South African Institute of Taxation

Tax Practice: *On the Move*
Legislative Interpretation

SAIT Webinar
13 October 2022

YOUR KEY TO THE TAX COMMUNITY

WITH YOU TODAY

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Agenda

In this webinar, we will cover the following topics:

- Legislation and policy
- National Treasury Response document
    - Two pot retirement system-Comments on broader retirement policy issues
    - Carbon Tax: Comments on US Dollar based carbon tax rates
    - Reviewing the debtor's allowance provisions to limit the impact on lay-by arrangements
    - Comments on short term insurers
    - Clarifying the treatment of amounts from hybrid equity instruments deemed to be income under CFC rules
- Reactive submissions
    - SARS draft documents for public comment – Value Added Tax Treatment of debt collection

Agenda (continued)

- New member benefit - Lexis Nexis
- Court cases of interest and tax importance
    - CSARS v Wiese and Others (15065-17)
    - Mr Taxpayer v Commissioner for SARS (IT 45628)

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National Treasury Response Document

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National Treasury Response document

Two pot retirement system-Comments on broader retirement policy issues

Comment: Automatic allocation of contributions in excess of the deductible limit is not required, as members can move contributions that they believe are in excess of their requirements from the savings pot to the retirement pot. Moreover, the proposal to allocate contributions in excess of the tax-deductible limits (currently R350 000 per annum or 27.5% of taxable income) cannot be executed by fund administrators.

> ***Accepted.*** The administrative constraints are sufficiently onerous to withdraw the proposal. As a result, the proposed changes to the definition of "savings pot" that reference section 11F in the 2022 draft Revenue Laws Amendment Bill will be withdrawn.

Comments: It is suggested by some commentators that no tax be levied on withdrawals from the savings pot, or for withdrawals from this pot to be taxed according to the pre-retirement lump sum tax tables.

> ***Not Accepted***. Taxing at marginal rates is more appropriate. Pre-retirement lump sum tables, in particular, give the impression that pre-retirement withdrawals attract lower rates than other income sources (this in addition to the generous contribution deductions). The main aim of retirement savings is income replacement, or income smoothing to meet basic expenditure needs. This set of reforms effectively enables some level of income replacement before retirement. This means that withdrawals from the savings pot are taxed in exactly the same way as other sources of income when they become disposable in the hands of the taxpayer. If the withdrawals from the savings pot come at a time when income is lost (e.g. retrenchment or resignation), then withdrawals that serve to replace that income will likely attract the same tax rates as it would usually attract (if not lower). If the withdrawal comes at a time when income is still intact, but expenditure rises unexpectedly, then the aim is to ensure that the withdrawal still attracts the appropriate level of tax that is disposable to the taxpayer.

National Treasury Response document

Two pot retirement system-Comments on broader retirement policy issues

Comment: It is not clear why the savings pot should also be subject to the 3-year waiting period when a taxpayer chooses to emigrate, as it is meant to be available at any time.

Response: **Accepted.** The 2022 draft Revenue Laws Amendment Bill will be amended to ensure that there is parity with domestic treatment.

Comment: The naming conventions utilised for the various pots in the reform need to be reconsidered as the current names run the risk of creating confusion, which should be avoided at all costs. The addition of further new definitions may therefore be required to mitigate the risk of causing confusion.

***Response*:** **Noted**. Government acknowledges that what is referred to as "pots" in the 2022 draft Revenue Laws Amendment Bill are for all intents and purposes components within the respective funds, and will consider an adjustment in the names to reflect their component nature. Further to the above, additional definitions will, where necessary, be incorporated into the 2022 draft Revenue Laws Amendment Bill

Comment: The current drafting as relates to the "savings pot", "savings withdrawal benefit" and retirement pot" definitions require some re-working so as to ensure that the policy intent is correctly reflected in legislation.

Response: **Accepted.** Clarification will be made in the 2022 draft Revenue Laws Amendment Bill.

National Treasury Response document

Carbon Tax: Comments on US Dollar based carbon tax rates

- Stakeholders are of the view that the formulation of the carbon tax rate in US$ will result in uncertainty and instability for South African taxpayers due to fluctuations in the exchange rate between the Rand and the US Dollar.

- The US$ based carbon tax rates will be converted to the Rand equivalent using the average exchange rates published by the South African Reserve Bank.

- Data available for a 12 month period is August 2021 to end of July 2022. It is proposed that the average exchange for this period of R15,40 to the dollar is used for the conversion of the carbon tax rates to the Rand equivalent and the rate increases are replaced with the specific tax rate.

- Future periodic adjustments of the carbon tax rates for example, every 3 years may be necessary to take into account global carbon pricing developments and to ensure equivalence with any carbon border taxes.

National Treasury Response document

Reviewing the debtor's allowance provisions to limit the impact on lay-by arrangements

- The Act makes provision for the debtor's allowance to be claimed as a deduction against income of taxpayer in respect of an agreement entered into by a taxpayer with any other person in respect of any property of which ownership or transfer is passed from the taxpayer to that other person after the receipt by the taxpayer of the whole or a certain portion of the amount payable in terms of the agreement, provided that the agreement has a duration of at least 12 months and in terms of which at least 25 per cent of the amount due to the taxpayer is only payable in a subsequent year of assessment.

- In terms of this provision, the whole of the amount due in terms of the agreement is deemed to have accrued to the taxpayer on the day on which the agreement was entered into and included in the taxpayer's income upfront.

- It has come to Government's attention that lay-by arrangements do not benefit from the above-mentioned debtors allowance rules because lay-by arrangements last for periods shorter than 12 months.

- In order to mitigate against the adverse effect of a upfront inclusion of proceeds from lay by arrangements, it is proposed that a new provision be added to section 24 of the Income Tax Act to make provision for a taxpayer to claim as an allowance against income, all proceeds from lay by arrangements, to the extent that such amount was not claimed by the taxpayer as an allowance in terms of the other provisions of the Act and subject to a condition that any proceeds from lay by arrangements claimed as allowance must be included in the taxpayer's income in the following year of assessment.

- The proposed amendments will come into operation on 1 January 2023 and apply in respect of years of assessment commencing on or after that date.

National Treasury Response document

Reviewing the debtor's allowance provisions to limit the impact on lay-by arrangements

Comment: The relief for retailers in respect of lay-by arrangements is welcomed. However, an earlier effective date should be considered considering the burden already shouldered by the retailers.

Response: **Accepted.** Changes will be made in the 2022 draft TLAB to change the effective date so that the relief comes into effect a year of assessment earlier than initially proposed and the amendments will come into effect on 1 January 2023 and apply in respect of years of assessment ending on or after that date.

Comment: With the addition of the debtors' allowance in respect of lay-by arrangements, a retailer may double dip in the instance that their lay-by arrangement meets the requirements of the already existing debtors' allowance and the debtors' allowance specifically provided for in respect of lay-by arrangements as proposed in the draft 2022 draft TLAB.

Response: **Accepted**. Changes will be made in the 2022 draft TLAB to clarify that where the debtors' allowance specifically providing for lay-by arrangements has been claimed, the current general debtors' allowance may not be claimed.

Comment: The reference to section 11(*j*) doubtful debt allowance under the proposed debtors' allowance for lay-by arrangements is misplaced and should be removed.

Response: **Accepted**. Changes will be made in the 2022 draft TLAB to remove the reference to section11(*j*) doubtful debt as in the context of lay-by arrangements, there is no debt that can be considered as being doubtful.

National Treasury Response document

Comments on short term insurers

Comment: There may be instances where a cell arrangement is accounted for as either an investment contract recognised under IFRS 9 or a reinsurance arrangement for purposes of IFRS 17.

***Response*: <u>Accepted</u>**. Changes will be made in the 2022 draft TLAB so that all transactions of the third-party cell captives are accounted for as per IFRS 17. AS a result, all premium received will be deemed to be the amount of insurance revenue as determined in accordance with IFRS 17 in respect of a third-party risk as defined in Insurance Act. Subsequently, a deduction will be allowed for liabilities in respect of claims related to these cell captive arrangements.

National Treasury Response document

Clarifying the treatment of amounts from hybrid equity instruments deemed to be income under CFC rules

The CFC rules contain an exclusion applicable to a payor and payee for intra-CFC interest, royalties, rental income, insurance premium or income of a similar nature, provided both the payor and payee are part of the same group of companies. In terms of hybrid equity instrument rules, certain dividends in relation to the recipient are deemed to be income. To ensure neutral tax treatment, it is proposed that specific reference be made for the exclusion of the payee company's deemed income for hybrid equity instruments between the CFCs.

