Tax Appeal Tribunal ruling: Commissioner Generals discretion must be exercised judiciously

Authors: Celia Becker and Phillip Karugaba. The recent ruling of the Tax Appeals Tribunal (**TAT**) in the case of *Century Bottling Company v Uganda Revenue Authority (**URA**),* has brought the discretion of the Commissioner General of the URA sharply in focus.

It is absolutely necessary and indeed important that in the exercise of their functions, public authorities exercise discretion. It is equally important that such discretion is properly exercised taking into account only the relevant considerations and for the proper reasons. The citizen has recourse to court to check the excesses of executive discretion. A public official is therefore not like the cultural leader kamala byona (he who finishes all matters). The formers discretion is very much controlled by law and by the courts.

The facts

In April 2020, Century Bottling, a Ugandan company responsible for the production and distribution of soft drinks under a franchise from Coca-Cola Company, filed an application with the TAT for the review of a tax assessment of approximately UGX60-billion. Under the TAT Act, one of the conditions for filing a matter before TAT is the payment of 30% of the tax assessed or the amount not in dispute, whichever is higher. The taxpayer applied to the Commissioner General to pay the

30% in instalments on the grounds that it did not have the means to pay the tax. As a result of the impact of the Coronavirus (COVID-19) restrictions, the company was operating at a fraction of its installed capacity and sales had dropped 55% without a corresponding reduction in its wage bill and other expenses.

Under the Tax Procedures Code Act 2014, the Commissioner General has the discretion to accept payment of taxes in instalments. The Commissioner General in the exercise of his discretion rejected the taxpayers application to pay in instalments, for reasons not stated in the ruling. The taxpayer then applied to the TAT for a review of the Commissioner Generals decision and to restrain the URA from enforced tax collection. It submitted that it will suffer irreparable loss, crippling its business and damaging its reputation and that, on a balance of convenience, the URA ought to be restrained.

The URA argued that the Commissioner Generals decision to reject the application did not amount to a tax decision as defined by the Tax Procedures Code Act and, accordingly, the TAT was not the proper forum to question the exercise of the Commissioner Generals discretion. As the TAT does not have the required jurisdiction, the taxpayer, instead, should have sought judicial review before the High Court. The URA also sought to resist the injunction on the ground that the taxpayer would not suffer any irreparable injury as the URA, as a statutory body, would be well able to pay any damages assessed against it.

The taxpayer countered that TAT had unlimited original jurisdiction over all tax disputes, including a review of the exercise of discretion by the Commissioner General. The taxpayer argued that the Commissioner General had acted unreasonably in not considering all the information provided to it and, further, were acting irrationally in insisting on full payment of the UGX60-billion assessed.

The decision

The TAT confirmed that the Commissioner Generals decision was in fact a tax decision as defined and, therefore, within the TATs jurisdiction to review such decision.

On the exercise of discretion, the TAT guided itself that discretionary power is not absolute, but is subject to general legal limitations expressed in a variety of different ways. Discretion must be exercised reasonably and in good faith, only relevant considerations must be taken into account, there must be no malversation of any kind and the decision must not be arbitrary or capricious.

The TAT then posed the question whether a reasonable authority addressing itself to the widespread economic losses occasioned to the manufacturing sector and the economy at large as a result of the COVID-19 pandemic, would reject a request by a taxpayer to pay the required 30% tax in instalments? The TAT added that the question should be understood in light of the fact that, not only does the authority in question have powers accorded to it by statute to grant such a request, but it has in the past granted such requests in times much less precarious than these and for amounts much smaller than what the taxpayer is required to pay.

Framed in that way, invoking the impact of COVID-19 and holding the URA to its own antecedents, one hardly need hold their breath to learn what followed. The TAT found that the decision of the Commissioner General in rejecting the application to pay 30% of the tax assessed in instalments was so outrageous in its defiance of logic that no sensible person who had applied his mind to the question to be decided could have arrived at it.

The TAT found a *prima face* case with a probability of success had been made by the taxpayer. On irreparable injury, the TAT cited a High Court decision involving another statutory body where an injunction was declined on the ground that the defendant, as a statutory body like the respondent, would be in position to pay damages that might be awarded against it.

The TAT, however, made a brilliant departure from the High Court precedent stating that while it is conceded that the respondent being a statutory body, may have access to funds from the national coffers, which could be used to pay damages, it goes without saying that a great deal of circumspection must be employed in ensuring that increases to the national debt are kept to a bare minimum and that the State is not burdened with debts that can be avoided through the use of prudence and good sense.

The TAT held that the taxpayer is permitted to pay 30% of the tax assessed in four equal instalments, and a temporary injunction restraining the URA from collecting the tax assessed was granted.

Conclusion

This is an excellent decision from the TAT clipping the eagle spread wings of the Commissioner General. Though under pressure to achieve tax collection targets in a declining economy, the Commissioner Generals discretion must still be exercised judiciously. The decision also demonstrates excellent commercial awareness and the judicial independence of TAT.

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Deferring tax on the transfer of listed shares to a collective investment scheme portfolio

Author: Ben Strauss.

Ms X inherited a large number of valuable shares in a blue chip listed company. She has no other material assets. She is concerned that, from a wealth planning perspective, all her eggs are in one basket. She wishes to diversify her portfolio. If Ms X sold her shares with a view to buying a mixture of other shares or investments, she would ordinarily incur capital gains tax (CGT) on the capital gain derived in respect of the sale, assuming that she holds her shares as a long-term investment, that is, not for speculative purposes.

Deferral of tax through asset-for-share transaction

There is one possible way for Ms X to diversify her portfolio without any immediate tax consequences, namely, by undertaking an asset-for-share transaction that meets the requirements of section 42 of the Income Tax Act 58 of 1962 (Act). If Ms X transfers her shares in accordance with the requirements in section 42 of the Act to, say, an approved unit trust portfolio in exchange for units in the portfolio, the effect will be the following:

- She will incur no CGT when the shares are transferred to the portfolio. She will only incur CGT if and when she disposes of units in the portfolio in future;
- No securities transfer tax will arise on the transfer of the shares; and
- As the portfolio is exempt from CGT, the portfolio may be able to rebalance its investments subsequently thereby selling the shares free of CGT and utilising the proceeds to acquire different shares, provided the shares disposed of are still held on capital account. We discuss this issue in the next section of the article.

Asset-for-share transactions are regulated by section 42 of the Act. Under that provision, if a person disposes of a capital asset to a company that is resident in South Africa in exchange for equity shares issued by that company, then there is a deferral of tax. Notably, in this context, the term company includes a portfolio of a regulated collective investment scheme in securities (CIS), and the term equity share includes a participatory interest in such a portfolio (see section 41(1) of the Act).

Tax considerations applicable to a CIS

A number of requirements must be met before a person will qualify for the relief offered by section 42 of the Act. Notably, the market value of the asset being transferred must exceed the base cost of the asset and, if the transferor holds the asset as a capital asset, then the portfolio must also acquire the asset as a capital asset.

It is the latter requirement that has sometimes caused uncertainty in practice. The problem is that, if the manager of the portfolio intends selling the asset immediately after having acquired it from the transferor who held it as a capital asset, the question arises whether the portfolio itself also acquired the asset as a capital asset. In other words, given the short timeframe in which the portfolio acquires and then disposes of the asset, the issue that arises is that the asset may be converted from being a capital asset (in the hands of the transferor) to a revenue asset, that is, trading stock (in the hands of the portfolio).

