred in order to improve their B-BBEE scorecards would seek to rely on the decision in *Warner Lambert SA (Pty) Ltd v Commissioner, South African Revenue Service*, [2003], and may disagree with SARS' view.

In the *Warner Lambert* case, the taxpayer was required to incur social responsibility expenditure, as the subsidiary of an American parent company, in order to avoid sanctions in the United States of America, in terms of the Sullivan Code. SARS argued that the expenditure was of a capital nature and not tax deductible. However, the Supreme Court of Appeal disagreed, and held that the social responsibility expenditure was incurred in order to protect the taxpayer's income-earning structure and was therefore deductible.

SARS previously issued rulings, such as Binding Class Ruling 2, that acknowledge the deductibility of social responsibility expenditure incurred in order to improve a taxpayer's B-BBEE scorecard. In principle, there is no difference between the types of expenditure that are incurred in order to improve a taxpayer's B-BBEE scorecard. However, one factor that may have been taken into account by SARS is that the expenditure is incurred on a one-off basis, and may provide an enduring benefit to the group companies, especially bearing in mind that the contribution received was used to subscribe for shares in the holding company of each employer company.

"In conclusion, the deductibility of B-BBEE expenditure therefore remains uncertain, and should be carefully considered on a case-by-case basis."

This line of argument must be carefully considered, as the so-called enduring benefit test is meant to apply where the expenditure creates or preserves a capital asset in the hands of the taxpayer. In the circumstances found in BCR 72, there is no asset that is created or preserved (this was a decisive consideration for the revenue/capital test in *BP Southern Africa (Pty) Ltd v Commissioner, South African Revenue Service*, [2007]). In our view, contrary to BCR 72, there is an argument to be made that the full contribution should be deductible. In conclusion, the deductibility of B-BBEE expenditure therefore remains uncertain, and should be carefully considered on a case-by-case basis.

It should be borne in mind that binding rulings of all types (a) are binding on SARS only and not on the taxpayer, even in relation to the taxpayer to which the ruling has been given, and (b) neither SARS nor a taxpayer can cite any published ruling in any proceedings between them.

Werksmans

Editorial comment: Published SARS rulings are necessarily redacted summaries of the facts and circumstances. Consequently, they and articles discussing them should be treated with care and not simply relied on as they appear. Furthermore, a *binding class ruling* only applies to *SARS and the class referred to in the ruling*, and is published for general information. It does not constitute a practice prevailing. A third party may not rely on a class binding ruling under any circumstances. In addition, published binding class rulings may not be cited in any dispute with SARS, other than a dispute involving the class identified therein.

Other documents

- Binding Class Ruling 72 ("Deductibility of employment related expenditure, incurred as part of a B-BBEE ownership transaction and the PAYE treatment of interest-free loan to a share trust");
- Binding Class Ruling 2 ("Expenditure incurred on corporate social investment programmes").

Cases

- *Warner Lambert SA (Pty) Ltd v Commissioner, South African Revenue Service* [2003] (5) SA 344 (SCA);
- *BP Southern Africa (Pty) Ltd v Commissioner, South African Revenue Service* [2007] BIP 364 (SCA).

Tags: broad-based black economic empowerment (B-BBEE); social responsibility expenditure; tax deductibility.

TRAVEL ALLOWANCES DURING COVID-19

COVID-19 has far-reaching effects for the South African taxpayer and, unbeknown to many, may be silently increasing their tax liability for the 2021 year of assessment.

There is a causal link between travel allowances (and the same applies to company vehicles) received by employees in the current tax year, and for which business travel was not possible.

In this article the general taxing principles of a travel allowance and reimbursement of travel expenses claims are revisited; we also consider how COVID-19 may increase the tax burden of an employee.

The general taxing principles of a travel allowance and a reimbursive travel allowance

Travel allowance

The travel allowance "deduction" operates on the premise that an allowance is included in a person's taxable income (see section 8(1)*(a)*(i) of the Income Tax Act, 1962 (the Act)), to the extent that the allowance has not actually been expended on business travel (section 8(1)*(a)*(i)*(aa)*).

In summary, private travel is taxable and business travel is not taxable. Interestingly, the term "travel", whether for business or private purposes, as described in SARS Interpretation Note 14 (IN14), refers to travel by a "motor vehicle" defined as a "road vehicle powered by a motor or engine"; this would include a motor cycle.

The SARS External Guide for Employers in respect of allowances specifically states that:

> "A travel allowance is any allowance paid or advance given to an employee in respect of travelling expenses for business purposes. Any allowance or advance in respect of travelling expenses not to have been expended on business travelling … shall be deemed not to have been actually expended on travelling on business."

The SARS External Guide further stipulates that, where the employer is satisfied that at least 80% of the travel appertains to business mileage then only 20% of the allowance is subject to the deduction of employees' tax. Should this not be the case then the allowance should be taxed at 80% on the payroll.

There are currently only two inclusion percentages that should be applied on the payroll, namely the 80% or 20%. Since the release of the 2019 SARS BRS Change – Patch Phase 3, ("Business Requirement Specification Change") it should be noted that the 100% inclusion rate is no longer applicable and should therefore not be implemented on the payroll.

To explain this by way of a practical illustration:

- Should an employee incur 80% or more on business mileage per annum, the allowance should be taxed at 20%, ie, where it is proven that 20% or less of total mileage will be attributed to private use.

- Should an employee incur less than 80% business mileage per annum, irrespective of what that amount is, the allowance should be taxed at 80%, ie, where it is proven that more than 20% of total mileage is attributed to private use.

Reimbursive travel allowance

An alternative to providing an employee with a monthly travel allowance amount is to provide the employee with a reimbursive travel allowance. A reimbursive travel allowance is an allowance paid to an employee for actual business kilometres travelled, according to either the SARS determined rate – which is R3.98 per kilometre from 1 March 2020 – or as determined by the employer.

The taxing of the reimbursive allowance has fundamentally changed from 1 March 2018. Where an employee is reimbursed using a rate higher than the SARS prescribed rate, the differential between the SARS prescribed rate and the rate utilised by the employer will be subject to employees' tax (PAYE), regardless of the number of business-related kilometres travelled.

It is advisable that employers prudently consider their reimbursement rates against the prescribed rate. An unintended consequence of reimbursing an employee on a higher rate will be an increase in the employee's PAYE liability and this may result in lower employee take-home pay.

An alternative to avoid this possible occurrence would be for the employer to reimburse the employee at a rate not higher than the prescribed rate of R3.98 per kilometre. The reimbursement will not attract PAYE and will also not be taxable on the employee's personal tax return.

Some businesses have a golden rule when it comes to employee travel debates, ie company car v travel allowance v reimbursive structure: an apples-with-apples computation must always be done. This means your opinion is only valid once you have done the actual computation on what gives the tax optimal outcome.

Although the reimbursive changes have not altered an employee's ability to claim against a travel allowance, they have introduced an additional record-keeping requirement. This becomes especially complex if travel reimbursive rates have changed during the tax year.

On 5 May 2020, the Commissioner for SARS gave taxpayers a valuable insight into what can be expected in light of COVID-19. Although not stated expressly, with a grim outlook on the decrease in revenue collection, SARS will look to extract every cent possible from the tax base.

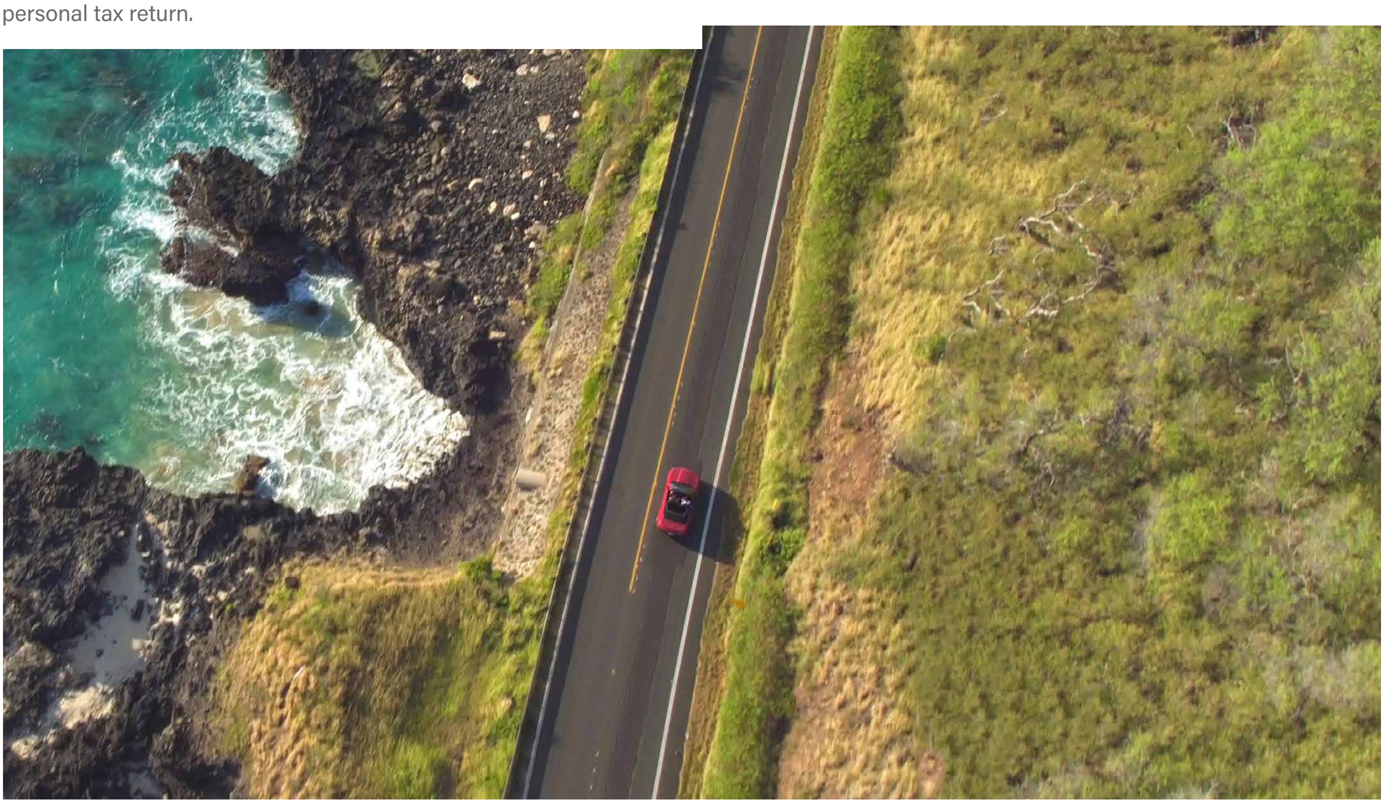
Building on their 2019 tax season approach, SARS will most likely enhance their robust stance on verifications and audits of tax returns. It is now, more than ever, particularly important to maintain an accurate and detailed travel logbook and to adopt good tax-filing and compliance strategies.

Must I own the vehicle or motorcycle?

In certain circumstances, employees who receive travel allowances can find themselves travelling with a vehicle that is not self-owned, for example a relative's motor vehicle. Will this disqualify the employee from claiming against the travel allowance?

No, it is not imperative that the car in question should be owned by the employee. Section 8 of the Act does not limit nor disallow the claim against the travel allowance in this instance.

Obviously, this can lead to an enquiry by the SARS auditor, who may perhaps check that no-one else is claiming on the same vehicle, in which case there would be some questions to answer.



"The Act does not define what is regarded as travel for business purposes, and what constitutes private use of a travel allowance."

Travel allowance with the right of use of motor vehicle

Where an employee receives a travel allowance and has made use of a company-provided car, a tax claim against the travel allowance (in terms of travel for business purposes) will not be allowed (section 8(1)*(a)*(i)*(aa)*).

This will raise a concern with the employee, as the use of a company motor vehicle is considered a taxable fringe benefit, in terms of paragraph 7(2)*(b)*) of the Seventh Schedule to the Act. Taxes on the fringe benefit may also be withheld at either 80% or 20% of the benefit.

Where the employee travels for business, and he or she receives a travel allowance and a company car, the following will apply:

Tax deduction against a right of use of motor vehicle

Although a deduction against a travel allowance is not possible under section 8, a reduction of the fringe benefit constituted by the use of an employer-provided vehicle can still be claimed. The claim against a fringe benefit under paragraph 7(2)*(b)*) has been worded in a similar way to the wording of section 8(1)*(a)*(i). The reduction of the fringe benefit operates on the premise that the fringe benefit should be excluded from a person's taxable income so far as it is expended on business travel.

In other words, the fringe benefit can be reduced to the extent that the benefit has been actually expended on travelling on business, and not on private travel. To reiterate: private travel is taxable and business travel is not taxable.

Similarly, the COVID-19 restrictions will have a direct impact on the business claim lodged against the fringe benefit. This may very well create an employee's tax exposure for those employers who apply the 20% rule and will cause an unwelcome surprise tax liability.

How does one prove or illustrate that travel was for business v private?

