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TAX CHRONICLES MONTHLY

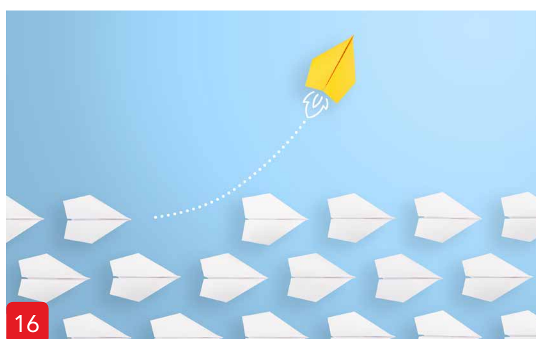
Official Journal for the South African Tax Professional

EMERGENCY TAX RELIEF
EMERGENCY TAX RELIEF MEASURES

GENERAL
TAX CONSIDERATIONS FOR EXPATS

TAX ADMINISTRATION
SECTION 163 PRESERVATION ORDER

CONTENTS



EMERGENCY TAX RELIEF

0337. Emergency tax relief measures 03

CORPORATE RESTRUCTURING

0338. Asset-for-share transactions 06

DEDUCTIONS AND ALLOWANCES

0339. Home office expenses 08

0340. Work-related expenditure 11

GENERAL

0341. Tax considerations for expats 13

INTERNATIONAL

0342. Planning for offshore relocation 15

0343. Retention of South African citizenship 17

0344. Working remotely abroad 19

TAX ADMINISTRATION

0345. Disclosing foreign assets 21

0346. Section 163 preservation order 23

0347. Unexplained deposits in a bank account 25

TRUSTS

0348. Funding offshore trusts 28

VALUE-ADDED TAX

0349. Mixed supplies 31

Paying tribute to Mr Afzal Khan

It is with deep sadness that the editorial panel of Tax Chronicles Monthly notes the untimely passing of Afzal Khan on 27 September 2021. He was a very long-standing member of the panel that produced the Integritax tax newsletter for SAICA and, thereafter, he has been part of the panel for this publication. He was also the driving force to push for and then implement the free online publication of all the tax articles that previously appeared in these publications. He was an esteemed colleague and friend. We extend condolences to his wife Jamilla and their children and extended family.

Editorial panel:

Mr KG Karro (Chairman), Prof KI Mitchell, Prof JJ Roeleveld, Prof PG Surtees, Ms MC Foster

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EMERGENCY TAX RELIEF MEASURES

"SARS will implement these tax relief measures because compliant taxpayers have paid their fair share of tax, making it possible for government to provide such a temporary safety net in a time of extreme difficulty" (SARS media statement on 30 July 2021)

How to claim ETI tax relief on the EMP201	
1.	Capture the full PAYE liability (the form will calculate the PAYE payable at 100%; you cannot change this value
2.	Capture the ETI calculated
3.	Calculate 65% of the PAYE liability in terms of the tax relief for PAYE for the first three (3) months
4.	Limit the ETI utilised to the lesser of the ETI calculated or 65% of the PAYE liability for the first three months or 100% of the PAYE liability in the fourth month.
5.	Calculate the Total Payable (as 65% of the PAYE liability for the first three months, or 100% liability for the fourth month) less ETI utilised plus the Skills Development Levy (SDL) payable plus the UIF payable

Three tax relief measures offered

1. *A tax subsidy of up to R750 per month, for four months, per employee earning below R6,500* – 1 August 2021 to 30 November 2021 – under the current employment tax incentive (ETI) for private sector employers. The first extended ETI can be claimed in your August EMP201 (due 7 September). SARS will pay monthly ETI refunds for the four-month period commencing on 13 September, subject to verification or audit steps required.
2. *Deferral of 35% of pay-as-you-earn (PAYE) liabilities over the three months* – 1 August 2021 to 31 October 2021, without penalties or interest. The first deferment can be claimed on the August 2021 EMP201 return, due 7 September. After 7 November, SARS will determine the four equal payments for the total amount that you have deferred and include it in your monthly statement of account. Payments will be made over a four-month period that will commence on 7 December 2021 with the last payment due by 7 March 2022.

How to claim PAYE tax relief on the EMP201	
1.	Complete the EMP201 as per normal with the full PAYE liability
2.	Calculate the Total Payable as 65% of the PAYE liability plus SDL payable plus UIF payable
3.	SARS will issue a statement of account, reflecting the tax relief (deferred amount) for PAYE and the total amount payable for that respective period
4.	Check your statement of account after 48 hours of submitting the EMP201 to make sure that SARS has not revoked the discount due to non-compliance.

3. *Deferral of excise duty payments for up to three months for businesses in the alcohol sector.*

How to implement excise duty payment deferrals	
1.	Apply in terms of rules 105.01 to 105.04 of the Customs and Excise Act, 1964, for deferral of payment and each case will be considered on its merits
2.	Applications can be sent to the following email address: osc@sars.gov.za

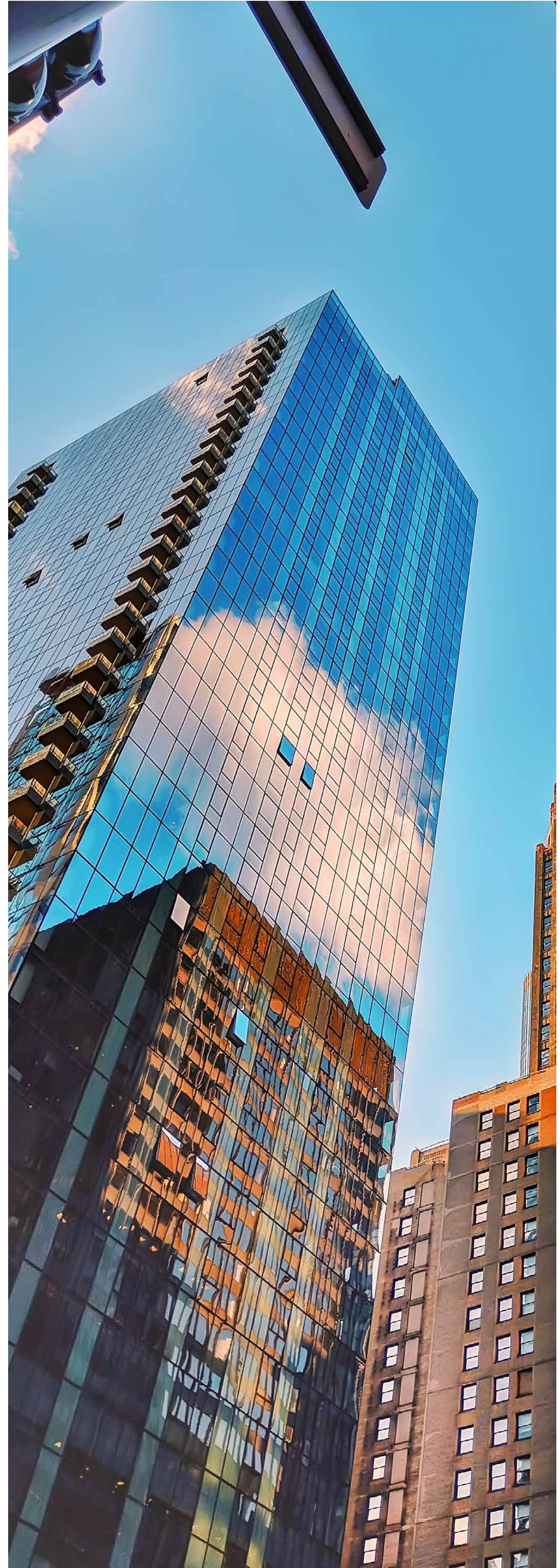
Note that this deferral is available immediately.

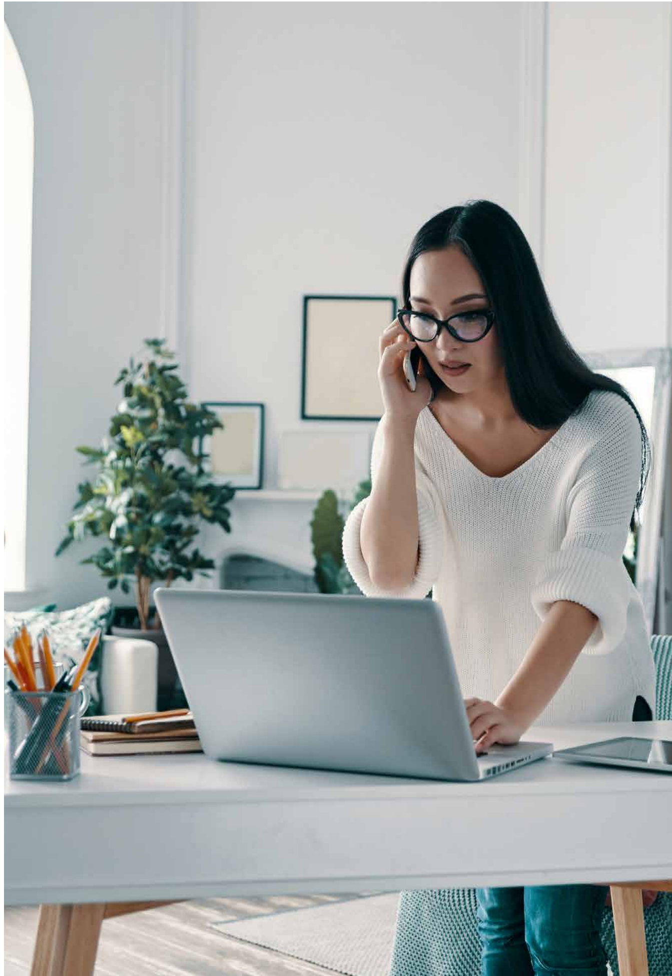
What are the qualifying criteria?

- Only tax compliant companies qualify for the emergency tax measures and that means that the business:
  - Is registered for all required taxes.
  - Has no outstanding returns for any taxes for which it is registered.
  - Has no outstanding debt for any taxes for which it is registered, excluding instalment payment arrangements, compromise of tax debt, and payment of tax suspended pending objection or appeal.
- The employer must be registered with the South African Revenue Service (SARS) as an employer by 25 June 2021.
- The employee tax subsidy applies to tax compliant private sector employers with employees earning below R6,500 per month.
- PAYE deferrals apply to tax compliant businesses with a gross income of up to R100 million, with a limitation that gross income should not include more than 20% of income derived from specific listed sources (ie, gross interest, dividends, foreign dividends, royalties, annuities, remuneration, and gross rental from the letting of immovable property (except if the rental income is the primary trading activity of the taxpayer)).
- Excise duty payments deferrals apply to compliant licensees in the alcohol sector that have applied to SARS.

Issues to consider

- **You are responsible** – The law holds an employer personally liable for an amount of tax withheld and not paid to SARS, or which should have been withheld but was not withheld. The employer could also be held criminally liable for failure to withhold and pay PAYE.





"Before announcing the details of these emergency tax relief measures, SARS Commissioner Edward Kieswetter made it clear that SARS has the capability to detect and make it costly for those that are non-compliant with their legal obligations and engage in criminal malfeasance."

- **SARS' focus on employers** – SARS has announced it has teamed up with the NPA (National Prosecuting Authority of South Africa) to deal with tax non-compliance, initially focussing on non-compliant employers. SARS' Criminal Investigations Division has already handed over 30 non-compliant employers to the NPA in their new joint venture.
- **Mistakes are costly** – While previously a mistake made by a taxpayer was only a crime when it was done "wilfully and without just cause", taxpayers can now in certain cases be convicted of an imprisonable criminal offence even if non-compliance was due to negligence or ignorance. If you decide to implement the relief measures, call in professional assistance from your accountant to ensure accuracy and recordkeeping.
- **We've been warned** – Before announcing the details of these emergency tax relief measures, SARS Commissioner Edward Kieswetter made it clear that SARS has the capability to detect and make it costly for those that are non-compliant with their legal obligations and engage in criminal malfeasance. Get a professional opinion to ensure your company qualifies and that the relief is correctly claimed.
- **Expect a verification or audit from SARS** – ETI refunds will be subject to any verification or audit steps that may be required. Your accountant can assist you in preparing for the likelihood of verifications and audits, and in successfully completing a verification or audit when selected.
- **Will you have recovered sufficiently in three months?** Three months is a very short time in these unpredictable times. The ability to recover during the grace period is an important consideration: the company's cash flow will improve initially, but after the three-month deferred payment period, an even higher PAYE liability is due – over the year-end and into the next financial year. Your accountant can help you to carefully project your financial position over the coming months to enable an informed decision.
- **Can you afford the deferred tax repayments?** While the lower PAYE payments for the three months of August, September and October will provide short-term cash-flow relief, one quarter of the total deferred amount must be paid – on top of the company's normal PAYE obligation for each month between November (due 7 December 2021) and February (due 7 March 2022). If your payment is made late, you will forfeit the benefit of the tax relief for PAYE and SARS will impose penalties and interest on the calculated total payable. It will also create other challenges, such as not being able to obtain a tax clearance certificate required for loan applications and tenders.