In addition, under section 42 of the Act, certain anti-avoidance provisions apply if the transferee disposes of the assets it acquired within 18 months of acquisition.

Generally speaking, while a CIS portfolio is a taxpayer in its own right, it pays no CGT (paragraph 61(3) of the Eighth Schedule to the Act) and it only pays income tax on revenue receipts that it does not pay over to investors within 12 months of receipt (section 25BA of the Act). A CIS portfolio is effectively a conduit: investors pay CGT only when they dispose of units in the CIS portfolio, and they pay income tax on revenue distributions from CIS portfolios (typically, interest).

But, if it could be said that a CIS portfolio was selling certain shares on revenue account, and if it did not distribute the proceeds of the sale to its investors within 12 months, then the CIS portfolio could be liable itself for income tax on the proceeds. See in this regard our Tax & Exchange Control Alert of 22 February 2018.

In 2018, National Treasury proposed amending the Act to state that any share sold by a CIS within less than 12 months of its acquisition, would automatically be considered to have been sold on revenue account. Following numerous submissions by the public regarding the proposal, National Treasury decided in the same year not to proceed with that proposed amendment.

SARS view previously expressed in relation to asset-for-share agreements involving a CIS portfolio

In 2016, there was a merger of a large local listed company with an international company. Shareholders in the local company were advised by some fund managers that, instead of selling their shares as part of the merger, they should transfer their shares to a CIS portfolio, thereby deferring their CGT and diversifying their portfolios.

At the time, SARS took a very dim view of the scheme, to the extent of releasing a press statement on 30 September 2016 warning against the scheme on the basis of the capital versus revenue issue above, and on the basis that the scheme may have amounted to impermissible tax avoidance the statement is still available on the SARS website.

SARS adopted that view despite the fact that it had previously ruled that such a scheme would benefit from the roll-over relief and that *[n]otwithstanding the short period that would have lapsed, the subsequent transfer of the participatory interest in the CIS to the third party will not change the character of the holding of the assets by the Applicant on the basis of it being held on capital account*: See SARS Binding Private Ruling 186 dated 12 February 2015 (BPR 186) and a discussion of the ruling in our Tax & Exchange Control Alert of 30 September 2016.

Binding Private Ruling 344

The type of transaction discussed under the previous heading was again the subject matter of the recent SARS Binding Private Ruling 344 dated 4 June 2020 (BPR 344). The facts in the ruling were that a fund manager wished, on behalf of certain of its clients, to transfer the listed shares of the clients to a CIS portfolio in exchange for units issued by the portfolio. After disposal of the shares by the clients, the CIS portfolios may have become obliged by their investment mandates to rebalance their portfolios by disposing of some of the shares acquired from the clients under the transaction. The disposals would have been undertaken in accordance with the normal investment authority and mandate of the relevant portfolio, and might have taken place within 18 months of the transaction thereby potentially triggering the relevant anti-avoidance provisions in section 42 of the Act.

SARS ruled that the transaction would meet the requirements for an asset-for-share transaction, and that the tax relief afforded by section 42 of the Act would apply. It ruled further that, while the 18-month anti-avoidance provision in section 42(7)(a) of the Act would apply to the subsequent disposal of the shares, in principle, the effect of its application will be nil. This is due to the application of paragraph 61(3) of the Eighth Schedule to the Act, the provision which exempts CIS portfolios from CGT.

SARS did provide the following warning, however: *The relief available in terms of this ruling does not preclude the subsequent application, if appropriate, of any general anti-avoidance provisions to the proposed transaction.*

Binding Private Ruling 339

SARS Binding Private Ruling 339 dated 21 February 2020 (BPR 339) also provides guidance. In that ruling, the trustees of a discretionary trust wished to transfer certain listed shares of the trust, together with the related investment management and administration functions, to a professionally managed and administered investment fund (that is, a CIS portfolio). In that case, SARS also ruled that the transaction would meet the requirements for an asset-for-share transaction, and that the tax relief afforded by section 42 of the Act would apply

It is important to note that under the Tax Administration Act 28 of 2011 a binding private ruling is only binding on the taxpayers who applied for and are party to the ruling. In practice, such a ruling is indicative of SARS view in respect of a certain set of facts and therefore another taxpayer (who is not a party to the ruling) can only place persuasive reliance on the rationale for a ruling, if it adopts a tax position based on that ruling. Importantly, SARS is not bound to apply what is stated in that ruling to anyone other than the specific taxpayer applicant.

Practically, it appears that the effect of the recent rulings is that, if an investor owns listed shares, and if the investor transfers the shares to a CIS portfolio in exchange for units issued by the portfolio, the relief afforded by section 42 of the Act could potentially apply in the following circumstances:

- The transaction must not be implemented to avoid tax impermissibly. In practice, this means that the transaction must not fall foul of the general anti-avoidance provisions in section 80A to 80L of the Act (GAAR) or constitute a sham or simulated transaction under the common law.
- If the portfolio disposes of the shares shortly after acquiring the shares, it should do so as part of a rebalancing of investments required by its investment policies. In other words, any disposals should be driven by commercial reasons. By its nature, a CIS is not a share trader even though it sells and buys assets on a daily basis. The mandate of a CIS, generally, is to realise capital growth over the medium to long term.
- The investor should be transferring its shares so as to move the management of the shares from itself to a professional fund manager for commercial reasons.

Conclusion

To return to the example at the beginning of the article, Ms X would need to exercise great caution if she wishes to diversify her portfolio through the asset-for-share arrangement. If her only desire is to diversify her investment pool, and if the CIS portfolio disposes of her shares shortly after acquiring the shares simply for the sake of diversifying her portfolio (and not because the portfolio is doing a rebalancing exercise pursuant to its investment policies), adverse tax consequences may still arise.

Inextricably linked contracts? The Constitutional Court has the final say regarding section 24C of the Income Tax Act

Author: Aubrey Mazibuko and Louis Botha.

On 21 July 2020, the Constitutional Court (CC) handed down judgment in *Big G Restaurants (Pty) Ltd v Commissioner for the South African Revenue Service* [2020] ZACC 16, which concerned section 24C of the Income Tax Act 58 of 1962 (Act). At issue before the CC was whether future expenditure incurred in terms of a franchise agreement was deductible against income derived by the taxpayer, Big G Restaurants (Pty) Ltd (Big G) from operating its franchise business.

In terms of section 24C of the Act, a taxpayer can claim an allowance in respect of future expenditure to be incurred, if certain requirements are met. The requirements are the following:

- Income must be received by or accrue to the taxpayer in terms of a contract;
- The income received or accruing to the taxpayer must be used in whole or in part to finance future expenditure which will be incurred by the taxpayer; and
- The expenditure must be incurred by the taxpayer in the performance of the taxpayers obligations under such contract.

Background

Big G is a franchisee operating a number of Spur and Panarottis restaurants in terms of various written franchise agreements concluded with a franchisor, the Spur Group (Pty) Ltd (Spur Group). Big G claimed a section 24C(2) allowance for the 2011–2014 years of assessment for the future costs of revamping its restaurant premises. The costs of revamping its premises were the direct result of a stipulation in the franchise agreements that Big G periodically revamp the premises.

Big G claimed the allowance on the basis that for purposes of section 24C(2), the income that it received from patrons in terms of individual contracts of sale, was income received in terms of the franchise agreements between it and the Spur Group. Therefore, it argued that the costs of revamping the premises constitute *future expenditure* as envisaged in section 24C of the Act. Future expenditure is defined as an amount of expenditure which will be incurred after the end of a year of assessment-in such manner that such amount will be allowed as a deduction from income in a subsequent year of assessment; or

in respect of the acquisition of any asset in respect of which any deduction will be admissible under the provisions of this Act.

