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Tax Practice – On the move

Tax Controversy 4 of 5

CORONATION INVESTMENT MANGEMENT
V
CSARS

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YOUR KEY TO THE TAX COMMUNITY

SARS still finalising its view

- What does that mean?
- Denis, D M. 2023. “The Supreme Court of Appeal’s Untidy Grapple With the Complexities of Section 9D of the Income Tax Act”, *The Taxpayer*, 72(3&4), pp. 46-49.
- on the SCA judgement:
  - “*regrettably this is another example of questionable tax jurisprudence emanating from the SCA*”

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Intro

- Context
- The judgment
- The Correct interpretation of the proviso to the FBE
- The USP argument raised by SARS in their cross appeal (and Thistle)

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Context

- s9D is an anti avoidance provision.
- It prevents SA taxpayers from deferring their SA obligations by exploiting SA tax residency rules.
- It does this by imputing the net income of a CFC into SA shareholder's hands and taxing the shareholders on their respective portions of the net income of the CFC.
- However, it allows SA taxpayers to operate in foreign jurisdictions if the aim is not to defer SA tax obligations but rather the running of a "proper business" in a foreign jurisdiction.

Context

- This exception is commonly known as “the foreign business establishment (FBE) exemption”.
- The term FBE is defined in section 9D(1).
  - Proper office with staff, equipment, necessary facilities etc.
- The proviso to the FBE definition allows for the “outsourcing” of offices, staff, equipment etc to another company (i.e. a company other than the CFC) under certain conditions:

Context

- If that other company:
  - is subject to tax in **the same tax jurisdiction** as the CFC;
  - The other company is part of the same group of companies as the CFC;
  - The outsourced office, staff etc is **based in the same country** as the CFC.

Coronation – The facts

- SA Taxpayer (Coronation) is an investment company.
- Coronation had a sub in Ireland (“Ireland SubCo”).
- Ireland SubCo was established to grant access to foreign investments.
- Ireland subco was established as a fund manager and applied for licenses in Ireland accordingly.
- Ireland subco outsourced/delegated the actual investment operations to companies based outside Ireland (in the UK and SA).

Coronation: The arguments

- SARS:
  - Ireland subCo was licenced to do investment management.
  - It outsourced (by choice) this activity to companies outside of Ireland and who are not subject to tax in Ireland.
  - As such, the requirements of the proviso to the FBE definition was not complied with.

Coronation: The arguments

- The taxpayer:
  - The question is not what a CFC can do in theory but rather what it in fact does;
  - The FBE exemption prevents “post box”/”paper” companies from qualifying for exemption - the question is whether there is “economic substance” - the fund manager business had economic substance so the proviso to the FBE exemption is irrelevant.

Coronation: The Judgment

- The question is indeed: what a business actually does, not what it can do in theory.
- SARS and the SCA misunderstood the business of Ireland SubCO.
- Its business is that of fund manager and not investment management **as borne out by the evidence**, despite it being the *chosen* business model of Ireland SubCo.

Coronation – The Judgment

- That business of fund manager, being its primary business activities, constitutes an FBE. I.e. the proviso to the FBE def is redundant.
- What is the correct interpretation then of the definition of FBE, in particular of the proviso dealing with “outsourcing”?

Coronation – Discussion

- Business model of choice?
- So the proviso to the FBE only becomes relevant if the chosen primary attentivities are outsourced?
- Chosen business model must still stack up commercially though and supported by the evidence and the facts
- Certainly not setting up a CFC and choosing to run an activity there to divert some income (and outsourcing elsewhere)which makes no commercial sense
- What was the plan originally?

USP's

- SARS cross appealed the SCA decision on USP's.
- Since Taxpayer succeeded with its appeal, the CC did not have to deal with SARS' cross appeal.
- Important though to consider SARS' submissions in the cross appeal:
  - SCA held that:
    - taxpayer's reliance on professional advice and opinion made the understatement a "*bona fide* inadvertent error".

USP's

- taxpayer's reliance on professional advice and opinion made the understatement a "*bona fide* inadvertent error".
- SARS' submissions in respect of cross appeal.
  - There are two requirements for *bona fide* inadvertent error:
    - *Bona fide* ("requirement 1"); and
    - Inadvertent ("requirement 2").

USP's

- The taxpayer did not disclose the opinion on which it allegedly relied in claiming the FBE exemption.
  - taxpayer could not prove the claim was made in good faith (i.e. requirement 1 not satisfied).
- But even if it could prove satisfaction of requirement 1, there is nothing inadvertent about deliberately claiming the exemption on the back of an opinion (i.e. requirement 2 not satisfied).

USP's

- The argument on requirement 2 is the same argument raised by SARS in the SCA in the Thistle (85 SATC 347) case.
- However, in Thistle, SARS "conceded" on the USP (correctly so according to the SCA)- ITC1890(79 SATC 62).
- Slight difference in facts between Thistle and Coronation:
  - Thistle: opinion was part of the court record.
  - Coronation: opinion was not part of the court record.
- So what?
  - the argument has already been tested (at least in the SCA in Thitsle) and failed and would likely have failed in Coronation too?
  - CC judgment in Thistle pending though…

SARS' submissions in Thistle cross appeal to the CC on USP

- SARS did not concede its case in the SCA on USP's.
- If there is an understatement there must be a USP.
- When there is an opinion, there can be no inadvertence.
- SCA simply assumed that because there is an opinion, it is a *bona fide* inadvertent error without considering the meaning of those words.
- The scheme of the act does not allow for taxpayers to escape liability for a USP simply because there was reliance on advice.
- Will it succeed?
  - ????

