Issue 64 | 2023
NOVEMBER

South African Institute of Taxation

Unstructured CPD 150mins

TAX CHRONICLES MONTHLY

Official Journal for the South African Tax Professional

GENERAL
MEASURES TO COMBAT MONEY LAUNDERING AND TAX EVASION

TAX ADMINISTRATION
PRESCRIPTION PERIOD LIMITATIONS

VALUE-ADDED TAX
ZERO-RATED VS EXEMPT SUPPLIES

CONTENTS

COMPANIES

0625. Asset swaps – section 42 03

GENERAL

0626. Measures to combat money laundering and tax evasion 05

INCOME TAX

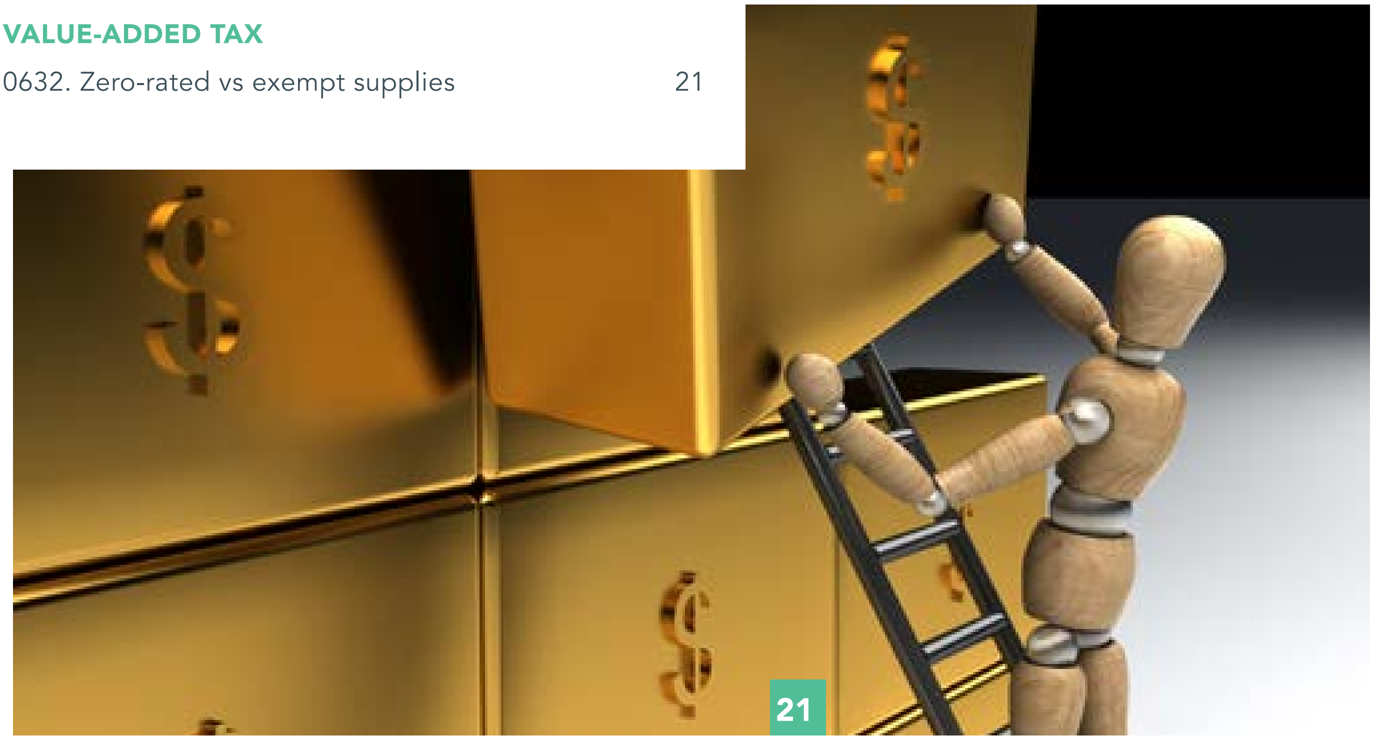
0627. Debt restructuring 07

TAX ADMINISTRATION

0628. Misrepresentation and prescription 09
0629. Prescription period limitations 11
0630. The rights of access to information and freedom of expression vs the right to privacy 15
0631. The Tax Court or the High Court? 19

VALUE-ADDED TAX

0632. Zero-rated vs exempt supplies 21



ASSET SWAPS – SECTION 42

Section 42 of the Income Tax Act, 1962 (the Act), is a cornerstone of the so-called "corporate rules" in the Act. Should certain conditions be met, this section provides roll-over relief to a taxpayer where that taxpayer exchanges an asset for shares in a company.

The application of section 42 to multiple transactions concluded back to back has been the subject of previous South African Revenue Service (SARS) binding private rulings (BPRs), such as BPR 288, where SARS decided that an asset transferred in terms of a section 42 transaction can again be transferred in terms of another section 42 transaction and the second transaction will still enjoy roll-over relief. The issue also arose in BPR 328.

In June 2023, in BPR 393, SARS again ruled on the question of back-to-back section 42 transactions. While not expressly stated in the ruling, one of the key questions addressed is the question of whether the successive nature of these transactions in the context of a group restructure alters the capital or revenue nature of assets transferred, specifically as a result of the second section 42 transaction.

SECTION 42

In short, section 42 provides that where a taxpayer holds an asset as a capital asset and disposes of this asset to a company in exchange for that company issuing the taxpayer equity shares, then the taxpayer will be deemed to dispose of that asset for proceeds equivalent to the base cost at which the taxpayer held that asset. The company will then be deemed to acquire that asset from the taxpayer for a consideration equal to the base cost at which the taxpayer held the asset (hence the term roll-over relief – the base cost rolls over from taxpayer to company). The effect then is that no capital gain (and thus no capital gains tax) is realised on the transaction.

Inter alia, in order for section 42 to apply, the taxpayer must hold at least 10% of the equity shares in the company to which the taxpayer transfers the asset following the transaction (if the company is an unlisted company). Furthermore, the company cannot dispose of the asset acquired within 18 months of the transaction without incurring a tax liability. This point was covered in BPR 288, where SARS clarified that a second section 42 transaction within 18 months of the first would still qualify for roll-over relief, based on the facts of that particular ruling.

Section 42 also provides that where a taxpayer holds an asset as a capital asset, the company acquiring that asset in exchange for issuing shares to the taxpayer will acquire that asset as a capital asset. However, should the company again dispose of that asset in terms of another section 42 transaction shortly after acquiring it (perhaps even envisaging the subsequent disposal in terms of section 42 when acquiring it in terms of section 42 in the first place), it becomes questionable whether the back-to-back nature of these transactions will alter the capital nature of the asset.

FACTS OF BPR 393

In BPR 393, the applicant company carried on a financial services business and a separate insurance business. In order to separate these two businesses into individual corporate vehicles, this company incorporated a holding company below it. It then incorporated two more subsidiaries (SubCo 1 and SubCo 2), each wholly owned by the holding company. The restructure of the applicant company's interests in the two businesses comprised a series of steps, two sets of these steps being relevant here.

The first relevant set of steps involved the applicant company transferring its financial services business assets to the holding company as a going concern in terms of section 42. The holding company then transferred these to SubCo 1 as a going concern in terms of section 42.

The second relevant set of steps involved the company transferring its insurance business assets to the holding company as a going concern in terms of section 42. The holding company then transferred these to SubCo 2 as a going concern in terms of section 42.

"Therefore, despite similar rulings in BPRs 288, 328 and 393, it is unlikely that one can argue that this constitutes a practice generally prevailing."