The Commissioner for the South African Revenue Service (SARS) disallowed the allowance claimed by Big G, on the basis that an allowance in terms of section 24C can only be claimed in respect of income that accrued in terms of the same contract that imposes the future expenditure for the allowance being claimed. The income in respect of which Big G was claiming the allowance was income that accrued in terms of contracts concluded by it with individual patrons at its restaurants and the future expenditure is not imposed by those contracts. SARS argued that the future expenditure was imposed by different contracts, these being the franchise agreements between Big G and the Spur Group.

Tax Court

The stated case before the Tax Court was that there were two questions of law to consider:

- firstly, whether the income received by Big G from operating its franchise businesses includes or consists of any amount received by or accruing to it in terms of the franchise agreements; and
- secondly, whether the expenditure required to refurbish, or upgrade is incurred by Big G in the performance of its obligations under such contract as envisaged in section 24C.

According to the Tax Court, the franchise agreements imposed an obligation on Big G to actively provide and sell meals to patrons and although the patrons were not parties to those agreements, the proximate cause of those sales was this obligation. It further held that the expenses to be incurred in making the refurbishments by Big G were sufficiently certain to warrant an allowance in terms of section 24C.

The Tax Court therefore concluded that Big G was entitled to claim the allowance under section 24C for the 2011-2014 years of assessments. We discuss the judgment of the Tax Court in our Tax & Exchange Control Alert of 2 March 2018.

Supreme Court of Appeal

In the Supreme Court of Appeal, Big G conceded that it would not earn any income if it did not provide meals to patrons, but persisted with the contention that it was obliged do so in terms of the franchise agreements, which was its source of income and which stated how it had to operate its restaurant.

The Supreme Court of Appeal rejected Big Gs arguments and reasoned that the income was received as a result of the contracts Big G concluded with individual patrons. Accordingly, it found that the income did not accrue to Big G in terms of the franchise agreements.

According to the Supreme Court of Appeal there is a direct and immediate connection between the requirements of section 24C, meaning that in order for Big G to claim the allowance, the income must be earned from the same contract in terms of which the obligations are incurred. The fact that the income and obligations must originate from the same contract, pointed to the conclusion that the allowance in section 24C was intended to apply to cases where income earned in terms of a contract is received before expenditure will be incurred to perform obligations under the same contract.

The Supreme Court of Appeal also rejected Big Gs argument that the franchise agreement and the contracts with patrons were inextricably linked, and that both contracts required Big G to service meals to its patrons to earn income, out of which franchise fees were payable to the franchisor. According to the Supreme Court of Appeal, section 24C required Big G to incur expenditure in the performance of its obligations in terms of the same contract under which income is received. The operative concept according to the Supreme Court of Appeal was contract and not a scheme or transaction. We discuss the judgment of the Supreme Court of Appeal in our Tax & Exchange Control Alert of 7 December 2018.

Constitutional Court

On appeal in the CC, Big G argued that the matter turned on the interpretation of the words *in terms of* in section 24C, and this raised an arguable point of law of general public importance which ought to be considered by the CC.

The majority of the CC, per Madlanga J, agreed with Big G that the interpretative question was a quintessential point of law that engaged the jurisdiction of the CC. The CC held that the matter required the interpretation of the relevant contracts, so as to determine whether they were so interlinked as to fall within section 24C(2) and this in turn, required an interpretation of section 24C(2).

On the merits, Big G submitted that the countless contracts of sale of food are, and have to be read as, part of the franchise agreement. So read, the income earned in terms of the sale of food contracts is income earned in terms of the franchise agreement.

Big G also placed reliance on the judgment of the Tax Court, which held that the franchise agreement itself imposed an obligation on the franchisee to sell food, something which constitutes the sole business of the franchisee in terms of that agreement and therefore the income generated from the sale of those meals is as a result of that contract.

According to the CC, under section 24C of the Act the contract in terms of which income is received or accrues (income-earning contract) must be the same contract that imposes the obligations, the performance of which are to be financed with that income (obligation-imposing contract). This to the CC demonstrated a requirement of *sameness*. However, the CC did not read the sameness requirement in the section to connote that there must be one single contract stipulating for the earning of income and the imposition of future expenditure. Two or more contracts may be so inextricably linked that they may satisfy this requirement.

The CC was however, not satisfied that Big G had been able to place the contracts in terms of which it earns an income from its patrons within the ambit of the income-earning contract envisaged in section 24C. Furthermore, the obligations that Big G has to perform are imposed, not by the sale of food contracts, but by the franchise agreements. This lack of correlation between the income-earning contracts and obligation-imposing contracts plainly made section 24C inapplicable.

Furthermore, according to the CC, Big G was not without recourse as it would be entitled to a deduction in terms of section 11 of the Act. It is just that it will not be able to make an upfront deduction under section 24C.

In a separate concurrence, Majiedt J agreed with the outcome and order of the main judgment but disagreed on the finding that the matter engaged the jurisdiction of the CC. According to Majiedt J, It could not be that an enquiry into which of two contracts give rise to the income, or whether they can be regarded as a single contract for the purpose of interpreting the phrase *in terms of*, amounts to a constitutional issue or an arguable point of law of general public importance.

Comment

There are two important issues that emerge from this judgment, the first being that from a practical perspective in order for a taxpayer to claim the allowance in terms of section 24C, there is a sameness requirement that it must satisfy.

The second issue is that whereas the Supreme Court of Appeal rejected the argument that two separate contracts could be so inextricably linked as to meet the requirements of section 24C, it appears that the CC accepted this argument. It reasoned that the requirements of section 24C did not preclude the existence of two or more contracts that may be so inextricably linked, under which circumstances the allowance could potentially be claimed. However, it seems that the CC left open the question regarding the degree to which two or more contracts had to be interlinked in order to satisfy the sameness requirement in section 24C.

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About tax debts and civil judgments the High Court considers sections 172 and 174 of the TAA

Author: Aubrey Mazibuko and Louis Botha.

Under the Tax Administration Act 28 of 2011 (TAA), the South African Revenue Service (SARS) has various powers to collect and enforce the payment of tax debts owing to it. One of the ways in which it can do so is by applying for a civil judgment for the recovery of tax, which is provided for in section 172 of the TAA.

On 15 May 2020, the Western Cape Division, Cape Town, (WCHC) delivered judgment in *Barnard Labuschagne Inc v South African Revenue Service and Another 2020 ZAWCHC* (15 May 2020), which concerned the application of sections 172 and 174 of the TAA. More specifically, the taxpayer, Barnard Labuschagne Inc, sought to rescind a statement filed by SARS under section 172 of the TAA. The judgment deals with a number of related issues, but we focus mainly on the WCHCs interpretation of the TAA provisions.

Facts

- The taxpayer is a law practice which encountered some difficulties with SARS in respect of the payments that it made which were not properly allocated to the taxpayers relevant accounts.
- Over the years, the taxpayer had encountered some difficulties with SARS in respect of the payments that the taxpayer made and which it alleged were not properly allocated to the relevant accounts.
- The taxpayer alleged that in 2013, SARS had previously filed with the registrar of court a similar statement to the one which the taxpayer sought to rescind in the current matter.
- The taxpayer further alleged that it opposed that statement on the basis that the payments to SARS were not allocated correctly. SARS had raised interest and penalties on the amounts that were paid on time and upon being advised of the payment allocation issue, SARS considered the unallocated amounts and the amount which SARS alleged the taxpayer owed decreased significantly. The judgment granted against the taxpayer was subsequently withdrawn.
- During 2013 and 2014, SARS made a further effort to resolve the payment allocation issue and made one of its

employees available to the taxpayer on a full-time basis. This exercise resulted in a considerable reduced tax debt.

