Issue 52 | 2022
NOVEMBER

South African Institute of Taxation

Unstructured CPD 150mins

TAX CHRONICLES MONTHLY

Official Journal for the South African Tax Professional

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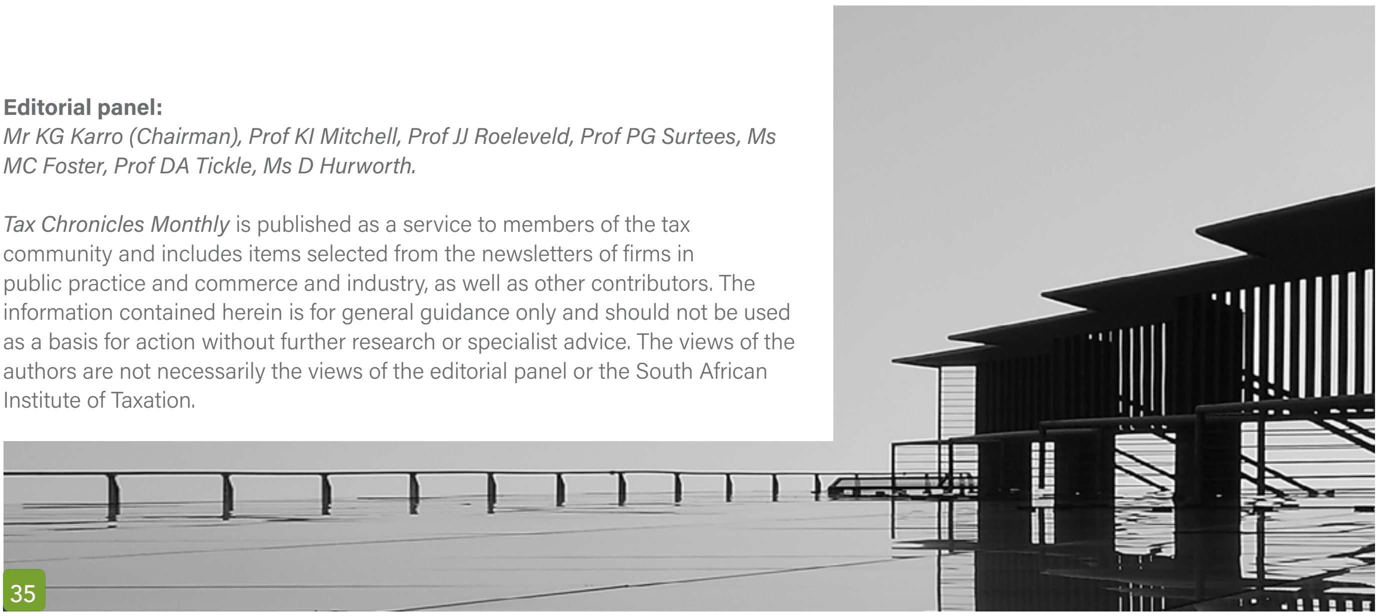
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GROUP OF COMPANIES

Confusion often arises when one concept has various nuanced meanings in different spheres. A "group of companies" is one such concept which has different meanings depending on the context.

The concept is, for example, defined differently in the Companies Act, 2008 (the Companies Act), the Income Tax Act, 1962 (the Act), and the IFRS. Furthermore, the concept is loosely referred to in conversation or the commercial world. However, only the tax concept and meaning (per the Act) provides access to special tax relief provisions.

A "group of companies" is defined in the Companies Act as "a holding company and all of its subsidiaries". On the face of it, the Companies Act definition is very broad. This definition is, however, narrowed with the definition of "holding company" as "in relation to a subsidiary, . . . a juristic person that controls that subsidiary". Therefore, a controlling element is added. There is a discord between the Companies Act definition, and the definition for tax purposes.

A "group of companies" has a different definition in section 1(1) of the Act, namely:

". . . two or more companies in which one company (hereinafter referred to as the 'controlling group company') directly or indirectly holds shares in at least one other company (hereinafter referred to as the 'controlled group company'), to the extent that—

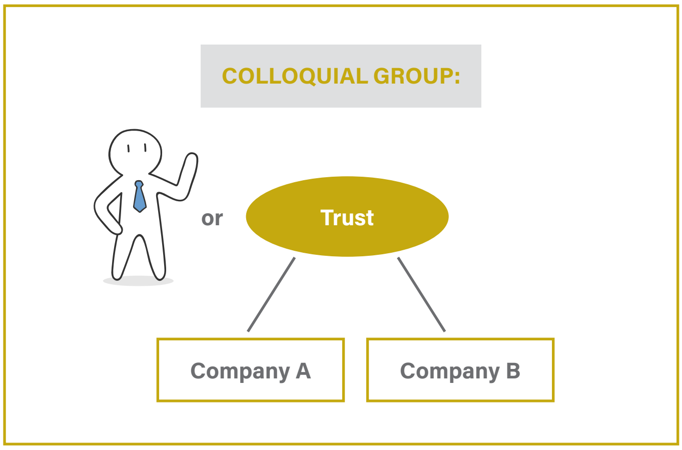
(a) at least 70% of the equity shares in each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and

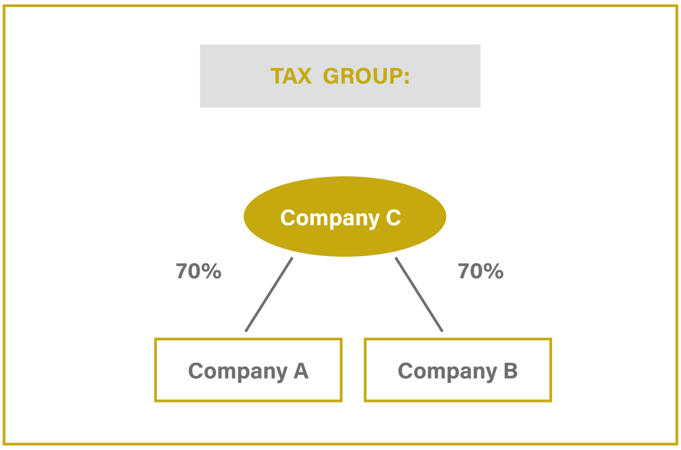
(b) the controlling group company directly holds at least 70% of the equity shares in at least one controlled group company."

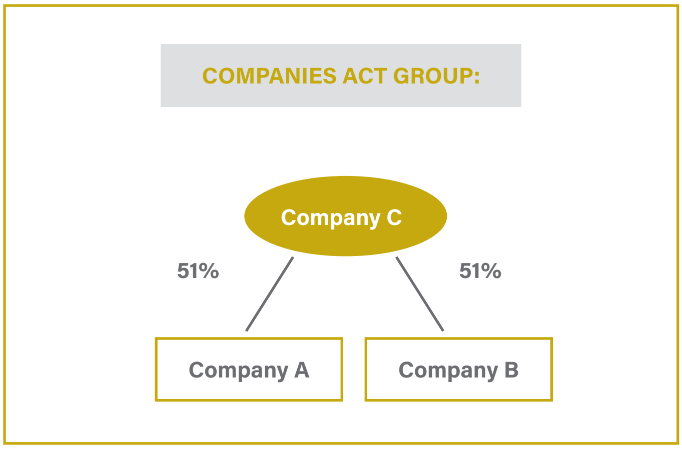
For tax purposes, a 70% shareholding between companies is required. A tax "group of companies" is therefore a very specific and narrow concept.

A "group of companies" is often colloquially used as well. It may well be that you have heard someone referring to their or their family's companies as a "group of companies". Despite being (probably) true in the literal sense, the Act requires the top holding entity to be a company. Should a family trust or the individual own all the shares in various companies for example, there may be an informal "group of companies", but the definition for tax purposes will not be met and no tax relief can be afforded in those cases, without restructuring being required from the outset.

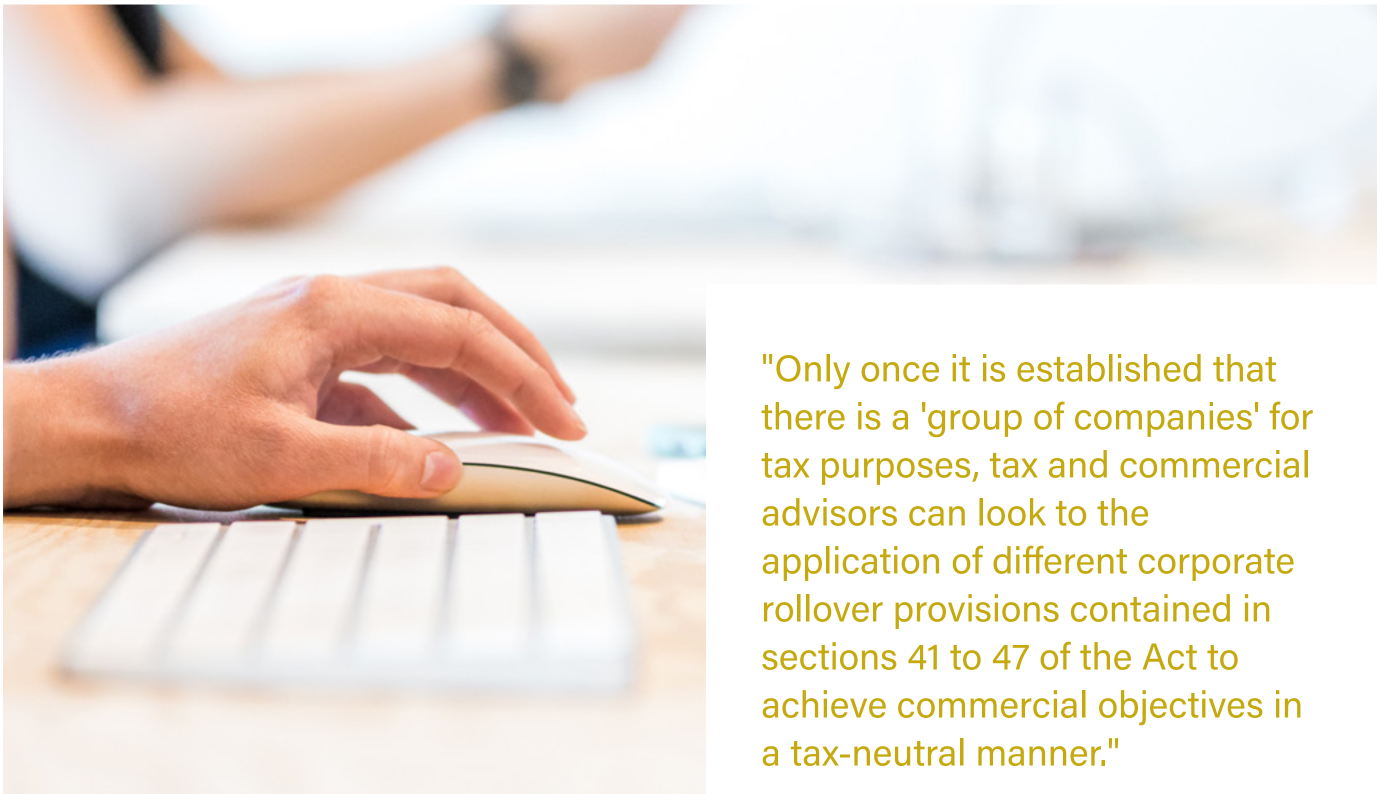
The different "group of companies" concepts are best illustrated as follows:







"It is recommended that taxpayers re-evaluate their shareholding structures from a commercial and tax perspective, as a 'group of companies' in the tax sense may prove an effective mechanism to achieve commercial objectives without the hindrance of adverse tax consequences."



"Only once it is established that there is a 'group of companies' for tax purposes, tax and commercial advisors can look to the application of different corporate rollover provisions contained in sections 41 to 47 of the Act to achieve commercial objectives in a tax-neutral manner."

The corporate rollover provisions have the effect of deferring normal tax and capital gains tax to a future disposal and could be applied for example when Company A wants to transfer an asset or part of its business to Company B. Generally, the transfer could result in capital gains tax, recoupments, or VAT being due. However, to the extent that one or more of the corporate rollover provisions are applied (as there is a "group of companies") this transfer would have no adverse tax consequences and there will only be a tax liability when Company B eventually transfers the asset outside of the "group" structure. There are numerous instances in which the corporate rollover provisions can be applied, all of which are fact-specific and, in many instances, require amongst other things the presence of a "group of companies" for tax purposes.

We emphasise that any restructure should be underpinned by proper commercial rationale and reasons, as SARS could for example attack any transaction on the basis that it is an impermissible scheme aimed at avoiding tax. At the same time, taxpayers are entitled to structure their tax affairs as efficiently as possible, within the legislative realm provided in the Act.

It is recommended that taxpayers re-evaluate their shareholding structures from a commercial and tax perspective, as a "group of companies" in the tax sense may prove an effective mechanism to achieve commercial objectives without the hindrance of adverse tax consequences.

Anton Lockem & Chrichan de la Rey

Shepstone & Wylie

Acts and Bills

- Income Tax Act 58 of 1962: Section 1(1) (definition of "group of companies");
- Companies Act 71 of 2008: Section 1(1) (definitions of "group of companies" & "holding company").

Other documents

- IFRS: Definition of "group of companies".

Tags: group of companies; holding company; corporate rollover provisions.

THE TAX TREATMENT OF WEDDING GIFTS

Getting married is a very special and joyous occasion for any bridal couple, as well as their family and friends. As many a bride will attest, it can also be quite stressful. Hopefully, however, tax will not be one of the issues causing stress on the happy day.

Of course, great care is always taken by the couple's family and friends in selecting appropriate wedding gifts.

In some cases, the bride or groom may be the senior executive / CEO / director of a corporate entity, or could be related to such a person, and it would then not be uncommon for the company to arrange for a wedding gift to be presented to the happy couple. The question arises what the tax implications of such a gift would be in the hands of the company, and / or the executive concerned. Where the gift is relatively immaterial, it would probably be accounted for as a routine staff welfare expense, eg, similar to the cost of flowers sent to an employee on occasion of the birth of a new baby, or in case of a bereavement. In such cases the gift would normally not be regarded as a taxable benefit in the hands of the recipient. In *ITC 701* (1950) 17 SATC 108 (N) it was held that reasonable birthday or other gifts to an employee cannot be said to be in respect of services rendered as it is an act of generosity and the rendering of services is purely incidental.

Should the wedding gift, however, be more significant, eg, where the company is sponsoring the cost of the entire event, or of the honeymoon trip undertaken by the newlyweds, then proper consideration should be given to the tax implications thereof. Failure to pay close attention to the tax implications of such costs could easily result in an additional and unnecessary element of stress.