Comment: The same exclusion for dividends in respect of section 8E hybrid equity instruments should be extended to dividends from third party-backed instruments in terms of section 8EA of the Act.

***Response*: <u>Accepted</u>.** Changes will be made in the 2022 Draft TLAB to extend the proposed amendment to dividends from third party-backed instruments in terms of section 8EA of the Act.

National Treasury Response document

Clarifying the treatment of amounts from hybrid equity instruments deemed to be income under CFC rules

A “foreign dividend” is defined in the Act as an amount paid by a foreign company in respect of a share in that foreign company. Specifically excluded from the definition of “foreign dividend” is any amount paid or payable that constitutes a redemption of a participatory interest in an arrangement or scheme contemplated in paragraph (e)(ii) of the definition of “company”. It has come to Government’s attention that in certain instances foreign law does not only deal with redemptions but also the sale of units, shares or interest to the arrangement, scheme or foreign management company of the scheme. It is therefore proposed that the term “or other disposal” be included to the exclusion from the definition of a “foreign dividend” to cater for any amounts from those disposals.

Comment: Given that the proposed amendment in the Draft TLAB is aimed at clarifying the existing legislation, it is submitted that there should be no defined effective date and the proposed clarification should come into effect on the date of promulgation.

***Response*: Accepted**. Changes will be made in the 2022 draft TLAB to change the defined effective date to the date of promulgation as the general practice is that if the amendment is merely clarifying the existing legislation, the effective is the date of promulgation of the TLAB.

South African Institute of Taxation

SAIT Submissions - SAIT response to call for comment on Draft Interpretation Note relating to the value-added tax treatment of debt collection.

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SAIT commentary

Specific comments – VAT Framework

- Input tax is deductible to the extent that it is incurred for the purposes of consumption, use or supply in the course of making taxable supplies. There must accordingly be a link between the input tax claimed and the supply of taxable goods or services.

- To establish the link between the supply of taxable goods and services and input tax incurred thereon, the point of departure is to identify the taxable and other goods or services supplied by a person. Input tax may then be claimed to the extent that it is linked to the making of taxable supplies of goods or services.

- Where goods or services are supplied on credit (i.e., retail credit) the supply of the goods or services is taxable, and any interest charged on the credit provided will be consideration for an exempt supply (i.e., the provision of credit).

- It is trite that the provision of credit by a credit provider does not constitute a supply of a debt security to the lender, whether supplied as stand-alone financing or as a credit line together with the supply of goods or services (i.e., retail credit).

SAIT commentary

Specific comments – The supply of retail credit

- We are of the view that where no interest is charged on a credit line, the recovery costs of the debt are directly linked to the original taxable supply of goods and services and the VAT is fully recoverable as input tax. Where interest is charged, we are of the opinion that VAT recovery fee VAT will be incurred for deal purposes and that apportionment should apply.

SAIT commentary

Specific comments – The supply of independent credit

- In the case of the supply of independent credit we are of the opinion that section 2(1)(f) read with section 1(a) of the VAT Act will apply i.e., an exempt supply of credit.

- If the credit consists of the capital amount, interest, administration or other fees charged, we are of the view that VAT incurred on commission for the recovery of the debt will still be recoverable to the extent that it relates to taxable administration or other charges included in the debt.

SAIT commentary

Specific comments - Supply of debt collection services (Recovery of the prescribed amounts under the Debt Collectors Act)

- We therefore request that consideration be given to expanding the application of the current proposed interpretation to situations where the recovery from debtors accrue directly to debt collectors, as is often the case in practice.

SAIT commentary

Specific comments - Conclusion and reference to the term “credit provider”

- Reference made to “*Debt collection costs incurred by the creditor*”. Whilst we note that the term “credit provider” is used as a reference in the rest of the document.

- The draft IN is silent on debt collection costs incurred by persons who are not “credit providers” as defined in the draft IN.

- Upon our reading thereof, we are of the view that the draft IN note is vague as to when a supplier of goods and services will become a “credit provider” as defined.

- Our initial observation is that uncertainty is created for taxpayers and SARS officials alike due to the vague definition of a “credit provider”.

- Based on the preposition that an interpretation note is issued to create clarity as to the application of law by SARS, we submit that the vague definition of “credit provider” may potentially create more confusion in law for both SARS officials and the taxpayers.

SAIT commentary

Additional comments

Suppliers of Instalment Credit Agreements

We are of the view that the draft IN issued by SARS fails to address the specific nature of supplies made by the suppliers of ICA's which we believe is an important aspect that should be within the scope of the IN. Failing which this will create confusion for taxpayers and SARS officials alike.

Immovable property

- The activities of the debt collector in so far as fixed property is concerned, are intrinsically linked to the actual payment of the output VAT.

- To deny an input tax deduction on costs that are incurred with at least a 15% intention to pay output VAT to SARS, is in our view not in accordance with the letter or the spirit of the law.

SAIT commentary

Additional comments

Attorney Fees

- *"This Note does not address debt collection activities outsourced to attorneys." The reason given is that "Attorneys are currently not regulated by the DCA."* .

- We agree that the draft IN can exclude the VAT treatment on debt collection income earned by attorneys from the perspective of the debt collector and even from the perspective of the debtor.

- It is however uncertain why the draft IN is silent on the VAT treatment of attorney's fees incurred by the credit provider since a significant portion of the debt collection costs incurred by the credit provider would constitute fees charged by attorneys.

SAIT commentary

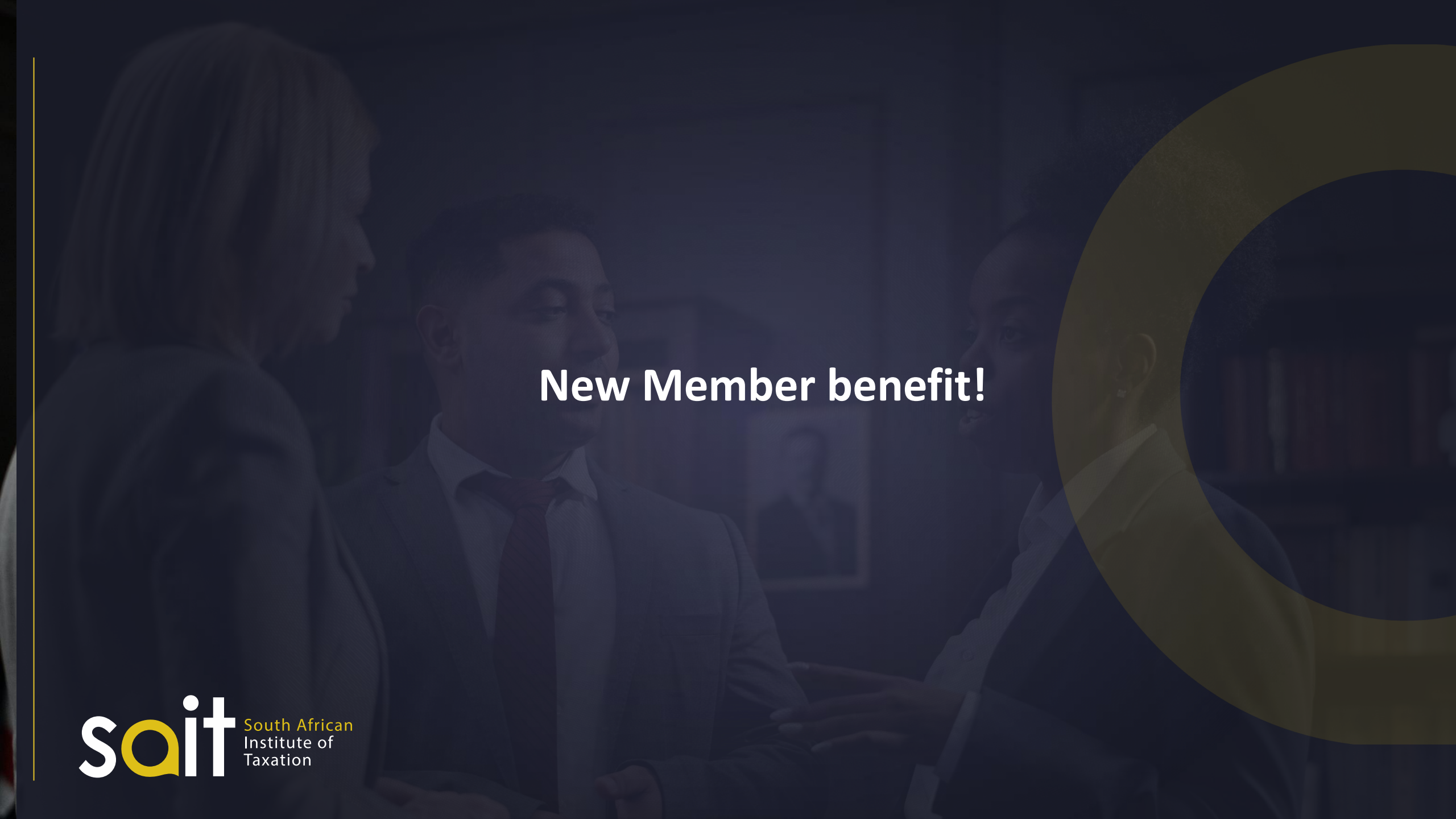
Additional comments – Concluding remarks

- The present definition of “Credit Provider” is vague and may potentially create uncertainty as to the application thereof.