- However, by September 2015, the taxpayers tax debt had shot up again.
- SARS engaged with the taxpayer to resolve the issue regarding the tax debt that had increased again, but due to the taxpayers perceived failure to co-operate, SARS issued a letter of final demand for the payment of outstanding tax debt in 2017.
- As the taxpayer did not respond to the final demand, SARS issued a third-party payment instruction to Absa, but after receiving a negative response from the bank, SARS sent a letter to the taxpayer advising it of its intention to file a section 172 statement.
- After the taxpayer did not respond to SARS letter, SARS continued to obtain a judgment against the taxpayer on 15 December 2017.
- The applicant subsequently brought an application to have the judgment rescinded.

Issue

The main issue that the court had to consider was whether the section 172 statement could be rescinded.

The taxpayer also challenged the constitutionality of sections 172 and 174, which aspect we deal with briefly.

Arguments before the WCHC

Some of the arguments raised by the taxpayer were the following:

- The grounds for rescission of the judgment were not based on an objection against an assessment or decision of SARS as referred to in section 104 of the TAA.
- The taxpayer argued that it applied for rescission as SARS had not raised assessments or made decisions

referred to in section 104 of the TAA, against which the applicant could object or appeal. The taxpayer argued that it was therefore entitled to bring these proceedings before the WCHC in terms of section 105 of the TAA.

In opposing the application, SARS raised numerous arguments, including the following:

- It argued that the taxpayer had several dispute resolution mechanisms at its disposal before approaching the WCHC.
- The considerations underpinning the *pay now, argue later* principle were of importance in this matter. These considerations include the public interest in obtaining full and speedy settlement of a tax debt and the need to limit the ability of recalcitrant taxpayers to use the objection and appeal procedures strategically to defer payment of their taxes.
- It was further contended by SARS that it serves the public interest to have a mechanism to collect tax debts relatively swiftly and to bring finality to disputes relatively quickly.
- There were numerous mechanisms available to the applicant in order to safeguard its rights. There was no prejudice or unfairness to the taxpayer who failed to timeously pay its tax liabilities and further repeatedly failed to comply with the procedures as set out in the TAA.

The Minister of Finance, who had been joined as second respondent following the constitutional challenge brought by the taxpayer, raised certain arguments, including the following:

- The taxpayers interpretation was untenable as it overlooked the clear language of the TAA.
- Section 174 of the TAA explicitly requires section 172

certificates to be treated as though they are civil judgments which were lawfully given and if the court were to treat the certificates as capable of rescission as per the taxpayers argument, the order so granted would be unlawful.

- Only a civil judgment that has a final effect could be rescinded and on the plain reading of sections 172 and 174, the certificates were not final in nature.
- In support of arguing that the section 172 statement did not have a final effect, reference was made to section 172(2) of the TAA, which states that the certificate may be filed irrespective of whether or not the amount of tax is subject to an objection or appeal. Furthermore, section 175 of the TAA even envisaged a situation whereby SARS may amend the amount of the tax due, if in the opinion of SARS, the amount in the statement is incorrect.
- According to the Minister of Finance, the granting of a rescission order would also offend two statutes, that is, the dispute resolution procedures as set out under Chapter 9 of the TAA that is designed for that purpose and the requirement under section 7(2) of the Promotion of the Administrative Justice Act 3 of 2000 which requires the exhaustion of internal remedies.
- In *Modibane v South African Revenue Service [2011] ZAGPJHC and Capstone 556 (Pty) Ltd v Commissioner, South African Revenue Service and Another* 2011 (6) SA (WCC), it was held that although the filing of a certified statement by SARS had all the effects of a judgment, it was nevertheless not in itself a judgment in the ordinary sense. It did not determine any dispute or contest between the taxpayer and the Commissioner.

Judgment

In respect of the main issue, the WCHC agreed with the Minister of Finances submission that sections 172 and 174 constituted a lawful enforcement mechanism and for one to understand their correct legal meaning the appropriate starting point was the language used.

According to the WCHC, section 172(2) was clear that SARS may file the statement irrespective of whether or not the amount of tax is subject to an objection or appeal under Chapter 9, unless the obligation to pay the amount has been suspended under section 164. This subsection confirmed that despite the application for a civil judgment, the dispute resolution would still be in motion. The upshot of this was that there was no finality to this civil judgment, and it could not be accorded the status of a judgment.

Furthermore, the language used in section 174 was explicit. It states that a certified statement filed under section 172 must be treated as a civil judgment lawfully given in the relevant court in favour of SARS, but it does not, in and of itself, constitute a civil judgment.

The interpretation put forward by the taxpayer, that it is a judgment, was at odds with the interpretation that ought to be ascribed to this section. In fact, if regard was had as to how the 2013 dispute was resolved between the parties, the taxpayer knew that SARS could withdraw the judgment. It followed therefore, that the section 172 statement was not final in nature and was not capable of rescission in a manner appropriately accorded to a court judgment.

Simply put, there was no judgment to be rescinded by the court and the taxpayer was well aware that these statements were not final in nature. The judgment obtained through the registrar of the court is treated as a civilly obtained judgment for recovery purposes.

A related finding made by the WCHC was that the taxpayer should not have approached it to have the judgment rescinded. The WCHC explained that the TAA creates clearly defined dispute resolution mechanisms. It stipulates that an objection can be lodged against assessment or decision, followed by an appeal against the assessment or decision. According to the court, the TAA does not state that a party can choose where the dispute has to be adjudicated. In this regard, the WCHC stated the following:

The applicant [taxpayer] somehow submitted that its ground for the rescission of judgment is not based on assessment or decision of SARS as referred to in section 104 of the TAA, as SARS has not raised assessments or made decisions as referred to in section 104 of the TAA. The applicant sought to create a situation whereby a dispute such as its dispute is not provided anywhere in the TAA, hence it approached the high court. In my opinion, the fact that SARS allocated payments incorrectly and subsequently, made a decision to recover a debt based on an incorrect amount, was a legitimate reason for the applicant to have raised an objection. I find the applicants contention opportunistic and mischievous as the applicant was bent over backwards to confer to itself its own jurisdiction to hear its dispute and thereby disregarding the dispute resolution mechanism as set out in the TAA.

With regards to the taxpayers constitutional challenge the WCHC held that the taxpayer misconstrued the language used in section 172 and section 174. Furthermore, the WCHC held that the taxpayer failed to lay out a basis for the constitutional challenge in its application.

Comment

The courts finding that a section 172 certificate is not a final judgment that can be rescinded, is consistent with the *Modibane and Capstone* judgments that the court relied on. However, the WCHCs suggestion that it did not have jurisdiction and that the taxpayer should have approached the Tax Court for relief is slightly odd.