Therefore, this restructure involved two instances where section 42 was used in back-to-back transactions in respect of the same assets – the insurance business assets and the financial services business assets. It was undisputed that the applicant company in the first instance held both the financial services business and insurance business assets as capital assets. The question, however, was whether the holding company held these assets as capital assets in light of the fact that it contemplated transferring them to the two subsidiaries in terms of section 42 immediately after receiving them in terms of a section 42 transaction.

SARS' DECISION

In relation to the relevant sets of steps, SARS ruled that –

- firstly, the transactions between the holding company and subsidiaries would constitute section 42 transactions and enjoy roll-over relief (this is consistent with the decision in BPR 288); and

- secondly, the holding company will receive, hold and then transfer the financial services business and insurance business assets as capital assets, despite holding them for a very short period of time and intending to dispose of them when receiving them – this means that the subsidiaries will receive and hold these assets as capital assets and not trading stock.

SARS' decision is consistent with the purpose behind section 42, and the "corporate rules" more broadly, in that it recognises the commercial need for taxpayers to change the immediate control/holding of certain assets, without relinquishing an interest in these assets. As always, however, SARS' decision must be understood within the correct context, as it was made with specific reference to the facts before SARS in this matter, and is not of general application to all transactions.

Therefore, despite similar rulings in BPRs 288, 328 and 393, it is unlikely that one can argue that this constitutes a practice generally prevailing. It is therefore advisable that taxpayers seek advice from a tax practitioner regarding any specific transaction or restructure which they intend to implement, in particular where the potential tax consequences are uncertain. It is important to appreciate that in terms of section 42, the need for the parties to hold the assets and shares acquired under a section 42 transaction for 18 months after the transaction in order to avoid negative tax consequences does not apply only if the consecutive transaction is concluded in terms of section 45, 46 or 47 of the Act. If the consecutive transaction (involving the same shares and assets) is concluded in terms of section 42 within 18-months there would be adverse tax consequences. In BPR 393, SARS held that the 18-month holding period requirement in section 42(7) still applies to the second set of section 42 transactions between the new holding company and the two subsidiaries.

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

Nicholas Carroll

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 42, 45, 46 & 47.

Other documents

- Binding Private Ruling 288 ("Consecutive asset-for-share transactions within 18 months") (17 January 2018);
- Binding Private Ruling 328 ("Consecutive asset-for-share transactions") (20 September 2019);
- Binding Private Ruling 393 ("Income tax consequences resulting from consecutive asset-for-share transactions") (15 June 2023).

Tags: equity shares; roll-over relief; applicant company; holding company; back-to-back transactions; corporate rules.

MEASURES TO COMBAT MONEY LAUNDERING AND TAX EVASION

Government has introduced new laws and regulations to combat money laundering and tax evasion.

These new rules require the creation and maintenance of records of the natural person beneficial ownership of entities and the collation of certain personal documents relating to these individuals. The object appears to be to establish who really owns or controls that trust or company/close corporation.

The obligation to maintain these registers falls on every trustee, director and member – there are severe financial penalties for failure to do so. The expertise required and the time and costs of complying should not be underestimated.

TRUSTS

The ultimate beneficial owners of a trust are defined in the Trust Property Control Act, 1988, to include the following natural persons:

- The founder of the trust;
- Each trustee;
- Each beneficiary actually named in the trust deed;
- Any individual who exercises effective control of the trust. This could probably include donors, protectors, etc.

If the founder of the trust is another trust or company, the natural person beneficial owners of that trust or company will need to be included as beneficial owners of the first trust.

Each trustee has the responsibility to collate, record and maintain detailed information and records.

The information and documentation which is required to be included in a register and to be submitted online to the Master of the High Court in respect of each natural person beneficial owner is as follows:

- Full names;
- Date of birth;
- Nationality;
- Citizenship;
- Official identity document number, country of issue and type of document (eg, SA identity card, passport, etc);
- Certified copy of identity document;
- Residential address (and alternate address for serving of notices if different from residential address);
- Alternate means of contact (eg, email address and mobile number);
- The category of the beneficial owner of the trust, eg, founder, trustee, named beneficiary, etc;
- South African tax registration number (if applicable);
- Date becoming a beneficial owner and date of ceasing to be a beneficial owner.

Accountable Institutions (AIs) include banks, financial services providers, trust service providers, company service providers, legal practitioners, etc. They will be required to do customer due diligence on all their clients.

A trustee must record the following details of an AI with which they have a business relationship:

- Name of AI;
- If the AI is not a natural person, the registration details of the AI;
- If the AI is a natural person, then the ID or passport number (and country of issue) of the natural person;
- The nature of the services and functions that the AI performs on behalf of the trustees;
- The date that the relationship with the AI was entered into.

A further duty falls on all trustees to provide details of and keep records of all AIs which they use as agents to carry out their trustee responsibilities. They must also disclose their position as trustee to any such AI.

COMPANIES AND CLOSE CORPORATIONS

For companies and close corporations, the governing body will be the Companies and Intellectual Property Commission known as CIPC. The Companies Act, 2008, and Companies Act Regulations, 2011, have been amended as follows:

The ultimate beneficial owners of a company or close corporation are defined to include the following natural persons who, directly or indirectly, ultimately own that company or exercise effective control of that company (eg, a director or member) by way of –

- Holding shares/membership in the entity (owns 5% or more of the entity);
- Control of the exercise of the voting rights in respect of that holding;
- Having a right to appoint or remove a director of the company or a member of the close corporation;
- Having the ability to exercise control of the company or close corporation;
- Having the ability to otherwise materially influence the management of that company or close corporation.

As with trusts, if any of the aforementioned beneficial owners is another company or a trust, the natural person beneficial owners of that company or trust will need to be included as beneficial owners of the first company.

The information and documentation required to be included in the register and to be submitted online to CIPC and continually updated in respect of each natural person beneficial owner are as follows:

- Full names;
- Date of birth;
- Official identity document number (or passport number, country of issue and country of birth);
- Certified copy of identity document;
- Personal income tax number;
- Residential and postal address;
- Email address;
- Mobile number;
- Interest type and scope (extent of beneficial interest), eg, shareholder, director, effective control, etc.

GENERAL

The new rules apply with effect from 1 April 2023. This means that urgent attention to these matters is required.

Once the registers have been compiled every change to any detail must immediately be advised to the Master of the High Court or CIPC, whichever is applicable. Although the wording of the requirement for trusts and companies is not identical, it is clear what information is considered important. Updates to registers can be done online.

The information must be submitted by the trustees, directors or members. They are entitled to request someone else to do so on their behalf. They will need to grant a power of attorney to such person.

Editorial comment: Various accountants, lawyers and tax advisors are now offering the compilation and updating of the registers on behalf of the relevant entities and trustees.

"The obligation to maintain these registers falls on every trustee, director and member – there are severe financial penalties for failure to do so."

Kent Karro

Crowe

Acts and Bills

- Trust Property Control Act 57 of 1988;
- Companies Act 71 of 2008.

Other documents

- Companies Regulations, 2011.

Tags: beneficial ownership; tax registration number; Accountable Institutions (AIs).

DEBT RESTRUCTURING

With increasing economic uncertainty and rising interest rates, the ability of businesses that are heavily leveraged to meet their funding obligations is becoming increasingly difficult.

To ensure their continued viability, businesses are likely to consider restructuring their debt. The restructuring can take various forms and could include –

- the waiver/cancellation of the debt;
- the conversion of debt into equity; and
- the subordination of the debt.

In considering the form of the restructure, debtors should be mindful of the tax consequences that may arise. In South Africa, these tax consequences are governed by the Income Tax Act, 1962 (the Act).

Section 19 and paragraph 12A of the Eighth Schedule to the Act deal with the tax consequences for the debtor. The consequences for the creditor are governed by the general provisions of the Act, which include sections 11 and 24J, as well as provisions of the Eighth Schedule, such as paragraph 56.

