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TAX CHRONICLES MONTHLY

Official Journal for the South African Tax Professional

TAX ADMINISTRATION
REDACTING DOCUMENTS REQUESTED BY SARS

VALUE-ADDED TAX
THE VAT REFUND PROCESS

TRUSTS
IS YOUR TRUST TAX COMPLIANT?

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SARS INTEREST RATES

TAX, VAT, FRINGE BENEFITS, LOANS, DONATIONS TAX AND DIVIDENDS TAX

The decrease in the repo rate announced by Treasury in September 2024, currently only affects certain SARS rates; further reductions in rates are likely.

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

- **Income tax, provisional tax, dividends tax, etc**

  Payable to SARS on short payments of all such taxes (other than VAT): 11.75% per annum with effect from 1 September 2023 (unchanged).

  Payable by SARS on refunds of tax (where interest is applicable): 7.75% per annum with effect from 1 September 2023 (unchanged).

  If the refund is made after a successful tax appeal or where the appeal is conceded by SARS, the interest rate is 11.75% per annum with effect from 1 September 2023 (unchanged).

- **VAT**

  Payable to SARS on late payments: 11.75% per annum with effect from 1 September 2023 (unchanged).

  Payable by SARS on VAT refunds after prescribed period: 11.75% per annum with effect from 1 September 2023 (unchanged).

- **Fringe benefits**

  Official interest rate for loans to employees, below which a deemed fringe benefit arises: 9.00% per annum with effect from 1 October 2024 (was 9.25% per annum with effect from 1 June 2023). See below for details of historical changes.

- **Dividends tax**

  Official interest rate for loans (designated in rands) to shareholders, below which the interest on such loans can be deemed to be dividends on which dividends tax is payable: 9.00% per annum with effect from 1 October 2024 (was 9.25% per annum with effect from 1 June 2023). See below for details of historical changes.

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

- **Donations tax**

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

- **Penalties**

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

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

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

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

  For employees' tax purposes, the amount of the tax benefit must be calculated as accruing to the employee with reference to whenever interest is payable; if not regularly, then on a monthly basis for monthly paid employees, weekly for weekly paid employees, etc.

- Subject to a number of exceptions, distributions of income and capital gains from a company / close corporation are normally subject to dividends tax at the flat rate of 20%. Loans or advances to or for the benefit of a shareholder / member will be deemed to be dividends but only to the extent that interest is not charged on the loan at the "official" rate (or market-related rate in the case of foreign currency loans) and to the extent that fringe benefits tax is not payable on an interest-free (or subsidised-interest) loan where the shareholder is an employee.

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

- Loans to trusts by connected natural persons with interest charged below the official rate create a donation subject to donations tax at 20% (25% if cumulative lifetime donations of the donor amount to more than R30m) on the interest forgone each year.

- With effect from 1 March 2011, the official rate has been defined as the rate of interest equal to the South African "repo rate" plus 1%. For foreign-currency loans, the rate is the equivalent of the foreign "repo rate" plus 1%. The South African repo rate currently stands at 8% per annum (with effect from 1 October 2024).

THE "OFFICIAL" RATE OF INTEREST OVER THE PAST FIVE YEARS

With effect from		*Rate per annum*
1 December 2018	–	7.75%
1 August 2019	–	7.50%
1 February 2020	–	7.25%
1 April 2020	–	6.25%
1 May 2020	–	5.25%
1 June 2020	–	4.75%
1 August 2020	–	4.50%
1 December 2021	–	4.75%
1 February 2022	–	5.00%
1 April 2022	–	5.25%
1 June 2022	–	5.75%
1 August 2022	–	6.50%
1 October 2022	–	7.25%
1 December 2022	–	8.00%
1 February 2023	–	8.25%
1 April 2023	–	8.75%
1 June 2023	–	9.25%
1 October 2024	–	9.00%

Kent Karro

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

SARS' MODERNISATION PROGRAMME

In an era where technology governs nearly every aspect of our lives, SARS has embraced cutting-edge advances to revolutionise tax compliance and surveillance.

Through the SARS Modernisation Programme, the revenue authority is prioritising essential and beneficial strategic initiatives to enhance voluntary compliance, increase public trust, and create a lean, integrated, and data-driven organisation.

THE RISE OF INTELLIGENT TAX SURVEILLANCE

SARS' transformation is fuelled by the integration of artificial intelligence (AI) and machine learning technologies, which have significantly upgraded its operational capabilities. These advances allow for the automation of routine tasks and the enhancement of data analysis, ensuring that no evasion attempt goes unnoticed. By leveraging these technologies, SARS is not only improving efficiency but also creating a more vigilant tax system.

AI is therefore at the core of SARS' modernisation efforts. It enables the analysis of vast amounts of data to detect patterns and anomalies that may indicate non-compliance. Through sophisticated algorithms, AI can identify discrepancies in tax filings, unusual financial transactions, and other indicators of potential tax evasion. This proactive approach allows SARS to address issues before they escalate, thereby ensuring higher compliance rates.

As an example, AI tools can mine data from various sources, including social media and transaction records, to detect inconsistencies and potential fraud. This enables enhanced detection by SARS, and raises the non-compliance flag.

GLOBAL AND LOCAL ACCESS

SARS' reach extends beyond South Africa's borders through its participation in international information-sharing initiatives. Collaborating with over 140 countries, SARS has access to foreign asset information, providing a comprehensive view of taxpayers' global financial activities. This global network ensures that individuals and businesses cannot hide assets or income abroad to evade taxes.

In addition to international collaborations, SARS has strengthened its domestic surveillance capabilities through partnerships with local banks. These partnerships grant SARS access to bank statements and other financial data, enabling the agency to cross-check declared incomes against actual financial activities. This level of scrutiny ensures that discrepancies are quickly identified and addressed.

IMPLICATIONS FOR TAXPAYERS

The integration of AI and data-driven insights into SARS' operations has significant implications for taxpayers.

Here is what one needs to know:

1. The advanced analytical capabilities of AI mean that even minor discrepancies in tax filings can be detected. Taxpayers should ensure that all income and assets are accurately reported to avoid penalties.

2. With access to international financial data, taxpayers can no longer hide assets or income in foreign accounts. Full disclosure is essential to stay compliant.

3. Local collaborations with banks mean that SARS can easily verify the accuracy of reported incomes against actual bank transactions. Taxpayers should ensure that their financial declarations match their banking records.

4. To avoid the hard and costly consequences of non-compliance, taxpayers should consider seeking professional tax advisory services. Engaging with SARS legally and correctly from the outset can safeguard against potential penalties or criminal charges.

STRATEGIC OBJECTIVES AND FUTURE TRENDS

SARS remains committed to its strategic objectives, focusing on making compliance easier for taxpayers and traders, increasing public trust, and transforming into a data-driven organisation. The SARS Modernisation Programme is pivotal in achieving these goals, positioning the revenue authority at the forefront of technological innovation.

As SARS continues to enhance its surveillance capabilities, taxpayers must stay informed and proactive in their compliance efforts. The integration of AI and global information exchange initiatives marks a new era in tax administration, where transparency and accuracy are paramount.

The future of tax compliance is here, driven by technology and data. SARS' use of artificial intelligence and international collaborations has transformed its approach to tax surveillance, making non-compliance both hard and costly. By staying informed and ensuring accurate financial reporting, taxpayers can navigate this new landscape and contribute to a fair and transparent tax system.

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Tax Consulting SA

Tags: tax compliance; voluntary compliance; artificial intelligence (AI).

CFC RULES AND SA DIVIDENDS

INTRODUCTION

The controlled foreign company (CFC) rules are contained in section 9D of the Income Tax Act, 1962 (the Act), and are designed as an anti-avoidance provision to prevent accumulation of (essentially) passive income in foreign companies owned by South African-resident shareholders, as opposed to being taxed in South Africa.

"The CFC rules are lengthy and complex with a number of exemptions and exceptions to the exemptions, and these are beyond the scope of this article, which focuses on an amendment introduced in 2020."