It should be noted that the relevant tax principles should remain the same, whether the cost of the wedding gift is regarded as immaterial or otherwise. However, each case must be judged on its own facts and circumstances.

If the company accounts for the expense as a donation, it is clear that the amount cannot be claimed as a tax deduction in the hands of the company. In terms of section 23*(b)* of the Income Tax Act, 1962 (the Act), the deduction of domestic or private expenses is expressly prohibited. There can be no doubt that the cost of a wedding or a honeymoon trip would, for tax purposes, be regarded as a private expense. Thus, it would have to be added back in the hands of the company. It would also not be regarded as an amount laid out or expended by the company for the purposes of trade as required by section 23*(g)* of the Act.

On the other hand, the company could simply pay a taxable cash bonus to the recipient, or to its employee who is a relative of the recipient, which should at least then secure the tax deduction in the hands of the company.

In the case of a donation, the Act specifies in section 56 that donations tax of 20% is payable on any donation, being "gratuitous disposal of property including any gratuitous waiver or renunciation of a right" or to the extent that the property has been disposed of for inadequate value, where the sum of the values of all casual gifts made by a company exceeds R10 000 per annum.

Regardless of the treatment of the expense as a tax deduction or otherwise in the hands of the company, a further consideration is the tax treatment of the wedding gift in the hands of the bride / groom, should one of them or a close family member be an employee of the company.

Where a gift is not in cash, paragraph *(i)* of the definition of "gross income" in section 1(1) of the Act refers to so-called fringe benefits defined and valued in the Seventh Schedule. Paragraph *(c)* of the definition of "gross income" includes "any amount, including any voluntary award, received or accrued in respect of services rendered or to be rendered, or any amount . . . in respect of any employment or the holding of any office" in the income of the recipient.

"The net effect of all of the above is that where the company buys and presents a wedding gift to an employee, the employee will be taxed on the value of the benefit received, which is determined as being the cost to the company of acquiring the gift. The amount will also be subject to the deduction of PAYE."

The definition of "remuneration" in paragraph 1 of the Fourth Schedule to the Act includes "any amount of income which is paid or is payable to any person ..... whether in cash or otherwise, and whether or not in respect of services rendered".

"Employee" is defined in that paragraph as "any person . . . who receives any remuneration".

Paragraph 2(1)*(a)* then requires every employer who pays or becomes liable to pay any amount by way of remuneration to any employee, to deduct employees' tax (PAYE) from any amount so paid.

Thus, the wedding gift could be regarded as "gross income" in the hands of the recipient, which would make it taxable and, as "remuneration" it would be subject to the deduction of PAYE.

In terms of paragraph 5 of the Seventh Schedule, where "an asset has been acquired by an employee ..... the cash equivalent of the value of the taxable benefit shall be so much of the value of such asset..... as exceeds the value of any consideration given by the employee for such asset."

Paragraph 5(2) further makes it clear that where the asset in question is movable property and was acquired by the employer in order to dispose of it to the employee, the value to be placed thereon shall be the cost thereof to the employer.

This means that the recipient of the wedding gift, if he or she is an employee of the company incurring the cost of the gift, or the company employee who is a relative of the recipient, will be subject to PAYE on the value, ie, the cost to the company of acquiring the gift.

Paragraph 16(1) of the Seventh Schedule provides:

> "an employee shall be deemed to have been granted a taxable benefit in respect of his employment with an employer if as a benefit or advantage of or by virtue of the employee's employment with the employer or as a reward for services rendered or to be rendered by the employee –
>
> *(a)* the employer has granted a benefit or advantage (whether directly or indirectly) to a relative of the employee.....; or
>
> *(b)* anything is done by the employer under any agreement, transaction or arrangement so as to confer any benefit or advantage upon any person other than the employee (whether directly or indirectly),
>
> and such benefit or advantage, if it had been granted directly by the employer to the employee, would have constituted a taxable benefit contemplated in paragraph 2."

The net effect of all of the above is that where the company buys and presents a wedding gift to an employee, the employee will be taxed on the value of the benefit received, which is determined as being the cost to the company of acquiring the gift. The amount will also be subject to the deduction of PAYE. Similarly, should a wedding gift be presented to a relative of an employee, eg, to the child of a director of the company, the director will be taxed as though it was given directly to him or her, with the associated PAYE implications.

Reliance could, however, be put on the judgment of the Special Tax Court in *ITC 701,* where it was held that reasonable birthday or other gifts to an employee cannot be said to be in respect of services rendered as it is an act of generosity and the rendering of services is purely incidental.

It is a moot point whether the company would be entitled to claim a deduction for the costs incurred in the case where the full amount is taxed as remuneration in the hands of the recipient, or the company employee who is a relative of the recipient. It is presumed that this will in fact be the case, on the grounds that the company could be argued as having paid a bonus to the recipient in respect of services rendered.

Tax professionals should therefore exercise due care when advising client companies where transactions of this nature have occurred, or are planned. It should be stressed that the correct tax principles should consistently be applied and that the size of the amounts concerned is irrelevant. Once again, each case must be judged on its own facts and circumstances.

> "Should the wedding gift, however, be more significant, eg, where the company is sponsoring the cost of the entire event, or of the honeymoon trip undertaken by the newlyweds, then proper consideration should be given to the tax implications thereof."

Johann Benadé

BDO

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "gross income" (paragraph *(c)*) & 23*(b)* & *(g)* & 56; Fourth Schedule: Paragraph 1 (definitions of "employee" and "remuneration"); Seventh Schedule: Paragraphs 5 (more specifically subparagraph (2)) and 16(1).

Cases

- *ITC 701* [1950] 17 SATC 108 (N).

Tags: donations tax; gross income; remuneration; employee.

LATEST SARS INTEREST RATE INCREASES

TAX AND VAT – INTEREST RATE INCREASES

SARS has again increased rates as detailed below.

It is important to remember that interest and penalties paid to SARS are not deductible expenses for income tax purposes. On the other hand, interest received from SARS is fully taxable (after deducting the current initial exemption of R23 800 per annum (R34 500 if you are 65 or older) for all local interest income earned by natural persons).

Income tax, provisional tax, dividends tax, etc

Payable to SARS on short payments of all such taxes (other than VAT): 9% per annum from 1 November 2022 (was 8.25% per annum with effect from 1 September 2022).

Payable by SARS on refunds of tax (where interest is applicable): 5% per annum from 1 November 2022 (was 4.25% per annum with effect from 1 September 2022).

If the refund is made after a successful tax appeal or where the appeal is conceded by SARS, the interest rate is 9% per annum from 1 November 2022 (was 8.25% per annum from 1 September 2022).

VAT

Payable to SARS on late payments: 9% per annum from 1 November 2022 (was 8.25% per annum from 1 September 2022).

Payable by SARS on VAT refunds after prescribed period: 9% per annum from 1 November 2022 (was 8.25% per annum from 1 September 2022).

Fringe benefits

Official interest rate for loans to employees below which a deemed fringe benefit arises: 7.25% per annum from 1 October 2022. See below for details of historical changes.

Dividends tax

Official interest rate for loans (designated in rands) to shareholders below which the interest on such loans can be deemed to be dividends on which dividends tax is payable: 7.25% per annum from 1 October 2022. See below for details of historical changes.

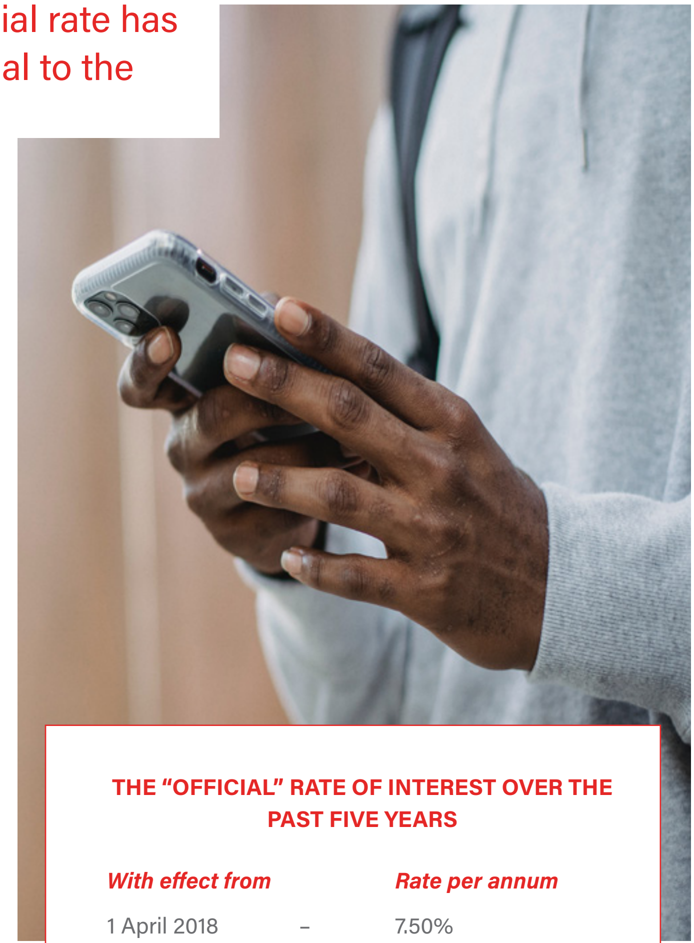
Donations tax

Loans to trusts by natural connected persons with interest charged at rates below the official rate create a donation subject to donations tax at 20% on the interest forgone each year.

Penalties

The amount of penalties for late payments (where applicable) are substantial (at least 10%) and are in addition to interest charged.

"With effect from 1 March 2011, the official rate has been defined as the rate of interest equal to the South African 'repo rate' plus 1%."



FRINGE BENEFITS, LOANS, DONATIONS TAX AND DIVIDENDS TAX – INTEREST RATES

- If inadequate interest is charged to an employee (including working directors) on loans (other than for the purpose of furthering their own studies) in excess of R3 000 from their employer (or associated institution), tax on the fringe benefit may be payable.

  Unless interest is charged at the “official” rate or greater, the employee is deemed to have received a taxable fringe benefit calculated as being the difference between the interest actually charged and interest calculated at the “official” rate.

  For employees’ tax purposes, the tax deduction must be made whenever interest is payable; if not regularly, then on a monthly basis for monthly paid employees, weekly for weekly paid employees, etc.

- Subject to a number of exceptions, distributions of income and capital gains from a company / close corporation are normally subject to dividends tax at the flat rate of 20%. Loans or advances to or for the benefit of a shareholder / member will be deemed to be dividends but only to the extent that interest at less than the “official” rate (or market-related rate in the case of foreign currency loans) is payable on the loan, or fringe benefits tax is payable on an interest-free (or subsidised-interest) loan to an employee.

  It is not the amount of the loan but the interest reduction which is deemed to be a dividend. Low-interest loans are accordingly subject to dividends tax payable by the company and only in respect of the interest benefit.

- Loans to trusts by natural connected persons with interest charged below the official rate create a donation subject to donations tax at 20% on the interest forgone each year.

- With effect from 1 March 2011, the official rate has been defined as the rate of interest equal to the South African “repo rate” plus 1%. For foreign-currency loans, the rate is the equivalent of the foreign “repo rate” plus 1%. The South African repo rate has been increased to 6.25% per annum (with effect from 1 October 2022).

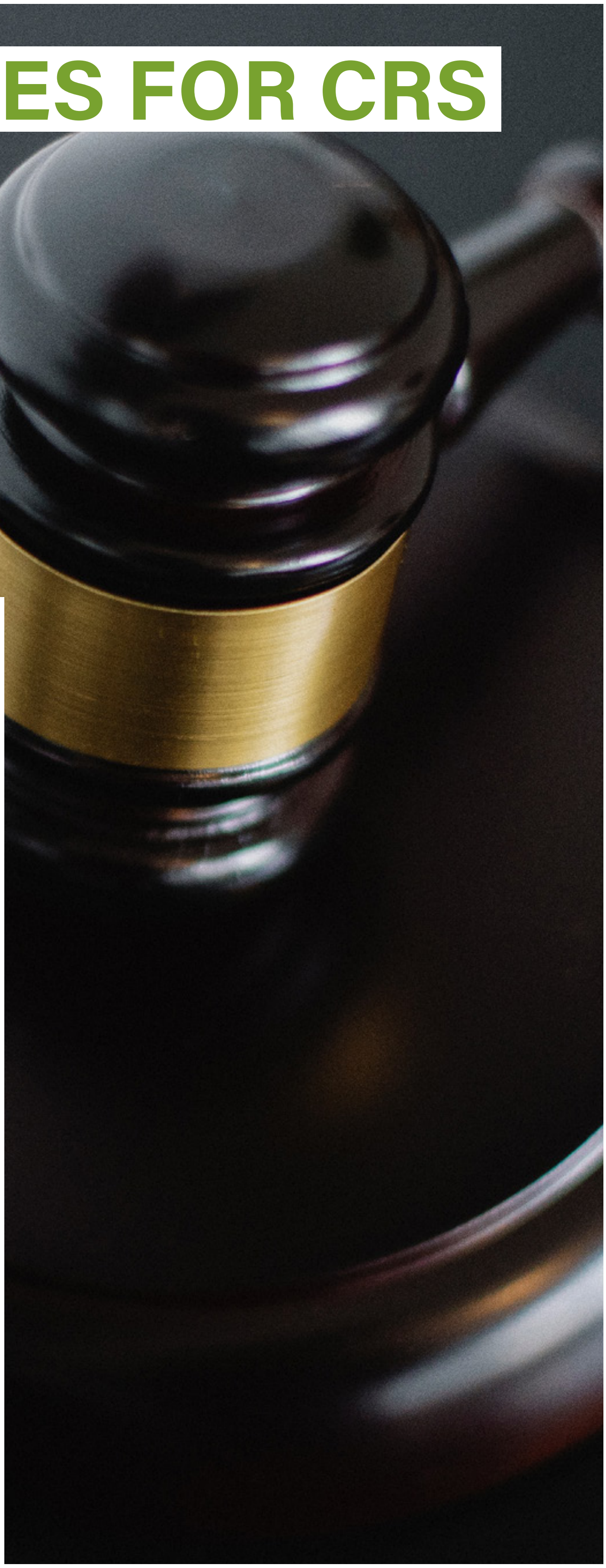
THE “OFFICIAL” RATE OF INTEREST OVER THE PAST FIVE YEARS

With effect from		*Rate per annum*
1 April 2018	–	7.50%
1 December 2018	–	7.75%
1 August 2019	–	7.50%
1 February 2020	–	7.25%
1 April 2020	–	6.25%
1 May 2020	–	5.25%
1 June 2020	–	4.75%
1 August 2020	–	4.50%
1 December 2021	–	4.75%
1 February 2022	–	5.00%
1 April 2022	–	5.25%
1 June 2022	–	5.75%
1 August 2022	–	6.50%
1 October 2022	–	7.25%

Kent Karro

Tags: deductible expenses; natural connected persons; donations tax; taxable fringe benefit; low-interest loans; repo rate.