REDUCTION OF DEBT

The position of the debtor will depend on what the proceeds of the debt in question have funded. A debtor may acquire debt –

- to acquire trading stock or fund tax deductible expenses (such as operational expenses); or
- to acquire allowance assets or non-allowance assets (such as capex expenditure).

Depending on the nature of the expenditure that was funded by the debt in question and subject to certain exemptions that may apply in limited circumstances, restructuring the debt may result in –

- an inclusion in the income of the debtor of deductible expenses or allowances claimed in respect of the debt;
- a reduction in the cost price of any trading stock that was funded by the debt;
- a reduction of the base cost of any capital asset that was funded by the debt; or
- an immediate capital gain for that year of assessment.

> "Where interest incurred on the subordinated debt is deemed to be a dividend *in specie*, it cannot be deducted under section 24J. As the interest is deemed to be a dividend *in specie*, dividends tax will then need to be considered."

Amounts included in the income of the debtor will potentially be subject to income tax in the debtor's hands, whilst the reduction of the base cost of an asset means that the debtor stands to realise a higher capital gain upon the disposal of the asset than would have been the case in the absence of the debt restructuring.

In the case of the creditor, it is important to understand in what circumstances a corresponding deduction from their income or a capital loss can be claimed, and in what circumstances a loss can be carried forward.

DEBT CONVERTED INTO EQUITY

A debt-to-equity transaction involves a creditor "swapping" indebtedness owed by a debtor to it, into shares in the debtor. The debt may be converted into ordinary shares or preference shares.

In the case of the debtor, again subject to the exemption available in this respect, the debt reduction provisions may be triggered where the debt is directly or indirectly reduced by conversion or exchange of that debt for shares, and the shares issued have a lower market value than the face value of that debt. As a result of this mismatch, a debt benefit may arise. However, this could be a better proposition for the debtor compared to a debt reduction because the conversion of the capital portion of the debt (excluding capitalised interest) into shares will not be taxed according to the debt reduction provisions discussed above.

Similarly, as is the case under a debt reduction, it is important to understand in what circumstances a creditor can claim a corresponding deduction from their income or a capital loss, and in what circumstances a loss can be carried forward. Furthermore, a creditor will also be concerned with obtaining base cost in the new shares acquired.

DEBT SUBORDINATION

Unlike debt waiver or debt capitalisation, the subordination of a debt does not extinguish the debt. Rather, subordination involves the claim of a creditor, against a debtor, subordinated in favour of another creditor's claim against that same debtor. The effect of this is that the claim of the existing creditor will be preferred over the claim of a subordinated creditor.

The concern is where the debt is deeply subordinated to the extent that there is a change in the nature of the claim, such that the return on the debt (interest) will be recharacterised as a return on equity (dividend *in specie*). This may arise where the repayment of that debt is made conditional upon the market value of the assets of the debtor not being less than the amount of the liabilities of the debtor.

Where interest incurred on the subordinated debt is deemed to be a dividend *in specie*, it cannot be deducted under section 24J. As the interest is deemed to be a dividend *in specie*, dividends tax will then need to be considered.

RECORD KEEPING

Where a debt has been specifically earmarked to fund one or two items, determining the tax consequences of a restructuring of the debt may be relatively simple. This will be the case where there are clear records regarding the use to which the debt was applied.

However, it is not unheard of for businesses that are considering the restructuring of their balance sheets to find themselves at a loss when having to determine the historic application of debt generally used in the business. At such a juncture, it is advisable to engage a tax advisor to plan a more tax-efficient debt restructure and avoid unnecessarily crippling an already struggling business with a tax liability.

CONCLUDING REMARKS

Addressing these issues prior to a debt restructure will mitigate unnecessary tax costs when implementing the debt restructure.

Diwan Kamoetie

Bowmans

Acts and Bills

- Income Tax Act 58 of 1962: Sections 11, 19 & 24J; Eighth Schedule: Paragraph 12A.

Tags: tax deductible expenses; operational expenses; debt-to-equity transaction; debt subordination; debt waiver; debt capitalisation.

MISREPRESENTATION AND PRESCRIPTION

As every taxpayer knows, SARS has extremely wide powers under the various fiscal Acts to enforce and collect tax.

One of the protections given to taxpayers is that, in the case of income tax, an additional assessment may not be raised after three years, while in the case of self-assessed taxes, such as PAYE and VAT, SARS is given five years within which it may raise additional assessments, after which it is prohibited from doing so. This statutory time limit is colloquially known as "prescription", a term that will be used in this article.

However, this protection is limited in that there are circumstances where SARS may disregard prescription. In the case of income tax, prescription may be disregarded if the full amount of tax was not assessed due to fraud, misrepresentation or non-disclosure of material facts. In particular, as regards misrepresentation, this could be deliberate or innocent. In the case of self-assessed taxes the law prescribes that the misrepresentation must be intentional or negligent before an assessment may be raised after five years.

This article deals only with SARS' misunderstanding at many levels of what misrepresentation involves.

MISREPRESENTATION

Shortly stated, misrepresentation means a false statement of fact. It has nothing to do with a legal point or a particular tax position adopted by a taxpayer.

So, for example, generally speaking, if shares in a South African company are held for more than three years, the proceeds are deemed to be of a capital nature. If they are held for less than three years, they are ***not*** deemed to be of a revenue nature, but the ordinary, common law rules apply in determining the capital or revenue nature of the receipts and, hence, whether the profit should be taxed as ordinary income or be subject to CGT. If a taxpayer indicates that it has held the shares for more than three years when, in reality, the shares were held for less than three years, on the assumption that this was not done fraudulently it would certainly amount to misrepresentation.

It is well-known that generally the burden of proof is on the taxpayer to show whether an amount is taxable or not, or is deductible or not. But not everything falls upon the taxpayer's shoulders. In this situation the onus of proof that there is misrepresentation falls upon SARS. Moreover, it is not enough to show that there is misrepresentation in order to disregard prescription – SARS must also show that it was the misrepresentation that was the cause of the taxpayer not being taxed within the three-year (or five-year) period.

THE PROBLEM

The first problem is that SARS generally does not take its obligation to prove the causality too seriously. Generally, if SARS is in the position to allege that there has been fraud or misrepresentation or non-disclosure of material facts, such allegation, in and of itself, is sufficient in its view to disregard prescription. It is almost as if SARS considers it self-evident that if there has been one of these factors then it must mean that, but for that factor, SARS would have taxed within three years. Of course, nothing could be further from the truth.

But that is not the main thrust of this article. What is more concerning is SARS' misunderstanding of what misrepresentation means in these circumstances.

Take the example given above in relation to a sale of an asset and whether the proceeds are of a capital or revenue nature. The courts have determined a number of tests, and possibly the most important test is whether or not the asset was acquired with a view to reselling in a scheme of profit-making. This involves ascertaining the intention of the taxpayer, which is also a question of fact, and also various other criteria. The courts will not lightly disregard the taxpayer's evidence as to its intention, but at the same time the courts will look carefully at all of the surrounding objective facts and circumstances in determining whether or not the profit is of a revenue or capital nature. And the courts have consistently stated that interpreting and drawing inferences from these facts in order to arrive at the conclusion of whether it is capital or revenue, is a matter of law.

Assume that a taxpayer purchases an asset and after, say, 18 months sells that asset at a considerable profit. Having regard to his or her subjective intentions and views, and possibly also having taken advice, the taxpayer decides to reflect the profit as a capital gain, subject to CGT, rather than as a revenue profit subject to normal income tax.

"One of the protections given to taxpayers is that, in the case of income tax, an additional assessment may not be raised after three years, while in the case of self-assessed taxes, such as PAYE and VAT, SARS is given five years within which it may raise additional assessments, after which it is prohibited from doing so."

