South African Institute of Taxation

SARS INTERPRETATION UPDATE AND CASES

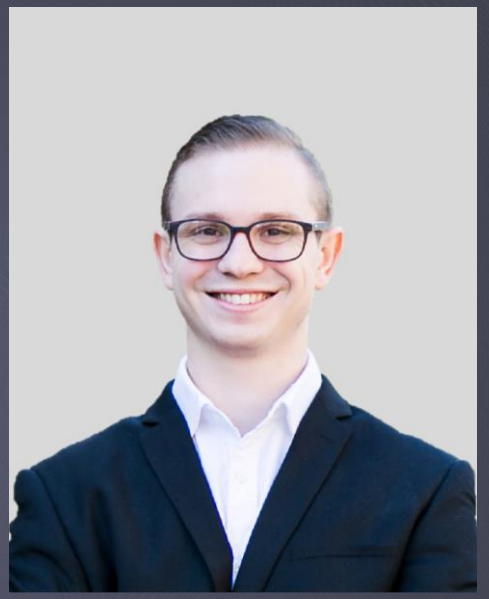
Session 1

Tax Practice on the Move Series

YOUR KEY TO THE TAX COMMUNITY

About The Presenters

Keitumetse Sesana
Tax Technical Specialist



Thomas Lobban
Head of Cross-Border Individual Tax at Tax Consulting SA

sait South African Institute of Taxation

AGENDA

- Is SARS going too far in its interpretation of “associated enterprise?
- Was SARS correct in raising its additional assessments against the Thistle Trust and imposing an understatement penalty?
- Was SARS’ Ruling on the VAT treatment of “airtime” vouchers correct, and was the Court correct in entertaining the application for declaratory relief brought by MTN?

DRAFT INTERPRETATION NOTE ON THE DEFINITION OF “ASSOCIATED ENTERPRISE”

Draft Interpretation Note – Definition of "associated enterprise"

- Introduction
  - The Act contains rules in section 31 which are aimed at preventing a reduction in the South African tax base as a result of the mispricing or incorrect characterisation of specified transactions, operations, schemes, agreements or understandings.
  - Affected transactions are transactions, operations, schemes, agreements or understandings directly or indirectly entered into or effected between or for the benefit of specified parties in relation to one another and that contain any terms or conditions that differ from those that would have existed had the parties been independent persons dealing at arm's length.
  - The definition of "affected transaction" currently only includes transactions, operations, schemes, agreements or understandings directly or indirectly entered between the specified parties that are connected persons in relation to one another.
  - Effectively not always capturing transactions between "associated enterprises" which may not fall within the "connected persons" definition.
  - Section 66(1) of the Taxation Laws Amendment Act 20 of 2021.
  - This will result in "affected transactions" applying to both associated enterprises and connected persons in respect of years of assessment commencing on or after 1 January 2023 .
  - Guidance on the interpretation and application of the definition of "associated enterprise" in section 31(1).

Draft Interpretation Note – Definition of "associated enterprise"

- SAIT Comments on the draft IN
  - *"The draft IN seems to be much broader than what is envisioned by the OECD Model Commentary. To elaborate, we are of the view that SARS has taken a very broad view of what constitutes control and management, which may in effect blur the lines of interpretation when taxpayers consult this draft IN."*

South African Institute of Taxation

Draft Interpretation Note – Definition of "associated enterprise"

- Expert Corner interview discussion with our Subject matter expert – Ernest Mazansky

Ernest Mazansky is the Head of the Tax Practice at Werksmans Attorneys.

With nearly 40 years tax experience, Ernest specialises in corporate tax planning; restructuring of corporate entities; share incentive schemes; dispute resolution/tax controversy; offshore structures & financing; exchange control; VAT; estate planning; and wills & trusts (local and international).

Ernest was named as a pre-eminent practitioner in Euromoney's Guide to the World's Leading Tax Advisers (2008 and 2018).

