



# Legislative Interpretation

SAIT Webinar  
10 February 2022

*YOUR KEY TO THE TAX COMMUNITY*

# Agenda

- Introduction to the Tax Practice on the Move: Legislative Interpretation webinar series and introduction of Anchors and Guest
- SAIT's legislative and policy portfolio
- Recent activity - Discussion of draft interpretation note
- Recent court cases
- Scheduled sessions for 2022

# Tax Practice on the Move: Legislative and Interpretation series

In this series, we will cover the following aspects:

- Legislation and policy
  - Reactive submissions
    - SARS draft documents for public comment – excluding customs and excise
    - National Treasury calls for comment
    - Pro-active submissions
- Court cases
  - Court cases of interest and tax importance

## Anchors and Guest

- **Jean du Toit – (Head of Tax Technical at Tax Consulting SA)**  
Jean du Toit is the Head of Tax Technical at Tax Consulting SA. Jean holds a BCom LLB, LLM and a PG Dip Tax.
- **Keitumetse Sesana – (Tax Technical Specialist at SAIT)**  
Keitumetse is the Tax Technical Specialist at SAIT. Keitumetse holds a BCom LLB and LLM in Tax Law.
- **David French – (B and F Advisory)**  
David is a corporate tax advisor. He is a Chartered Accountant, and holds a BCom, BAcc, H Dip Tax and Diploma in Financial Markets and Instruments.

# SAIT's legislative and policy portfolio

## Composition

- CEO – Keith Engel
- Head of Strategic Development - Beatrie Gouws
- Tax Technical Specialist – Keitumetse Sesana
- 8 work groups with industry specialists and ad hoc specialists that provide comments based on their areas of expertise.

## Mandate

- Building strategic relationships with government departments, such as, inter alia National Treasury, DTIC, SARS, DSI.
- Reactive and pro-active submissions, as necessary
- Bridge the gap between member requests and the relevant government department

## Recent activity

### Draft document for comment – January 2022

- Draft Interpretation Note – Extraordinary dividends treated as income or proceeds on disposal of certain shares; and
- Draft document: Draft Interpretation Note 28 (Issue 3) – Deductions of home office expenses incurred by persons in employment or persons holding and office

Draft interpretation note - Extraordinary dividends treated as income or proceeds on disposal of certain shares

### *Background*

Section 22B and paragraph 43A relates to the income tax treatment of extraordinary dividends on certain disposals and deemed disposals of shares by a company to prevent so-called “dividend stripping”.

## Draft Interpretation Note – Extraordinary dividends treated as income or proceeds on disposal of certain shares (continued)

- Specific anti-avoidance provision
- Why?
  - Interaction of capital gains tax and dividends
- Affects
  - South African companies
  - Foreign shareholders to a limited extent (where treaty benefit for dividends)
  - Where dividends are exempt from tax, but capital gains are taxable
- Foreign shareholders limited because only sale of property rich shares is subject to capital gains tax

## Draft Interpretation Note – Extraordinary dividends treated as income or proceeds on disposal of certain shares (continued)

- How – depends on an “extraordinary dividend”
  - Preference shares: portion > 15% of consideration received for share (face value?)
  - Ordinary shares: portion > 15% of greater of market value of share:
    - Date of disposal
    - 18 months prior to disposal
  - Extraordinary dividend deemed part of gross income or proceeds on disposal of asset

## Draft Interpretation Note – Extraordinary dividends treated as income or proceeds on disposal of certain shares (continued)

- Draft interpretation note & feedback
  - On the whole, a competent description of the effects of s22B and p43A
- Pedantic stuff:
  - Reference to “group of companies” should be to “group of companies as contemplated in the definition of connected person”
  - Could use some work on the flow of the document
  - Author got a little lazy about definition of dividend
  - Statement that there is no definition of interest in the Income Tax Act is incorrect – there is one in section 24J, but it is not relevant in this context

## Draft Interpretation Note – Extraordinary dividends treated as income or proceeds on disposal of certain shares (continued)

- Draft interpretation note & feedback
  - On the whole, a competent description of the effects of s22B and p43A
- Substantive stuff
  - Preference shares versus equity shares
    - Does not use the correct approach to interpretation of preference share
    - Example 5 concludes that share is equity share, my conclusion is that preference share
  - Companies only, resident or non-resident



## Recent court cases

## Recent court cases:

- *W Taxpayer v Commissioner for the South African Revenue Services* (IT 45672)
- *XYZ (PTY) LTD v Commissioner for the South African Revenue Services* (IT 24790)
- *Purveyors South Africa Mine Services (Pty) Ltd v Commissioner for the South African Revenue Services (Pty) Ltd* (135/2021) [2021] ZASCA 170 (7 December 2021)