If SARS seeks to raise an assessment after three years, it is not uncommon in circumstances such as these that SARS relies on misrepresentation. And this is despite the fact that every question in the tax return has been correctly answered and all the information required in the tax return has been fully and properly provided. The only difference between the taxpayer's and SARS' versions is that the profit was reflected as a capital gain rather than as a revenue profit.

In such a case SARS will argue that it is relying on misrepresentation because the taxpayer misrepresented the profit as being of a capital nature rather than of a revenue nature. And here is the very problem: whether or not, based on the facts, a profit is of a capital or revenue nature is not a question of fact – it is a question of law, as the courts have stated. Therefore a taxpayer cannot misrepresent the law to SARS – the latter is as capable of interpreting the law as is the taxpayer. The only question is whether there are any incorrect facts in the tax return which supported the taxpayer's tax position, which facts, if properly stated, would have pointed to the contrary position. If SARS cannot point to incorrect statements of fact in the tax return, it cannot rely on the taxpayer's categorisation of the profit as being capital rather than revenue as constituting misrepresentation – there has simply not been a misrepresentation of fact, but only a difference of view as to what the tax position, ie, the legal position, was in relation to those facts. SARS' defence is that, if that is the case, how can it ever rely on misrepresentation. Well, one can ask the question the other way around: if that is not the case, when can the taxpayer ever rely on an absence of misrepresentation?

CONCLUSION

Unfortunately, a view such as this is quite pervasive within SARS, at any rate at those levels that deal directly with taxpayers, such as at the audit level and also involving the committees that decide issues such as whether or not to allow an objection and what rate of penalty should be imposed.

Experience has shown that this scenario arises frequently.

There are two lessons to be learned from this: first, and very importantly, it behoves SARS properly to educate and train its auditors and the related structures within SARS as to the precise ambit of "misrepresentation". Secondly, and equally importantly, taxpayers must vigorously resist such an incorrect application of the law.

Ernest Mazansky

Werksmans Attorneys

Tags: self-assessed taxes; prescription; misrepresentation; non-disclosure of material facts; capital nature; revenue nature.

PRESCRIPTION PERIOD LIMITATIONS

On 24 April 2023, in I-Cat International Consulting (Pty) Ltd v Commissioner for the South African Revenue Service, *[2023], the Gauteng High Court handed down judgment on whether an assessment had become prescribed in terms of the Tax Administration Act, 2011 (the TAA).*

This was an application by I-Cat International Consulting (Pty) Ltd (I-Cat) to review and set aside the decision of the South African Revenue Service (SARS) to refuse an application for a reduced assessment in respect of I-Cat's 2015 tax year. SARS contended that the 2015 assessment had passed the prescription period of three years and on that basis refused the request for application for a reduced assessment.

It is interesting to note that before the commencement of the hearing, I-Cat had contended that the 2015 assessment should be regarded as a "self-assessment" as defined in section 1 of the TAA. This was an interesting argument by I-Cat as this would have meant that the prescription period applicable to the 2015 assessment would have been five years and not three years and that the assessment in question would not have become prescribed. Assessments issued in respect of tax returns submitted for value-added tax and dividends tax, among others, are "self-assessments" as defined whereas income tax returns are not. This is because "self-assessment" is defined as the determination by a taxpayer of an amount of tax payable under a tax Act and the submission of a return that incorporates the determination of the tax or, if no return is required, making a payment of the tax. In the case of an income tax return, the tax payable is not incorporated into the return and is determined by SARS once the return has been assessed.

It is unclear what the basis for I-Cat's argument was on this issue but it may have been that the current system, whereby income tax returns are assessed by SARS, has similar characteristics to a self-assessment system. For example, a SARS official generally does not apply his or her mind at the time an assessment for income tax is issued. The process has been automated.

However, I-Cat conceded that the assessment was not a "self-assessment" – the prescription period that the court had to consider was thus three years, meaning that the assessment in respect of the 2015 year had potentially become prescribed.

FACTS OF THE CASE

The origin of this case was I-Cat's 2014 assessment. In completing its 2014 income tax return, I-Cat deducted an amount of R17,171,433 under the general deduction formula (section 11*(a)* of the Income Tax Act, 1962) as part of the cost of its stock. This amount was paid to a third party as compensation for royalties, resulting from the cancellation of a distribution agreement. I-Cat based its treatment of the royalty payment on tax advice that it had sought. The tax opinion concluded that the amount incurred met the requirements of the general deduction formula and as such that it was deductible in the 2014 tax year.

On 15 July 2015, SARS disallowed the amount as a deduction on the sole ground that it was an amount of a capital nature. I-Cat objected to the disallowance shortly after this, on 15 September 2015.

On 26 February 2016, I-Cat filed its 2015 income tax return, absent of any claim for a deduction relating to the royalty payment of R17,171,433. On the same date, SARS assessed the 2015 return, meaning that the normal three-year prescription period for the 2015 assessment commenced to run from this date and would become final (prescribe) on 25 February 2019. After an assessment has become prescribed, a taxpayer cannot raise any objections nor can SARS alter the assessment (ie, raise an additional or reduced assessment), other than in the special circumstances provided for in section 99 of the TAA.

On 5 October 2018, SARS filed its Rule 31 statement in respect of the *2014 assessment*. In this document, for the first time, SARS raised an alternative argument, namely that only R7,007,633 was actually incurred in the 2014 tax year and the balance of the R17,171,433 payment was incurred in the 2015 tax year.

On 28 October 2019, I-Cat's appeal against the *2014 assessment* was due to be heard in the tax court. On the same date (28 October 2019), I-Cat and SARS settled the 2014 assessment dispute, and the tax court made the settlement an order of the court.

The settlement agreement included a statement that the issues pertaining to the deductibility of the amount as it related to the 2015 tax year fell outside of the issues dealt with in the 2014 assessment appeal and that "the appellant may endeavour to address such issues in terms of section 93 of the TAA". Section 93 allows SARS to make reduced assessments in several circumstances.

On 26 January 2021, SARS refused the application for reduced assessment for the 2015 assessment, based on the view that the 2015 assessment had become prescribed in terms of section 99.

The question before the Gauteng High Court was whether SARS was correct in refusing I-Cat's application for a reduced assessment in respect of its 2015 assessment on the basis that the assessment had been prescribed.

I-CAT'S ARGUMENT

I-Cat argued that both subparagraphs (i) and (iii) of section 99(2)*(d)* applied, based on the facts of the case.

Section 99(2)*(d)*(i) provides that prescription does not apply to the extent that it is necessary to give effect to the resolution of a dispute under chapter 9 of the TAA. Section 99(2)*(d)*(iii) provides that prescription does not apply if the assessment that SARS is seeking to make is a reduced assessment in terms of section 93(1)*(d)* and if SARS became aware of the readily apparent undisputed error in the return in question, before the expiry of the prescription period.

I-Cat argued that at the time when SARS lodged its Rule 31 statement (which was prior to the expiry of the prescription period), SARS knew of the error that affected the 2015 assessment and that the settlement agreement related to both the 2014 and 2015 years.

SARS' ARGUMENT

SARS argued that the appeal to the tax court related only to the 2014 assessment, and not to the 2015 assessment, and that the tax court is limited to the specific year(s) in dispute. It also argued that SARS was not bound to decide in I-Cat's favour regarding the 2015 assessment and that I-Cat should have objected to the 2015 assessment prior to the end of the prescription period of 25 February 2019.

"From a practical perspective, the case illustrates that it is crucial to take care in the terms included in settlement agreements with SARS, especially in circumstances such as these in which the treatment of a disputed item may have a 'knock-on' effect on subsequent years of assessment."

