A Departure From ‘Adequate Reasons’ and Common Sense

Author: Daniel Areias & Johan Kotze (Bowman Gilfillan)

All taxation, in one way or another, may impact upon fundamental human rights. However, to ensure that the imposition is not absolute, section 5 of the Promotion of Administrative Justice Act provides that every person, whose rights may have been materially and adversely affected by administrative action, may request written reasons for that action from the administrator responsible.

It is interesting to compare the current cautious right to reasons (also in the light of the discussion that follows with regard to reasons for assessments) with the generous right to reasons per the Interim Constitution, which gave every person the right to be furnished with reasons, in writing, for administrative action that affected any of his/her rights or interests, unless the reasons for such action have been made public.

This right is for tax purposes manifested in the Tax Court Rules (the Current Rules) which provides in Rule 3 that a taxpayer who is aggrieved by any assessment may request SARS to furnish reasons for that assessment.

SARS, at least, has to furnish ‘adequate reasons’, which if it has already been provided, SARS must notify the taxpayer accordingly, which notice must refer to the documents wherein such reasons were provided, or if it has not been provided, SARS must provide such reasons in writing.

The concept of ‘adequate reasons’ was never defined in the Current Rules, the Income Tax Act or any other tax Act and its interpretation was bound to appear before the Courts eventually.
The meaning of ‘adequate reasons’ was first discussed in the Tax Court case of Income Tax Case No. 1811, where the Gauteng Tax Court expressed agreement with the standard of what constitutes ‘adequate reasons’ as laid down, in the context of Administrative Law, by the Minister of Environmental Affairs and Tourism v Phambili Fisheries quoting the Federal Court of Australia in Ansett Transport Industries (Operations) Pty Ltd and Another v Wraith and Others. The Tax Court was of the view that:

‘...the decision-maker should set out his understanding of the relevant law, any findings of fact on which his conclusions depend (especially if those facts have been in dispute) and the reasoning process which led him to those conclusions. He should do so in clear and unambiguous language, not in vague generalities or the formal language of legislation.’

Accordingly, the Tax Court quoted the SARS Guide on Tax Dispute Resolution and found that ‘adequate reasons’ requires the decision maker to explain his decision in a way which would enable a person aggrieved to say: ‘Even though I may not agree with it, I now understand why the decision went against me’. Ideally, the aggrieved taxpayer should be in a position to decide whether that decision is worth challenging. In this regard, the Tax Court commented that this was a relatively high standard which SARS set for itself to comply in giving reasons. In a latter issue of SARS’ Guide on Tax Dispute Resolution this standard was dropped, which one may argue is in disrespect of the letter of the law.

The meaning of ‘adequate reasons’, for purposes of the Current Rules, was finally put to rest in the Supreme Court of Appeals case of Commissioner for South African Revenue Service v Sprigg Investment 117CC T/A Global Investment, which confirmed the meaning attributed to it in Minister of Environmental Affairs and Tourism v Phambili Fisheries.

In February 2013 the SARS released the draft Tax Court rules
to be promulgated under section 103 of the Tax Administration Act, 2011 (TAA) (Proposed Rules). The Proposed Rules, which are expected to replace the existing Tax Court Rules, promulgated under section 107A of the Income Tax Act (Current Rules), prescribe the procedures to be followed in respect of objections and appeal proceedings against assessments or certain other administrative decisions made by SARS.

For the most part, the Proposed Rules are similar to the Current Rules, but, as always, there are a few notable departures. One of these departures is the rule regulating the request for reasons of an assessment.

Given the furor surrounding the concept of ‘adequate reasons’, it is surprising that SARS, in drafting the Proposed Rules, did not allocate a concrete meaning to it. The rule regulating reasons for an assessment can be found in Rule 6 of the Proposed Rules. Rule 6 (4) and (5) provides a clue why SARS neglected to allocate a meaning to concept of ‘adequate reasons’, and reads as follows:

‘(4) SARS must provide reasons for the assessment within 45 days after delivery of the request for reasons.

(5) The period for providing reasons may be extended by SARS if a SARS official is satisfied that more time is required by SARS to provide reasons due to exceptional circumstances, the complexity of the matter or the principle or the amount involved.’ (author’s emphasis)

It is clear that Rule 6 of the Proposed Rules discards the concept of ‘adequate reasons’ and simply prescribes that SARS must provide reasons for an assessment. Given the judicial progression of the meaning of ‘adequate reasons’ and the finality of its meaning attributed by the SCA, it is surprising that SARS simply chose to ignore such judicial insight and opt for the lower threshold of simply providing ‘reasons’.
The concept of what constitutes ‘reasons’ in the context of an assessment issued by SARS is bound to create uncertainty and come under judicial scrutiny in much the same vein as the meaning of ‘adequate reasons’.

Or is it? Another noteworthy departure can be found in Rule 6(7) which provides that the provision of reasons given by SARS under Rule 6 is final. Does this finality mean that reason provided by SARS can never be challenged by an aggrieved taxpayer regardless of how thin they are? If the provision remains in the final version of the Proposed Rules who will then determine what would constitute ‘reasons’? SARS the law unto themselves? This provision is clearly beyond the powers of SARS and contradicts numerous well established constitutional and common law principles.

Group tax: A simple solution?

Ingé Lamprecht
New bill introduces complications.
JOHANNESBURG – The benefits of a group taxation system should be investigated.