STRICTER RULES FOR CRS COMPLIANCE



On 9 October 2020, the South African Minister of Finance published updated regulations (the 2020 Regulations) to align with the OECD's Standard for Automatic Exchange of Financial Account Information in Tax Matters (CRS).

The 2020 Regulations repealed the regulations published in *Government Gazette* No. 39767 on 2 March 2016 (the 2016 Regulations) and have generally been in force since 1 June 2021, except for paragraph B of section XI, which is intended to take effect from 1 March 2023.

Although the 2016 Regulations were repealed, much of the content in the 2020 Regulations remains the same, with the notable changes being:

"Considering that CRS is constantly evolving, it is important to keep abreast of the developments as authorities in the international tax society seek to improve international tax compliance."

1. The new section on commentaries on the CRS, to be followed when interpreting the regulations.

2. The exception to the requirement that, with respect to new individual accounts or new entity accounts, a reporting financial institution (RFI) must obtain a self-certification upon opening an account. In terms of the update, a 90-day period of compliance is allowed:

   - where a self-certification is obtained when opening the account, but cannot be validated because it is a subsequent process undertaken by the RFI's back-office function; or

   - in exceptional cases, where it is not possible to obtain a self-certification on the first day of the account-opening process due to the requirements of the business of the RFI.

3. The insertion of the new paragraph B under section XI, which permits an RFI to suspend transactions or close a financial account where the account holder or controlling person fails to provide a self-certification within 90 days from the date on which it is required.

4. The new section on mandatory disclosure rules, set to come into effect from 1 March 2023, will require an "Intermediary" or the user of a "CRS Avoidance Arrangement" or "Opaque Offshore Structure" to disclose to the South African Revenue Service certain information set out in the regulations, if certain requirements are met. These rules essentially place a reporting obligation on persons involved in setting up structures that result in the avoidance of CRS legislation or make it difficult to determine the identity of the beneficial owners of the structure. Briefly, for the purposes of these rules, the 2020 Regulations define –

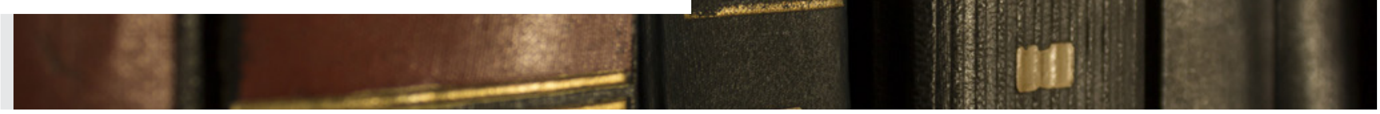
   - "CRS Avoidance Arrangement" as any arrangement designed to circumvent or which is marketed as, or has the effect of, circumventing CRS legislation or exploiting an absence thereof through various ways described in the 2020 Regulations;

   - "Intermediary" as any person who is responsible for the design or marketing of a "CRS Avoidance Arrangement" or "Opaque Offshore Structure" and any person that provides relevant services in respect of that arrangement or structure where that person can reasonably be expected to know that the arrangement or structure constitutes a "CRS Avoidance Arrangement" or "Opaque Offshore Structure";

   - "Opaque Offshore Structure" as a passive offshore vehicle that is held through an opaque structure which is designed to allow a natural person to be a beneficial owner of that passive offshore vehicle, in a manner that makes it difficult to determine who the beneficial owner is or which creates the appearance that such person is not a beneficial owner.

There are instances in which an "Intermediary" or user will not be obliged to disclose any information. In particular, they are not required to disclose confidential information that is protected under professional secrecy rules set out in domestic law.

Considering that CRS is constantly evolving, it is important to keep abreast of the developments as authorities in the international tax society seek to improve international tax compliance.



Ursula Diale-Ali

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 1 (definition of "international tax standard" (paragraph *(a)*) & 257.

Other documents

- 2020 Regulations (definitions of "CRS Avoidance Arrangement", "Intermediary" & "Opaque Offshore Structure") – published on 9 October 2020 in *Government Gazette* 43781 and came into effect on 1 June 2021 (except for paragraph B of section XI, which will come into effect wef 1 March 2023) to align with the OECD's Standard for Automatic Exchange of Financial Account Information in Tax Matters (CRS));

- 2016 Regulations (published in *Government Gazette* 39767 on 2 March 2016), repealed by 2020 Regulations wef 1 June 2021 except for paragraph B of section XI, wef 1 March 2023.

Tags: reporting financial institution (RFI); CRS Avoidance Arrangement; beneficial owner.

COLLATERAL ARRANGEMENTS

Any transfer of a share issued by a South African incorporated company or listed on a South African exchange is subject to securities transfer tax (STT), which is levied in terms of the Securities Transfer Tax Act, 2007 (the STT Act). In the context of providing shares as security by transferring ownership of the shares, the STT consequences are therefore an important consideration.

The STT Act contains various exemptions, including the so-called "collateral arrangement" (defined in section 1) exemption, which came into force on 1 January 2016 and applies in respect of any "lending arrangement" (also defined in section 1) entered into on or after that date. This exemption essentially provides relief in respect of collateral arrangements, ie, where an outright transfer of collateral of South African listed equities is executed in respect of an amount owed.

Before the introduction of the "collateral arrangement" exemption, the provision of security by transferring South African shares or shares listed on a South African exchange was subject to STT. The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2015 (which introduced the "collateral arrangement" exemption) (the 2015 EM), recognised that regulatory changes applying to the financial sector necessitated an urgent review of the tax treatment of collateral. It also referred to the benefits of an outright transfer of collateral as identified by the financial sector including the "reduction of transaction costs and market pricing because of the ability to rehypothecate collateral and reduce tax costs; and . . . making South Africa more attractive as an investment destination".

After the introduction of the "collateral arrangement" definition, certain amendments were effected to the definition with effect from 1 January 2017 by –

- extending the 12-month limitation of a collateral arrangement to a 24-month limitation (ie, to extend the allowable period within which the identical shares are returned to the collateral provider by the collateral taker from the date on which the collateral arrangement was entered into);
- broadening the definitions of "identical share" and "identical security" in section 1(1) of the Income Tax Act, 1962, to cater to other specified corporate actions; and
- including listed government bonds as allowable instruments on security lending and collateral arrangements.

Further changes were introduced with effect from January 2018 to extend the tax relief in terms of a collateral arrangement to include listed foreign government bonds to address concerns regarding the limited scope of tax relief in respect of the provision of collateral.

In the 2021 Budget Speech, which was delivered on 24 February 2021, the matter of collateral arrangements was raised. The 2021 Budget Review stated that at issue was the rehypothecation of collateral (ie, where the collateral taker reuses collateral received for trading or as security for its own borrowing through a tax-neutral collateral arrangement).

It was proposed that changes be made to the legislation to clarify the policy intention that further rehypothecation of the collateral received by the collateral taker can only form part of subsequent collateral arrangement transactions.

These changes were promulgated in the 2021 Taxation Laws Amendment Act by introducing a proviso into the collateral arrangement definition (the 2021 Proviso). In terms of the 2021 Proviso, a "collateral arrangement" will not include a transaction in terms of which the transferee (ie, the recipient of collateral) has subsequently transferred the listed share or bond contemplated in a manner other than a transfer contemplated in paragraphs *(a)* to *(e)* of the collateral arrangement definition (ie, a further "collateral arrangement") unless the listed share or bond is transferred for purposes of –

- a repurchase agreement entered into with the South African Reserve Bank as contemplated in section 10(1)*(j)* of the South African Reserve Bank Act, 1989;
- complying with Regulation 28 of the Pension Funds Act, 1956; or
- securing overnight cash placement to comply with the Basel III Supervisory Framework for measuring and controlling large exposures.

Of note is that the above proviso will only come into operation on 1 January 2023 and will apply in respect of any collateral arrangements entered into on or after that date.

The 2022 Budget Review noted that the 2021 amendments were proposed to clarify that the use of collateral for purposes other than subsequent collateral arrangements or proposed limited regulated transactions is against the policy rationale for the introduction of these provisions, and could result in the avoidance of STT or capital gains tax. It did not provide details as to how the STT or capital gains tax is avoided because of the use of a collateral arrangement. The 2022 Budget Review stated that after reviewing the public comments on the Bill, government decided to postpone the effective date for these amendments to 1 January 2023 to give both National Treasury and affected stakeholders more time to consider the impact of the proposed amendments. Government proposed to review the impact of the 2021 amendments during the 2022 legislative cycle. Pursuant to such review, government has indicated, during a workshop with industry on 29 September 2022, that the proposed amendments will hold.

To the extent that changes are not made to the 2021 Proviso during the 2022 legislative cycle, then from 1 January 2023, the collateral arrangement exemption will only apply to the provision of collateral insofar as the recipient does not on-transfer the shares or on-transfers them in accordance with the exclusions in the 2021 Proviso. This means, *inter alia,* that where the collateral recipient is required to enforce the security by selling the shares, STT will be due and the recipient of the collateral will be on the line for the tax (and potential penalties and interest) in respect of the initial transfer of the shares as security to the collateral recipient. This will negate most of the benefits recognised in the 2015 EM as set out above.

It remains to be seen whether submissions to National Treasury to address the far-reaching implications of the changes will be taken into account.

"Before the introduction of the 'collateral arrangement' exemption, the provision of security by transferring South African shares or shares listed on a South African exchange was subject to STT."

Magda Snyckers

ENSafrica

Acts and Bills

- Income Tax Act 58 of 1962: Section 1(1) (definitions of "identical share" & "identical security");
- Taxation Laws Amendment Act 20 of 2021;
- Securities Transfer Tax Act 25 of 2007: Section 1 (definition of "collateral arrangement" and specifically the proviso to the definition);
- South African Reserve Bank Act 90 of 1989: Section 10(1)*(j)*;
- Pension Funds Act 24 of 1956.

Other documents

- Regulation 28 of the Pension Funds Act, 1956;
- Explanatory Memorandum on the Taxation Laws Amendment Bill, 2015;
- 2021 Budget Speech (delivered on 24 February 2021);
- 2021 Budget Review;
- 2022 Budget Review;
- Basel III Supervisory Framework for measuring and controlling large exposures.

Tags: securities transfer tax (STT); collateral arrangement; identical share; identical security.

APPROPRIATE SUPPORTING DOCUMENTATION

In the tax court judgment of Taxpayer Z v Commissioner for the South African Revenue Service, *[2022], (16 March 2022), the court had to determine the consequences arising from the questionable actions of the "controlling mind" of the taxpayer – both in respect of the tax position they adopted and the manner in which they engaged with the South African Revenue Service (SARS).*

FACTS

The taxpayer was a close corporation engaged in, among other things, the construction business. The business was operated by the taxpayer in conjunction with two associated entities, which respectively provided the taxpayer with (i) various leased vehicles and drivers; and (ii) maintenance services in respect of the vehicles used by the taxpayer. As consideration for these services, the taxpayer reduced the loan accounts owing by each associated enterprise with the amounts (totalling approximately R16 million) invoiced for services rendered.

In its 2014 tax return, the taxpayer claimed the amounts incurred in respect of the aforementioned services as "management fee" deductions from its taxable income. The taxpayer also claimed various amounts that it had "donated" as deductions. However, it transpired that the amounts allegedly donated were either not proper donations, or they were not made to a registered public benefit organisation such that a deduction could be claimed in terms of section 18A of the Income Tax Act, 1962 (the Act).

Subsequent to the submission of the 2014 tax return, SARS notified the taxpayer that its return had been selected for verification in terms of section 40 of the Tax Administration Act, 2011 (the TAA). Thereafter SARS requested the taxpayer to provide certain relevant documents and information.

Over a period of approximately six years, SARS and the taxpayer exchanged correspondence in terms of which SARS requested further documents and the taxpayer, for the most part, failed to fully co-operate with SARS to make the necessary documents available. Of particular importance in respect of the documents that were ultimately provided by the taxpayer was that –

- only two invoices were provided to SARS, and these invoices did not detail the specific transactions (and related information) comprising the globular amounts reflected in the invoices;

- the taxpayer's representatives conceded that the response it provided to SARS in respect of the management fees did not enable SARS to properly establish the nature of the services or the year in which they were rendered; and

- the documents contained incorrect and conflicting information.

SARS ultimately issued the taxpayer with an assessment in terms of which it disallowed the management fees claimed by the taxpayer and imposed interest (in terms of section 89*quat* of the Act) and understatement penalties.

Prior to the hearing of the appeal the taxpayer conceded, in respect of the donated amounts, (i) that it had received advice – prior to the 2014 tax year – that the amounts claimed by it did not constitute deductible donations; (ii) that it in any event continued to incorrectly claim such amounts in subsequent tax years; and (iii) that it should not have claimed such amounts as deductible donations. As such, the donation deductions incorrectly claimed by the taxpayer were relevant to the appeal only on the basis that SARS had imposed an understatement penalty of 125% in respect thereof (on the grounds that the taxpayer had been grossly negligent on a repeated basis).

JUDGMENT

The onus of establishing whether any particular expense item is deductible for income tax purposes rests with the taxpayer. In the present instance, the critical error with the taxpayer's case in respect of the management fees was that it was unable to provide the necessary documentary proof of the expenses that were incurred by it. To this end, SARS contended that invoices between related parties are insufficient to show that the services had been rendered and that it was necessary for the taxpayer to provide details to prove that the work had been done (such as the identification of the vehicles involved and when the work was performed).

A further problem faced by the taxpayer in discharging the burden of proof was that the evidence given on its behalf during the hearing was inconsistent and contradicted the information that it had previously provided to SARS.

On the basis that the taxpayer could not properly demonstrate that the services in respect of which the expenditure had been incurred had actually been rendered to it, the court found that the taxpayer had not discharged its burden of proof and the management fees were, as a result, disallowed.