The Gauteng High Court held in favour of I-Cat, that section 99(2)*(d)*(i) was applicable (ie, that prescription does not apply to the extent that it is necessary to give effect to the resolution of a dispute under chapter 9 of the TAA) and therefore that SARS was not precluded from issuing a reduced assessment in relation to 2015, despite the normal three-year prescription period having lapsed. In arriving at its finding, the court reasoned as follows.

Regarding the SARS argument that I-Cat should have objected to the 2015 assessment, SARS only raised this issue in the tax court and then only as an alternative argument. It was clear from I-Cat's proceedings that it believed in its case and there was no reason for it to have objected to the 2015 assessment.

Although the tax court would only be ruling on the 2014 assessment, in arriving at its findings it would also have provided certainty, albeit indirectly, in respect of the position for the 2015 assessment. For example, if only a portion of the R17,171,433 was incurred in the 2014 tax year, it would follow that the balance would have had to have been incurred in the 2015 tax year.

At the time the settlement was entered into, SARS knew that the balance of the amount had been incurred in 2015. Although SARS could not bind itself to the outcome of a section 93(1)*(d)* approach, by using the term "endeavour", at least the taxpayer was given the right to apply.

If SARS' argument were to stand, it would imply that at the time that the settlement was agreed to, SARS knew that the taxpayer's section 93(1)*(d)* request would have to be denied on the basis that the 2015 assessment had prescribed. This would have rendered this wording of the settlement agreement superfluous.

In summing up its views on how the wording of the settlement should be interpreted, the court cited with approval the following extract from *Wellworths Bazaars Ltd v Chandler's Ltd and Another,* [1947]: "[Legal documents] should not, without necessity or some sound reason, impute to its language tautology or superfluity and should be rather at the outset be inclined to suppose every word intended to have some effect or be of some use."

Hence, I-Cat's request for reassessment of its 2015 year of assessment was remitted back to SARS for reconsideration on the merits of the request. SARS was ordered to pay the costs of the application on a party-and-party scale.

From a practical perspective, the case illustrates that it is crucial to take care in the terms included in settlement agreements with SARS, especially in circumstances such as these in which the treatment of a disputed item may have a "knock-on" effect on subsequent years of assessment. The implications of such knock-on effects and how SARS would deal with them should they arise, should ideally be set out in the settlement agreement. This would remove any doubt that SARS was aware of the effects prior to the expiry of the prescription periods of the subsequent years of assessment and would also leave the door open to the taxpayer, as in this case, to argue that the resolution of the knock-on effects is part of the resolution of the dispute.

Thato Mgoboli & Associate Professor David Warneke

BDO

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 1 (definition of "self-assessment"), 93 (emphasis on subsection (1)*(d)*) & 99 (99(2)*(d)*(i) and (iii)); chapter 9 (sections 101–150);
- Income Tax Act 58 of 1962: Section 11*(a)*.

Other documents

- Rule 31 statement.

Cases

- *I-Cat International Consulting (Pty) Ltd v Commissioner for the South African Revenue Service* [2023] (Case no 41667/2021) [2023] ZAGPPHC 268 (24 April 2023);
- *Wellworths Bazaars Ltd v Chandler's Ltd and Another* [1947] (2) SA 37 (A).

Tags: reduced assessment; self-assessment; royalty payment; Rule 31 statement; prescription period.

THE RIGHTS OF ACCESS TO INFORMATION AND FREEDOM OF EXPRESSION VS THE RIGHT TO PRIVACY

In Issue 63 of Tax Chronicles Monthly *(October 2023) the Constitutional Court's (CC) majority judgment in* Arena Holdings (Pty) Ltd t/a Financial Mail and Others v South African Revenue Service and Others, *[2023], was discussed. The judgment was handed down on 30 May 2023. This second article takes a closer look at the minority judgment.*

The minority held that the High Court's order to declare sections 35 and 46 of the Promotion of Access to Information Act, 2000 (PAIA), and sections 67 and 69 the Tax Administration Act, 2011 (the TAA), unconstitutional to the extent that they preclude access to tax records by a person other than the taxpayer, even where the requirements of, the "public interest override" are met, should not be confirmed.

As noted in the October article, the matter originates from a PAIA request that was made by Warren Thompson (the third applicant in the matter) to the South African Revenue Service (SARS) in terms of which the applicant requested access to former President Jacob Zuma's tax records. The application was premised on allegations that were made by Jacques Pauw in his book titled *The President's Keepers*. In terms of the application to SARS, it was averred that there was "credible evidence" that, while he was president, Zuma was not tax compliant.

In terms of the High Court application, which was brought pursuant to the unsuccessful PAIA applications, the applicants contended that there was credible evidence that former President Zuma –

- had evaded tax while he was president;
- had failed to disclose other sources of income he received; and
- did not pay tax on the fringe benefits he received.

The applicants argued that the prohibition to access information of a taxpayer contemplated in sections 35(1) and 46 of PAIA and Chapter 6 of the TAA was unconstitutional in so far as such access was in the interest of the public. Additionally, the applicants submitted that this prohibition was an unjustifiable limitation of their constitutional right to freedom of expression and right of access to information.

The majority judgment, written by Kollapen J, agreed with the above contention and confirmed the order handed down by the High Court to declare sections 35 and 46 of PAIA and sections 67 and 69 of the TAA unconstitutional.

The minority judgment, written by Mhlantla J, on the other hand, "regrettably" disagreed with the majority's judgment. Ultimately, the minority held that the limitation on the right of access to information (and by implication the right to freedom of expression) contained in sections 35 and 46 of PAIA and sections 67 and 69 of the TAA was justifiable, and as such, the High Court's order of invalidity should not be confirmed. Considering the importance of the issues at hand and the close 5-4 split in support between the majority and minority decisions, this article analyses the minority judgment in a bit more detail.

An analysis of the minority's basis for declining to confirm the order of unconstitutionality follows.

"Fundamentally, it seems that the majority's finding is premised on the fact that the starting point in assessing the constitutional challenge is the provisions of PAIA, whereas the minority seemed to rely on the provisions of the TAA to justify its outcome."

THE PROHIBITION IS NOT ABSOLUTE

It was the applicants' submission that there was an absolute prohibition on the disclosure of tax information of a taxpayer held by SARS to a PAIA requester other than the taxpayer. In this context, it was noted that the "public-interest override", which permits the disclosure of information listed in Chapter 4 of Part 2 of PAIA, does not apply to section 35 of PAIA. In relation to sections 69 and 67 of the TAA, it was submitted that the exceptions contained in section 69 do not include a PAIA request, and section 67 prohibits the disclosure to a third party and prohibits the further disclosure of taxpayer information that has been obtained contrary to Chapter 6 of the TAA. It was, therefore, contended by the applicants that these prohibitions prevent the media from obtaining tax information from SARS, and from reporting on the said tax information, "even if the information contains conclusive evidence of corruption, malfeasance or other law-breaking".

In support of their submissions, the applicants argued that this matter was similar to information that was sought against analogous prohibitions on access to information in *Johncom Media Investments Ltd v M and Others*, [2009], and *Mail and Guardian Media Ltd and Others v Chipu NO and Others*, [2013].

The respondents, however, contended that the secrecy and confidentiality provisions are not absolute as they are subject to tightly controlled exceptions. The minority judgment agreed with this contention and noted that the very presence of these exceptions demonstrate that the limitation in question is not absolute.

The minority judgment noted that the *Johncom* and *Chipu* matters were distinguishable from the current matter because in both matters the prohibitions went beyond the purpose for which they existed.

JOHNCOM AND *CHIPU* OVERVIEW

Johncom concerned the general rule that courts are open to the public and the prohibition on the publication of the identity of parties to divorce proceedings. The CC in this matter held that section 12 of the Divorce Act, 1979 (the Divorce Act), unjustifiably infringed the right to freedom of expression as enshrined in section 16 of the Constitution of the Republic of South Africa, 1996 (the Constitution). The court further held that the purpose of protecting the rights of divorcing parties and their children could be achieved by less restrictive means, and accordingly, the limitation occasioned by section 12 of the Divorce Act could not be justified.