Zweli Mabhoza, head of taxation services at SizweNtsalubaGobodo, says one of the reasons why group taxation – where legal entities within a group of companies are treated as one taxpayer – has been opposed in the past, is because South Africa does not have sufficient skills to support the introduction of such a complicated tax system.

The US as well as European countries like France and Germany permits group taxation subject to certain limitations.
But, says Mabhoza, some of the proposals in the recently published taxation amendment bills, introduce complications to the extent that the legislation is moving towards such complexity that criticism against the difficulty of a group tax system can no longer apply.

**Complexity**

One of the recently proposed changes to tax legislation relates to finance structures, Mabhoza says.

National Treasury is trying to limit the deductions that taxpayers may claim with regards to interest. This could spell the end for transactions that were previously entered into for the sole purpose of reducing the tax liability.

Mabhoza says it often happens that one company within a group would be in a taxpaying position (company B) while another is not (company A). In order to reduce the tax liability, company A would then provide funding to company B and charge interest. Company A would subsequently use the interest income to reduce the tax loss while company B would use the interest expense to lessen the taxable income.

The proposals now seem to try and curtail the deductions in respect of interest that taxpayers may claim by introducing a complicated formula that would limit the interest deductibility to 40% of the adjusted taxable income.

Mabhoza says the proposed calculation is further complicated by the fact that in order to determine the applicable adjusted taxable income, the calculation will have to be repeated twice – once in the year during which the transaction was entered into and also during the year of assessment in which the interest is deducted.

For a business, the costs of the proposed changes will not only be the limitation of the interest deductions, but also to engage advisors to help them with the calculation, he says.
The introduction of the formula is also problematic since it could require companies to revisit calculations that were done a number of years back (when the companies first engaged in the transaction). Often the employees that were responsible for capturing the initial transaction are not working at the company anymore which means that someone else has to take time to try and decipher the calculations, Mabhoza says.

The proposed effective dates could result in a transaction entered into five years ago, also being affected by the change. Although the tax return will not need to be reopened the information that was used during that year of assessment will be required for current tax calculations.

Mabhoza says the new provisions also lack clarity on what the implications would be if the South African Revenue Service (Sars) requests an audit for prior years that results in a change of the taxable income. Since the interest rate deduction that will be allowed is linked to the taxable income, this could result in additional recalculations, he says.

Mabhoza says South Africa has to deal with these complications since it does not use a group tax system. Although corporate rules were intended to address some issues, it is not comprehensive, he notes.

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**Tax Ombud: Lots of bark, but will it bite?**

How the office could affect taxpayers.

The recently promulgated Tax Administration Act, No. 2011 (TAA), introduces the Office of the Tax Ombud (the Tax
According to section 14 read with section 259 of the TAA, the Minister of Finance must appoint a person as Tax Ombud within one year after the commencement date of the TAA, which was on 1 October 2012. The Minister further announced in his 2012 Budget Speech on 22 February 2012 that the Tax Ombud will be appointed during the course of this year.

In ordinary language, the term “ombudsman” (derived from the Swedish term meaning “legal representative”) can be defined as “an official appointed to investigate individuals’ complaints against maladministration, especially that of public authorities” (Oxford English Dictionary). With its origins in Scandinavian history, it is generally accepted that the modern office of ombudsman derives from 1809, when the Swedish legislature established the Office of the Parliamentary Ombudsmen. The main purpose of this institution was to safeguard the rights of citizens by way of a supervisory agency that was completely independent, and which could contend with complaints submitted by the general public regarding administrative matters.

In South Africa, the Katz Commission proposed the introduction of an ombudsman to deal specifically with tax issues in 1995. Various submissions were made to Treasury in this regard, and a Tax Ombud was finally proposed in draft legislation in the 2011 Tax Administration Bill. After initial rounds of public and further comments, the Tax Ombud officially became a legislative institution on 1 October 2012.

Staffing and funding of the Tax Ombud

The TAA determines that the Tax Ombud will be staffed by Sars employees who will be seconded from Sars upon request. In Treasury’s comments on the legislation, it was mentioned that this provision was included to ensure that individuals are appointed who have a sound knowledge of South African tax legislation and are well-versed in Sars policies and procedures. The Tax Ombud will be funded by Sars.
Powers, duties and functions of the Tax Ombud

The Tax Ombud is tasked with reviewing and investigating taxpayer complaints relating to service, procedural or administrative matters. Examples of such issues include if Sars does not respond to correspondence; does not assist with reasonable taxpayer requests; or fails to adhere to correct procedures prescribed by the Income Tax Act, No. 58 of 1962 (the ITA). The Tax Ombud may not, however, review Sars policy (unless it has resulted in administrative or service issues); nor may it review legislation or tax matters that are subject to objection or appeal.

Taxpayers must first avail themselves of the existing complaint resolution mechanisms within Sars before approaching the Tax Ombud. This process involves first contacting a local Sars branch or call centre, and then, if necessary, escalating the matter to a Sars manager or specialist support. If a taxpayer’s complaint is not resolved at this stage, the Sars Service Monitoring Office can be approached.

Only once all of these channels have been exhausted without success, can taxpayers approach the Tax Ombud for assistance (exceptions may be made, however, i.e. there is a possibility of undue hardship or if there is sufficient urgency). The Tax Ombud is positioned within the existing legislative framework as an intermediate step between Sars’ internal procedures and the domain of the public protector and court system.