The CFC rules are lengthy and complex with a number of exemptions and exceptions to the exemptions, and these are beyond the scope of this article, which focuses on an amendment introduced in 2020 as an adjunct to the exchange control relaxation of the so-called "loop" rules.

GENERAL PRINCIPLES

The general principle in relation to the CFC rules is that the foreign company's taxable income (where any of the exemptions do not apply) is calculated in terms of the requirements under the Act, and then an amount equal thereto is included in the (taxable) income of each South African-resident shareholder, pro-rata to their shareholding.

In doing so, no account is taken of the identity of the South African shareholder. For example, if a CFC makes a capital profit on disposal of an asset, the capital gain is calculated as being 80% thereof, so that an individual who is a shareholder will be taxed at 45% of that capital gain, giving rise to an effective tax rate of 36%, as opposed to the effective 18% CGT rate otherwise applicable to natural persons.

A similar problem arises with foreign dividends. In general, if a South African-resident company earns a foreign dividend which is taxable in South Africa, the taxable portion of the dividend is determined by multiplying the dividend by the ratio of 20 to 27. When that taxable portion is multiplied by the company tax rate of 27%, the effective tax rate is 20% (ie, R100*20/27*27% = R20). On the other hand, a foreign dividend received by an individual results in a taxable amount equal to the foreign dividend multiplied by the ratio of 20 to 45, and when this taxable amount is multiplied by the individual rate of 45%, the effective rate of tax on the dividend is also 20% (ie, R100*20/45*45% = R20).

However, for CFC purposes the taxable portion of the foreign dividend is still multiplied by the corporate ratio of 20 to 27. So if the shareholder is an individual and the taxable portion of the dividend is multiplied by 45%, the effective rate is not 20% but 33.33%.

THE LOOP PROVISIONS

In the past, there used to be a total prohibition imposed by the Reserve Bank on so-called loop arrangements, where South African residents were directly or indirectly interested in an offshore structure that, in turn, held assets in South Africa. These rules have gradually been relaxed and, while theoretically they have been abolished, in practice there are still certain restrictions on them.

One of the requirements to facilitate further relaxation of the loop rules was that certain amendments needed to be made to the Act, and particularly in relation to the CFC rules. For the purposes of this article, the focus is on the treatment of South African dividends payable by a South African company to an offshore holding company which is a CFC.

PRIOR TO THE AMENDMENT

As is well known, leaving aside exemptions applicable to certain categories of South African resident shareholders, the rate of dividends tax to be withheld from a dividend distributed by a South African company is 20%. In the case of a foreign shareholder this rate may be reduced in terms of an appropriate double tax agreement. Particularly in the case of foreign corporate shareholders, the rate could generally be reduced to as low as 5%.

So assume that the shares in a South African company (SACo 1) are held by a holding company in Mauritius (MCo), the rate of withholding tax will, under the double tax agreement between the two countries, be reduced from 20% to 5%. If the shares in MCo were held by South African residents to the extent of more than 50%, then MCo would be a CFC. However, because MCo's taxable income had to be determined in terms of the Act, the dividend from SACo 1 was not taxable; this is the case because South African dividends are exempt from income tax (albeit subject to the dividends tax, which is a separate tax).

SUBSEQUENT TO THE AMENDMENT

As mentioned, the purpose of the amendment was to facilitate the relaxation of the loop rules for exchange control purposes, but without resulting in a reduction of the South African tax base. As demonstrated, this could result in a reduction of dividends tax from 20% to 5%.

Accordingly, the exemption from income tax normally applicable to South African dividends was partially removed under section 9D of the Act in calculating the CFC's taxable income. The removal of the exemption depended upon the extent to which dividends tax was actually payable. So, for example, if the dividends tax rate was 20% (because the CFC was resident in the jurisdiction where there was no double tax agreement), then the South African dividend effectively retained its full exemption for CFC purposes. But if the withholding rate was only 5%, such as under the treaty with Mauritius, then effectively 75% of the dividend was brought into the net, and then that amount of 75% was multiplied by the ratio of 20 to 27 to give the taxable amount.

EFFECT OF THE AMENDMENT

So consider the situation where a South African company (SACo 2) is the shareholder of MCo. In computing the taxable income on a dividend from SACo 1 of, say, R1 million, from which 5% or R50 000 was withheld as dividends tax, 75% of the dividend would be multiplied by the ratio of 20 to 27 to arrive at the taxable income of MCo. That taxable income would then be taxable in the SACo 2's hands at the rate of 27%, and the tax so computed will amount to R150 000 (ie, R1 000 000*75%*20/27*27%). So if this amount is then added to the R50 000 withheld by SACo1 as dividends tax, it results in a total South African tax of R200 000, which represents the headline withholding tax rate of 20% on a dividend of R1 million.

PROBLEMS WITH THIS APPROACH

The first problem is to ask why a South African corporate shareholder of the CFC (SACo 2 here) should be subject to 20% tax on the dividend from the South African company (SACo 1 here). After all, if MCo had not been interposed between SACo 2 and SACo 1, SACO 2 would not have been taxable on the dividend at all because a dividend from one South African company to another South African company is exempt from dividends tax. So here a dividend is being subject to tax at 20% where, but for the loop, it would have been zero. One must therefore ask, where is the prejudice to the South African tax base? In fact, with the MCo being interposed there is still the withholding of R50 000, which would not have been payable had MCo not existed in the chain of ownership. And, what is more, with SACo 2 having been taxed directly and indirectly to the extent of R200 000, if it receives a dividend from MCo and on-distributes it to its (non-corporate) shareholders, there will be further dividends tax at the rate of 20%.

The second problem arises where the shareholder of MCo is an individual or a trust. Once again, applying the formula, the taxable income of MCo under the CFC rules will be 75% of the dividend of R1 million multiplied by the ratio of 20 to 27. When this taxable income is taxed under the CFC rules in the hands of the shareholder, it is multiplied by 45%. This results in tax payable of R250 000 (ie, R1 000 000*75%*20/27*45%) so that, when added to the withholding tax of R50 000, it gives a total effective tax rate of 30% – much more than the 20% by which the tax base has supposedly been prejudiced. This now becomes punitive rather than it merely being a case of protecting the tax base to enable the fiscus to receive what should have been received but for the interposition of MCo.

Ernest Mazansky

Werksmans Attorneys

Acts and Bills

- Income Tax Act 58 of 1962: Section 9D.

Other documents

- Controlled foreign company (CFC) rules (contained in section 9D of the Income Tax Act).

Tags: controlled foreign company (CFC) rules; foreign dividend; loop arrangements; corporate shareholder.

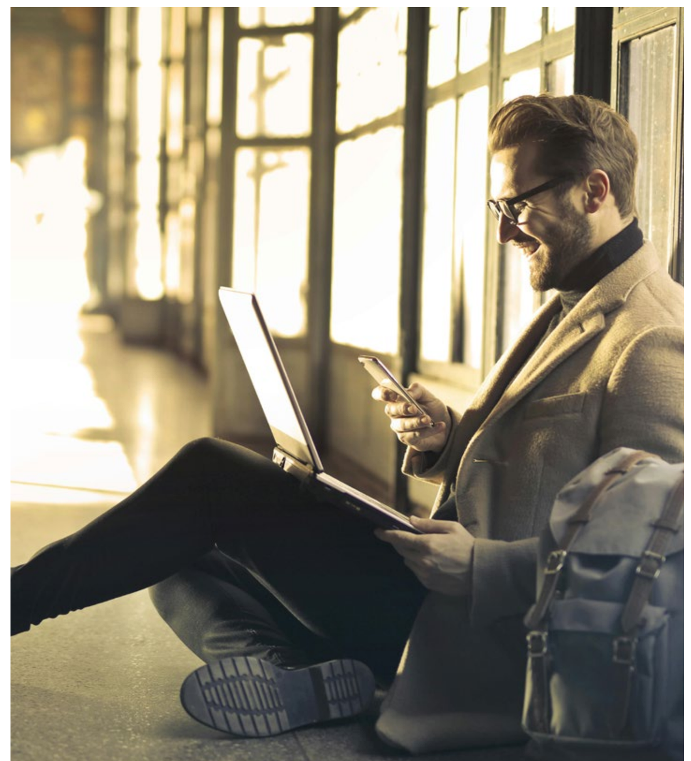
TAX CONSIDERATIONS, INCLUDING POTENTIAL REPORTABLE ARRANGEMENT OBLIGATIONS, FOR NON-RESIDENTS WITH REMOTE EMPLOYEES IN SOUTH AFRICA

Improved technology, relaxed work-from-home policies and an increased trend toward globalisation have allowed employees to continue working for the same employer, but from a foreign jurisdiction.