While these tax measures introduced for employers may be a lifeline for some companies to survive, all businesses are well advised to call on the advice and assistance of their accountant, both when carefully considering the decision to take up this tax relief and in claiming the tax relief.

Crowe

[*Editorial comment*: The announcements on the emergency tax relief on which this article is based eventually have to be promulgated by Parliament.]

Acts and Bills

- Customs and Excise Act 91 of 1964.

Other documents

- SARS media statement on tax relief matters (30 July 2021);
- Draft Explanatory Notes on Emergency Tax Measures in response to the continuing Covid-19 pandemic and recent unrest in the country (28 July 2021);
- EMP 201 (monthly employer declaration – a payment declaration in which the employer declares the total payment together with the allocations for PAYE, SDL, UIF and/or ETI).

Tags: employment tax incentive (ETI); PAYE liability; pay-as-you-earn (PAYE); excise duty payments; ETI refunds.

ASSET-FOR-SHARE TRANSACTIONS

The corporate reorganisation rules contained in sections 42–47 of the Income Tax Act, 1962 (the Act), provide taxpayers, in broad terms, with a mechanism to defer the tax implications that would otherwise result from certain restructure transactions; an example of this is where a group of companies seeks to reorganise its operations to achieve commercial objectives or benefits.

Section 42 of the Act, in particular, is a useful provision where a natural person seeks to transfer business assets to a company and where a group of companies seeks to restructure or move assets to different companies or reporting lines within the group.

Section 42 applies to "asset-for-share transactions" (as defined in subsection (1)), which is any transaction in terms of which a person (the transferor) disposes of an asset, the market value of which is equal to or exceeds, in the case of an asset held as a capital asset, the base cost of that asset on the date of that disposal to a company which is a resident (the transferee), in exchange for the issue of an equity share in that company (exchange shares) and that person at the close of the day on which that asset is disposed of, holds a qualifying interest (also defined in subsection (1)) in that company.

A "qualifying interest" includes a 10% equity shareholding in a company or an equity share held in a company where the transferor and transferee form part of the same group of companies.

There are further requirements in relation to the intention with which the transferee acquires the relevant assets vis-à-vis the intention of the transferor which must also be met.

"If all the requirements are met, in relation to capital assets, the transferor is deemed to have disposed of the assets at their base cost and the transferee is deemed to have acquired the assets at that same base cost, ie, the transferee steps into the shoes of the transferor."

If all the requirements are met, in relation to capital assets, the transferor is deemed to have disposed of the assets at their base cost and the transferee is deemed to have acquired the assets at that same base cost, ie, the transferee steps into the shoes of the transferor. The same principles apply in relation to assets held as trading stock and, in addition, no recoupments arise for the transferor in respect of deductions and allowances previously claimed.

In relation to the exchange shares, the transferor obtains a deemed base cost in the exchange shares equal to the base cost of the assets transferred (assuming the exchange shares are acquired and held as capital assets).

The section 42 relief is often used in the context of the transfer of a business to a company and often the debts attached to the business are assumed by the transferee. Section 42(8) then becomes relevant and applies where an asset which is transferred in terms of an asset-for-share transaction secures a debt and such debt is assumed by the transferee. If the debt falls into certain categories, broadly speaking, the amount of such debt must be added to the proceeds when the exchange shares are disposed of by the transferor.

In broad terms, section 42(8) applies to the following categories of debt (qualifying debts):

- A debt (or an equivalent amount of debt) which secures any asset transferred where the debt was incurred by that person –

  (i) more than 18 months before that disposal; or

  (ii) within a period of 18 months before that disposal –

    (aa) and that debt was incurred at the same time as that asset was acquired by that person; or

    (bb) to the extent that debt constitutes the refinancing of any debt in respect of that asset incurred as contemplated in (i) or *(aa)* above; and

- where any business undertaking as a going concern is disposed of and that disposal includes any amount of debt that is attributable to, and arose in the normal course of, that business undertaking.

Therefore, if the transferee company assumes any qualifying debts, the face value of such debts will be deemed to be proceeds for the transferor in the event of a disposal of the exchange shares.

The corporate reorganisation rules are often used in combination to achieve a restructure. For example, a transferor may, subsequent to an asset-for-share transaction, dispose of all the exchange shares in terms of a transaction which also qualifies for relief in terms of the corporate reorganisation rules. In this scenario, since the transferor (now the transferee) is deemed to have disposed of the exchange shares at their (inherited) base cost and since this base cost is rolled over to the purchaser of the exchange shares under the subsequent reorganisation transaction, section 42(8) has no impact, ie, no "additional proceeds" will be realised by the transferor on disposal of the exchange shares.

However, as part of the tax proposals pursuant to the Budget Speech delivered on 24 February 2021, the following was stated in Annexure C to the 2021 Budget Review:

> "The asset-for-share transaction rules contain an anti-avoidance measure aimed at preventing a permanent loss to the fiscus (instead of a tax deferral) when a person disposes of an asset that was acquired using debt and the debt is assumed by the company acquiring that asset……
>
> However, the rules that trigger additional consideration on disposal are undermined when the shares are subsequently transferred in terms of corporate reorganisation transactions because the applicable corporate reorganisation rules will enforce the rolled-over base cost of the previous asset-for-share transaction….."

It was thus proposed that the additional consideration in terms of section 42(8) should be taken into account in relation to all transactions which qualify for relief in terms of any of the corporate reorganisation rules until the shares are disposed of in a transaction that falls outside these rules. Therefore, it seems that the additional proceeds resulting from section 42(8) would "follow" the exchange shares and ultimately be added to the proceeds of the holder of such shares that disposes of these shares outside the corporate reorganisation rules.

It remains to be seen how the legislation will be amended to achieve this objective and what the effective date of such changes will be (and in particular whether they would have retrospective effect), but it is important to bear this possible change in mind when implementing asset-for-share transactions.

Nicolette Smit

ENSafrica

Acts and Bills

- Income Tax Act 58 of 1962: Sections 42–47 (corporate reorganisation rules) (especially section 42(1) (definitions of "asset-for-share transactions" and "qualifying interest") and 42(8)).

Other documents

- Annexure C to the 2021 Budget Review.

Tags: corporate reorganisation rules; asset-for-share transactions; capital asset; qualifying interest; anti-avoidance measures.

HOME OFFICE EXPENSES

Since the forced lockdown experienced in 2020, many employees have had to work from home. In some instances, due to a shift in corporate culture, employees have chosen to continue this practice by no longer travelling to a fixed office on a daily basis. In some cases people have converted space at their home to function as their home office.

Working from home has in some cases increased the productivity of employees, allowing people to have more flexibility and a better work/life balance. In many cases this has also reduced the employer's overheads depending on their line of work.

Employees may wish to claim a tax deduction for certain expenses incurred in relation to a home office. Before claiming any tax deduction, employees must ensure that they meet the necessary requirements and that the amount that they wish to deduct is determined correctly.

On 14 March 2021 SARS released a draft updated Interpretation Note 28 as guidance on what SARS will accept as allowable expenditure and how the deduction must be determined. The deadline for comments on the draft Interpretation Note was 14 June 2021.

At the outset, a distinction needs to be made between someone earning commission and someone receiving a fixed salary as an employee or as the holder of an office. Where a taxpayer mainly earns commission, the expenditure that can be claimed by the taxpayer is much broader than if that taxpayer received a fixed salary.

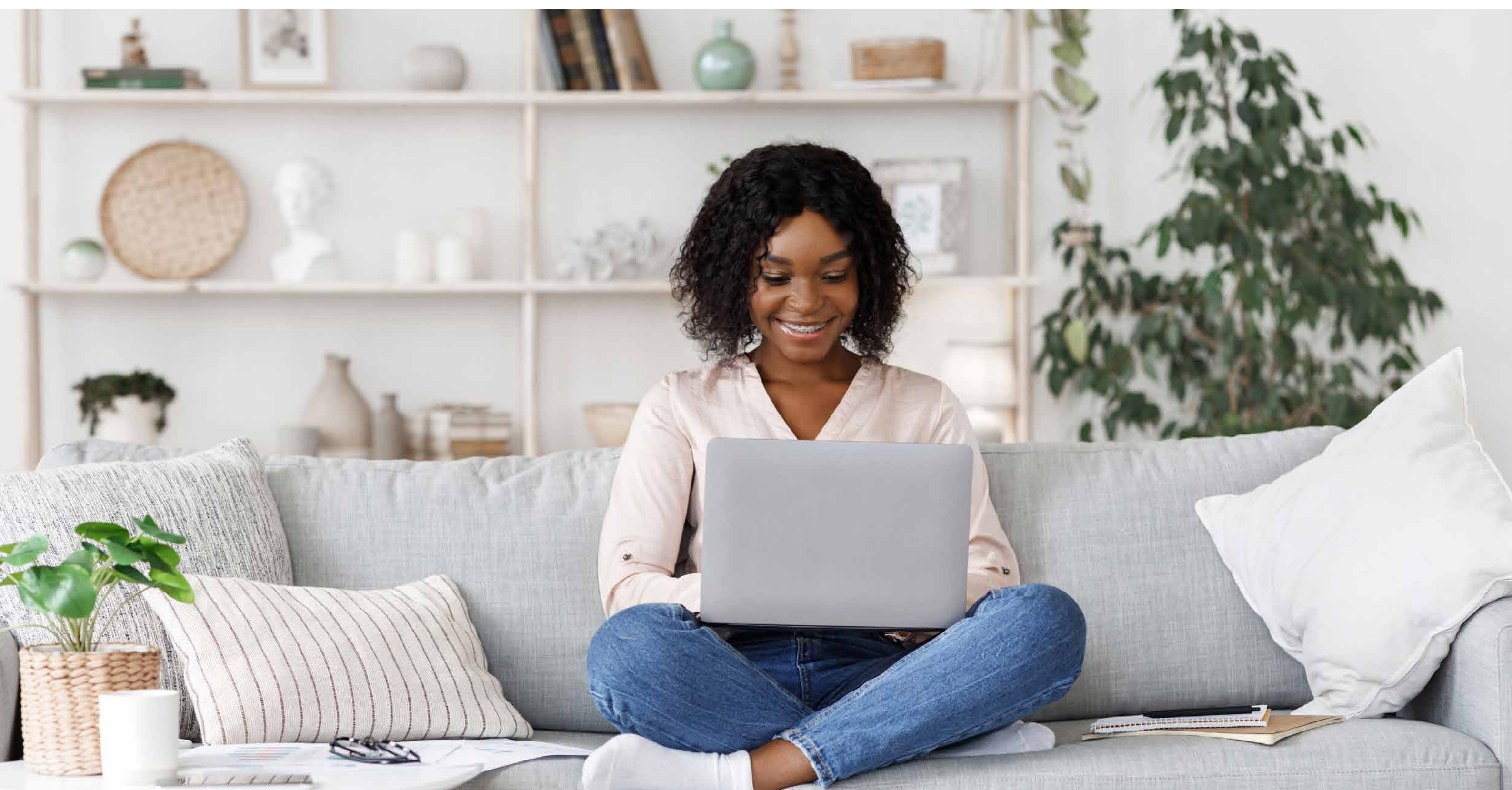
Generally, the deductibility of expenses relating to a home office must be determined with reference to section 11 of the Income Tax Act, 1962 (the Act), read with section 23*(b)* and 23*(m)*.