The Tax Ombud is mandated by the TAA to act independently and to follow informal, fair and cost-effective procedures. It must review all complaints received, but is free to decide which complaints it will seek to resolve and how it will go about doing so. The Tax Ombud can further decide to terminate a complaint resolution process that has been initiated, but must give reasons to the taxpayer as to why it decided to do so. Certain factors are listed in the TAA to guide the Tax Ombud in reaching such a decision, including the age of the
request; the nature and seriousness of the issue; and the findings of any other redress mechanisms.

The Tax Ombud is mandated to identify any systemic and emerging issues that come to its attention during the course of its operations. Such issues can relate to Sars’ service, the application of the TAA and any administrative or procedural aspects that result from the application by Sars of any of the listed “Tax Acts” (which include the ITA and the Value-Added Tax Act, No. 89 of 1991, for instance). e

There is an obligation on the Tax Ombud to communicate with Sars in its attempts to resolve taxpayer complaints. It is bound by confidentiality and it may not reveal taxpayers’ information to Sars, except if necessary to assist with the resolution of the complaint. The Tax Ombud may, for example, have to provide a complainant’s tax reference number and the details regarding the complaint to Sars to seek resolution. Ultimately, the Tax Ombud may make recommendations to the taxpayer or Sars in seeking to resolve the matter. These recommendations are not, however, binding on Sars or on the taxpayer.

**Duty to report to the Minister of Finance**

The Tax Ombud must submit an annual report to the Minister of Finance and a quarterly report to Sars. The reports must contain a summary of at least ten of the most serious issues investigated by the Tax Ombud during the period in question. An inventory must be included that describes the actions taken by the Tax Ombud in seeking resolution, as well as the results thereof. It must further set out what action has been planned and is still pending, as well as indicate where no action was taken and the reasons for inaction. The report must highlight any systemic or emerging issues identified over the course of the period. Lastly, the report must make recommendations as to administrative action suggested to resolve complaints and to address systemic or emerging issues.
Conclusion

Although the introduction of a Tax Ombud by the TAA is a commendable step in an effort to improve the efficiency of tax administration in South Africa, there may be certain shortcomings in the legislative framework.

The TAA for instance requires the Tax Ombud to act independently, fairly and informally, but this may be threatened by the fact that the Office will be staffed by Sars employees and funded by Sars. Moreover, the Tax Ombud has a wide discretion as to the handling of complaints, and there is no guarantee to taxpayers that their complaints will be resolved. While the reporting obligation may act as an incentive to the Tax Ombud, there is no clear and direct enforcement mechanism if it fails to perform.

The fact that the Tax Ombud’s recommendations are not binding on Sars is a further cause for concern, and raises doubts as to the efficacy of this institution. The Ombudsman for Short-term Insurance is a noteworthy example of a contrasting approach, as short-term insurers have agreed to be bound by its decisions. This is an exemplary safeguard offered to consumers of short-term insurance.

It is submitted that the Tax Ombud would be a more useful and appropriate institution if Sars and taxpayers were similarly bound by its recommendations. Treasury has expressed its contrary view that the Tax Ombud would be more effective if its primary weapon was not enforcement or other direct redress mechanisms, but rather the ability to publicise details of complaints and systemic or emerging issues. Taxpayers faced with complaints that cannot be resolved by the Tax Ombud would probably not agree. This may yet prove to be an opportunity missed to provide South Africa’s taxpayers with an effective complaint resolution mechanism, removed from the vast expenses of the court system.
To be fair, however, the Tax Ombud has yet to be constituted and has not yet heard a taxpayer complaint or issued any reports. It is with much anticipation, therefore, that we look forward to seeing it in action, with the hope that its bark is chilling enough to disguise its lack of bite.

Rudi Katzke, associate, Webber Wentzel

Receiver Throws Information Net Wider

On 5th April 2013, the Commissioner: South African Revenue Service issued Government Notice number 260, which appeared in Government Gazette number 36346 on 5th April 2013, setting out returns of information which must be submitted by third parties in terms of section 26 of the Tax Administration Act, No 28 of 2011.

It is appropriate to point out that, on 29th February 2012, the Commissioner: South African Revenue Service published a Government Notice requiring reporting institutions to furnish bi-annual returns of investment and interest with effect from the 2013 year of assessment. That government notice required certain financial institutions to supply extensive information to the Commissioner: SARS. As a result of the Tax Administration Act taking effect, it was necessary for a new notice to be published specifying information to be supplied by various third parties to Commissioner: SARS.

At the time that the Tax Administration Act was being finalised, it was indicated that the legislation was being enhanced to improve the gathering of information from third parties by the Commissioner: South African Revenue Service, so
as to increase the levels of tax compliance in South Africa and to assist in the further pre-population of tax returns to be submitted by individuals.

The latest notice requires financial institutions to supply details of retirement annuity contributions paid by taxpayers and for medical aid schemes to supply details of contributions made by persons in respect of the medical scheme, as well as all expenses paid for a person by a medical scheme.

These two particular requirements will assist SARS in pre-populating tax returns to be lodged by individuals. In addition, financial institutions in receipt of premiums paid for income protection policies must disclose that to the Commissioner, which should assist taxpayers in satisfying the Commissioner: SARS as to the deductibility of premiums paid on income protection policies.