# *W Taxpayer v Commissioner for the South African Revenue Services (IT 45672)*

## Background

- The taxpayer is a waste management company and this case had three issues for determination: (1) Taxpayer's entitlement to claim s 12C allowances; (2) taxpayer's entitlement to claim s 24C allowances; and (3) imposition of penalties. We will focus on the imposition of USPs.
- Taxpayer contends it was not aware it had completed its returns incorrectly and it had detected the error during a subsequent financial audit. Further contended it acted in good faith with no intention to avoid or evade tax.
- SARS accepts that the taxpayer did not act intentionally or in a grossly negligent manner but that given the materiality of the amount, the taxpayer failed to exercise reasonable care.
- The court ultimately had to decide if the mistake made by the taxpayer could be regarded as a bona fide inadvertent error, which would result in the USPs falling away.

# *W Taxpayer v Commissioner for the South African Revenue Services (IT 45672)*

## Court's decision

- The taxpayer based its position on its own decision, it did not do so on outside professional advice.
- The taxpayer is a large company which employs its own tax manager, a CA, specifically to ensure its returns are accurate.
- The tax manager should reasonably have realised that the sizable sum of almost R26m which came about as a consequence of a decision made by the management of the company needed to be treated with reasonable care and caution.
- It was in fact the SARS auditor who picked up the error, which according to the auditor was a glaring one.
- The tax manager did not adduce evidence to counter the SARS auditor's testimony.
- The taxpayer's appeal was dismissed

## *W Taxpayer v Commissioner for the South African Revenue Services (IT 45672)*

### Take away

- The take away here is that even if the taxpayer believes that its return is correct, there is a duty of care on the representatives of the company to file correct and accurate returns.
- Seemingly, where this is conducted by professionals such as a CA, they will be held to a higher standard.
- Although not expressly stated, where third party advice is procured the court will be more lenient in ascribing the applicable understatement behaviour.

# *XYZ (PTY) LTD v Commissioner for the South African Revenue Services (IT 24790)*

## Background

- The taxpayer provides outsourced staffing services and payroll administration for clients in the construction and civil engineering sectors in SA.
- In doing so it enters into a staffing services contract with its client and a separate contract of employment with each of its employees. The taxpayer is obliged to pay employees in accordance with the provisions of the relevant labour statutes and industry collective agreements.
- The taxpayer's charge out rate to clients, although not expressly stated, includes a component for accrued leave and bonus liabilities.

# *XYZ (PTY) LTD v Commissioner for the South African Revenue Services (IT 24790)*

## Background

- The bonus is paid out at the December year-end industry shut-down period, with that portion of the bonus obligation which has accrued from 1 December to the end of February, and which has not been paid out, treated for accounting purposes as a liability at the end of February. For tax purposes, the same amount is claimed as a deduction.
- As with bonus, the taxpayer calculates leave which has accrued for the period from 1 December to the end of February and treats this for accounting purposes as a liability at the end of February. As with the bonus, for tax purposes, the same amount is claimed as a deduction.
- The taxpayer has a high employee turnover rate where employees are dismissed for operational reasons where there is a lack of projects.

# *XYZ (PTY) LTD v Commissioner for the South African Revenue Services (IT 24790)*

## Background

- Due to the high turnover rate, provision is made for cash payments in lieu of notice pay (25%). This liability is determined and claimed as a deduction at the end of February.
- The same applies to severance pay where the employee's services are terminated on grounds of operational requirements. On this item a 80% risk factor is applied based on historical trends.
- In its 2015 income tax return, as it had done in previous years, the taxpayer declared an amount of R3 124 574.00 as "other current liabilities" which it claimed as deductible from its taxable income in terms of section 11(a) for notice pay, severance pay, accrued leave and accrued bonus liability.
- In the alternative, in respect of the leave payment and bonus liability only, the taxpayer sought to deduct these amounts as future expenditure in terms of section 24C.

# *XYZ (PTY) LTD v Commissioner for the South African Revenue Services (IT 24790)*

## Leave pay and bonus

- The taxpayer called for a different interpretation of s 7B in this case because the bonus and leave pay pertained to an absolute invariable amount, which constituted expenditure actually incurred.
- SARS disagreed. It argued that s 7B expressly pertains to these amounts and the deeming provision should prevail. In other words, the date of payment triggers the accrual and deductibility.
- The court considered the authorities on interpretation and specifically the rule of interpretation that general provisions do not derogate from special provisions. S 11 is a general provision, whereas s 7B is a specific provision catering for these amounts.
- The court held that the fact that bonus is not defined for purposes of s 7B does not support the contention that the term is limited to variable bonuses or where the bonus is discretionary. This same applies to leave pay, which is by its nature variable, even under the current circumstances.