- The exclusion of the VAT treatment of attorney’s fees incurred by a credit provider is an oversight in the scope of the IN, which we believe may create confusion for Taxpayers and SARS officials alike.

- We recommend that the draft IN also address the following supplies:
  - Supplies made under ICA’s;
  - Supplies of fixed property where VAT is only payable to SARS as and when payment is made by the debtor; and
  - Supplies made by vendors registered on the payments basis where VAT is only payable to SARS as and when monies are collected from the debtor.

- Recommended that the draft IN include the application and implications of the link between debt collection costs and VAT claimable on bad debts.



New Member benefit!

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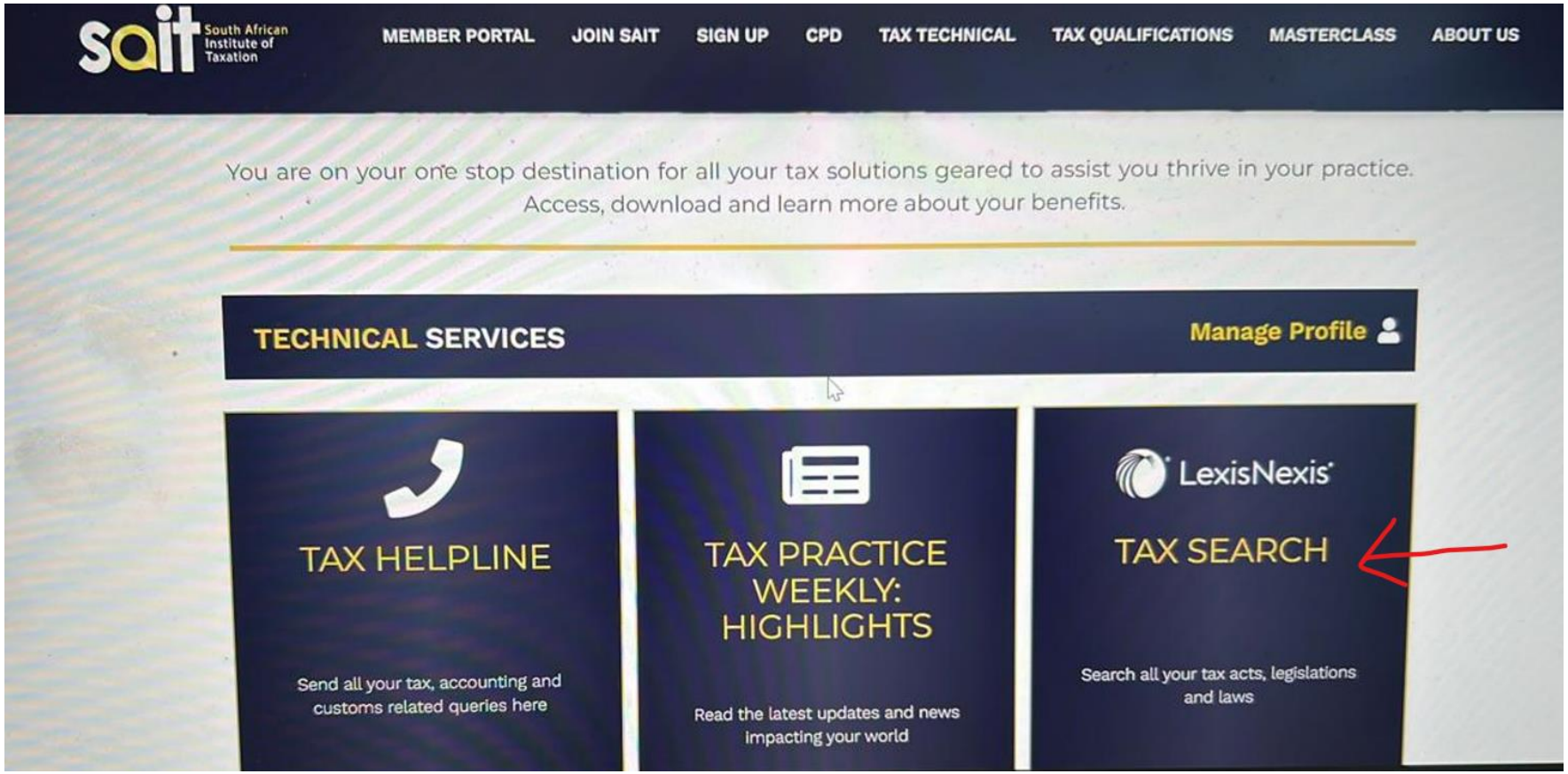
NEW Member benefit - the SAIT's TAX SEARCH

This new benefit can be found on the SAIT's member portal – click on the TAX SEARCH icon



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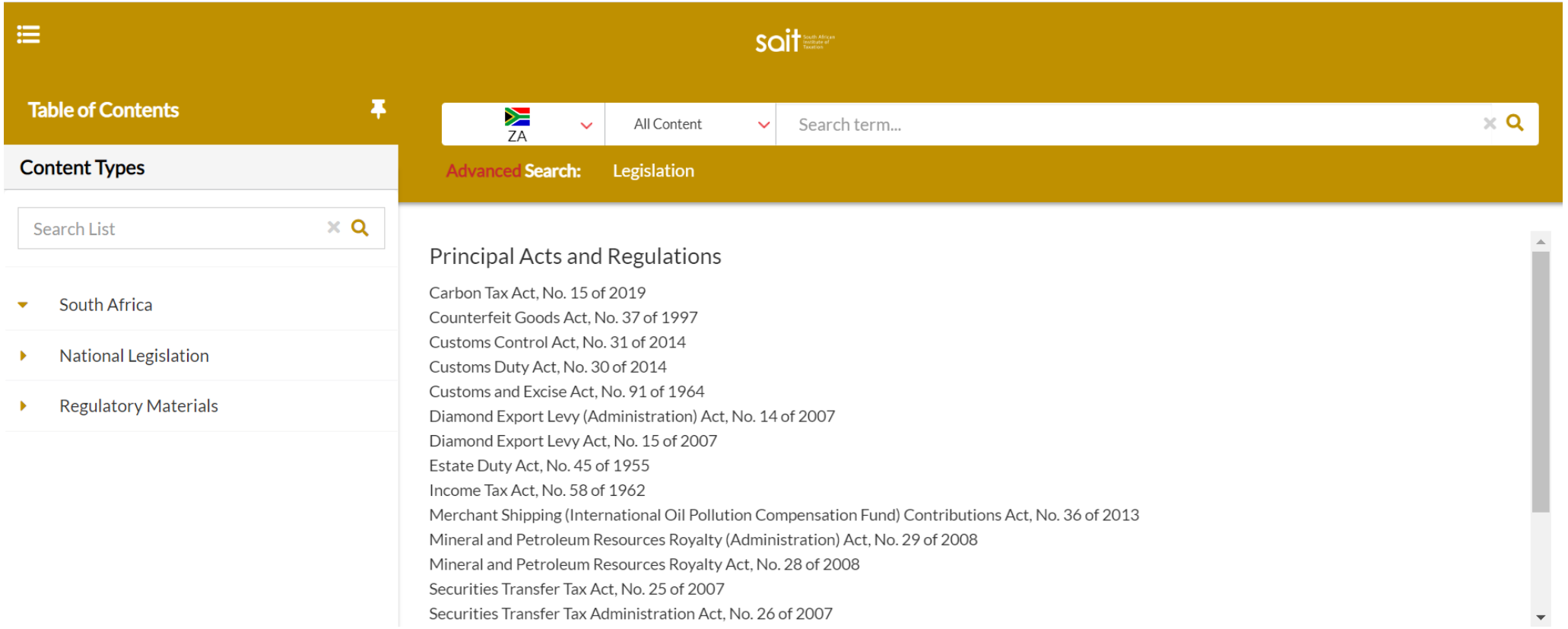
Contents of the SAIT's TAX SEARCH