The notice issued on 5th April 2013 requires the following persons to submit a return in the manner prescribed in the notice:

- banks regulated by the registrar of banks in terms of the Banks Act or the Mutual Banks Act;
- co-operative banks regulated by the Co-operative Banks Development Agency in terms of the Co-operatives Banks Act;
- financial institutions regulated by the executive officer, deputy executive officer or board, as defined in the Financial Services Board Act, whether in terms of that Act or any other act;
- companies listed on the JSE and connected persons in relation to the companies that issue bonds, debentures or similar financial instruments;
- state-owned companies, as defined in section 1 of the Companies Act that issue bonds, debentures or similar
financial instruments;
- organs of state, as defined in section 239 of the Constitution of the Republic of South Africa that issue bonds, debentures or similar financial instruments;
- any person, including a co-operative, as defined in section 1 of the Income Tax Act, who purchases any livestock, produce, timber, ore, mineral or previous stones from a primary producer other than on a retail basis;
- any medical scheme registered under section 24 of the Medical Schemes Act;
- any person who, for their own account, carries on the business as an estate agent, as defined in the Estate Agency Affairs Act and who pays to or receives on behalf of a third party any amount in respect of any investment, interest or the rental of property; and
- any person who, for their own account, practices as an attorney, as defined in section 1 of the Attorneys Act, and who pays to or receives on behalf of a third party any amount in respect of any investment, interest or the rental of property.

The notice then describes the nature of the information to be provided by the categories of persons specified in the notice. The Commissioner is seeking information regarding amounts paid or received in respect of or by way of any investment, rental of immovable property, interest or royalty, and transactions that are recorded in an account maintained for another person, that is, so-called transactional accounts like bank accounts.

Furthermore, those persons involved in the purchase and disposal of financial instruments for clients are required to disclose details of amounts paid in respect of the purchase and disposal of financial instruments.

Insurance companies are required to report the payment of amounts made upon the death of a person in terms of an
insurance policy.

Monies paid in respect of the purchase, sale or shipment of livestock, timber, ore, mineral, precious stones or by way of a bonus, in the case of a co-operative, are required to be disclosed to the Commissioner by affected persons.

The affected third parties are required to submit the requisite IT3 form to the Commissioner, or, alternatively, a data file compiled in accordance with SARS’s business requirements specification for IT3 data submission.

The requirement to submit information to the Commissioner is onerous in that the returns specified in the notice containing all information required in respect of the period from 1 March to 31 August of each tax year must be submitted by 31 October and, in respect of the period from 1 March to the end of February, must be submitted by 31 May. This increases the administrative burden on the affected persons, and will, no doubt, require amendments to computer systems to facilitate the transfer of data electronically to the Commissioner.

It is indicated that, where the third party return comprises twenty or less detailed records, the declaration portion of the return and detailed portion of the return must be submitted electronically using the SARS e-filing platform, or manually to the SARS office closest to the person’s place of business.

For those larger organisations, and where the third party return comprises twenty-one to fifty thousand detailed records, it is necessary to submit the declaration electronically using SARS’s e-filing platform, and the detailed portion of the return must be submitted electronically, using SARS’ hypertext transfer protocol secure (https) bulk data file platform.

In the event that the third party return comprises more than fifty thousand detailed records, the declaration portion of
the return must be submitted electronically using SARS’ e-filing platform, and the detailed portion of the return must be submitted electronically, using SARS’ managed data transfer platform.

The Government Notice provides that alternative arrangements may be made by affected persons as to how the information should be transferred or made available to SARS.

The Government Notice was issued so as to enable SARS to enhance third party information received by it, to ensure enhanced compliance with the tax laws of South Africa, and, also, to facilitate a greater degree of pre-populating of tax returns issued by SARS for completion by individuals.

Some commentators may seek to argue that the provision of the information called for violates the taxpayer’s right to privacy, but it must be remembered that any right contained in the Constitution is capable of limitation under section 36 of the Constitution of the Republic of South Africa, No 108 of 1996, as amended.

The request of the information set out in the notice may be construed as a violation of the right to privacy, but it is necessary for SARS to call for such information in order to comply with its obligations in administering the tax laws of South Africa, and, on this basis, the limitation of rights provision contained in section 36 of the Constitution would assist SARS should the information called for be challenged by taxpayers or affected persons.

Author: Beric Croome (ENS)
South Africa’s tax treaty with the DRC provides a new avenue for international investment

The tax treaty entered into between the Democratic Republic of Congo (DRC) and South Africa provides opportunity to promote South Africa as a hub for inward investment into the DRC. The tax treaty provides multinational companies with alternative investment opportunities in the DRC.

Until recently, the DRC had entered into only one Double Taxation Agreement (DTA) tax treaty (with Belgium). On 18 July 2012, the DRC doubled this number when its DTA with South Africa came into effect. When a foreign company holds its DRC investment through South Africa, the treaty and South Africa’s headquarter company regime may reduce the tax cost of doing business in the DRC.

The South African Government regards the DRC as a strategic partner in the African continent. According to recent statistics issued by the Department of Trade and Industry, two-way trade between South Africa and the DRC stood at R7.8 billion in 2011 compared to R6.2 billion in 2010 and R4.8 billion in 2009.

The treaty applies to amounts paid on or after 1 January 2013 and with respect to tax years beginning on or after 1 January 2013.

The DRC’s domestic laws provide that dividends paid by resident companies to non-resident companies are subject to a 20% withholding tax (10% for mining companies). However, the treaty with South Africa will reduce the rate to 5% if the South African resident company holds at least 25% of the DRC
company. In all other cases, the rate is reduced to 15%.

Dividends include income from shares, mining shares, founders’ shares or other rights, as well as income from other corporate rights which is subject to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

Interest arising in the DRC is subject to a 20% withholding tax rate (0% in the mining industry under certain conditions). If the beneficial owner of the interest is a South African resident, the treaty reduces this rate to 10%. Interest includes income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor’s profits.