Draft Interpretation Note – Definition of "associated enterprise"

Article 9 of the OECD Model Tax Convention on Income and on Capital, Condensed Version (as it read on 21 November 2017)

"ASSOCIATED ENTERPRISES

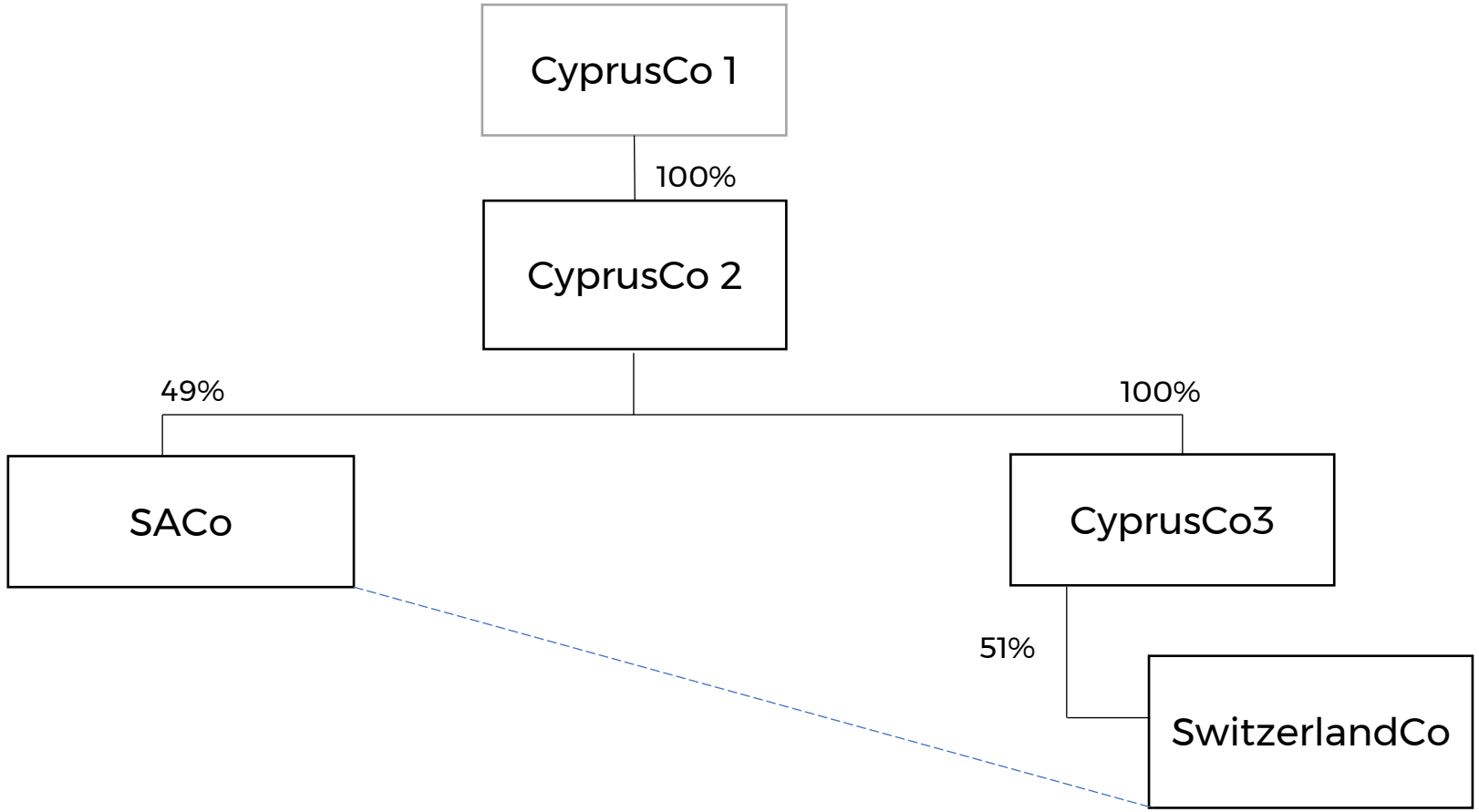
1. Where
   a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or
   b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other."

Draft Interpretation Note – Definition of "associated enterprise"

Example 1 - Same persons participate directly in the management of two companies



Keys:
——— Shareholding
------ Transaction

South African Institute of Taxation

CSARS v The Thistle Trust (516/2021)

CSARS v The Thistle Trust

Background

- This matter came before the Supreme Court of Appeal (SCA) on appeal from a Tax Court ruling in favour of SARS.
- The Thistle Trust ("Thistle Trust") was a beneficiary of different trusts comprising the "Zenprop Group", i.e., 10 vesting trusts conducting the business of the Zenprop Group, being property ownership & development (referred to here as "the Tier 1 Trusts").
- During the 2014 – 2016 tax years, the Tier 1 Trusts disposed of certain capital assets, and the capital gains derived therefrom were distributed, among others, to the Thistle Trust.
- In turn, the Thistle Trust distributed the amounts to its beneficiaries and treated the proceeds received as taxable in the hands of those beneficiaries.
- SARS raised additional assessments for the 2014 – 2016 tax years, treating the amounts received by the Thistle Trust as being taxable in its hands (i.e., not in the hands of the ultimate beneficiaries).
- SARS further imposed an understatement penalty against the Thistle Trust, as well as interest.

