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TRUSTS
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GENERAL
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PERMANENT ESTABLISHMENTS

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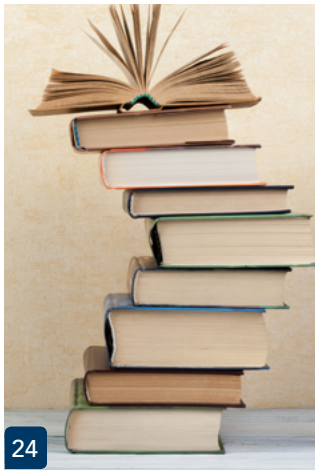


GENERAL ANTI-AVOIDANCE RULES

GAAR (general anti-avoidance rules) is one of the most important, although often ignored, tax concepts, which can scupper all your clever tax plans. What does GAAR mean and why is it so important, by reference to South Africa?

Tax frameworks generally have general rules, the long complex pages of tax law, and then specific anti-avoidance rules, generally brought in over time to attack specific tax nefariousness. The rules around transfer pricing, controlled foreign companies, and disguised remuneration are all examples of specific anti-avoidance rules. A growing number of countries also have general anti-avoidance rules as an additional mop-up, often in tandem with rules around reportable arrangements (whereby certain types of transaction are deemed *de facto* dodgy and must be disclosed upfront to the relevant tax authority). These general anti-avoidance rules differ from country to country but essentially all say that even if what you are doing is legal under the tax rules, ie, not caught by any specific anti-avoidance legislation, if you did it purely or mainly to get a tax benefit, then any such tax benefit can be overruled.

These rules are very powerful and give the relevant revenue authority the power to ignore or reimagine specific transactions and levy the tax that they think would have been due had the transaction not been entered into.

This can be intimidating, particularly when we consider that usually the onus is on the taxpayer to demonstrate that tax was not the main reason for entering into the transaction; the assumption is therefore that the motive *was* tax avoidance unless the taxpayer can prove differently. Today we focus on the GAAR in South Africa to explore the mechanics. The rules are contained in Part IIA of Chapter III of the Income Tax Act, 1962 (the Act), and came into operation in November 2006. Although it makes up a very small part of the Act, only consisting of 12 sections (sections 80A to 80L), it has far-reaching consequences.

In a nutshell:

- Section 80A defines an impermissible tax avoidance arrangement;
- Section 80B lays out the remedies that can be enacted by the South African Revenue Service (SARS) with respect to avoidance arrangements;
- Sections 80C to 80G expand on the requirements of an impermissible tax avoidance arrangement as set out in section 80A;
- Sections 80H to 80L provide general procedures and definitions.

While in theory a taxpayer is allowed to arrange his tax affairs in an optimal manner, where arrangements are entered into for the sole or main purpose of obtaining a tax benefit (which is any avoidance, reduction, or even postponement of any liability for any tax), the GAAR rules will apply and classify such arrangement as an impermissible tax arrangement. In other words, a taxpayer that enters into such an arrangement will be at risk of SARS challenging the arrangement and enforcing remedies.

Section 80A basically defines the term "impermissible tax avoidance arrangement" to be an arrangement of which the sole or main purpose was to obtain a tax benefit; the transaction was either carried out in a manner which would not normally be employed in the course of business, or such arrangement lacks commercial substance.

In terms of section 80C an arrangement lacks commercial substance where it results in a significant tax benefit for one party but does not have a significant effect on the business risks or net cash flows of that party. Arrangements often have indicators of lack of commercial substance such as the following:

- Section 80D deals with round trip financing, which includes funds being transferred between or among parties which results in a tax benefit and significantly reduces or eliminates many business risks incurred by any party in connection with the avoidance arrangement. An example includes a sale and leaseback arrangement of an asset in which capital allowances initially cannot be claimed. Roundtrip financing is present as funds were transferred from the purchaser to the seller and the seller (now lessee) will repay the same funds to the purchaser (now lessor) and claim a deduction for the lease payments.
- An accommodating or tax-indifferent party, as explained in section 80E, means a party that receives an amount in connection with the avoidance arrangement which is not subject to tax or is significantly offset by expenditures or losses and which directly or indirectly results in another party having a reduced taxable income. A party will not be considered an accommodating or tax-indifferent party where such party continues to engage directly in substantive active trading activities in connection with the avoidance arrangement for a period of at least 18 months, provided that these activities constitute *bona fide* business operations conducted at suitable premises which are suitably equipped with suitable facilities and suitable staff.

"In terms of section 80C an arrangement lacks commercial substance where it results in a significant tax benefit for one party but does not have a significant effect on the business risks or net cash flows of that party."

An arrangement will also be considered an impermissible tax-avoidance arrangement in any context if such arrangement/transaction created rights or obligations that would not normally be created between persons dealing at arm's length (for example an additional deduction is claimed as a result of such arrangement) or such arrangement would result in the misuse or abuse of the provisions of the Act.

What can SARS do if an arrangement meets the definition of an impermissible tax avoidance arrangement as set out in section 80A? The answer is quite a lot! Most commonly, SARS will treat the impermissible avoidance arrangement as if it did not exist or in such a manner that SARS deems appropriate. This means that the tax liability linked to such impermissible avoidance arrangement will be calculated in a manner that is normally employed in business or between arm's length parties, or in practice in whatever way SARS decides so as to undo the benefit being sought.

This means that SARS may disregard, combine or recharacterise any steps or parts of the arrangement, disregarding any tax-indifferent party, deeming persons who are connected persons to be one and the same person for purposes of determining the tax treatment of any amount, and reallocating or recharacterising gross income, expenditure or receipt or accrual of a capital nature.

In summary, for GAAR to apply, there must first be an arrangement (section 80L) in which a tax benefit is derived; secondly, such arrangement's sole or main purpose must be to obtain a tax benefit and the arrangement must be classified as an impermissible tax avoidance arrangement (section 80A) by having abnormal characteristics, lacking commercial substance (section 80C) or including round trip financing (section 80D).

One should remember that an avoidance arrangement is presumed to be entered into or carried out for the sole or main purpose of obtaining a tax benefit unless the taxpayer can prove otherwise; one should therefore make sure that one structures and documents one's arrangements wisely.

Serushka Moodley

Regan van Rooy

Acts and Bills

- Income Tax Act 58 of 1962: Chapter III: Part IIA (sections 80A to 80L).

Tags: anti-avoidance rules; tax benefit; impermissible tax avoidance; tax-indifferent party.

LIMITATIONS ON USE OF ASSESSED LOSSES AND DEDUCTIBILITY OF INTEREST

The Minister of Finance (the Minister) announced in February 2022 in his Budget Speech that the corporate income tax (CIT) rate will be reduced to 27% for years of assessment ending on or after 31 March 2023.
The reasons outlined by the Minister for proceeding with this reduction are as follows:

- Corporate income and profits have been more resilient than anticipated with tax collection recently buoyed by strong increases in the prices of exports relative to imports.
- South Africa's CIT rate exceeds the Organisation for Economic Co-operation and Development's (OECD) average of 23%.
- The CIT rates of countries with strong investment and trading ties to South Africa are significantly lower than ours; this provides a strong incentive for tax avoidance.
- The reduction in CIT is part of a broader restructuring of the corporate income tax system in South Africa.
- While the reduced CIT rate will result in a revenue loss, it will be offset by the additional revenue earned from protecting and broadening the tax base.

"Some exceptions aside, South African corporate taxpayers are currently permitted to use the full balance of an assessed loss to shield taxable income in a year."

With the reduction in the CIT rate confirmed, the following amendments aimed at protecting and broadening the tax base now also come into play (ie, for years of assessment ending on or after 31 March 2023):

- The limitation on the use of assessed losses; and
- Further restricting the deductibility of interest paid to tax-exempt persons.

We deal with these proposed amendments in more detail below.

Limitation on use of assessed losses

Some exceptions aside, South African corporate taxpayers are currently permitted to use the full balance of an assessed loss to shield taxable income in a year. However, under the revised rules which now become effective for years of assessment ending on or after 31 March 2023, a company can only offset a balance of an assessed loss against the higher of R1 million or 80% of taxable income arising in a year. The impact of this revised rule is illustrated in the following example:

> Company A has an assessed loss brought forward of R2 000 000 and has taxable income of R1 100 000 for its tax year ending 30 June 2023. In determining its taxable income for this year, Company A can only offset the higher of R1 000 000 or R880 000 (80% of R1 100 000) by the assessed loss brought forward. Company A will thus pay tax on R100 000 and will carry forward an assessed loss of R1 000 000 to the following tax year.