# *XYZ (PTY) LTD v Commissioner for the South African Revenue Services (IT 24790)*

## Leave pay and bonus

- It follows that in terms of section 7B(1)(2), the amounts accrued in respect of bonus and leave pay constituted expenditure which could only be incurred by the employer when such amounts are paid to the employee.
- As to the s 24C argument, the court held that the fact remains that the treatment of both bonus and leave pay liabilities are expressly included within the ambit of section 7B, in terms of which it is provided that such expenses are deductible in the year that they are paid. On this basis this argument was dismissed.

# *XYZ (PTY) LTD v Commissioner for the South African Revenue Services (IT 24790)*

## Notice and severance pay

- In relation to severance pay and notice pay, it was argued for the taxpayer that for purposes of section 11(a) the liability incurred in respect of notice and severance pay constituted expenditure actually incurred in the production of income insofar as there existed a sufficient degree of certainty that an obligation to pay severance and notice pay had arisen.
- The court held that the fact that a risk factor was applied to the amounts claimed in respect of notice and severance pay indicates that these amounts constitute probable future expenditure, but that the amount of such payments remained uncertain in the sense that it could not factually be determined with sufficient certainty.
- The court therefore upheld SARS' argument and dismissed the taxpayer's appeal.

# *Purveyors South Africa Mine Services (Pty) Ltd v Commissioner for the South African Revenue Services (Pty) Ltd (135/2021) [2021] ZASCA 170 (7 December 2021)*

## Background

- On 12 January 2015, Purveyors entered into a dry lease agreement with Freeport, a company incorporated and tax resident in the United States of America, in respect of an Aircraft registered in the United States of America. The dry lease agreement allowed Purveyors to operate air charter services for the benefit of a mining company in the DRC.
- On 19 January 2015, Purveyors commenced with the provision of air charter services under a usage agreement. The aircraft transports employees, sub-contractors, suppliers, and business guests from Johannesburg to Lubumbashi and Kinshasa in the DRC generally three times a week.
- On 30 January 2017, Purveyors requested, via e-mail, a meeting with SARS *‘to regularize the VAT that was supposed to be paid over.’* In the e-mail, Purveyors informed SARS that: *‘We have just received a VAT technical opinion from PwC that we were supposed to pay the VAT over to SARS upon the import of the aircraft.’*

# *Purveyors South Africa Mine Services (Pty) Ltd v Commissioner for the South African Revenue Services (Pty) Ltd (135/2021) [2021] ZASCA 170 (7 December 2021)*

## Background

- On the 1 February 2017, SARS responded in an e-mail from Mr Johannes Du Preez in which he indicated that the aircraft was subject to penalty implications. He also requested to see documentation in terms of s 101 of the Customs and Excise Act 91 of 1964.
- On 2 February 2017, Purveyors acknowledged receipt of Mr Du Preez's email and indicated that they would revert as soon as possible with the requested information. On 29 March 2017, Mr Du Preez wrote to Purveyors explaining the reasons why VAT and penalties were payable.
- Purveyors responded on the same day, indicating that it understood from Mr Du Preez's e-mail and from their telephone discussion that VAT output and custom duties were applicable, as well as fines and penalties.
- Purveyors took no further steps to regularise its liability for VAT and penalties until 4 April 2018 when it applied for voluntary disclosure relief in terms of s 226 of the TAA.

# *Purveyors South Africa Mine Services (Pty) Ltd v Commissioner for the South African Revenue Services (Pty) Ltd (135/2021) [2021] ZASCA 170 (7 December 2021)*

## Background

- Relying on s 227, SARS rejected the application on the grounds that it was not voluntary; and did not contain the facts of which SARS was unaware as those facts had already been disclosed to it prior to the voluntary disclosure application.
- The Tax Court agreed with SARS and dismissed Purveyors' case. It found, inter alia, that the application was not voluntary as there was an element of compulsion on the part of Purveyors when it submitted the application. This further appeal by Purveyors is with the leave of the Tax Court.
- The question is if the exchange or discussions between the representatives of SARS and the officials of Purveyors have any material bearing on the application?