Chipu, on the other hand, dealt with the issue of whether the requirement of absolute confidentiality in proceedings before the Refugee Appeal Board was a justifiable limitation of the constitutional right to freedom of expression (which includes the freedom of the press and the freedom to receive and impart information or ideas). In this matter the CC held that, to the extent that section 21(5) of the Refugees Act, 1998, does not confer a discretion upon the Refugee Appeal Board to allow access to its proceedings in appropriate cases, the limitation on the right to freedom of expression is unreasonable, unjustifiable and accordingly invalid.

With the above context in mind, it was held by the minority that in this matter there was no basis for concluding that the impugned prohibitions go beyond the purpose for which they are meant to serve, especially when considering the evidence relied upon by SARS in justification thereof. Although the applicants argued that the evidence proffered by SARS did not sufficiently establish the correlation between tax compliance and taxpayer information secrecy, the minority noted that the applicants erred in their attempt to demonstrate the perceived insufficiency of the evidence by failing to consider that in a constitutional challenge, a court weighs up "legislative facts differently".

As noted above, the minority held that the mere presence of exceptions demonstrates that the limitation in question is not absolute. In this regard, the minority judgment highlighted the fact that sections 70 and 71 of the TAA make provision for exceptions to the prohibition of disclosure of tax information. It held that the fact that the exceptions provided for in the TAA do not include the public or media houses was irrelevant and, therefore, the applicants' argument for absolute prohibition could not be sustained.

TAXPAYER COMPLIANCE AND THE ASSURANCE OF CONFIDENTIALITY

It is trite that the South African tax system is largely premised on voluntary compliance. According to SARS, taxpayers are not only encouraged but are compelled to make full and frank disclosure of their personal information and "secrets" to SARS, including the disclosure of any criminal conduct in which they may be engaged and any income from it. As such, the respondents submitted that the impugned provisions serve to preserve taxpayers' secrets and ensure taxpayers' voluntary compliance. SARS, therefore, submitted that the extension of the override provision in section 46 would not only undermine the assurance given to taxpayers that SARS will keep their secrets, but would also undermine taxpayers' confidence in SARS.

The minority judgment agreed with the submissions raised by SARS in this regard. The minority judgment noted that the connection between taxpayer compliance and tax secrecy has been recognised for years in our legal order and has been equally recognised and accepted by our courts for countless years. According to the minority judgment, the historical justification for taxpayer information secrecy continues to be of relevance today. The minority held that taxpayer information secrecy is central to efficient tax administration. As such, the limitation of the right of access to information, as well as the right to freedom of expression, serves a vital role in the sustained and unhampered taxation system.

SOUTH AFRICA'S INTERNATIONAL OBLIGATIONS

Notwithstanding the aforementioned, SARS submitted that the policy of keeping taxpayers' secrets gives effect to South Africa's obligations under international law. It was the respondents' view that the relief sought by the applicants would breach South Africa's international obligations as contemplated in the various treaties and agreements to which South Africa is a party, and could result in the ostracisation of South Africa from the international network for the exchange of taxpayer information.

The minority judgment was, again, in agreement with the respondent's contentions in so far as they related to South Africa's international obligations. Another factor that was raised in the minority judgment was that the general practice of maintaining taxpayer secrecy has also been adopted and sustained in various other jurisdictions. The minority used jurisdictions such as the UK and Canada as examples to drive the point home.

It was, therefore, held that the limitation is not only aimed at preserving taxpayer privacy and tax compliance, but also at ensuring South Africa's compliance with its international law obligations. If access to tax records is granted to the public, it would constitute a manifest breach of these objectives.

PUBLIC INTEREST OVERRIDE AND ORDINARY CITIZENS

In terms of the application, the remedy that was sought by the applicants included (but was not limited to) (i) the extension of the "public–interest override" as contemplated in section 46 of PAIA to section 35 of PAIA and (ii) the reading-in of an exception into section 69(2) of the TAA to permit disclosure of taxpayer information where access has been granted under PAIA. The applicants contended that the proposed remedy would not violate South Africa's international obligations as suggested by SARS as it would only apply to the disclosure of information held by SARS where it has been gathered domestically.

In response, SARS contended that the relief sought by the applicants would not only violate individuals' right to privacy, under section 14 of the Constitution, but also the *Marcel principle.*

The *Marcel principle* is a well-established principle of the law of confidentiality, which states that where information of a personal or confidential nature is obtained in the exercise of a legal power or in furtherance of a public duty, the recipient will in general owe a duty to the person from whom it was received or to whom it relates not to use it for other purposes.

In this regard, SARS noted that the relief sought by the applicants would enable a PAIA requester to freely disseminate tax information to any person, without constraint. SARS further submitted that if taxpayer information were to be made subject to disclosure to the media and the public under section 46 of PAIA, this would be an undue limitation of taxpayers' rights to privacy.

The minority judgment seemed to agree with this contention as it noted that what was being sought by the applicants was a "drastic measure that may have grave consequences to a taxpayer".

The minority expressed the concern that, although the facts in the current matter related to a public figure, section 46 of PAIA does not make the status of a public figure a precondition of the applicability of the test. Therefore, if the "public-interest override" were to be extended as proposed, the provision would be indiscriminately applicable to ordinary civilians or private individuals where their tax records could potentially prove "a substantial contravention of, or failure to comply with, the law" or "an imminent and serious public safety or environmental risk" and where their disclosure would potentially be in the public interest. The minority was therefore not convinced that the relief sought justified the possible challenge to the privacy interests of individuals and the possible detrimental effect that the proposed extension could have to the reputations and societal standings of taxpayers. The minority also raised the point that, if the proposed remedy were implemented, it would require tax administrators to make a judgement call as to whether PAIA requesters and their reasons for filing a request have satisfied the requirements of the "public-interest override". It was the minority's view that there are less restrictive ways to achieve the purpose being sought by the applicants.

LESS RESTRICTIVE MEANS

The minority judgment highlights the fact that the current legal framework already has measures in place to allow for a balance to be struck between access to taxpayers' information and maintaining taxpayer secrecy. In this regard, the minority judgment notes that the TAA contains numerous exceptions in terms of which a taxpayer's information may be disclosed. It was noted by the court that for purposes of addressing substantial contravention of the law, a report could always be filed with the relevant authorities – namely, SARS itself, the National Prosecuting Authority and/or the South African Police Service.

COMMENT

Is the minority judgment correct in saying that the court's judgment will have "grave consequences" for taxpayers? The majority may be correct in stating that a PAIA requester who seeks to successfully invoke the benefit of section 46 will face "formidable substantive and procedural hurdles" before a request can be granted by SARS. Whilst one appreciates the valid concerns raised by the minority judgment regarding the potentially excessive disclosure of taxpayer information, the majority judgment went some way to explaining how the disclosure of taxpayer information pursuant to the application of the "public interest override" can be limited to only serve the purpose intended by the provision. The majority's reference to the severance and redaction provisions in PAIA (section 28) is crucial in this regard. Whilst SARS will ultimately go through the process set out in PAIA when considering a PAIA request and will have to consider whether the requirements of the "public interest override" have been satisfied, it can still disclose the record requested, with parts of it severed or redacted.

Fundamentally, it seems that the majority's finding is premised on the fact that the starting point in assessing the constitutional challenge is the provisions of PAIA, whereas the minority seemed to rely on the provisions of the TAA to justify its outcome. Considering that PAIA gives effect to the right of access to information in the Constitution, there is substantial merit to the argument that PAIA should be the starting point in analysing the issue at hand. Whereas one could argue that the TAA protects the constitutional right to privacy, the gist of the majority judgment is that access to information and freedom of expression must trump privacy, but only to the extent provided for by the "public interest override". It is also arguable that the judgment is a good example of constitutional subsidiarity, the principle that legislation must give effect to constitutional rights unless the legislation is inconsistent with the Constitution.