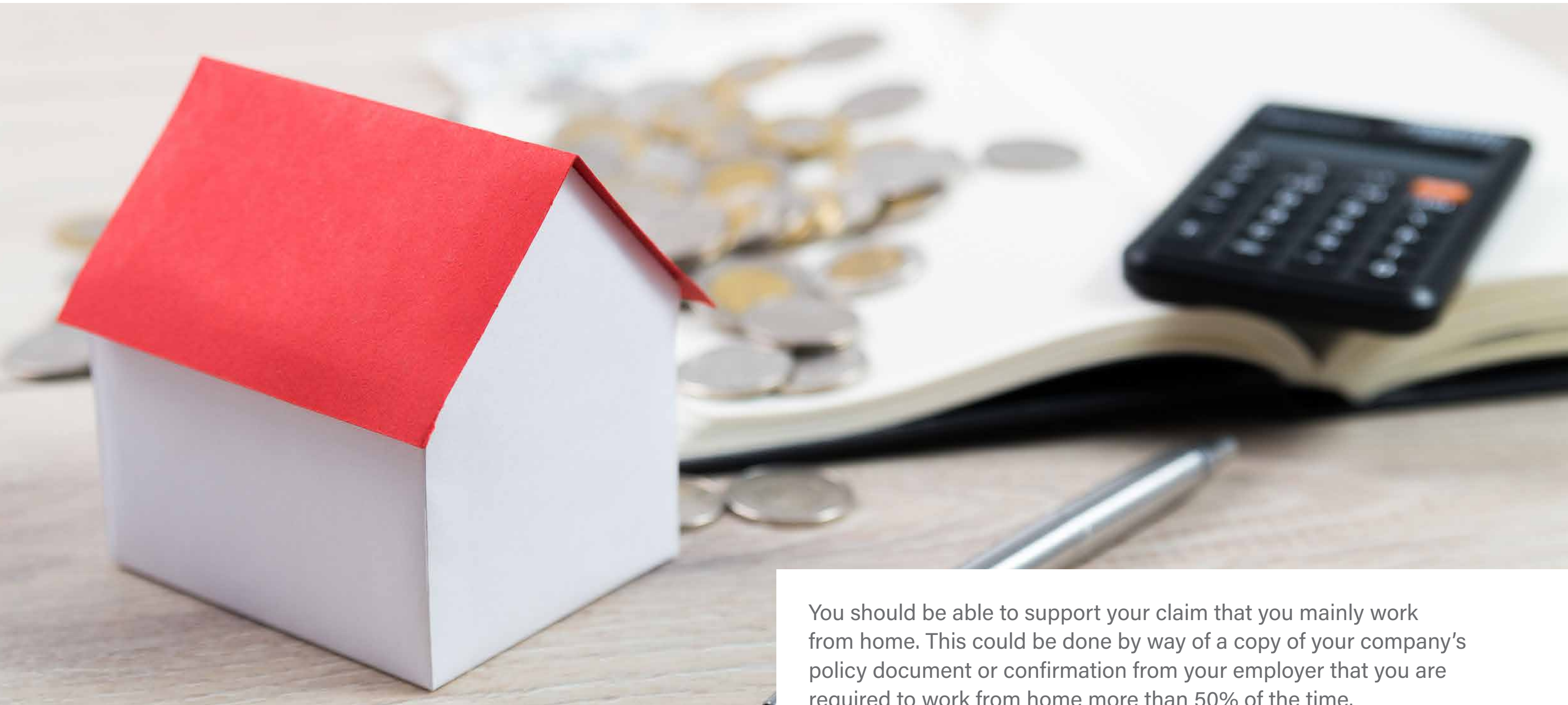
Section 23*(b)* sets out the circumstances under which expenses related to a home office can be claimed. Section 23*(m)* limits the types of expenses that can be claimed where the taxpayer is in employment or the holder of an office and 50% or less of the taxpayer's remuneration is in the form of commission.

Home office expenditure in general (before the relevant restrictions contained in section 23*(m)* are considered)

Home office expenditure includes expenditure in relation to the premises used by the taxpayer, including the rental of the premises or the interest paid on a mortgage bond (if the taxpayer owns the premises); the cost of repairs to the premises and the expenses in connection with the premises are typically regarded as being part of the overheads of the taxpayer.

Expenditure included in the maintenance of a home office would also include expenditure in respect of phones, internet, stationery, rates and taxes, cleaning, office equipment, furniture and fittings and repairs thereto as well as general wear and tear of the furniture and fittings in the home office.





Restrictions to home office expenditure

Where a taxpayer is in receipt of remuneration from employment or the holder of an office and where more than 50% of that income is *not* mainly due to sales-based commissions, the allowable expenditure (details above) is limited as follows:

The taxpayer will only be able to claim interest on a mortgage bond, rental, repairs and expenses incurred in relation to a dwelling, house or domestic premises where –

- the expenditure is derived from carrying on that employment, including employment that can be seen to have been incurred in the production of that income and that is not of a capital nature;
- the actual expenditure relates to the repairs of that property used as a home office;
- the expense would be regarded as wear and tear of any assets acquired as tools to assist you in carrying on employment, ie, a desk, computer, printer, etc.

Do your premises qualify as a home office (as approved by SARS)?

In order for an employee to be allowed to claim domestic or private expenses relating to their home office, the requirements of section 23*(b)* must be met.

In order for a part of your dwelling to be regarded as a "home office", the space used must be specifically equipped to allow you to carry on your employment. In addition, the space must have the right tools and instruments allowing you to perform your duties and the area must be regularly and exclusively used to carry on your employment.

If you only use your "home office" occasionally, ie once a week, this would not be regarded as regular use of those premises and it would therefore not be regarded as a home office.

You should be able to support your claim that you mainly work from home. This could be done by way of a copy of your company's policy document or confirmation from your employer that you are required to work from home more than 50% of the time.

If you work from your dining room table, or allow your family to use the same area on weekends or in the afternoon, this will also not be regarded as a home office as it is not exclusively used to carry on your employment. If you share the space with a spouse who carries on their own employment, it will also disqualify you from being able to claim any home office expenditure, as the space would not be used exclusively by one particular taxpayer.

Should your work space qualify as a home office, when completing your income tax return, you would be able to claim expenditure to reduce your taxable income in relation to the home office. Any expense relating to your property as a whole will have to be apportioned to the extent that it applies to your "home office". Therefore, if for example your home office is $10m^2$ and your house $150m^2$, the portion of the rates and taxes/ interest on bond/ rental that you can claim as part of your home office expenses will be calculated in accordance with the ratio 10/150.

The burden of proof that an amount is deductible rests with the taxpayer. Evidence of the expense should therefore be retained by the taxpayer in case it is called for.

Repairs can only be claimed if they are directly related to the home office area; ie, if the garage or bathroom is repainted, this will not qualify. If, however, the roof of your house is blown away in a storm, you would claim a portion of the repair as part of your home office.

Examples of expenditure that will qualify:

- Interest paid on a mortgage bond;
- Rental expenditure;
- Rates and taxes including other municipal charges;
- Levies;
- Electricity; and
- Cleaning costs.

"Should you be eligible to claim home office expenditure in relation to your primary residence, you should be mindful that this will have an effect on your capital gains tax calculation at the time of the disposal of your property."

Expenditure that will not be allowed (SARS is of the view that such expenditure is not incurred in connection with the premises; it therefore falls outside the scope of qualifying expenses):

- Bond and household insurance costs;
- Phone and data costs;
- Furniture;
- Stationery;
- Computer and communication equipment; and
- Fibre installation.

Where a modem, phone or furniture is purchased, the cost incurred can be deductible in the form of wear-and-tear allowances, governed by section 11*(e)* of the Act.

Capital gains tax adjustment

Should you be eligible to claim home office expenditure in relation to your primary residence, you should be mindful that this will have an effect on your capital gains tax calculation at the time of the disposal of your property. Where you dispose of your primary residence, there is an annual exclusion of R2 million that will reduce any capital gain, at the time of disposal. Should you have used a portion of your property as a home office, you will need to apportion the gain, based on the time that the property was used as a home office and the area of the property. This portion of a gain applicable to your home office will not qualify for the primary residence exclusion as it was used for trade.

Although the Interpretation Note has clarified the expenditure that can be claimed as part of home office expenditure, it is still quite restrictive in relation to taxpayers who are in employment. Should you, however, qualify for a deduction, you would have the benefit of reducing your taxable income.

Sharon MacHutchon

Mazars

Acts and Bills

- Income Tax Act 58 of 1962: Sections 11 (more specifically also paragraph *(e)*) and 23*(b)* and *(m)*.

Other documents

- Draft Interpretation Note 28 (Issue 3) (published for comment on 14 March 2021).

Tags: home office expenditure; qualifying expenses.

WORK-RELATED EXPENDITURE

The deduction of an individual's work-related expenses for tax purposes was considered in the recent Australian judgment of Munkayilar and Commissioner of Taxation (Taxation), *[2021], which was delivered by the Taxation and Commercial Division of the Australian Administrative Appeals Tribunal (the tribunal). In particular, the tribunal reflected on whether the taxpayer had met the requirements under Australian tax law to claim the relevant expenses as a deduction and whether an administrative penalty ought to be imposed to the extent that such expenses did not qualify for deduction.*

FACTS

In his 2018 tax return, the taxpayer claimed work-related expenses amounting to AUS$15,492 as a tax deduction. The expenses claimed by the taxpayer included:

- clothing expenses (the cost of laundry and shoes);
- self-education expenses (the cost of course fees, a study loan and depreciation on a computer, as well as travel expenses incurred pursuant to his self-education); and
- other expenses (the cost associated with the use of his cell phone and the cost of specialised hand cream necessary for his occupation as a social worker).

On 3 June 2019, the Australian Commissioner of Taxation (the commissioner) notified the taxpayer that an audit was being conducted in respect of the work-related expenses that he had claimed in his 2018 tax return. To this end, the commissioner requested that the taxpayer provide supporting documentation in order to substantiate the work-related expenses that had been claimed as deductions.

The taxpayer's tax agent responded to this request by informing the commissioner that the taxpayer was unable to find the receipts and other documents on which the claims were based, and further that the deductions that were claimed in respect of the self-education course fees had been incorrectly claimed on the basis of incorrect information provided by the taxpayer. The taxpayer then submitted a voluntary disclosure form which sought to reduce the work-related expenses claimed for the 2018 year.

In the subsequent finalisation of audit letter and amended assessment that was issued by the commissioner, the taxpayer's work-related expenses claim was disallowed in full and an administrative penalty of 50% on the shortfall amount was imposed. The administrative penalty was imposed on the basis that the taxpayer had made false or misleading statements in his tax return as a result of the taxpayer and his agent's recklessness in preparing the 2018 tax return.

The taxpayer first lodged an objection to the amended assessment, which was unsuccessful; he then lodged an application to the tribunal for a review of the commissioner's decision to disallow the objection.

During the tribunal proceedings, the taxpayer was able to provide only a copy of his bank statements (on which he had made handwritten notes describing what the relevant amounts were spent on) as documentation supporting his deduction claims.

JUDGMENT

In terms of Australian tax law, losses and expenses which are actually incurred in the course of gaining or producing assessable income are deductible, unless those losses or expenses are capital, domestic or private in nature. Work-related expenses may only be claimed if they are deductible in terms of a legislative provision contained in Australian tax law, and if they can be substantiated by written evidence. To this end, if a taxpayer cannot comply with a request to provide written evidence of the expense, then that expense cannot be allowed as a deduction.

In determining whether the commissioner's additional assessments had been incorrect or excessive, the tribunal considered each type of expense that was claimed by the taxpayer and ultimately identified three fundamental issues with the taxpayer's claim for deductions.

The *first significant issue* was that some of the expenses that he had claimed were not actually incurred or paid by him. While giving evidence, the taxpayer conceded that he had not actually paid any amounts towards his course fees (which were covered by the government) or his study loan during the 2018 year of assessment. As no amounts were expended by the taxpayer in respect of these items, the tribunal found that the taxpayer had not been entitled to a deduction of the amounts that had been claimed (but not paid) and the tribunal therefore upheld the commissioner's amended assessment in this regard.

The *second issue* that the tribunal highlighted was that the taxpayer had been unable to establish a sufficient link between some of the expenses incurred and the production of his assessable income. In this regard, the tribunal considered the taxpayer's travel expenses and the depreciation claim in respect of his computer. The taxpayer's overall inability to demonstrate a close enough link between the expenses and his income-producing activities, and more particularly his inability to show precisely how he calculated the particular amounts of the expenses that actually pertained to his income-producing activities, led the tribunal to find that he had not been entitled to claim the travel and computer expenses.

The *last issue* on which the tribunal focused was that the taxpayer had been unable to provide the necessary written evidence that the expenses had actually been incurred. It was the taxpayer's submission that he previously had receipts and other documents that would have substantiated his claims, but that he had subsequently lost them; he had made little or no effort to obtain replacement documents. In respect of the bank statements that the taxpayer had produced, the tribunal noted that the written descriptions included thereon did not indicate exactly what items were purchased or how these purchases were incurred in the production of the taxpayer's assessable income. As there were no other documents before the tribunal that could substantiate the taxpayer's claims, it was held that the expenses could not be claimed as a deduction.

On the issue of the administrative penalty, the tribunal found that the taxpayer had not discharged his obligation to show that he had taken reasonable care in preparing his 2018 tax return. It was held that a reasonable person in the same circumstances would have exercised greater care and would have made reasonable inquiries into the correctness of the tax position before lodging their tax return. In coming to this finding, the tribunal took into account the taxpayer's circumstances, including his knowledge, education, experience and skill. The amount of the penalty imposed by the commissioner was, however, reduced by the tribunal on the basis that the taxpayer had made a "genuine attempt to meet his tax obligations and made an effort to do the right thing despite recklessly including false and misleading statements in his tax return". This finding was made in large part due to the voluntary disclosure that the taxpayer had made.

Ultimately, the tribunal accepted the commissioner's amended assessment and reduced (but did not fully remit) the administrative penalty that had been imposed.

"It is critically important that documentary evidence of the expenses incurred be retained by the individual."

COMMENT

There are significant differences between the types of expenses that may be claimed by individuals in terms of South African and Australian tax law. However, the principles laid down by the tribunal in this case are noteworthy for those South African individuals, and more particularly South African employees, who are considering claiming deductions in respect of the expenses that they have incurred pursuant to their employment.

With respect to the types of deductions that may be claimed by employees, and the requirements that must be met in order to claim them, individuals in South Africa intending to claim such deductions, should be aware that the onus to prove that they are entitled to the deductions rests on them. In this regard, the following fundamental principles that were highlighted by the tribunal should be borne in mind:

- The expenses that are claimed as deductions must have been expenses that were actually incurred by the individual in the relevant year of assessment.

- There must be a connection between the expenses that are claimed and the employment functions carried out by that individual (in a South African context one would consider whether the "close connection" requirement laid down in the 1936 *PE Tramways* case was met).