This article aims to address some of the tax risks and obligations for non-residents with employees working in South Africa.

BACKGROUND

South Africa has a residence-based system of tax. Any resident, as defined in section 1(1) of the Income Tax Act, 1962 (the Act), subject to exemptions, deductions and other provisions, is subject to income tax on their worldwide income. By contrast, any non-resident is only subject to tax on income from an SA source. A company is "resident' in South Africa for income tax purposes if it is either incorporated, established or formed in South Africa or if it has its place of effective management (POEM) in South Africa, provided that it is not deemed to be exclusively a resident of another country for purposes of a double taxation agreement (DTA) between South Africa and that other country.



PERMANENT ESTABLISHMENTS

Notwithstanding the fact that a company formed outside of South Africa might be able to satisfactorily prove that its POEM will remain in the foreign jurisdiction (and therefore that it should be exclusively tax resident in the foreign jurisdiction and not in South Africa), there remains a potential risk for non-resident companies that involves the concept of a permanent establishment (PE).

In terms of DTAs entered into between South Africa and many foreign jurisdictions, South Africa has taxing rights over business profits of a resident of the other jurisdiction to the extent that the business profits are attributable to a PE in South Africa of that non-resident. For purposes of this article, the concept of PEs will not be considered in detail, but rather in the context of employees of non-resident companies who are present in South Africa.

A PE is defined in section 1(1) of the Act to mean a PE as defined from time to time in Article 5 of the Model Tax Convention on Income and on Capital of the Organisation for Economic Co-operation and Development (OECD MTC). Under Article 5(1) of the OECD MTC (and most DTAs), a PE is "a fixed place of business through which the business of an enterprise is wholly or partly carried on".

SARS has not published guidance on whether an employee's home office could constitute a "fixed place of business" for purposes of interpreting the PE definition. However, the OECD's Commentary on the OECD MTC (the OECD Commentary) specifically addresses the use of home offices, and South African courts have in the past considered the OECD Commentary in interpreting DTA articles. According to the OECD Commentary, if a home office is used on a continuous basis for carrying on business activities for an enterprise and it is factually clear that the company has required the individual to use that location to carry on the enterprise's business, such a home office may be considered to be at the disposal of the company and to constitute a PE.

It is worth noting that even if an enterprise does not have a fixed place of business in South Africa, a dependent agent who acts on behalf of an enterprise in a certain manner can still create a PE for the non-resident enterprise.

PEs are a complex concept which should be analysed in detail, having sufficient regard to legislation and the applicable DTA as may be modified by the Multilateral Convention to implement tax treaty-related measures to prevent base erosion and profit shifting (the so-called "MLI" or "Multilateral Instrument").

PAYROLL IMPLICATIONS

An employer that is a resident must register for and withhold employees' tax (PAYE) on remuneration paid to employees. Previously, non-resident employers had an obligation to withhold PAYE on remuneration paid to employees if the employer had a "representative employer" in South Africa. A representative employer that resides in South Africa is essentially any agent with the authority to pay remuneration. However, the Tax Administration Laws Amendment Act, 2023, in section 13, amended paragraph 2(1) of the Fourth Schedule to the Act. A non-resident employer conducting business through a PE in South Africa is now required to deduct PAYE from remuneration paid to its employees, unless SARS directs otherwise. These non-resident employers must also register as "employers" with SARS for PAYE purposes if they have any employees with a tax liability in South Africa.

Due to the wording of the Unemployment Insurance Fund (UIF) and Skills Development Levy (SDL) legislation, a misalignment exists. A non-resident employer would usually still be obligated to pay UIF and SDL to SARS relating to its employees in South Africa, even if the company does not have a representative employer or PE in South Africa.

REPORTABLE ARRANGEMENTS

If an employee has established a PE for a non-resident entity in South Africa, further implications could arise for the non-resident entity in relation to Reportable Arrangements in terms of the Tax Administration Act, 2011 (the TAA), particularly in terms of paragraph 2.6 of Government Notice 140 (issued on 3 February 2016). In these circumstances, a reportable arrangement could arise if payments exceeding R10 million in aggregate are made for services rendered by the non-resident entity to persons who are neither residents nor its employees. For example, if payments by the non-resident entity are made to another non-resident company that will have its employees physically present in South Africa for the purpose of rendering services to the non-resident entity (and if the other requirements discussed below are met).

Sections 34 to 39 of the TAA mandate the disclosure of certain transactions to SARS, known as "reportable arrangements". An "arrangement" qualifies as a "reportable arrangement" (as defined in section 34) if it meets specific characteristics outlined in section 35(1) of the TAA or if it is specifically listed by the Commissioner for SARS in a Public Notice. In this regard, Public Notice 140 was issued on 3 February 2016 in accordance with section 35(2) (the Notice).

According to paragraph 2.6 of the Notice, an arrangement will constitute a reportable arrangement if it involves service fee payments made by a South African resident, or a non-resident with a PE in South Africa, to a non-resident. These services include consultancy, construction, engineering, installation, logistical, managerial, supervisory, technical or training services. Additionally, the expenditure for these services on or after the date of publication of the Notice should exceed or be reasonably expected to exceed R10 million and should also not qualify as remuneration for employees' tax purposes. Also, a person that is a not a resident or an employee, agent or representative of that person must either be physically present in South Africa or be anticipated to be physically present in South Africa, in connection with or for purposes of rendering those services.

In terms of section 37 of the TAA, a "participant" (as defined in section 34) in a reportable arrangement must report that reportable arrangement to SARS within 45 business days of the arrangement qualifying as reportable arrangement, or if the participant becomes a participant in an arrangement after the arrangement qualifies as a "reportable arrangement" , within 45 business days of becoming a "participant". A "participant" includes a "promoter' in relation to the arrangement, any person who directly or indirectly derives or is assumed to derive a tax benefit or financial benefit from the arrangement or any other party to an arrangement listed in a public notice.

Therefore, if the above criteria for a reportable arrangement are met, both the person performing the listed services and the South African resident (or non-resident with a PE in South Africa) have an obligation to report the arrangement. However, section 37(3) of the TAA states that a "participant" need not report a reportable arrangement if a written statement from any other "participant"' is obtained that the other "participant' has disclosed the reportable arrangement. Failure to disclose a reportable arrangement can result in significant penalties imposed by SARS.

CONCLUSION

The above discussion has highlighted various risks for non-residents with employees in South Africa. It is important for such non-residents to be mindful of the potential tax consequences to avoid the imposition of the various penalties and interest that may result from non-compliance with the provisions of the relevant legislation.

Martin Groenewald

BDO

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definitions of "permanent establishment" & "resident"); Fourth Schedule: Paragraph 2(1);
- Tax Administration Act 28 of 2011: Sections 34 to 39 (specific reference to sections 34 (definitions of "arrangement", "participant" and reportable arrangement"), 35(1) & 37);
- Tax Administration Laws Amendment Act 18 of 2023: Section 13;
- Unemployment Insurance Act 63 of 2001;
- Skills Development Levies Act 9 of 1999.