Section 8(1)*(b)*(iii) provides that:

> "where such allowance or advance is based on the actual distance travelled by the recipient in using a motor vehicle on business … or such actual distance is proved to the satisfaction of the Commissioner to have been travelled by the recipient, the amount expended by the recipient on such business travelling shall … be deemed to be an amount determined on such actual distance at the rate per kilometre fixed … in the *Gazette* for the category of vehicle used".

It is interesting to note that the word "logbook" is not specifically mentioned in the Act. Rather, reference is made to a travel allowance claim being allowed to a taxpayer that proves business distance travelled to the satisfaction of the Commissioner.

Nonetheless – and in practice – a taxpayer can discharge the onus of proof that travelling with a private vehicle was travel for business purposes through keeping a logbook and recording the necessary

information related to business travel (see IN14, paragraph 5.4.2). SARS has provided an acceptable format:

According to the SARS eLogbook Guide for 2019/2020 on the acceptable format, the bare minimum information required to claim a tax deduction is the following:

- The date of business travel
- The business kilometres travelled
- The business travel details (where to and the reason)

It is not necessary to keep record of the details of private travel. This format and the requirement to record only business kilometres travelled have remained consistent since the 2018 year of assessment.

This was not the case during the 2015, 2016 and 2017 years of assessments, according to the respective 2015, 2016 and 2017 SARS eLogbook Guides. The SARS eLogbook Guide for 2020/2021 continues the same theme of 2019/2020 and requires a record of business travel only – continuing to provide taxpayers with administrative relief.

Whilst the law does not specifically require a format in which the onus must be discharged, the SARS logbook format is generally recommended as the path of least resistance. Nonetheless, as long as the logbook can discharge the taxpayer's onus of proof it will be acceptable.

"In our experience, the deemed costs method requires less administration and is almost always more favourable than the actual costs method."

What is defined as business travel?

The Act does not define what is regarded as travel for business purposes, and what constitutes private use of a travel allowance. The "travel between home and work" exclusion has caused interpretation problems for as long as can be remembered.

The law clearly determines that private travelling includes "travelling between … place of residence and … place of employment or business" (section 8(1)*(b)*(i)).

To reduce the uncertainty, SARS published IN14, noting the examples below to distinguish between business and private travel. (These should only be used as a guideline. It must be noted that SARS is not bound by Interpretation Notes and may deviate from them.)

Examples of business travel include:	**Examples of private travel include:**
Where the employee travels from the office to attend a conference	Travel between the home and the office
Travelling from home to a client and the travel after the meeting to the office	Travelling from a friend's house to the office
Travelling from a home office to a client's premises	Travelling from home to different places of work on different days
Travelling from home to another branch of your employer where you are not ordinarily working	

Could the context of COVID-19 restrictions introduce an added interpretation problem on what constitutes business travel? Where an employee falling under the essential services category has travelled for business purposes during the lockdown periods, one would not anticipate any dilemma in claiming against a travel allowance.

Considering that the restrictions announced by Government were legally binding, it will be interesting to see whether a claim for business kilometres travelled by a non-essential service employee, during the same period, will also be considered as valid business kilometres.

This may very well become an added SARS audit requirement.

Calculating the claim

There are two methods of calculating the deductible amount against the travel allowance: the actual costs method and the deemed costs method. Each method has its own set of requirements.

The actual costs method

This method requires accurate information in the form of receipts, tax invoices and other relevant source documents. For the purpose of finance charges (section 8(1)*(b)*(iiiA)*(bb)*(B)) and wear-and-tear expenses (section 8(1)*(b)*(iiiA)*(bb)*(A)) the maximum vehicle value is R595 000.

The qualifying deduction is based on computing actual expenditure per kilometre and multiplying it with the business kilometres. To illustrate this, let us consider the below example:

Mr X owns a vehicle valued at R280 000 and incurred the following expenses:

Fuel costs	R18 000
Wear-and-tear expenses	R40 000 (R280 000 ÷ 7)
Maintenance costs	R8 000
Insurance costs	R2 400
Finance charges	R17 500
Licensing costs	R650
Total costs	R86 550

Mr X travelled a total of 32 000 km, of which 8 000 km were for business purposes, as evidenced by his logbook. Mr X received a total travel allowance of R48 000 for the 2020 year of assessment. As a result, Mr X would be able to claim R21 625, (8 000 km ÷ 32 000 km x R86 550) as a deduction against his travel allowance.

The deemed costs method

The deemed costs method comprises three components: the fixed costs, the fuel costs and the maintenance costs. SARS provides a table from which the taxpayer determines the appropriate deemed cost elements based on the vehicle value. The table can be found on SARS' website and is revised annually. Taxpayers who want to claim using this method must bear maintenance costs and fuel costs themselves.

Considering the information provided in the previous example, the fixed costs, fuel costs and maintenance costs components can be referenced as follows (according to the SARS eLogbook for 2019/2020). Figures below are relevant for a vehicle fitting into the R255 0001 to R340 000 cost bracket.

Fuel costs per kilometer	R1.248
Maintenance costs per kilometer	R0.519
Fixed costs component	R2.896 (R92 683 ÷ 32 000 km)
Total costs per kilometer	R4.663

In using this method, Mr X would be able to claim R37 304 (8 000 km x R4.663 per km) as a deduction against his travel allowance.

In our experience, the deemed costs method requires less administration and is almost always more favourable than the actual costs method.

"Regardless of the rate adopted by the employer, the impact of COVID-19 and the limitations placed on the employee's business travel may translate into a 2021 tax liability for the employee on submission of the related return."

COVID-19 and travel allowances

The travel allowance will become a contentious item where employees are receiving a travel allowance for business travel and such business travel is not possible, under the levels of restriction. Consequently, employees will be required to take extra care in preparing their logbooks.

In determining the taxing rate of the travel allowance – that is whether taxes should be withheld on 80% or 20% of the travel allowance – the employer and employee would have adopted a rate based on the actual travel performed in previous years. Regardless of the rate adopted by the employer, the impact of COVID-19 and the limitations placed on the employee's business travel may translate into a 2021 tax liability for the employee on submission of the related return.

Employers that have resolved to tax 20% of a travel allowance paid to an employee who is not an essential services employee should perhaps consider adopting the 80% rate. This will likely assist the employee to "prepay" the pending tax liability resulting from an expected reduced travel allowance claim.

In case of a reimbursive travel allowance, the above dilemma appears to be conveniently avoided, even where a tax liability arises.

A reimbursive allowance is paid to an employee at a rate multiplied by business kilometres travelled. This thus creates a relationship between the allowance and the business kilometres travelled.

Employees will find that the risk of a deferred 2021 tax liability is eliminated, as their business travel claim will be directly aimed at the reimbursive allowance. The importance of a well-maintained travel logbook, for such employees, must be emphasised.

In addition, it is best practice that the employer's resolution to tax more of the allowance should be performed on a case-by-case basis and based on the factual circumstances of the employee, as opposed to a blanket approach.

The change in withholding taxes will reduce take-home pay and will be felt immediately in the employee's pocket, although it will prevent a cash flow burden in the long run.

Travel allowance deduction: The independent contractor perspective

What is the difference between employees' and independent contractors' deductions?

Due to the nature of the contract between an independent contractor and a client, the provision of a travel allowance would be unusual. An independent contractor would usually recover business travel costs incurred by invoicing or charging a disbursement fee.

An independent contractor, as explained in Interpretation Note 17, is an individual or person similar to an entrepreneur – someone clearly distinguishable as an "employer" and not an "employee".

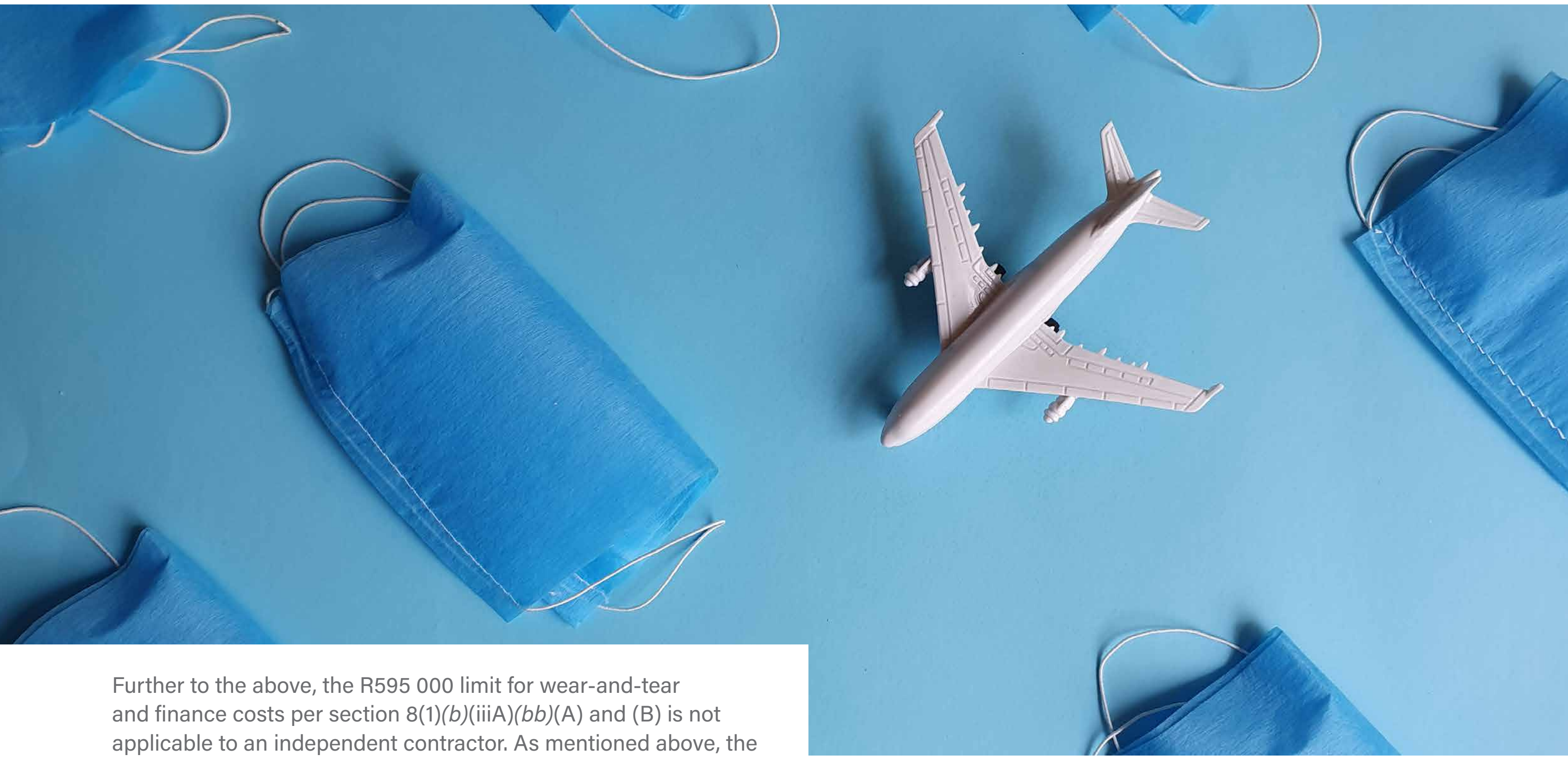
Implications of travel costs deduction

Section 8 does not cater for an independent contractor. Consequently, an independent contractor can rely on section 11*(a)* to obtain a deduction for travel costs – as well as section 11*(e)*, in terms of claiming a capital allowance for the wear-and-tear incurred on his or her vehicle.

The burden of proof is placed on the independent contractor (section 102 of the Tax Administration Act, 2011). This means relevant source documents, including a logbook, would need to be provided. The position may be summarised as follows:

The independent contractor does not need a travel allowance or reimbursement to claim, and any amounts received by the independent contractor for business travel will form part of their gross income.

The tax deduction is effectively claimed in the same way as an employee would claim against a travel allowance, by using the actual costs method, with a logbook indicating the portion of business travel.



Further to the above, the R595 000 limit for wear-and-tear and finance costs per section 8(1)*(b)*(iiiA)*(bb)*(A) and (B) is not applicable to an independent contractor. As mentioned above, the vehicle wear-and-tear expense is claimed separately as a capital allowance under section 11*(e)*.

Example (based on the details provided above):

Mr X owns a vehicle valued at R280 000 that he bought on 1 March 2018. He incurred the following expenses:

Fuel costs R18 000

Wear-and-tear expenses (claimed under section 11*(e)* – see below)

Maintenance costs R8 000

Insurance costs R2 400

Finance charges R17 500

Licensing costs R650

Total costs R46 550

Mr X travelled a total of 32 000 km, of which 8 000 km were for business purposes, as evidenced by his logbook. As a result, Mr X would be able to claim R11 637 (8 000 km ÷ 32 000 km x R46 550) as a business travel expense against his gross income. In addition, Mr X would be able to claim a R14 000 wear-and-tear capital allowance – in terms of section 11*(e)*, read together with Interpretation Note 47.