While the overall aim of this proposed amendment is generally appreciated by the taxpaying public, the timing thereof is still unfortunate and may burden businesses trying to recover from the effects of the COVID-19 pandemic. It also negates the effect of accelerated allowances as an incentive, which is particularly concerning and may adversely impact the level of investment into critical energy- and gas-related projects going forward.

Further restricting the deductibility of interest paid to tax-exempt persons

The existing rules that limit the tax deductibility of interest paid to tax-exempt persons are encapsulated in section 23M of the Income Tax Act, 1962 (the Act), and first became effective for interest incurred on or after 1 January 2015. In order to strengthen the application of these rules (ie, to increase the amount of "interest" that does not qualify for a tax deduction) the 2021 legislative cycle included changes to section 23M as follows:

- broadening the definition of interest to include payments made under interest rate swap agreements, the finance cost element of finance leases, and foreign exchange differences;
- introducing a fixed-ratio limitation of 30% of adjusted taxable income, which is essentially a form of earnings before interest, taxes, depreciation, and amortisation for purposes of the rules in section 23M;
- curbing the circumvention of the rules by using back-to-back loans; and
- ensuring that the rules apply even if the interest is subject to the withholding tax on interest in South Africa.

The last change outlined above is particularly noteworthy as section 23M currently does not apply where the interest has been subject to any level of withholding tax in South Africa. This is a critical change and will result in significantly more cross border interest-bearing loans being subject to section 23M.

Corporate taxpayers are thus advised to revisit the application of section 23M to interest paid once the revised rules become effective.

Lance Collop

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Section 23M.

Tags: broadening the tax base; assessed losses; tax-exempt persons; withholding tax on interest.

CANCELLATION OF CONTRACTS

Parties wishing to cancel a contract should try to do so within the same year of assessment as it was entered into, to avoid adverse cash-flow consequences.

The Taxation Laws Amendment Act, 2015, introduced a number of amendments to, *inter alia*, certain sections of the Income Tax Act, 1962 (the Act), and certain paragraphs of the Eighth Schedule to the Act in order to address the cancellation of contracts. These amendments came into effect on 1 January 2016.

The principle underlying these amendments is that prior year assessments cannot be reopened to take account of subsequent events.

In *Caltex Oil (SA) Ltd v Secretary for Inland Revenue*, [1975], Botha JA stated the following at paragraph 15:

> "What is clear, I think, is that events which may have an effect upon a taxpayer's liability to normal tax are relevant only in determining his tax liability in respect of the fiscal year in which they occur, and cannot be relied upon to redetermine such liability in respect of a fiscal year in the past."

The taxpayer in *New Adventure Shelf 122 (Pty) Ltd v Commissioner for South African Revenue Service*, [2017], learned this lesson the hard way when it lost its appeal to the Supreme Court of Appeal (SCA). The company had sold immovable property in 2007. It cancelled the contract in 2012 and reacquired the property. The SCA rejected its bid to have the capital gain that arose in 2007 redetermined retrospectively.

When an agreement is cancelled –

- in the same year of assessment, paragraph 11(2)*(o)* of the Eighth Schedule provides that the disposal must be disregarded, provided that the parties are restored to the same position as before the agreement; and

- in a subsequent year of assessment, a capital gain recognised in the year of disposal is reversed as a capital loss under paragraph 4*(c)* of the Eighth Schedule in the year of cancellation, while a capital loss arising in the year of disposal is reversed as a capital gain in the year of cancellation under paragraph 3*(c)*.

Under paragraph 20(4) of the Eighth Schedule, the seller's base cost is restored to its pre-sale amount plus the cost of reimbursing the buyer for any improvements effected by the buyer. It would appear that paragraph 20(4) applies to a cancellation during the same year of assessment as well as one that occurs in a year of assessment subsequent to the year of disposal.

It will be evident that the legislature made no provision for the reopening of assessments to reverse the consequences. There are in fact very few situations in the Act in which a reopening of an assessment to give effect to a subsequent event is possible.

One exception to this rule appears to be when an executor disposes of an asset, which had been bequeathed to the surviving spouse, to a third party. In this situation, the roll-over under section 9HA(2) of the Act, read with section 25(4), becomes inapplicable. It may be necessary to reopen the deceased's last tax return to recognise the deemed disposal at market value.

A similar result may ensue when a surviving spouse enters into a redistribution agreement because the asset he or she ultimately acquired may not be what was bequeathed to him or her. It is unsatisfactory that future events are allowed to influence how the deceased person will be taxed.

Agreement

Claassen's Dictionary of Legal Words and Phrases defines an agreement as follows:

> "A contract is an agreement between two or more persons which gives rise to personal rights and corresponding obligations; in other words, it is an agreement which is legally binding and enforceable by the parties (*Wille's Principles of South African Law* 6ed 301); *Wilken v Kohler* 1913 AD 135 140; *Pattison v Fell* 1963 3 SA 277 (N) 279."

It is worth bearing in mind that the articles of association of a company (now incorporated into a company's Memorandum of Incorporation) represent a contract between the members and the company (see *Hickman v Kent or Romney Marsh Sheep-breeders' Association*, [1915]). This fact can be relevant when dealing with agreements involving the cancellation of share transactions.

Return of the same asset

Paragraph 11(2)*(o)* requires that the person that disposed of the asset reacquire "that asset". In other words, the disposer must be restored with the same asset.

A question arises as to how this will be possible, for example, with identical assets such as dematerialised shares. The Eighth Schedule is concerned with the disposal and reacquisition of rights. In *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others*, [1983], Corbett JA stated the following (at 288):

> "A share in a company consists of a bundle, or conglomerate, of personal rights entitling the holder thereof to a certain interest in the company, its assets and dividends."

It is submitted that as long as a shareholder receives a share with rights that are identical to those of the share disposed of, the shareholder would have met the "same asset" requirement.

In practice, SARS accepts that the specific identification method can be used in relation to dematerialised shares under paragraph 32 on a nomination basis. In SARS' *Comprehensive Guide to Capital Gains Tax* (Issue 9) it is stated in chapter 8.36.2 ("Permissible methods for determining base cost of identical assets") that dematerialised shares can be identified by date of acquisition and cost. This approach by SARS recognises the fungible nature of dematerialised shares.

What constitutes a cancellation?

Sometimes an agreement will contain a cancellation clause which may be triggered by a resolutive condition. For example, section 24N(2)*(d)* of the Act enables a capital gain to be recognised on a due and payable basis, subject to a number of conditions, one of which is that the purchaser of equity shares must return them "in the event of failure by the purchaser to pay any amount when due".

But contracts can also be cancelled by agreement. *Christie's Law of Contract in South Africa* states the following (at pages 506–507):

"Both paragraphs 11(2)*(o)* and 20(4) require the parties to be restored to the position they were in prior to entering into the agreement but do not give any indication when this will be regarded as having occurred."

> "When the parties to an existing contract come together in an agreeing frame of mind and formally, or informally, agree to vary or discharge their contract we have no difficulty about describing what has happened as a variation or discharge by agreement, or a cancellation by agreement."

What constitutes restoration to the position prior to entering into the agreement?

Both paragraphs 11(2)*(o)* and 20(4) require the parties to be restored to the position they were in prior to entering into the agreement but do not give any indication when this will be regarded as having occurred. However, paragraph 20(4) recognises that the buyer may improve the asset while holding it and permits the seller's original base cost to be increased by any expenditure the seller incurred in reimbursing the buyer for improvements. This rule recognises that improvements to an asset can be made before it is returned to the seller.

The *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2015*, which supported the insertion of paragraph 11(2)*(o)*, does not provide any comment on the restoration requirement.

One of the common-law remedies available under contract law is *restitutio in integrum.* This is described in the *Glossary of Foreign Terms* (RD Claassen: June 2020), which forms part of the index to the South African Tax Cases Reports, as follows:

> "Restitution in full, by which the parties to a contract are restored to the same position as they occupied before the contract was entered into."

It was no doubt with this remedy in mind that paragraphs 11(2)*(o)* and 20(4) were drafted.