Other documents

- Model Tax Convention on Income and on Capital of the Organisation for Economic Co-operation and Development (OECD MTC): Article 5 (definition of "permanent establishment");
- Public Notice 140 (issued on 3 February 2016 in accordance with section 35(2) of the TAA): Paragraph 2.6 (an arrangement qualifies as a "reportable arrangement" if it meets specific characteristics . . . or if it is specifically listed by the Commissioner for SARS in a Public Notice).

Tags: residence-based system of tax; place of effective management (POEM); double taxation agreement (DTA); fixed place of business; Multilateral Instrument; representative employer; non-resident employer; reportable arrangement.

REDACTING DOCUMENTS REQUESTED BY SARS

Section 46 of the Tax Administration Act, 2011 (the TAA), allows the South African Revenue Service (SARS) to require a taxpayer to submit relevant material to SARS for purposes of administering an Act. In the judgment of Commissioner for the South African Revenue Service v J Company, *[2024], SARS' authority under section 46 came under the scrutiny of the Western Cape Division of the High Court.*

In terms of section 46, SARS is authorised to require "relevant material" relating to a taxpayer, "whether identified by name or otherwise objectively identifiable", from the taxpayer or another person within a reasonable period, to administer a tax Act. The term "relevant material" is defined in section 1 of the TAA as "any information, document, or thing that SARS considers to be foreseeably relevant for the administration of a tax Act […]".

SARS, as the applicant, sought an order compelling the taxpayer to comply with its obligation to respond in full to requests directed to it in terms of section 46. The taxpayer responded to the notices with the requested information and supporting documents; however, most of these documents had been heavily redacted. The crisp issue addressed in this matter was whether SARS had the authority to compel the taxpayer to produce these documents free of redaction.

SARS argued that by requesting the unredacted documents it was lawfully exercising its powers under section 46. In addition, SARS argued that by responding to the notices, the taxpayer acknowledged that the documents it produced fell within the scope of the section which, in the opinion of SARS, established a reasonable basis for requesting the unredacted documents. SARS also argued that it has a right to the unredacted documents because the redacted information falls within the ambit of section 46 as it relates to how the taxpayer interacts with clients and service providers, and, as a result, their identities are related to the administration of a tax Act in relation to a taxpayer. Lastly, SARS argued that with respect to the notices, it was inaccurate to hold that an expansion of the target of the notices to the taxpayer, its clients, and service providers constituted a so-called "fishing expedition".

Whilst the taxpayer claimed to have provided SARS with the requested information, on legal advice from its attorneys, it redacted portions of the documents that – in its view – fell outside the "legitimate ambit of section 46". The taxpayer also argued that SARS failed to provide the basis on which it formed the opinion that the requested information was relevant to the administration of a tax Act. According to the taxpayer, a mere assertion by SARS of its opinion without any reasonable grounds is insufficient. The taxpayer believed that SARS did not issue a section 46 notice to obtain relevant information about its tax affairs, but rather to conduct an "open-ended fishing expedition" related to its clients. The taxpayer submitted that a valid section 46 notice may pertain to tax information not only of the taxpayer but also of "taxpayers in an objectively identifiable class of taxpayers" as specified in section 46(2)*(a)* of the TAA. The taxpayer contended that SARS, in making unspecific reference to the taxpayer's clients and service providers, failed to meet this requirement. Finally, the taxpayer submitted that SARS had not remained consistent in its notices, arguing that it was only in the second section 46 notice that SARS considered the requested material "to be foreseeably relevant for the administration of a tax Act in relation to it [the taxpayer] and/or clients and service providers".

Judge Kusevitsky held that in most cases SARS does not have knowledge of the information or documents available for it to fully exercise its function of assessing a taxpayer's tax liability and that it is for this reason that SARS needs a mechanism to enable it to fulfil its functions. This mechanism (section 46), according to Kusevitsky, imposes a reciprocal duty on the taxpayer to supply SARS with the necessary information to enable it to perform its functions.

The taxpayer claimed that SARS did not provide an objective basis on which it formed its opinion regarding the requested information's relevance for administering a tax Act and that the words "in the opinion of SARS" contained in the Act create this issue as they insulate SARS from having to do anything more than state that it has formed an opinion. However, the judge held that since the information required to make this decision lies solely within the taxpayer's knowledge, SARS has limited information at its disposal to make such a determination. Kusevitsky further held that if the taxpayer then withholds such information, it cannot then assert that SARS could not have applied its mind simply because it has not disclosed the basis on which the decision was made.

The judge concluded that it is not unreasonable for SARS to request the unredacted documents and information and that it is not for the taxpayer to say that SARS has failed to provide the basis to prove that the documents may be "foreseeably relevant" when the taxpayer is the one obstructing the very production of the material for the determination of relevance to be made. Furthermore, Kusevitsky remarked that although the taxpayer did not claim privilege as a basis for its refusal to provide un-redacted documents, the nature of the redacted information would have rendered that argument unsuccessful.

This remark by Kusevitsky emanates from the distinguishable case of *A Company and Others v Commissioner for the South African Revenue Service,* [2014], in which the applicants applied for a declaratory order that certain content of two fee notes rendered by their attorneys was subject to legal privilege. In delivering this judgment, Judge Binns-Ward indicated that the vast majority of the redactions in respect of which the taxpayer purported to assert privilege were not awarded. However, three of the redacted passages qualified for the assertion of legal advice privilege and the judge declared that the identified portions of the tax invoice of the attorneys of the applicants are protected from being disclosed to SARS by reason of legal advice privilege.

The lesson for taxpayers is that they ought to carefully consider the basis upon which redacted information is provided to SARS and to seek advice from experienced tax lawyers before doing so.

"Whilst the taxpayer claimed to have provided SARS with the requested information, on legal advice from its attorneys, it redacted portions of the documents that – in its view – fell outside the 'legitimate ambit of section 46.'"

Arnaaz Camay & Nqobile Sithole

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Acts and Bills

- Tax Administration Act 28 of 2011: Sections 1 (definition of "relevant material") & 46 (specific reference to subsection (2)*(a)*).

Other documents

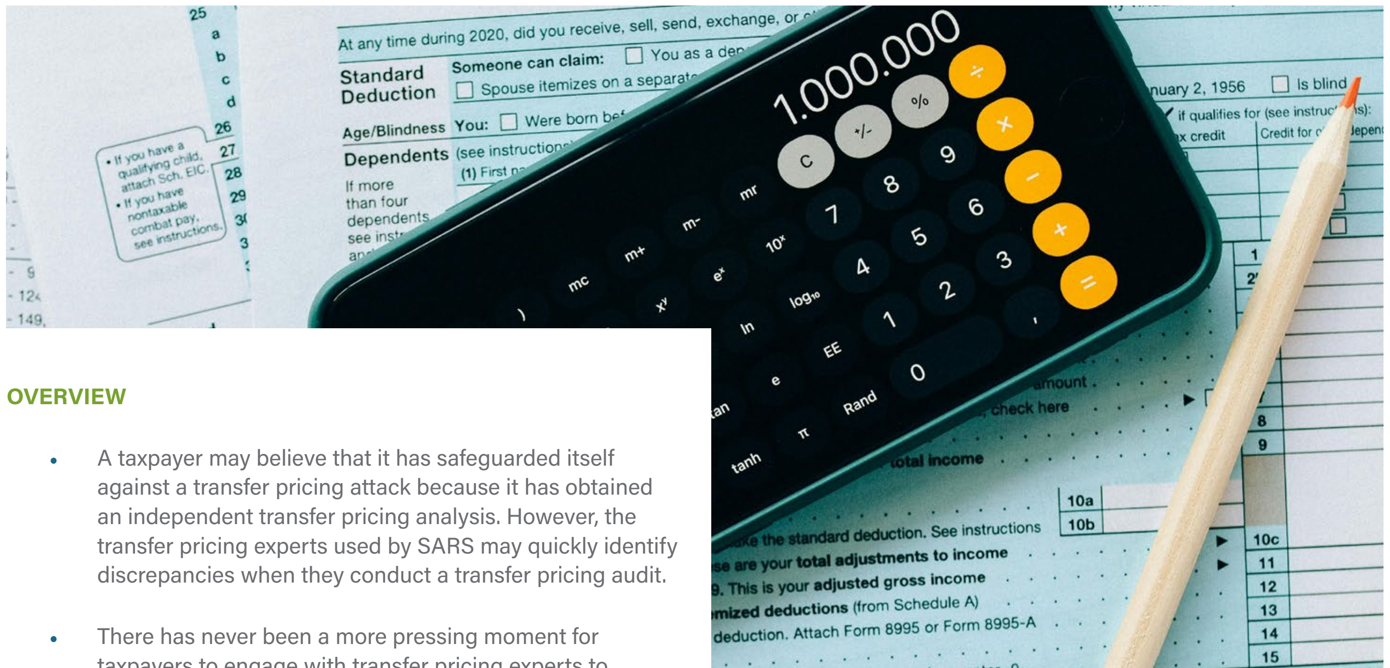
- Section 46 notices.