In the *Rampersadh* judgment, heard by the KwaZulu-Natal High Court (KZNHC) and discussed in one of our previous alerts, that court clearly explained that only where tax legislation expressly states that a decision is subject to objection and appeal, can the matter be heard by the Tax Court. In that case, the KZNHC held that SARS decision not to alter an assessment in terms of section 93 of the TAA on the ground that there was an undisputed error, had to be taken on review to the High Court. Considering the facts of the *Barnard Labuschagne* matter, it appears that the rationale applied in *Rampersadh*, should also apply here and that the taxpayer was entitled to approach the WCHC for relief. In other words, while rescission was not the appropriate remedy that could be granted in the circumstances, the taxpayer appears to have been entitled to approach the WCHC and apply for relief, other than rescission of the judgment. The judgment should also serve as a reminder to taxpayers to consistently manage their tax affairs and constructively engage with SARS to manage their tax debts, within the scope of the TAA and without undermining their rights.

Deductions available for commission earners

Author: Joon Chong, a Tax Partner a Webber Wentzel.

Commission earners could make an argument to SARS that they should be allowed to deduct their normal range of business expenses, even if commission is no longer more than 50% of their total remuneration under the exceptional circumstances of the Covid-19 pandemic.

Who is a commission earner?

Commission earners who earn more than 50% of their total remuneration as commission income are not limited in the type of business expenses they can claim, as long as these are incurred in the production of their income and are not capital or personal in nature.

To determine if these employees are entitled to claim business expenses, commission income recorded under code 3606 should be more than 50% of the total remuneration on the IRP5, which is the sum of gross retirement funding income (3697) and gross non-retirement funding income (3698). Total remuneration includes basic salary, medical aid contributions, group life premiums and any retirement fund contributions made by the employer.

Remuneration subject to PAYE

A commission can be a flat fee or a percentage of transaction value. It is an amount paid for executing a transaction. Although a commission earner can be referred as an “agent” or “representative”, the individual is regarded as an “employee” in the Fourth Schedule of the Income Tax Act. Commission income is variable income. The employer is deemed to incur the commission earned and the employee deemed to accrue the amount in the month of payment, regardless when the sales or turnover amounts forming the basis of the commission calculations have taken place.

In many ways, the deductions for business expenses available to these commission earners are similar to those available to individuals who are sole proprietors or independent contractors. Typically, these commission earners would apply for fixed percentage directives using the IRP 3(b) form which requires a detailed income and expenditure statement to be included with the application. The detailed income and expenditure statement should contain projected income amounts, which can be based on amounts earned in the latest year of assessment, adjusted for any increases, and a breakdown of anticipated expenses with corresponding upward adjustments. The fixed percentage directives would provide for the percentage of employees' tax (PAYE) that their employers should withhold on remuneration paid to them.

Types of expenses claimed as deductions

Unlike other salaried employees, these commission earners are able to claim actual travel expenses as deductions even if they do not receive a travel allowance or the use of a company vehicle from their employers. They will be able to claim wear-and-tear allowances on vehicle costs, interest and fees on the instalment sale agreements, and maintenance, fuel, licence and insurance costs. They should maintain logbooks recording business kilometres with dates, kilometres travelled and purposes of travel. The logbook will assist in apportioning travel expenses according to business versus total kilometres.

These commission earners are also able to claim home office expenses proportionate to the area used for business on rent, rates, water and electricity, interest and fees on the mortgage bond, cleaning, internet connectivity, and wear and tear allowances on business equipment. Cellphone invoices with a sample of business use relative to personal use calls should be maintained for verification purposes. Repairs to the home office specifically will be allowed in full. Repairs to the building in general, however, must not be included in total costs.

Unlike other salaried employees, the room containing the home office need not be regularly and exclusively used by the individual to work for the employer from which they earn remuneration. These commission earners can claim for home office expenses if their work performance and duties are mainly in their home offices, i.e. more than 50%.

Other expenses which commission earners can claim include any service fees such as accounting, legal, administration, and sales and marketing fees paid to service providers. (Non-commission salaried earners are only allowed accountancy fees if they receive income other than salary, pension or annuities.)

Commission earners can claim entertainment expenses for various sales and marketing initiatives. It would be advisable to compile a spreadsheet together with the names of clients and reasons for the expenses which reconciles with the relevant invoices, receipts or statements of account. Notably, other salaried employees who do not earn commissions at all, or who earn less than 50% of total remuneration in commissions, cannot claim any entertainment expenses. These salaried employees should rather claim reimbursements for entertainment expenses from their employers, based on supporting invoices.

As with any claims for deductions, supporting documents in the form of schedules, invoices, receipts, statements of accounts and calculations with amounts on schedules reconciling with the source documents should be retained for five years and submitted to SARS if the ITR12 return is selected for verification. Bank statements or credit card statements are not accepted as supporting documents. An apportionment calculation of square meter of home office area relative to the total residence, with the same ratio applied to expenses such as rates and interest, must also be submitted. Expenses which are not allocated a code on the ITR12 should be claimed using code 4016.

Reduction in commission income due to Covid-19 lockdowns

Unfortunately, the Covid-19 lockdown conditions have resulted in devastating reductions in commission income for some of these individuals. Where the anticipated commission income in the 2021 year of assessment is likely to fall below 50% of total remuneration due to the economic impact of the lockdown, there is an argument to be made that these commission earners should still be allowed to claim all the business expenses regardless. This is because their remuneration isnormallyderived mainly from commissions based on sales or turnover attributable to them. Covid-19 times are unprecedented, and the OECD has acknowledged this period is exceptional and temporary in nature, i.e. not normal. The same should be the case in determining whether a commission earner meets the 50% threshold in the 2021 year of assessment.

It would be a good idea to anticipate this issue in a verification, to prevent SARS disallowing expenses claimed and having to object to the additional assessment. The commission earner should provide a schedule with commission income 3606 amounts comprising more than 50% of the total remuneration in the 2019 years of assessment and beyond. Communication from the employer on pre-lockdown sales targets to be reached in 2020 and further communication with reduced lockdown targets would also assist in demonstrating that the decrease in sales (and corresponding decrease in commission income) is due to the lockdown and exceptional in nature.

Where the decrease in commission income is not expected to fall below 50% of total remuneration, the commission earner could request a revised fixed percentage directive to reduce the percentage of PAYE to be withheld by the employer due to the reduced remuneration. Commission earners should consult their tax advisers on whether to submit a new request. Their employers should continue to withhold PAYE according to the existing fixed percentage directive until provided with a new directive.

Ends

Link:
https://www.webberwentzel.com/News/Pages/deductions-available-for-commission-earners.aspx

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Tax Filing Season 2020 for Individuals

In support of the Presidents call to the Covid-19 pandemic, that Social Distancing be observed at all times and that we should at most stay indoors and limit movement, SARS is responding by rapidly enhancing its efforts to further simplify the tax return filing requirements for individual taxpayers and removing the need to travel to our Branches in 2020. Through the increased use of third-party data, SARS will be completing your tax return for you more accurately than ever. Where we have the required information we will provide you with a proposed assessment without the need to file a tax return. This enables you to view, accept or edit your proposed assessment from the comfort of your home or place of work using eFiling or SARS MobiApp.

Individual income tax return filing dates

- 1 September to 16 November 2020: Taxpayers who file online
- 1 September to 22 October 2020: Taxpayers who cannot file electronically can do so at a SARS branch by

appointment

- 1 September 2020to 31 January 2021: Provisional taxpayers who fileelectronically.

Individual filing opening

Taxpayers, your turn to file your tax return starts on 1 September this year. The good news is that a significant number of individual taxpayers will be auto-assessed this year, and this process will happen in August. No need to call us, we will send you an SMS if you are selected to be auto-assessed. If you accept your auto-assessment, any under or overpayment of tax will be processed as normal. If you want to edit your return, you can file your return on eFilingfrom 1 September.