In *Hall-Thermotank Natal (Pty) Ltd v Hardman*, [1968], the court cited *Wessels, Law of Contract* (2 ed (1951) at 4742) as follows:

> "Although there must be restitution, and although the parties must be placed as much as possible in the position in which they were before the sale, yet a *restitutio in integrum* in the case of sale does not imply that the article must always be restored in exactly the same condition in which it was at the moment of delivery. As the fault is due to the seller the court ought to give considerable latitude to the buyer. All the latter need therefore to do is to restore the article subject to such incidents as it may be liable to in the ordinary course of affairs, either from its inherent nature or from the legitimate use to which the buyer put it prior to the discovery of the defect. The very contract of sale gives the purchaser the right to deal with the thing bought, and if it deteriorates in the hands of the buyer whilst making a reasonable use or trial of it, the reduction in value resulting from such depreciation must be borne by the seller, and does not preclude a *restitutio in integrum*."

The same quote is cited in *Van Der Boon NO v Moletsane*, [2020] (at 6).

On the question of unjust enrichment, the court in the *Hall-Thermotank Natal* case observed as follows (at 832):

> "The basis of *restitutio in integrum* is the equitable doctrine that no one is permitted to enrich himself unjustly at the expense of another."

While the case dealt with a seller who was at fault, which may not always be applicable, the case is useful in that it emphasises the point that the asset need not be in exactly the same condition as when it was first acquired. It stands to reason that most assets would experience some change in value or condition.

If the application of paragraph 11(2)*(o)* or 20(4) is prevented when these changes are of a minor nature, it would not advance the purpose of the provision, which was to avoid onerous tax consequences for a seller who was restored to the same economic position.

A minor change in value would not amount to an unjust enrichment that results in the parties not being restored to their pre-sale position.

In *Natal Joint Municipal Pension Fund v Endumeni Municipality*, [2012], Wallis JA stated the following in relation to the interpretation of statutes or contracts (at 604):

> "A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document."

He continued (at 610):

> "An interpretation will not be given that leads to impractical, unbusinesslike or oppressive consequences or that will stultify the broader operation of the legislation or contract under consideration."

Conclusion

If parties to a contract wish to cancel it, they should try to do so during the same year of assessment in order to take advantage of paragraph 11(2)*(o)*. Cancelling the contract in a subsequent year of assessment will not help to undo the adverse cash-flow consequences of paying tax upfront and then being rewarded with a capital loss in the year of cancellation. Whether the parties have been restored to the position they were in prior to entering into the agreement is a question of fact, but the common-law remedy of *restitutio in integrum* at least offers some flexibility in the interpretation of the cancellation provisions of the Eighth Schedule.

[This article was first published in Accountancy SA (ASA) September 2021.]

Duncan McAllister

Webber Wentzel

Acts and Bills

- Income Tax Act 58 of 1962: Sections 9HA(2), 24N(2)*(d)* & 25(4); Eighth Schedule: Paragraphs 3*(c)*, 4*(c)*, 11(2)*(o)*, 20(4) & 32;
- Taxation Laws Amendment Act 25 of 2015.

Other Documents

- *Claassen's Dictionary of Legal Words and Phrases* RD Claassen [online] (My LexisNexis: June 2020);
- *Wille's Principles of South African Law* 6ed 301;
- *Christie's Law of Contract in South Africa (*G Bradfield 7 ed (2016) (at pages 506&507) [online] (My LexisNexis: 31 December 2015);
- *Glossary of Foreign Terms*, RD Claassen [online] (My LexisNexis: June 2020);
- South African Tax Cases Reports; Index;
- *Wessels, Law of Contract* 2 ed (1951) (at 4742);
- SARS' *Comprehensive Guide to Capital Gains Tax* (Issue 9) (paragraph 8.36.2) (issued on 5 November 2020).

Cases

- *Caltex Oil (SA) Ltd v Secretary for Inland Revenue* [1975] (1) SA 665 (A); 37 SATC 1 (at 15);
- *New Adventure Shelf 122 (Pty) Ltd v Commissioner for South African Revenue Service* [2017] (5) SA 94 (SCA), 2 All SA 784 (SCA), 79 SATC 233;
- *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2012] (4) SA 593 (SCA);
- *Wilken v Kohler* [1913] AD 135 (at 140);
- *Pattinson and Another v Fell and Another* [1963] (3) SA 277 (D) (at 279);
- *Hickman v Kent or Romney Marsh Sheep-breeders' Association* [1915] 1 Ch 881 (at 900);
- *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* [1983] (1) SA 276 (A) (at 288);
- *Hall-Thermotank Natal (Pty) Ltd v Hardman* [1968] (4) SA 818 (D);
- *Van Der Boon NO v Moletsane* [2020] JDR 2499 (FB) (at 6).

Tags: redistribution agreement; dematerialised shares; resolutive condition; *restitutio in integrum.*

SARS INTEREST RATES

Tax and VAT – interest rate increases

The SARS interest rates have been increased as detailed below.

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): 7.5% per annum from 1 May 2022 (was 7.25% per annum with effect from 1 March 2022).

  Payable by SARS on refunds of tax (where interest is applicable): 3.5% per annum from 1 May 2022 (was 3.25% per annum with effect from 1 March 2022).

  If the refund is made after a successful tax appeal or where the appeal is conceded by SARS, the interest rate is 7.5% per annum from 1 May 2022 (was 7.25% per annum from 1 March 2022).

- **VAT**

  Payable to SARS on late payments: 7.5% per annum from 1 May 2022 (was 7.25% per annum from 1 March 2022).

  Payable by SARS on VAT refunds after prescribed period: 7.5% per annum from 1 May 2022 (was 7.25% per annum from 1 March 2022).

- **Fringe benefits**

  Official interest rate for loans to employees below which a deemed fringe benefit arises: 5.25% per annum from 1 April 2022. 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: 5.25% per annum from 1 April 2022. See below for details of historical changes.

- **Donations tax**

  Loans to trusts by natural connected persons with interest charged at rates below the official rate create a 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 tax deduction must be made 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 at less than the "official" rate (or market-related rate in the case of foreign currency loans) is payable on the loan, or fringe benefits tax is payable on an interest-free (or subsidised-interest) loan to an employee.

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

  It is not the amount of the loan but the interest reduction which is deemed to be a dividend. 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 natural connected persons with interest charged below the official rate create a donation subject to donations tax at 20% 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 is currently 4.25% per annum (with effect from 1 April 2022).

The "official" rate of interest over the past five years

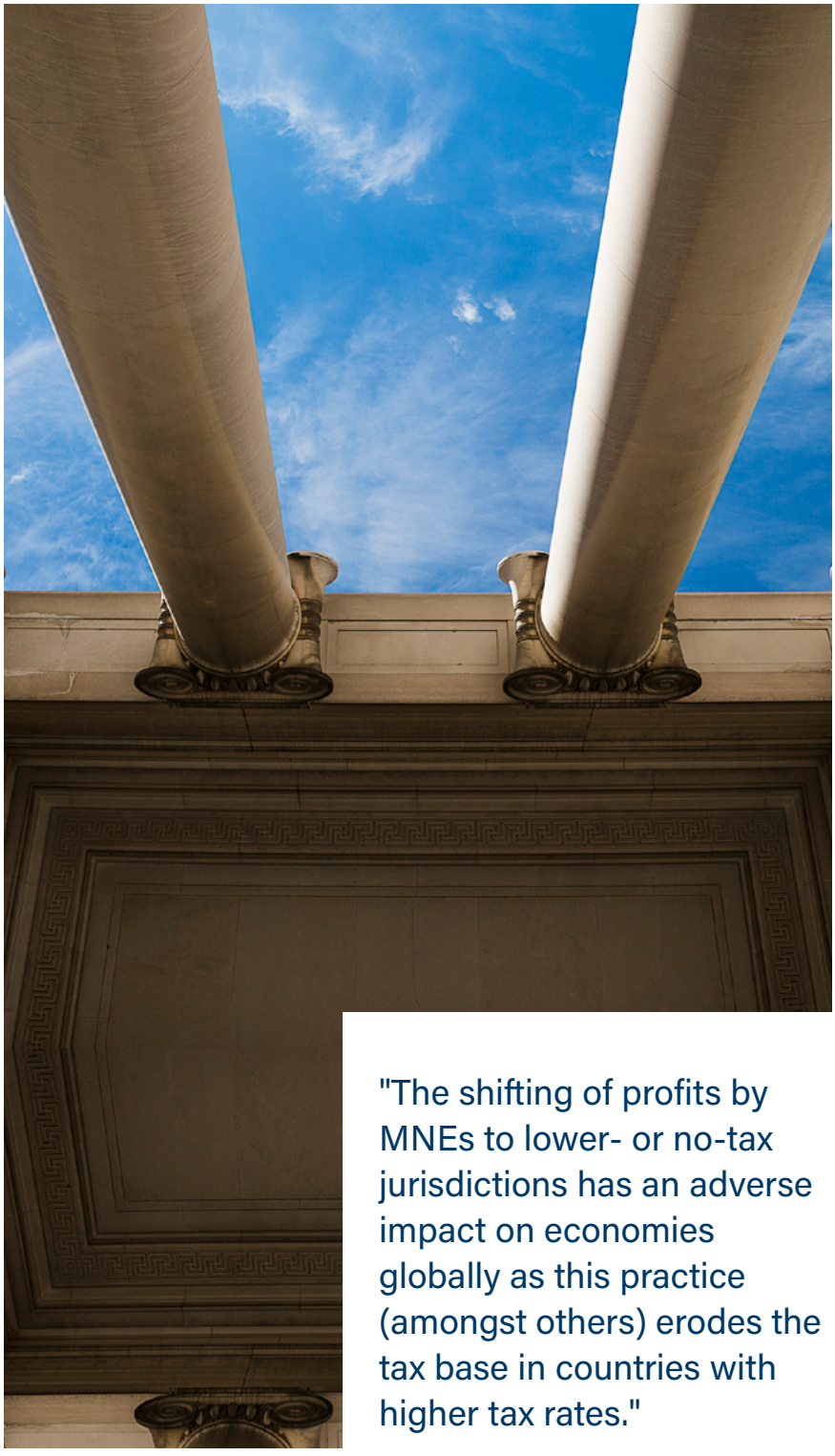
With effect from		Rate per annum
1 August 2017	–	7.75%
1 April 2018	–	7.50%
1 December 2018	–	7.75%
1 August 2019	–	7.50%
1 February 2020	–	7.25%
1 April 2020	–	6.25%
1 May 2020	–	5.25%
1 June 2020	–	4.75%
1 August 2020	–	4.50%
1 December 2021	–	4.75%
1 February 2022	–	5.00%
1 April 2022	–	5.25%

