INTEGRITAX

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DIVIDENDS TAX

2593. Rate increase

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One of the most controversial tax related announcements made on 22 February 2017 relates to the steep 33% increase in the dividend withholding tax (DWT) rate, from 15% to 20%. National Treasury projects that R6.8 billion in tax revenues will be collected as a result of this increase.

Heads are still spinning on the practical implications arising from the DWT hike. The confusion related to the proposed effective date, since different publications initially reflected different dates. The date as communicated by National Treasury in Chapter 4 of the Budget Review is **22 February 2017**, in respect of local dividends. The exemption and rates for foreign dividends will also be adjusted in line with the new rate, effective for years of assessment commencing on or after 1 March 2017. The issue of effective date was cleared up when relevant stakeholders confirmed to SAICA that the proposed effective date for the DWT amendment is indeed 22 February 2017.

The practical implications of the proposed effective date for listed companies imply that any dividend being 'paid' on or after 22 February 2017 has to be taxed at the higher 20% DWT rate, even in instances where these were declared prior to 22 February 2017. The reason is that section 64E(2)(*a*)(i) of the Income Tax Act, 1962 (the Act) provides that the dividend declared by a listed company is deemed to be paid on the date on which the dividend is actually **paid**.

The proposed effective date has resulted in uncertainty and concerns insofar as it relates to unlisted companies, as the answer as to which DWT rate applies is not as clear cut. In contrast with the above, unlisted companies may, when it comes to a strict reading of the Act, still pay the reduced 15% DWT rate if they pay the dividends to their shareholders on or after 22 February 2017, as long as the unlisted companies at least declared the dividend prior to 22 February 2017 (assuming that on the date of declaration, such dividend became due and payable). Section 64E(2)(*a*)(ii) of the Act, in this regard, states that the dividend declared by an unlisted company is deemed to be paid on the earlier of the date on which the dividend is **paid <u>or</u> becomes due and payable**. Conversely, the higher 20% DWT rate will apply if unlisted companies declare dividends on or after 22 February 2017.

It should further be noted that where the dividend constitutes a distribution *in specie*, such dividends will be treated the same as the distribution of a cash dividend by an unlisted company. In other words, dividends declared *in specie* for both listed companies and unlisted companies are deemed to be paid at the earlier of the date on which the dividend is paid or becomes due and payable. This is as a result of the provisions of section 64E(2)(*b*) of the Act not specifically differentiating between listed and unlisted companies. It merely states that where a dividend consists of a distribution of an asset *in specie,* it will be deemed to be paid on the earlier of the date on which the dividend is **paid or becomes due and payable**. However, if the asset *in specie* consists of a loan to a shareholder with low interest or an interest free loan, the date of payment is different. Subsection 4(*c*) of section 64E provides that where during any year of assessment a company is deemed to have paid a dividend in terms of section 64E(4)(a), that dividend must be deemed to have been paid on the last day of that year of assessment.

During the 1 March 2017 Parliamentary debate on the 2017 Budget Review, it appeared that National Treasury did in fact want dividends declared, but unpaid, by unlisted companies prior to 22 February to be subject to the 20% DWT rate rather than 15%. It sought to achieve this through the wording of the effective date of the DWT rate change in the draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill 2017.

It was noted that the proposal will, however, not achieve the relevant intent. The proposed amendment to section 64E(1), which gives effect to an increase in the DWT rate, does not alter the definition of the term ‘paid’ in so far as it relates to dividends. If National Treasury seeks to impose DWT at 20% on all dividends actually paid (and not due and payable) on or after 22 February, a substantive amendment to section 64E(2) of the Act – dealing with the definition of the term ‘paid’ – will be required. From a tax policy perspective, such an amendment would undermine the anti-avoidance nature of the current provision. As is often the case in respect of small unlisted companies, dividends are declared but are not paid in cash but are credited to the shareholder’s loan account. These dividends become due and payable to the shareholder, but are not actually paid. The current wording (which was amended to take into account the commercial reality of dividends declared on loan account), ensures that the DWT in respect of dividends declared by unlisted companies becomes payable by the end of the month following the month in which the respective dividend becomes due and payable – regardless of whether or not it is actually paid in cash.

The principle of retrospective and retroactive rate increases was also raised during the Parliamentary debate and again in the SAICA submission made to National Treasury in respect of the draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill 2017. It was noted in the submission that the retrospective implementation of tax rates creates fiscal uncertainty with retroactive amendments creating even more cause for concern, both requiring further scrutiny as a policy matter.

In terms of the South African common law it is generally understood that statutes are not to be construed to operate retroactively unless an express or implied intention exists to the contrary.[1] In ***Bellairs v Hodnett and Another***[2] the following was stated:

> *'There is a general presumption against a statute being construed as having retroactive effect and even where a statutory provision is expressly stated to be [retroactive] in its operation it is an accepted rule that, in the absence of contrary intention appearing from the statute, it is not treated as affecting completed transactions and matters which are the subject of pending litigation.'*

The rationale behind the South African common law presumption against retroactivity is the need for legal certainty.[3] The rationale can also be said to be

[1] ***Adampol (Pty) Ltd v Administrator, Transvaal*** [1989] 4 All SA 776 (AD) on page 783, ***Unitrans Passenger (Pty) Ltd t/a Greyhound Coach Lines v Chairman, National Transport Commission*** [1999] 3 All SA 365 (A) at paragraph 12, ***Curtis v Johannesburg Municipality*** 1906 TS 308 on page 311, ***Mohamed NO v Union Government*** 1911 AD 1 at 8 and ***Bellairs v Hodnett and Another*** 1978 (1) SA 1109 (A) 1148F-G). Also see Taljaard, J. C. (2001) ***Geld die gewone reëls en beginsels van wetsuitleg by die uitleg van belastingwetgewing*** M.Comm (Taxation) Stellenbosch University at 2.4.1 and the reference therein to ***Principal Immigration Officer v Pushotam*** 1928 AD 435 443, ***Jockey Club of SA v Transvaal Racing Club*** 1959 1 SA 441 A 451 and ***Edwards v Tuckers Land and Development Corporation (Pty) Ltd*** 1983 1 SA 577 A 580.
[2] 1978 (1) SA 1109 (A) 1148F-G).
[3] Louw, H. ***Retrospective application*** Without Prejudice September 2012 on page 08.