CSARS v The Thistle Trust

Background (continued)

- The Thistle Trust filed an objection to the additional assessments, primarily on the following basis:

  "having regard to the provisions of section 25B of the ITA and paragraph 80(2) of the Eighth Schedule to the ITA ("the Eighth Schedule"), the capital gains . . . ought not to have been taxed as our client derived no taxable income in this regard, and such gains were properly taxable in the hands of our client's beneficiaries under those provisions of the ITA."

- The objection was disallowed by SARS, and the Thistle Trust lodged an appeal to the Tax Court, which then found that the Tier 1 Trusts had disposed of capital assets and realised capital gains.
- The Tax Court held that the capital gains (distributed to the Thistle Trust and then its beneficiaries) constituted amounts contemplated in section 25BB(1) and section 25BB(2) of the Income Tax Act ("the ITA"), and paragraph 80(2) of the Eighth Schedule thereto.
- As such, the Tax Court found that the distribution to the beneficiaries of the Thistle Trust was a distribution of capital gains which are taxable in the hands of the said beneficiaries. The additional assessments were set aside, and SARS lodged a further appeal to the SCA.

CSARS v The Thistle Trust

Issues before the Court

1. The first issue in consideration was whether the capital gains, accrued as a result of the disposal of capital assets by the Tier 1 Trusts, were taxable in the hands of the Thistle Trust or its beneficiaries.
2. The second issue was the imposition of an understatement penalty, in the event that the capital gains were taxable in the hands of the Thistle Trust.

    - In this latter case, the question was thus whether the circumstances giving rise to the tax treatment applied by the Thistle Trust (regarding the further distribution to its beneficiaries) warranted the imposition of an understatement penalty.

CSARS v The Thistle Trust

SARS' Argument

- SARS argued that paragraph 80(2) of the Eighth Schedule applies exclusively, and that section 25B of the ITA does not apply. Capital gains tax ("CGT") is expressly dealt with in the Eighth Schedule.
- Section 26A, read with the Eighth Schedule, provides for a specific form of tax and for the effect of the vesting of such capital gains as are realised in the hands of successive trusts.
- SARS further argued that the proceeds of the asset disposal by the Tier 1 Trusts constituted capital gains in their hands. However, the capital gains were distributed to the Thistle Trust and, therefore, paragraph 80(2) applies. The Thistle Trust acquired a vested right to the capital gains distributed to it, but not to the disposed capital assets.
- The amount received by the Thistle Trust was distributed to its beneficiaries and, in doing so, did not realise a capital gain in respect of the disposal of a capital asset in terms of paragraph 80(2).
- Therefore, with respect to the beneficiaries, paragraph 80(2) would not apply. This instead applied to the Thistle Trust, and the capital gains accrued upon the disposal of the assets was accordingly taxable in the hands of the Thistle Trust.
- Furthermore, SARS argued that section 25B of the ITA would not apply as the "amounts" in issue were of a capital nature, thus dealt with in the Eighth Schedule.

CSARS v The Thistle Trust

Taxpayer's Argument

- The Thistle Trust contended that paragraph 80(1) and paragraph 80(2) of the Eighth Schedule were both applicable. These provisions support a "see-through" approach when dealing with taxation of capital gains arising from the disposal of assets by a trust or to the benefit of resident beneficiaries.
- On this basis, the capital gains accrued would be taxable in the hands of the resident beneficiaries.
- It was submitted that, per paragraph 11(1)(*d*) of the Eighth Schedule, a disposal for CGT purposes includes the vesting of an interest in an asset of a trust in a beneficiary.
- The Thistle Trust further argued that paragraph 80(2) ought to be read with s25B, and that "an amount" as contemplated in this section is inclusive of capital gains.

CSARS v The Thistle Trust

Findings of the Court

- The SCA found in favour of SARS, and it upheld the appeal albeit only to the extent that the understatement penalty was set aside. A cost order was awarded against the taxpayer.
- The SCA ruled that paragraph 80(2) concerns proceeds from the disposal of capital assets, and that these provisions were triggered only when the Tier 1 Trusts disposed of the assets.
- The vesting of the capital gain by the Thistle Trust did not arise from the disposal of a capital asset by the Thistle Trust and, consequently, paragraph 80(2) of the Eighth Schedule would not apply.
- When the proceeds that giving rise to the capital gain were received by the Thistle Trust, they were received as a capital amount and not income. Therefore, the Thistle Trust could not rely on section 25B of the ITA, which only relates to income received by a trust and vested in a beneficiary.
- The proceeds from the sale of assets by the Tier 1 Trusts was not income received by the Thistle Trust; and as such, the beneficiary should account for capital gains tax under paragraph 80(2) of the Eighth Schedule.
- However, the Court found that the Thistle Trust had a *bona fide* belief that section 25B applied. Accordingly, an understatement penalty was not warranted in the present matter.