Kent Karro

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

BEPS PROJECT AND THE TWO-PILLAR SOLUTION

In order to curb tax base erosion and profit shifting (BEPS) by multinational enterprises (MNEs) that take advantage of low-tax jurisdictions, the Organisation for Economic Co-operation and Development (OECD) (in conjunction with the G20) introduced the BEPS Project in 2015. The BEPS Project aims to ensure that profits are taxed in the jurisdiction where the economic activities generating such profits are performed.



While significant strides have been made in the implementation of the 15 Actions of the BEPS Project, there are still certain gaps that remain. One of these gaps pertains to the ability of large MNEs to earn substantial income in jurisdictions where they are not paying corporate income tax.

In order to address this, the members of the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) agreed to the Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (the 2021 Statement) on 8 October 2021. This statement contains the Two-Pillar Solution to establish a new framework for international tax, as well as a detailed implementation plan that envisages the implementation of this new framework by 2023. Subsequent to the publication of the 2021 Statement, the OECD also published additional rules and detailed technical guidance in respect of the domestic implementation of a 15% global minimum tax.

"The shifting of profits by MNEs to lower- or no-tax jurisdictions has an adverse impact on economies globally as this practice (amongst others) erodes the tax base in countries with higher tax rates."

Introduction to BEPS and the G20 Inclusive Framework

The shifting of profits by MNEs to lower- or no-tax jurisdictions has an adverse impact on economies globally as this practice (amongst others) erodes the tax base in countries with higher tax rates. In particular, this leads to unhealthy tax competition between jurisdictions and undermines the integrity of tax systems, often taking advantage of developing countries and low-income jurisdictions.

In 2016, the OECD and the G20 established the Inclusive Framework, which ensures that member countries (with a special emphasis on developing countries) can participate on an equal footing in the development of standards on BEPS-related issues. At present, there are 141 countries working together to implement the 15 Actions outlined in the BEPS Project to reduce tax avoidance and BEPS.

The Two-Pillar Solution

In October 2020, subsequent to discussions pertaining to the tax challenges posed by the digitalisation of the economy, the OECD released a "blueprint" for a Two-Pillar Solution to address the said tax challenges. A year later, the 2021 Statement was issued by the OECD/G20 and was agreed to by 136 members of the Inclusive Framework. As previously indicated, the 2021 Statement contained a detailed implementation plan pertaining to the Two-Pillar Solution.

"Pillar One aims to ensure a fairer distribution of profits and taxing rights among countries with respect to the largest MNEs operating in those countries."

Pillar One

Pillar One aims to ensure a fairer distribution of profits and taxing rights among countries with respect to the largest MNEs operating in those countries. This will be done by reallocating taxing rights over 25% of the residual profit of the largest and most profitable MNEs to the jurisdictions where the customers of those MNEs are situated. The 2021 Statement indicated that "residual profit" is defined as profit in excess of 10% of an MNE's global revenue.

It should be noted that, pursuant to the reallocation of profits highlighted above, Pillar One introduces a new special purpose nexus rule permitting the allocation of its profits to a market jurisdiction only to the extent that the MNE derives at least –

- €1 million, in the case of jurisdictions with a GDP of €40 billion or more; or
- €250,000, in the case of smaller jurisdictions with a GDP less than €40 billion.

Pillar One also seeks to promote tax certainty through mandatory and binding dispute resolution procedures, with an elective regime to accommodate certain low-capacity countries.

Of importance in respect of the implementation of Pillar One is the removal of digital service taxes and other similar measures. To this end, digital service taxes will be replaced by the taxation of the reallocated profits envisioned under Pillar One.

The last key element of Pillar One involves the establishment of a simplified and streamlined approach to the application of the arm's length principle in specific circumstances. This element is focused on the needs of developing, low-capacity countries which will benefit from less onerous rules.

Pillar One is intended to apply to MNEs with a global annual turnover in excess of €20 billion and profitability above 10%, calculated using an averaging mechanism. The turnover threshold is likely to be reduced to €10 billion after a period of seven or eight years should this Pillar be implemented successfully.

"Pillar One also seeks to promote tax certainty through mandatory and binding dispute resolution procedures, with an elective regime to accommodate certain low-capacity countries."

Pillar Two

Pillar Two consists of –

- two interlocking domestic rules (together the Global Anti-Base Erosion (GloBE) Rules), being –
    - an Income Inclusion Rule (IIR), which imposes a top-up tax on a parent entity in respect of the low taxed income of a constituent entity; and
    - an Undertaxed Payment Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent that the low taxed income of a constituent entity is not subject to tax under an IIR; and
- a treaty-based rule (the Subject to Tax Rule (STTR)), which allows source jurisdictions to impose limited source taxation on certain related-party payments subject to tax below a minimum rate.

In terms of the GloBE Rules under Pillar Two, a global minimum tax of 15% will be imposed on all MNEs that generate annual revenue over €750 million. It is worth noting that government entities, international organisations, non-profit organisations, pension funds and investment funds that are the ultimate parent entities of an MNE group are not subject to the GloBE Rules.

The GloBE Rules will operate to impose a top-up tax using an effective tax rate test that is calculated on a jurisdictional basis and that uses a common definition of covered taxes and a tax base determined with reference to financial accounting income (with specified adjustments). In respect of existing distribution tax systems, there will be no top-up tax liability if earnings are distributed within four years and are taxed at or above the minimum level.

In terms of the STTR, Inclusive Framework members that apply nominal corporate income tax rates below the STTR minimum rate to interest and royalty payments (amongst others) would (when requested to do so) implement the STTR into their bilateral tax treaties with members of the Inclusive Framework that constitute developing countries. The taxing right under the STTR will be limited to the difference between the minimum rate (9% at present) and the tax rate actually imposed on that payment by the jurisdiction in question.

Recent developments

In order to facilitate the swift and consistent implementation of Pillar One, a multilateral convention (MLC) will be developed by the OECD/G20 to introduce a multilateral framework for all jurisdictions that join the Inclusive Framework, regardless of whether a tax treaty currently exists between the relevant jurisdictions. The MLC will be supplemented by an explanatory statement that describes the purpose and operation of the rules and processes.