When considering the understatement penalties imposed by SARS, the court took cognisance of –

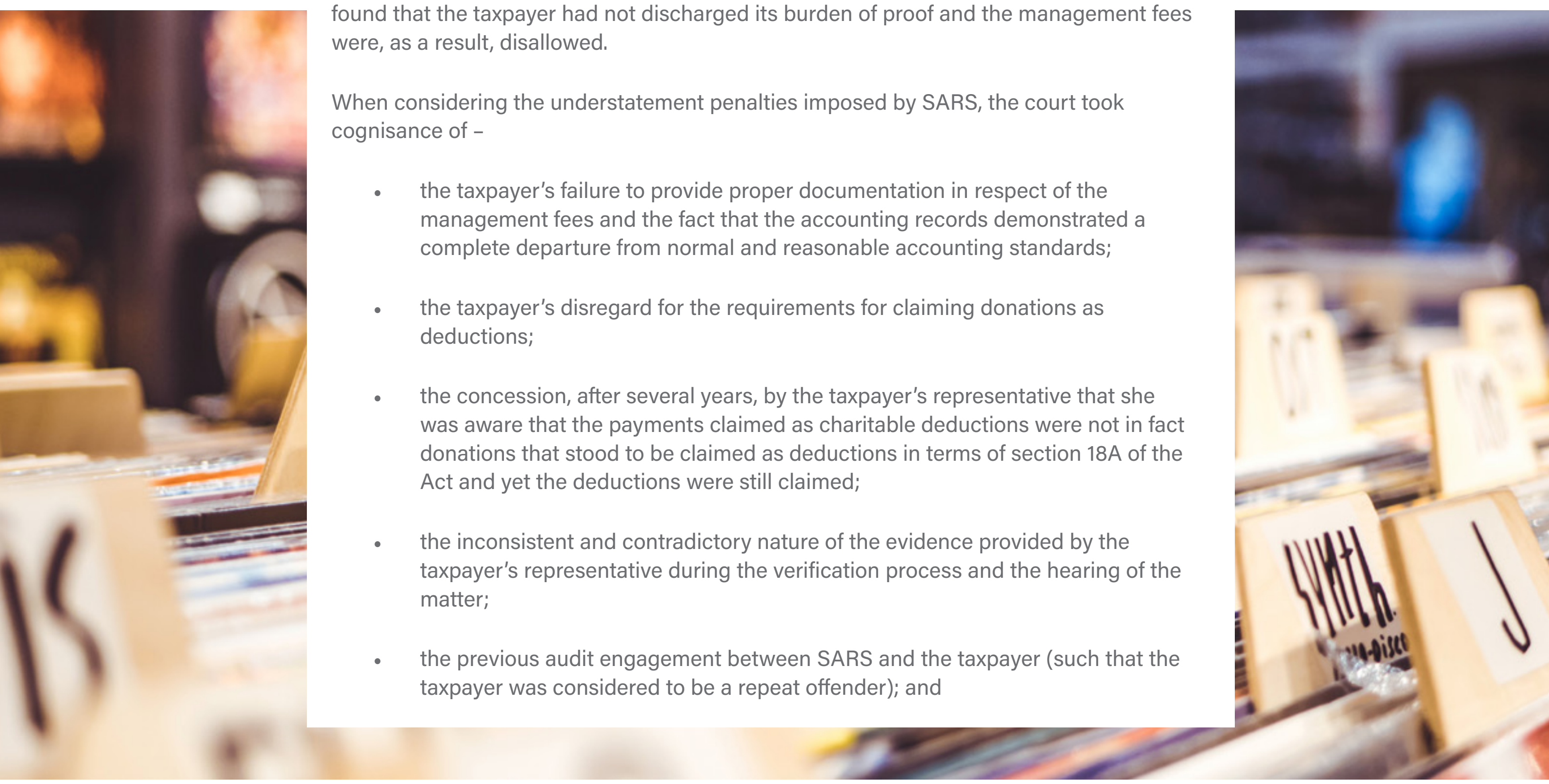
- the taxpayer's failure to provide proper documentation in respect of the management fees and the fact that the accounting records demonstrated a complete departure from normal and reasonable accounting standards;

- the taxpayer's disregard for the requirements for claiming donations as deductions;

- the concession, after several years, by the taxpayer's representative that she was aware that the payments claimed as charitable deductions were not in fact donations that stood to be claimed as deductions in terms of section 18A of the Act and yet the deductions were still claimed;

- the inconsistent and contradictory nature of the evidence provided by the taxpayer's representative during the verification process and the hearing of the matter;

- the previous audit engagement between SARS and the taxpayer (such that the taxpayer was considered to be a repeat offender); and



- the fact that the "controlling mind" of a large entity (or group of entities) cannot rely, for an extended period of time, on ignorance as an excuse for not being aware of the state of their accounting records and any such continued ignorance is indicative of reckless behaviour.

On the basis of the factors set out above, the court took the view that SARS would in fact have been entitled to assess the taxpayer as falling into the "intentional tax evasion" understatement penalty category, rather than the "gross negligence" category as the taxpayer's conduct (by means of its representative) "seemed to be arguably designed to evade the taxes payable". As such, the understatement penalty imposed by SARS was upheld by the court.

Lastly, on the basis that the taxpayer did not contend that the underpayment of its 2014 taxes was beyond its control, the court held that the interest in terms of section 89*quat* had been properly imposed. The appeal was therefore dismissed with a partial costs award being made for the benefit of SARS.

"A further problem faced by the taxpayer in discharging the burden of proof was that the evidence given on its behalf during the hearing was inconsistent and contradicted the information that it had previously provided to SARS."

COMMENT

This case is a clear warning to taxpayers that the burden of proving whether an amount is deductible for tax purposes rests with the taxpayer and it is of critical importance that accurate and complete records are maintained by taxpayers in order to discharge this burden. The obligation on taxpayers to maintain relevant records is prescribed in section 29 of the TAA, which requires the said records to be maintained for a period of five years (barring certain circumstances).

This judgment also serves as a reminder to taxpayer litigants that it is necessary to be adequately prepared when a matter is to be heard in the tax court as ill-preparedness could result in a "shot-gun" approach (as described by the tax court) in adducing documentary evidence in court. This may have adverse consequences and the awarding of a cost order in terms of section 130 of the TAA.

Louise Kotze

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 18A & 89*quat*;
- Tax Administration Act 28 of 2011: Sections 29, 40 & 130.

Cases

- *Taxpayer Z v Commissioner for the South African Revenue Service* (Case No 35448) [2022] ZATC 3 (16 March 2022).

Tags: registered public benefit organisation; understatement penalties; deductible donations; gross negligence.

CORRECTION OF AN ASSESSMENT: SECTION 93

Out in the Tax Administration Act, 2011 (the TAA), the dispute resolution rules lay out the legal framework to be followed by both the taxpayer and the South African Revenue Service (SARS) to resolve disputes. Section 93 of the TAA lists a number of circumstances under which SARS can reduce a taxpayer's tax liability by means of issuing a reduced assessment.

An aggrieved taxpayer has the right to dispute a decision or an assessment that SARS has issued. Section 93(1)*(d)*, other than the formal dispute resolution process, introduces a less formal mechanism to request the correction of an assessment and furthermore requires either a return or an assessment to contain a "readily apparent" error.

SARS can issue a reduced assessment in terms of section 93 in the following circumstances:

- Where a taxpayer successfully disputed an assessment under Chapter 9 of the TAA;
- Where it is necessary to give effect to a settlement or a judgment pursuant to an appeal where there is no right to further appeal (Parts F and E of Chapter 9);
- Where there is a readily apparent undisputed error in the assessment by SARS or the return of the taxpayer;
- Where a senior official of SARS is satisfied that the assessment was based on the failure to submit a return, the submission of an incorrect return by a third party or an employer, a processing error by SARS or a return that a person unauthorised by the taxpayer fraudulently submitted.

Section 93(1)*(d)* will only apply when all the requirements are satisfied and should be seen as an alternative to the formal dispute resolution process. Despite its limited application, this informal mechanism is cost-effective in resolving disputes where errors are readily apparent.

In considering the requirements above, it is important to consider what the words "readily apparent" actually mean.

An error that is readily apparent is clear and visible and can be identified without any difficulty and/or hesitation. Any doubt that may arise would, in this regard, bar a taxpayer's request for a reduced assessment as the error cannot in these instances be said to be clear and unquestionable.

SARS must, in this regard, be able to identify the error on the face of a return or an assessment, otherwise the error cannot be said to be "readily apparent". The requirements of section 93(1)*(d)*, notwithstanding its benefits, are onerous, and all taxpayers must ensure compliance with the requirements in their entirety before requesting correction under this provision.

[*Editorial note:* A draft SARS Interpretation Note ("Reduced assessments: meaning of 'readily apparent undisputed error'") was published on 16 August 2021. The due date for comment was 21 October 2021.]

"An error that is readily apparent is clear and visible and can be identified without any difficulty and/or hesitation. "

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Acts and Bills

- Tax Administration Act 28 of 2011: Section 93 (more specifically subsection (1)*(d)*); chapter 9 (sections 101–150; more specifically Parts E & F (sections 133–150)).

Other documents

- Draft SARS Interpretation Note ("Reduced assessments: meaning of 'readily apparent undisputed error'"): Published on 16 August 2021. The due date for comment was 21 October 2021.

Tags: reduced assessment; readily apparent undisputed error.

SEARCH AND SEIZURE

In the case of Bechan and Another v SARS Customs Investigations Unit and Others, *[2022], the High Court was tasked with deciding whether the South African Revenue Service (SARS) acted unlawfully in searching motor vehicles parked outside of designated premises and whether the affected persons could demand the return of the seized items through the* mandament van spolie.

On 28 March 2022, a warrant was issued in terms of sections 59 and 60 of the Tax Administration Act, 2011 (the TAA). The warrant authorised SARS to seize information and documentation at the premises of, and related to, a particular taxpayer (the Taxpayer).

The day after obtaining the warrant, SARS arrived at the Taxpayer's premises in order to execute it. The premises were located within an office park, which was shared with a number of other companies. Access to the office park was controlled, and SARS was delayed in entering the premises. During the time of this delay, SARS officials noticed various people carrying items from the office premises to motor vehicles parked in the general parking area. When the SARS officials eventually gained access to the premises they encountered several of the Taxpayer's directors as well as the applicant in this case, Mr Bechan, who informed SARS that he was at the office park for business with a different company.

"Section 62 of the TAA, titled 'Search of premises not identified in warrant', and section 62(1) in particular, essentially empowers a SARS official to enter and search premises not identified in a warrant, as if those premises had been identified in the warrant – subject to the qualifications in this section."

While executing the warrant, SARS investigated the vehicles parked in the general parking lot and noticed that several of these vehicles contained documents relating to the Taxpayer.

On SARS' version, when Mr Bechan was asked to open his motor vehicle he informed them that he did not have the keys. Considering the resistance SARS faced to execute its warrant, both the South African Police Service (SAPS) and the Hawks were called in to assist. SARS then procured the services of a locksmith to open Mr Bechan's vehicle and the other vehicles whose owners had refused to open them.

On Mr Bechan's version, he denied ever refusing to open his vehicle and claimed that he had immediately handed both his cell phone and his vehicle's keys to SARS. Despite the differing versions, once Mr Bechan's vehicle was opened, SARS removed certain items and took them into custody, duly inventoried.

MANDAMENT VAN SPOLIE APPLICATION

Mr Bechan then brought an application for a *mandament van spolie* order. This was an order to obtain the return of the items taken from his vehicle, which by the time the court heard the application, amounted to two laptops and two cell phones. SARS had returned all the other items beforehand.

The court relied on the principles stated in the Constitutional Court case of *Ngqukumba v The Minister of Safety and Security and Others,* [2014], that the "essence of the *mandament van spolie* is the restoration before all else of unlawfully deprived possession of the possessor". Essentially, it is premised on the philosophy that no one should resort to self-help to obtain or regain possession and aims to preserve public order by restraining people from taking the law into their own hands and encouraging them to rather follow due process.

"While executing the warrant, SARS investigated the vehicles parked in the general parking lot and noticed that several of these vehicles contained documents relating to the Taxpayer."

Mr Bechan's application was based on the contention that the items had been in his undisturbed possession and that SARS had unlawfully dispossessed him of them.

The court noted that on Mr Bechan's version of events, he had handed his vehicle keys to SARS upon request and so had voluntarily relinquished possession of his vehicle – which means that the fundamental requirements for the *mandament van spolie* would not be met.

However, the court considered SARS' version to be fundamentally more probable and that Mr Bechan did not relinquish possession of his vehicle, since SARS had involved both the SAPS and the Hawks and had experienced a delay of approximately 10 hours before the vehicle could be opened by a locksmith. This militated against Mr Bechan's version. As such, the court was in no doubt that Mr Bechan was deprived of possession by SARS.

The court noted that the *mandament van spolie* can only succeed where the dispossession was unlawful and so the next question was whether the deprivation was lawful or not. SARS submitted that although neither Mr Bechan nor his vehicle was specifically identified in the warrant, section 62(1) of the TAA applied in these circumstances.

SEARCHING PREMISES NOT IDENTIFIED IN A WARRANT

Section 62 of the TAA, titled "Search of premises not identified in warrant", and section 62(1) in particular, essentially empowers a SARS official to enter and search premises not identified in a warrant, as if those premises had been identified in the warrant – subject to the qualifications in this section.

The court explained that with this section being applicable, SARS was entitled, in executing the warrant, to confirm whether Mr Bechan had in his possession or under his control any of the Taxpayer material specified in the warrant. Considering that SARS officials witnessed material being carried to motor vehicles, their decision to search Mr Bechan and his vehicle was not unreasonable.

In defending Mr Bechan's election to pursue restoration of the items under the *mandament van spolie*, SARS argued that the appropriate procedure to obtain the return of his property was in terms of section 66 of the TAA.

RETURNING SEIZED MATERIAL

Section 66, titled "Application for return of seized relevant material or costs of damages", essentially states that a person may request SARS to, among other things, return some or all of the seized material; if SARS refuses the request, the person may apply to the High Court for the return of the seized material. The court may then, if good cause is shown, make the order it deems fit.

Mr Bechan's counsel argued that the warrant had to be construed as narrowly as possible, including that since the TAA contained no definition of "person" (and should be read interchangeably with "taxpayer"), the proper interpretation of "premises" in section 62 ought to be read to mean the premises of the taxpayer in respect of whom the warrant had been issued. The contention being that since Mr Bechan parked in a general parking area – which was not on the premises of the Taxpayer – it was unlawful for SARS to open his vehicle and seize the items.