Mobile Telephone Networks (Pty) Ltd

v

Commissioner for the South African Revenue Service

Mobile Telephone Networks (Pty) Ltd v CSARS

Background

- This matter came before the Supreme Court of Appeal (SCA) on appeal from a High Court ruling in favour of SARS.
- The taxpayer ("MTN") sells "pre-paid multi-purpose vouchers" (referred to as "pre-paid vouchers"). The sale of the pre-paid vouchers was previously treated by MTN as falling within the ambit of section 10(19) of the Value-Added Tax Act ("VAT Act").
- MTN sought a Binding Private Ruling ("BPR") from SARS, to the effect that the sale of the pre-paid vouchers would thenceforth be dealt with under section 10(18) of the VAT Act.
- SARS issued a BPR to the effect that section 10(19) would apply, and not section 10(18).
- MTN approached the High Court for declaratory relief, which application was dismissed with costs.

Mobile Telephone Networks (Pty) Ltd v CSARS

Issues before the Court

1. The first issue in consideration was whether seeking a declaratory order was appropriate in the circumstances; and
2. The second issue was whether SARS' ruling was correct.

Mobile Telephone Networks (Pty) Ltd v CSARS

Taxpayer's Argument

- MTN contended that its application was "a legitimate approach to the high court for a declaration of rights." This situation aligned with the circumstances described in the *Langholm Farms* case, which supported its approach to the High Court instead of following the normal SARS processes.
- With regard to the substantive (2nd) issue, MTN submitted that 2 types of vouchers it supplies fall under the different provisions in question:
    - The first specifies the goods obtainable from the use of the voucher, such one for data – these cannot be used for anything else. This type of voucher falls under section 10(19).
    - The second is a pre-paid voucher, which have a Rand value and can be used to access a wide range of services offered by MTN. These are not limited to specific goods or services. These are typically referred to as "airtime" vouchers. This type of voucher would fall under section 10(18).
- A section 10(18) voucher specifies the value of goods or services, rather than specifying the goods or services. However, a section 10(19) voucher specifies the particular goods or services that me be acquired rather than their value.
- An "airtime" voucher involves a credit of a sum of money equal to the face value of the voucher. Therefore, section 10(18) would apply thereto.

Mobile Telephone Networks (Pty) Ltd v CSARS

SARS' Argument

- SARS submitted that the procedure utilised by MTN was in appropriate. The correct approach would have been for MTN to have submitted a return, treating the vouchers as falling under section 10(18); and where this is rejected by SARS, to then have submitted an objection per the SARS dispute process.
- On the substantive issue, SARS contended that the factual position as to *"how the vouchers are purchased, what information is provided to customers and the manner in which the vouchers are actually used"* was unclear and ambiguous, noting MTN's terms and conditions.
- SARS argued that it wasn't clear on what "airtime" actually connoted, and that MTN's terms and conditions supported this view.
- Put simply, SARS' position was that it was unclear that the services to which holders of the pre-paid vouchers were entitled were not specified by usage or arrangement. If they were so specified, then the pre-paid vouchers would fall under s 10(19).

Mobile Telephone Networks (Pty) Ltd v CSARS

Findings of the Court

- The SCA found in favour of SARS, and upheld the appeal accordingly. A cost order was awarded against the taxpayer.
- The SCA ruled that that declaratory relief in tax matters will be considered in limited circumstances and where there are clear, uncontested facts. Other factors can also weigh in on such decisions, but the Court raised the concern of opening 'floodgates for applications to court where certainty is sought from the court prior to applying a new strategy'.
- It was held that this was not a matter where there was "a set of clear, sufficient, uncontested, facts". As such, the SCA found that the High Court erred in holding that *"no … further facts or information would alter the respondent's legal view"* and that MTN's declaratory application was properly before the Court.
- Furthermore, even if the facts were clear and uncontested, it was doubtful whether this matter warranted the exercise of the discretion of the High Court regarding the declaratory relief.
- On the basis of the foregoing, the second (substantive) issue in consideration could not be decided.

YOUR KEY TO THE TAX COMMUNITY