The wear-and-tear capital allowance is calculated as follows:

(R280 000 ÷ 5 × (12 months ÷ 12 months)) × (8 000 km ÷ 32 000 km) = R14 000

It is important to note that in this instance – in terms of section 11*(e)*, and read with Interpretation Note 47 – an independent contractor who seeks to claim this capital allowance needs to be the owner of the vehicle or should have borne the cost of purchasing the vehicle.

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Acts and Bills

- Income Tax Act 58 of 1962: Sections 8(1)*(a)*(i)*(aa)*, 8(1)*(b)*(i) & 8(1)*(b)*(iiiA)*(bb)*(A) & (B); 11*(a)* & 11*(e)*; Seventh Schedule: Paragraph 7(2)*(b)*;
- Tax Administration Act 28 of 2011: Section 102.

Other documents

- Interpretation Note 14 (Issue 4) – ("Allowances, advances and reimbursements" – published on 18 March 2019);
- Interpretation Note 17 (Issue 5) – ("Employees' tax: Independent contractors" – published on 5 March 2019);
- Interpretation Note 47 (Issue 4) – ("Wear-and-tear or depreciation allowance" – published on 24 March 2020);
- SARS External Guide for Employers in respect of allowances (PAYE-GEN-01-G03);
- 2019 SARS BRS Change – Patch Phase 3;
- SARS eLogbook Guide for 2019/2020;
- SARS eLogbook Guides for 2015, 2016 and 2017.

Tags: travel allowance; business kilometres; wear-and-tear expense; independent contractor.

FUNDAMENTAL CHANGES TO THE EXCHANGE CONTROL SYSTEM

In the Budget Speech of the Minister of Finance in 2020, National Treasury proposed a complete overhaul of the exchange control system. This aimed to modernise and reduce some of the burdensome and unnecessary administrative approval processes by implementing a new capital flow management system.

On 31 July 2020, National Treasury released the draft Taxation Laws Amendment Bill, 2020, for comment; it included tax proposals linked to the implementation of the new capital flow management system. The Taxation Laws Amendment Bill, 2020, was introduced on 28 October 2020. In terms of this Bill, which was agreed to by Parliament early in December 2020 and promulgated in the *Government Gazette* as an Act on 20 January 2021, the changes to the exchange control system will take place in 2021.

Proposed reforms to exchange control system

The overhaul of the exchange control system will involve a shift from the current negative list framework. By default, all foreign exchange control actions are prohibited unless specifically approved to a positive list framework, in terms of which all cross border transactions will be allowed (other than those that are subject to capital flow measures or pose a high risk in respect of illegitimate transactions). This is a fundamental change that will be implemented during the current year.

The features of the new capital flow management framework will include:

- A shift from exchange controls to capital flow management measures to regulate cross-border capital flows;
- a more modern, transparent and risk-based approval framework;
- stronger measures to fight illegitimate financial cross-border flows and tax evasion;
- strengthening cooperation between the Financial Intelligence Centre, South African Reserve Bank (SARB), South African Revenue Service, and other law enforcement agencies; and
- enhancing cross-border reporting requirements.

To implement the new capital flow management system, new legislation in the form of "new capital flow management regulations" is required to be drafted along with the implementation of relevant tax amendments. As noted above, it is anticipated that this will likely be implemented during the course of 2021.

"It is also important to note that the proposed new capital flow management system will require the drafting and implementation of new regulations as well as the implementation of related tax amendments to combat illegitimate transactions or transactions that pose a high risk in respect of illicit cross-border flows."

What will the impact of these changes be?

The new system is expected to ultimately ease the compliance costs and administrative processes for many corporates which are subject to exchange controls. However, based on the guidance provided by the SARB on the new capital flow management framework, it seems that very little will change initially. In particular, it has become clear that cross-border foreign exchange activities will continue to be conducted through authorised dealers and regulated by the SARB. In addition, it appears that many of the current policies applicable to related-party transactions will continue to be enforced for the time being. For example:

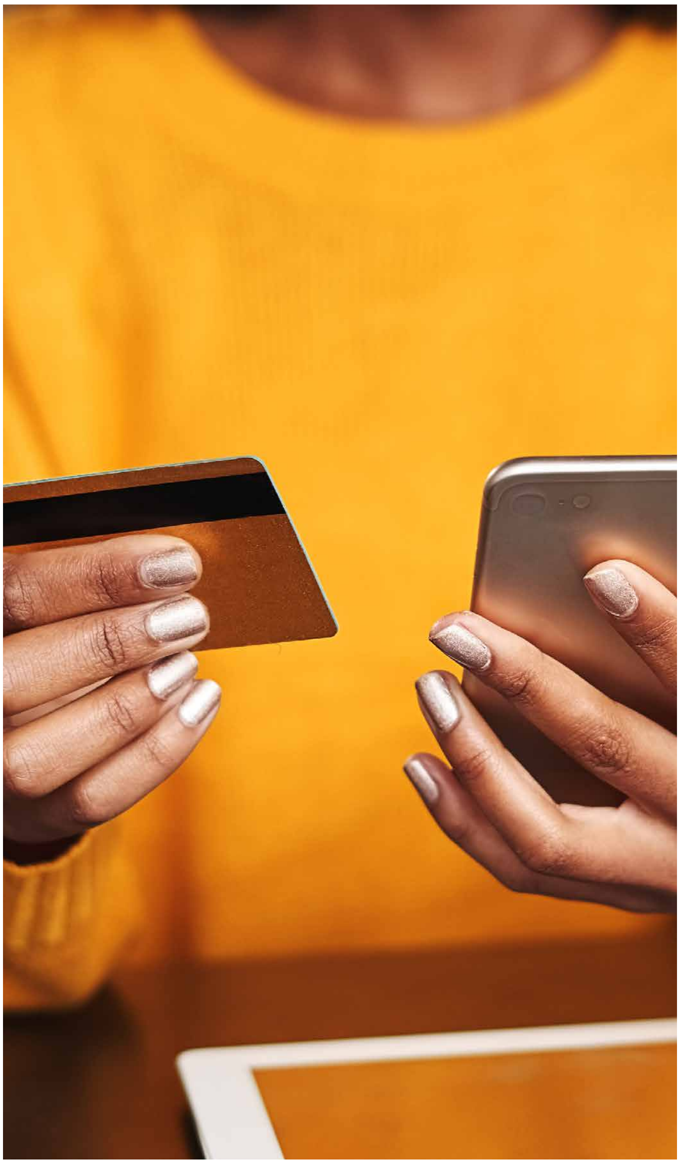
- Inward foreign loans must be approved subject to certain set criteria;
- The transfer of South African intellectual property to a related non-resident party in whatever form is prohibited unless specifically approved by the SARB;
- The loop policy for corporates and individuals (up to 40%) will remain, pending changes to tax legislation [*Editorial comment*: With effect from 1 January 2021, the loop structure restrictions have been removed by the SARB.]; and
- Foreign direct investments (FDIs) by South African corporates will still require approval by an authorised dealer or the SARB and the adjudication limits will be retained. Further loans by South African corporates to their FDIs will be permitted but loans to third-party companies will be subject to SARB approval.

It is important to note that, at this stage, no specific guidance has been provided in respect of inbound service and licence arrangements and it is not clear whether these sorts of arrangements will still require the same stringent ongoing exchange control consents.

It is also important to note that the proposed new capital flow management system will require the drafting and implementation of new regulations as well as the implementation of related tax amendments to combat illegitimate transactions or transactions that pose a high risk in respect of illicit cross-border flows.

For example, the SARB proposes that individuals who transfer more than R10 million offshore will be subject to a risk management test which will include certification of tax status and source of funds, and confirmation that the individual complies with the anti-money laundering and countering terror-financing requirements prescribed by the Financial Intelligence Centre Act, 2001.

In addition, the current cooperative practices in the form of automatic sharing of information between tax authorities on individuals' financial accounts and investments will remain in place to ensure that South African tax residents who have offshore income and investments pay the appropriate level of tax.



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Acts and Bills

- Taxation Laws Amendment Act 23 of 2020;
- Taxation Laws Amendment Bill 27B of 2020;
- Draft Taxation Laws Amendment Bill, 2020;
- Financial Intelligence Centre Act 38 of 2001.

Tags: capital flow management system; exchange control system; cross-border capital flows; foreign direct investments (FDIs).

TAX CHANGES TO FACILITATE EXCHANGE CONTROL DEVELOPMENTS

In the Budget Speech which was delivered on 25 February 2020 it was announced that the exchange control system would be restructured towards what was called a new capital flow management framework. The premise on which the framework is based is a system of "positive bias" where all cross-border transactions will be allowed except those that are subject to the capital flow management measures in respect of transactions which pose a high risk in respect of illegitimate cross-border financial flows. It was stated that one of the main features of the capital flow management framework is to strengthen the measures that will fight tax evasion.

The Financial Surveillance Department of the South African Reserve Bank (the FinSurv) views offshore structures established by a resident (or in which a resident has an interest) that reinvests into the Common Monetary Area (CMA) by acquiring shares or other interests in a CMA company or CMA asset as a contravention of the Exchange Control Regulations. This is colloquially referred to as a "loop structure".

The FinSurv views such structures as resulting in or having the potential to result in the direct or indirect export of capital abroad to a non-resident company or other relevant non-resident trust or entity for the ultimate benefit of a resident. The export of capital could be in the form of dividends arising from increased profits, revenue reserves or capital reserves from CMA growth assets of the CMA company.

Until 31 October 2019 South African resident individuals were not allowed to hold shares in an offshore company that in turn held investments in South Africa as this would have constituted a prohibited loop structure. From 31 October 2019, South African exchange control resident individuals may hold up to 40% in a foreign company that in turn holds investments in South Africa. A similar rule exists for South African corporates.

In instances where South African resident individuals or South African corporates intend to acquire an interest in an offshore company which exceeds 40% and such company holds or is to hold investments in the CMA, exchange control approval can only be given by National Treasury, which can take up to 12 months to obtain, if at all.

One of the changes to the current exchange control rules envisaged above is the relaxation of the approval that is required for loop structures where the 40% shareholding is exceeded. This is a welcome relaxation. However, it was stated in the 2020 Budget Review that the relaxation of exchange control rules in respect of loop structures will be implemented after the tax amendments are implemented to address the effect of reducing South Africa's tax base by an offshore company in a loop structure. While the proposed "loop structure" relaxation has focused on outbound shareholdings by South African residents in foreign companies, it is worth noting that the FinSurv holds the view that a "loop structure" can arise in various forms, including through offshore discretionary trusts. The relaxation referred to above, which has applied since 31 October 2019, does not extend to offshore trusts in which South African residents are beneficiaries, but is limited to the situation where resident individuals in their personal capacities hold interests in foreign companies which in turn hold assets in South Africa. [*Editorial comment*: With effect from 1 January 2021, the loop structure restrictions have been removed by the Finsurv. This change in policy does not impact on the tax issues dealt with in this article.]

The main tax benefits that have been identified in relation to a loop structure appear to be the treatment of dividends and capital gains on the sale of shares in a foreign company. In respect of the former, dividends withholding tax on a dividend which is declared by a South African company to an offshore company which is resident in a country that is a signatory to a double taxation agreement with South Africa can be reduced from the domestic dividends tax rate of 20% to as low as 5%. Should the offshore company declare a dividend to a South African tax resident shareholder which holds at least 10% of the equity shares and voting rights in such company, the dividend will be exempt from income tax. On a simplified basis, if the South African resident shareholder (which is not a company) receives a dividend from the South African company directly and not via the offshore company, the shareholder would have been subject to dividends tax at 20%; on the other hand, through the "loop" structure the dividend is subject to an effective 5% tax. This of course assumes that the offshore company is resident in a country which does not levy any withholding tax on dividend distributions.

However, it is worth noting that this treatment only applies if the shareholder in the offshore company is not a corporate. If, however, the shareholder is a corporate, a "loop" structure could give rise to a greater tax cost relative to a direct investment in the South African company that is declaring the dividend. This is because the first dividends distributed to the offshore company would be subject to dividends tax at a reduced rate of 5% and if such dividends are received by the South African shareholder in the offshore company and are ultimately declared by the South African company to non-corporate shareholders, dividends tax at 20% will be levied on the final dividend. This could result in a total dividends tax liability of 24% (ie 5% + (20% of 95%)) on amounts which are ultimately sourced from the same after-tax profits of the initial South African company which declared the dividend to the offshore company.

Within this context the restriction on "loop" structures will be relaxed on the premise that the proposed amendments to the taxation of dividends received by a controlled foreign company (CFC) as well capital gains from the sale of shares in a CFC will address the apparent mischief. A CFC is an offshore company in which South African residents, either alone or collectively, hold more than 50% of the participation rights. The CFC rules provide for the taxable income of the CFC to be calculated as if the CFC was a South African taxpayer and to be attributed to and taxed in the hands of the resident shareholders. In view of the fact that domestic dividends are included in gross income under paragraph *(k)* of the definition of "gross income" in section 1(1) of the Income Tax Act, 1962 (the Act), but may qualify for exemption under section 10(1)*(k)*(i) of the Act, such dividends would typically not be included in the net income of the CFC.