No need to call

Taxpayers, your tax matters are in better hands when you make use of eFiling or the SARS MobiApp.Register your profile now to ensure a smooth filing experience. No need to call us, you canregister online or download the MobiApp on your phone or tablet.

We will do the filingfor you

Taxpayers, your tax matters, we continue to make it easier for you to comply. In August, we will be assessing a significant number of taxpayers automatically. If you accept the outcome you do not have to file a tax return at all. We auto-assess based on the data we receive from employers, financial institutions, medical schemes, retirement annuity fund administrators and other 3rd party data providers. If you have not yet received your IRP5/IT3(a)s and other tax certificates like medical certificate, retirement annuity fund certificate and other 3rd party data that are relevant in determiningyour tax obligations, you should immediately approach your employer or medical scheme or retirement annuity fund or other 3rd party data providers to make sure that they have complied with their submission requirements.

What to prepare before filing starts

Now is a good time to get your tax matters ready to ensure a smooth filing experience! Make sure that you have received your IRP5/IT3(a)s and other tax certificates like medical certificate, retirement annuity fund certificate and any other 3rd party data that are relevant in determining your tax obligations. Reset your eFiling username and password if you have forgotten them. Update your personal information such as banking details, address and contact details online on eFiling or the SARS MobiApp.

Making it easy for taxpayers

Through the increased use of third-party data, SARS will be completing your tax return for you more accurately than ever. Where we have the required information, we will provide you with a proposed assessment without the need to file a tax return. This enables you to view, accept or edit your proposed assessment from the comfort of your home or place of work using eFiling or SARS MobiApp.

High Court sets aside notice by SARS to debit a taxpayers

bank account

Authors: Heinrich Louw and Ndzalama Dumisa.

In the recent case of *SIP Project Managers (Pty) Ltd v The Commissioner for the South African Revenue Service* (Case Number 11521/2020) (as yet unreported), the High Court set aside a notice by the South African Revenue Service (SARS) to a bank to debit a taxpayers bank account in terms of section 179 of the Tax Administration Act 28 of 2011 (TAA), and ordered SARS to repay the amount to the taxpayer.

Factual background
The facts of the matter were briefly as follows:

- During June 2019, SARS issued an assessment to the taxpayer in terms of which the taxpayer was to receive a refund.
- SARS subsequently conducted a verification and requested certain additional documents from the taxpayer, which documents were never furnished.
- As a result, SARS issued an additional assessment to the taxpayer on 9 October 2019, which effectively resulted in the previous assessment being reversed, and the taxpayer owing an amount of R1,233,231.00 to SARS. The date for payment of the amount was reflected on the additional assessment as 30 September 2019.
- On or about 6 February 2020, the taxpayer received notice from its bank that the bank had received a notice from SARS in terms of section 179 of the TAA, requiring the bank to debit the taxpayers bank account with the amount due under the additional assessment.

- The taxpayer, via its accountant, then for the first time became aware of the additional assessment on its e-filing profile.
- However, no letter of demand could be found on the taxpayers e-filing profile in respect of the amount owed in terms of the additional assessment.
- The taxpayer forthwith lodged an objection against the additional assessment and a request for suspension of the obligation to make payment pending finalisation of the objection.
- However, the bank had in the meantime debited that taxpayers bank account as per the notice issued by SARS.
- When the taxpayer contacted SARS, it was informed that three letters of demand were previously sent to the taxpayer before the notice was given to the bank, and that the letters were posted to the taxpayers e-filing profile. However, on further contact with SARS via its call centre, the taxpayer was informed that there were no letters of demand on the taxpayers e-filing profile.
- The taxpayer maintained that it never previously received the letters of demand and that they could not be found on its e-filing profile.
- The taxpayer subsequently demanded repayment from SARS, but after not receiving any reply from SARS, the taxpayer applied to the High Court for relief.

Section 179 of the TAA

Section 179(1) of the TAA provides as follows

A senior SARS official may authorise the issue of a notice to a person who holds or owes or will hold or owe any money, including a pension, salary, wage or other remuneration, for or to a taxpayer, requiring the person to pay the money to SARS in satisfaction of the taxpayers outstanding tax debt.

This section effectively allows SARS to collect outstanding tax debts by requiring any debtor of a taxpayer, on notice, to make payment to SARS and not the taxpayer. In practice, such notices are often issued by SARS to a taxpayers bank or employer.

Section 179(5) provides that a third-party notice may only be issued after delivery to the taxpayer of a final demand for payment, which must be delivered at least 10 business days before the issue of the notice.

Decision

The High Court highlighted the following

- The taxpayer produced a screenshot of its e-filing profile showing that there were no letters of demand.
- The taxpayer also averred in its papers that an official from the call centre confirmed that there were no letters of demand on its e-filing profile.
- SARS was therefore required to counter by showing that a letter of demand was posted to the taxpayers e-filing profile.
- SARS, in its papers, at best established that letters of demand were actually generated.
- However, it is not sufficient by itself that a letter of demand was actually generated by SARS. Section 179(5) of the TAA requires delivery of such letter of demand to the taxpayer, whether physically or electronically.
- SARS failed to establish such delivery, and specifically that a letter of demand was posted to the taxpayers e-filing profile.
- SARS also chose to not deal with the taxpayers averment that a SARS official from the call centre confirmed that no letters of demand could be found on the taxpayers e-filing profile.

Accordingly, the court accepted the taxpayers version, and found that no letter of demand was delivered to the taxpayer as required by section 179(5) of the TAA.

The court further held that the requirement in section 179(5) of the TAA that a final demand for payment be delivered to the taxpayer at least 10 days before a notice in terms of section 179(1) of the TAA is issued, is peremptory.

On the basis of the finding that no letter of demand was delivered to the taxpayer, this peremptory requirement was not met.

The court then further had to establish whether such non-compliance was fatal to the notice issued to the bank.

In considering this issue, the court had regard to the purpose of section 179(5) of the TAA, and stated that the section was clearly introduced to limit the powers of SARS to recover tax debts by appointing third parties without advising the taxpayer.

The court effectively held that failure by SARS to comply with section 179(5) of the TAA was fatal to the notice to the bank and rendered the process unlawful.

The court accordingly declared the notice issued by SARS to the bank to be null and void, and ordered SARS to repay the amount of R1,262,007.00 to the taxpayer, together with interest as from the date that the amount was debited from the taxpayers bank account.

COVID-19: Some practical tax

issues

Author: Ben Strauss.

Businesses and individuals may well ask themselves what practical, day-to-day tax consequences the COVID-19 pandemic now holds for them.

For example, a company operating a financial services business may be obliged to incur expenditure which it would not incur in the ordinary course, such as sanitizers, gloves, masks and temperature measuring equipment for screening employees and customers. A taxpayer is entitled to deduct expenditure provided certain requirements are met. Notably, to be deductible, the expenditure must be actually incurred in the production of income as contemplated in section 11(a) of the Income Tax Act, 58 of 1962 (Act).

In the seminal case of *Port Elizabeth Electric Tramway Co Ltd v CIR* 1936 CPD 241 the court held as follows:

The purpose of the act entailing expenditure must be looked to. If it is performed for the purpose of earning income, then the expenditure attendant upon it is deductibleThe other question is, what attendant expenses can be deducted? How closely must they be linked to the business operation? Here, in my opinion, all expenses attached to the performance of a business operation bona fide performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or attached to it by chance or are bona fide incurred for the more efficient performance of such operation provided they are so closely connected with it that they may be regarded as part of the cost of performing it.