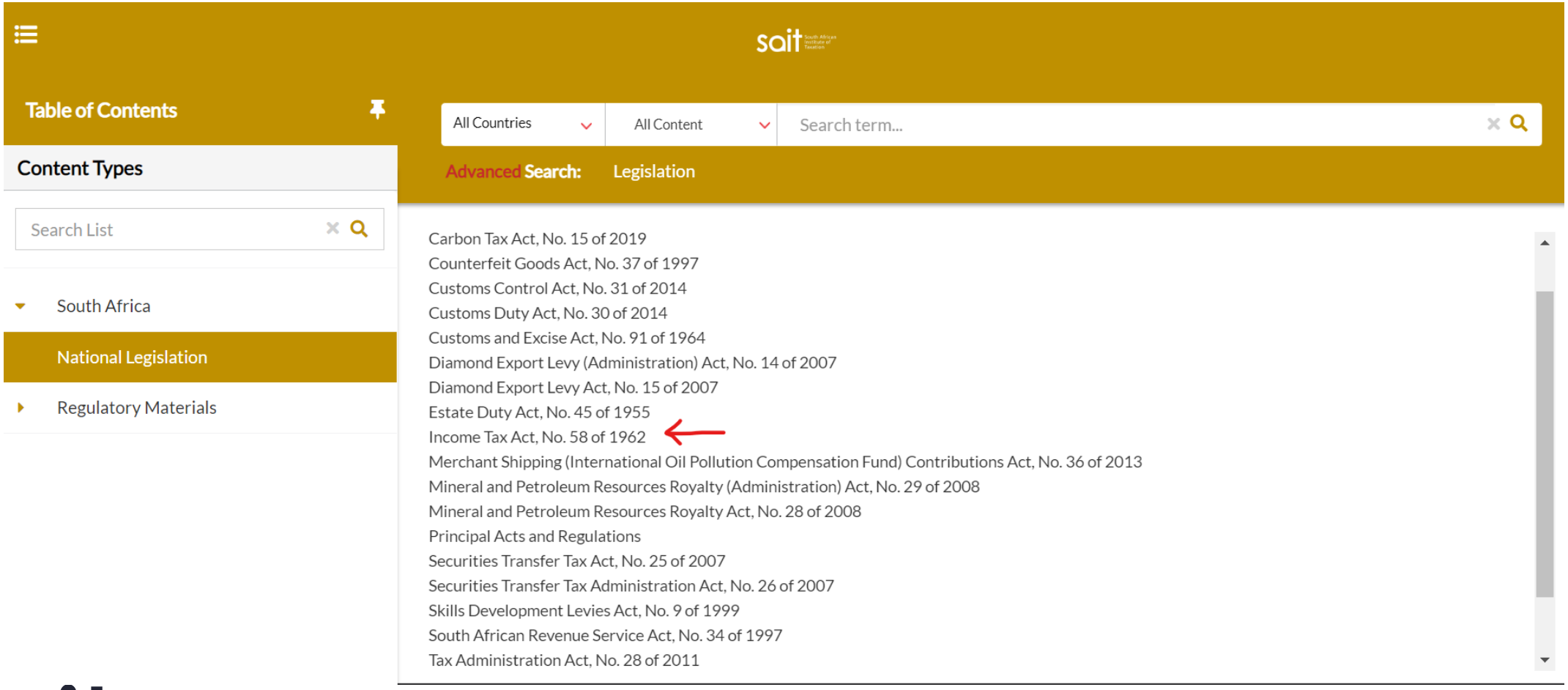
Includes National legislation and Regulatory Materials

View defaults to National Leg as this is the most used.



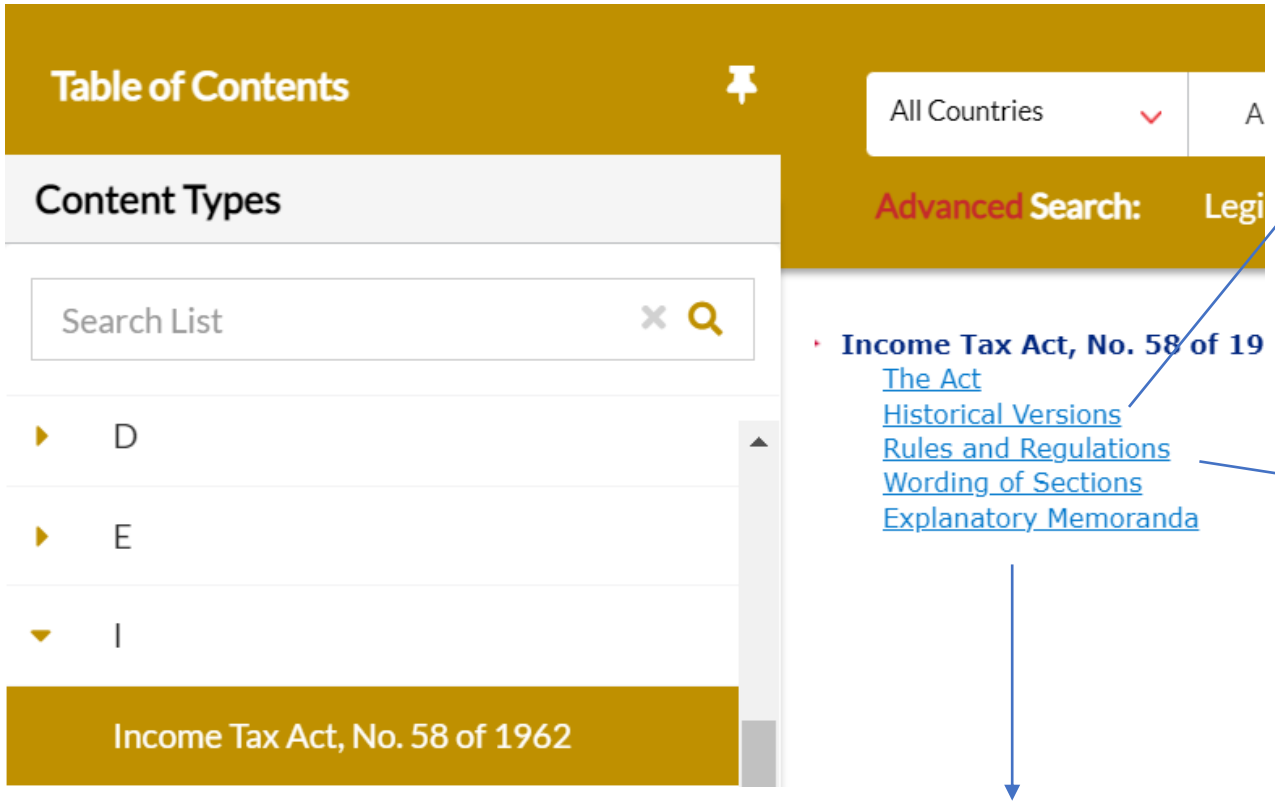
Contents of the sait Gateway site

National Legislation: Carefully selected TAX legislation including 21 Principal Acts



Contents of the SAIT's TAX SEARCH – National Legislation

Looking at the Income Tax Act 58 of 1962, you can access:



PDFs of the Income Tax Act at a point in time

Comments – principal Act as amended by	View
Act 20 of 2020 (GG 45787)	Full Act PDF
Act 20 of 2020 (GG 45787)	Full Act PDF
Act 19 of 2021 (GG 45786) | Act 20 of 2020 (GG 45787) | Act 21 of 2020 (GG 45788)	Full Act PDF

Rules and Regulations

- Regulations
- Rules
- Notices
- Agreements and Conventions
- Rules and Regulations by section of Act
- Draft Rules and Regulations
- Repealed Rules and Regulations

DTA's

PDFs of Explanatory Memos to Bills

Explanatory Memoranda

- Explanatory Memorandum on the Taxation Laws Amendment Bill, 2021
- Explanatory Memorandum on the Taxation Laws Amendment Bill, 2020
- Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019