During February 2022, the OECD launched a public consultation process in respect of Pillar One that is to be implemented in stages. In particular, it has been indicated that working documents on each building block of Pillar One will be systematically released in order to obtain public feedback quickly and before completion of a comprehensive document regulating Pillar One. To date, the OECD has published for public comment the *Draft Rules for Nexus and Revenue Sourcing* (4 February 2022) and the *Draft Rules for Tax Base Determinations under Amount A of Pillar One* (18 February 2022).

In order to give effect to Pillar Two, model rules (intended to give effect to the GloBE Rules) and a model treaty provision (intended to give effect to the STTR) were to have been developed by the end of November 2021.

On 20 December 2021, the OECD published the Pillar Two model rules for the domestic implementation of the 15% global minimum tax (the 2021 Model Rules). The 2021 Model Rules define the scope, and set out the mechanism, for the GloBE Rules under Pillar Two and are intended to assist countries with bringing the GloBE Rules into domestic legislation in 2022. Specifically, the 2021 Model Rules –

- provide for a co-ordinated system of interlocking rules that determine the scope and application of the global minimum tax;
- address the treatment of acquisitions and disposals of group members and include specific rules to deal with particular holding structures and tax-neutrality regimes; and
- address administrative aspects, including information-filing requirements, and provide for transitional rules for MNEs that become subject to the global minimum tax.

"Under Pillar One, it is estimated that taxing rights on more than $125 billion of profit are expected to be reallocated to market jurisdictions each year, whereas Pillar Two is estimated to generate around $150 billion in new tax revenues globally per year."

On 14 March 2022, the OECD released the *Commentary to the GloBE Rules* (the Commentary) which provides MNEs and tax administrations with detailed and comprehensive technical guidance on the operation and intended outcomes of the 2021 Model Rules. The Commentary is intended to promote a consistent and common interpretation of the GloBE Rules that will facilitate co-ordinated outcomes for both tax administrations and MNE Groups.

It has been indicated that a multilateral instrument (MLI) will be developed by mid-2022 to facilitate the implementation of the STTR in the relevant bilateral treaties and it is the intention of the Inclusive Framework to finalise the implementation of both Pillar One and Pillar Two by 2023.

Comment

On the basis that BEPS can have a significantly negative economic impact, especially on developing countries, the movement towards the actual implementation of the Two-Pillar Solution is likely to be a welcome step in ensuring a fairer distribution of tax revenue in the tax jurisdictions where those profits are generated.

Under Pillar One, it is estimated that taxing rights on more than $125 billion of profit are expected to be reallocated to market jurisdictions each year, whereas Pillar Two is estimated to generate around $150 billion in new tax revenues globally per year. These results are expected to significantly stabilise the international tax system.

By its own admission, the 2023 deadline set by the OECD/G20 to fully implement the Two-Pillar Solution is quite ambitious and there is still a significant amount of work to be done (on a global level and especially on a domestic level) before the Two-Pillar Solution will be fully effective. However, now that the Two-Pillar Solution is taking shape, it will be important for MNEs to take cognizance of the thresholds referred to under each Pillar to determine whether they will be subject to the new rules of international taxation.

Louise Kotze

Cliffe Dekker Hofmeyr

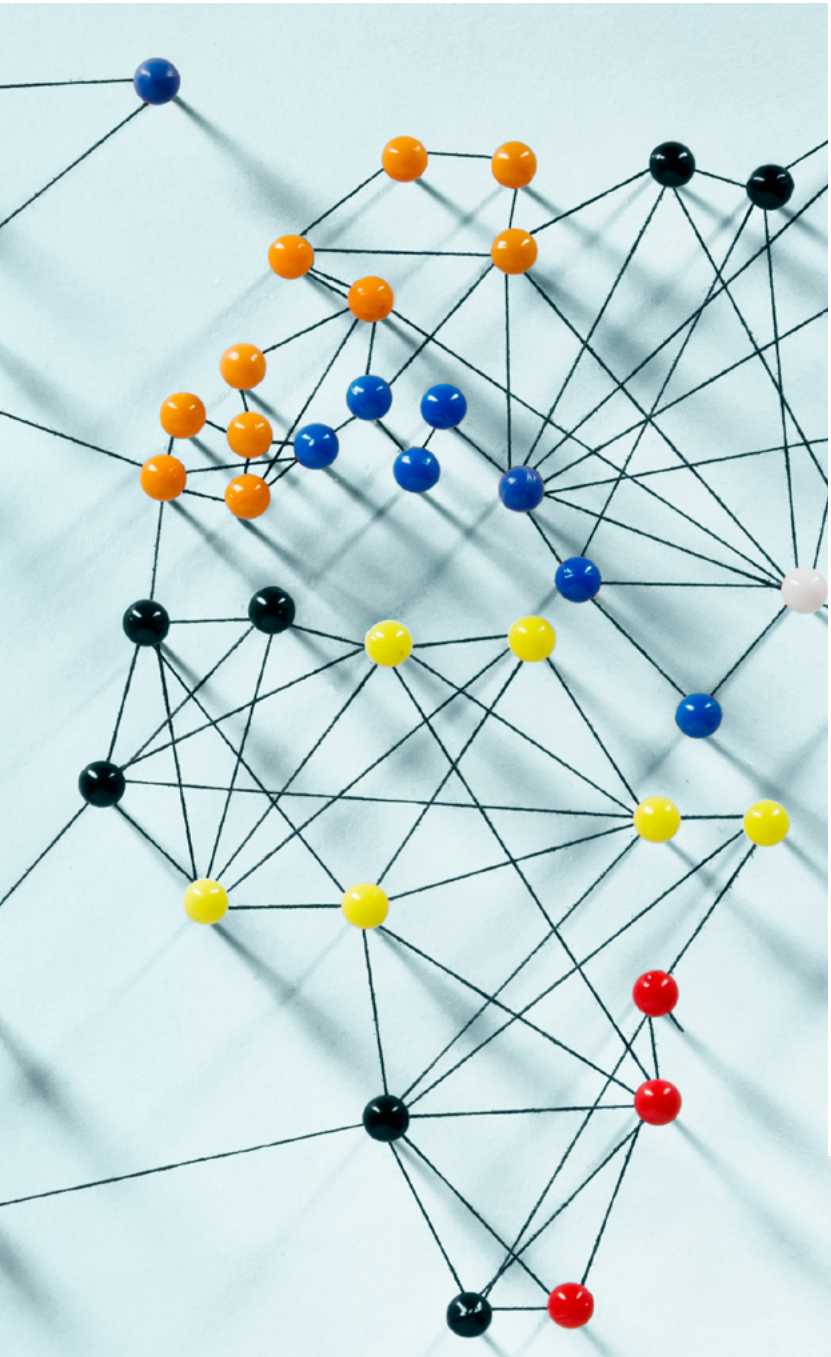
Other documents

- Exchange Control Regulations.
- 15 Actions of the BEPS Project;
- Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (8 October 2021);
- Global Anti-Base Erosion (GloBE) Rules;
- Income Inclusion Rule (IIR);
- Undertaxed Payment Rule (UTPR);
- Subject to Tax Rule (STTR).

Tags: tax base erosion and profit shifting (BEPS); low-tax jurisdictions; Inclusive Framework; Global Anti-Base Erosion (GloBE) Rules; Income Inclusion Rule (IIR); Undertaxed Payment Rule (UTPR); Subject to Tax Rule (STTR).

PERMANENT ESTABLISHMENTS

Generally, businesses try very hard to avoid creating a permanent establishment (PE) when they operate across borders. However, there are a few instances where it is actually better to create a PE! The reality is that where countries levy a high service withholding tax, which is often the case in Africa, a PE may actually result in lower tax.



What is a PE?

A PE is basically a taxable branch that an entity from one country creates in another country by operating or having a presence there. Each country has its own specific definition and rules around what a PE is, but, generally, it is a fixed place of business (eg, a shop or office) through which the company conducts business activities in that other country. For a PE to exist, the company usually has to have a presence in the foreign country for at least six months (although this period can be shorter in some countries or for certain activities). When calculating the period of time spent in a country, the aggregate time spent by each employee is added together with that of other employees to determine whether the six-month threshold has been breached. If you therefore have three salespersons each spending two months per year in a country, this could give rise to a PE.

There are various exemptions, eg, if the work being undertaken is preparatory (eg, conducting a feasibility study) or ancillary (ie, not part of the "real" business of the company), or if the fixed presence is used simply to store goods. However, typically these exemptions only apply where there is a double taxation agreement (DTA) between the two countries in question. This, along with reduced withholding taxes, is a key reason why DTAs are so helpful.