- It is critically important that documentary evidence of the expenses incurred be retained by the individual. To this end, individuals must be able to show that the expenses were incurred and must be able to demonstrate how they calculated the relevant deductions.

In a media statement issued on 2 July 2021, the South African Revenue Service advised taxpayers to carefully consider any claims in respect of home office expenditure as these claims are likely to be selected for verification or audit. In the event of verification or audit, the taxpayer will need to provide the necessary proof that they are entitled to the deductions. To the extent that taxpayers are not legally entitled to claim the deductions, they may face penalties.

Louise Kotze

Cliffe Dekker Hofmeyr

Cases

- *Munkayilar and Commissioner of Taxation (Taxation)* [2021] AATA 1839 (22 June 2021) (delivered by the Taxation and Commercial Division of the Australian Administrative Appeals Tribunal);

- *Port Elizabeth Electric Tramways Co v Commissioner for Inland Revenue* [1936] CPD 241.

Tags: administrative penalty; work-related expenses; income-producing activities; assessable income.

TAX CONSIDERATIONS FOR EXPATS

Adding to the challenges of 2020, the South African Revenue Service (SARS) announced that it did not make its annual budget. In addition, SARS amended the tax laws for South African expats, now drawing them into this diminishing tax net.

Previously all income for services rendered abroad were exempt from tax, as long as certain criteria were met by the South African expat. In 2020, SARS, through section 10*(c)* of the Taxation Laws Amendment Act, 2020, amended section 10(1)*(o)*(ii) of the Income Tax Act, 1962 (the Act), with retrospective effect. A maximum cap of R1.25 million will now possibly be exempt from tax. From 1 March 2020, any taxable income above that amount is fully taxable.

Bearing this in mind, South African expats should consider the below five top tips to make them tax-ready when tax filing season opens:

1. Travel calendar

When working abroad, it is easy to jumble up days and dates. The section 10(1)*(o)*(ii) requirements state that you must be outside of South Africa for in excess of 183 days in any 12-month period, while more than 60 of those must be consecutive days. [*Editorial comment*: For the Covid period in the 2021 year of assessment the number of consecutive days is reduced to 117 days.]

"The perception of many expats is that they must only disclose what has been deposited into their bank accounts. This is not accurate. Expats must disclose *all* their gross earnings when submitting their tax returns."

To ensure you do not fall short of this requirement by a mere day or two, you should prepare a tax travelling calendar to keep record of your movements which should correlate directly with your passport stamps.

2. Statement of gross earnings

The perception of many expats is that they must only disclose what has been deposited into their bank accounts. This is not accurate. Expats must disclose *all* their gross earnings when submitting their tax returns. If your employer does not provide you with a detailed statement which summarises your gross earnings, you must request a complete breakdown of your remuneration for the period of 1 March 2020 to 28 February 2021. This statement serves the purpose of a country-specific equivalent of our IRP5 document.

3. Disclosure of benefits

The onus of proof lies with expats to enquire from employers what benefits were paid on their behalf. This is not as obvious as it sounds. Generally, as a rule of thumb, any benefit which has a private component attached thereto, should be disclosed as part of your taxable income.

If you compare relocation flights to a host country with home leave flights to visit family, you will pay tax on the latter but not necessarily on the former; this is due to certain exemptions available in the Act. Similarly, you should incorporate medical insurance, transportation and accommodation benefits paid by your employer, to name but a few.

Expats should disclose all benefits whilst on assignment to mitigate understating their taxable income, which may have grave penalty and interest consequences.

4. Foreign tax credits

Global tax laws are not meant to prejudice employees by paying taxes in two jurisdictions. Therefore, South African tax residents have the right to claim back a portion of foreign taxes paid which were deducted from their gross remuneration in the host country.

To prove that foreign taxes were indeed paid in the host country, it is vital to obtain an official document or tax certificate from your employer (or relevant host tax authority) that clearly depicts what taxes were deducted, and when.

5. Additional tax deductions

You will still qualify for tax deductions from your taxable income in the form of retirement annuity contributions, medical aid contributions in South Africa, or similar schemes or expenses. It is recommended to consult with a specialist tax expert who can advise you on what additional tax deductions you can legally take advantage of to minimise your tax liability in South Africa.

In closing

One of the biggest challenges facing expats is that most taxable benefits are processed by the company finance departments, to which neither the expat, nor their direct line management, may have immediate access. Further complicating the matter is that many benefits are not necessarily seen as taxable in the host country.

SARS aims to deal harshly with any transgressions and will not tolerate any form of negligence. You will still be held accountable for any omissions; this may be treated as a criminal offence.

Expats must tend to their finance matters with care and should seek guidance from a tax professional. With the right help, they can submit their tax returns knowing that they have not overlooked anything of importance.

Tanya Tosen

Tax Consulting SA

Acts and Bills

- Income Tax Act 58 of 1962: Section 10(1)*(o)*(ii);
- Taxation Laws Amendment Act 23 of 2020: section 10*(c)*.

Tags: tax travelling calendar; South African tax residents; taxable benefits.

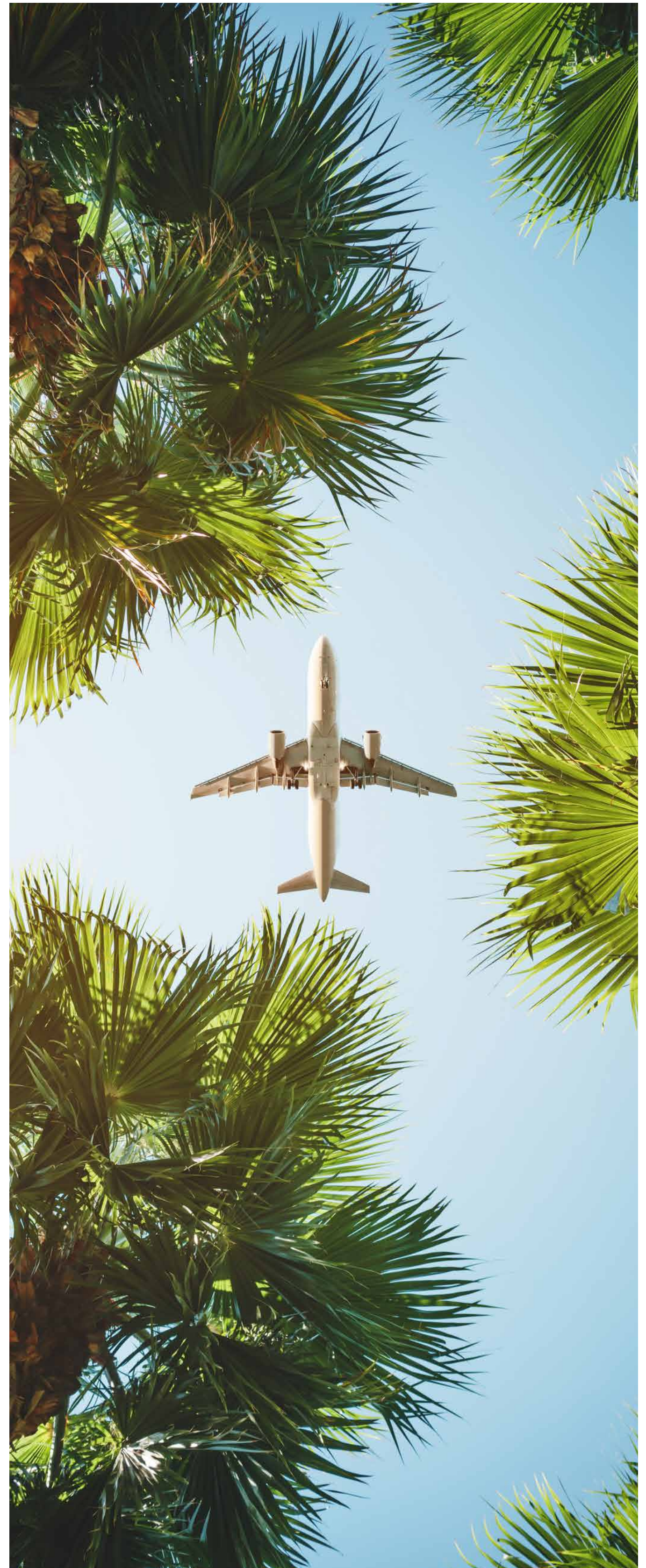
PLANNING FOR OFFSHORE RELOCATION

Donald Rumsfeld, the youngest person to have served as Secretary of Defence to the USA, gave a memorable response at a US Department of Defence news briefing about the lack of evidence linking the government of Iraq with the supply of weapons of mass destruction, just over a year before the Iraq war started:

> “there are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns – the ones we don’t know we don’t know”

While the remarks initially led to some ridicule towards the Bush administration in general and Rumsfeld in particular, the consensus regarding it has shifted over the years, and it now enjoys some level of respect. Indeed, this concept has long been used by national security and intelligence professionals as an analysis technique referred to as the Johari window.

"Crucially, you may not, however, have considered taking tax or legal advice in the country to which you are moving. Surprisingly few people do this until late in the day, if at all."



Applying the “known unknowns” paradox to South Africa

Moving to another country involves knowns and unknowns – emigration queries by South Africans increased by 70% from 2018 to 2019, and remain high.

If you leave, you know you have to pack up, sell or keep/rent your home, get a passport or a visa to enter the other country, and find somewhere to live. You should also know that you need to take South African (SA) tax and exchange control advice. Crucially, you may not, however, have considered taking tax or legal advice in the country to which you are moving. Surprisingly few people do this until late in the day, if at all. For example, it is known that wealthy people moving to the UK have left again shortly afterwards so they could return at a later date because they did not take UK tax advice before moving. An unknown unknown. They did not know that they should take UK tax advice before moving, or how beneficial that could be.

So how can someone plan for the unknowns?

It is very difficult because you do not know what you do not know. In addition, each person’s situation is different and so you will face different issues.

For example, just one, critical, element of pre-UK arrival tax advice is determining when you will become UK tax resident. If you are not UK tax resident then, generally, you are not subject to UK tax. As such, you can make disposals and restructure your assets

UK tax free. However, there is not one test to work out whether you are UK tax resident, but *seven*. To advise on this typically includes analysing information including, family, spouse, children, accommodation, SA home, UK home, personal possessions, work, work location, date of arrival, and lots of day counting for different aspects. So you can, seemingly, have a very similar situation to someone else but have a different tax profile. You may be UK resident, the other person not. This difference can be as little as one more day spent in the UK.

"Good advice is crucial, be it legal advice or advice on immigration, emigration, or on death/gift taxes."

Advice

Good advice is crucial, be it legal advice or advice on immigration, emigration, or on death/gift taxes. Then it has to be co-ordinated and put together like a jigsaw.

For example, the UK tax rules are not the same as the UK immigration rules. This means that you can become UK tax resident but not spend enough time in the UK to keep your visa.

Part of the jigsaw is fitting the SA advice together with the advice in the other country. For example, when leaving SA there is a deemed capital gains tax exit charge. The question is whether you will get any credit for this tax in the other country. Say you have a business in SA and pay the exit charge on leaving. A few years later you sell the business. In the UK the gain on sale will be calculated from when you acquired the business in SA, not when you paid the SA exit tax. This is because it is a deemed gain in SA (there was no actual disposal). This can result in double taxation. There is some debate about whether the UK/SA double tax treaty will assist here. Taking proper advice can test the treaty and look at whether the interaction of the UK remittance basis rules and business asset disposal relief can also assist.

Another example is if your children go to live in another country but you stay in SA. They may not have many of the tax and legal issues you would. Instead, you may want to support and fund them. You might have a trust or a business in SA or offshore, or some kind of structure or set up for your family that works well from an SA perspective. If you want to benefit your children while you are alive, or on death, then you will now have to consider the tax and succession implications of the country in which they are living. What might work smoothly and tax efficiently in SA might have adverse consequences in the other country. To illustrate this further, SA tax paid by an SA trust is, largely, not taken into account for UK tax purposes. A trust distribution can therefore, effectively, result in double taxation. Often this issue can, largely, be avoided if the trust makes a loan instead. But, again, without taking advice this is another unknown unknown!

Jonathan Colclough & Hugo van Zyl

Other documents

- Double taxation agreement between South Africa and the United Kingdom.

Tags: UK tax resident; double taxation.

RETENTION OF SOUTH AFRICAN CITIZENSHIP

Many South Africans are relocating to other countries. While the reasons for their decisions can vary, there is no denying that they will face a mountain of paperwork or be bombarded with terms that are alien to them.

It is, however, imperative for South Africans, when applying for another country's citizenship, to be mindful that they do not unknowingly renounce their South African citizenship. Consequently, the most prominent hurdles in obtaining dual citizenship have become the (i) retention of SA citizenship (ii) application for foreign citizenship and (iii) physical and / or financial emigration. Here is a quick look at the differences.

What is dual citizenship

Dual citizenship is the right to become a citizen of more than one country. It sounds fairly straight-forward, but South Africans need to apply to keep their South African citizenship. Many first world countries no longer allow individuals to keep dual citizenship with other countries.