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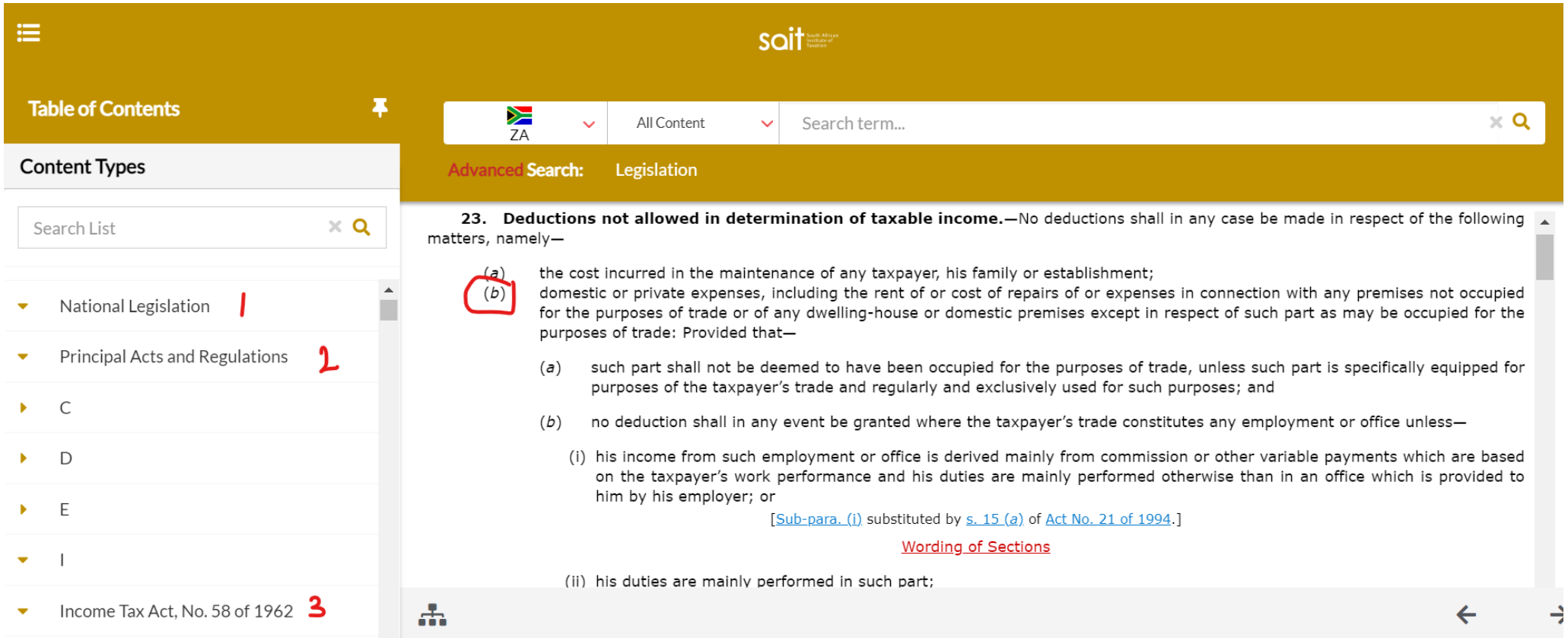
Access Section 23 (b) of the Income Tax Act using the Table of Contents

Go to National Legislation then select Principal Act, go to "I" then select Income Tax Act



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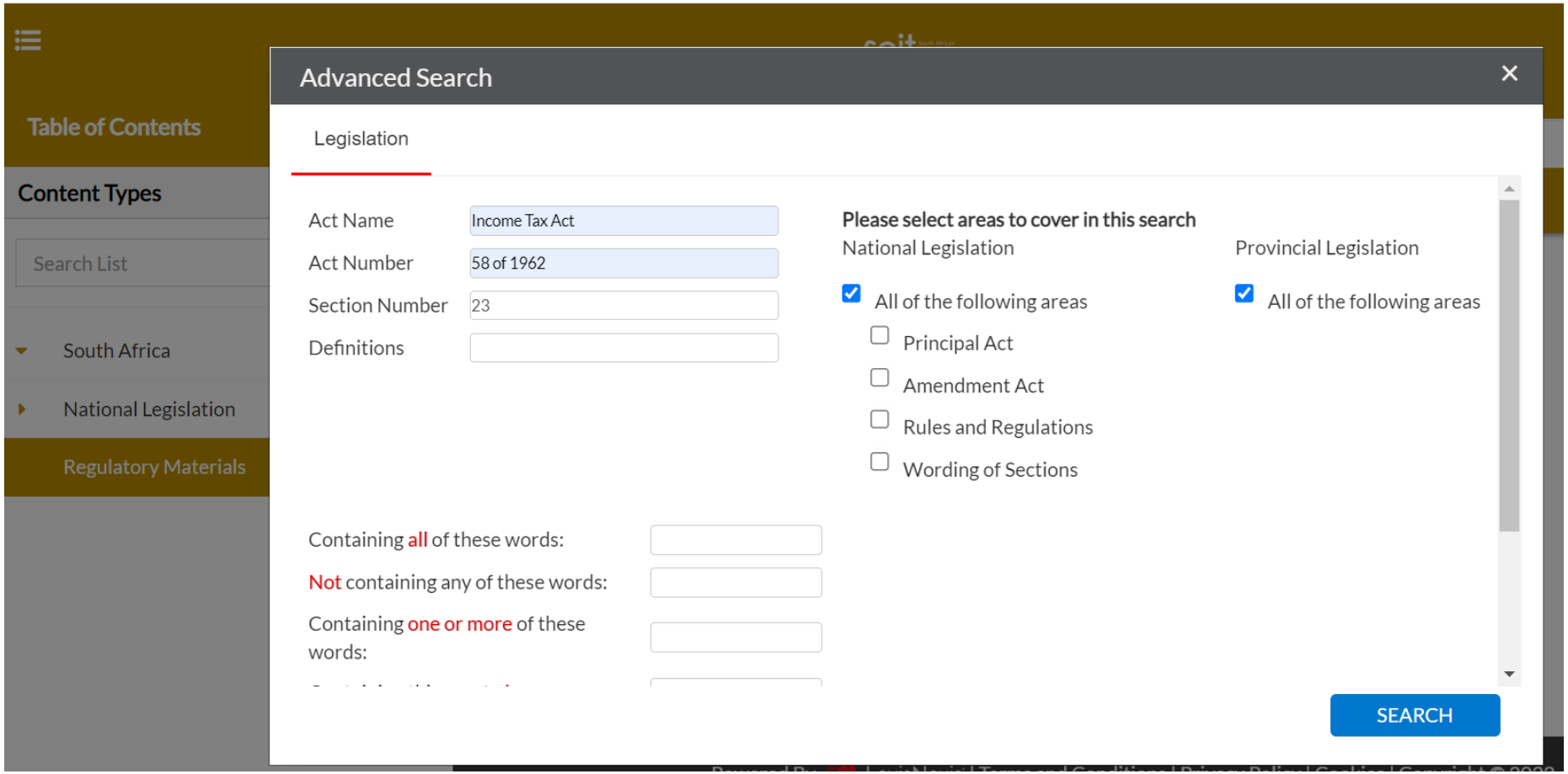
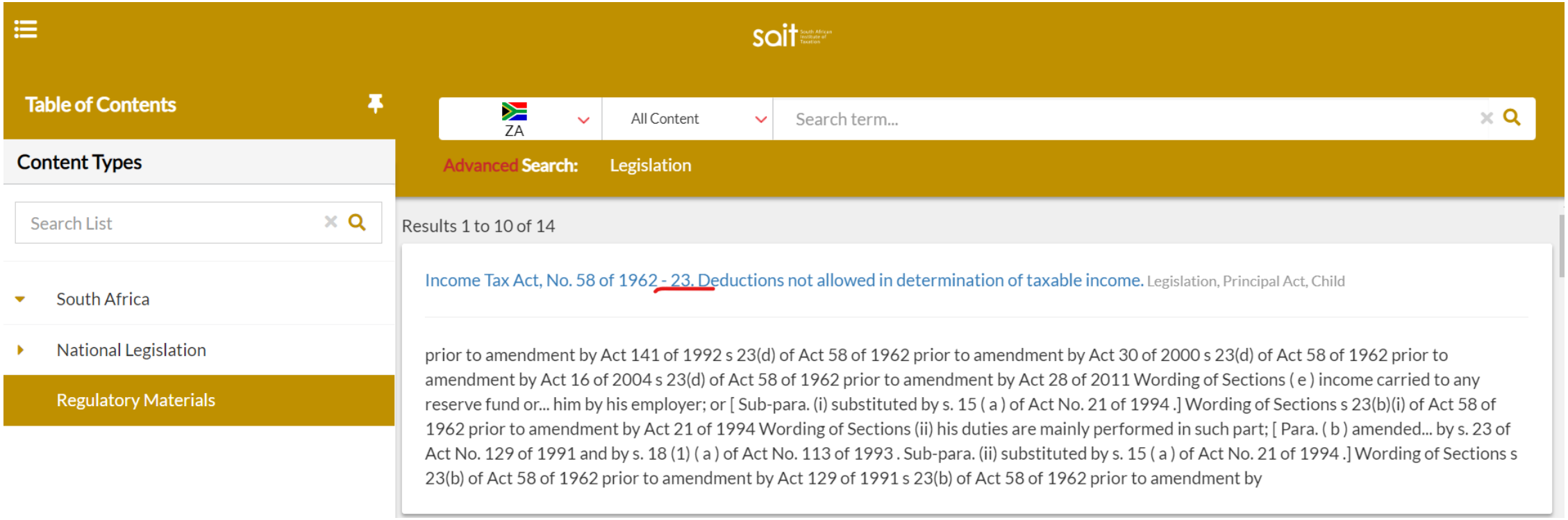
Access Section 23 (b) of the Income Tax Act using the Advanced Search bar