Why do we not want PEs?

Where a company creates a PE in a foreign country, all the profits earned as a result of the activities conducted in that foreign country can be taxed there. However, the PE profits will also be taxed in the home country as foreign branch profits are generally included in a company's taxable income. So, double taxation arises. Also, in terms of compliance, the company would have to register for tax in the foreign country, submit tax returns and also prepare branch accounts and comply with in-country company law and regulatory requirements.

"Companies should definitely carefully consider if they are at risk of creating a PE, and, if so, the implications if they were to do so."

The PE will therefore be taxed in the foreign country, but how do we determine what profits should be allocated to a PE? That is where transfer pricing (TP) comes in. So, the PE will then have to conduct a TP exercise to justify its allocation of profits to the revenue authorities.

The other problem with a PE is that it pulls a legal entity resident in one country into another country's tax and legal regime; this is messy and limits country-risk and company-risk ring-fencing. Generally, it is advisable to avoid a PE, or if it cannot be avoided, ie, if you really are going to be trading in that other country, to rather set up a subsidiary instead of a PE as the tax and compliance burden should be similar but country and company ring-fencing can be effected.

Would it ever be better to create a PE?

A PE equals in-country tax and double taxation; surely that should therefore be avoided if possible? African countries love withholding tax (WHT), even more than transfer pricing. And their favourite form of withholding tax is on service fees. Even where there is a DTA in place that essentially prohibits WHT on services unless the foreign company has a PE in that country, they still like to apply them. So, although in most cases where there is no PE, there should be no services WHT, many African countries merrily levy the services WHT. This is why it may be better to establish a PE and essentially pay foreign corporate tax on your margin rather than foreign WHT on your gross income.

Let us consider an example: South Africa and Azania for instance have a DTA in place which contains a service / technical fees article so that Azania is entitled to levy a 20% service WHT; where a South African (SA) company therefore invoices ZAR 100 to an Azanian client, the client will deduct a 20% services WHT.

However, where a PE is created in Azania, the PE would be subject to corporate tax in Azania on their locally sourced income at the corporate tax rate of, say, 30%.

At first glance, it seems as though a local PE is worse due to a corporate tax rate of 30% compared to a WHT of 20%. However, the difference is that the WHT is levied on the *gross* amount of income, whereas corporate tax is levied on the *net* amount of income. Depending on the gross profit margin of a company, this could result in significant tax savings. So, assuming a gross profit margin of 25%, the PE would be subject to tax at 30% x $25 profit = $7.5 tax, versus a WHT of $100 x 20% = $20. South African tax relief would also come into play, as well as potentially branch dividend WHT on the after-tax profits. The former is generally limited in terms of service fees as these are often SA-sourced (no foreign tax credit permitted) and the latter (dividend WHT) is on a net amount; the overall tax bill can therefore end up being lower with a PE. As a rule of thumb, the higher the WHT and the lower the margin (especially if on SA-sourced services) the more likely it is that a PE could give a better result.

So, what should we do?

The answer, as always in international tax, is "it depends". Companies should definitely carefully consider if they are at risk of creating a PE, and, if so, the implications if they were to do so. Where a high service withholding tax is levied, creating a PE may actually be cheaper from a tax perspective than not having a PE.

Of course, the administrative costs of registering for tax and submitting tax returns in a country should be borne in mind. A company should also consider how easy it would be to allocate the profits between the PE and the head office company.

Vanessa Turnbull-Kemp

Regan van Rooy

Tags: permanent establishment (PE); legal entity resident; corporate tax rate.

APPLICATION OF DEFAULT JUDGMENT

It is not often that the tax court hands down judgment in two separate matters on consecutive days, especially where those two matters deal with the same legal question – yet this is exactly what happened in November 2021.

On 18 November, the tax court handed down judgment in *Commissioner for the South African Revenue Service v SAV South Africa (Pty) Ltd* (Case No IT25117) (as yet unreported), where the court granted a taxpayer's application for default judgment in terms of rule 56 of the rules (the Rules) promulgated under section 103 of the Tax Administration Act, 2011 (the TAA).

On 19 November, the tax court handed down judgment in *CDC (Pty) Ltd v Commissioner for the South African Revenue Service* (Case No IT2020/95) (as yet unreported), which also dealt with an application for default judgment in terms of rule 56. While the subject matter of both judgments is identical, our discussion of the second judgment here will reveal that the outcome was not the same in both instances. [*Editorial comment*: The first case (*Commissioner for the South African Revenue Service v SAV South Africa (Pty) Ltd*, [2021] (Case No IT25117)) was discussed by the same author in Issue 45 of TCM (April 2022 – article 415: *Requests for extension of time*).]

Facts

The taxpayer (CDC) brought a rule 56 application pursuant to the following:

- SARS disallowed a substantial assessed loss (approximately R38.5 million) claimed by the taxpayer in its 2011 year of assessment.
- CDC objected to the disallowance of the assessed loss by objecting to SARS' assessment, but SARS disallowed the objection.
- On 22 July 2016, CDC attempted to appeal against SARS' disallowance of the objection by

submitting certain supporting documents to SARS via eFiling, including a special power of attorney. It was disputed whether a typed undated document headed "*Memorandum*" which contains CDC's grounds of appeal, was submitted by eFiling. The applicant contended in the tax court that this "*Memorandum*" was filed then and constituted its notice of appeal (NOA). The "*Memorandum*" was included as an annexure to the founding affidavit of the rule 56 application.

- Following the submission of these documents, there was email correspondence between SARS and CDC on the same day, as to when CDC would submit its NOA, with CDC indicating that it would submit the NOA not later than 12 August 2016.

- After not receiving the NOA of CDC, SARS asked CDC on 12 September 2016 when it would file the NOA, with CDC responding that it had already been filed on 22 August 2016.

- In July 2019, CDC delivered its rule 56 application, withdrew it, and then filed a new rule 56 application approximately two years later, which is the subject matter of this judgment.

- In opposing the application, SARS also filed a supplementary affidavit to prove that CDC had not delivered its grounds of appeal as contemplated under rule 10(2) of the Rules.

The basis for CDC's rule 56 application is that SARS had allegedly failed to file its Statement of Grounds of Assessment in terms of rule 31 of the Rules (the Rule 31 statement) timeously.

Relevant legal provisions

The tax court considered rules 10(2) and 56 in its judgment. Rule 10(2) states the following:

A notice of appeal must –

- be made in the prescribed form;

- if a SARS electronic filing service is used, specify an address at which the appellant will accept delivery of documents when SARS electronic filing service is no longer available for the further progress of the appeal;

- specify in detail the following:

  - in respect of which grounds of the objection referred to in rule 7 the taxpayer is appealing;

  - the grounds for disputing the basis of the decision to disallow the objection referred to in section 106(5) of the TAA; and

  - any new ground on which the taxpayer is appealing;

- be signed by the taxpayer or the taxpayer's duly authorised representative; and

- indicate whether or not the taxpayer wishes to make use of the alternative dispute resolution procedures referred to in Part C of the Rules, should the procedures referred to in section 107(5) of the TAA be available.

Rule 56(1) states that if a party has failed to comply with a period or obligation prescribed under the Rules or an order by the tax court under the Rules, the other party may –

- deliver a notice to the defaulting party informing the party of the intention to apply to the tax court for a final order under section 129(2) of the TAA in the event that the defaulting party fails to remedy the default within 15 days of delivery of the notice; and

- if the defaulting party fails to remedy the default within the prescribed period, apply, on notice to the defaulting party, to the tax court for a final order under section 129(2).

However, rule 56(2) states that the tax court may, on hearing the application, decline granting the application if good cause is shown by the defaulting party for the default.

Judgment

Firstly, the tax court granted SARS' application to file the supplementary affidavit as it could not be shown that it would prejudice CDC.

On the issue of the rule 56 application, the tax court held that one had to determine whether a valid NOA had been filed by CDC. In this regard, it considered whether CDC had complied with rule 10(2) of the Rules. The court held that the "*Memorandum*" allegedly filed by CDC on 22 August 2016 (containing grounds of appeal) did not comply with rule 10(2) as it was not the prescribed NOA form. The tax court accepted SARS' assertion that the documents filed on 22 July 2016 did not include an NOA compliant with rule 10(2), as SARS would then not have asked on the same date by email when the NOA would be filed. SARS relied on a letter dated 4 August 2016 stating that an extension for late filing of the NOA will be granted until 25 August 2016. The court found that CDC's response thereto, that it managed to file the NOA on 16 July 2016, is inconsistent with the other undisputed evidence presented.