Royalties arising in the DRC are subject to a withholding tax at an effective rate of 14%. However, if the beneficial owner of the royalties is a South African resident, the treaty reduces this rate to 10%. Royalties include payments received for the use of any copyright of literary, artistic or scientific work including films, tapes or discs used for radio or television broadcasting, any patent, trademark, design or model, plan, or for the use of industrial, commercial, or scientific equipment.

As is common in most agreements of this nature, the DRC/South Africa Double Tax Treaty ensures that the business profits of a South African enterprise will be subject to tax in the DRC only if the South African enterprise carries on business in the DRG through a permanent establishment. In the case of professional services rendered by an individual, the individual will be deemed to have a permanent establishment in the DRC only if he is present in the DRC for a period or periods in aggregate of more than 183 days in any 12 month period commencing or ending in a year of assessment.
Directors’ fees derived by a South African resident are an exception to this provision as the tax treaty grants taxing rights to the DRC for income earned in one’s capacity as a member of the board of directors of a company resident in DRC.

On 24 September 2012, the DRC amended its tax legislation. The corporate income tax rate applied to a DRC company, subsidiary or branch or a foreign company has been reduced to 35%. This is applicable to the 2013 fiscal year in the DRC. Furthermore, a new withholding tax has been introduced on service fees. The DTA is based on the Organisation for Economic Co-operation and Development (OECD) Model Convention. On this basis one should consider that South African residents should be taxable on such fees only if they fall within the ambit of business profits and are attributable to a permanent establishment in the DRC. However the application of Article 20.3 of the DTA leaves room for doubt. If the service fees are treated by the DRC as income subject to Article 20, the service fees will be subject to the DRC withholding tax.

South African companies that qualify as a headquarter company enjoy treaty benefits, but the dividends, interest and (in future) royalties paid by such a company will enjoy relief from the withholding regime that will be fully operational from 1 March 2014. For this reason, multinational companies with existing and planned investments in the DRC may wish to consider the potential benefits of holding their investments through South Africa.

Author: PwC (PwC, Synopsis, Tax Today, May 2013)
Shareholders liable for tax debts of companies on winding up

By Ben Strauss, Director, Tax, Cliffe Dekker Hofmeyr

Be aware of potential liabilities.

The Tax Administration Act, No 28 of 2011 (TAA) took effect on 1 October 2012.

Among other things, the TAA makes third parties liable for the tax debts of taxpayers, under certain circumstances. In terms of s181 of the TAA, shareholders of a company can be liable for the tax debts of a company on winding up.

In terms of s181(1) of the TAA the provision applies “where a company is wound up other than by means of an involuntary liquidation without having satisfied its tax debt…..” Put simply, a tax debt is an amount of tax due in terms of any law administered by the South African Revenue Service (Sars).

Section 181(2) of the TAA states that persons who are shareholders of the company within one year prior to its winding up are jointly and severally liable to pay the unpaid tax debt to the extent that:

· they receive assets of the company in their capacity as shareholders within one year prior to its winding up; and

· the tax debt existed at the time of the receipt of the assets or would have existed had the company complied with its tax obligations.

The term ‘asset’ is defined very widely in s1 of the TAA. As an example, the shareholders of a company (company A) resolve to voluntarily wind up company A. In the process of winding up, company A distributes cash or shares that it owns to its
shareholders. The shareholders will be liable (jointly and severally between them) for the unpaid tax debts of company A.

In terms of s181(3) of the TAA, the liability of the shareholders is secondary to the liability of the company. That is Sars must first try and recover the unpaid tax from the company and may only thereafter recover the unpaid tax from the shareholders. The people who are liable for tax of a company may avail themselves of any rights against Sars, which would have been available to the company as per s181(4) of the TAA.

In terms of s181(5) of the TAA, the provisions of s181 of the TAA do not apply in respect of:

· a company where its shares are listed on a recognised securities exchange (for instance, the Johannesburg Stock Exchange (JSE)); or

· a shareholder of a company whose shares are so listed.

In my view, the provision is inequitable. Shareholders do not manage the day to day affairs of companies, this is the role of the directors of the company. In closely held companies the shareholders and directors are often the same people. But in many cases, shareholders are passive investors and do not necessarily have knowledge about the affairs of the company, particularly the tax affairs of the company. It is unfair to saddle those shareholders with the tax debts of the company simply by virtue of their shareholding.

This consideration is even more relevant in the case where a person acquires shares from a third party. For example, a person (B) buys shares in a company (company C) from the shareholder (D). B decides to wind up company C and to procure that company C distributes all its assets to B. In that case, B will be jointly and severally liable with D for the tax debts of company C, despite the fact that B was not a
shareholder of company C when the tax debts arose.

The term ‘shareholder’ in s1 of the TAA is essentially a person who holds a beneficial interest in a company. A person holding a preference share in a company would accordingly also be caught in the net under s181 of the TAA if the company is voluntarily wound up while they are a shareholder. It is perhaps even more unfair for a preference shareholder who typically may only have a limited right to the profits and assets of a company to be liable jointly and severally with ordinary shareholders for the tax debts of the company.

Section 181 of the TAA only appears to apply in the case of a voluntary winding up of a company; it does not appear to apply in the deregistration of the company. Winding up and deregistration are not the same thing. The distinction is recognised for instance in s45 and s64B of the Income Tax Act, No 58 of 1962. Presumably, the legislature purposefully omitted the application of the provision in the event of deregistration because the liability of directors and shareholders do not cease in the event of deregistration – compare s83(2) of the Companies Act, No 71 of 2008.