The CFC rules are currently such that if a South African individual held more than 10% of the equity shares and voting rights in a CFC, and that CFC received dividends from a South African company, which it on-declared to the South African shareholder, that shareholder would receive the dividends tax free. Similarly, under the current rules, a South African tax resident shareholder of a CFC could dispose of his or her shares in a CFC at a profit to an unrelated non-resident, without triggering any tax. This is often referred to as the CGT participation exemption. This exemption is beneficial in that if the CFC disposed of its investment in a South African company the resultant gain would generally be subject to tax in the hands of the shareholders, whereas a sale of the shares in the CFC would not be subject to CGT.

"In terms of the changes to the Act contained in the Taxation Laws Amendment Act, 2020 (the TLA Act), the Act will be amended to tax South African resident shareholders of CFCs, under the CFC rules, on domestic dividends paid to a CFC in a loop structure."

In terms of the changes to the Act contained in the Taxation Laws Amendment Act, 2020 (the TLA Act), the Act will be amended to tax South African resident shareholders of CFCs, under the CFC rules, on domestic dividends paid to a CFC in a loop structure. The tax on the dividends will be based on a 20/28 ratio, so that 20/28 of the dividend will be included in the taxable income of the CFC, and this is intended to tax the dividend at an effective rate of 20% (ie 20/28 x 28% = 20%). This ratio achieves this objective where the shareholder of the CFC is a company; however, where the shareholder is a natural person or a trust, the dividend could be subject to an effective tax rate of 32.14% (ie 20/28 x 45% = 32.14%).

Further, the TLA Act does not provide a credit for the dividends tax that the CFC is subject to, which will give rise to an effective tax on the dividend distributed to the CFC of at least 25%, which is 5% more than the domestic dividends tax rate. The proposed changes to the Act also fail to recognise the fact that a corporate shareholder in a CFC will be required to withhold dividends tax on a distribution it distributed to its non-corporate shareholders. The effect of this is that a single dividend distributed by a South African company to a CFC could ultimately be subject to three levels of taxation, the first being dividends tax at a reduced rate (the lowest of which is 5%), tax on an amount equal to the dividend received by the CFC in the hands of the resident shareholder at 20% and potentially a further 20% withholding tax on dividends distributed by the corporate shareholder of the CFC if the same amounts are received by the corporate shareholder and distributed as a dividend.

In addition to the proposed amendments on the taxation of dividends received by a CFC, it is also proposed that the CGT participation exemption should not apply to the disposal of shares in a CFC to the extent that the value of the assets of the CFC are derived from South African assets. It would be for the taxpayer to determine what portion of the gain is derived from the South African assets and which portion is exempt, which will add complexity to taxpayers' compliance.

A number of submissions have been made to National Treasury to rectify the multiple levels of taxation. In particular, that a credit be granted to the CFC for dividends tax withheld and that CFC inclusion only applies to CFCs which are held by non-corporate shareholders. While the proposed "loop structure" relaxation has focused on outbound shareholdings by South African residents in foreign companies, it is worth noting that the FinSurv holds the view that a "loop structure" can arise in various forms, including through offshore discretionary trusts. The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2020, states that there is no need to provide for specific legislation in this regard. The reason is that, in terms of section 25B(2B) of the Act, introduced two years ago, if an offshore trust holds more than 50% of the participation rights in an offshore company, any dividend received by the trust (even if the dividend is sourced from profits comprising a dividend from a South African company) which is capitalised and then in a later year is distributed to a South African resident beneficiary, will be taxable at the effective rate of 20% in the hands of the beneficiary; and that is only if, in the year that it is received by the trust, it is not taxable in the hands of the South African resident donor under the attribution rules in section 7(8) of the Act. Similar rules apply for CGT purposes.

Werksmans

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "gross income": paragraph *(k)*), 7(8), 10(1)*(k)*(i) & 25(2B);
- Taxation Laws Amendment Act 23 of 2020;
- Taxation Laws Amendment Bill 27B of 2020;
- Draft Taxation Laws Amendment Bill, 2020.

Other documents

- Explanatory Memorandum on the Taxation Laws Amendment Bill, 2020.

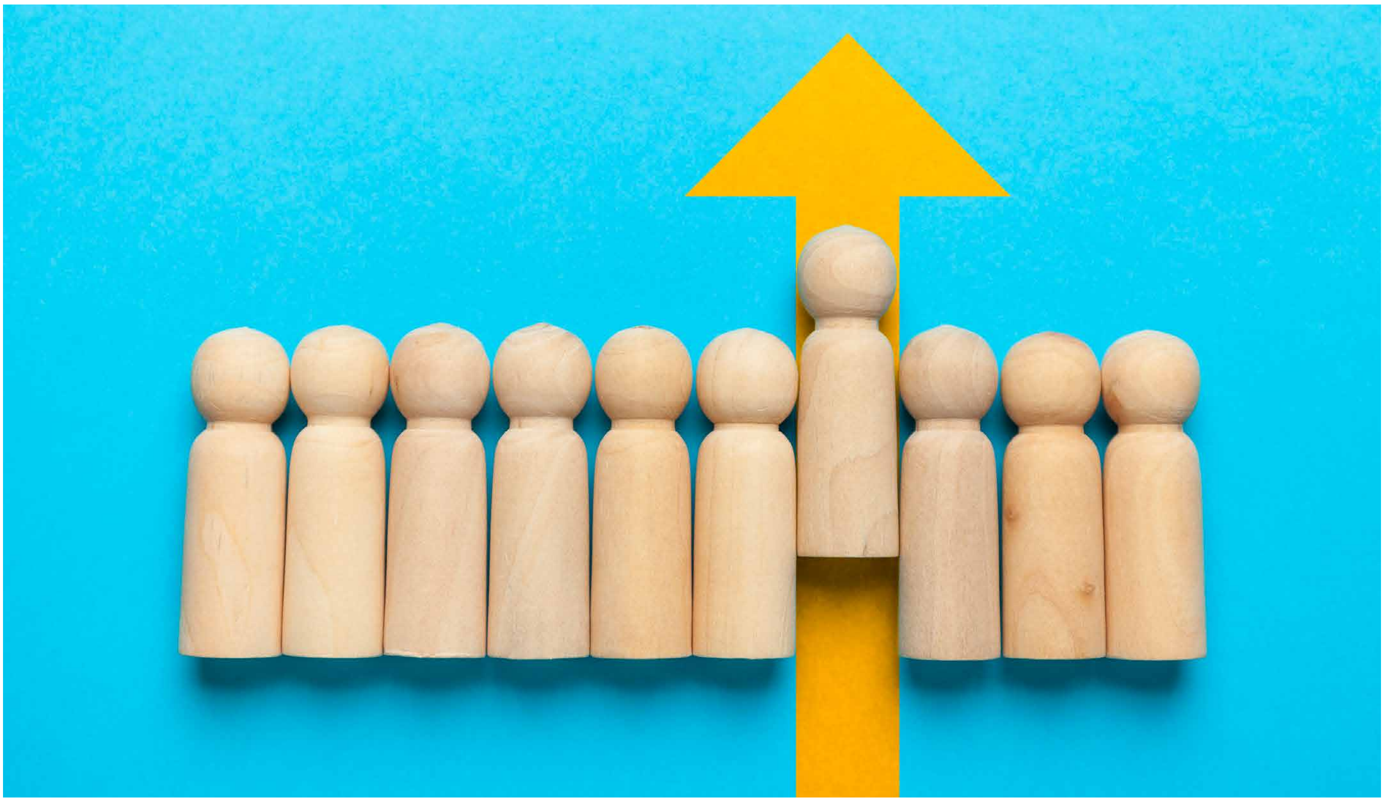
Tags: exchange control system; capital flow management framework; loop structure; dividends tax; taxable income; CGT participation exemption.

BURSARIES TO FAMILY

Over the past several years, many employers and employees have made use of the beneficial tax treatment of bursary and scholarship schemes, as provided for in the Income Tax Act, 1962 (the Act). The Act contains provisions that provide an exemption in respect of bona fide *bursaries or scholarships granted by employers to employees or relatives of qualifying employees, subject to certain monetary limits and requirements stipulated in the Act. Essentially, an employee is not taxed on an amount granted to him or her when it meets the criteria as set out in the Act.*

In the case of a *bona fide* bursary or scholarship granted to a relative of the employee without a disability, the Act makes provision for the exemption from tax to apply only if the employee's remuneration does not exceed R600 000 during the year of assessment. In addition, the amount of the bursary or scholarship will only be exempted up to a limit of R20 000 for studies from Grade R to 12, including qualifications at NQF levels 1 to 4, and R60 000 for qualifications at NQF levels 5 to 10. These levels are increased where the bursary or scholarship is made to a person with a disability.

"These bursary schemes are developed by an institution other than the employer and marketed to the employer as a means of providing tax-exempt bursaries to their employees or relatives of employees at no additional cost to the employer."



National Treasury has noted that it has come to Government's attention that a number of schemes have emerged in respect of employer bursaries granted to the employees or relatives of employees. These bursary schemes are developed by an institution other than the employer and marketed to the employer as a means of providing tax-exempt bursaries to their employees or relatives of employees at no additional cost to the employer. These schemes seek to reclassify ordinary taxable remuneration received by the employees as a tax-exempt bursary granted to the relatives of employees. As a result, an employee can cater to their relative's studies by way of salary sacrifice. The portion of the salary sacrificed by the employee is paid directly by the employer to the respective school and is treated as a tax-exempt bursary in the employee's or relative's hands.

The requirement that the applicability of the exemption is dependent on the fact that the employee's remuneration package is not subject to an element of salary sacrifice, has been reinstated in the Taxation Laws Amendment Act, 2020.

As a means of further encouraging employers to grant bursaries to relatives of employees without subjecting such bursary to an element of salary sacrifice, the employer deduction in relation to the said bursaries is permitted. Even if the bursary to the employee's relative is subject to an element of salary sacrifice, while the exemption for the employee is denied, the deduction for the employer is still granted.

The Taxation Laws Amendment Bill, 2020, was passed by Parliament early in December 2020 and the Taxation Laws Amendment Act was promulgated in the *Government Gazette* on 20 January 2021.

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Acts and Bills

- Income Tax Act 58 of 1962;
- Taxation Laws Amendment Act 23 of 2020;
- Taxation Laws Amendment Bill 27B of 2020.

Tags: taxable remuneration; tax-exempt bursary.

TAX DEBTS IN BUSINESS RESCUE

A company in financial distress may have a variety of outstanding tax debts at the commencement of business rescue. Besides capital amounts of tax due, there could also be tax returns for VAT, PAYE and income tax which are due and have not been submitted, resulting in tax liabilities which are due and payable, but do not yet appear on the relevant statements of account. The late submission of returns will also result in 10% late payment penalties for VAT, PAYE and provisional taxes, and potentially 20% underestimation penalties for income tax, plus interest. There could also be administrative penalties imposed for non-submission of income tax returns.

This article considers where these tax debts should rank in business rescue proceedings and also practical issues which arise from the VAT liabilities which are triggered in terms of section 22(3) of the Value-Added Tax Act, 1991 (the VAT Act).

All references to "section" in this article are to sections of the Companies Act, 2008 (the Companies Act) unless otherwise provided.

Where do tax debts rank?

In *Commissioner, South African Revenue Service v Beginsel NO and Others*, [2013], the Western Cape High Court held that no statutory preferences are created in Chapter 6 of the Companies Act, dealing with business rescue, such as those in sections 96 to 102 of the Insolvency Act 24 of 1936 which granted SARS a preferent creditor status. Accordingly, SARS is not a preferent creditor but a concurrent creditor in terms of section 145(4)*(b)* of the Companies Act with voting interests equal to the value that the creditor can expect to receive if the debtor was liquidated.

The *Beginsel* case dealt with outstanding VAT, PAYE, SDL, UIF, penalties and interest which existed *prior to* commencement of business rescue. What about tax debts which arise *after* commencement of business rescue? Are tax debts which arise after commencement of business rescue "post commencement finance" or "costs of business rescue" and should they be given priority in ranking to other unsecured concurrent creditors?

In *South African Property Owners Association v Minister of Trade and Industry and Others*, [2018], the court was requested by way of a declaratory order to interpret "post-commencement financing" and "costs arising out of the costs of the business rescue proceedings" in section 135(2) and 135(3). The applicant, SAPOA, acts as an umbrella body of homeowners' associations and represents approximately 1,300 companies and organisations.

The applicant applied for a declaratory order that the rent for immovable property occupied, rates, taxes, electricity, water, sanitation and sewerage charges payable by a company in business rescue after commencement of business rescue constitute post-commencement financing or alternatively, costs of business rescue proceedings.

The court held that the financing intended in section 135(2) (ie post-commencement financing) relates to the obtaining of actual financing in order to assist in managing the company out of its financial distress, hence the provision that any asset of the company may be used to secure that financing to the extent that the asset is not otherwise encumbered.