The court contemplated the following elements of the warrant: firstly, it provided for the seizure of material relevant to the Taxpayer at the specified premises; secondly, the warrant referred to the physical street address where the Taxpayer conducted business and where Mr Bechan found himself on the day in question; and finally, the description of the warrant of the address where it was to be executed together with the description of the material forming the subject of the warrant made it clear that SARS sought material relevant to the Taxpayer.

The court then held that –

- the warrant in its terms provided for the search anywhere on the premises identified in the warrant, which included vehicles parked on the premises;

"However, the court considered SARS' version to be fundamentally more probable and that Mr Bechan did not relinquish possession of his vehicle, since SARS had involved both the SAPS and the Hawks and had experienced a delay of approximately 10 hours before the vehicle could be opened by a locksmith."

- interpreting the warrant as restrictively as argued by Mr Bechan's counsel would undermine its efficacy – which is the very situation SARS encountered when its entry to the premises was delayed;

- even if it could be argued that the warrant was not sufficiently wide to include Mr Bechan's vehicle, the provisions of section 62 entitled SARS to open the vehicle and take possession of the Taxpayer information in it.

Consequently, the court dismissed the application.

OBSERVATION

The importance of this case lies in suggesting that SARS is not strictly limited in its execution of a warrant. Rather, in certain circumstances, it appears that SARS is empowered to investigate other premises with the purpose of seeking any relevant material related to the taxpayer in question. Furthermore, while a taxpayer is entitled to request the return of seized material, the judgment seems to indicate that a taxpayer should do so in terms of section 66 of the TAA and not the *mandament van spolie*.

Taigrine Jones & Howmera Parak

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 59, 60, 62 (particularly subsection (1)) & 66.

Cases

- *Bechan and Another v SARS Customs Investigations Unit and Others* (19626/2022) [2022] ZAGPPHC 259 (28 April 2022);
- *Ngqukumba v The Minister of Safety and Security and Others* [2014] (5) SA 112 (CC).

Tags: *mandament van spolie*; unlawfully deprived possession; voluntarily relinquished possession.

TAX COURT RULES

In Taxpayer M v the Commissioner for the South African Revenue Service, *[2022], Taxpayer M applied for a default judgment in terms of Rule 56(1), after SARS had failed to deliver its Rule 31 statement.*

The applicant prayed for a final order to set aside understatement penalties. SARS opposed the application for a default judgment and brought a counter-application for condonation to file the Rule 31 statement. This counter-application was opposed by Taxpayer M.

FACTS

On 3 June 2019, Taxpayer M submitted notices of appeal (NOA) against the disallowance of its objection letter by the South African Revenue Service (SARS). In terms of the Rules promulgated under section 103 of the Tax Administration Act, 2011 (the Rules), more specifically Rule 31(1)*(d)*, SARS had to deliver a statement of the grounds of assessment, and opposing appeal within 45 days after the delivery of the NOA. SARS' attorney addressed an email to Taxpayer M's attorney on 31 July 2019, requesting that litigation be pended until a meeting is held between the party's legal representatives. Taxpayer M's counsel noted the contents of that email. From 15 August 2019 to 4 September 2019, further emails between the attorneys of SARS and Taxpayer M were exchanged, with the attorney of Taxpayer M suggesting in the last email that "the parties continue to hold over pleadings so as to provide an opportunity to ventilate the disputes…". On 14 October 2020, Taxpayer M proposed a without prejudice settlement of the disputes. On 12 April 2021, SARS rejected the proposal. On 15 April 2021, Taxpayer M sent a notice of default in terms of Rule 56(1) to ABC Inc and not the attorneys of SARS. On 26 April 2021, SARS' attorney informed Taxpayer M that the Rule 56 notice had been sent to the wrong attorneys and that it only became aware of the notice when ABC Inc informed Mr T, ie, SARS' attorney, thereof. ABC Inc informed Mr T on 22 April 2021. If the 45 days were calculated from 15 April 2021, then SARS had until 21 June 2021 to file its Rule 31 statement. SARS filed it on 21 July 2021.

ISSUES

Issue 1: Whether SARS had shown good cause for its default to timeously file the Rule 31 statement, and whether the court should condone the late filing of the Rule 31 statement, and direct that the appeal should proceed on the merits;

Issue 2: If the failure to submit the Rule 31 statement by SARS is not condoned, whether the default judgment in terms of Rule 56 should be granted in favour of Taxpayer M; and

Issue 3: Whether or not two applications submitted by Taxpayer M to strike out in terms of Rule 42, read with the Uniform Court Rules, should succeed.

FINDINGS

Taxpayer M contended that the failure by SARS to deliver its Rule 31 statement should be calculated from the date the notice of appeal was submitted, ie, 3 June 2019. According to Taxpayer M, the Rule 31 statement is almost two years late. SARS argued that there was an agreement between SARS and Taxpayer M to suspend the litigation to provide for an opportunity to ventilate the dispute. The court was satisfied

"On 3 June 2019, Taxpayer M submitted notices of appeal (NOA) against the disallowance of its objection letter by the South African Revenue Service (SARS)."

that the unambiguous wording of the emails sent by the counsel of Taxpayer M, gave the impression that litigation was indeed suspended. The court was of the opinion that the agreement to suspend the litigation was only terminated by Taxpayer M when its attorneys served a notice on ABC Inc (even though it was not served on the attorneys of SARS). Therefore, SARS was not in any default prior to 21 June 2021, which is 45 days ("day" being defined in Rule 1 as a "business day") from 15 April 2021.

What is of interest is that the court suggested that Taxpayer M had two options regarding the calculation of the 45-day period provided for in Rule 31. Taxpayer M could have calculated the 45 days afresh, ie, from 15 April 2021, when the notice was sent to SARS; or Taxpayer M could account for the days that were not suspended by the agreement between the parties. Meaning, that the period from the date the notice of appeal was submitted, until the date the parties agreed to suspend litigation, will be included in the calculation of the 45 days. That said, it seems that the court accepted that SARS should have filed its Rule 31 statement on 21 June 2021, but only filed it on 21 July 2021.

The court, therefore, turned its attention to the reasons provided by SARS for filing the Rule 31 statement a month late. The counsel for SARS pointed out that initially the Rule 56 notice had been sent to the wrong attorneys, and that they only became aware of the notice when ABC Inc informed them of this. Also, during the beginning of June 2021 both the attorney of SARS, as well as the junior counsel contracted COVID-19. SARS argued that having regard to the timeline, it was only in default for a short period and that the delay was not a result of any non-compliance on the part of SARS, but a result of the conduct of SARS' attorneys and counsel. When the court considered those arguments, it made it clear that a litigant cannot escape the consequences of any default that arose from the conduct of its legal representative, but that there are certain instances where the non-compliance on the legal representative's part is not severe and not attributable to any fault of the litigant.

The court was thus satisfied that it was not proper to close the doors of the court to SARS in this instance since SARS was not to blame for the delay and that the prejudice against SARS would be severe. SARS also dealt in great detail with the prospects of success in the tax appeal, and the court agreed that "lateness" is not the only consideration, and the test for condonation is whether or not it will be in the interest of justice to grant such a condonation. Accordingly, the court was satisfied that SARS had not been in any default prior to 21 June 2021 and that SARS provided reasonable grounds for the default period between 21 June 2021 and 21 July 2021. Those explanations, combined with the prospects of success, convinced the court to condone the late submission of the Rule 31 statement.

Issue two became irrelevant since the court allowed the condonation request submitted by SARS. However, the court did make the following observation. Before 15 April 2021, SARS was not in default. The subrule of Rule 56 makes it clear that there must be a default prior to the delivery of a Rule 56 notice. Since there was no default on 15 April 2022 when Taxpayer M issued the Rule 56 notice, the application for default judgment was premature and fatally defective. Taxpayer M also incorrectly indicated in its Rule 56 application that the reason for the default was SARS' failure to indicate whether or not this could be resolved via the alternative dispute resolution (ADR)

"The court was of the opinion that the agreement to suspend the litigation was only terminated by Taxpayer M when its attorneys served a notice on ABC Inc (even though it was not served on the attorneys of SARS)."

proceedings, and not SARS' failure to file a Rule 31 statement. This did not make sense, since the capital assessments were already subject to a tax appeal, and not capable of an ADR proceeding. This oversight by Taxpayer M was a further indication that the Rule 56 notice was invalid.

Issue 3 related to Taxpayer M's request to strike out certain portions of SARS' answering affidavit in respect of the default application, and SARS' entire replying affidavit in its condonation application. The basis on which Taxpayer M wished this to be done was that the allegations in those documents constituted new matters, and/or were scandalous, and/or vexatious, and/or irrelevant and that they were argumentative. The court found that the content of the replying affidavit was important, especially the fact that it referred to the agreement to suspend the litigation process, which was not disclosed by Taxpayer M. The court also felt that the content of the affidavits was not scandalous, vexatious, irrelevant, or argumentative. However, the court did feel that the documents SARS wanted to rely on could have easily been summarised, and even though SARS was successful in its opposition to this application, it should be deprived of any costs in the striking out application.

The application for default judgment was dismissed with costs, including the costs of two counsel.

The application for condonation was granted with costs, including the costs of two counsel.

The application to strike out was dismissed. There was no order as to costs.

The appeal was dismissed with costs.

Franscios Celliers

Mazars

Acts and Bills

- Tax Administration Act 28 of 2011: Section 103.

Other documents

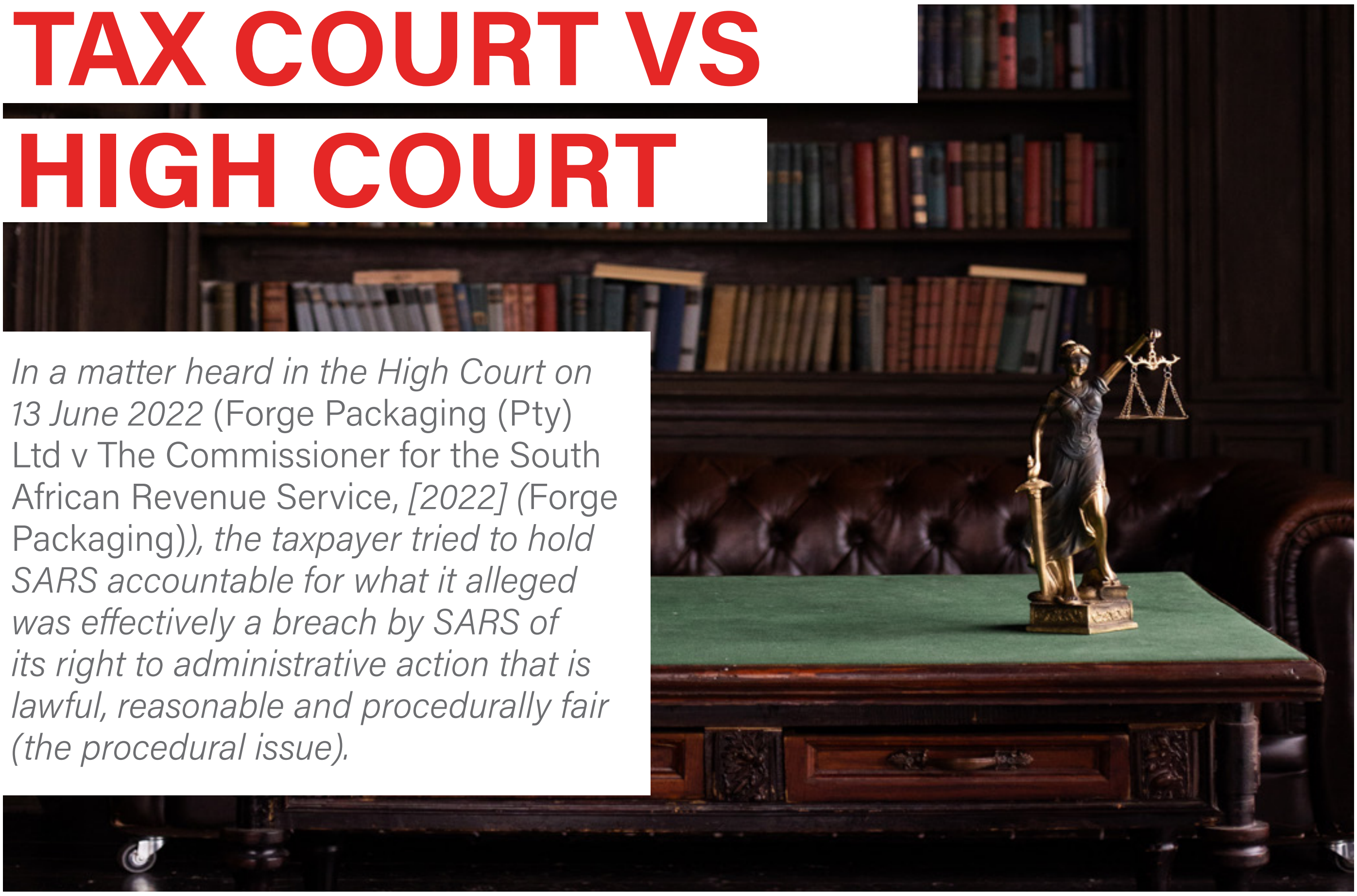
- Rules promulgated under section 103 of the Tax Administration Act, 2011: Rules 31 (more specifically Rule 31(1)*(d)*), 42 & 56(1);
- Rule 31 statement;
- Rule 56 notice;
- Uniform Court Rules.

Cases

- *Taxpayer M v the Commissioner for the South African Revenue Service* [2022] (VAT 1826) (handed down on 10 May 2022).

Tags: understatement penalties; Rule 31 statement; business day; application for default judgment.

TAX COURT VS HIGH COURT



In a matter heard in the High Court on 13 June 2022 (Forge Packaging (Pty) Ltd v The Commissioner for the South African Revenue Service, *[2022] (*Forge Packaging)*), the taxpayer tried to hold SARS accountable for what it alleged was effectively a breach by SARS of its right to administrative action that is lawful, reasonable and procedurally fair (the procedural issue).*

It turned out, however, that the taxpayer instituted action in the wrong court. The taxpayer should, according to the High Court, raise its concern in the tax court. This despite the fact that the taxpayer had previously been "told" by the tax court that it cannot entertain the matter and that the taxpayer should in fact raise the procedural issue in the High Court. It appears then, at first glance, that the issue complained about is simply being "hit around" between the courts with neither willing to decide the procedural issue. Is that really what is going on here?