Now, strictly speaking, the costs of the items listed in the example above do not *per se* lead to the generation of income for the financial services company. However, there is an argument that the costs should be deductible because they are incurred *bona fide* and the costs are necessary to perform the business operations. In other words, if the company did not incur the costs of protecting staff and customers they would not be able to continue operations effectively, or at all.

Consider also the following scenario. A building contractor is obliged to send his workers home for an extended period of time. The contractor accordingly is unable to deliver the building on time. The customer sues the contractor for breach of contract. The court awards damages to the customer. Will the contractor be able to deduct the amount of the damages for tax purposes?

Our courts have held on a number of occasions that, generally, damages payable which arise from commercial inefficiency, negligence and willful breach of contract are not deductible in the hands of the taxpayer who is liable to pay the damages: *see Kangra Group (Pty) Ltd v C:SARS* [2018] 4 All SA 383 (WCC). On the other hand, if a taxpayer becomes liable to pay damages through no fault of its own, the damages could be deductible in its hands. In the *Kangra* case, the Court provided the example where a coal supplier faces a damages claim from the buyer arising out of non-delivery due to a breakdown in the railway system resulting in the load not reaching the port on time. There is a potential argument that, if a taxpayer does not deliver goods or services on time as a result of an innocent act or omission resulting from COVID-19, the taxpayer should be able to deduct the amount of the damages paid for income tax purposes.

The payment of damages may give rise to value-added tax (VAT). Accordingly, from the perspective of the taxpayer paying the damages, the amount should be stated as being exclusive of VAT. In the case where a taxpayer receives compensation under a loss-of-profits insurance policy, the compensation will generally be subject to income tax in the hands of the taxpayer in accordance with *ITC* 594 (1945) 14 SATC 249. The compensation may be subject to VAT in terms of section 8(8) of the Value-Added Tax Act, No 89 of 1991. Please see in this regard our previous Tax Alert discussing VAT on out of court settlements and payments of damages.

Consider also the position where employees are obliged to work from home.

If, for instance, the company provides a 3G data card to an employee who does not have sufficient data available at home to perform her functions properly during the lockdown period, the company may be able to deduct the expense so long as the 3G data card is utilised for business purposes. The same would potentially apply where the employee purchased the data herself and was then reimbursed by the company. In such case, the employee would potentially not pay income tax on the reimbursement of the data purchases that was used for business purposes.

The employee may incur additional expenses because she has to work from home. Generally, in accordance with section 23(b) of the Act, domestic and private expenses are not deductible by an employee. However, an employee may deduct expenses in respect of the part of her house which is used for work purposes, subject to certain provisos. First, that part of her house must be specifically equipped for work purposes. Second, that part of the house must be used regularly and exclusively for work purposes. Third, the employee must not be paid a fixed salary, or the employee must perform her duties mainly in that part of the house.

The problem that many employees may face is that they may not have a dedicated workspace for the period that they are working from home. For example, if an employee sets up a workspace on the kitchen table, that part of the house will not be used exclusively for work purposes, and the employee will not be able to deduct any expenses.

If employers are obliged to retrench employees, the employers should ensure that any severance benefits are structured correctly so that employees get the full benefit of reduced taxes provided for in the Act that may apply in those cases.

It is apparent from the examples above that COVID-19 has given rise to several unforeseen tax consequences. Taxpayers should consult their tax advisers when incurring expenses, claiming under insurance policies, and dealing with employees.

VAT on imported services payable by non-registered VAT vendors and goods sold in execution – the who, what and how of declarations to SARS

Author: Varusha Moodaley.

On 1 June 2020, the South African Revenue Service (SARS) issued an external guide titled Manage Declaration for Non-Registered VAT Vendors (SARS Guide). The SARS Guide provides guidance to non-vendor recipients of imported services and in instances where goods are sold in execution of a debt, on how to settle their VAT liabilities with SARS.

On 1 June 2020, the South African Revenue Service (SARS)

issued an external guide titled [Manage Declaration for Non-Registered VAT Vendors (SARS Guide)]. The SARS Guide provides guidance to non-vendor recipients of imported services and in instances where goods are sold in execution of a debt, on how to settle their VAT liabilities with SARS.
The VAT principles applicable to imported services and goods sold in execution of a debt are first briefly described below.

Imported services

Subject to certain exceptions, VAT is payable at the standard rate of 15% by a South African recipient of imported services. This is irrespective of whether the recipient is a registered VAT vendor or a non-vendor. There are four requirements for a service to fall within the ambit of the definition of imported services in the VAT Act, namely:

- The services must be rendered by a supplier who is resident outside South Africa or who carries on business outside South Africa;
- The recipient of the services must be a resident of South Africa;
- The services must be utilized or consumed in South Africa; and
- The purpose for acquiring the services must be otherwise than for the making of taxable supplies.

Where imported services are acquired for a value exceeding R100, the recipient is required to pay VAT on such importation where the services are acquired wholly or partly for a non-taxable purpose.

South Africa introduced legislation with effect from 1 June 2014 requiring foreign suppliers of electronic services (e-services) to register as VAT vendors in South Africa to the extent that they make taxable supplies of e-services to South African recipients. The regulations defining what constitutes e-services were amended and the scope of what constitutes e-services was significantly broadened from 1 April 2019. The effect of the amendment is that virtually all services that are supplied by way of electronic means such as cloud computing, computer software, music, games and any online services are now included as electronic services. As a result, most foreign suppliers of e-services will be registered vendors in South Africa. This removed the obligation to pay VAT on such services from the South African recipient to the foreign supplier. Consequently, a South African recipient who acquires e-services from a non-resident supplier will only be required to pay VAT on imported services if the supplier is not registered as a vendor under the e-services provisions.

Goods sold in execution

Where a person purchased goods under a credit arrangement and then defaults, another person, normally the Sheriff of the court, may take possession of the goods purchased, and the Sheriff may then sell the goods in execution of the debt owed by that person.

Where goods are sold in execution of a debt, the sale is, in certain circumstances, deemed to be made in the course of an enterprise and the sale will therefore be subject to VAT. In this instance, the seller, and not the owner of the goods is required to account for VAT thereon to SARS.

The Declaration process

Where imported services are acquired by a recipient who is a registered vendor, the VAT liability in respect thereof may be included in the vendors VAT201 declaration. However, where the recipient is a non-vendor, such non-vendor was previously required to complete a form VAT215 and to make payment of the VAT
to a SARS branch office.

Where goods are sold in execution of a debt and the sale is subject to VAT, the VAT on such sale must be accounted for and paid separately to SARS and may not be accounted for under the VAT number of the seller or that of the owner of the goods.

The seller was previously required to complete a form VAT216 and to make payment of the VAT at a SARS branch office.

Where the recipient of imported services is not registered for VAT, there is no VAT number under which payment can be made to SARS. The making of payments without a VAT number at a SARS branch office became a challenge and SARS branch offices often refused to accept these payments as they did not seem to know how to process payments without a VAT number and where to allocate such payment. The process for making these payments has now been amended and the SARS Guide has been issued to clarify the payment process. The VAT215 and VAT216 forms have been updated accordingly.

In terms of the SARS Guide, the VAT liability must be determined by completing a form VAT215 (imported services) or a form VAT216 (sale in execution), which are available on the SARS website. The VAT liability must then be paid via the liable persons SARS e-filing profile following the process as described in the SARS Guide.