The costs referred to in the application are costs incidental to the leased property, and are subject to the terms of the particular lease agreement. These costs arise out of the terms of the lease agreement. These costs do not constitute, by any interpretation, costs arising out of the business rescue proceedings. Furthermore, the liability of such costs arises out of the relevant lease agreement, despite being continually incurred, even after commencement of the business proceedings. To hold that such costs constitute post-commencement financing would elevate an obligation prior to commencement of business rescue proceedings to a preference over other creditors not provided or contemplated by section 135.

Income tax liabilities arise from taxable income derived from trading activities of the company. Similarly, VAT liabilities arise from the supply of goods or services by the company under business rescue and PAYE liabilities arise from remuneration paid to employees. Based on the *Beginsel* and *SAPOA* cases, it would be difficult to argue that these tax liabilities are post-commencement finance or costs of business rescue proceedings. These tax liabilities are thus unsecured concurrent claims.

This would be the position even if these tax debts arise on a continuous basis after commencement of business rescue. Costs of business rescue proceedings in section 135(3) contemplate costs similar to the remuneration of practitioners, not tax debts arising from the trade carried on by the debtor after commencement of business rescue. Examples of fees for other professional advisers include fees for legal advisers, accountants, auditors and valuers assisting in the business rescue process. This view is supported by the ranking of claims set out in two unreported cases in the Johannesburg High Court.

Kgomo J held in *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies & Engineering Company (Pty) Ltd & Another*, [2013], and *Redpath Mining South Africa (Pty) Ltd v Marsden NO & Others*, [2013], that the effect of section 135 was to provide a ranking of claims as follows:

1. the practitioner, for remuneration and expenses, and other persons (*including legal and other professionals*) for costs of business rescue proceedings (section 135(3));
2. employees for any remuneration which became due and payable after business rescue proceedings began (section 135(1) and 135(3)*(a)*);
3. secured lenders or other creditors for any loan or supply made after business rescue proceedings began, ie post-commencement finance (section 135(3)*(a)*(i) and section 135(3)*(b)*);
4. unsecured lenders or other creditors for any loan or supply made after business rescue proceedings began, ie post-commencement finance (section 135(3)*(a)*(ii));
5. secured lenders or other creditors for any loan or supply made before business rescue proceedings began;
6. employees for any remuneration which became due and payable before business rescue proceedings began;
7. unsecured lenders or other creditors for any loan or supply made before business rescue proceedings began (ie the concurrent creditors) (section 135(3) generally).

The ranking above gives rise to the issue of secured creditors for pre-commencement debt (number 5) ranking lower than unsecured creditors for post-commencement debt (number 4). However, the above ranking has not been overturned by a decision of a higher court and remains sound authority. Notably, this ranking issue does not affect the discussion in this article of where tax debts should rank, given that tax debts are usually unsecured.

There is also the use of "post-commencement finance" in these two judgments in 2013, which are later clarified in the *SAPOA* judgment in 2018. Read in context, the phrase "post-commencement finance" in these 2013 judgments should be taken to mean debts which arise after commencement and should include tax debts owed to SARS, ie not only the narrow meaning of actual financing provided to manage the debtor out of financial distress as determined in the later 2018 *SAPOA* judgment.

Income tax liabilities only arise on issue of assessments

Income tax liabilities are assessed annually after submission of ITR 14 tax returns when SARS issues the ITA 34 assessments. Income tax liabilities thus only arise when the assessments are issued.

Income tax liabilities which are due and payable, and which appear on the relevant statements of account at commencement, would rank as unsecured creditors before business rescue proceedings began (number 7).

If income tax returns are late and not submitted at the commencement of business rescue, income tax due for the periods before commencement would not have arisen and cannot be dealt with in the business rescue plan until the returns are submitted and those years assessed.

Income tax liabilities (including late payment and underestimation penalties and interest) in assessments issued after commencement which relate to years prior to commencement would be unsecured claims which arise after commencement of business rescue (number 4). This is on the basis that income tax liabilities only arise when assessments are issued.

Income tax liabilities in assessments relating to post commencement business would similarly be unsecured claims ranking at number 4. These tax debts arise as a result of taxable income earned by the debtor during the business rescue process. SARS was not a lender that provided actual financing, and the tax debts were not costs of remuneration or fees of advisers to facilitate the business rescue of the debtor.

Similar to income tax liabilities, administrative penalties for non-submission of income tax returns only arise on the issue of the related penalty assessments. If the penalty assessments were issued by SARS *after* commencement relating to years before or after commencement, the amounts owed would be unsecured claims which rank at number 4. If they were issued *before* commencement, they would rank at number 7.

VAT liabilities are triggered by supply and PAYE liabilities by payment of remuneration

VAT and PAYE returns are self-assessments submitted by the taxpayers. VAT and PAYE liabilities arise on a continual periodic basis as and when they occur in the relevant months. VAT and PAYE due in the months before commencement would already have arisen in those months regardless of whether returns were submitted by the taxpayers. The submission of the returns forming the self-assessment does not trigger the tax due. For VAT, the taxable supplies, and for PAYE, the payment of remuneration in the relevant months, are the appropriate triggers for these tax liabilities. The debtor's submissions of the returns or self-assessments merely facilitate the payments of these taxes to SARS.

These VAT and PAYE liabilities relating to years *before* commencement would not be post-commencement finance and costs of business rescue proceedings for the same reasons discussed above for income tax liabilities. Where returns are late, the business rescue practitioner would need to estimate these tax liabilities or submit the outstanding returns to have these tax liabilities reflected in the relevant statements of accounts. These tax liabilities, including late payment penalties and interest, would then need to be listed as part of the list of creditors in the business rescue plan and be dealt with as pre-commencement unsecured claims ranking at number 7.

Similarly, VAT and PAYE liabilities arising *after* commencement and which relate to post-commencement business would be unsecured claims after commencement ranking at number 4.

"Examples of fees for other professional advisers include fees for legal advisers, accountants, auditors and valuers assisting in the business rescue process."

Deemed output VAT in business rescues (section 22(3) of the VAT Act)

Expiry of 12 months

Section 22(3) of the VAT Act applies when a vendor claimed an input VAT deduction on an invoice and then did not pay the full consideration on this invoice (which was due and payable) within 12 months after the tax period in which the deduction had been made. (The contract does not provide for a payment period longer than 12 months.) There would then be a deemed output VAT on the tax fraction of the remaining outstanding amount to be accounted for by the vendor in the next tax period after the 12 months (usually in the 13th month if monthly returns are submitted).

"Income tax liabilities which are due and payable, and which appear on the relevant statements of account at commencement, would rank as unsecured creditors before business rescue proceedings began."

For example, if the supply and invoice in January 2020 had been for R115, the vendor would have claimed the input VAT of R15 in the January 2020 tax period, with the January VAT 201 declaration submitted by the end of February 2020. If the vendor had not paid the invoice of R115 by January 2021 (ie within 12 months after expiry of January 2020), there would be a deemed supply of the R115 and a deemed output VAT of R15 in the February 2021 tax period, to be declared and paid in the VAT 201 due by the end of March 2021.

If the 12 months after the end of the tax period in which the input VAT was claimed expire *before* commencement of business rescue, then any deemed output VAT liability which is not paid or declared would be an unsecured claim ranking at number 7.

If the 12 months expire *after* the commencement of business rescue, then the deemed output VAT amounts on the outstanding invoices are unsecured claims ranking at number 4.

Practical issues with penalties and interest

In practice, the business rescue plan will usually also deal with the anticipated section 22(3) deemed output VAT in the list of creditors. SARS will receive the same cents to the rand as all other concurrent creditors.

The deemed output VAT triggered should, however, also be reduced by the distribution to other concurrent creditors whose outstanding amounts after 12 months have triggered the liability. If an outstanding invoice is R115 (VAT inclusive) and the creditor would receive a distribution of R1 for every R100 in the business rescue plan, the creditor would then receive R11.50 from the invoice outstanding of R115. The VAT on the R11.50 distributed would be R1.50. Therefore, the deemed output VAT triggered should only be R15 less R1.50 = R13.50. SARS should then be entitled to the distribution as a concurrent creditor on R13.50, not on the full R15 initially claimed as input VAT.

The practical issue of penalties and interest on VAT statements of account when the deemed output VAT is triggered after expiry of the 12 months remains. There is no clarity on how to deal with the ongoing penalties and interest once the deemed output VAT is declared.

SARS would have ongoing post-commencement concurrent claims for the penalties and interest at number 4 which rank higher than pre-commencement unsecured trade creditors. This is an unfair outcome which results in SARS receiving a preference in ranking for tax debts relative to the other unsecured pre-commencement trade creditors whose debts continue to be unpaid with no penalties and interest. The debtor under business rescue would have ongoing tax debts which are not anticipated during the business rescue process. This would defeat the purpose of maximising the likelihood of the company continuing in existence on a solvent basis.

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Acts and Bills

- Companies Act 71 of 2008: Chapter 6 (sections 122 to 155), more specifically section 135(1), (2) & (3)*(a)*(i) & (ii) & *(b)*; section 145(4)*(b)*;
- Value-Added Tax Act 89 of 1991: Section 22(3);
- Insolvency Act 24 of 1936: Sections 96–102.

Other documents

- ITR 14 tax returns;
- ITA 34 assessments.

Cases

- *Commissioner, South African Revenue Service v Beginsel NO and Others* [2013] (1) SA 307 (WCC);
- *South African Property Owners Association v Minister of Trade and Industry and Others* [2018] (2) SA 523 (GP);
- *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies & Engineering Company (Pty) Ltd & Another* [2013] ZAGPJHC 109 (10 May 2013);
- *Redpath Mining South Africa (Pty) Ltd v Marsden NO & Others* [2013] JDR 1410 (GSJ); [2013] ZAGPJHC 148 (14 June 2013).

Tags: late payment penalties; costs of business rescue; taxable income; input VAT deduction.

UNWINDING TREASURY SHAREHOLDINGS

It is fairly common for a subsidiary company to hold shares in its holding company, colloquially referred to as treasury shares. Subsidiary companies of an issuer may hold treasury shares for the purposes of facilitating the implementation of employee share schemes. Other reasons why a subsidiary may seek to acquire shares in the holding company include utilising the shares as payment in a business transaction, to structure a black economic empowerment transaction or to utilise the investment opportunity when the share price is trading below net asset value.

Conversely, a holding company may seek to repurchase or acquire the treasury shares held by the subsidiary where the business purposes identified as motivations to hold the treasury shares in the subsidiary are no longer applicable or where the 10% limit in terms of the Companies Act (on treasury shares held by subsidiaries) has been reached.

Unwinding a treasury shareholding can be achieved by way of a repurchase by the holding company or by way of an *in specie* distribution of the treasury shares by the subsidiary to its holding company. The tax implications of either option are likely to influence the manner of unwinding the treasury shareholding.

In terms of the latter option, a distribution by a subsidiary of an asset to its holding company is a disposal of an asset which is deemed to take place at market value for CGT purposes. If the market value of the treasury shares is greater than the base cost, a capital gain will arise for the subsidiary. The holding company will also have acquired an asset, ie the shares in itself, at a market value and will immediately have disposed of that asset by virtue of its cancellation. A cancellation of shares, however, is deemed not to be a disposal for CGT purposes and thus has no CGT consequences.

Eliminating treasury shares in a tax efficient manner could previously be achieved by way of a share repurchase, which if implemented as a dividend, would have had no adverse tax implications for the subsidiary which is disposing of the treasury shares. However, with the introduction and subsequent modification of various anti-avoidance rules dealing with share repurchases and so-called dividend-stripping transactions, such a repurchase could give rise to CGT implications for the subsidiary disposing of the treasury shares.

In the context of the above, it is worth noting the contents of SARS Binding Private Ruling 336 (BPR), issued on 6 December 2019, which confirmed the application of the roll-over provisions of the Income Tax Act, 1962 (the Act), where the subsidiary holding the treasury shares is liquidated in terms of section 47 of the Act.

Section 47 forms part of so-called corporate roll-over provisions. The special rules are meant to facilitate genuine corporate restructuring and mergers and acquisitions and to promote tax efficiency in the implementation of such transactions by permitting tax "rollovers" to operate, where the statutory requirements are satisfied.

In the ordinary course, the liquidation, winding-up or deregistration of a subsidiary company will involve the transfer of assets to its holding company which invariably results in adverse tax implications as the transfer may give rise to a liability for normal tax, dividends tax and CGT.

The objective of section 47 is to provide a type of "roll-over relief" when a liquidating company distributes all its assets to its holding company in terms of a liquidation distribution. To the point, where section 47 applies, a capital gain on the transferred capital assets is deferred in that the base cost of a capital asset is "rolled over" to the holding company. This roll-over relief applies where the capital asset distributed by the subsidiary is acquired by the holding company.

In the BPR under consideration, Company A was a listed company that held 100% of Company B. Company B held treasury shares in Company A which were acquired by way of a loan advanced from Company A. Company B was to make a liquidation distribution to Company A by way of Company B passing a resolution to distribute its assets, the treasury shares, as a dividend *in specie* to Company A, in anticipation of the deregistration of Company B.