Cases

- *Commissioner for the South African Revenue Service v J Company* (14944/19) [2024] ZAWCHC 63; [2024] JDR 0900 (WCC) (29 February 2024);
- *A Company and Others v Commissioner for the South African Revenue Service* (16360/2013) [2014] ZAWCHC 33; [2014] (4) SA 549 (WCC) (17 March 2014).

Tags: relevant material; unredacted documents; foreseeably relevant.

TRANSFER PRICING AUDITS



OVERVIEW

- A taxpayer may believe that it has safeguarded itself against a transfer pricing attack because it has obtained an independent transfer pricing analysis. However, the transfer pricing experts used by SARS may quickly identify discrepancies when they conduct a transfer pricing audit.
- There has never been a more pressing moment for taxpayers to engage with transfer pricing experts to undertake an independent audit to confirm that the functional analysis has been performed correctly and reflects the actual functions performed, assets used and risks involved in the context of intra-group cross-border transactions. This will enable such experts to prepare a transfer pricing defence file to prepare the taxpayer to defend a transfer pricing dispute with SARS.

It has been widely reported that the South African Revenue Service (SARS) is focusing on taxpayer compliance with the aim of collecting additional tax revenue. Further, SARS is gradually rebuilding its capacity and technical skills with an emphasis on hiring transfer pricing specialists. Auditing cross-border related-party arrangements is seen as an easy way to address the shortfall. This creates the expectation that SARS will be more active, with taxpayers experiencing an increase in transfer pricing-related queries and audits often leading to litigation.

In line with global trends, South African tax law has evolved over the past few years, increasing the compliance requirements related to transfer pricing. Most multinational enterprises are required to prepare and submit a transfer pricing master file and a local file. Higher revenue-earning multinational enterprises are also required to attend to country-by-country reporting. These international reporting initiatives will be further enhanced with the implementation of the so-called Pillar 1 and Pillar 2, which aim to address tax avoidance and ensure coherence with international tax rules.

"To prepare a transfer pricing policy defence, taxpayers need to engage a competent transfer pricing expert to perform and document a functional and economic analysis."

The evidence of the change of focus by SARS is illustrated by the recent decision on a transfer pricing dispute (between *ABD Limited and the Commissioner for the South African Revenue Service*) by the Gauteng Tax Court (heard on 14 February 2024). SARS attacked the transfer pricing arrangements by the taxpayer (ABD Limited), even though the taxpayer had obtained independent confirmation by a transfer pricing expert on its cross-border pricing arrangements. SARS presented evidence of its own independent analysis by two transfer pricing experts, which contradicted the pricing recommended by the expert used by the taxpayer. Fortunately, the taxpayer won the case, essentially due to a misunderstanding of the nature of the relevant intra-group agreement by the SARS transfer pricing specialist..

To prepare a transfer pricing policy defence, taxpayers need to engage a competent transfer pricing expert to perform and document a functional and economic analysis. The functional analysis aims to identify the functions, assets and risks involved in the cross-border intra-group activities of the enterprise and to determine key strategic insights into the inner workings of such business. It should provide an understanding of the relative contributions of the parties to the transaction and their roles in overall value creation. The results of the functional analysis are then used to perform the economic analysis, which aims to identify independent comparable supplies of goods or services and to select appropriate methodologies to determine the acceptable range of arm's length pricing.

Taxpayers should also prepare appropriate intra-group agreements to evidence their intra-group cross-border transactions. Preparation of such intra-group agreements should be viewed as a critical part of the taxpayer's transfer pricing documentation. These agreements need to accurately reflect the actual functions undertaken and assets used, and which entity takes responsibility for any risks flowing from such agreements. It is advisable to first undertake a functional analysis before the agreements are drafted, since the actual functions and risks involved are often incorrectly reflected in such agreements.

A key aspect of any functional analysis is to determine whether the intra-group cross-border agreements actually reflect the real activities, assets and risks involved in the transactions with other group companies. Discrepancies can have a material impact on the subsequent economic analysis and thus the pricing applied to the transaction.

When the intra-group agreements correctly reflect the information contained in the functional analysis, this mitigates the potential tax exposure and improves the chances of a successful defence in the case of a SARS audit. If the pricing of supplies under such intra-group agreements is determined based on intra-group agreements that do not correctly reflect reality, the independent analysis is not valid and can be contested by SARS. Furthermore, the contract must clearly outline the rights and obligations of the parties to avoid an incorrect economic analysis, as illustrated by the misunderstanding of the SARS transfer pricing specialist in the *ABD Limited* case.

Multinational enterprises must not only have documentation to support their transfer pricing, but also a deeper understanding of their cross-border transactions with related parties at all levels of their organisations involved in such transactions. The <u>most</u> critical aspect is to ensure that what is happening in practice (ie, in the factory, the research and development team, the logistics team, the financial disclosure team, etc) aligns with what has been documented in the intra-group agreements. By way of example, if an agreement provides that the South African supplier of goods takes the risk of the transport and delivery of the goods to the foreign group company, the goods cannot then be delivered free on board (FOB) to the local port. Larger organisations, with many "moving parts/ bodies" are most at risk. Aligning the activities of employees to what is documented between the parties and recorded in the functional analysis is crucial. Getting this wrong is likely to lead to a taxpayer's downfall in court, as witnesses who are called to testify may contradict the facts as reflected in the contractually agreed arrangement.

Therefore, a taxpayer may be of the view that the enterprise is safeguarded against a transfer pricing attack because it has obtained an independent transfer pricing analysis. However, the transfer pricing experts used by SARS may quickly identify discrepancies when they conduct a transfer pricing audit.

Taxpayers need to engage with experts to undertake an independent audit to confirm that the functional analysis has been performed correctly and reflects the actual functions performed, assets used and risks involved in the context of intra-group cross-border transactions to ensure that the taxpayer is prepared to defend a transfer pricing dispute with SARS.

Esther Geldenhuys, Marvin Petersen, Robyn Berger & Wally Horak

Bowmans

Other documents

- Base Erosion and Profit Shifting (BEPS) initiative of the Organisation for Economic Cooperation and Development (OECD): Pillar One and Pillar Two (aiming to address tax avoidance and ensure coherence with international tax rules).

Cases

- Transfer pricing dispute between *ABD Limited and the Commissioner for the South African Revenue Service* [2024] SARSTC *IT 14302* [14 February 2024].

Tags: intra-group cross-border transactions; country-by-country reporting; intra-group agreements.

CAN TRUSTS RELY ON DOUBLE TAX AGREEMENTS?

When setting up a foreign structure, discretionary trusts are a useful planning tool for Ultimate Beneficial Owners (UBOs).

If set up and funded sensibly, discretionary trusts offer many benefits such as continuity of ownership of assets in the case of the death of one of the UBOs, protection against creditors, protection against the volatile South African exchange rates as well as protection against the dreaded exit tax where SA resident UBOs emigrate.

This article looks at the question as to whether international trusts can benefit from the various reliefs provided by double tax agreements (DTAs).