The tax court concluded that SARS correctly believed at all material times that CDC failed to deliver a valid NOA in terms of rule 10(2) and that the documents uploaded on 22 July 2016 do not specify in detail the grounds of appeal.

In finding that there was no valid NOA filed, the court held that SARS had shown good cause (as required by rule 56) that it had never defaulted by not filing the Rule 31 statement.

Comment

The most important lesson from this case is that a taxpayer should always ensure that, when it lodges an appeal against SARS' decision to disallow an objection, it files the appeal in accordance with the Rules, so as to avoid a situation where SARS argues that the appeal is invalid. A taxpayer bringing a rule 56 application will be unsuccessful if it did not file a valid appeal in terms of Rule 10.

As this matter illustrates, where there is no valid NOA before SARS, there is no requirement that SARS must do anything further, including filing a rule 31 statement.

This differs from the provisions pertaining to objections, where SARS will notify a taxpayer if an objection is invalid and allow the taxpayer 20 business days to file a valid objection.

Where a taxpayer is uncertain whether it has filed a valid NOA, it should (where possible), follow up with the auditor or SARS official involved in the matter via email, and request confirmation that the appeal has been received and is being considered. This is especially so when taxpayers encounter challenges with submitting the appeal via eFiling.

"The most important lesson from this case is that a taxpayer should always ensure that, when it lodges an appeal against SARS' decision to disallow an objection, it files the appeal in accordance with the Rules, so as to avoid a situation where SARS argues that the appeal is invalid."

Louis Botha

Cliffe Dekker Hofmeyr

Arts and Bills

- Tax Administration Act 28 of 2011: Sections 103, 106(5), 107(5) & 129(2).

Other documents

- Rules promulgated under section 103 of the TAA: Rules 7, 10(2), 31 & 56;
- Rule 31 statement.

Cases

- *Commissioner for the South African Revenue Service v SAV South Africa (Pty) Ltd* (Case No IT25117) (as yet unreported);
- *CDC (Pty) Ltd v Commissioner for the South African Revenue Service* (Case No IT2020/95) (as yet unreported).

Tags: default judgment; assessed loss; duly authorised representative; notice of appeal (NOA).

CONFIRMATION OF TAX RESIDENCY

One of the challenges faced by taxpayers who have left South Africa and ceased their South African (SA) tax residency has been obtaining objective confirmation of the fact.

Ordinarily, this dilemma would require a taxpayer to maintain a preponderance of objective evidence to demonstrate the fact that they are non-resident, and this evidence would generally include obtaining a tax compliance system (TCS) Pin from SARS that indicates that they have emigrated from South Africa.

However, a TCS Pin is only valid for one year following the date of issuance and can only be applied for once at the declaration of your cessation of tax residency. As such, this was not generally considered to be sufficient proof, in the longer term, of the fact that SARS has formally and indefinitely accepted the status of a taxpayer as being a non-resident for tax purposes.

"This means that a taxpayer who permanently left South Africa and ceased their tax residency in South Africa is now able to apply for a 'Notice of Non-Resident Tax Status' from SARS, which confirms that taxpayer's change in status from being a resident to a non-resident."

In response to these challenges, SARS previously mentioned that it would begin to issue certificates formally confirming the change in status of expatriates who ceased their South African tax residency. These would be issued by SARS to ensure that those taxpayers are able to adequately meet their international tax compliance obligations. It now appears that SARS has met this commitment.

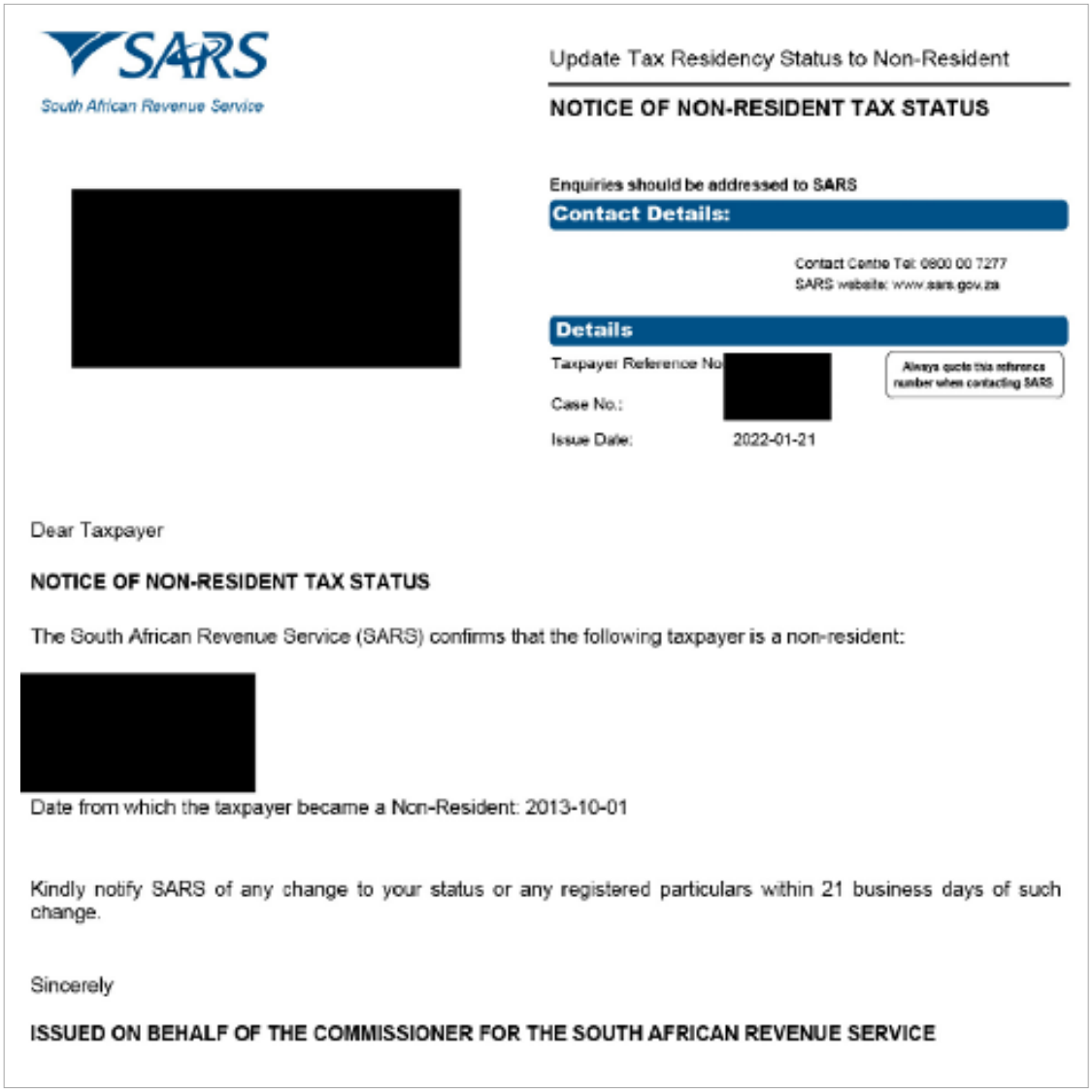
This means that a taxpayer who permanently left South Africa and ceased their tax residency in South Africa is now able to apply for a "Notice of Non-Resident Tax Status" from SARS, which confirms that taxpayer's change in status from being a resident to a non-resident.

Uniquely, the notice in its current form provides the specific date on which the taxpayer ceased to be a tax resident of South Africa. This is, furthermore, stamped by SARS on the issuance date.

These details could prove extremely useful for taxpayers, especially when seeking to claim relief from tax in South Africa that is only available to non-residents.

This document would further serve as a non-resident taxpayer's first line of defence after ceasing their South African tax residency, upon any later enquiry by SARS into their residency; more specifically, however, it would be their "shield and armour" against any foreseeable tax liability on their foreign sourced income moving forward.

Whereas it remains to be seen whether SARS will keep to their further commitment of introducing a new portal for the issuance of non-residency certificates, the issuance of these notices is a definite step in the right direction and a hopeful sign of more progress to come.