The ruling given by SARS states that the distribution of shares by Company B to Company A constitutes a "liquidation distribution" as defined in section 47(1) (see paragraph *(a)* of the definition) with the result that no CGT consequences will result for Company A and Company B from the transfer of the treasury shares.

"The objective of section 47 is to provide a type of 'roll-over relief' when a liquidating company distributes all its assets to its holding company in terms of a liquidation distribution."

An important consideration here is that the holding company has to acquire the assets in question (in this case the treasury shares) as a capital asset, where the subsidiary company holds it as a capital asset. This is an essential requirement before the relevant CGT relief can apply. The crucial question that arises in this regard is whether there is an acquisition of an asset by the issuer of shares (Company A) when it receives its own shares pursuant to a distribution from its subsidiary company in the same group. Without elaborating on the technical analysis of this issue, there are diverging views whether the holding company does acquire the treasury shares, but the ruling seems to confirm this view. The view in favour holds that the shares were acquired, and the fact that the treasury shares are immediately cancelled does not alter the fact that the holding company acquired such capital asset. Put differently, there is no requirement that the holding company must acquire and hold such capital asset for the relief in section 47 to apply. The contrary view is that the acquisition and cancellation were simultaneous, so that no asset was acquired.

Accordingly, where the facts allow, the relief afforded in terms of section 47 could be used to eliminate a treasury shareholding on a tax-efficient basis. However, owing to these divergent views, given that taxpayers other than the applicant cannot rely on the BPR in any dispute with SARS, and given that SARS could change their minds about the interpretation despite what it said in the BPR (as has happened in the past), we would recommend that any company wishing to take this route should obtain its own binding ruling.

Werksmans

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

Acts and Bills

- Income Tax Act 58 of 1962: Section 47 (including the definition of "liquidation distribution" in subsection (1));
- Companies Act 71 of 2008.

Other documents

- SARS Binding Private Ruling 336 (6 December 2019).

Cases

- *ABC v DEF* [2023].

Tags: subsidiary company; treasury shares; holding company; anti-avoidance rules; transferred capital assets.

ALLOCATION OF TAX PAYMENTS

The Tax Administration Laws Amendment Act, 2020 (the TALA Act), which was promulgated in the Government Gazette *on 20 January 2021, proposes the provision of specific timeframes within which the South African Revenue Service (SARS) can allocate payments made by a taxpayer to SARS which are not specifically assigned (or assigned incorrectly) by a taxpayer to a specific tax debt that is due.*

The proposal is made with the objective of providing SARS with sufficient time within which to make a determination as to the nature of the payment and as such, curtailing the current procedure of SARS simply effecting a refund of such amount to a taxpayer, with the taxpayer incurring interest on the tax debt which remains due and to which the initial payment, now refunded, was intended to be allocated towards.

This alert outlines how National Treasury (Treasury) seeks to achieve this objective through amendments to section 187 of the Tax Administration Act, 2011 (the TAA), in light of the issues arising out of the practicalities of section 190(1)*(b)* of the TAA.

Section 190(1)*(b)* places a statutory obligation on SARS to pay a refund to a taxpayer if that taxpayer is entitled to a refund of an amount of any form of tax levied by SARS which is erroneously paid in excess, including interest thereon.

Section 187, on the other hand, sets out the general rules applicable to the calculation of interest on, amongst other things, outstanding taxes due by a taxpayer to SARS. In terms of section 187(1), interest accrues and is payable on the amount of the outstanding tax balance, if that tax debt is not paid in full by the effective date. The "*effective date*" for purposes of the calculation of interest varies and is determined based on the specific tax type or scenario on which interest is levied and is set out in section 187(3).

The Memorandum on the Objects of the 2020 Taxation Laws Amendment Bill (the TALAB) states that payments made to SARS that are not properly allocated by a taxpayer under a specific tax type or that are incorrectly allocated, are administratively difficult for SARS to allocate correctly. This issue frequently arises when a taxpayer makes a lump sum payment to SARS which is not placed under a specific tax type by the taxpayer. Due to the incorrect allocation or non-allocation of the payment by the taxpayer, SARS is unable to allocate the amount correctly and will likely refund that amount to the taxpayer (as it may prove administratively easier for SARS to regard the amount as an overpayment owing to, as well as due to its statutory duty under section 190(1)*(b)* of the TAA). As a result, the outstanding tax debt which the taxpayer sought to settle remains unpaid, as the amount was not properly allocated to a specific tax type at the time it was paid, and interest accrues on the outstanding tax balance after the effective date.

Because the taxpayer is inadvertently penalised through the standard scenario of SARS simply refunding the unallocated amount with the tax debt accruing interest under section 187, it has been proposed that section 187 be amended to allow SARS a specific period within which to determine the nature of the payment prior to such payment being refunded to the taxpayer. During such period, the taxpayer will not be subject to interest on the tax debt. Ensuing from this, the TALA Act therefore proposes that an additional "*effective date*" definition be inserted under section 187(3), to provide for the calculation of interest in relation to erroneous payments made by a taxpayer to SARS.

"Section 190(1)*(b)* places a statutory obligation on SARS to pay a refund to a taxpayer if that taxpayer is entitled to a refund of an amount of any form of tax levied by SARS which is erroneously paid in excess, including interest thereon."

Initially, in the draft Taxation Laws Amendment Bill (published in July 2020), Treasury proposed a period of 60 business days. Whilst members of the public expressed the view that it would be administratively efficient for SARS to be provided with a grace period to confirm whether an amount is a genuine overpayment or constitutes an amount which must be set off against existing tax debts before interest is calculated thereon, they found that the 60-day period was excessive and ought to be reduced to 21 business days in order to align the period with similar legislative provisions. SARS accepted the view and has reduced the period to 30 calendar days, as indicated in the TALAB, introduced on 28 October 2020.

CONCLUSION

The in-principle outcome of the amendment is that taxpayers are less likely to incur interest on unpaid taxes, which they have in reality attempted to settle, as SARS would reasonably be in a better position to allocate the amounts correctly, given the sufficient amount of time to ensure proper allocation. However, as the amendment does not specifically place an obligation on SARS to utilise the 30-day period to allocate payments correctly (instead, it is drafted in a manner which merely clarifies when interest will accrue in relation to erroneous payments made by taxpayers), it is not known whether SARS will practically administer the allocation within the envisaged 30-day period.

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: sections 187(1) & (3) (definition of "effective date") & 190(1)*(b)*;
- Tax Administration Laws Amendment Act 24 of 2020;
- Tax Administration Laws Amendment Bill 28 of 2020;
- Draft Tax Administration Laws Amendment Bill, 2020.

Other documents

- Memorandum on the Objects of the Tax Administration Laws Amendment Bill, 2020.

Tags: outstanding tax debt.

OBJECTING TO AN ASSESSMENT

When a taxpayer objects to an assessment, great care should be exercised to ensure that every issue that is contested is included in the objection. Failure to do so places a taxpayer at risk of unnecessary loss if an issue might have been successfully contested but for its omission from the notice of objection.

The Gauteng North High Court recently considered an appeal brought by SARS against a decision of the tax court in which an appeal by a taxpayer had been allowed and an application to include an additional ground of appeal to obtain remission of interest levied on the assessment had been permitted and upheld.

FACTS

The facts in *Commissioner for the South African Revenue Service v The Executor of the Estate Late Lot Maduke Ndlovu*, [2020], related to the disposal of shares acquired on exercise of employee share options which were disposed of while the taxpayer was a director of Nedbank. The administrator of the share scheme disposed of the shares on the taxpayer's behalf in three tranches and accounted to him by paying over the net gain of R7 121 744. No taxes were withheld from the amounts paid to the taxpayer.

The Administrator provided the taxpayer with three IT3(a) certificates, in respect of payments for work for services from which no PAYE had been withheld. The reason for no taxes having been withheld was stated in the certificates as "*Code 4: non-taxable earnings*".

In 2010, the taxpayer asked the Administrator whether the amount of R7 121 744 was taxable, to which a written response was received stating that "the earnings arising from the options exercised were non-taxable".

Thus informed, the taxpayer submitted his return of income for the 2007 year of assessment. He did not declare the gain as income or a capital gain and he failed to record in the return that he had received an amount that he considered non-taxable.

SARS conducted an audit of the 2007 return of income and raised an additional assessment including the amount of R7 121 744 in taxable income and levied income tax, penalties and interest.

The taxpayer objected to the additional assessment, stating that the amount of R7 121 744 was not taxable as income or as a capital gain and that the additional tax should be remitted in full. SARS reduced the penalty from 200% to 100% but otherwise disallowed the objection.

Following disallowance of the objection and a failed alternative dispute resolution hearing, the taxpayer conceded that the amount of R7 121 744 was taxable as income but lodged an appeal in the tax court against the remainder of the disallowed amounts.

Prior to the hearing of the appeal, SARS reduced the penalty from 100% to 10%. The appeal nevertheless proceeded, with the taxpayer seeking remission of the penalty in full. At the hearing of the appeal, the taxpayer raised the issue of remission of the interest chargeable for late payment of the tax for the first time. Despite SARS' argument that this would introduce a new ground of objection, the tax court allowed the application to include the interest as an appeal issue. Judgment was given in favour of the taxpayer and the penalty and interest were remitted in full.

SARS did not accept the tax court decision and brought the issue before the High Court on appeal.

THE ISSUES

The principal issue was whether SARS had been entitled to raise a penalty if the taxpayer had no intention to evade the payment of tax. The second issue was whether the tax court had been correct in remitting the penalty and the final issue was whether the tax court had been correct in allowing a new ground of appeal in respect of the interest that had been levied.

The matter was decided under the provisions of the Income Tax Act, 1962, as it then applied. In essence, if a taxpayer omitted an amount from a return or claimed an amount as a deduction to which he was not entitled, SARS was required to levy a penalty of 200% of the tax chargeable in respect of the taxpayer's default. The Commissioner was entitled to remit the amount of any such penalty in whole or in part:

> "Provided that, unless he is of the opinion that there were extenuating circumstances, he shall not so remit if he is satisfied that any act or omission of the taxpayer ... was done with the intent to evade taxation."

Pretorius J noted at paragraph [21] that the right of SARS to impose the penalty did not require an examination of the taxpayer's intent:

> "The only requirements in terms of the provisions of the Act is that a taxpayer had omitted from his return an amount of income which should have been included. There is no indication in this provision that it had to be done intentionally – not declaring income will suffice."

The manner in which SARS had applied the Commissioner's discretion to remit the penalty is documented at paragraph [26]:

> "In this instance SARS ... did not come to the conclusion that the [taxpayer] had the intention to evade the tax. SARS found extenuating circumstances and first remitted the additional tax from the prescribed 200% to 100%, and then reduced it further to 10%. The [taxpayer] relied on the fact that his employer had to deduct the appropriate tax and he did not intend evading the payment of tax. [SARS] had already taken this into account as an extenuating circumstance when further remitting it from 100% to 10%. The provision is very clear that had the [taxpayer] had the intention to evade the payment of tax, no remission would have been granted."

As to whether the remaining 10% penalty should be remitted because of a lack of intention to evade tax, the court held that the taxpayer had been a director of a major bank and ought to have satisfied himself whether tax was payable and not passively relied on the assertions of the administrator. Furthermore, Pretorius J found at paragraph [29]:

> "It is significant that the taxpayer refrained from declaring this as a non-taxable receipt in his 2007 tax return. No further reasons were submitted for a further remittance to 0%, alternatively to 1%. It is expected of a taxpayer, in the [taxpayer's] situation, to set out valid reasons for a further remittance where [SARS] had already found extenuating circumstances by first remitting the amount from the prescribed 200% to 100% and then to 10%."