Section 181(5) of the TAA is not clear. Presumably, the intention is that s181 of the TAA will not apply in the case where a company whose shares are listed on an exchange is wound up, and will not apply to the shareholders of such a company being wound up. However, if it is read literally, the provision appears to suggest that if a person holds shares in any listed company, the shareholder will never be liable under s181 of the TAA, even in relation to the receipt of assets on winding up of another company. The legislature should consider clarifying the provision.

Shareholders of companies should be aware of their potential liabilities under s181 of the TAA. People who acquire shares
from third parties should ensure that they obtain the appropriate security from the third parties in the event that they should become liable for the debts of the company on winding up after acquiring the shares.

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**Sars has increased powers under the Tax Administration Act**

**An overview**

The recently promulgated Tax Administration Act, No. 28 of 2011 (TAA) contains provisions that grant some dramatically increased powers to the South African Revenue Service (Sars).

**Tax recovery on behalf of foreign governments**

Section 185 of the TAA contains the measures available to Sars to recover tax on behalf of foreign governments. Broadly defined, the provisions of section 185 provide that revenue authorities of a foreign country (with which South Africa has a tax treaty) can request Sars to assist in the collection of foreign taxes due by a person to that country.

These powers are not an entirely new development. Similar provisions were contained in the repealed section 93 of the Income Tax Act, No. 58 of 1962 (the Income Tax Act), and some remain in section 75 (not repealed) of the Value-Added Tax Act, No. 89 of 1991.
The TAA envisages two types of mutual assistance requests from foreign governments. The first is a request for conservancy of an amount of tax alleged to be due in a foreign country, where there is a risk of dissipation or concealment of assets located in South Africa. The second is a request for the collection of an amount of tax due under the laws of a foreign country. Whereas the latter is not a new concept, the provision dealing with a request for conservancy was not previously dealt with under the Income Tax Act.

If Sars receives a request for conservancy, section 185 of the TAA enables Sars to bring an ex parte application to a High Court for a preservation order. Preservation orders are, in turn, governed by section 163 of the TAA. Such an order, if granted, prohibits any person from dealing with the assets at the risk of dissipation or concealment. If there is sufficient urgency, Sars may even seize and remove such assets up to 24 hours before applying for a preservation order.

If a pre-emptive seizure is carried out, however, Sars must preserve and safeguard the assets seized. If a preservation order is granted and Sars has reasonable grounds to believe that assets that are subject to the order are at risk of being disposed of or removed, Sars may seize such assets.

It should be noted that Sars’ power to apply for a preservation order in terms of section 163 is not limited to instances when a foreign government has sought assistance with tax collection by way a request for conservancy. In fact, Sars can apply for a preservation order in any instance when it has a reasonable suspicion that tax collection will be frustrated because assets are or will be removed or dissipated.

The provisions contained in section 185, read in conjunction with section 163 of the TAA, equip Sars with important measures to assist with tax collection under South Africa’s tax treaties. In particular, the powers to apply for an ex
parte preservation order and even to pre-emptively seize assets are considerable additions to Sars’ arsenal, and taxpayers should take careful note thereof.

On the other hand, Sars will presumably seek to employ such pre-emptive measures only if it has compelling evidence to justify its suspicion that assets will be removed or dissipated. If it has incorrectly or unjustly seized assets, it could face litigation from taxpayers who may have been unduly prejudiced.

**Compulsory repatriation of foreign assets**

The TAA also provides for a new tax recovery provision in section 186. This section affords Sars the power to apply for a High Court order to compel a taxpayer to repatriate assets situated abroad. Sars can only do so, however, when a taxpayer does not have sufficient assets in South Africa to satisfy a tax debt in full.

A senior Sars official must furthermore have a reasonable belief that the taxpayer either has assets situated outside South Africa, or has transferred assets out of South Africa for no consideration or for less than market value. This provision was most likely introduced in the light of Sars’ widely publicised and on-going legal battles with certain prominent South African businesspersons.

An important distinction between this provision and section 163 (described above) is that Sars cannot apply to a Court for an order to compel the repatriation of assets on an ex parte basis. Sars must give notice to the taxpayer, who will then have the opportunity to respond with reasons as to why the order should not be granted.

If the Court decides in favour of Sars, however, it has wide powers regarding the content of the order. Section 186 determines that the Court may specify the period within which the assets must be repatriated; may impose certain limitations
on the taxpayer until the tax debt is satisfied, including limitations on the taxpayer’s right to travel (requiring the surrender of passports); may withdraw the taxpayer’s right to do business in South Africa (if applicable); and may require the taxpayer to cease trading; or may issue any other appropriate order.

A taxpayer who fails to comply with the Court order could be charged with contempt of court and may face imprisonment if found guilty. These Court sanctions are far-reaching and can clearly have serious consequences for delinquent taxpayers.

**Technical concerns**

The wording of section 186 of the TAA introduces some technical concerns. Firstly, the definition of a “tax debt” in section 1 of the TAA is very wide, being defined as “an amount of tax due by a person in terms of a Tax Act”. It is submitted that this definition could even include tax debts that are subject to dispute.

A “Tax Act”, in turn, is defined in section 1 of the TAA as comprising the statutes referred to in the Sars Act, No. 34 of 1997 (see section 4, read with schedule 1 of the Sars Act). It as such includes an extensive list of tax legislation administered by the Commissioner of Sars, and excludes only the Customs and Excise Act, No. 91 of 1964.