WHAT ABOUT SARS AUDITS?

An important practical question is this – what happens if SARS considers a PAIA request and finds that the "public interest override" requirements are met, if it has not audited that taxpayer based on the information sought? Take for example paragraph *(a)* of section 46 of PAIA, namely the requirement that the disclosure of the record would reveal evidence of a substantial contravention of or failure to comply with the law. Section 40 of the TAA states that SARS may select a person for inspection, verification or audit on the basis of any consideration relevant for the proper administration of a tax Act, including on a random or risk assessment basis. While SARS is a large organisation, it is known that SARS' resources (and experienced staff) were declining for a number of years and are now in the process of increasing, also pursuant to the Nugent Commission findings. Will SARS initiate an audit out of fear that they may have missed something from a tax perspective, before the information is disclosed to the PAIA requester?

It is entirely possible that SARS may not have audited someone in respect of the information that is being sought in terms of the PAIA request, as the information requested is not relevant for the purposes of determining tax compliance or a risk or random assessment done did not reveal such risk. It is also possible that no such audit took place, due to SARS' limited resources compared to the sheer number of returns, for numerous taxes, that it has to consider and assess each year. In the PAIA request context, SARS will need to assess whether there is a contravention of any law, which goes broader than tax laws. An interesting issue that comes to mind is cases involving the tax treatment of illegal income (see for example *MP Finance Group CC (In Liquidation) v Commissioner for South African Revenue Service,* [2007]).

Ultimately, the proof of the pudding is going to be in the eating and it remains to be seen how the disclosure of taxpayer information pursuant to PAIA requests to which section 46 applies, will affect taxpayers.

Louis Botha & Puleng Mothabeng

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Section 40; Chapter 6 (sections 67–74, specifically sections 67, 69, 70 & 71);
- Promotion of Access to Information Act 2 of 2000: Chapter 4 of Part 2 (sections 33–46); specifically sections 28, 35 & 46 (more specifically paragraph *(a)* of section 46);
- Divorce Act 70 of 1979: Section 12;
- Constitution of the Republic of South Africa, 1996: Sections 14 & 16;
- Refugees Act 130 of 1998: Section 21(5).

Other documents

- *The President's Keepers* (Jacques Pauw);
- *Tax Chronicles Monthly*: Issue 63 (October 2023).

Cases

- *Arena Holdings (Pty) Ltd t/a Financial Mail and Others v South African Revenue Service and Others* [2023] ZACC 13 (handed down on 30 May 2023);
- *Johncom Media Investments Ltd v M and Others* [2009] (4) SA 7 (CC);
- *Mail and Guardian Media Ltd and Others v Chipu NO and Others* [2013] (6) SA 367 (CC);
- *MP Finance Group CC (In Liquidation) v Commissioner for South African Revenue Service* [2007] SCA 71 (RSA); [2007] (5) SA 521 (SCA).

Tags: prohibition to access information of a taxpayer; absolute prohibition on the disclosure of tax information of a taxpayer; public-interest override; absolute confidentiality; right to freedom of expression; *Marcel principle*; constitutional right to privacy; disclosure of taxpayer information.

THE TAX COURT OR THE HIGH COURT?

In March 2023, the SCA handed down two judgments dealing with certain procedural aspects of dispute resolutions as provided for in the TAA.

The key conclusion in both cases, namely, *United Manganese of Kalahari (Pty) Limited v Commissioner for the South African Revenue Service,* [2023], and *Commissioner for the South African Revenue Service v Rappa Resources Proprietary Limited,* [2023], is that, should a taxpayer wish to have the court review a decision by SARS, the court of first instance will be the tax court, unless the taxpayer demonstrates that exceptional circumstances exist and that a High Court orders that a dispute will be heard by it.

By way of background, it has long been accepted by the courts in South Africa that a taxpayer, aggrieved by an assessment issued by SARS, is not obliged to go the route of lodging an objection and then an appeal to the tax court. Rather the route of a review by the High Court is an acceptable alternative, as long as there are no disputes of fact and only a legal dispute. The advantage of a review over a conventional tax appeal is that one gets to court much quicker.

The Supreme Court of Appeal (the SCA), on 24 March 2023, handed down judgments in two very similar cases.

Albeit with different facts, both cases involved consideration by the SCA of a taxpayer's ability to dispute an assessment raised by SARS by way of review by the High Court, as a court of first instance. In this regard, section 105 of the Tax Administration Act, 2011 (the TAA), as it currently stands, provides that "a taxpayer may only dispute an assessment or 'decision' as described in section 104 in proceedings under this Chapter, unless a High Court otherwise directs".

In the *United Manganese* case, SARS raised an additional assessment of R351 million in January 2020. In February 2020 the taxpayer informed SARS that it would be instituting legal proceedings against SARS in the High Court. In terms of its application, the taxpayer requested that, *inter alia*, the additional assessments raised by SARS be reviewed and set aside. The High Court therefore needed to consider whether it had the requisite jurisdiction to hear a review.

SARS contended that, in light of the reading of section 105, the only forum in which assessments, including additional assessments, may be challenged is in the tax court, unless a High Court directed otherwise, which, per SARS' argument would only be the situation if a litigant made out a case for why a High Court must deviate from the normal course of adjudicating the matter in the tax court. The taxpayer denied that section 105 contained any formal requirement in terms of which a person would have to prove exceptional circumstances for its matter to be heard on review in a High Court. However, the High Court found in favour of SARS and held that the taxpayer had not made a case for deviation from the ordinary course under section 105 and, as such, the court lacked the necessary jurisdiction to hear a review regarding the merits of the additional assessment.

The High Court left open to interpretation whether, had the taxpayer pleaded a case for the tax relief sought, the court would have granted such relief.

Similarly, the *Rappa Resources* case was taken on appeal to the SCA by SARS, after the court *a quo* found in favour of the taxpayer and allowed the assessments raised by SARS to be reviewed and set aside. SARS' contentions in *Rappa Resources* in respect of the jurisdiction of the High Court echoed those set out in *United Manganese*. The taxpayer contended, however, that it could circumvent the appeal procedure under the TAA and take the assessment on review to the High Court as it was challenging the legality of the assessments and not simply the merits thereof (as in *United Manganese*). In this regard, it was held that a tax appeal is an appeal in the widest sense and can be regarded as being more akin to a revision than an appeal in the ordinary sense. This means that the tax court equally has the power to determine the legality of an assessment.

In delivering the SCA's judgments, Ponnan ADP stated that the default rule, as provided in section 105, is that a taxpayer "may only dispute an assessment by the objection and appeal procedure under the TAA and may not resort to the high court unless permitted to do so by order of that court". The court further stated that the High Court will only permit such a deviation in "exceptional circumstances" and that tax cases are "generally reserved for the exclusive jurisdiction of the Tax Court in the first instance." This view is reinforced by the objective set out in the Memorandum on the Objects of the Tax Administration Laws Amendment Bill, 2015, which accompanied the amendments to section 105 contained in that Bill. The Memorandum provided that the predecessor of the current section 105 created an impression that a dispute arising in Chapter 9 (being the chapter which governs dispute resolutions) may either be heard by the tax court or a High Court for review, whereas the purpose of the provision was rather to ensure that internal remedies, such as the objection and appeal process, be exhausted before a higher court is approached and that the tax court deal with the dispute in the first instance.

"Similarly, the *Rappa Resources* case was taken on appeal to the SCA by SARS, after the court *a quo* found in favour of the taxpayer and allowed the assessments raised by SARS to be reviewed and set aside."