Countries like Singapore, China, Japan, United Arab Emirates and Saudi Arabia have become firm favourites with South Africans looking to earn foreign income. However, none of these countries make provision for dual citizenship.

While the act of having dual nationality can hold many rewards, it can also create a tax maze and have other, more complex, implications to consider.

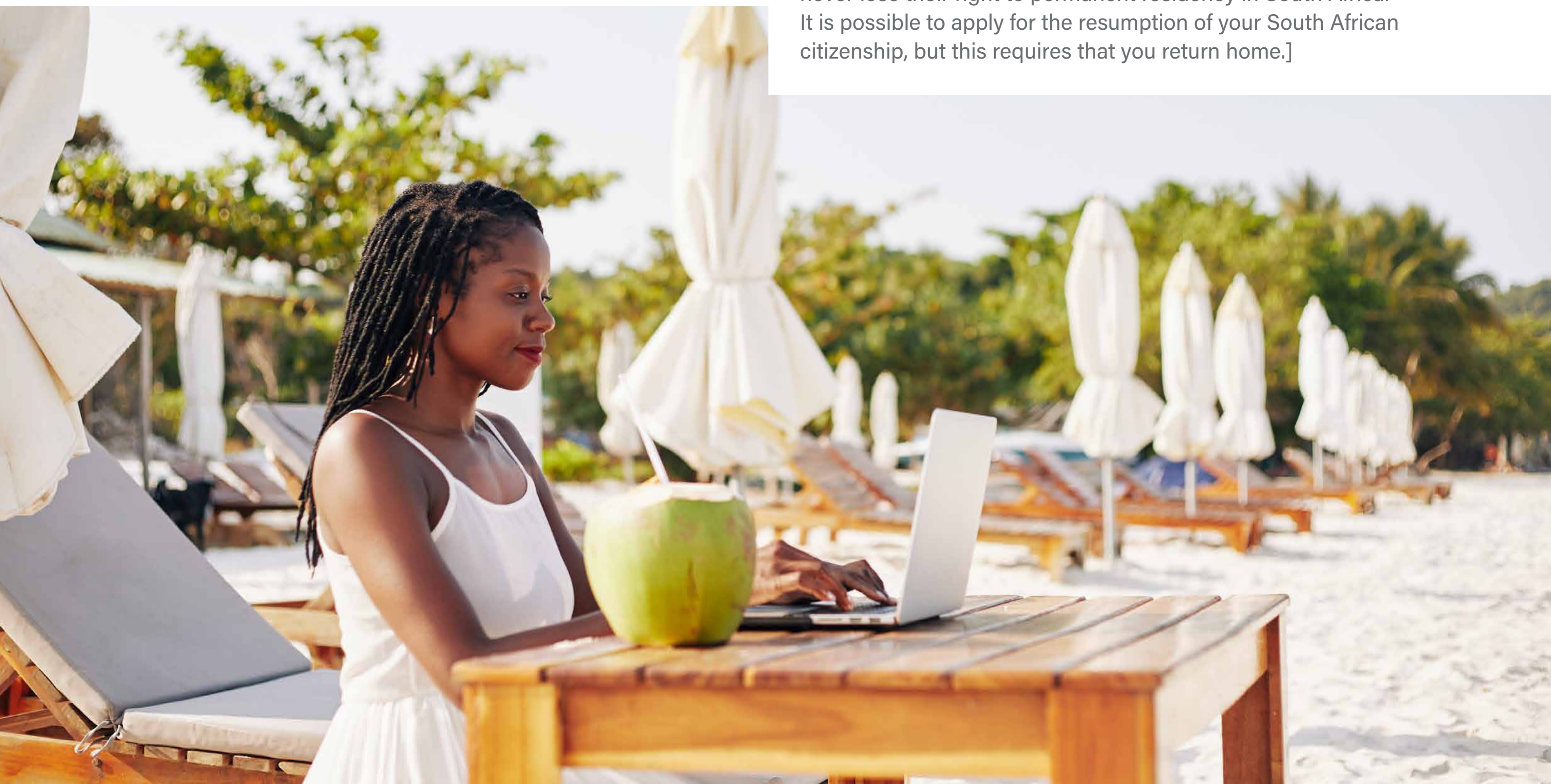
Can I lose my citizenship?

While South Africa allows its citizens to hold dual citizenship, it is necessary to understand the requirements and the correct way of applying for it.

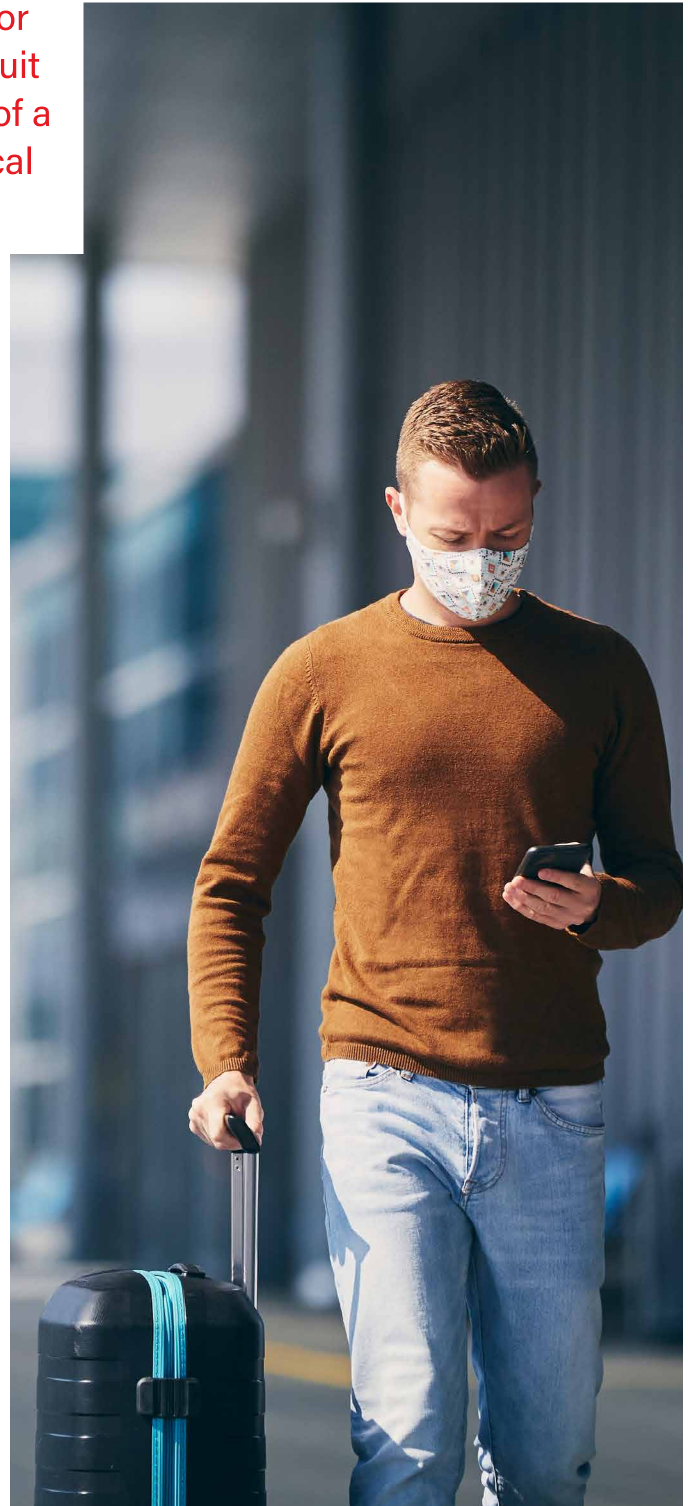
For instance, you must first apply to the Department of Home Affairs (the DHA) to request retention of your SA citizenship before applying for foreign citizenship; where this step is not completed, you will automatically lose your SA citizenship.

This section of the South African Citizenship Act, 1995, is currently being challenged because it is alleged to be unconstitutional. Whether this is true or not, thousands of South Africans lose their citizenship every year without knowing it.

If you have already lost your citizenship, it is a complex and onerous process to get it back again. One of the ways to reclaim or resume your citizenship requires you to move back to South Africa on a permanent basis and then make application to the DHA. This can be a massive setback for professionals who were under the impression that they do indeed have dual citizenship and have already made the big move. [*Editorial comment*: South Africans by birth who have automatically lost their South African citizenship never lose their right to permanent residency in South Africa. It is possible to apply for the resumption of your South African citizenship, but this requires that you return home.]



"Regardless of what your needs might be, or which of the above scenarios would best suit your situation, be sure to use the services of a specialist who knows the legal and technical ins-and-outs of working abroad."



Physical and financial emigration

Emigration is the act of moving away from a country, but there is a difference between physical emigration and financial emigration; these are two entirely separate matters, and you can undertake one without necessarily having to undertake the other.

What is physical emigration?

Although physical emigration is, as its name indicates, the act of packing your bags, jumping on the first flight and leaving South Africa, it requires a decision on whether you would like to take up residency or citizenship of the country to which you are relocating; where you do decide to apply for citizenship, the next decision required is whether you would like dual citizenship (where allowed) or whether you are giving up your SA citizenship. As noted earlier, where you intend to retain your SA citizenship you must initiate the process with the DHA before applying for other citizenship. This can be a daunting process and many people are uncertain of the steps; this results in many not properly concluding this process.

Is there help?

It can be overwhelming or demanding to work abroad. Completing paperwork and submitting applications is probably the furthest thing from your mind when you are planning to work abroad. You should consider consulting professionals and firms that facilitate the physical emigration and work permit processes and whose goal is to take this time-consuming burden off your hands.

What is financial emigration?

Financial emigration is the process of cutting financial ties with South Africa. This means that, for exchange control purposes, the South African Revenue Service (SARS) changes your residency status from resident to non-resident. Because SARS requires an emigrant to have tax compliance status before considering financial emigration, it is wise to consult a specialist who can help you with this procedure.

By undertaking a financial emigration, you do not alter your status as a South African citizen. You retain your passport and your citizenship until you have undertaken a physical emigration process through the DHA.

Is there help?

Some firms offer extensive expat tax assistance, work visa services and services facilitating international travel permit applications. More often than not, complications hinder the financial emigration process.

Regardless of what your needs might be, or which of the above scenarios would best suit your situation, be sure to use the services of a specialist who knows the legal and technical ins-and-outs of working abroad.

Marisa Jacobs

Xpatweb

Acts and Bills

- South African Citizenship Act 88 of 1995.

Tags: SA citizenship; financial emigration; tax clearance certificate.

WORKING REMOTELY ABROAD

Remote work has become the norm for many employees and professionals alike. Along with the growth of the "gig" economy, which surged during the Covid-19 pandemic, the most remarkable change is the flexibility and mobility of remote-working employees, who can criss-cross the country and global borders without taking a day's leave.

While it's now entirely possible for employees and independent contractors to remain productive while travelling across international borders, this trend may be problematic from a tax and immigration law perspective.

FLEXIBILITY TO FLY – BUT NOT SO FAST

There is no doubt that the benefits of remote working include flexibility. One can work from home, a coffee shop, another province or even across borders.

Certain trends include employees who travel to foreign countries for personal reasons, ie holidays or visiting family, and decide to extend their stays and work remotely. Others with citizenship or permanent residency in another country may decide to travel between South Africa and the foreign country and perform their employment duties wherever they find themselves.

However, certain employees and their employers are blissfully unaware of the fact that working in foreign jurisdictions has several serious tax and immigration implications.

TAX WARNINGS TO BE HEEDED

Personal taxes

Where a tax resident of one country performs income-generating activities in another jurisdiction, one must consider the principles of international taxation. Generally, where a person physically performs employment duties in another country for extended periods (more than 183 days in a 12-month period), both that country and their country of residence will have a right to tax that income, resulting in double taxation. Extended presence may also trigger tax residency in the foreign country, further complicating the individual's tax obligations considerably.

Corporate taxes

Beyond the individual tax implications, employees may create complications for their employer as well. Depending on the nature of the activities conducted by the employee and their designation, they may create a taxable presence for their employer in the foreign country, potentially dragging a portion of the company's profits into the foreign country's tax net.

In some cases it is advisable for SA employers to reconsider the individual's contract if they are working abroad.

Consider your options

Where the employee intends to remain in the foreign country for an extended period, it may be advisable to terminate the individual's permanent employment contract and renegotiate their services as an independent contractor. Provided the substance of the relationship supports this, it severs the link between the employer and the employee, therefore shifting the tax liability from the employer to the individual.

Independent contractors working abroad would also have to consider the following:

- Their rate of taxation;
- Their tax implications whilst still working for an SA-based firm; and
- Whether they still meet the tax residency test, making them liable for tax in SA and in the foreign country.

REMOTE WORKING MAY BE ILLEGAL

Immigration rules must be strictly adhered to. It is suggested that a country's restrictions on the right to work should be investigated while visiting.

Where you are present in another country on a visitor's visa, you are generally not permitted to work in that country. Where you remotely perform your South African employment duties in that country, you are in contravention of the terms of your visa.

"Businesses are at risk of suffering serious reputational damage if employees opt to work remotely abroad without understanding and complying with all the tax and immigration rules."