Basically, the question is whether a trust is a "person" for DTA purposes. The answer, as so often in the world of tax, is "it depends".

One needs to consider Article 1: "*Persons covered*" and the clause that deals with the definition of "*person*", generally contained in Article 3. These two Articles determine whether the DTA could be applicable to the entities.

Article 1 of the Model Tax Convention on income and on capital of the Organisation for Economic Cooperation and Development (OECD) states that "This Convention shall apply to persons who are residents of one or both of the Contracting States". Article 3 follows with the definition of "person" being "an individual, a company and any other body of persons". Since "body of persons" is not defined one can refer to clause 3(2), wherein it states "As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a different meaning pursuant to the provisions of Article 25, *have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State*. (our emphasis). From a general law perspective in South Africa, a trust is not a person. However, trusts are specifically included as "persons" in the definition in section 1(1) of the Income Tax Act, 1962, which law covers DTAs.

"In common law countries, such as the United Kingdom, the United States, and many Commonwealth nations, a trust is not considered a separate legal entity but rather a legal relationship where the trustee holds property on behalf of the beneficiaries."

It follows that from a South African perspective, trusts can benefit from South African DTAs. So far so good. But is this also the case in other countries and what will it mean when there is a DTA between two countries where one sees a trust as a person and the other does not? This will depend on the domestic law (general and tax law) of the relevant country, and the answer will generally be different for civil and common law countries.

COMMON LAW VS CIVIL LAW FOR TRUSTS

In common law countries, such as the United Kingdom, the United States, and many Commonwealth nations, a trust is not considered a separate legal entity but rather a legal relationship where the trustee holds property on behalf of the beneficiaries. The trustee, who holds legal title, acts as the legal "person" for the trust. In many common law jurisdictions, the trustee is considered the taxpayer for income generated by trust assets. The trustee's residency often determines which DTAs apply, potentially reducing or eliminating withholding taxes on income such as dividends, interest, or royalties. However, if the trust is "transparent" or "flow-through", where income is taxed directly in the hands of the beneficiaries, the beneficiaries' residency becomes relevant for DTA purposes. If the beneficiaries are resident in a country which has a DTA with the income source country, they may benefit from reduced tax rates under that DTA.

On the other hand, civil law countries, such as France and Germany, do not traditionally recognise trusts as separate legal entities, and the concept of a trust as understood in common law does not exist domestically. In these jurisdictions, the application of DTAs to trusts is more complex. While some civil law countries recognise foreign trusts, the absence of a domestic trust framework can lead to uncertainties in how DTAs are applied. In such cases, the focus may still be on the residency of the trustee or beneficiaries, similar to common law countries, but there may be varied interpretations by tax authorities. Some civil law jurisdictions have introduced trust-like arrangements, such as the "*fiducie*" in France. The application of DTAs to these structures may follow rules specific to the arrangement, with a focus on the residence of the fiduciary or beneficiaries. However, the lack of recognition of trusts as legal entities in civil law countries may lead to inconsistent treatment under DTAs, particularly when dealing with foreign trusts.

Overall, in common law jurisdictions, DTAs generally apply to trusts based on the residency of the trustee or beneficiaries, while in civil law jurisdictions, the application of DTAs can be more complicated due to the lack of recognition of trusts as legal entities. The treatment under DTAs in civil law countries depends on whether the country has specific provisions or agreements that address foreign trusts or trust-like structures, leading to potential differences in tax outcomes for trusts depending on the jurisdictions involved.

CONCLUSION

The lesson to learn here is that one should not assume that trusts are persons for tax purposes and that DTAs will apply to them. As with all things tax structuring-related – careful upfront planning is needed.

Vanessa Turnbull-Kemp

Regan van Rooy

Acts and Bills

- Income Tax Act 58 of 1962: Section 1(1) (definition of "person").

Other documents

- Model Tax Convention on income and on capital (of the Organisation for Economic Cooperation and Development (OECD)): Articles 1 & 3 (specific reference to 3.1: definition of "person").

Tags: Ultimate Beneficial Owners (UBOs); double tax agreements (DTAs); common law countries; civil law countries.

IS YOUR TRUST TAX COMPLIANT?

On 4 June 2024, The South African Revenue Service (SARS) announced the 2024 income tax return filing dates for individual and trust taxpayers. This announcement brought a noteworthy change to the filing season for trust taxpayers.

Historically, the filing season for trust taxpayers aligned with that of individual taxpayers. However, trusts now have their own dedicated filing season, starting 16 September 2024 to 20 January 2025.

With 2024 being the first year that trust taxpayers are tasked with submitting third party IT3(t) returns to SARS by 30 September 2024, this change of the filing season could potentially offer a silver lining for trust taxpayers, granting them additional time to prepare for their 2024 tax return filing along with the added compliance measures that come with the submission.

Trusts have encountered a wave of compliance changes in recent years with SARS introducing enhanced compliance requirements to increase transparency and ensure that trusts are used for legitimate purposes. For settlors, trustees, donors, and beneficiaries, understanding these changes and ensuring compliance is essential.

NEW COMPLIANCE REQUIREMENTS

The new compliance measures introduced by SARS are mainly driven from international pressure to ensure enhanced compliance of trusts, and various initiatives can be directly tied to South Africa's commitments and actions aimed at exiting the grey listing as well as to ensure that trust taxpayer compliance is enabled through technology.

These measures have resulted in changes to the trust tax return and the extent of tax reporting required for trust taxpayers.

KEY CHANGES TO THE TRUST TAX RETURN

In 2023, significant amendments were made to the trust income tax return, with these changes continuing in the 2024 tax season. Trusts must now provide more detailed information in several key areas that include:

- **Beneficial ownership**

  One major change is the requirement for the detailed disclosure of the beneficial ownership of the trust. Trusts must now provide comprehensive information about individuals, including beneficiaries identified as beneficial owners. Accurate reporting of this information is crucial for compliance.

- **Income and activities**

  Trusts are now required to disclose detailed information about their income and activities. This includes comprehensive reporting on all income sources, the nature of the trust's activities, and how these activities align with the trust's objectives. This helps SARS verify that trusts are used appropriately and transparently.

- **IT3(t) reporting**

  In line with its modernisation efforts, SARS is expanding third-party data information requirements. Trusts must now declare distributions to beneficiaries annually through IT3(t) reporting.

- **Compulsory upload of supporting documents**

  Sufficient documentation is required to support the information disclosed in the trust income tax return. Especially since all trust taxpayers are now subject to a compulsory upload of supporting documents upon filing their tax return, trusts must maintain accurate and complete supporting documents to demonstrate compliance. This includes trust financial statements, resolutions, and any other relevant documentation verifying the trust's financial activities.

ENSURING COMPLIANCE

To ensure that a trust complies with the new SARS requirements, one should consider the following:

1. **Maintain detailed records:** Ensure that there are meticulous records of all resolutions passed and financial transactions during the tax year, in order to ensure that these supporting documents are readily available to submit to SARS as part of the tax return filing.

2. **Accurate beneficial ownership disclosure:** Double-check that all beneficial owners are correctly reported and match the beneficial ownership register that is lodged with the Master of the High Court.

3. **Comprehensive reporting of income and activities:** Ensure that the trust can account for all income sources and activities, aligning them with the trust's objectives.

4. **Accurate IT3(t) form submission:** Report all amounts vested or distributed to trust beneficiaries accurately on the IT3(t) form to avoid penalties.

5. **Stay informed:** Regularly review updates from SARS and other regulatory bodies to stay up to date with the latest trust compliance requirements.

CONCLUSION

Ensuring compliance with the latest SARS requirements is essential for trusts.

By seeking professional advice, and staying informed about regulatory updates, trustees can confidently tackle these new compliance requirements.

Sidney Fletcher

Tax Consulting SA

Other documents

- Third party IT3(t) returns.

Tags: beneficial ownership; third-party data information; IT3(t) reporting.