To answer this question, it is good to start with the relevant judgment of Cloete J in the tax court *(The Commissioner for the South African Revenue Service v FP (Pty) Ltd,* [2021] (Case Nos: 25330, 25331 & 25256)). By way of background, SARS, following certain investigations conducted on the taxpayer, raised a few assessments. The taxpayer duly objected to these assessments and when the objections were disallowed, noted an appeal, ultimately to the tax court. In both the objection and the appeal to the tax court, the taxpayer complained about several things, including substantive issues and the procedural issue.

The taxpayer later (and whilst the pleadings were still open in respect of the appeal) took advice to the effect that it can "isolate" the procedural issue and have that adjudicated upon by the tax court by launching a legality review in the tax court pending the appeal. That advice, it turned out, was not entirely correct as the taxpayer found out after SARS had blocked that application by successfully seeking an order to have it set aside as an irregular step.

The reason for this, based on our reading of the judgment of the tax court, is simply that : the tax court is a creature of statute. When considering the rules that govern the tax court, it is clear that the tax court does not have jurisdiction to hear a legality review application. With respect, that conclusion can hardly be faulted. The High Court, however, should have the requisite jurisdiction. The tax court accordingly ordered that the taxpayer's appeal proceedings be stayed pending a determination by the High Court on the procedural issue.

> "In terms of this section, the High Court's jurisdiction to hear certain tax disputes (such as the one in question) is ousted in favour of the tax court, unless the High Court directs otherwise."

Sometime later, the taxpayer launched its application in the High Court. This time, however, there was another issue standing in the taxpayer's way: section 105 of the Tax Administration Act, 2011 (the TAA).

"It appears then, at first glance, that the issue complained about is simply being 'hit around' between the courts with neither willing to decide the procedural issue."

In terms of this section, the High Court's jurisdiction to hear certain tax disputes (such as the one in question) is ousted in favour of the tax court, unless the High Court directs otherwise. The High Court previously ruled, in *Absa Bank Limited and Another v Commissioner for the South African Revenue Service* (2019/21825 [P]) that it can direct otherwise in terms of section 105 and thereby hear these tax disputes (as opposed to their being heard in the tax court) only in exceptional circumstances, for example, where the dispute revolves only around a point of law.

Enter then the nature of the procedural issue complained about by the taxpayer in the High Court (and in its appeal in the tax court and in its legality review application in the tax court): the taxpayer complained that SARS, amongst other issues, did not comply with its obligations under section 42 of the TAA in the process leading up to the making of the assessments.

Section 42 places an obligation on SARS to do certain things when it is auditing the taxpayer and in the process leading up to the issue of an assessment following an audit.

It, however, transpired in the High Court that it was under dispute between the taxpayer and SARS whether the investigation conducted by SARS before raising the assessments in question constituted an "audit" or a "verification". An audit and a verification are quite simply not the same thing and compliance with section 42 is only required when SARS is conducting an audit (similar obligations may arise though under other legislation in the context of verifications). There clearly being a dispute of fact also (ie, whether the investigation conducted by SARS before raising the assessment was an audit or a verification) the High Court held it cannot direct otherwise under section 105 and sent the taxpayer back to the tax court to have the procedural issue adjudicated upon by the tax court.

Directing the taxpayer back to the tax court might seem strange given that the tax court directed the taxpayer to the High Court in the first place. However, the High Court did not direct the taxpayer to launch the legality review again in the tax court. The High Court simply held that the taxpayer should raise its procedural issues in its appeal that was pending in the tax court together with the substantive issues raised there.

In the end, then, the to-and-fro between the tax court and High Court appears to have been the result of an attempt by the taxpayer to "isolate" the procedural issue from the substantive issues raised in the appeal and not the result of the courts trying to dodge, so to speak, the issue.

What might be the reason for the taxpayer trying to isolate the issue? (This is apart from the fact that the procedural issue may be dispositive of the entire dispute, including the substantive issue, because the taxpayer could have also raised the procedural issue as a point *in limine* as was done in [2018] *ITC 1921*, 81 SATC 373.)

Whilst we can only speculate, our experience has shown that some seem to take the view that the tax court has no jurisdiction to hear cases relating to procedural issues arising before the making by SARS of an additional assessment and that taxpayers should rather approach the High Court on these matters. Whilst the correctness of this view has been the subject of much debate in some circles, the High Court judgment discussed here *(Forge Packaging)*, as well as those in, amongst others, *A Way to Explore v Commissioner for the South African Revenue Service*, [2017], and *South Atlantic Jazz Festival (Pty) Ltd v Commissioner, South African Revenue Service,* [2015], seems to support the view that the tax court can hear these issues during an appeal "together" with substantive issues in an appeal (or indeed as a point *in limine*.).

We can only hope that attempts to defend complaints about pre-assessment non-compliance by SARS, on the basis of the tax court's jurisdiction, are now finally a thing of the past, lest we end up in a situation where no court has jurisdiction to hear these issues.

[*Author's note:* It is worth mentioning that the taxpayer also complained in the High Court about SARS' alleged non-compliance with section 106(5) of the TAA. This section states that SARS must provide a basis for its decision in respect of an objection. Whilst the exact nature of this complaint is not clear from the judgment, our guess, based on past experience, is that SARS did not respond to the grounds for objection regarding SARS' non-compliance with section 42 in the notice of outcome of objection. If correct, then the correct procedure for this complaint would likely have been a default judgment application under rule 56 of the Tax Court Rules, especially in light of the fact that the obligation on SARS to provide a basis for a decision on objection is also contained in rule 9(1) of those rules.]

Nico Theron

Unicus Tax Specialists SA

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 42, 105 & 106(5).

Other documents

- Tax Court Rules: Rules 9(1) & 56.

Cases

- *Forge Packaging (Pty) Ltd v The Commissioner for the South African Revenue Service* (21634/2021) [2022] ZAWCHC 119 (13 June 2022)];
- *The Commissioner for the South African Revenue Service v FP (Pty) Ltd* [2021] (Case Nos: 25330, 25331 & 25256);
- *Absa Bank Limited and Another v Commissioner for the South African Revenue Service* (2019/21825 [P]);
- *ITC 1921*, 81 SATC 373 [2018];
- *South Atlantic Jazz Festival (Pty) Ltd v Commissioner, South African Revenue Service* [2015] (6) SA 78 (WCC);
- *A Way to Explore v Commissioner for the South African Revenue Service* [2017] ZAGPPHC, [2018] 80 SATC 211.

Tags: administrative action; tax court's jurisdiction; pre-assessment non-compliance.

TAXPAYER CONFIDENTIALITY

*Following the High Court's decision regarding the disclosure of former President Jacob Zuma's tax returns (*Arena Holdings (Pty) Ltd and Others v South African Revenue Service and Others, *[2022]* (Arena Holdings)*), the confidentiality (or possible lack thereof) of taxpayer information has entered the public mind.*

Recently, a second case dealing with this confidentiality came before the Eastern Cape Division of the High Court (Grahamstown) in *Structured Mezzanine Investments (Pty) Ltd and Another v Commissioner for the South African Revenue Service,* [2022] (Case No 1824/2021) (as yet unreported) (*SMI v SARS*). Although appearing to further erode the confidentiality of taxpayer information under section 69 of the Tax Administration Act, 2011 (the TAA), on careful reading this case is not cause for taxpayer concern.

FACTS

The South African Revenue Service (SARS) requested information from Structured Mezzanine Investments (SMI) in terms of section 46 of the TAA, specifically regarding certain loan agreements that SMI had concluded. SMI failed to comply with this request, resulting in SARS launching an application in the High Court (main application) to compel SMI to provide the information requested, which in SARS' view constituted "relevant material" as contemplated in section 46 of the TAA.

In response, the applicants (SMI and the second applicant) launched an interlocutory application to the main application. The interlocutory application alleged, *inter alia*, that SARS disclosed confidential taxpayer information in the founding papers of the main application, including information regarding SMI's tax audits. In the interlocutory application the applicants requested, amongst other things, that the High Court order the main application to be heard *in camera* and the court file sealed. The remaining relief sought in the interlocutory application was not in issue before the High Court.

"Additionally, the court observed that section 124 of the TAA, which mandates the sittings of the tax court to be *in camera* does not apply to the High Court."

CONTEXT

Before discussing the court's decision, it is helpful to set out the provisions referred to and discussed in the judgment.

Section 46(1) states the following:

> "SARS may, for the purposes of the administration of a tax Act in relation to a taxpayer, whether identified by name or otherwise objectively identifiable, require the taxpayer or another person to, within a reasonable period, submit relevant material (whether orally or in writing) that SARS requires."

Following this, the relevant subsections of section 67 of the TAA state that –

- there is a general prohibition against disclosure of "taxpayer information", which means "any information provided by a taxpayer or obtained by SARS in respect of the taxpayer, including biometric information" (subsection (1)); and
- a person who receives information under sections 68, 69, 70 or 71 must preserve the secrecy of the information and may only disclose the information to another person if the disclosure is necessary to perform the functions specified in those sections (subsection (3)).

> "In short, the applicants argued that the founding papers of the main application made references to taxpayer information that was confidential under sections 67 and 69 of the TAA."

Subsections (1) and (2) of section 69 of the TAA provide the following:

> "(1) A person who is a current or former SARS official must preserve the secrecy of taxpayer information and may not disclose taxpayer information to a person who is not a SARS official.
>
> (2) Subsection (1) does not prohibit the disclosure of taxpayer information by a person who is a current or former SARS official –
>
> *(a)* in the course of performance of duties under a tax Act or customs and excise legislation, such as –
>
> (i) to the South African Police Service or the National Prosecuting Authority, if the information relates to, and constitutes material information for the proving of, a tax offence;
>
> (ii) as a witness in civil or criminal proceedings under a tax Act; or
>
> (iii) the taxpayer information necessary to enable a person to provide such information as may be required by SARS from that person;
>
> *(b)* under any other Act which expressly provides for the disclosure of the information despite the provisions in this Chapter;
>
> *(c)* by order of a High Court; or
>
> *(d)* if the information is public information."

Linked to this, section 124(1) of the TAA provides that "the tax court sittings for purposes of hearing an appeal under section 107 are not public".

Finally, section 32 of the Superior Courts Act, 2013 (the Superior Courts Act), provides that:

> "Save as is otherwise provided for in this Act or any other law, all proceedings in any Superior Court must, except in so far as any such court may in special cases otherwise direct, be carried on in open court."

ARGUMENTS

In short, the applicants argued that the founding papers of the main application made references to taxpayer information that was confidential under sections 67 and 69 of the TAA. Its arguments on the papers were summarised by the court as follows:

- The provisions of the TAA on confidential taxpayer information were implicated in SARS' application and SARS had breached its statutory duty to preserve the secrecy of such information, which it may not disclose in terms of sections 67 and 69.

- Proper parties within SARS would not have authorised this application or would have ensured that the matter be heard *in camera* and court papers kept confidential.
- The making public of information by refusing to agree to an *in camera* hearing is not relevant to a SARS official's duties under a tax Act and there is nothing in a tax Act necessitating the public disclosure of confidential taxpayer information.
- Public confidence in SARS is eroded by the disclosure of taxpayer information.
- The prevailing practice directive in the Gauteng Tax Court is for all matters to be heard *in camera* so as to comply with the secrecy provisions.
- In any event, there was a disproportionate degree of disclosure to the public of the relevant taxpayer's information.

In response, SARS argued that the applicants had failed to show any statutory provision mandating tax proceedings in the High Court to be held *in camera*. Beyond this, SARS disagreed with the allegations made by the applicants and argued that the applicants had failed to show why a departure from the High Court norm of open justice was necessary in the circumstances.

DECISION

On the papers before it, the court found that the only taxpayer information disclosed in the founding affidavit of the main application was in the form of an affidavit previously deposed to in a liquidation application, and an article published by the *Mail & Guardian*. Both of these pieces of taxpayer information were already in the public domain and thus fell into one of the exceptions listed in section 69(2) of the TAA. Any other taxpayer confidential information referred to in the founding affidavit is not referred to in any detail. Furthermore, the court found that gathering taxpayer information in terms of section 46 of the TAA constitutes SARS' performance of its duties, which falls into another of the exceptions listed in section 69(2). Leading from this, the court commented that the information SARS sought from SMI in terms of its section 46 request would be confidential taxpayer information protected by section 69(1).

Additionally, the court observed that section 124 of the TAA, which mandates the sittings of the tax court to be *in camera*, does not apply to the High Court. Rather, it found that the tax court is a creature of statute and falls subject to the provisions of the TAA, while for the High Court the hearing of cases in open court is constitutionally protected and the applicants had to rely on section 32 of the Superior Courts Act to support their application and explain why this was a "special case", which they did not do. The court went further and said that even if this section was relied upon, there were no special circumstances to justify a deviation in terms of this section.

Therefore, the court decided that the TAA does not provide for the confidentiality of taxpayer information in respect of High Court proceedings. As such, it decided that the main application would be held in open court and that the court file would not be sealed.

COMMENT

The significance of this judgment is that it clarifies the difference between hearings in the tax court and hearings in the High Court, specifically with regard to confidentiality. The judgment does not seem to suggest that in all circumstances a High Court hearing involving a taxpayer and SARS will have to be heard in open court. Rather, it emphasises that confidentiality only automatically applies to hearings in the tax court under section 124 of the TAA, but in the High Court, an *in camera* hearing can only take place where the request is justified under section 32 of the Superior Courts Act, 2013.

While this judgment and the one involving former President Zuma's tax affairs (*Arena Holdings*) both engage the principle of taxpayer confidentiality, they are quite different. In *Arena Holdings,* parts of sections 67 and 69 of the TAA are constitutionally challenged in that they do not allow for the disclosure of taxpayer information pursuant to an application under the Promotion of Access to Information Act, 2000. On 23 August 2022, the Constitutional Court heard an application to confirm the High Court's decision in *Arena Holdings* on unconstitutionality while at the same time considering SARS' appeal against the High Court's finding of unconstitutionality. It remains to be seen whether the Constitutional Court's judgment will have any bearing on the issue of taxpayer confidentiality and its application in High Court proceedings, such as those in *SMI v SARS*.

Nicholas Carroll & Louis Botha

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 46 (more specifically subsection (1)), 67, 68, 69, 70, 71, 107 & 124(1);
- Superior Courts Act 10 of 2013: Section 32;
- Promotion of Access to Information Act 2 of 2000.

Cases

- *Arena Holdings (Pty) Ltd and Others v South African Revenue Service and Others* [2019] (Case No 88359/2019); [2022] (2) SA 485 (GP);
- *Structured Mezzanine Investments (Pty) Ltd and Another v Commissioner for the South African Revenue Service* [2022] (Case No 1824/2021) (as yet unreported).