Go to Advanced search and add in details



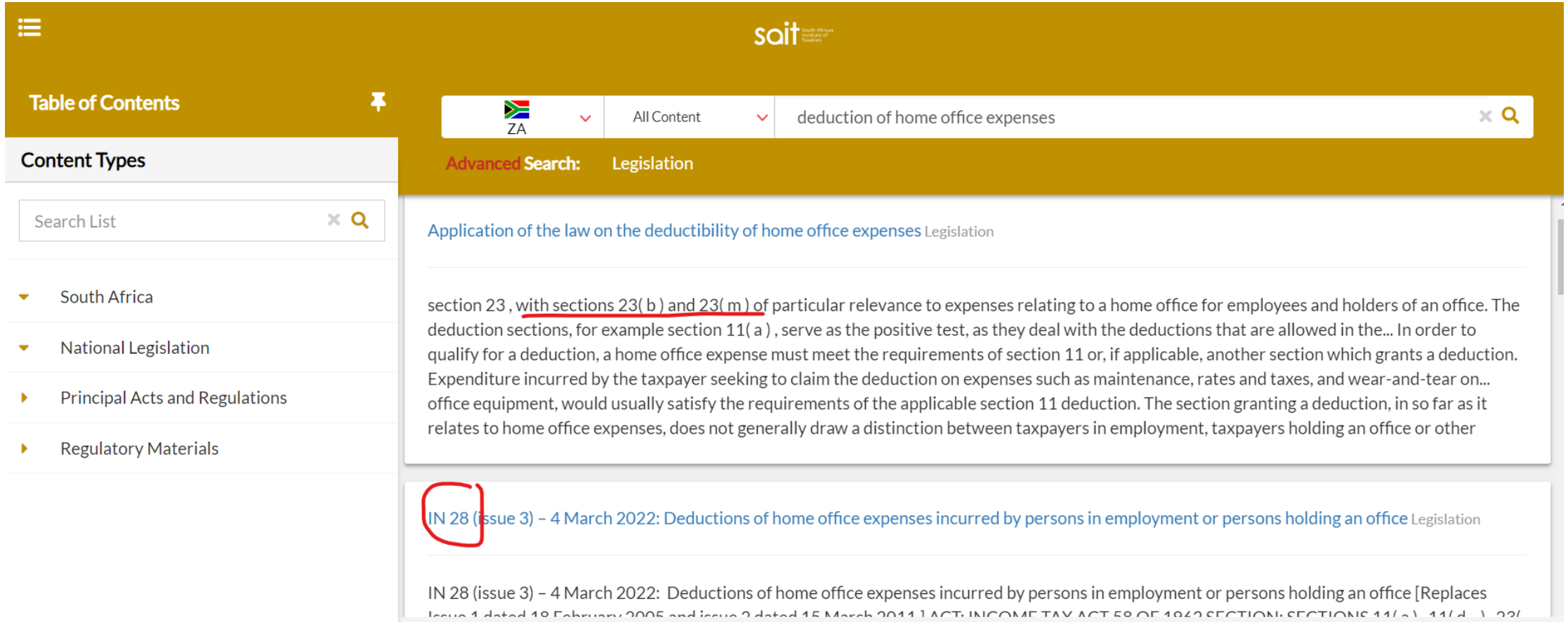
Access Section 23 (b) of the Income Tax Act using the Advanced Search bar

Click on link and it takes you directly to section 23



Look for ALL materials related to home office expenses using the General search bar

Search 'deduction of home office expenses' to see what is relevant. If you click on link to IN 28 it takes you to Interpretation note 28 which is housed under Regulatory Materials.



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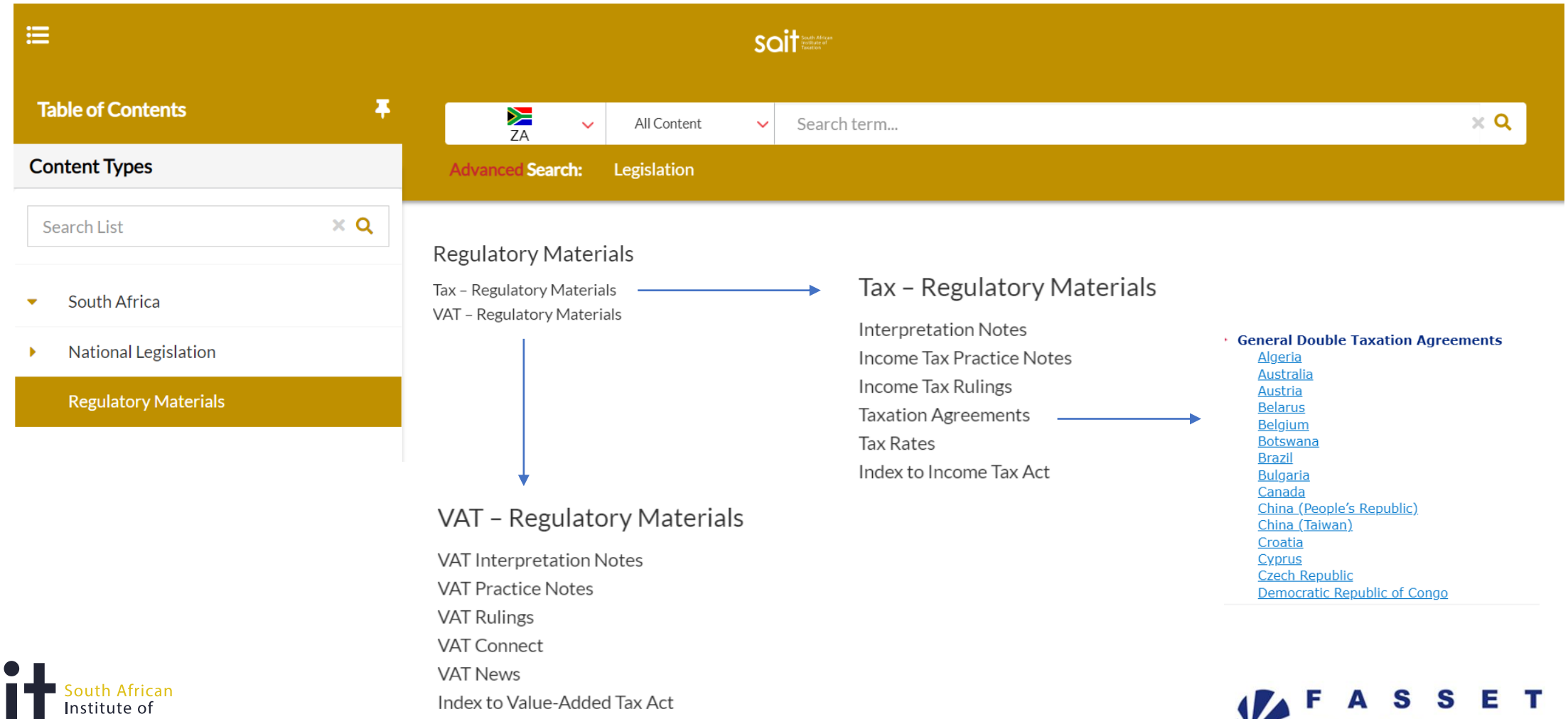
Contents of the sait's TAX SEARCH – Regulatory Materials