Corporate reputational damage

Again, these implications extend beyond the individual. Businesses are at risk of suffering serious reputational damage if employees opt to work remotely abroad without understanding and complying with all the tax and immigration rules.

If, for example, you chose to relocate to the United Kingdom, Portugal, or Switzerland but do not possess permanent residency or a work visa that allows you to work in your new temporary home country, you are falling foul of the country's laws and working illegally, albeit for an SA firm. This can create serious brand damage for the business, which may find its expansion plans in that country hampered if a foreign government holds the incursion against it when making future decisions.

Seek professional advice

It is absolutely vital that businesses and employees seek professional advice when navigating this new territory of remote working across international borders. While we are now more flexible than ever, the decision to work in a foreign country remains one of considerable gravity, as it triggers a cascade of tax and immigration implications.

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Tax Consulting South Africa

Tags: permanent residency; income-generating activities; independent contractor; tax liability.

DISCLOSING FOREIGN ASSETS

In February 2021, SARS issued a media release that it had received, from 87 jurisdictions across the world, information detailing the offshore financial assets of South African taxpayers and that SARS intended to undertake a careful review of the information and audit it, where necessary.

SARS then started issuing letters to taxpayers advising them of SARS' receipt of information through the Automatic Exchange of Information (AEOI) regarding South Africans who have offshore assets. SARS is, however, willing to engage with the taxpayer and give the taxpayer an opportunity to disclose to SARS what offshore assets and dealings the taxpayer has. SARS is not disclosing to the taxpayer what SARS already knows or what information they have but only mentions that they are in possession of "information". Below is an example of some of the information that SARS is requesting the taxpayer to furnish:

- Confirmation that the taxpayer has offshore assets;
- Details of such offshore assets;
- The years of assessment during which the taxpayer held such assets;
- The nature of assets held and the jurisdictions where the assets are held;
- The nature of the investment and the source of the funds that were invested;
- The capital amount invested and the movements thereon;
- Income earned on the investments, eg, dividends and interest;
- What tax obligations have been discharged with regards to these assets, eg, declaration of foreign income; and
- Where taxpayers have not complied with disclosure of these assets in their tax returns, SARS requires an explanation of why this was not done.

Taxpayers should note that the above is just an example and each letter might be different depending on the specific circumstances of the taxpayer. SARS ordinarily requires the taxpayer to respond and submit the requested information within 21 working days. Failure to

"The VDP offers more favourable terms in respect of understatement and other administrative penalties."

submit the requested information may constitute a criminal offence and penalties may apply.

The welcome part is that SARS is still allowing taxpayers to utilise the Voluntary Disclosure Programme (VDP) to regularise their affairs. Under the VDP, SARS considers applications submitted voluntarily by taxpayers to disclose tax defaults. The VDP offers more favourable terms in respect of understatement and other administrative penalties. Usually, when SARS has issued a letter of verification to a taxpayer, the taxpayer cannot apply for VDP as SARS has approached the taxpayer first. The disclosure ceases to be voluntary. However, with the letters that SARS is sending to taxpayers, SARS is indicating that, should the taxpayer wish to utilise the VDP, it can still do so within 21 working days. In the VDP application SARS requires the taxpayer to still disclose or provide all the information they have requested in their letter.

SARS advised that the above-mentioned request for information is for risk assessment purposes and that it therefore does not constitute the commencement of an audit process (which would impact the ability to submit a VDP application).

Affected taxpayers should ensure that they obtain professional advice on how to deal with these letters and on responding to SARS. It is recommended that taxpayers who have offshore assets regularise their affairs even if they have not received such letters as the automatic exchange of information process and systems within SARS and between the various tax jurisdictions are likely to improve at a fast pace. Therefore, it may only be a matter of time before all taxpayers with unregularised assets will receive such letters.

Memory Damba

PKF

Editorial comment:

Co-operation between tax administrations is critical in the fight against tax evasion and protecting the integrity of tax systems. A key aspect of that co-operation is exchange of information.

Automatic exchange of information (AEOI) is information required by law to be collected by financial institutions around the world for reporting to tax authorities.

The Common Reporting Standard (CRS) is an information standard for the AEOI regarding financial accounts on a global level, between tax authorities, which the Organisation for Economic Co-operation and Development (OECD) developed in 2014.

Its purpose is to combat tax evasion. By 2021 more than 100 countries have signed an agreement to implement it, with more countries intending to sign later. First reporting occurred in 2017 (South Africa was one of the 49 countries who undertook exchanges in 2017), with many of the rest starting in 2018.

Tags: Voluntary Disclosure Programme (VDP); risk assessment; automatic exchange of information.

SECTION 163 PRESERVATION ORDER

In Commissioner for the South African Revenue Service v Raphela and Others, *[2021], the Pretoria High Court confirmed the provisional preservation order granted to the applicant, the Commissioner for the South African Revenue Service (CSARS) against the third respondent, Mrs Mdlulwa (Mdlulwa).*

Section 163 of the Tax Administration Act, 2011 (the TAA), empowers a senior SARS official to authorise an *ex parte* application to the High Court for a preservation order to prevent the disposal or removal of any realisable assets that may frustrate the collection of tax. In terms of this provision the preservation order can be obtained in respect of:

- the full amount of tax that is due or payable; or
- the amount of tax which to the satisfaction of the SARS official may, on reasonable grounds, be due or payable.

In anticipation of the application for a preservation order, SARS may in terms of the TAA seize the assets of a taxpayer or "other person" and appoint a *curator bonis* to preserve the assets, pending the outcome of the application for a preservation order.

BACKGROUND

The second respondent, PSR Solutions (Pty) Ltd (the Taxpayer), was awarded a tender to supply facemasks for use by the South African Police Service. The tender was valued at R45 million and in terms of the Value-Added Tax Act, 1991, the Taxpayer was required to charge VAT on the supply and pay it over to SARS. Due to a lack of funds on the part of the Taxpayer and its sole director (ie, the first respondent, Mrs Raphela), Mdlulwa was approached by a third party (Third Party) for funding. Mdlulwa advanced the amount of approximately R19,9 million to the suppliers of the facemasks and after the completion of the tender, the Taxpayer paid Mdlulwa approximately R33 million, with the result that Mdlulwa made a profit in excess of R13 million. In addition, the Taxpayer made several payments to or on behalf of Raphela in excess of R4 million and a payment of R1 million to the Third Party. The Taxpayer did not at any point disclose the VAT due to SARS. In terms of SARS'

provisional calculation, the total VAT liability, late-payment, and non-disclosure penalties amounted to R14,5 million, an amount which remained unpaid and continued to accrue.

Considering these facts, the CSARS applied on an urgent basis to the High Court for a preservation order, which was granted provisionally, and in terms of which a *curator bonis* was appointed.

Upon investigation, the *curator bonis* found that the Taxpayer and Raphela had funds well below the Taxpayer's tax liability. As a result, Mdlulwa's account, which contained funds of approximately R24 million, was frozen, on the basis that the majority of the funds which could have been utilised by the Taxpayer to settle the tax debt had been dissipated to Mdlulwa. At this stage, it is worth noting that Mdlulwa resided in Spain and had emigrated for exchange control purposes.

MDLULWA'S SUBMISSIONS

Mdlulwa argued, *inter alia*, that her funds ought to have been released on the basis that:

1. she had obtained the requisite approval to expatriate the funds to Spain;
2. there was a difference between the extent of the tax liability of the Taxpayer and the funds in the frozen account; and
3. only the account of any other person who "knowingly assisted the taxpayer in dissipating" assets should be frozen.

In considering Mdlulwa's submissions, the court concluded that:

1. It was irrelevant that the expatriation of funds had occurred in compliance with the Exchange Control Regulations, 1961, as those funds were no longer recoverable and the funds that came from the Taxpayer to Mdlulwa, and that were in South Africa, indicated a "practical utility" of a preservation order.
2. The Taxpayer's tax liability of R14.5 million continued to attract penalties and interest. Moreover, the Taxpayer's income tax liability had not yet been determined, which also had the potential to attract interest and penalties. It was also considered that the amount preserved would possibly not be enough to cover the Taxpayer's tax liability at the time that it became due.

   The court noted that in instances where hardship has materialised because of a preservation order, section 163(7)*(d)* provides for a variation of the preservation order and empowers the court to make ancillary orders regarding how the assets must be dealt with. Usually, the court will consider this in light of various circumstances, such as the reasonable living expenses of the person against whom the preservation order is granted, as well as those of his or her legal dependants. Although Mdlulwa attempted to claim hardship, the court concluded that the claims were vague as the required information had not been disclosed.
3. Mdlulwa's strict interpretation of section 163 could not be accepted, on the basis that section 163 does not require the CSARS to prove the intention of such "other person" as contemplated in the provision. Therefore, the court concluded that there does not need to be an element of collusion between the Taxpayer and such person whose assets are seized and preserved in terms of a preservation order. The court further clarified that the aim of the section is to prevent the dissipation or further dissipation of assets by the taxpayer, which if not preserved, could lead to the tax being unrecoverable.

"When there is a concern that a taxpayer may dissipate assets that could have been used to settle that taxpayer's tax liability, the CSARS may apply to the High Court for an order to preserve such assets."

COMMENT

When there is a concern that a taxpayer may dissipate assets that could have been used to settle that taxpayer's tax liability, the CSARS may apply to the High Court for an order to preserve such assets. As it appears, the application is likely to succeed where there is no basis for the disposal or removal of the assets (much like the excess profit which the Taxpayer paid to Mdlulwa in this case), and the disposal or removal of those assets would hinder the collection of tax. It appears that the intention or innocence of the recipient of the assets is irrelevant for purposes of the section 163 preservation order, as the provision does not require that the CSARS prove the intention of that "other person" whose assets may be preserved for purposes of settling the taxes due.

Ursula Diale-Ali

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Section 163 (more specifically subsection (7)*(d)*);
- Value-Added Tax Act 89 of 1991;
- Currency and Exchanges Act 9 of 1933: Section 9(1).

Other documents

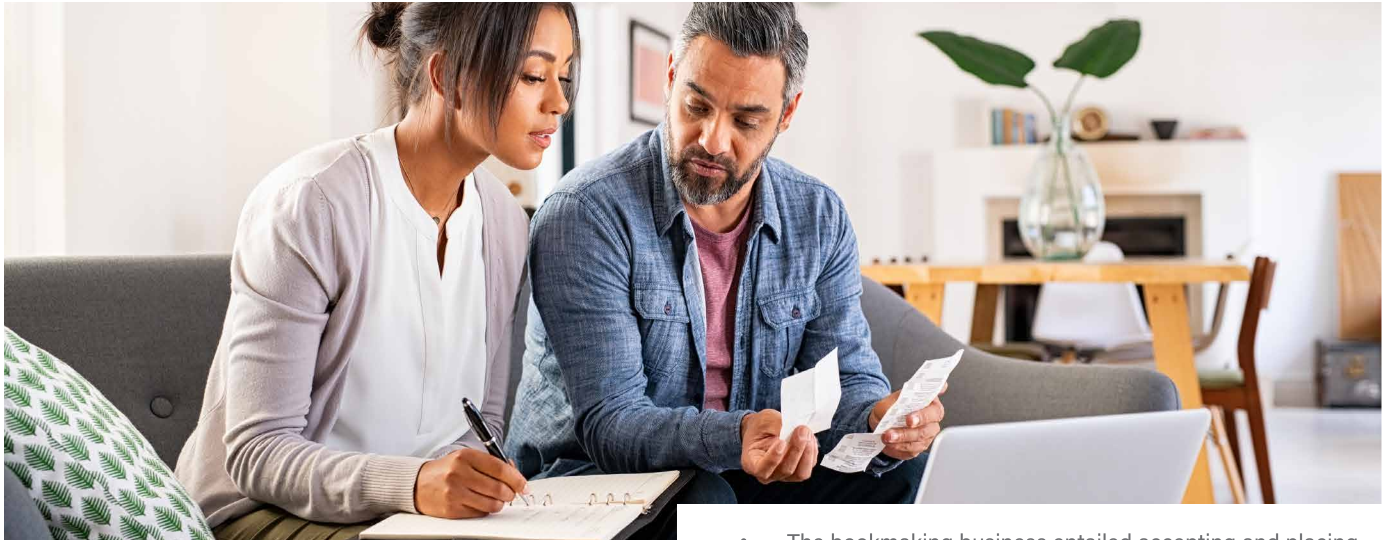
- Exchange Control Regulations, 1961 (made under section 9(1) of the Currency and Exchanges Act 9 of 1933).

Cases

- *Commissioner for the South African Revenue Service v Raphela and Others* (2091/2021) [2021] ZAGPPHC 191 (29 March 2021).

Tags: realisable assets; preservation order; expatriation of funds. realisable assets; preservation order; expatriation of funds.