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Bona fide inadvertent – An alternative argument FOR SARS

- Perhaps an “alternative argument”:
  - Currently finalizing my views…

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USP’s, CFC’s, Coronation, Thistle and future relevance.

- Going forward: legislative amendments?
  - **FBE**
  - **USP’s**
    - What will happen to USP’s if reliance on professional advice = *bona fide* error.
    - … USP provisions = placeholders

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USP's, CFC's, Coronation, Thistle and historic relevance and TDR

- USP's:
  - Reliance on professional advice = bona fide inadvertent error? (lets see what the CC says about USP's if anything)
  - How many USP's where then incorrectly imposed?
- Outsourcing is allowed
  - How many FBE exemptions incorrectly disallowed?

USP's, CFC's, Coronation, Thistle and historic relevance and TDR

- Go back?
  - Object? Appeal?
    - 3 year cut off – section 104(5)
    - Condonation – exceptional circumstances
  - Prescription?
    - exceptions
  - Finality - section 100?
    - No objection/appeal having been lodged (finality) vs despite the fact that no appeal has been lodged (reduced assessments)
- Certainly not impossible!

Thank you

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Southafricatax

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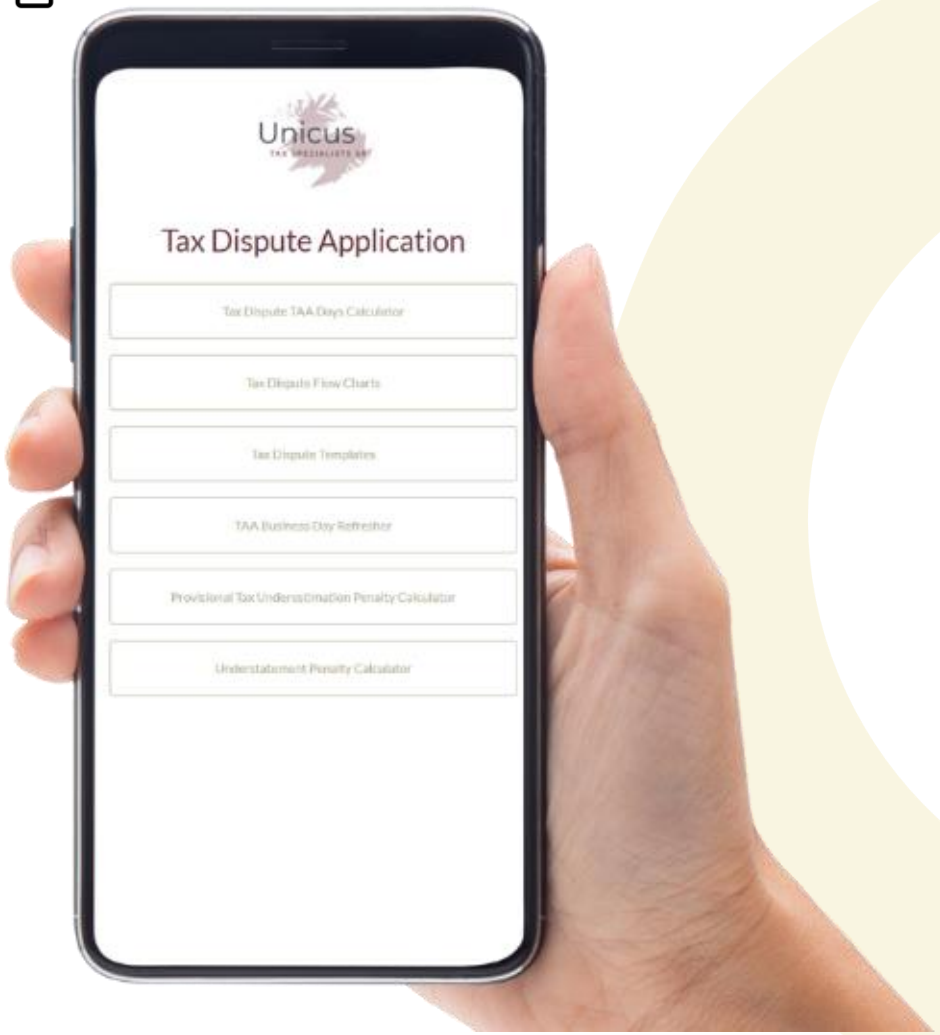
Tax Dispute Resolution Application



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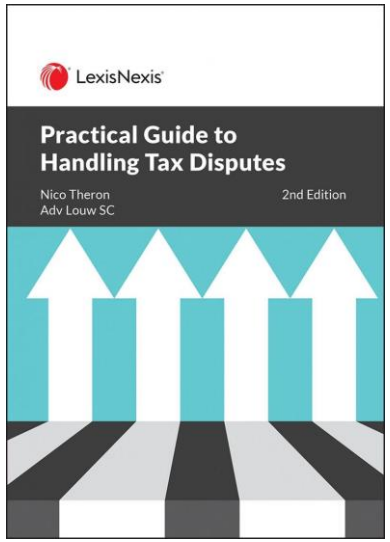

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