The key conclusion that can be reached is that, should a taxpayer wish to review a decision by SARS, the court of first instance will be the tax court, unless the taxpayer demonstrates that exceptional circumstances exist such that a High Court orders that a dispute will be heard by it. Unlike with the previous section 105, the taxpayer cannot choose which court to institute proceedings. Rather, in the absence of exceptional circumstances, the court of first instance will be the tax court.

That, of course, does not mean that the route of a review to the High Court has forever been blocked if a tax court appeal is an alternative. If, for example, there are relevant grounds for review under the Promotion of Administrative Justice Act, 2000 (PAJA), a High Court review would still be a possibility.

Varshani Ramson

Werksmans Attorneys

Acts and Bills

- Tax Administration Act 28 of 2011: Chapter 9 (sections 101–150) (specifically sections 104 & 105);
- Promotion of Administrative Justice Act 3 of 2000.

Cases

- *United Manganese of Kalahari (Proprietary) Limited v Commissioner for the South African Revenue Service* (1231/2021) [2023] ZASCA 29 (24 March 2023);
- [2017] JDR 1640 (GP);
- *Commissioner for the South African Revenue Service v Rappa Resources Proprietary Limited* (1205/2021) [2023] ZASCA 28 (24 March 2023).

Tags: additional assessments; exceptional circumstances.

ZERO-RATED VS EXEMPT SUPPLIES

"Confused? Confusion is good. It's an excellent place to learn something new from." – Henna Inam

Although seemingly simple, the value-added tax (VAT) concept of zero-rated supplies vs exempt supplies is often confused and misused.

The importance of distinguishing between these concepts is, however, crucial for purposes of determining the VAT liability of a vendor as well as a vendor's entitlement to claim input tax deductions in respect of expenses incurred. The distinction between these concepts as well as the importance behind the distinction is unpacked below.

NATURE OF SUPPLIES

VAT is often referred to as a tax on the consumption of goods or services and is levied on the supply by a vendor of goods or services in the course and furtherance of any enterprise carried on by a vendor.

For VAT purposes all supplies are treated as either being standard rated, zero-rated, or exempt. Supplies that are standard rated or zero-rated are "taxable supplies", as defined in section 1(1) of the Value-Added Tax Act, 1991 (the VAT Act).

Standard rated supplies are supplies that are subject to VAT at the prescribed rate of 15%. The supply of goods and services is generally subject to VAT at the standard rate unless such supply is specifically zero-rated or exempt in terms of the VAT Act.

A zero-rated supply is a taxable supply on which VAT is levied at the rate of 0%. That is, even though the supply has been classified as being a taxable supply, VAT is only chargeable thereon at the rate of 0%. This means that even though no VAT is levied on a supply, and that no output tax will be payable to the South African Revenue Service (SARS), it is still considered to form part of a vendor's enterprise activities.

Zero-rating is only granted to specific transactions that serve certain objectives considered more significant by the Government than collecting additional VAT. Most transactions granted zero-rated status involve exporting goods or services, which is intended to promote exports and increase competitiveness globally.

Section 11 of the VAT Act sets out specific instances of supplies of goods and services that may be zero-rated. These include, for example, certain zero-rated foodstuffs, the exportation of goods, the sale of a business as a going concern, services supplied to non-residents who are not in South Africa, services physically rendered offshore, and certain international transport services.

An exempt supply is the supply of goods or services upon which no VAT is chargeable at either the standard rate or the zero rate. There is therefore no VAT levied on exempt supplies. An exempt supply is not a taxable supply and the term "enterprise", as defined in section 1(1) of the VAT Act, therefore, specifically excludes the making of exempt supplies.

Supplies that constitute exempt supplies are specifically provided for in section 12 of the VAT Act. These include, for example, the supply of residential accommodation in a dwelling, certain forms of local passenger transport, certain educational services, childcare services, and financial services.

Most exemptions are justified on the basis that they are so-called merit goods, such as education. However, some goods are exempt because they are perceived to be hard to tax, for example, financial services. In the case of public transport in South Africa, the exemption was justified on the basis that compliance would be a major challenge, given the significant number of small informal taxi operators (The Davis Tax Committee: First Interim Report on VAT to The Minister of Finance (December 2014)).

IMPORTANCE OF DISTINCTION

It seems that the confusion that exists when distinguishing between zero-rated and exempt supplies stems from the fact that, in both instances, no VAT is levied on such supplies made by vendors. In practice, when discussing the type of supplies made by a vendor, the terms are thus often used interchangeably as if they have the same meaning, without a clear understanding of the importance of the distinction.

An input tax deduction may be claimed when VAT is incurred on goods and services acquired for the purpose of consumption, use, or supply in the course of making taxable supplies. As discussed above, zero-rated supplies constitute "taxable supplies", whereas exempt supplies are not taxable supplies. It follows that vendors making zero-rated supplies are entitled to claim input tax deductions on goods or services acquired in the course of making such taxable supplies, whereas vendors may not claim an input tax deduction in respect of goods or services acquired in the course or furtherance of making exempt supplies. Furthermore, a person that makes only exempt supplies cannot register as a vendor as such person will not be seen to be carrying on an "enterprise" as defined.

The significance of zero-rating thus lies in the fact that a person who makes zero-rated supplies is required to charge 0% VAT, ie, no VAT, but must still register as a vendor and is entitled to claim full input tax credits on all goods and services acquired, in the

same way as a vendor that charges tax at the standard rate. Zero-rating is thus the most advantageous type of VAT treatment and vendors making zero-rated supplies generally find themselves in a VAT refund position. As indicated above, persons making exempt supplies may not register as vendors and may not claim input tax deductions in respect of expenses incurred. Furthermore, where a vendor makes mixed supplies, ie, taxable and exempt supplies, such vendor will be required to apportion its expenses which cannot be directly attributed wholly to either taxable or exempt supplies and may only claim input tax deductions to the extent that such expenses have been incurred for the purpose of making taxable standard rated or zero-rated supplies.

SUMMARY

Zero-rated and exempt supplies are treated differently for VAT purposes and thus distinguishing between these concepts is important to ensure proper VAT compliance by a vendor.

A zero-rated supply is still subject to VAT, but the VAT rate is 0%. A registered vendor may claim input tax deductions in respect of expenses incurred for the purposes of making zero-rated supplies, thus effectively enabling the vendor to recover the VAT incurred on its expenses.

> "It seems that the confusion that exists when distinguishing between zero-rated and exempt supplies stems from the fact that, in both instances, no VAT is levied on such supplies made by vendors."

On the other hand, an exempt supply is simply not subject to VAT. A person who makes exempt supplies may therefore not claim any input tax deductions in respect of expenses incurred for purposes of making exempt supplies, and as such, must bear the cost of any VAT incurred on its expenses.

The difference between zero-rated and exempt supplies can significantly impact a business's cash flow and profitability. Businesses making zero-rated supplies may recover input tax, thus reducing their costs and increasing their profits, whereas businesses making exempt supplies cannot recover input tax, thus increasing their costs and reducing their profits. It is therefore important for businesses to understand the difference between zero-rated and exempt supplies and to accurately apply the correct VAT treatment to their supplies to avoid any potential penalties and to maximise their profitability.

Varusha Moodaley

Cliffe Dekker Hofmeyr

Acts and Bills

- Value-Added Tax Act 89 of 1991: Sections 1(1) (definitions of "enterprise" (paragraph (v) of the proviso) & "taxable supplies"), 11 & 12.

Other documents

- The Davis Tax Committee: First Interim Report on VAT (submitted to the Minister of Finance on 30 December 2014).

Tags: zero-rated supplies; exempt supplies; input tax deductions; taxable supplies; standard rated supplies; input tax credits.

South African
Institute of
Taxation