DOMESTIC REVERSE CHARGE REGULATIONS

The long-awaited amendments to the value-added tax (VAT) Domestic Reverse Charge (DRC) Regulations on Valuable Metal were published on 10 May 2024. The amendments apply retrospectively with effect from 1 January 2024 and no transitional rules have been provided in the regulations themselves.

The amendments followed long after a public workshop was held by the National Treasury on 9 December 2022 regarding the tax proposals for the 2023 fiscal year. Annexure C to the 2023 Budget Review published in February 2023 contained several proposals relating to the DRC Regulations and draft amendments were published for public comment on 31 July 2023. The 2024 Budget Review contained only one proposed DRC amendment relating to the "primary gold sector". No other, or more recent, public workshops or consultation processes regarding the DRC amendments seem to have taken place and no revised draft of the amendments was circulated for comment prior to the publication thereof.

The DRC Regulations are an anti-avoidance measure aimed at curbing VAT refund fraud in the second-hand gold industry. The reverse charge mechanism requires the purchaser to account for VAT on the transaction (instead of the supplier) before the purchaser may claim the VAT as an input tax deduction from the South African Revenue Service (SARS). This ensures that the VAT does not "go missing" in the supply chain.

The regulations first came into effect on 1 July 2022 (with a one-month transition period) and they apply to gold-containing material supplied in certain prescribed forms between VAT-registered vendors. Before the recent amendments, gold supplied in the form of jewellery, bars, blank coins, ingots, buttons, wire, plate, granules, solution, residue, or similar forms was within scope.

The key changes to the DRC Regulations, as contained in the amendments, are summarised below.

NEW 1% *DE MINIMIS* THRESHOLD

A new 1% *de minimis* threshold has been introduced. Goods supplied in one of the prescribed forms will no longer be subject to the regulations where they contain less than 1% of gold based on gross weight.

Previously various commodities containing trace elements of gold (such as platinum group metals, silver, coal, etc) were caught by the regulations even though no value and no part of the purchase price were allocated to the gold content of the goods.

In addition, any VAT-registered businesses that acquired certain gold-containing goods as long-service awards or corporate gifts were also inadvertently affected, even though the goods may have contained very little gold.

SIX ADDITIONAL FORMS ADDED

Six additional forms have been introduced as constituting "valuable metal" to which the regulations apply, namely: sponge, powder, sheet, tube, strip, and rod. This was ostensibly done to align the ambit of the regulations (which are form-based) with the forms of unwrought and semi-fabricated precious metals found in the Precious Metals Act, 2005.

Gold is extremely malleable and has many applications. In addition to the number of unintended consequences the regulations have created since first introduced, it now appears that the culinary industry could be caught in the crosshairs. Decorative consumables such as 24-carat edible gold leaf (available in various sizes of finely hammered "sheets") and 24-carat lustre cake dust (available in "powder" form) could now be subject to the regulations. 24 Carat amounts to pure gold; therefore, it is unlikely that the 1% *de minimis* threshold will find application in this regard.

MINE "RESIDUE" TO REMAIN IN SCOPE (SUBJECT TO CERTAIN EXCLUSIONS)

One of the prescribed forms subject to the regulations is "residue", referring to aspects such as debris, discard, tailings, slurry, waste rock, and foundry sand, commonly found in the mining industry. The definition of "residue" has been clarified as relating only to that resulting from mining operations, as opposed to a potentially wider application previously believed to include gold-containing debris or discard from the general factory floor or other shop "sweeps".

This means that all "residue" from mining operations (including certain historic mine dumps) remains within the scope of the regulations, unless the transaction is zero-rated (subject to VAT at 0%, such as exports) or if the mining exclusion in the regulations applies. The mining exclusion provides that supplies of gold-containing goods produced from raw materials by a mining title "holder" (as defined in section 1 of the Mineral and Petroleum Resources Development Act, 2002), or any person contracted to such "holder" to carry on mining operations, are excluded while unregulated mine material (eg, Zama Zama gold) is caught by the regulations. Although it is understood that the mining exclusion applies at an entity level (as opposed to a transaction level), varying interpretations are still being applied in practice.

The 2023 Budget Review contained a proposal that the scope of the mining exclusion would be clarified; however, no amendments have been made in that regard. Also, no amendments were included to address the government's concern, as stated in the 2024 Budget Review, that the fraudulent VAT schemes and malpractices suspected in the second-hand gold industry may have shifted to the primary gold sector.

GOLD-PLATED JEWELLERY REMOVED FROM SCOPE

Another welcome amendment is the exclusion of gold-plated jewellery from the ambit of the regulations.

Even though the regulations were never aimed at the jewellery and short-term insurance (which often directly replaces jewellery for claimants) industries, the last-minute inclusion of "jewellery" as a prescribed form to which the regulations apply, caused several compliance challenges for vendors operating in this space. Other gold-plated items in a prescribed form besides jewellery will still be subject to the regulations.

NEW FLEXIBILITY ON RECORDING OF GOLD PERCENTAGE

Before the amendments, a purchaser was required to provide a written statement to the supplier containing, *inter alia*, a full and proper description of the valuable metal, as well as the percentage of the gold content thereof. Although it is a common feature of the second-hand gold industry for the purchaser to establish the gold content of the goods, many purchasers not operating in this industry were affected by the DRC Regulations and were either not privy to this information, or did not have the necessary equipment or know-how to determine the gold content.

Based on the amendments, the supplier and purchaser may now agree on which one of them is to determine the gold percentage of the goods. While the purchaser is still required to include a full and proper description of the valuable metal in the DRC statement it is required to furnish to the supplier, it no longer needs to specify the percentage of the gold content of the goods.

PRACTICAL IMPLICATIONS

Various practical challenges and questions arise regarding the VAT treatment of valuable metal supplied between the retrospective effective date of 1 January 2024 and the date on which the amendments were published on 10 May 2024. Whilst certain additional supplies were brought within the ambit of the DRC Regulations (eg, due to additional forms added into scope), others fell outside the ambit (eg, due to the new 1% *de minimis* threshold). Due to the reverse charge mechanism under the DRC Regulations, the retrospectivity of the amendments could mean that the incorrect party may have accounted for the VAT in its VAT returns (eg, the supplier instead of the purchaser, or *vice versa*).

In addition, purchasers of "valuable metal" potentially face risks to the validity of their input tax claims due to the requirement that they may not claim VAT on DRC-subject transactions until they have accounted for the VAT on the transactions in their VAT returns.

In this regard, SARS has published an updated version of its "*Frequently Asked Questions (FAQs) on the Domestic Reverse Charge (DRC) Regulations*" (Issue 3, dated 10 June 2024), in which it provides practical transitional rules as a means of providing clarity to vendors of what is required of them. In terms of question 3 of the FAQs, historic transactions should be dealt with as follows:

- transactions that have a time of supply before 10 May 2024, must be treated in accordance with the "old" DRC Regulations (ie, as they read before the recent amendments);
- supplies made on or after 1 July 2024 must comply with the "new" DRC Regulations (ie, as they currently read following the amendments); and
- affected vendors were allowed time until 30 June 2024 to amend their systems to enable them to issue the correct documentation regarding supplies from 1 July 2024 onwards.

Further, in terms of the DRC amendments the supplier of valuable metal must now "provide [sic] full and proper description of the valuable metal as well as the percentage of the gold content contained" therein (unless agreed otherwise with the purchaser). However, the manner in which this information is to be provided, or to whom, has not been specified as part of the amendments (eg, statement, invoice, etc).

Lastly, from a commercial perspective, consideration should be given to potential disputes arising between transacting parties on the quantum of gold contained within the valuable metal and which party is to account for the VAT on the transaction, especially where results are borderline around the 1% *de minimis* threshold.

Vendors affected by these changes should carefully consider their VAT position.

"This means that all 'residue' from mining operations (including certain historic mine dumps) remains within the scope of the regulations, unless the transaction is zero-rated (subject to VAT at 0%, such as exports) or if the mining exclusion in the regulations applies."