Accordingly, Sars can apply for a High Court order to compel the repatriation of assets to satisfy a wide variety of tax debts; potentially even for disputed tax debts (except if the taxpayer has applied for a deferment; for instance under section 88 of the Income Tax Act).

If the repatriation order is granted and assets or funds are repatriated, but the relevant tax dispute is ultimately settled in favour of the taxpayer, the taxpayer would likely have been subject to considerable inconvenience. For instance, a taxpayer could potentially have been compelled by
the Court order to sell foreign immovable property and repatriate the proceeds. Sars could face litigation from taxpayers in such situations, especially if it is found that the tax debt was incorrectly or unjustifiably disputed by Sars.

There is furthermore uncertainty as to whether the limitations that the Court may impose in terms of section 186 of the TAA – particularly orders requiring a taxpayer to cease trading or to restrict his or her right to travel – will stand up to a Constitutional challenge.

**Conclusion**

It will be interesting to monitor how the balance is maintained between Sars’ application of the powerful measures discussed above, and taxpayers’ rights to just administrative action and Constitutional protection. More pertinently, these measures highlight the importance of ensuring that tax debts are timeously settled; because unlike the new Tax Ombud (introduced by the TAA), Sars has plenty of teeth and seems to constantly grow new ones.

By Rudi Katzke, associate, Webber Wentzel

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**Expert gives assurance on SA, Mauritius tax deal**

THE renegotiated double-taxation agreement between South Africa and Mauritius should not be a concern to any group that has structured its affairs properly, says Werksman tax head Ernest Mazansky.
His comments come as South Africa has renegotiated its double-taxation agreement with Mauritius following earlier concerns by the South African Revenue Service (SARS) and the Treasury that South African multinationals were abusing the current treaty, negotiated in 1996.

Mr Mazansky said where a Mauritian company was not merely a “post box” company but truly had its effective management in Mauritius, there was nothing to fear under the current treaty, nor would there be anything to worry about under the new treaty.

However, Mr Mazansky also said it was often easier said than done to ensure that there was no effective management in South Africa, which was why so many Mauritian structures were at risk.

Under South Africa’s domestic law a company is resident where it has its place of effective management, whereas under Mauritian law it is resident where it is incorporated or where it is managed and controlled. If, under the existing treaty, the company is resident in both countries, the tie-breaker article states that the company would be resident where it has its place of effective management.

Mr Mazansky said that in marginal cases there was no doubt that the new treaty deprived a taxpayer of legal rights to obtain a more certain outcome.

SARS commissioner Oupa Magashula said in a letter to Business Day this week that few companies would be affected by the change in the tie-breaker rule to decide a company’s country of residence if it was resident in both countries under their domestic laws. If no agreement could be reached between the South African and Mauritian tax authorities, the company would end up paying tax in both countries.

Mr Magashula said the emphasis placed on the uncertainty created about the possibility of double taxation was alarmist
and incorrect. Far from resulting in double taxation, the mutual-agreement approach was intended to help counter abuses of treaties that might result in double non-taxation.

Mr Mazansky said if it was only a small minority that were at risk, one wondered why there was a need for the change and why the existing laws were not enforced more vigorously in respect of those minority of cases. “After all, if they fail under the new treaty, they would have failed under the old treaty,” Mr Mazansky said.

“While it is true, as the commissioner says, that a mutual-agreement procedure between tax authorities is not an uncommon method of resolving a deadlock as to residence, this does not make it any the more acceptable,” Mr Mazansky said. The treaty had also been renegotiated as it did not permit withholding taxes on interest and royalties.

Meaning of primary residence

The term ‘primary residence’ is defined in paragraph 44 of the Eighth Schedule to the Income Tax Act No. 58 of 1961 (the Act).

The reason this definition has captured the minds of many is due to the exclusion on the gain or loss made on disposal of one’s primary residence, provided the gain does not exceed R2 million or the proceeds from the sale of the property do not exceed R2 million. To qualify as a primary residence, and receive the benefit of the exclusion, a residence must be one in which a natural person or a special trust holds an interest. But, in addition, the natural person or a beneficiary of the special trust or spouse of the person or beneficiary must:
ordinarily reside or have resided in the residence as his or her main residence; and
use or have used the residence mainly for domestic purposes.

In order for property to qualify as a primary residence, the residence must meet both of the latter requirements or face disqualification as a primary residence. The definition also makes it clear that a company, ordinary trust or close corporation owning a residence, will not qualify for the primary residence exclusion.

The SARS Guide to the Disposal of a Residence from a Company or Trust, 1 October 2010 to 31 December 2012 (the Guide), provides that the term ‘mainly for domestic purposes’ implies a purely quantitative standard of more than 50% of the residence being used for domestic purposes. This may be measured on a floor-area or time basis. This interpretation was given by Botha JA in SBI v Lourens Erasmus (Eiendoms) Bpk [1966] 28 SATC 233 at 245 (see page 15 of the Guide).

Aside from the above definition in the Act and the two requirements that need to be met, the ‘primary residence’ definition has not been interpreted by South African courts. In order to provide some clarity in this regard, we look to the recent Australian case of Commissioner of State Revenue v Burdinat [2012] WASC 359. The case discussed comes on appeal from the State Administrative Tribunal of Western Australia and relates to the principal place of residence (PPR) land tax exemption under section 21 of the Australian Land Tax Assessment Act, 2002 (the LTAA), being similar to the South African primary residence rebate.