*Purveyors South Africa Mine Services (Pty) Ltd v Commissioner for the South African Revenue Services (Pty) Ltd* (135/2021) [2021] ZASCA 170 (7 December 2021)

Arguments

- Essentially Purveyors contended that disclosure does not denote a requirement that the disclosure ought to be new or something of which SARS was not previously aware.
- SARS argues that the application did not comply with the requirements of s 227 of the TAA because, on a proper construction of s 227, Purveyors did not disclose information or facts of which SARS was unaware. It submits that the application was not voluntary as Purveyors was prompted by SARS. In essence, the application was brought because Purveyors was warned that it will be liable for penalties and interest arising from its failure to have paid the relevant tax.

*Purveyors South Africa Mine Services (Pty) Ltd v Commissioner for the South African Revenue Services (Pty) Ltd* (135/2021) [2021] ZASCA 170 (7 December 2021)

Court's decision

- The court held that the starting point is that the section relates to “voluntary disclosure”. The language used in the section clearly indicates the legislature’s intention to arm the Commissioner with extensive powers to prevent taxpayers from disclosures which are neither voluntary nor complete in all material respects.
- The fact that the section provides that the disclosure application must be made in the prescribed form or manner rather than obtaining ad hoc advice from SARS is a clear indication that the mischief sought to be prevented is one where a taxpayer discloses information to SARS and later on makes a voluntary disclosure application.
- No purpose would be served if the TAA enables errant taxpayers to obtain informal advice and when it does not suit them, to then apply for voluntary disclosure relief.

*Purveyors South Africa Mine Services (Pty) Ltd v Commissioner for the South African Revenue Services (Pty) Ltd* (135/2021) [2021] ZASCA 170 (7 December 2021)

Court's decision

- The correspondence between the parties makes three things clear. First, the VDP application by Purveyors was prompted by compliance action on the part of SARS which was aware of the default following interactions between Mr Du Preez and Purveyors' representatives. Second, Purveyors itself appreciated that it was liable for fines and penalties which had to be paid before it would be tax-compliant. Third, the VDP application was not motivated by any desire to come clean, but rather to avoid the payment of fines and penalties.
- It is difficult to understand on what conceivable basis a taxpayer can obtain a voluntary disclosure relief in circumstances where SARS had prior knowledge of the default, regardless of the source of such prior knowledge, and had in addition, warned the taxpayer of the consequences of its default.
- The SCA agreed with the Tax Court that the application by Purveyors was not voluntary and did not meet the requirements of s 227 because SARS knew of its default and warned that it would be liable for VAT plus penalties and interest. Nothing new was disclosed and the appeal was dismissed.

# Scheduled sessions for 2022

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## Date

**Thursday, 10 March 2022**

**Thursday, 14 April 2022**

**Thursday, 12 May 2022**

**Thursday, 9 June 2022**

**Thursday, 14 July 2022**

**Thursday, 11 August 2022**

**Thursday, 8 September 2022**

**Thursday, 13 October 2022**

**Thursday, 10 November 2022**

**Thursday, 8 December 2022**

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## *David French biography*

*David started his career with articles at Ernst & Young, and after qualifying as a Chartered Accountant he moved into their tax division. He spent some 18 years with the firm concentrating on corporate income tax, and in particular the taxation of financial services, before moving on to the South African Revenue Service.*

*Here, his primary responsibility was the identification and investigation of tax avoidance structures and administration of the Reportable Arrangement regime. In addition to his primary responsibilities David was involved in several other areas, including:*

- Acting as Special Advisor to the General Anti-avoidance Rule (GAAR) Committee to which all GAAR assessments must be presented before being issued;*
- Reviewing and approving the technical opinions for assessments in the Transfer Pricing division;*
- Capacity building in other African Revenue Authorities in conjunction with the European Union and the African Tax Authority Forum, including reviewing policy, and training in audit and transfer pricing;*

## *David French biography (continued)*

- *Delegate representing South Africa at the Organisation for Economic Co-operation and Development (OECD) on Working Party 11 of the Base Erosion and Profit Shifting (BEPS) project, focusing on Interest deductions, Hybrids, Mandatory Disclosure and Controlled Foreign Companies; and*
- *Delegate to the OECD JITSIC Panama Papers working group, and Competent Authority with regard to exchange of information related to the Panama Papers.*

*David's move back into the consulting world saw him join Mazars Gauteng as a Director - Tax Consulting for four and a half years, focusing on all areas of corporate tax, including tax restructuring, mergers and acquisitions, financial services and instruments, international tax and exchange control.*

*In January 2022 he moved to B and F Advisory (Pty) Ltd, a boutique Tax Advisory Firm.*



Thank you