UNEXPLAINED DEPOSITS IN A BANK ACCOUNT



It is safe to say that in most legal disputes, proof is everything. Where a taxpayer embarks on entrepreneurial activities and these activities involve payment of amounts into and out of a bank account held in his own name, the ability to prove what the amounts relate to is even more important. This, in a nutshell, is what the tax court's judgment in Mr X v The Commissioner for the South African Revenue Service *(Case No IT13178), handed down on 31 March 2021 (as yet unreported), is all about. As discussed below, the court ultimately decided the matter in SARS' favour due to Mr X (the Taxpayer) not being present at the proceedings, but there are a number of important things that one can learn from this matter.*

FACTS

The Taxpayer's business activities and imposition of additional tax

- The Taxpayer appealed against the additional assessments raised in respect of the Taxpayer's 2005–2007 tax years.

- The Taxpayer is a businessman who earned his living from two parallel business ventures, namely bookmaking and equity futures trading.

- The bookmaking business entailed accepting and placing horseracing bets from private individuals and the public (the punters). If the bets placed with the Taxpayer win, he is obliged to pay out the winnings to the relevant punters; to mitigate his exposure to risks from winning bets, the Taxpayer places hedging bets with other bookmakers.

- To monitor the betting transactions, the Taxpayer maintained a spreadsheet on a daily basis. The Taxpayer alleged that during the 2005–2007 tax years, the settling of bets made by the Taxpayer was done verbally on a mutually agreed figure on a weekly basis. In other words, no settling statements or statements of account were issued.

- Following a tax audit and an analysis of deposits made to his bank account, SARS found that the Taxpayer underdeclared income from his bookmaking business during the 2005–2007 tax years. The underdeclared amount for each year was between R3,8 and R4,81 million.

- In respect of the Taxpayer's equity futures trading business, the Taxpayer operated an account with Z Securities (Pty) Ltd (Z Securities), which is a stock brokerage firm and a member of the South African Futures Exchange (SAFEX).

- An analysis of the Taxpayer's bank statements for the futures trading account reflected undeclared profits for the 2005–2007 tax years, varying between R219,000 and R950,000, in each tax year.

- The Taxpayer also failed to declare interest that accrued to him from the funds held with Z Securities and from a call account held with Y Bank.

- SARS imposed interest in terms of section 89*quat* of the Income Tax Act, 1962 (the Act), and additional tax, at the rate of 100%, on top of the tax owing in respect of the income that was allegedly not declared correctly (interest, bookmaking and equity futures trading income referred to above).

"When the matter was due to be heard on 4–5 February 2021, the Taxpayer's attorneys of record withdrew and the proceedings took place in the Taxpayer's absence."

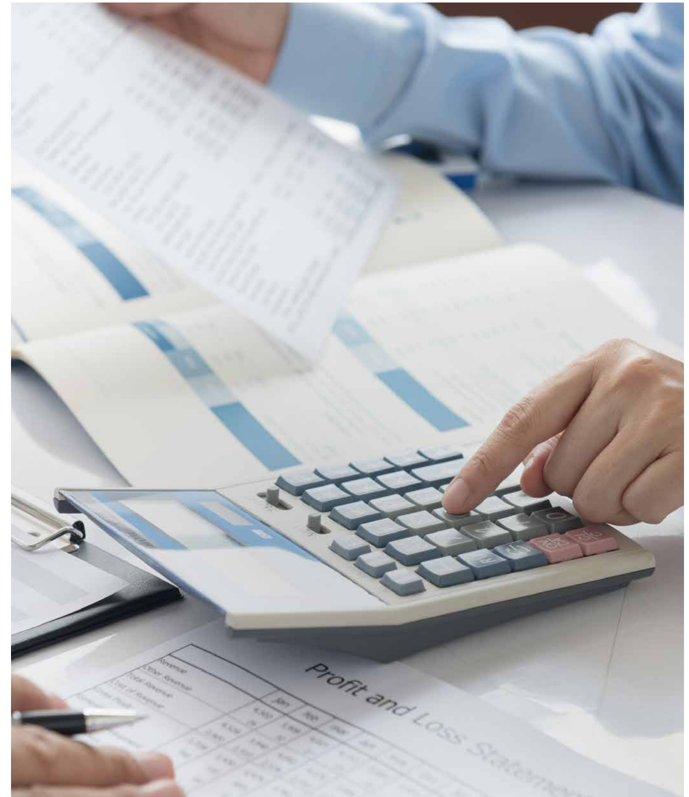
The Taxpayer partially successful on objection and appeal proceedings

- At the hearing of the matter, Ms M, a SARS official, explained that the Taxpayer's objection against the additional assessments was allowed partly. SARS conceded that the proceeds in the futures trading account were capital in nature and imposed capital gains tax on the profits made for the 2005–2007 tax years.
- SARS also allowed those deductions proved by the Taxpayer and invited the Taxpayer to explain the unexplained deposits.
- SARS also considered extenuating circumstances and reduced the additional tax rate to 50%, instead of the original rate of 100% that was used. The Taxpayer appealed against those parts of his objection that were not allowed.
- The Taxpayer requested a postponement of the appeal proceedings before the tax court on numerous occasions, with the aim of trying to settle the matter.
- The Taxpayer's last application for postponement was made on 24 November 2020 and when the tax court granted that application, it indicated that no further postponements would be granted.
- When the matter was due to be heard on 4–5 February 2021, the Taxpayer's attorneys of record withdrew and the proceedings took place in the Taxpayer's absence. The withdrawal was only communicated to the tax court on the first day of proceedings.

ISSUES FOR DETERMINATION

The tax court had to decide on the following issues, amongst others:

- Whether SARS was entitled to issue additional assessments as a result of the unexplained receipts and deposits in the Taxpayer's bank account on the basis that they formed part of his "gross income" (as defined in section 1(1) of the Act) derived from his bookmaking business and equity futures trading business.
- Whether the interest income that accrued to the Taxpayer formed part of the Taxpayer's gross income.
- Whether the Taxpayer produced sufficient evidence to satisfy SARS that the additional tax imposed under section 76(2) of the Act (which applied at the time of the Taxpayer's underdeclaration) should be remitted.
- Whether the Taxpayer successfully contended that the amounts in dispute should not have been declared in his income tax returns to justify the remittal of interest under section 89*quat*(3) of the Act.



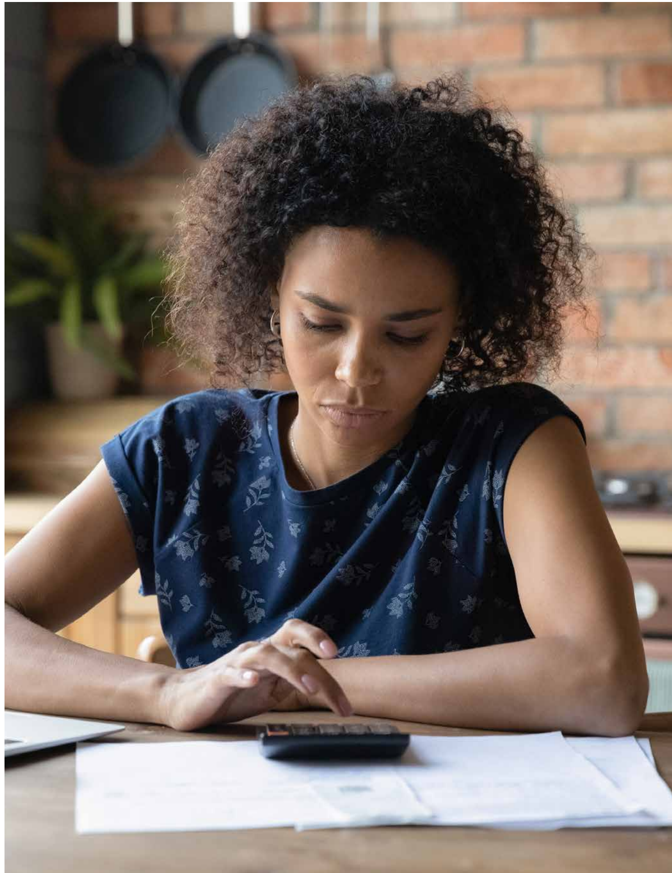
JUDGMENT

Due to the proceedings taking place in the Taxpayer's absence, the tax court did not have any evidence to consider, save for what was submitted by SARS during the hearing. It discussed the provisions in the Act that were applicable to decide the issues for determination and considered SARS' argument as to whether the court should grant default judgment in terms of rule 44(7) of the rules promulgated under the Tax Administration Act, 2011 (the TAA) (Tax Court Rules).

Rule 44(7) states the following:

> If a party or a person authorised to appear on the party's behalf fails to appear before the tax court at the time and place appointed for the hearing of the appeal, the tax court may decide the appeal under section 129(2) of the TAA upon—
>
> - the request of the party that does appear; and
> - proof that the prescribed notice of the sitting of the tax court has been delivered to the absent party or absent party's representative, unless a question of law arises, in which case the tax court may call upon the party that does appear for argument.

The court noted that the submission in terms of rule 44(7) was well grounded as it was submitted to the court that the Taxpayer failed to provide instructions to his attorneys in preparation for the appeal, after the last postponement had been granted in November 2020.



In coming to its decision in the matter, the court considered the following:

- The Taxpayer must prove that amounts are deductible, with reference to section 11*(a)* of the Act and section 102 of the TAA. The latter provision states that the Taxpayer bears the burden of proof on whether an amount is deductible.
- In terms of section 76(2) of the Act (which applied at the time of the contravention), SARS may remit the additional tax imposed under section 76(1), but only if SARS is of the opinion that there were extenuating circumstances and that the Taxpayer did not do anything with the intent to avoid tax.
- In terms of section 89*quat*(3) of the Act, interest imposed may be remitted if the Taxpayer has on reasonable grounds contended that an amount should not have been included in taxable income or should have qualified for deduction.

The tax court queried SARS as to how it arrived at its calculations and after considering SARS' submissions, it granted judgment against the Taxpayer in default, as provided for in terms of rule 44(7) of the Tax Court Rules.

COMMENT

The judgment illustrates the following important principles that should also be kept in mind by taxpayers:

Firstly, taxpayers always bear the burden of proving that an amount should not be subject to tax or that it should qualify for deduction. There are only a few instances mentioned in the TAA where SARS bears the burden of proof. A taxpayer should therefore ensure that they have the necessary evidence (documentary or otherwise) that proves why they treated an amount in a certain way for tax purposes. If a taxpayer receives income or pays business expenses from his personal bank account, it is therefore crucial to have supporting documentation for information contained in the bank statement, so that it is clear what pertains to business (and is subject to tax) and what is not.

Secondly, taxpayers should, as far as possible, avoid a tax dispute from being drawn out unnecessarily. In the current matter, one does not know all the reasons why it took 10 years before the matter reached the tax court, but it appears to be at least partly due to the Taxpayer's requests for postponement. Aside from late payment interest that is charged on the unpaid tax and from additional tax and interest, a witness' ability to recall an event and provide cogent evidence can be adversely affected by such a long delay.

Thirdly, when taxpayers make settlement proposals, they should be made strategically and whilst appreciating the relevant settlement provisions in the TAA that must be taken into account. For example, the TAA states that if certain facts are present, SARS will not agree to settle a dispute.

Finally, although trading in cryptocurrency was not in issue in this case, the judgment is also a reminder for persons engaged in cryptocurrency trading to ensure that they keep sufficient proof of all income derived and expenses incurred in the course of trading, especially if they use their personal accounts for this purpose. Any trading-related income received into a person's bank account, including any cryptocurrency that accrues to the person by virtue of receipt into their digital wallets, could be subject to tax, if it accrued to them or was received in the course of trading.

Louis Botha

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "gross income"), 11*(a)*, 76(1) & 76(2) (which applied at the time of the contravention (ie, the Taxpayer's underdeclaration)), 89*quat* (more specifically subsection (3));
- Tax Administration Act 28 of 2011: Sections 102 & 129(2).

Other documents

- Tax Court Rules: Rule 44(7).

Cases

- *Mr X v The Commissioner for the South African Revenue Service* (Case No IT13178) (handed down on 31 March 2021 (as yet unreported)).

Tags: tax audit; additional assessments; late payment interest; settlement provisions.

FUNDING OFFSHORE TRUSTS

Many South African tax residents have settled offshore trusts in various jurisdictions outside South Africa. These offshore trusts are often funded by way of rand or foreign currency denominated interest-free and interest-bearing loans made by these South African tax-resident individuals. This article examines the principal South African income tax implications in respect of such loans.

Donor attribution rules

The so-called donor attribution rules contained in the Income Tax Act, 1962 (the Act), may give rise to tax consequences for a South African tax resident who has made a donation, settlement or other disposition to a foreign trust, on the income of that trust which is attributable to such a donation, settlement or other disposition. These donor attribution rules also apply to an interest-free loan or a loan where interest is charged at less than a market-related rate of interest.

The South African resident is obliged to disclose the donation, settlement or other disposition in writing when submitting their tax return for the relevant tax year in which the donation, settlement or other disposition was made.

The income of the trust (determined as if the trust had been a resident) should be apportioned on a *pro rata* basis to determine the amount of the income which is attributable to the interest which was not charged. If these rules apply, the South African resident must include, in their gross income, the amount of attributable income and may claim a *pro rata* deduction for allowable expenditure of the trust.