Once the payment has been successfully made via SARS e-filing, the e-filing system will generate a payment confirmation receipt number. The recipient of the imported services, or the seller of the goods sold in execution, as the case may be, is then required to insert the payment confirmation receipt number in the Receipt Number field on the VAT215 or VAT216 form. The recipient or the seller, as the case may be, is not required to submit the completed VAT215 or VAT216 forms to SARS; they are simply required to retain the completed form for a period of five years and must be able to produce this to SARS if requested to do so. Consequently, the recipient or the seller will no longer be required to visit a SARS branch office for purpose of making payment.

Comments

It is important to note that to make the VAT payments to SARS in respect of imported services or goods sold in execution via SARS e-filing, the income tax reference number of the recipient of the imported services or seller of goods sold in execution is a pre-requisite. It is therefore only recipients or sellers who are registered for income tax and who are also registered on the SARS e-filing system will be able to adhere to the new mandated declaration and payment process. It seems, however, that the requirement to be registered for income tax represents a shortcoming in the process because there could be instances where a non-vendor recipient of imported services may not be registered for income tax, even though such instances are exceptional.

The amended process of making payments of VAT electronically in these circumstances is welcomed. However, SARS may need to reconsider introducing an alternate declaration process for persons who are also not registered for income tax.

VAT apportionment v direct attribution: A (preliminary) win for the taxpayer

Author: Gerhard Badenhorst.

The debate between taxpayers and the South African Revenue Service (SARS) as to what constitutes a fair and appropriate apportionment formula to determine the deductible value added tax (VAT) incurred on expenses where the taxpayer makes both taxable and exempt supplies, is ongoing. However, it is up to the taxpayer to determine whether an expense incurred is wholly attributable to making taxable supplies, in which case the total amount of VAT incurred is deductible. SARS cannot rule beforehand on whether an expense is directly attributable to taxable supplies, by virtue of a notice published in terms of section 80(2) of the Tax Administration Act 28 of 2011 (GN No. 748 24 June 2016), known as the so-called *no-rulings* list.

The Tax Court (Megawatt Park, Sunninghill) was recently called upon in the case of *ABC (Pty) Ltd v The Commissioner for the South African Revenue Service* (Case No: VAT 1626 3 March 2020) to determine whether the VAT on certain expenses incurred by the taxpayer were wholly attributable to making taxable supplies and therefore fully deductible as input tax, or whether the expenses were subject to apportionment. The Tax Court found in favour of the taxpayer and held that the VAT was fully deductible as input tax.

The facts and issues considered

The taxpayer carries on business as a bureau de change in the course of which it exchanges travellers cheques and currencies for inbound and outbound travellers. It carries on business in three separate divisions, being the head office, treasury and a branch network of 52 branches. The treasury division is responsible for setting exchange rates for buying and selling foreign currencies to the customers and sets the rate of the currency and adds a margin thereon. The branch network is responsible for the exchange and sale of foreign currencies to customers. The branch processes the currency exchange transactions of customers and charges the customer a commission or fee for its services.

The taxpayer argued that its branch network only makes taxable supplies for which it charges commissions or fees to customers, and that the total amount of VAT incurred on expenses by its branch network is deductible as input tax.

The Tax Court had to consider whether the branch network only made taxable supplies, or whether it was involved in making both taxable and exempt supplies.

Legal framework

The relevant provisions of the Value Added Tax Act 89 of 1991 (VAT Act) which were considered by the Tax Court in deciding the matter, are the following:

Section 2(1)(a) deems the activity comprising of the exchange of currency to be a financial service. Section 12(a) exempts from VAT the supply of a financial service.

The proviso to section 2(1) excludes from *financial services* the activity comprising of the exchange of currency to the extent that the consideration payable for the activity is any fee or commission.

The definition of the terms *goods* and *services* both exclude money. *Money* is defined to include any bill of exchange. This definition is similar to the definition of currency in section 2(2), which defines the word to mean any banknote or other currency of any country.

The term *consideration* is defined to mean, in relation to the supply of goods or services by any person, any payment made or to be made in respect of, in response to or for the inducement of the supply of any goods or services.

Judgment

The case concerns the exchange of currency, which involves the buying and selling of currency against the payment of a commission or fee. The Tax Court stated that the taxpayers treasury division is responsible for buying and selling the foreign currency and sets the daily buy and sell rates for the branches. The services rendered at the branches involve customers buying and/or selling foreign currency notes in person at the branch, for which the branches charge a commission or fee.

The taxpayer led evidence that the services rendered at the branches are administratively intense and time-consuming, as forms need to be completed, data needs to be captured in systems, and cash needs to be counted. FICA compliance must be ensured and SARB requirements must be met.

The judgment turned on the interpretation of the proviso to section 2(1)(a) to determine whether the taxpayer only made taxable supplies at the branches, which justified the direct attribution applied by the taxpayer. The issue was whether the exchange of currency falls within the definition of *financial services*, the supply of which is exempt under section 12(a) of the VAT Act.

The Tax Court considered the contractual arrangement under which the supply is made. The agreements provide for the exchange of specified currencies at a particular rate of exchange nominated by the taxpayer, and the payment by the customers of a commission. The margin at which the taxpayer purchases and sells foreign currency is not part of the agreements, as it is not known by the treasury division or the customer when the transaction is closed at the branch.

The Tax Court commented that it will be absurd and untenable to decide VAT consequences of transactions with reference to margins or profits earned by vendors as opposed to relying on the true nature of the rights and obligations arising from a particular contract.

The Tax Court found on the facts and the evidence that the only payment that the customer makes for the exchange of currency is the commission or fee. The consideration in the form of a commission removes the activity of the *exchange of* *currency* from being a deemed financial service. The margin which the taxpayer made when buying or selling foreign currency was not considered to be relevant for purposes of deciding the case. The Tax Court seems to have accepted the taxpayers arguments that the profit margin was not a payment made in respect of, in response to, or for the inducement of, the exchange of currency. The margin was part and parcel of the exchange, of which the customer was ignorant. The margin was further not a term of the contract, but was a consequence for the taxpayer of the terms of the contract, because it produced a profit for the taxpayer.

The Tax Court concluded that the only consideration charged for the exchange of the currency was the taxable commission or fee, and that the branches therefore only made taxable supplies. The VAT incurred by the branches on their expenses was consequently directly attributable to such taxable supplies, and as such the VAT qualified in total as input tax.

Costs

Section 130(1) of the Tax Administration Act allows for an order for costs to be made in certain specific circumstances. However, it is rarely the case that an order for costs is made by the Tax Court.

In this case the Tax Court considered the grounds of assessment and the decision of SARS to disallow the input tax deduction to be unreasonable, *especially for insisting that the appellant reverts to and must continue to use the apportionment method and not the direct attribution method without any legal justification in circumstances where it was reasonable to expect it to.* Consequently, SARS was ordered to pay the costs of the taxpayer.

Appeal

In view of the significance of the judgment and the implications thereof, it is not surprising that SARS has applied for leave to appeal, which we understand has been granted. The appeal court (the Supreme Court of Appeal or the High Court) will have to determine, amongst others, whether the Tax Court was correct in finding that the exchange of currency is neither the supply of goods nor services; whether the charging of a commission or fee removes the exchange of currency completely from being a financial service; and whether the margin earned by the taxpayer is irrelevant for determining the VAT status of the supplies.

Vendors who operate on a similar basis as the taxpayer in this case should consider the judgment with caution, as an appeal court could interpret the relevant provisions of the VAT Act differently and overturn the judgment of the Tax Court.