SARS
South African Revenue Service

Update Tax Residency Status to Non-Resident

NOTICE OF NON-RESIDENT TAX STATUS

[redacted]

Enquiries should be addressed to SARS

Contact Details:

Contact Centre Tel: 0800 00 7277
SARS website: www.sars.gov.za

Details

Taxpayer Reference No: [redacted]
Case No.:
Issue Date: 2022-01-21

Always quote this reference number when contacting SARS

Dear Taxpayer

NOTICE OF NON-RESIDENT TAX STATUS

The South African Revenue Service (SARS) confirms that the following taxpayer is a non-resident:

[redacted]

Date from which the taxpayer became a Non-Resident: 2013-10-01

Kindly notify SARS of any change to your status or any registered particulars within 21 business days of such change.

Sincerely

ISSUED ON BEHALF OF THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE

Victoria Lancefield & Thomas Lobban

Tax Consulting South Africa

Tags: tax compliance system (TCS) Pin; cessation of tax residency; international tax compliance obligations.

UNIFORM RULES OF COURT APPLICABLE TO THE TAX COURT

Chapter 9 of the Tax Administration Act, 2011 (the TAA), lays a path for taxpayers and the South African Revenue Service (SARS) to walk away from a dispute resolution where they encounter a dispute around the taxpayer's affairs.

The TAA's dispute resolution process regulates the administrative engagement between SARS and the taxpayer at the point where a dispute about a decision by SARS arises. Chapter 9 also prescribes the mechanisms available for resolving a tax dispute, as it is the statutory origin of tax boards, tax courts and the Tax Court Rules – including the opt-in alternative dispute resolution procedures.

On 19 October 2021, the tax court in Cape Town delivered its decision in *Commissioner for the South African Revenue Service v FP (Pty) Ltd*, [2021], Case Nos 25330, 25331 and 25256. The matter involved SARS raising a challenge that a review of an additional assessment in the tax court was an irregular step. In deciding this challenge the judgment deals with the appropriateness of bringing a principle legality review in the tax court in the context of the dispute resolution provisions of the TAA.

SARS' argument

SARS raised a challenge under Rule 30 of the Uniform Rules of Court to the taxpayer's attempt to challenge and set aside the additional assessments on application to the tax court in terms of a legality review. The basis for this was that the tax court is a creature of statute, with its jurisdiction and competence defined by the TAA.

SARS argued that where a taxpayer is aggrieved by an assessment, under section 104(1) of the TAA, they may lodge an objection and pursue the dispute. It argued further that a taxpayer may only deviate from the TAA dispute resolution procedure of following an appeal to the tax court if permitted to do so by a High Court in terms of section 105 of the TAA.

The taxpayer's argument

The taxpayer argued that under section 117(1) of the TAA the tax court has jurisdiction over tax appeals lodged under section 107 of the TAA. Section 117(1) of the TAA reads:

> "**117. Jurisdiction of the tax court**
>
> (1) The tax court for purposes of this Chapter has jurisdiction over tax appeals lodged under section 107."

Therefore, as the review arose in the context of an appeal under section 107 of the TAA, the tax court has jurisdiction to adjudicate the review. It relied on *South Atlantic Jazz Festival (Pty) Ltd v Commissioner, South African Revenue Service* [2015], where it was held that:

> "The jurisdiction of the tax court to determine tax appeals is conferred without any limitation in s 117(1) of the Tax Administration Act. . . ; the court must be taken to have been invested with all the powers that are inherently necessary for it to fulfil its expressly provided functions."

The taxpayer further contended that it would be unfair and irrational and that it would create "an undesirable dichotomy between the High Court ... and the Tax Court", if it had to pause the tax appeal proceedings and approach the High Court under section 105 of the TAA in a parallel litigation process.

The decision

The court emphasised that SARS had brought a procedural challenge to the taxpayer's review, which as a point of law required a determination of the jurisdiction of the tax court. It distinguished the present facts from *South Atlantic Jazz Festival* on the basis that section 105 had been amended and that the taxpayer in that case was exercising its right of appeal to the tax court and not seeking to review SARS' administrative action. The court also noted that the taxpayer had conceded that the review application was not an interlocutory or procedural one launched under section 117(3) of the TAA, which reads:

> "**117. Jurisdiction of the tax court**
>
> (3) The court may hear and decide an interlocutory application or an application in a procedural matter relatinto a dispute under this Chapter as provided for in the 'rules.' "

The crux of the decision of the tax court was based on section 105 of the TAA. It held that section 105 makes it clear that a taxpayer may only dispute an assessment or "decision" as described in section 104 in accordance with Chapter 9 of the TAA and the Tax Court Rules, unless a High Court directed otherwise.

"Preventing the parallel jurisdiction of the High Court at the primary appeal stage of the TAA dispute resolution system enables the TAA's specialised dispute resolution system to function in a contained environment."

Therefore, as the taxpayer was bound by section 105 of the TAA to seek leave to bring the legality review, SARS was correct to raise a Uniform Rule 30 challenge, as the launching of the review proceedings in the tax court in these circumstances constituted an irregular step.

The court ordered that the review application be set aside and stayed the appeal proceedings in the tax court pending the determination of the review application to be launched in the High Court by the taxpayer.

Comment

This case provides a good illustration of the scope of the tax court to determine tax disputes. The design of the dispute resolution process under the TAA requires taxpayers to participate within its structures unless the High Court determines that there are grounds for departing from that procedure.

Preventing the parallel jurisdiction of the High Court at the primary appeal stage of the TAA dispute resolution system enables the TAA's specialised dispute resolution system to function in a contained environment.

Tsanga Mukumba

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Chapter 9 (sections 101–150) (more specifically also sections 104(1), 105, 107 & 117(1) & (3)).

Other documents

- Tax Court Rules;
- Uniform Rule 30.

Cases

- *Commissioner for the South African Revenue Service v FP (Pty) Ltd* (25330; 25331; 25256) [2021] ZATC 8 (19 October 2021);
- *South Atlantic Jazz Festival (Pty) Ltd v Commissioner, South African Revenue Service* [2015] (6) SA 78 (WCC).

Tags: principle legality review; additional assessments.

SPECIAL TRUSTS

Unlike "conventional trusts" that are taxed at a flat tax rate, a special trust is taxed on the same sliding scale applicable to natural persons.

The Income Tax Act, 1962, provides for two types of "special trust" (as defined in section 1(1) and in paragraph 1 of the Eighth Schedule): a so-called type-A and type-B trust. In essence, a type-A trust is created for a person (or persons) having a disability, while a type-B trust is created on a testator's death and can exist only while it has a minor as a beneficiary. The distinction between a type-A trust and a type-B trust is vital because a type-A trust qualifies for specific relief from capital gains tax but the same is not granted to a type-B trust. This article focuses on the characteristics of a trust in order for it to qualify as a type-A trust.

Characteristics of a type-A trust

A type-A trust can either be –

- an *inter vivos* trust created during the lifetime of the founder of the trust;
- a testamentary trust created by or under the will of a deceased person (testator); or
- a trust created as a result of a court order in favour of a specified natural person.

Type-A special trusts must have the following characteristics to qualify for the favourable tax dispensation:

- The trust must be created *solely* for the benefit of one or more persons with a disability. In essence, this means that the trust deed must not provide for the possibility of any beneficiary who does not have a "disability" for as long as the person(s) with a disability is (or are) alive.
- For a trust to be a type-A trust, its beneficiaries must be incapacitated as a result of their disabilities from –
    - earning sufficient income for their maintenance; or
    - managing their own financial affairs.
- It is a requirement that at least one of the beneficiaries, for whose sole benefit the trust was created, should be alive on the last day of February of the relevant year of assessment of the trust. A trust will accordingly cease to be a type-A trust from the commencement of the year of assessment during which all the beneficiaries with a disability for whose sole benefit the trust was created, are deceased.
- A trust that is created solely for the benefit of more than one person with a disability must be for the benefit of persons with a disability who are each others' relatives. The relationship between the founder or settlor and the beneficiaries has no impact on whether a trust qualifies as a type-A trust. The requirement is that the beneficiaries having a disability must be relatives, not the founder or settlor.

It is important that where persons with a disability are reliant on trust income to support their livelihood, these requirements be carefully considered and that the trust is correctly registered as a type-A trust with the South African Revenue Service. Should you require assistance in this regard, it is recommended that you contact your tax adviser for more detai

T Roos Accountants

Acts and Bills

- Income Tax Act 58 of 1962: Section 1(1) and Eighth Schedule: Paragraph 1 (definition of "special trust").

Tags: special trust; *inter vivos* trust; testamentary trust.