Regulatory Materials includes regulatory materials issued by SARS



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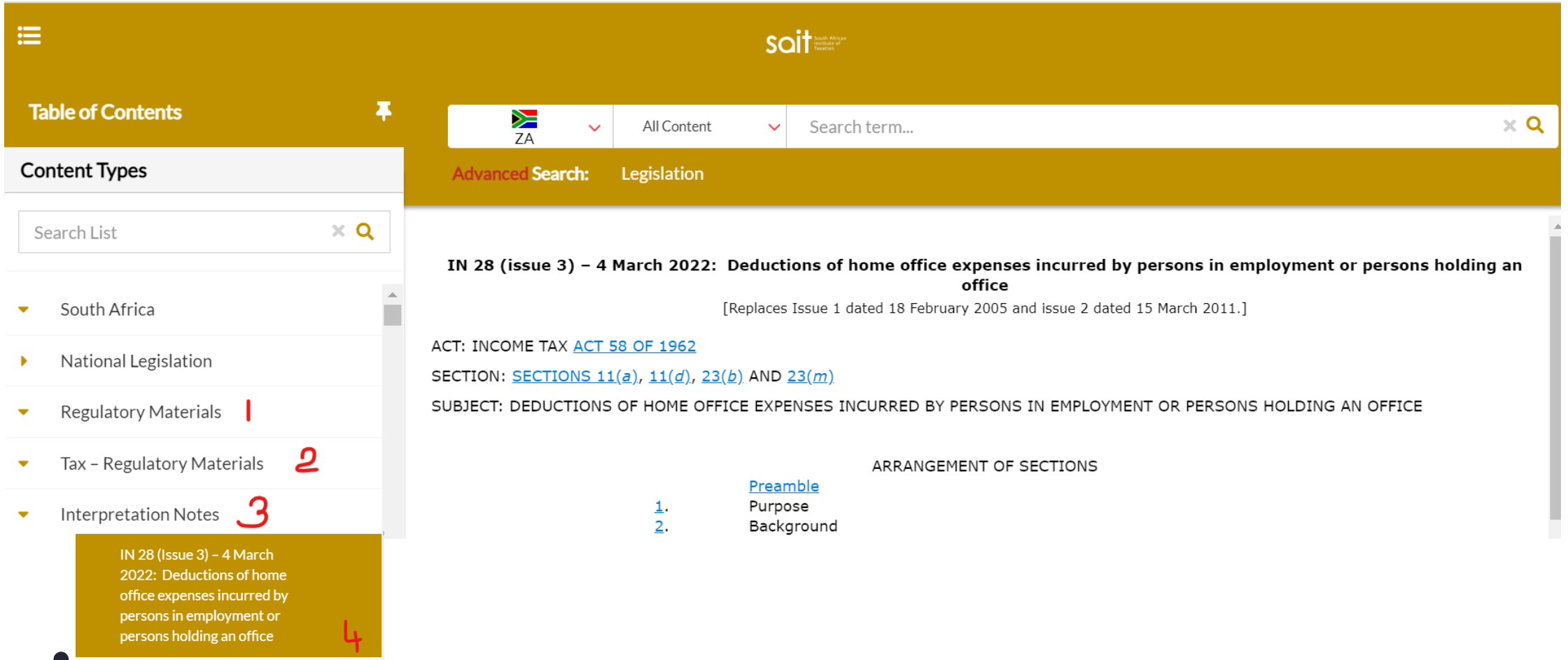
Example of Regulatory materials – Tax
SARS Interpretation Note 28

Access Interpretation note 28 under Regulatory Materials - TAX then Interp Notes and select 28



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Recent court cases

South African Institute of Taxation

Recent court cases:

- *CSARS v Wiese and Others (15065-17)*
- *Mr Taxpayer v Commissioner for SARS (IT 45628)*

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CSARS v Wiese and Others (15065-17)

Background

The Tullow Group undertook a restructure of its African operations in January 2007, which, prior to the restructure, Energy Africa Proprietary Limited ("the taxpayer") formed part of the Tullow Group. Thereafter, the taxpayer sold its shares and claims in Energy Africa Holdings (Pty) Ltd ("EAH") to Tullow Overseas Holdings BV ("TOH").

In November 2012, SARS issued a notice to the taxpayer in terms of section 80(J)(1) of the TAA, informing the taxpayer of its intent to effect adjustments to the taxpayer's 2007 assessment following an audit that was conducted by SARS. SARS alleged that the taxpayer was liable in total for R940 million for capital gains tax and secondary tax on companies as the sale of shares and claims during that period of assessment amounted to impermissible tax avoidance as defined in the Income Tax Act, No. 58 of 1962 ("the Act").

SARS granted the taxpayer 2 extensions in submitting a formal response to the audit findings and the notice, whereafter the First Defendant instructed the Second Defendant to obtain the distribution of the loan claim against Titan Share Dealers (Pty) Ltd to Titan Premier Investments (Pty) Ltd, and subsequently the sale of the taxpayer to Friedshelf (Pty) Ltd.

CSARS v Wiese and Others (15065-17)

Background

The taxpayer's attorney disputed the tax liability in totality on grounds being "substance over form" and the alternative under the General Anti-Tax Avoidance Rules ("GAAR"). It must be noted that at all relevant times, the taxpayer's only asset was a loan claim against Titan Share Dealers (Pty) Ltd to the value of R216 million.

In April 2013, and prior to the assessment being raised by the SARS, the taxpayer disposed of its only asset by making a distribution to its sole shareholder, Elandspad. Thereafter, this was further distributed from Elandspad to its holding company, Titan Premier Investments (Pty) Ltd.

The taxpayer's attorney formally responded to the finalization of audit letter in September 2013 advising SARS that the taxpayer disputes any tax liability, and that the taxpayer did not have any assets or cash to pay towards the tax liability. The taxpayer, after remaining dormant, was wound up in April 2016 by order of the High Court.

CSARS v Wiese and Others (15065-17)

Issues before the Court

The issues before the High Court in this matter were twofold:

1. The determination of the admissibility of a Defendant's transcript in an inquiry; and

2. Whether the capital gains tax and secondary tax on companies are considered a "tax debt" for purposes of section 183 of the Tax Administration Act, No. 28 of 2011 ("TAA").

CSARS v Wiese and Others (15065-17)

The Taxpayer's Case

According to the taxpayer, the transaction that took place in 2007 was not simulated and held that the deemed dividend provision contained in section 64C(2)(a) of the Income Tax Act did not apply.

The taxpayer further contended that the transactions under consideration do not constitute impermissible avoidance arrangements, and that the sole purpose of the transaction was not to obtain a tax benefit and, based on this, SARS was not obliged to rely on the provision of section 80B of the Act.

SARS' Case

SARS argued that, in terms of section 64C(2)(a) of the Act, the distributions are in fact deemed to be dividends declared by the companies and paid to its shareholder.

CSARS v Wiese and Others (15065-17)

Outcome

The Court ordered that the separated issues are decided in favour of SARS with costs (to include costs of two counsel).

Core Reasoning

The Court held that a "tax debt" as contemplated in section 183 requires SARS to issue an assessment before invoking section 183; or the term can be read in terms of section 169 which will allow SARS to issue a notice in anticipation of an adjusted assessment and thereafter determine the taxpayer's tax liability.

The provisions in terms of section 183 of the TAA provides as follows:

"If a person knowingly assists in dissipating a taxpayer's assets in order to obstruct the collection of a tax debt, the person is jointly and severally liable with the taxpayer for the tax debt to the extent that the person's assistance reduces the assets available to pay the taxpayer's tax debt."

The Court noted that section 183 was enacted by the Legislature for purposes of holding a person(s) jointly and severally liable if he assists in dissipating a taxpayer's assets in order to avoid the payment of tax. Chapter 11 deals with the recovery of tax, and Part D thereof wherein section 183 is found, deals with the liability and collection of tax debt from a party other than the taxpayer. In these instances, where the purpose and aim of the TAA is to hold a third party liable, the notice as issued by SARS on 16 November 2012, which included the notice in terms of 80J(1) is more than sufficient to fall within the true meaning of a 'tax debt' as contemplated in section 183.

Mr Taxpayer v Commissioner for SARS (IT 45628)

Background

The taxpayer met a Mr. A, whilst conducting research for his Master's degree in chemical engineering, and together they established a profitable business, processing various precious metals from mining by-products ("the company"). Both men were directors and employees of the company. Regrettably their relationship soured, and the taxpayer was forced out of the company.

The taxpayer launched litigious proceedings against the company by medium of AB Trust, however prior to the trial date, a settlement agreement was concluded between parties, whereby the company would pay AB Trust R160 million. Additionally, the settlement agreement contained a suspensive condition that the taxpayer would enter into a five-year restraint of trade agreement, and the company would pay him R60 million in consideration thereof.