The facts are briefly that a retired couple (the Burdinats), who had lived in their Bicton home for 25 years, took an extended holiday from early June to early September 2011, to a warmer part of the country, where they lived in a caravan on their own Broome Vacation Village site. While they were away
they let their house in Bicton, fully furnished, mainly for security reasons. Shortly after their return, they were issued with a land tax assessment, which effectively provided that the Vacation Village site and not their Bicton residence, was granted the PPR land tax exemption. The question the Supreme Court of Western Australia was required to answer, was whether the Bicton property was the Burdinats’ primary residence. The reason for this question was that according to the LTAA, private property is exempted from land tax, if at midnight on 30 June in the preceding year, the property was owned by husband and wife, where at least one of them used it as a primary residence. Thus, given that the couple were away over the crucial date of 30 June, the tax assessment was issued.

This case is helpful in that, the court examined a multitude of analogous cases in determining the meaning of primary residence, specifically in the light of absences from the residence in question. Various judgments provided that where a place has been determined to be the primary residence, the taxpayer is not ‘less resident’ because he leaves from time to time for business and pleasure. In other words, where the place of abode has been established, physical presence or absence from it does not change its status. It would require a change of intention by the taxpayer to change the status. The duration of residency alone does not determine permanence.

On a broad view of the facts, the Court dismissed the appeal by the Commissioner against the review decision in favour of the Burdinats, finding that their primary residence was the house in Bicton. Despite the taxpayers having been away from their residence on that crucial date namely, 30 June, the Court was not persuaded that the grounds for appeal had been made out by the Commissioner.

Thus, for South African taxpayers it is encouraging to note from the Australian example, that the primary residence definition must be applied specifically to each case, taking all circumstances into account. It is also positive that where
a primary residence has been established, absences from the residence for business or recreation will not result in the residence losing its status and exemption as primary residence.

Cliffe Dekker Hofmeyr

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**Sale of shares in a foreign company**

South African residents are taxed on their worldwide income. Accordingly, a capital gain arising from the sale of shares in a foreign company will be subject to South African tax unless an exemption applies or a double tax agreement provides otherwise.

In particular, paragraph 64B of the Eighth Schedule to the Income Tax Act No. 58 of 1962 (the Act) provides, *inter alia*, that any capital gain or loss determined in respect of the disposal of any equity share in any foreign company (except certain shares where the value of the foreign company is largely derived from South African immovable property or immovable property rights and equity shares in certain foreign collective investment schemes) should be disregarded, provided certain requirements are met. This exemption is often referred to as the “participation exemption”.

It should be noted that the participation exemption only applies to capital gains. If the proceeds from the disposal of shares in a foreign company are revenue in nature, the gain will be subject to income tax. In terms of amendments to the Act in the Taxation Laws Amendment Act No. 22 of 2012 (TLAA),
the participation exemption in paragraph 64B(1) now applies under the following circumstances:

- the seller (whether alone or together with any other person forming part of the same group of companies as that person) immediately before that disposal held at least 10% of the equity share capital and voting rights of the foreign company;
- such interest had been held for at least 18 months prior to that disposal, unless the seller is a company and that interest was acquired by the seller from any other company which forms part of the same group of companies and the seller and that other company in aggregate held that interest for more than 18 months, and
- that interest is disposed of to any person that is not a resident, other than a controlled foreign company (CFC), for an amount that is equal to or exceeds the market value of the interest.

Prior to the amendments in the TLAA, the participation exemption applied, inter alia, to the disposal of equity shares in a foreign company to a CFC in relation to the seller or to a CFC that formed part of the same group of companies as the seller. Although the gain would have been disregarded in the seller’s hands, the acquiring entity’s “base cost” in respect of the shares would have been equal to the “proceeds” (usually the purchase consideration). The amendment to the participation exemption to exclude disposals to a CFC came into operation on 1 January 2013 and applies in respect of disposals on or after that date.

Although the sale of shares in a foreign company to a CFC no longer qualifies for the participation exemption, in the case of a disposal within a group the “corporate rules” contained in sections 42 to 47 of the Act may provide roll-over relief.

In particular, in terms of section 42(1)(b), an “asset-for-share transaction” means any transaction in terms of which a
company disposes of an equity share in a foreign company, held by that company as a capital asset, to another foreign company in exchange for the issue of an equity share in that other foreign company (provided further requirements are met). Similarly, the TLAA extended the scope of an “intra-group transaction” envisaged in section 45 to include any transaction in terms of which an equity share in a foreign company, held by a company as a capital asset, is disposed of by that company to another company (“transferee company”) in exchange for the issue of debt or shares (other than equity shares) by that transferee company (provided further requirements are met). In both instances it is envisaged that the acquiring entity can/must be a CFC and that the seller and the acquiring entity must form part of the same “group of companies” as defined in section 1 of the Act, that is, including non-resident entities.

Generally, where the corporate rules apply, the transferor is deemed to have disposed of the asset in question for proceeds equal to its base cost (resulting in no capital gain) whilst the transferee is deemed to acquire the asset for expenditure equal to the transferor’s base cost.

Accordingly, although the participation exemption will no longer apply to a disposal of shares to a CFC, in certain instances the roll-over provisions of sections 42 or 45 may apply, thereby resulting in no capital gain in the seller’s hands. However, importantly, unlike instances where the participation exemption applies, the acquiring entity will not have a step up in its base cost in respect of the shares in the foreign company.

Edward Nathan Sonnenbergs