Tags: relevant material; confidential taxpayer information; disclosure of taxpayer information.

TRANSFER PRICING RISKS

Transfer pricing (TP) is progressively seen as the key tax risk area for multinational businesses. TP is not like "normal" tax; it is seen as difficult and quite subjective.

It deals with complex technical aspects because it always involves satisfying compliance and reporting requirements in more than one jurisdiction and the arm's length standard is subject to different interpretations.

Companies should aim to minimise their TP-related tax risks and prevent situations arising where TP becomes a major pain point.

RAISING THE RED FLAGS:

1. ***High-value transactions and significant inter-company transactions:*** If your transactions are high-value, either standalone or in the context of your business, you are a likely audit target. It is crucial that evidence of arm's length pricing is compiled.

2. ***Intangibles and intellectual property (IP):*** All intangibles should be properly identified and adequately documented to avoid unnecessary and burdensome questions from the tax authorities. Furthermore, you need to ensure that you are not inadvertently developing economic IP in jurisdictions other than where you may have intended.

3. ***TP inconsistency and misalignment of legal agreements:*** Making sure that TP reports, financial data, tax returns, and legal agreements are aligned with TP policies that are appropriately implemented, is a basic TP must. In practice, however, this is a common problem. Reconciliation of data is key, and mismatching data and fact patterns are an easy red flag for any tax authorities.

4. ***TP models not supported by an appropriate level of substance:*** Significant people functions and substance are increasingly being challenged, particularly in low-tax jurisdictions. Ensure that economic substance has been considered in your TP model, narrative, and practice in your business.

5. ***High-interest rates/quantum of related-party debt:*** One of the OECD's BEPS recommendations is that tax relief on debt should be restricted. This could cause significant increases in tax liabilities, especially for highly geared businesses. Interest rates and (often forgotten) guarantees also need to comply with TP rules and be properly supported.

6. ***Lack of annual TP documentation (Master file / Local file), benchmarking, and supporting evidence:*** TP documentation is required to support the pricing of related-party transactions. Without TP documentation (including benchmarking studies), it is close to impossible to discharge the taxpayer's burden of proof. TP documentation that does not explain your business and commercial practices is potentially as bad as none.

7. ***Procurement structures are being increasingly challenged:*** Procurement hubs (or centralised hubs of any nature) can be highly value-adding for groups, but appropriate structure and TP models are key to reaping the true value from the supply chain.

8. ***Limited-risk entity structures:*** Even though limited-risk entities generally earn a low, stable guaranteed return, COVID might have had unintended impacts on profitability. Proving that you are indeed limited-risk has become more complicated if suddenly you are experiencing reduced or volatile profitability.

9. ***Business restructuring:*** Whether you are dealing with an M&A, debt restructuring, change in supply chain, disposal, or change in the functional/risk profile of a group entity, a restructuring should automatically trigger a TP review. This often-overlooked chapter of the OECD Guidelines is getting more attention, as tax authorities catch up before businesses.

10. ***Increase in TP disputes:*** Hungry tax authorities are getting busier, with a significant increase in TP controversy across the board. Make sure that you are defence-ready.

It has never been more important to manage TP risk effectively. TP audits are lengthy, expensive, and resource-intensive processes. Getting it right up-front can be a substantial cost-saving exercise and reap wider commercial benefits.

"Companies should aim to minimise their TP-related tax risks and prevent situations arising where TP becomes a major pain point."

Deborah Alberts

Regan van Rooy

Tags: arm's length pricing; economic IP; TP review; TP audits.

ASSUMPTION OF LIABILITIES

When a purchaser acquires a business, they often also assume some or all of the seller's liabilities in relation to the business. In negotiating the purchase price, the purchaser may contractually agree to assume the seller's obligation to pay existing or future liabilities.

The question is whether the assumption of such liabilities forms part of the consideration for the supply of the business, on which value-added tax (VAT) is payable.

The term "consideration" is widely defined in section 1(1) of the Value-Added Tax Act, 1991 (the VAT Act), to mean:

> "any payment made or to be made, . . . whether in money or otherwise, or any act or forbearance, . . . in respect of, in response to, or for the inducement of, the supply of any goods or services, whether by that person or any other person."

Where a business is transferred as a going concern which qualifies for the zero rate in terms of section 11(1)*(e)* of the VAT Act, or if the business transferred falls outside the scope of VAT under section 8(25), it may not be considered important to determine whether the assumption of the liabilities forms part of the consideration payable. In this case, the VAT on the assumption of the liabilities as part of the business acquisition will generally follow the VAT status of the consideration payable for the business. However, it is critical to determine whether the assumption of the liabilities forms part of the consideration payable if the transaction does not qualify for zero rating, or for the exclusion under section 8(25).

The VAT consequences of the assumption of the more common types of liabilities which are generally assumed as part of a business acquisition are discussed below.

TRADE CREDITORS

The purchaser may agree with the seller that the purchaser will assume the seller's contractual liability to make payment of amounts owing to trade creditors at the date of the transfer of the business. The parties agree that the purchase price for the business payable to the seller will be reduced by the amount owing to the trade creditors. These liabilities exist independently of the business assets that are being disposed of.

The consideration paid for the business in this case comprises of two parts, (i) the consideration paid to the seller for the business and (ii) the amounts paid to the trade creditors to settle the amounts owing by the seller and to relieve the seller of its liabilities. The amount of consideration on which VAT is payable is the aggregate of the two, as they both form part of the monetary consideration payable in respect of the supply of the business.

WARRANTY CLAIMS

The purchaser and the seller may agree that the purchaser will honour the seller's warranty obligations for goods sold prior to the transfer of the business. In this case the amount payable by the purchaser is not known at the time that the business is transferred. The parties agree that the purchase consideration will be reduced by an agreed amount, determined on some basis as an estimate of the warranty claims that are expected to be made.

The undertaking by the purchaser to settle the seller's warranty obligations that arise after the effective date of the transfer of the business comprises non-monetary consideration for the supply of the business. The value placed on this obligation by the parties acting at arm's length and by which the purchase price for the business is reduced, forms part of the consideration payable for the business. VAT is therefore payable on the actual amount paid by the purchaser to the seller plus the value placed on the warranty obligations assumed by the purchaser.

"If a liability is imposed by a statute on the operator of the business, the liability reduces the value of the business."

STATUTORY OBLIGATIONS

Certain liabilities may be imposed by statute, in which case the purchaser assumes the liability as a consequence of purchasing the business. Where a statute imposes an obligation on the owner of the business, the seller is released from the liability when the business is transferred, and the purchaser assumes the statutory liability.

A typical example of such an obligation is provided in Interpretation Note 94 (IN 94), citing a judgment by the Supreme Court of Canada, in *Daishowa-Marubeni International Ltd v Canada,* [2013], where the appellant disposed of its right to harvest timber and the buyer assumed the appellant's statutory obligation to reforest the land on which it had previously felled timber. The issue was whether the value of the assumed liabilities comprised part of the consideration received for the disposal of the right to timber. The court held that the reforestation obligation was simply a future cost tied to the forest tenures that depressed the value of the assets and was not a separate obligation, and therefore it did not comprise consideration for the sale.

Although IN 94 deals with the income tax implications of contingent liabilities assumed in the acquisition of a business, the same principles regarding statutory obligations equally apply in a VAT context. If a liability is imposed by a statute on the operator of the business, the liability reduces the value of the business. The liability assumed by the purchaser is embedded in the business acquired. In these circumstances the purchaser does not assume the liability in terms of a contractual arrangement between the supplier and the purchaser, but as a consequence of the operation of a particular statute. Accordingly, the assumption of a statutory obligation does not form part of the consideration paid to the supplier for acquiring the business.

PAYMENT MADE FOR ASSUMPTION OF A LIABILITY

The above scenarios must be distinguished from the situation where a person who has an existing or future liability pays another person to assume that liability. As an example, a company may have an existing third-party claim against it, or have contingent warranty claims in respect of goods manufactured. The liability in this scenario comprises a "debt security", and the transfer thereof to another person is a financial service in terms of section 2(1)*(c)* of the VAT Act, which is exempt from VAT in terms of section 12*(a)*. A "debt security" is defined in section 2(2) to include an obligation or liability to pay money that is or is to be owing by any person. It therefore includes current liabilities as well as liabilities that may arise in the future.

Consequently, a person who receives a payment as consideration for the assumption of another person's current or future liability is not liable to account for VAT on the payment, because it is exempt from VAT.

CONCLUSION

The VAT consequences of the assumption of liabilities depend on the nature of the specific liabilities and on the nature of the transaction under which the liabilities are assumed. In some instances, the assumption of liabilities is standard-rated and sometimes it may form part of a zero-rated transaction. The assumption of certain liabilities may fall outside the scope of VAT, and in other instances it could be exempt from VAT. Each scenario must therefore be considered on its own merits and on the relevant facts.

Tersia van Schalkwyk & Gerhard Badenhorst

Cliffe Dekker Hofmeyr

Acts and Bills

- Value-Added Tax Act 89 of 1991: Sections 1(1) (definition of "consideration"), 2(1)*(c)*, 2(2) (definition of "debt security"), 8(25), 11(1)*(e)* & 12*(a)*.

Other documents

- Interpretation Note 94 *("Contingent liabilities assumed in the acquisition of a going concern")*.

Cases

- *Daishowa-Marubeni International Ltd v Canada* [2013] SCC 29.

Tags: consideration; zero rate; assumption of the liabilities; non-monetary consideration; statutory liability; debt security.

CREDIT NOTES

The SARS VAT verification process is a daily occurrence for many VAT vendors. Tax invoices are uploaded with other information as requested by SARS.

Tax invoices are scrutinised to ensure compliance with section 20(4) of the Value-Added Tax Act, 1991 (the VAT Act). However, in some instances the document uploaded is a credit note.

Credit notes do not always receive the same attention and scrutiny as tax invoices do. In most instances, the validity of the credit note from a VAT perspective is never questioned. This can often be attributed to lack of knowledge on the part of the person processing the credit note. In fairness, the focus of VAT training, even at a rudimentary level, tends to be on the requirements of a valid tax invoice rather than the requirements of a valid credit note.

A further reason for non-compliance is that, when many of the accounting systems or packages used by businesses are configured, the requirements of a valid credit note are not considered to ensure that the credit notes issued by the system constitute valid credit notes.

Failure to issue valid credit notes could result in, among other things, much needed VAT refunds being delayed or not paid out at all.

It is therefore crucial that businesses ensure that the credit notes that are generated by their accounting system and issued to their clients, comply with the provisions of the VAT Act.

Section 21(3)*(a)* of the VAT Act provides that a credit note must reflect the following particulars:

(i) The words "credit note" in a prominent place;

(ii) the name, address and VAT registration number of the vendor;

(iii) the name and address of the recipient; where the recipient is a registered vendor, also the VAT registration number of the recipient;

(iv) the date on which the credit note was issued;

(v) either—

(aa) the amount by which the value of the said supply shown on the tax invoice has been reduced and the amount of the excess tax; or

(bb) where the tax charged in respect of the supply is calculated by applying the tax fraction to the consideration, the amount by which the consideration has been reduced and either the amount of the excess tax or a statement that the reduction includes an amount of tax and the rate of the tax included;

(vi) a brief explanation of the circumstances giving rise to the issuing of the credit note; and

(vii) information sufficient to identify the transaction to which the credit note refers.

In most instances, credit notes issued by VAT vendors comply with the requirements in (i) to (v) above. However, complying with the requirements set out in (vi) and (vii) usually poses a challenge.

BRIEF EXPLANATION OF THE CIRCUMSTANCES GIVING RISE TO THE ISSUING OF THE CREDIT NOTE

In many instances, credit notes issued by vendors do not provide a brief explanation of the circumstances which gave rise to the issuing of the credit note. As mentioned above, the non-compliance with this requirement can often be attributed to the configuration of the accounting system which does not allow for the brief explanation to be included on the credit note. However, in other instances, it is often due to a lack of knowledge of this requirement on the part of the person processing the credit note.

> "Credit notes do not always receive the same attention and scrutiny as tax invoices do. In most instances, the validity of the credit note from a VAT perspective is never questioned."

Where the non-compliance arises due to the accounting system, it would seem that the most practical solution to this problem is to insert the brief explanation in the description section of the credit note.

However, this would obviously require the person processing the credit note to be aware of this requirement.

INFORMATION SUFFICIENT TO IDENTIFY THE TRANSACTION TO WHICH THE CREDIT NOTE REFERS

The wording of this requirement does not specifically state what information is required. One could assume that the purpose of this requirement is to provide an audit trail which SARS could use to easily establish the original transaction or transactions to which the credit note relates. According to *Juta's Value-Added Tax* (Revision Service 17 (p 21-8A)), this could be a reference to the relevant tax invoice's serialised number. The example of a credit note on p 120 in SARS' VAT 404 Guide for Vendors refers to "tax invoice reference".

The question that then arises is what the vendor should do if unable to link the credit note to one specific tax invoice or transaction.

In its now withdrawn General written rulings and decisions (withdrawn by BGR (VAT) 2, dated 1 January 2007), SARS previously provided guidance on a number of scenarios relating to the issuance of credit notes.

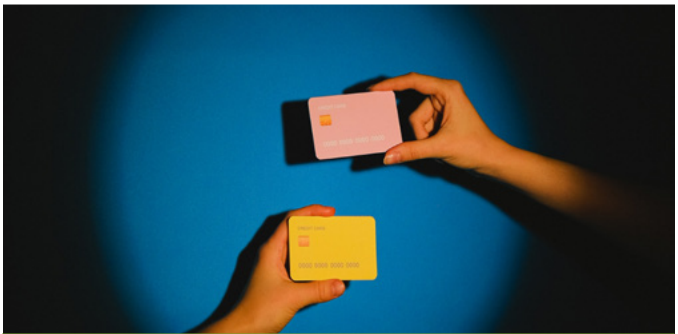
In SARS VAT Ruling 7, which dealt with the return of goods in circumstances where the vendor could not determine when goods returned had been supplied because of the nature of the goods, SARS stated that where it is *impossible* to identify the transaction to which a credit note refers, this requirement need not be complied with.

In VAT Ruling 209, which also dealt with the return of goods, it was stated that where it is impossible to identify the original transaction (ie, where no serial or registration number exists), an endorsement on the credit note to the effect that "this credit note refers to sales made between x date and x date", together with the volume of the goods returned, will constitute sufficient information to identify the transaction for purposes of this requirement.