A similar attribution rule applies to a capital gain of a foreign trust (including any amount that would have constituted a capital gain if the trust had been a resident), which is attributable to a donation, settlement or other disposition made by a resident to the foreign trust. Such capital gains may be attributed to the resident donor.

The total amount of income and/or capital gain that can be attributed to the resident donor is limited to the amount of the benefit derived by the trust from that donation, settlement or other disposition. The benefit derived from a donation, settlement or other disposition means the amount by which the trust has benefitted from the non-charging of interest on the loan.

Where interest is charged on the loan by the South African resident lender at a market-related rate, the resident should not be regarded as having made a donation, settlement or other (gratuitous) disposition to the non-resident trust and the donor attribution rules should, therefore, not apply in that instance.

Deemed donation

Section 7C of the Act came into effect on 1 March 2017 and applies to any loan, advance or credit which is directly or indirectly provided to, amongst others, a trust by:

- a natural person; or
- at the instance of that person, by a company in relation to which that individual is a “connected person” (as defined in section 1(1) of the Act),

and where either no interest is charged in respect of the loan or interest is charged at a rate lower than the “official rate of interest” (as defined in section 1(1)), subject to certain exclusions.

Section 7C will, however, not apply in respect of any amount owing by a trust or company during a year of assessment in respect of a loan, advance or credit if “that loan, advance or credit constitutes an affected transaction as defined in section 31(1) that is subject to the provisions of that section”. The transfer pricing rules in section 31 are set out in more detail below.

Section 7C will also not apply in the case of a vesting trust, ie, where the loan, advance or credit was provided to the trust by a person by reason of, or in return for, a vested interest held by that person in the receipts and accruals and assets of that trust, and provided that certain other requirements are met.

The "official rate of interest" is defined as follows:

- If the loan is a South African rand denominated loan, the South African repurchase rate plus 100 basis points.
- If the loan is denominated in a foreign currency, a rate of interest that is the equivalent of the South African repurchase rate applicable in that currency plus 100 basis points.

If section 7C applies to a loan, the difference between the actual interest incurred by the trust and the amount that would have been incurred at the official rate of interest (which may be higher or lower than an arm's length rate), must be treated as a donation made to that trust by the individual who advanced the loan on the last day of that year of assessment of the trust, for donations tax purposes.

Transfer pricing rules

The South African transfer pricing rules will apply to any transaction, operation, scheme, agreement or understanding where –

- that transaction constitutes an affected transaction (as defined); and
- any term or condition of that transaction, operation, scheme, agreement or understanding results or will result in any tax benefit being derived by a person that is party to the affected transaction.

The term "affected transaction" is defined in section 31(1) of the Act and means –

"Any *transaction, operation, scheme, agreement or understanding* where –

(a) that transaction, operation, scheme, agreement or understanding has been directly or indirectly entered into or effected between or for the benefit of either or both –

(i) *(aa)* a person that is a resident; and

(bb) any other person that is not a resident;

…

and those persons are connected persons in relation to one another; and

(b) *any term or condition of that transaction, operation, scheme, agreement or understanding* is different from any term or condition that would have existed had those persons been *independent persons dealing at arm's length."* (*our emphasis added*)

"If no interest is charged on the loan funding provided by a South African tax resident to a non-resident trust or the interest rate is lower than what would constitute an arm's length (ie, market-related) rate, that resident effectively avoids the liability to pay tax on the difference."

A "connected person" includes the following in relation to a trust:

- any beneficiary of that trust; and
- any connected person (as defined) in relation to such beneficiary.

A "tax benefit" is defined in section 1(1) of the Act and includes any avoidance, postponement or reduction of any liability for tax purposes.

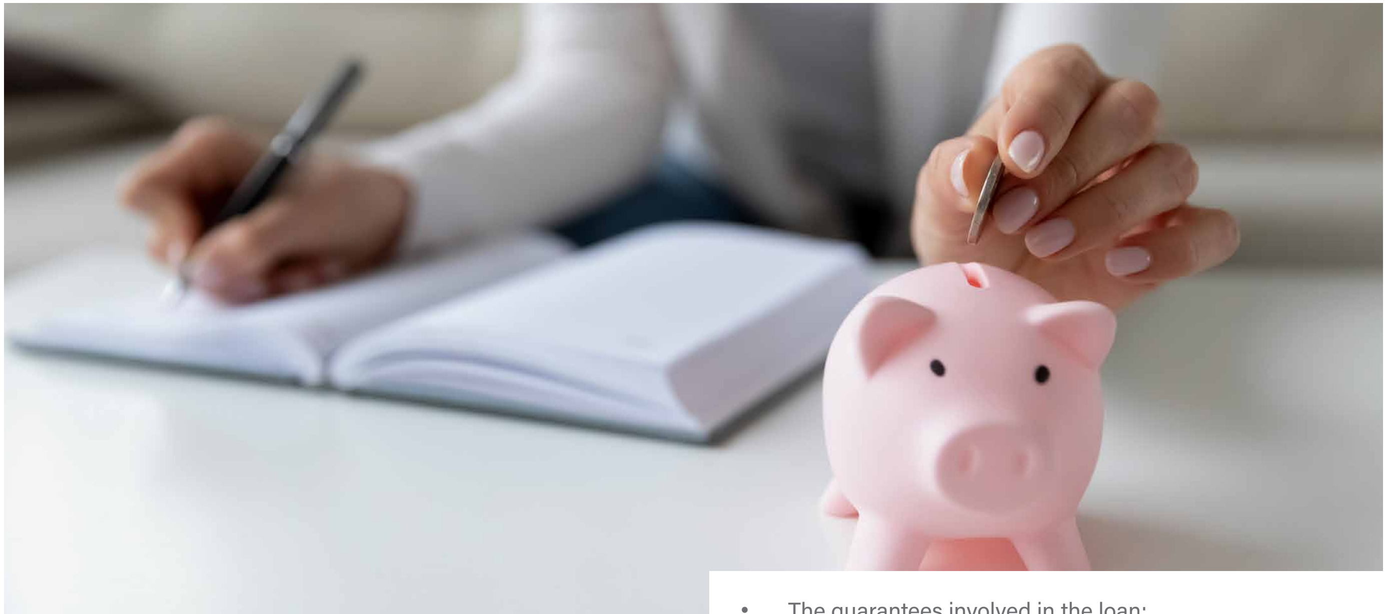
In these circumstances, section 31(2) places an obligation on each party to the affected transaction which derives a tax benefit, to calculate its taxable income or tax payable as if that transaction, operation, scheme, agreement or understanding had been entered into on the terms and conditions that would have existed, had those persons been independent persons dealing at arm's length.

If the loan funding was provided by the South African tax resident to the non-resident trust on terms and conditions that would not have existed had they been independent persons dealing at arm's length (for example, the interest rate is different from what would constitute an arm's length rate), such loan would be an affected transaction for purposes of the transfer pricing rules in section 31 of the Act. In this situation the South African transfer pricing rules would apply if there was a "tax benefit" to the South African tax resident from the loan transaction.

If no interest is charged on the loan funding provided by a South African tax resident to a non-resident trust or the interest rate is lower than what would constitute an arm's length (ie, market-related) rate, that resident effectively avoids the liability to pay tax on the difference. The affected transaction should, therefore, result in a tax benefit being derived by the South African tax resident.

Accordingly, in that instance, the South African tax resident will have to calculate their taxable income as if the terms and conditions would have been consistent with the arm's length principle, which means that the difference between the actual amount of interest charged and the arm's length amount would have to be included in the taxable income of the South African tax resident. This is referred to as the "primary adjustment".

In addition, section 31(3) deems the amount of the transfer pricing adjustment, in the case of a person other than a company, to be a so-called "secondary adjustment" in the form of a donation for donations tax purposes. This donation is deemed to have been made by the South African tax resident to the non-resident trust on the last day of the six-month period following the end of the tax year in which the primary adjustment is made.



"In examining whether the interest rate applied is of an arm's length nature, all circumstances of the individual case will be taken into account."

Essentially, the burden of proof is on the taxpayer to show that they have entered into the transaction, operation, scheme, agreement or understanding with connected persons on the terms and conditions that would have existed had the persons been independent persons dealing at arm's length.

As far back as 2013 SARS issued a draft interpretation note ("Determination of the taxable income of certain persons from international transactions: Thin capitalisation"). SARS states therein that, in order to apply the arm's length principle to funding arrangements, a taxpayer should consider the transaction from both the lender's perspective and the borrower's perspective. That is, from the lender's perspective, whether the amount borrowed *could* have been borrowed at arm's length (that is, what a lender would have been prepared to lend and therefore what a borrower could have borrowed) and from the borrower's perspective, whether the amount *would* have been borrowed at arm's length (that is, what a borrower acting in the best interests of its business would have borrowed). [*Editorial comment*: This draft interpretation note of 2013 has never been finalised.]

In examining whether the interest rate applied is of an arm's length nature, all circumstances of the individual case will be taken into account. This may include the following factors:

- The nature and purpose of the loan;
- The market conditions at the time the loan is granted;
- The principal amount, duration and terms of the loan;
- The currency in which the loan is denominated;
- The exchange risks borne by the lender or borrower;
- The security offered by the borrower;
- The guarantees involved in the loan;
- The credit standing of the borrower; and
- The interest rate prevailing at the *situs* of the lender or borrower for comparable loans between unrelated parties.

In practice, assuming that the taxpayer is a connected person in relation to the non-resident trust, the taxpayer needs to be able to substantiate the arm's length interest rate in respect of the loan to the trust, for example, by obtaining a quotation from a bank or other financial institution in the applicable foreign jurisdiction for a loan to the non-resident trust on similar terms.

Taxation of interest income

Any amount of foreign interest received or accrued by the South African tax resident from the non-resident trust in respect of the loan will constitute taxable foreign interest and must be disclosed in their South African tax return in the applicable tax year.

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ENSafrica

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definitions of "connected person", "official rate of interest" and "tax benefit"); 7C; 31(1) (specifically definition of "affected transaction"), (2) & (3).

Other documents

- Draft Interpretation Note issued by SARS in 2013 ("Determination of the taxable income of certain persons from international transactions: Thin capitalisation").

Tags: donor attribution rules; natural person; connected person; official rate of interest; transfer pricing rules; affected transaction; tax benefit.

MIXED SUPPLIES

On 25 May 2021, the Supreme Court of Appeal (SCA), in Commissioner for the South African Revenue Service v Tourvest Financial Services (Pty) Ltd*, [2021], upheld an appeal by the Commissioner for the South African Revenue Service (SARS) against Tourvest Financial Services (Pty) Ltd (Tourvest), a licensed dealer in foreign exchange, concerning its value-added tax (VAT) liability. The judgment sets very clear guidelines on when apportionment for VAT inputs must be made, where vendors make both taxable and exempt supplies.*

The question before the SCA was whether Tourvest, in conducting its enterprise of the exchange of currency through its branch network, made both taxable and exempt supplies (as SARS contended) or whether it only made taxable supplies (as Tourvest contended).

Tourvest's business consists of 52 branches countrywide and a head office, with a centralised treasury division that procures stock of foreign currency and sets the exchange (buy and sell) rate at which the branches may transact with customers. Tourvest offers to sell foreign currency to the public at a rate in excess of the rate at which it acquires that currency and offers to buy foreign currency at a rate that is lower than the price at which it expects to sell that currency. It also charges a commission, based on a percentage of the transaction value. VAT is levied on the commission.

"It followed that the relevant *proviso* in the VAT Act created a mixed supply out of an identified activity, rather than causing the activity to lose its exempt status in its entirety."

Previously, Tourvest applied an apportionment in terms of section 17(1) of the Value-Added Tax Act, 1991 (the VAT Act). However, Tourvest changed its stance in 2013 and took the view that the goods and services obtained for their branches were used by it wholly in the course of making taxable supplies and not at all in the course of making exempt supplies. Accordingly, Tourvest concluded that no apportionment was required.

Tourvest contended that it had overpaid VAT in each tax period over the prior five years and claimed an input tax deduction of R24 million in the September 2013 tax period, which was paid by SARS. Following an audit, SARS issued an additional assessment adding back the refunded amount, on the basis that the goods and services had been acquired by Tourvest for use in the course of making both taxable and exempt supplies and accordingly an apportionment of input tax was necessary.

The SCA found that what would otherwise have been an exempt financial service was to an extent treated as a taxable supply (so that the commission carried VAT). This did not mean that the activity lost its exempt nature entirely. It remained an exempt supply for all other purposes, while the taxable component carried VAT. It followed that the relevant *proviso* in the VAT Act created a mixed supply out of an identified activity, rather than causing the activity to lose its exempt status in its entirety.

The SCA further held that the effect of the *proviso* in the present context was merely to add a taxable element to what was, and at its core remained, an exempt financial service. It turned the activity into a partly exempt and a partly taxable supply.

T Roos

Acts and Bills

- Value-Added Tax Act 89 of 1991: Section 17(1).

Cases

- *Commissioner for the South African Revenue Service v Tourvest Financial Services (Pty) Ltd* (Case no 435/2020) [2021] ZASCA 61 (25 May 2021).

Tags: taxable and exempt supplies; taxable supplies; mixed supply.