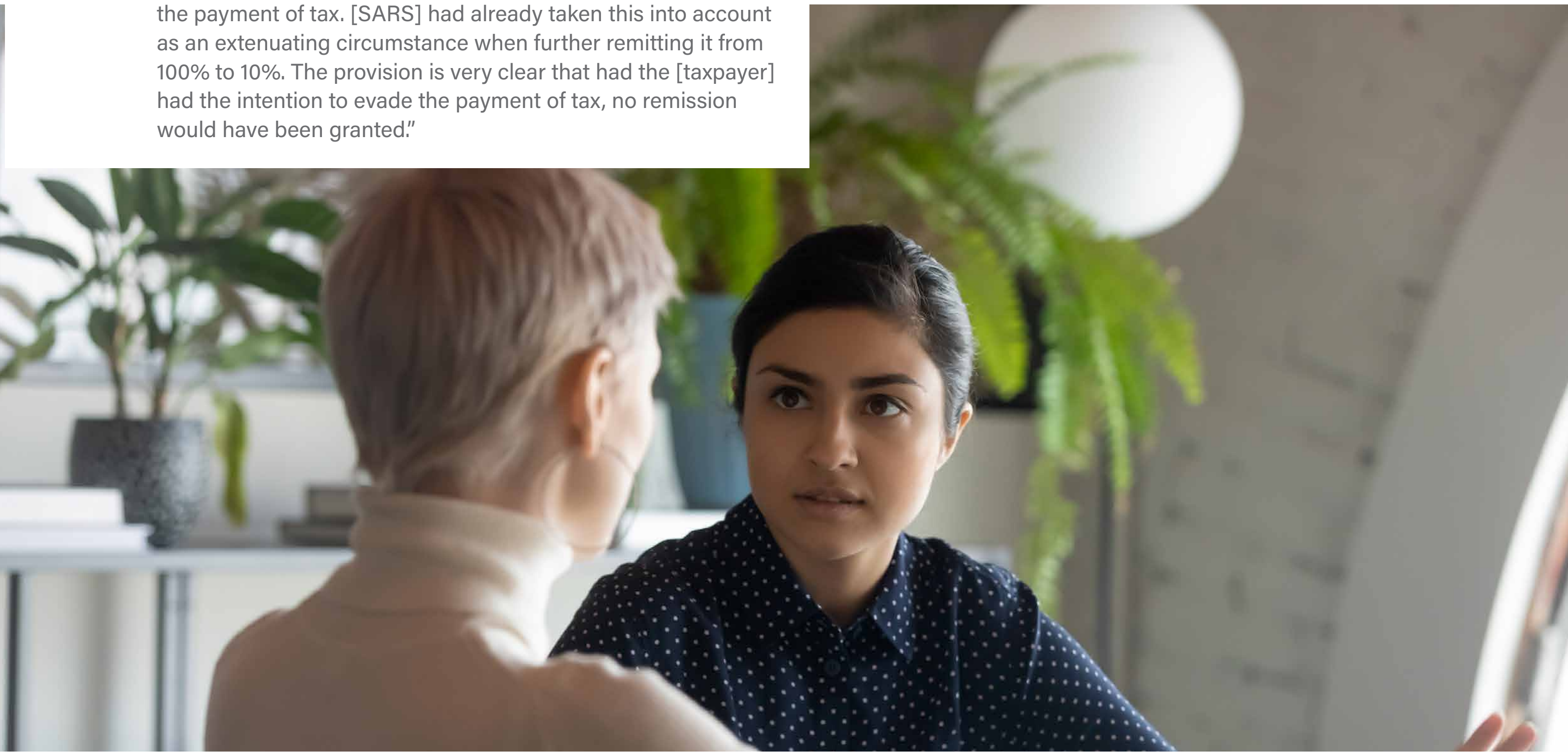
Further remission of the 10% penalty was denied.

Turning then to the third issue, the issues on appeal are determined based on the rules promulgated under section 103 of the Tax Administration Act, 2011 (the Rules), for the conduct of disputes. In paragraphs [34] and [35], Pretorius J stated, first, the provisions of Rule 7(2), which requires a taxpayer who lodges an appeal to specify which of the grounds of assessment are disputed, and then Rule 10(2) and (3). In the latter regard, he stated (paragraph [35]):

> "In terms of Rule 10(2)*(c)*(i) a notice of appeal has to specify in detail the grounds of objection appealed against. Rule 10(3) provides that a taxpayer may not appeal on any ground that constitutes a new objection against a part or amount of disputed assessment not objected to under Rule 7."

Judicial authority that confirmed this principle was cited at paragraph [36]:

> "In *HR Computek (Pty) Ltd v Commissioner, South Africa Revenue Service* 2012 JDR 2281 (SCA) the Supreme Court of Appeal held that a taxpayer is precluded from raising a new ground of objection at the appeal stage before the Tax Court."



"The salutary lesson to all persons who may become embroiled in a dispute with SARS is that they should identify every reason for an assessment by SARS that they dispute and set forth the basis on which they are disputing each of those reasons."

Further support for the court's decision came in paragraph [37]:

> "This Court takes note of the dictum in *Matla Coal Ltd v Commissioner of Inland Revenue* 1987 (1) SA 108 (A), where the Court, *inter alia*, held that a Court should not be unduly rigid in its approach when deciding whether to allow a new ground of objection only at the appeal stage. The circumstances of each case should be taken into consideration, when the Court considers the facts of the case.
>
> In *CSARS v Brummeria Renaissance (Pty) Ltd and Others* 2007 (6) SA 601 (SCA) at para 26 held:
>
>> '... But it is also in the public interest that disputes should come to an end – *interest reipublicae ut sit finis litium* and it would be unfair to an honest taxpayer if the Commissioner were to be allowed to continue to change the basis upon which the taxpayer were assessed until the Commissioner got it right – memories fade; witnesses become unavailable; documents are lost.'
>
> The converse should apply, that it is in the public interest that a taxpayer cannot be allowed to continue changing the grounds of his objection and appeal."

After due consideration of the circumstances, the court could find no circumstances to justify allowing the introduction of a fresh ground of appeal and found that the taxpayer was liable to the payment of interest as assessed.

CONCLUSION

There is a distinct possibility that the taxpayer would have been able to obtain a remission of the interest if the grounds of objection had been full and explicit.

Although the standard for remission of interest is much higher than that for remission of penalties, extenuating circumstances had been found in relation to the penalty and it is possible that these circumstances would have been sufficient to justify a remission of interest.

The salutary lesson to all persons who may become embroiled in a dispute with SARS is that they should identify every reason for an assessment by SARS that they dispute and set forth the basis on which they are disputing each of those reasons.

PWC

Acts and Bills

- Income Tax Act 58 of 1962;
- Tax Administration Act 28 of 2011: Section 103.

Other documents

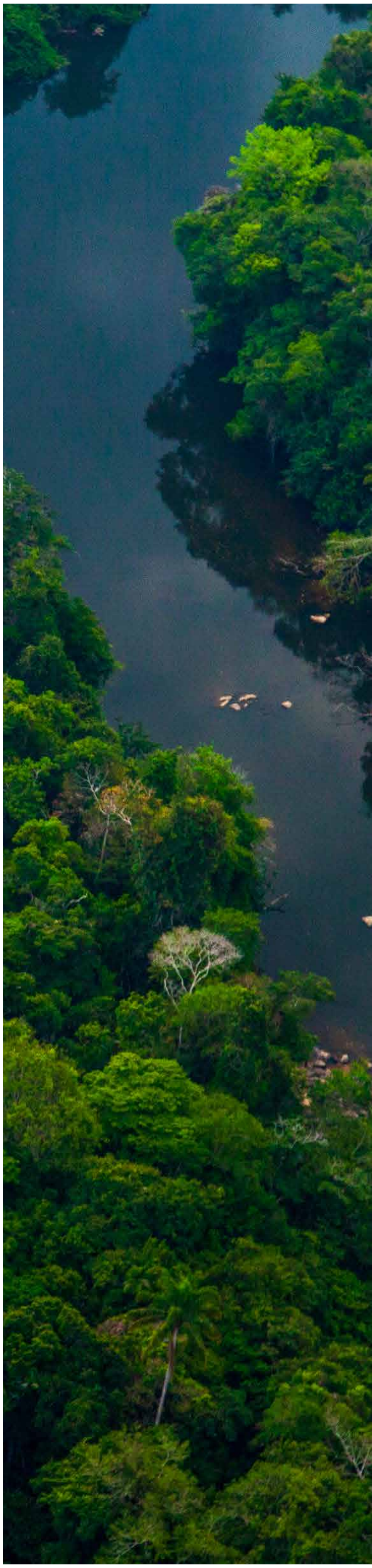
- Rules in terms of section 103 of the Tax Administration Act 28 of 2011: Rule 7 (7(2)); Rule 10(2) and (3); Rule 10(2)*(c)*(i);
- IT3(a) certificate.

Cases

- *Commissioner for the South African Revenue Service v The Executor of the Estate late Lot Maduke Ndlovu* [2020] ZAGPPHC 601 (12 October 2020); 2020 JDR 2405 (GP): Paragraphs [21], [26], [29], [34], [35], [36] & [37];
- *HR Computek (Pty) Ltd v Commissioner for the South Africa Revenue Service* [2012] JDR 2281 (SCA); 2012 ZASCA 178 (29 November 2012);
- *Matla Coal Ltd v Commissioner of Inland Revenue* [1987] (1) SA 108 (A);
- *Commissioner, South African Revenue Service v Brummeria Renaissance (Pty) Ltd and Others* [2007] (6) SA 601 (SCA).

Tags: taxable income; remission of interest.

VOLUNTARY DISCLOSURE PROGRAMME



The Voluntary Disclosure Programme (VDP), contained in Part B of Chapter 16 of the Tax Administration Act, 2011 (the TAA), was introduced to encourage non-compliant taxpayers to come forward, and provide an account of their non-compliance with a view to regularising their tax affairs. A valid disclosure and conclusion of a voluntary disclosure agreement with SARS shields the taxpayer from criminal prosecution and provides relief from the non-compliance and understatement penalties which would ordinarily have been imposed.

Section 226(1) of the TAA provides that persons acting in their personal, representative, withholding or other capacity may apply for voluntary disclosure relief. Section 227 prescribes the requirements for a valid disclosure, and it must:

- be voluntary;
- involve a "default", defined in section 225 as "the submission of inaccurate or incomplete information to SARS, or the failure to submit information or the adoption of a 'tax position', where such submission, non-submission, or adoption resulted in an understatement";
- be full and complete;
- involve a behaviour listed in column 2 of the understatement penalty percentage table in section 223(1), for example "*reasonable care not taken in completing return*", "*substantial understatement"* and *"intentional tax evasion*";
- not result in a refund being due by SARS; and
- be made in the prescribed form.

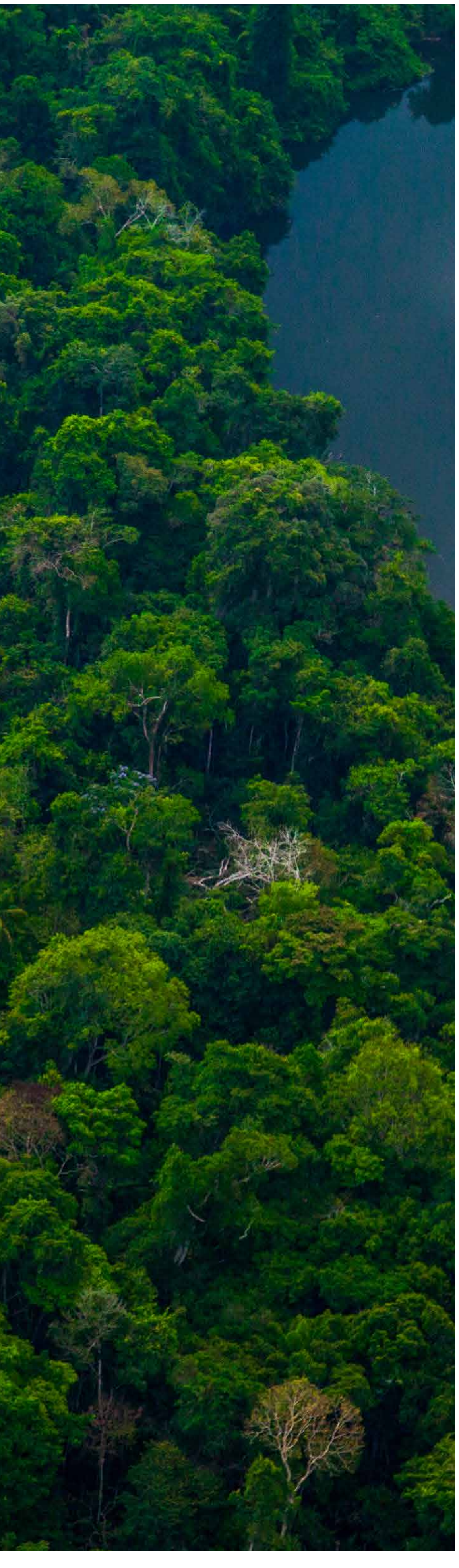
The recent case of *Purveyors South Africa Mine Services (Pty) Ltd v The Commissioner for the South African Revenue Service*, [2020], (the *Purveyors* case) dealt with the interpretation of the requirements for a valid disclosure and the voluntariness thereof under sections 226 and 227 of the TAA.

FACTS

During 2015 the taxpayer in the *Purveyors* case imported an aircraft into South Africa to use in its business operations. This importation attracted a liability for import VAT, but the taxpayer failed to pay the amount due.

During the latter part of 2016, the taxpayer expressed reservations about having failed to pay the VAT due and accordingly engaged with SARS representatives to obtain a view on its liability in early 2017. In this engagement the taxpayer only presented a broad overview of the facts at hand.

On 1 February 2017, SARS informed the taxpayer that VAT ought to have been paid on the importation and that penalties were to be imposed as a result of the taxpayer's default; until May 2017 SARS from time to time engaged with the taxpayer to take steps to regularise its tax affairs.



On 4 April 2018 the taxpayer applied for voluntary disclosure relief under the VDP. This application was rejected by SARS, leading to the application to review SARS' decision to reject the application.

JUDGMENT

The existence of a default, as defined, in the non-payment of VAT was common cause. However, the taxpayer argued that under section 226(2) the disclosure was voluntary, as it had not been given notice of an audit or criminal investigation, nor had such audit or investigation been concluded at the time of making the VDP application.