Upon receipt of the payment of the R60 million, the taxpayer declared the amount to SARS as a capital gain and paid the amount of R8 million to SARS after receiving a somewhat suspect "directive" from SARS confirming same.

Thereafter, SARS was dissatisfied with the classification of the R60 million and adjusted it to fall within the ambit of section 1(cB) of the Act. Unhappy with this development, the taxpayer proceeded to file an objection which was subsequently disallowed by SARS. The taxpayer proceeded to file two appeals, one in connection with the amount received in consideration for the restraint of trade amount (R60 million), and the other for the share purchase agreement amount (R160 million). Shortly before the hearing date, SARS withdrew its opposition to the second appeal, with the effect that only the issue of costs thereof had to be considered by the Tax Court.

Mr Taxpayer v Commissioner for SARS (IT 45628)

Issue before the Court

The core issue before the Tax Court was whether a payment in the amount of R60 million, received by the taxpayer in consideration of a restraint of trade agreement, should be classified as revenue under the definition of “gross income” under section 1(cB) of the Income Tax Act, No. 58 of 1962 (“the Act”).

Mr Taxpayer v Commissioner for SARS (IT 45628)

The Taxpayer's Case

The taxpayer made several assertions in support of his appeal, which primarily revolved around a "directive" that had been issued to him by an erstwhile SARS official, Mr. C. The directive stated that SARS confirmed that the taxpayer had been paid an amount of R60 million which should be classified as a capital gain. The tax payable to SARS was stated therein as being R8 million.

Mr. C testified in court that he had not signed the document, and that it would have been impossible for him to have issued the document, as he did not have access to the SARS system used to issue such directives or tax assessments. Mr. C also conceded under cross examination that the document in question was not a tax assessment.

Thereafter, a chartered accountant and tax practitioner who had assisted the taxpayer with the matter, a Mr. N, testified that he had advised the taxpayer to tender payment of R8 million to SARS upon perusal of the "directive". However, Mr. N conceded that he was unsure whether the amount of R60 million should be classified as a capital gain or income, and that the "directive" had made no mention of a restraint of trade.

Mr Taxpayer v Commissioner for SARS (IT 45628)

The Taxpayer's Case

The taxpayer asserted that the restraint of trade agreement was linked with the objective of protecting the company's shares, and not with his status of employment with the entity. Flowing from this, the restraint of trade agreement was an ancillary part of the settlement agreement, and as such, the taxpayer contended that the R60 million payment should have been assessed as a capital gain.

Furthermore, the taxpayer made the submission that the company had terminated his employment some four and a half years prior to his receipt of the R60 million, and thus no causal link existed between his former employment with the company and the restraint of trade agreement.

Mr Taxpayer v Commissioner for SARS (IT 45628)

SARS' Case

SARS called the operational specialist auditor that performed an audit of the taxpayer's tax return, a Mr. E, who testified that he addressed a letter to the taxpayer on 11 January 2018. Therein, he requested that the taxpayer furnish SARS with relevant information for the capital gains tax, as reflected in the taxpayer's tax return for the 2016 year of assessment.

SARS referred to a letter received from Mr. N, wherein it was clearly stated that the sum of R60 million arose from a restraint of trade agreement, and that SARS had issued the taxpayer with a "directive" confirming that the R60 million was capital in nature. SARS disputed the veracity of the purported "directive" and referred to a June 2018 letter sent to the taxpayer which confirmed this position.

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Outcome

The Tax Court found in favour of SARS and the first appeal was dismissed with costs. In the second appeal, costs were awarded on a punitive scale to the taxpayer.

Core Reasoning

As a point of departure, the Tax Court examined two different types of restraint of trade agreements. The first type could be concluded between employees and employers, with the second type being entered into between sellers and purchasers of business entities.

The Tax Court held that the distinction between the two types of restraints is vital, when tested against section 1(cB) of the Act. This section explicitly states that any amount received by or accrued to any natural person as consideration for any restraint of trade imposed, due to either employment or the holding of any office; alternatively past or future employment or the holding of any office, would be classified as “income”.

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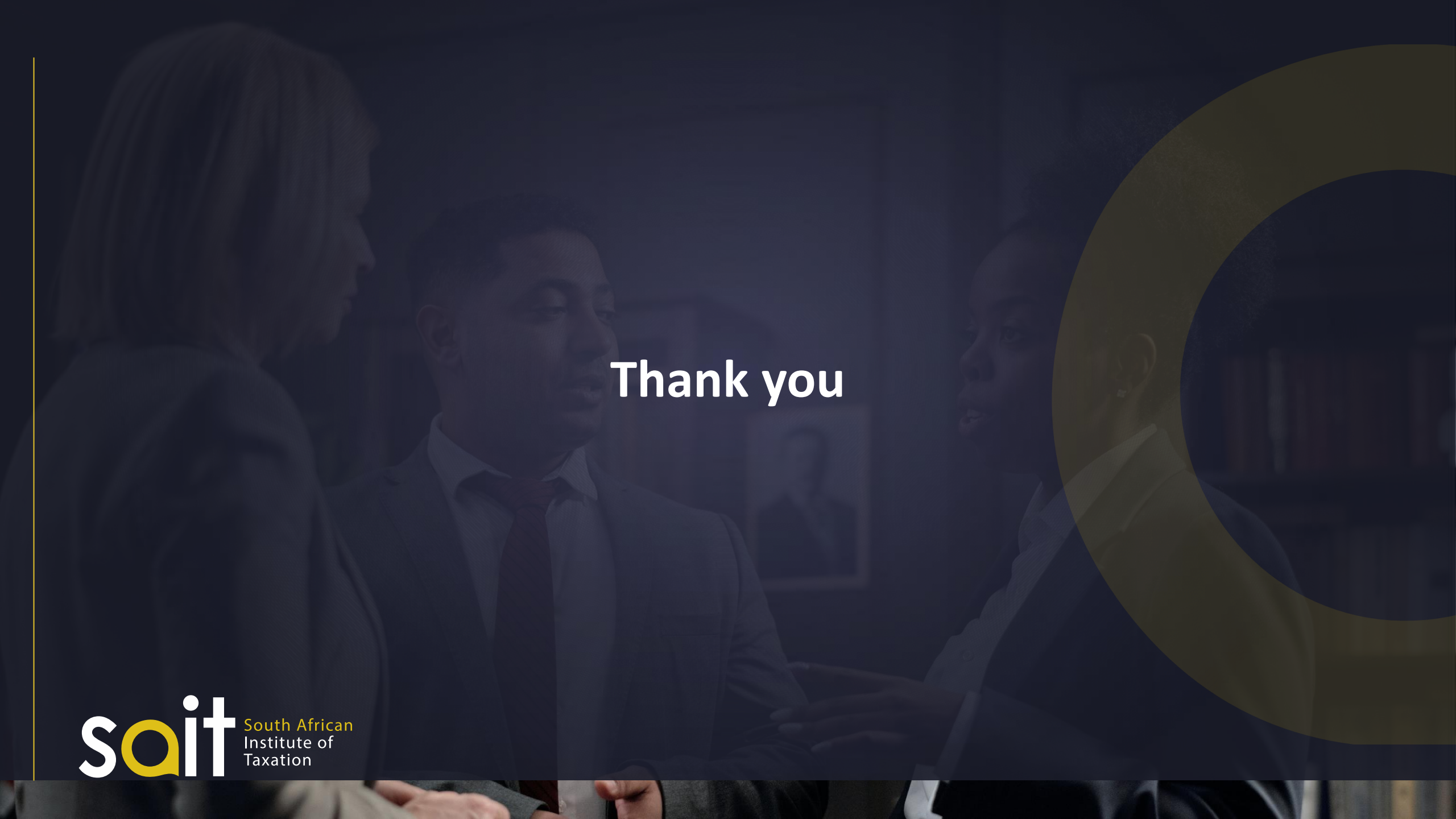
Core Reasoning

The Tax Court held that, as a causal link existed between the restraint of trade agreement and both the taxpayer's employment contract and position as director of the company, the R60 million received by the taxpayer should be classified as "gross income" as per section 1(1) of the Act.

Flowing from this determination, the Tax Court also ruled that it would be reasonable for SARS to levy both interest and an understatement penalty on the R60 million. This was adjudged to be reasonable as the taxpayer was assisted by a seasoned tax practitioner of 27 years' experience (Mr N.), and relied on a "directive" that on face value was neither a directive nor a tax assessment.



Thank you

South African Institute of Taxation