Annelie Giles

ENS

Acts and Bills

- Precious Metals Act 37 of 2005;
- Mineral and Petroleum Resources Development Act 28 of 2002: Section 1 (definition of "holder").

Other documents

- Value-Added Tax (VAT) Domestic Reverse Charge (DRC) Regulations on Valuable Metal (amendments published on 10 May 2024);
- 2023 Budget Review (published in February 2023): Annexure C;
- 2024 Budget Review;
- *Frequently Asked Questions (FAQs) on the Domestic Reverse Charge (DRC) Regulations* (Issue 3, dated 10 June 2024 – published by SARS): Question 3.

Tags: VAT-registered vendors; valuable metal.

THE VAT REFUND PROCESS

A VAT refund is an amount of VAT that is payable by SARS to a vendor.

In terms of section 1(1) of the Value-Added Tax Act, 1991 (the VAT Act), a vendor means any person who is, or is required to be, registered under the VAT Act, provided that where the Commissioner has under section 23 or 50A determined the date from which a person is a vendor, that person shall be deemed to be a vendor from that date.

A VAT refund will apply where the total amount of VAT charged to the vendor on the acquisition of goods and services or on the importation of goods (input tax) exceeds the total amount of VAT charged on the supply of goods or services by the vendor (output tax) for a tax period, or if a vendor has erroneously paid an amount of VAT which exceeds the amount that should have been paid to SARS.

If a vendor is entitled to a VAT refund, SARS must pay that VAT refund within 21 business days of receiving the correctly completed VAT return.

Should the refund not be paid within 21 business days, SARS must pay interest to the vendor at the prescribed rate, on the amount that is refundable.

There are exceptions where SARS can withhold a VAT refund or suspend the 21-business-day period without the payment of interest. These include where:

1. The VAT return or supporting documents submitted are defective or incomplete. SARS may not be satisfied with the documents provided if they do not comply with the requirements of the VAT Act. The vendor should ensure, before submission of the VAT return, that their documents meet these requirements.

2. Banking details are not provided or cannot be successfully verified by SARS. The vendor must ensure that the proper documentation is submitted to SARS so that SARS can verify the vendor’s banking details. This process usually takes 21 business days. Once the banking detail validation process has been completed, the refund should normally be paid within 72 hours.

3. There are VAT returns outstanding for other tax periods. The vendor should ensure that they are compliant and submit all returns timeously, as well as check their compliance status on a monthly basis.

4. If the vendor is a non-resident and has not appointed a VAT representative. This appointment process can take up to 21 business days, provided the correct documentation is submitted to SARS.

5. The VAT return is selected for audit. It could take up to 90 business days from the date of receipt of all the required supporting documents in a complete and correct manner, unless alternative arrangements are communicated, whereafter the refund should be paid within 72 hours.

VAT refunds that are due to electronic service providers come with their own complications, considering that these vendors are mainly foreign entities and as such do not usually have bank accounts in South Africa.

"If a vendor is entitled to a VAT refund, SARS must pay that VAT refund within 21 business days of receiving the correctly completed VAT return."

According to SARS, refunds are only paid into valid South African bank accounts. The basis for SARS' practice of only paying VAT refunds into local bank account refunds is uncertain, as neither the VAT Act nor the Tax Administration Act, 2011, provides that refunds must be paid into a South African bank account. One possible reason is that SARS does not want to pay the high bank charges associated with foreign exchange payments.

In these circumstances, the vendor will need to appoint a tax representative in South Africa and make use of the representative's bank account for purposes of receiving the VAT refund.

SARS may also select vendors for verification in respect of their VAT refund claims. In this case, the vendor will be required to submit supporting documentation.

The documentation submitted (for example, tax invoices or credit notes) needs to comply with the requirements of the VAT Act.

The submission of the correct information is also crucial because the submission of incorrect documentation may result in SARS raising an additional assessment, which would result in a delay of the VAT refund being paid out. If there is any doubt, the VAT vendor should therefore call SARS prior to submitting the documentation to establish exactly what documentation it requires.

In the event that SARS raises an additional assessment, a vendor may also object to or appeal against such assessment, if they are dissatisfied with it. An objection must usually be submitted within 80 business days after the date of the additional assessment.

Should a refund be due because the vendor made an erroneous payment to SARS, the vendor must make a claim to SARS and within 90 days of that claim provide their banking details to SARS. SARS will not pay out a claim without adequate justification and the vendor's banking details will have to be of a bank account in the vendor's name. Reasons will also have to be provided as to why the payment was made as well as a stamped proof of payment issued by the vendor's bank.

If a vendor has an outstanding tax debt, a VAT refund will be set off against that outstanding debt and should there be a balance remaining thereafter, this will be paid by SARS to the vendor. The vendor will have to go through a payment allocation process to request these additional funds.

The payment allocation process includes the submission of various documents to SARS, which can be a burdensome process.

Vendors who are registered for eFiling can view the status of their VAT refund by obtaining a statement of account or checking the eFiling refund dashboard.

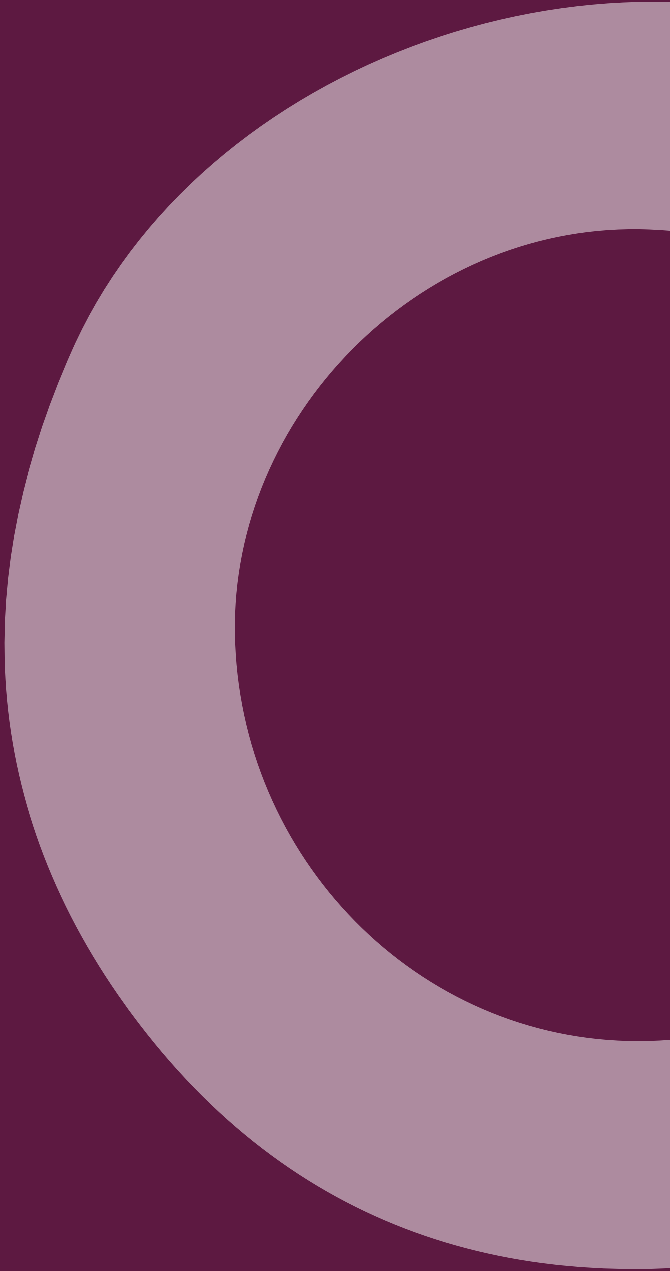
Aaliya Adam

BDO

Acts and Bills

- Tax Administration Act 28 of 2011;
- Value-Added Tax Act 89 of 1991: Sections 1(1) (definition of "vendor"), 23 & 50A.

Tags: VAT refund; VAT representative; additional assessment.



sait South African Institute of Taxation