SARS in turn argued that section 227 envisages a disclosure of facts or information of which SARS had not been aware. Further, as there had been an indication by SARS officials that the VAT was due and penalties would be imposed, the disclosure was not voluntary.

Fabricius J held that the concepts of "*voluntary*" and "*disclosure*" would be determinative of the dispute. In order to properly interpret the provisions, the court held it necessary to first set out the context of the VDP.

The purpose was held to be "to enhance voluntary compliance in the interests of good management of the tax system and the best use of SARS' resources. It seeks to encourage taxpayers to come forward on a voluntary basis to regularise their tax affairs with SARS and thus avoid imposition of understatement penalties" and the "VDP is further aimed at promoting ethical and moral conduct by incentivising errant taxpayers to make amends in respect of any defaults by them by informing SARS of the default and of which SARS is ignorant".

The court accepted SARS' contention that section 226(1) applies to any taxpayer, while section 226(2) only applies to taxpayers who have been issued with a notice of audit or investigation, but that the requirements of section 227 must be satisfied in either case. The court further held that the interpretation argued for by the taxpayer – that an application is always voluntary if no notice of audit or investigation has been issued – was too narrow.

Turning to the meaning of the word "*voluntary*", Fabricius J held that in accordance with the ordinary meaning of the word it must be interpreted as meaning "*an act in accordance with the exercise of free will*." Further, that "*if there is an element of compulsion underpinning a particular act, it is no longer done voluntarily*." Thus, where a taxpayer has been warned of its liability for interest and penalties, the voluntariness of the disclosure is undermined – as was the case here.

The application was thus dismissed.

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Section 223(1) (understatement penalty percentage table); Part B of Chapter 16 (sections 225 to 231 – more specifically sections 225 (definition of "default"), 226(1) & (2) & 227).

Cases

- *Purveyors South Africa Mine Services (Pty) Ltd v The Commissioner for the South African Revenue Service* [2020] ZAGPPHC 409 (25 August 2020); 2020 JDR 1830 (GP).

Tags: understatement penalties; voluntary disclosure relief.

RIGHTS OF BENEFICIARIES

Based on judgments in the law reports, it seems that family trusts provide rich potential for family squabbles. The decision of the Supreme Court of Appeal in Griessel NO and Others v De Kock and Another, *[2019], is a typical example. In issue was whether beneficiaries to the trust had vested or discretionary rights and, if the latter, whether they had the right to protect their discretionary interest against maladministration by the trustees. The court found that discretionary beneficiaries have that right.*

Two sisters had created the Arathusa Trust in 1999. Its only assets were all the shares in Manyeleti (Pty) Ltd, a company that owned a farm which was part of a game reserve. The beneficiaries of the trust, described as "potential beneficiaries", appear to have comprised members of the family of the founding sisters. All the potential beneficiaries had been afforded the right to visit the farm with their families for vacations on a rotational basis. When a difference of opinion arose between De Kock, the son of one of the founding trustees, and the rest of the family over the development of the farm for commercial use, the trustees amended the trust deed and removed him as a beneficiary. De Kock approached the High Court for reinstatement, and the matter was settled on the basis that the purported amendment was to be regarded as of no force and effect and invalid. The settlement was made an order of court.

It appears that the parties then entered into a dispute about the terms of the settlement, which culminated in De Kock approaching the High Court again. De Kock sought an order that what he described as his "vested rights" under the trust be reinstated and that the existing trustees be removed and replaced by "independent and impartial" trustees to be appointed by the Master of the High Court. The trustees contended that De Kock, as a "potential beneficiary", had no vested right in the trust property and accordingly had no rights to protect. The court found that the trustees had unlawfully discriminated against De Kock, because the law did not allow them to withhold the benefit enjoyed by the other beneficiaries simply because the rest of the family "had issues with him". Accordingly, the court ordered De Kock's reinstatement as a beneficiary, and further that the Master should appoint an additional independent trustee in consultation with the other family members and "other interested parties" (without identifying these parties in the judgment). The court made a punitive costs order against the trustees.

Before the SCA the trustees and the other family members sought to appeal against the High Court's decision and sought a determination of three issues: (i) whether leave to appeal should be granted; (ii) whether De Kock, as a discretionary beneficiary, had acquired rights as against the trustees which were capable of protection; and (iii) if so, whether the court had been correct in granting the reinstatement order, directing the Master to appoint an additional trustee, and issuing a punitive costs order.

The trust deed clothed the trustees with the power in their discretion to allow any beneficiary free use and enjoyment of the property. The trust deed provided that the right of any beneficiary under the trust would vest only on payment or transfer to the beneficiary. This did not include loans to a beneficiary.

Both sides argued on the question whether or not the right of access to the farm afforded to a beneficiary was a vested right. The trustees were at pains to point out that they had not yet selected beneficiaries. No vesting of rights was consequent, so the argument

"The total costs of these two actions must have been astronomical, and one cannot but think that there must have been less expensive ways to resolve a family dispute."

went, on the occasional occupation by beneficiaries. They made much of the fact that the company, not the trust, owned the farm and it was the company that had the exclusive right to allow access to the farm. The court made short shrift of this contention, pointing out that, as the shareholders of the company in their office as trustees, the trustees were making the decisions. This left for consideration the question whether De Kock, as a "potential" beneficiary, had a right to protect.

The court rejected as misplaced De Kock's submission that he had acquired vested rights. Read in the context of the purpose and the other provisions of the trust deed, the occasional right of use on a rotational basis did not amount to vesting. It then addressed point (ii) above and referred to the SCA decision in *Potgieter and Another v Potgieter NO and Others*, [2011], where the court found that:

> "The import of acceptance by the beneficiary is that it creates a right for the beneficiary pursuant to the trust deed, while no such right existed before. The reason why, after that acceptance, the trust deed cannot be varied without the beneficiary's consent, is that the law seeks to protect the right created for the first time. In this light, the question whether the right thus created is enforceable, conditional or contingent should make no difference. The only relevant consideration is whether the right is worthy of protection, and I have no doubt that it is. Hence, for example, our law affords the contingent beneficiary the right to protect his or her interest against maladministration by the trustee…"

Based on this *dictum*, De Kock was entitled to protect his discretionary right against maladministration by the trustees. The withdrawal from him of the privilege of having a vacation on the farm constituted differential treatment without a justifiable basis, prompted by his attitude towards development of the farm for commercial purposes. A trustee had the fiduciary duty towards all the beneficiaries of a trust irrespective of the nature of their rights. This was so, even if a beneficiary was obstructive and contrarian.

As to the instruction to the Master to appoint an additional independent trustee, the court had this to say: "It is clear that there was a dispute of fact pertaining to [De Kock's] allegation that the trustees did not attend to the affairs of the trust to the point where a letter of demand was issued against the trust. The court a quo merely stated that the appointment of another independent trustee might quell the acrimony between the parties and restore the role of the trustees to what it should be. The third [trustee] is a chartered accountant by profession and is therefore qualified to properly understand the responsibilities of trusteeship. In the absence of facts conclusively showing that the third [trustee] would not be able to play that role, there is simply no legal basis for an order directing the Master to appoint an additional trustee. The need for the appointment of an additional trustee was simply not established in this matter. In any event, in terms of the trust deed decisions must be arrived at consensually. That would mean that the family and all the potential beneficiaries have to reach agreement, which obviates any need for the appointment of a further trustee."

When it came to the punitive costs order, in light of the court's findings the trustees had had a measure of success. Despite the attempts of De Kock to defend the "unsustainable" punitive costs order, the decision as to costs was that the punitive element was removed from the High Court's order and the costs of the appeal were to be borne by the respective parties.

The total costs of these two actions must have been astronomical, and one cannot but think that there must have been less expensive ways to resolve a family dispute.

Prof Peter Surtees

Cases

- *Griessel NO and Others v De Kock and Another* [2019] (5) SA 396 (SCA); Case No 334/18;
- *Potgieter and Another v Potgieter NO and Others* [2011] ZASCA 181; 2012 (1) SA 637 (SCA).

Tags: vesting of rights; punitive costs.

VAT RELIEF FOR COVID ASSISTANCE

INTRODUCTION

The COVID-19 pandemic has disrupted our lives and brought many of the challenges countries were facing to the fore. One of these challenges was Government's ability to deal with a health crisis.

Due to the Government's limited resources, the President and Ministers appealed to corporate citizens to assist in dealing with the health crisis.

Many corporate citizens heeded the call and opened up their cheque books and their business resources to assist. These corporate citizens are invariably taxpayers who are registered for VAT.

Assistance provided to Government comprised financial aid as well as the donation of certain goods and services such as, for example, food, personal necessities, personal protective equipment and, in some cases, medical equipment.

In response, Government provided limited VAT relief for corporate and other tax citizens. While this relief is and was welcomed, it has not catered for all areas impacting businesses that have provided assistance.

VAT impact on business assisting Government

Below, we assess the extent of the VAT relief provided by Government to businesses that assist in dealing with the COVID-19 pandemic.

The acquisition of personal protective equipment (PPE) solely for the purpose of donation to Government or the public

Businesses registered for VAT (excluding certain welfare organisations) acquiring PPE to donate to the general public or Government will be disappointed to note that any VAT incurred on such purchases will not be allowed as an input tax deduction.

SARS is of the view that these goods or services are not acquired for purposes of making taxable supplies and therefore cannot be regarded as qualifying input tax deductions for VAT purposes. In addition, no exception and/or dispensation is considered by SARS in order to provide VAT relief to businesses in this regard and in these challenging times. In addition, notwithstanding proposals made to National Treasury as part of the COVID-19 Relief Bills and other tax amendments to allow for such a deduction, this was not accepted by National Treasury and no amendments have been noticed.

The importation of PPE v the local acquisition of PPE for purpose of donation to Government or the public

For a limited period, which expired at the end of 5 June 2020, businesses were permitted to import PPE under a VAT exemption contained in the VAT Act. This exemption allowed businesses to import PPE without paying the VAT due on importation, irrespective of the ultimate purpose (ie to resell or donate or for own use). For the same period, however, the local acquisition of PPE was subject to VAT in all instances.

For reasons previously mentioned, locally purchased PPE which is or was acquired for purposes of donating such PPE to the general public or to Government in order to mitigate the impact of the pandemic was not regarded as a permissible deduction for VAT purposes and, as such, the VAT incurred cannot be deducted as input tax.

Preferential treatment was accorded to imported PPE versus PPE purchased locally, which is contrary to the construct of the VAT Act, which seeks to create tax parity for goods and services acquired locally or internationally.

Furthermore, from the measures implemented in relation to the importation of PPE and other necessities in terms of the pandemic, it is clear that the objective of Government was to create tax and customs relief in respect of essential or necessary goods during the pandemic. This, however, did not filter through to the local purchase of similar essential goods for purposes of donating such to Government and other general public members in need.

The manufacture of PPE for the purpose of donation to Government or the public

During the various stages of lockdown, many companies kept their businesses open to manufacture PPE both to supply such PPE in the normal course of its business or enterprise and to donate such PPE to the general public or Government.

Based on SARS' approach, any VAT incurred in relation to the acquisition of the raw materials in the production process, or in procuring other goods or services in order to manufacture such equipment, would not be deductible as input tax to the extent being used to make donations.

Again, should manufacturers have imported all materials necessary for the manufacture of the PPE during the time period mentioned above, such importations would have been "VAT free", resulting in the local and foreign acquisition of PPE not being treated equally, placing the local market at a disadvantage.

The building of COVID-19 field hospitals for the purpose of donating them to Government

Where a business assists or has assisted Government in making premises available and converting such premises into a field hospital or other medical facility and equipped the facility with the necessary PPE, beds, ventilators and other medical equipment, any VAT incurred by the business in order to do so would not be deductible as input tax. This is again based on the premise that all of these goods and services are not acquired for purposes of consumption, use or supply in the course of making taxable supplies. This would be the case irrespective of whether the hospital is made available to Government temporarily whilst the pandemic is ongoing or whether it is permanently donated to Government.

If this VAT cost were allowed as a deduction, it could have been further applied by businesses to contribute to the efforts to deal with the pandemic. In other words, should the vendor have received the VAT on acquisitions of PPE or other equipment etc as a deduction, this amount could have been used to purchase more PPE or other equipment for use in the pandemic, and thereby further contributing to the cause and Government's request for assistance.

CONCLUSION

Having regard to the above, although some VAT relief has been provided by Government during the COVID-19 pandemic, this relief is limited and does not materially assist businesses that have come forward to assist Government through various other initiatives.

Businesses must carefully consider their respective activities in this regard and the concomitant VAT impact thereof in order to avoid future assessments by SARS.

To date, no further measures in relation to any of the above which will provide relief to these businesses have been introduced by Government.

PwC

Acts and Bills

- Value-Added Tax Act 89 of 1991;
- COVID-19 Relief Bills
  - Disaster Management Tax Relief Bill 11B of 2020;
  - Disaster Management Tax Relief Administration Bill 12B of 2020.

Tags: VAT relief; taxable supplies; input tax.