CONCLUSION

As can be seen from the above discussion, the validity or otherwise of credit notes issued by vendors often poses significant tax risks for these vendors. In these tough economic times, cash flow is key and issuing an invalid credit note could result in SARS raising assessments and disallowing input tax credits claimed, together with the imposition of penalties and interest. This could also result in refunds not being paid out by SARS.

Do not hesitate to contact experts in the field should you be in any doubt as to the validity of credit notes issued by your organisation.



Seelan Muthayan

BDO

Acts and Bills

- Value-Added Tax Act 89 of 1991: Sections 20(4) & 21(3)*(a)*.

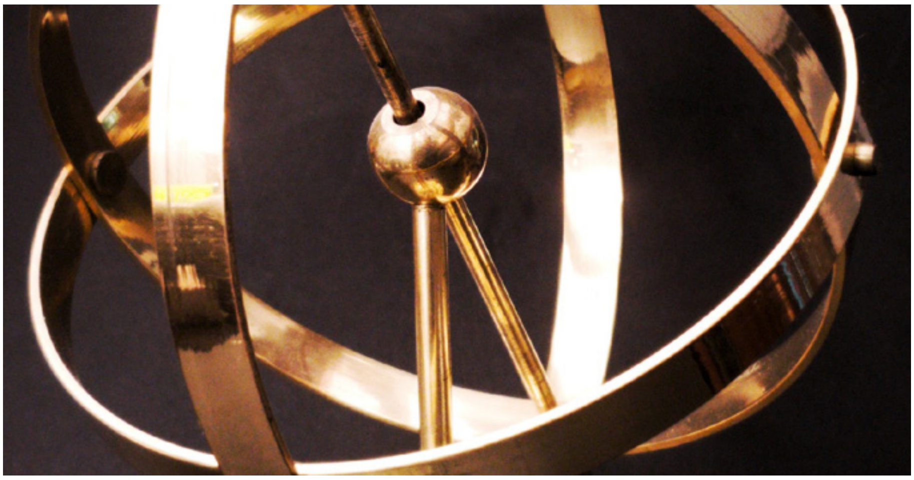
Other documents

- *Juta's Value-Added Tax,* Revision Service 17 (p 21-8A);
- *SARS' VAT 404 Guide for Vendors* (dated 12 December 2019, p 120);
- Binding General Ruling 2 (VAT) – published on 1 January 2007 and withdrawn wef 1 October 2011;
- SARS VAT Rulings 7 & 209.

Tags: credit note; tax invoices; VAT refunds.

DOMESTIC REVERSE CHARGE ON "VALUABLE METAL"

On 8 June 2022, South Africa's Minister of Finance published regulations to introduce a domestic reverse charge on "valuable metal" relating to gold-containing material, which includes secondary gold sources as well as certain mine dumps.



Under a domestic reverse charge mechanism, the purchaser accounts for the VAT (at 15%) on the transaction rather than the supplier.

The Regulations on Domestic Reverse Charge relating to Valuable Metal (the Regulations) came into operation on 1 July 2022 and vendors were afforded one month (ie, until 31 July 2022) to become compliant.

BACKGROUND AND PURPOSE OF THE REGULATIONS

The main purpose of the Regulations is to curb VAT refund fraud involving illicit gold trading suspected by the South African Revenue Service (SARS) to be prevalent in the second-hand gold industry. The illicit gold is believed to originate mainly from illegally melted Krugerrands, illegally mined gold (so-called "zama-zama" gold), and illegally imported gold. The fraudulent scheme is premised on vendors introducing illicit gold (which does not carry VAT) into the supply chain and unlawfully claiming VAT refunds using fabricated documents.

Although concerns of VAT refund fraud in the second-hand gold industry are not new, a new *modus operandi* whereby the fraud is supposedly committed has been identified. In recent years, fictitious businesses (shell companies) are registered for VAT and required documentation (eg, tax invoices) is fabricated. This is done to enable the purchasing vendor to claim *actual* (not notional) input tax deductions in respect of VAT at 15% supposedly charged by a fictitious supplier. Typically, the VAT reflected on the false documentation is never paid over to SARS.

MECHANICS OF THE REGULATIONS

Ordinarily, a VAT-registered supplier will charge VAT on a taxable supply of goods or services (eg, gold sales) to a purchaser. The purchaser will pay the VAT to the supplier and the supplier is required to declare and pay such VAT to SARS. A VAT-registered purchaser who has acquired the goods or services for taxable purposes (eg, gold for on-sale in the local or export market) can claim the VAT incurred as an input tax deduction. However, where VAT refunds are claimed fraudulently SARS is out of pocket. The Regulations are therefore aimed at ensuring that SARS is left in a neutral cash-flow position.

The Regulations provide that the purchaser is required to self-account (reverse charge) the VAT on the purchase of "valuable metal" before that purchaser is entitled to claim a corresponding input tax deduction on the transaction, whether in the same or a subsequent VAT return. As a result, no VAT will go "missing" in the supply chain as the purchaser declares and pays the VAT directly to SARS instead of the supplier. This ensures that no VAT refunds will be paid by SARS to purchasers in instances where suppliers are fictitious.

> "The main purpose of the Regulations is to curb VAT refund fraud involving illicit gold trading suspected by the South African Revenue Service (SARS) to be prevalent in the second-hand gold industry."

THE AMBIT OF THE REGULATIONS

The Regulations will find application to a transaction when all three of the following elements are present:

- Both the seller and the purchaser are VAT-registered vendors;
- The goods supplied are "valuable metal" as defined in the Regulations; and
- The transaction is subject to VAT at 15%.

By implication, the Regulations will not apply to transactions between a VAT-registered purchaser and a non-VAT-registered supplier (eg, the general public, or illegal miners), zero-rated sales (eg, gold exports, or sales of Krugerrands when intact), or goods that do not fall within the "valuable metal" definition.

For example, if an illegal miner (natural person, not VAT-registered) sells illicit gold (valuable metal) to a VAT-registered purchaser, the Regulations will not apply. As the illegal miner is not registered for VAT there would not and should not be a VAT charge to the purchaser on the transaction. However, if the purchaser tries to interpose a fictitious VAT registered business as a front to conceal the true (illicit) origin of the goods and unlawfully claim the VAT supposedly incurred on the transaction in its VAT returns, the Regulations will apply as all three of the above requirements will be met.

The Regulations will also apply if VAT-registered vendors melt Krugerrands or manufacture them into purpose-made jewellery and try to conceal the origin thereof by misrepresenting the goods as "scrap gold" or "scrap jewellery" on tax invoices.

"VALUABLE METAL", AS DEFINED

What constitutes "valuable metal" is defined in the Regulations as any goods containing gold in the following prescribed forms: jewellery, bars, blank coins, ingots, buttons, wire, plate, granules, in a solution, residue (being any debris, discard, tailings, slimes, screening, slurry, waste rock, foundry sand, beneficiation plant waste or ash) or similar forms, including any ancillary goods or services.

The following supplies are specifically excluded from the definition and therefore not caught by the Regulations:

- In relation to mines, supplies of goods produced from raw materials by any "holder" as defined in section 1 of the Mineral and Petroleum Resources Development Act, 2002 (the MPRDA). However, it is important to note that mine dumps created by mining operations conducted before 1 May 2004, when the MPRDA took effect, are not regulated under the MPRDA and therefore do indeed fall within the ambit of the Regulations.
- In relation to contract miners, supplies of goods produced from raw materials by any person contracted to such "holder" to carry on mining operations in respect of the mine where the "holder" carries on mining operations.
- Supplies contemplated in section 11(1)*(f)* of the VAT Act, being gold supplied to a South African registered bank, the South African Reserve Bank (SARB), or the South African Mint Company (Proprietary) Limited in certain prescribed forms. However, the impact of the High Court case of *Lueven Metals (Pty) Ltd v The Commissioner for the South African Revenue Service*, [2022] (19 May 2022), should be carefully considered.
- Supplies of certain gold coins (including Krugerrands) "as such" as contemplated in section 11(1)*(k)*. Therefore the supply of these coins is excluded from the Regulations only when they are intact and not melted.
- Supplies contemplated in section 11(1)*(m)*, being movable goods sold and delivered to a customs-controlled area enterprise or SEZ (special economic zone) operator.

REPORTING OBLIGATIONS

From a practical perspective, it is important to note that transacting vendors to whom the Regulations apply will no longer be declaring their transactions in fields 1 and 4 (for output tax on sales) or field 15 (for VAT claims on purchases) of their respective VAT returns.

To demonstrate, the transacting vendors' respective VAT returns will henceforth look as follows:

Area	Transaction	What to declare	Field	As the supplier	As the purchaser
Valuable metal transactions					
Output	Sales of valuable metal	Value only (excl VAT)	3	100	-
Output	Purchases of valuable metal	DRC VAT at 15%	12	-	15
Input	Purchases of valuable metal	Normal VAT claim at 15%	18	-	-15
Credit / debit notes					
Output	DRC debit notes	Increase in DRC VAT	12	-	15
Input	DRC credit notes	Decrease in DRC VAT	18	-	-15
Output/ Input	Other credit / debit notes	Normal adjustments	12/ 18	-	Normal rules
Net VAT payment / (VAT refund):			20	-	-

Vendors supplying valuable metal that is subject to the Regulations must revalidate (update) their VAT registration status with SARS. The Regulations also contain additional requirements with which tax invoices must comply, as well as detailed documentation requirements to be adhered to. Affected vendors are advised to contact their tax advisors for clarification if they are unsure.

LIABILITY FOR VAT

Failure to apply the domestic reverse charge on supplies of valuable metal will result in the supplier and purchaser, being VAT-registered vendors, being held jointly and severally liable for any VAT loss suffered by the fiscus in this regard. However, recipient vendors are expected to bear the brunt of SARS' enforcement action in respect of any obligation to account for and pay VAT to SARS in terms of the Regulations.

Vendors operating in the second-hand gold industry should ensure that they fully understand the ambit of the Regulations and their respective obligations in terms thereof now that the Regulations have come into effect.

Annelie Giles (reviewed by **Charles de Wet**)

ENSafrica

Acts and Bills

- Mineral and Petroleum Resources Development Act 28 of 2002: Section 1 (definition of "holder");
- Value-Added Tax Act 89 of 1991: Sections 11(1)*(f)*, *(k)* & *(m)* & 74(2).

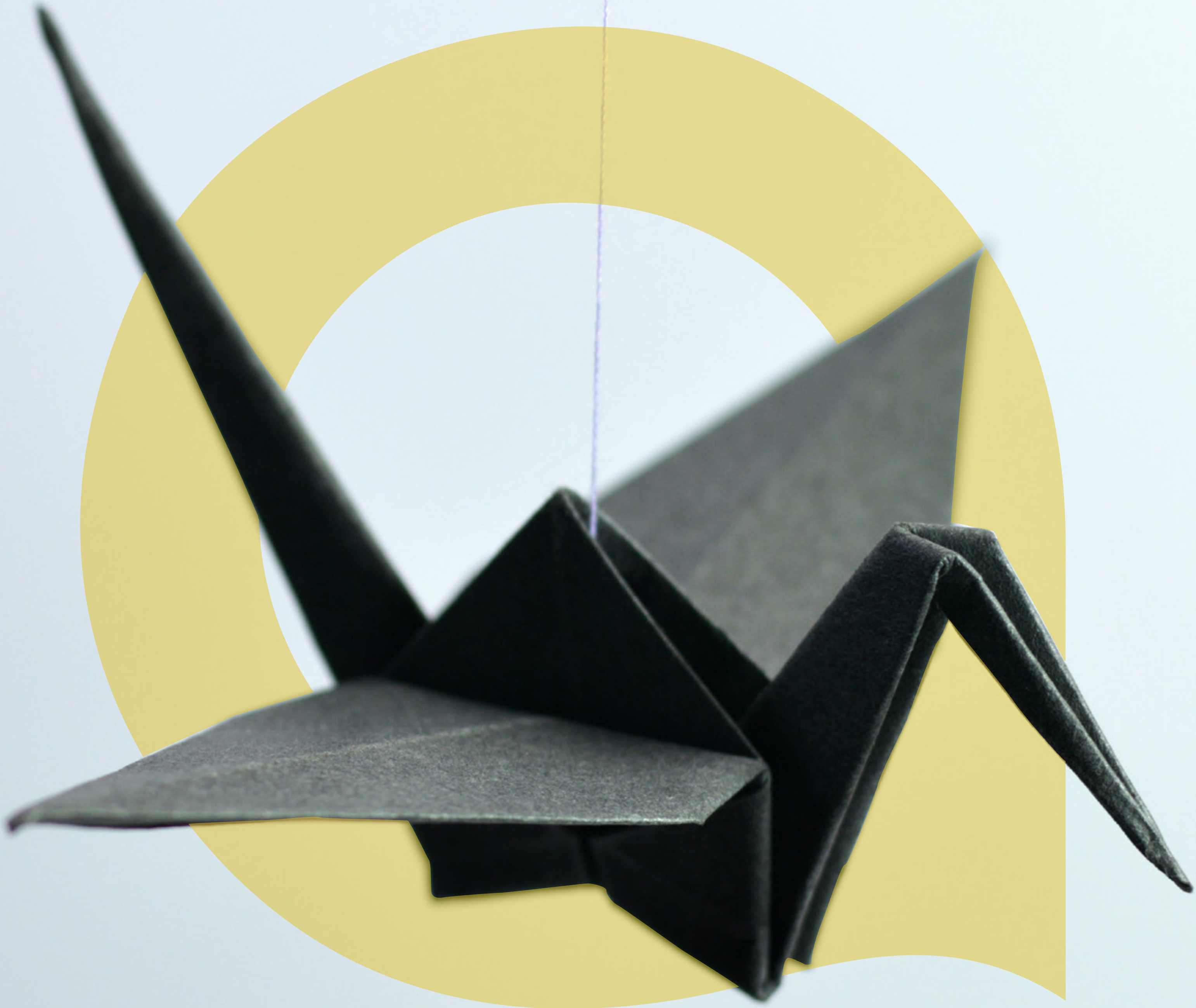
Other documents

- Regulations on Domestic Reverse Charge relating to Valuable Metal (issued in terms of section 74(2) of the VAT Act; GN 2140 in *GG* 46512 of 8 June 2022 (wef 1 July 2022) (also specifically: Definition of "valuable metal").

Cases

- *Lueven Metals (Pty) Ltd v The Commissioner for the South African Revenue Service* (31356/2021) [2022] ZAGPPHC 325 (19 May 2022).

Tags: domestic reverse charge; VAT-registered purchaser; valuable metal; output tax on sales.



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