that those subject to legislative provisions should be treated fairly, irrespective of the prospective or retroactive nature of the legislative provision in question.[4]

Considering the increased DWT rate, one would need to further ponder on the transitional arrangements required in completing the DTR01 forms. Considering that the DTR01 form has been revised and allows for one to input a rate of between 0% - 20%, depending on the facts applicable in respect of the dividend 'paid', this seems to allow for the correct rate to be applied in respect of all dividends 'paid' before 22 February 2017 and those 'paid' after 22 February 2017.

Many unanswered questions still remain, including the following:

1. Will the definition of 'paid' remain unchanged or will unlisted companies now be subject to DWT on the date of actual payment in cash (rather than the earlier of date the dividend becomes due and payable or is paid)?
2. What rate should one apply until the legislation amending the rate has been promulgated?
3. What are the penalty exposures for taxpayers who adopt the incorrect tax treatment of the dividends based on their own interpretation of the legislation in circumstances where there is a lack of guidance from SARS and National Treasury?, and
4. Where a taxpayer incorrectly pays the DWT at the higher rate of 20%, how will SARS ensure an expedient refund process so as not to prejudice the taxpayer?

As regards the first question, it is not clear, at this stage, what position will be taken on the definition of the term 'paid' as referred to above when the final legislation is promulgated. The hope remains that the term will be intact for now given the intention to differentiate between listed versus unlisted companies.

[4] Du Plessis, L. M. ***Law of South Africa Volume 25(1) – Second Edition Volume – Statute Law and Interpretation*** at 341.

With respect to the rate to be applied in the interim, until promulgation of the legislation, this places those taxpayers affected in a very uncertain situation. Given that the amendment is still in draft, legally one should be entitled to apply the rate of 15% until such time that the legislation is promulgated, in all instances – in respect of both listed and unlisted companies. However, should the effective date of 22 February 2017 be retained, this will give rise to penalties imposed on DWT payments at a rate of 15%, which taxpayers would then need to dispute and hope that these penalties are waived in circumstances that are clearly unfair and costly to taxpayers.

The alternative would be to pay the DWT at the rate 20%. However, if for some reason, the effective date is moved forward which would clearly be the more reasonable and equitable approach, the question remains how one would recover the refund due as a result of overpayment. Many hold the view that the legislation, if applied as intended by National Treasury, will result in retrospective legislation which is considered to be grossly unfair to taxpayers.

Practically speaking, corporate entities in South Africa have embraced the change, despite the concerns raised over the challenges in implementation thereof.

These and other issues were raised in the comments submitted to National Treasury on the draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill due by 31 March 2017 and those affected by these changes will be keeping a close eye on the developments.

Somaya Khaki: SAICA Tax Division
ITA: Section 64E
Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2017

2017 Budget Speech and related documents

Author's Comment: Also, refer to Article 2596, in this issue which deals with the powers granted to the Minister to change tax rates, specifically, 'the rates of tax chargeable in respect of **taxable income'**. (my emphasis). It is questionable as to whether this power extends to the amendment of the dividends tax rate as DWT is not a tax in respect of taxable income.

CAPITAL GAINS TAX

2594. Irrecoverable proceeds

One of the illogical features of an income tax system is that, as a general rule, it operates on a strict year-by-year basis, in which each tax year is a closed compartment, separate from the years before and the years thereafter. The determination of taxable income for a particular year takes account only of events that occurred during that year and ignores events that occurred after that year. A year is of course a completely arbitrary period, but there are many practical advantages for a tax system to operate on this annualised basis.

The New Adventure judgment

In *New Adventure Shelf 122 (Pty) Ltd v CSARS* [2016] 78 SATC 190, in which judgment was delivered on 17 February 2016, the Western Cape High Court was faced with the question whether the Income Tax Act, 1962 (the Act) allows a tax assessment that has been issued in respect of a given tax year to be re-opened after the end of that year to take account of the fact that part of the assessed taxable income for that year was not received, because a contract that gave rise to that accrued income was cancelled before payment, or full payment, was received.

In this case, a capital amount had accrued to the taxpayer in year one when it sold certain immovable property for a price of some R17 million, with payment to take place in a later year, and the taxpayer consequently was assessed for a taxable capital gain in year one. A few years later the contract was cancelled, with the result that the taxpayer would not, in the event, receive the full envisaged proceeds.

Can the prior year's assessment be re-opened and amended?

In such circumstances, is the taxpayer entitled to require SARS to re-open the tax assessment that was issued for year one and re-determine the taxable income for that year?

The High Court articulated the issue in the context of this particular case as follows (footnotes omitted):

"[1] This matter concerns how a capital gain accrued as a result of the disposal of an asset in a particular year of assessment falls to be treated for capital gains tax purposes when the contract in terms of which the asset was sold is cancelled during a subsequent tax period, with the effect that the taxpayer does not realise the full proceeds of the disposal that had been taken into account in assessing its taxable income in the year that the asset was disposed of. It was ultimately common cause between the parties that on the facts of the current case the relevant provisions of the Eighth Schedule deem the date of the disposal to have been the date upon which the contract was concluded and that the proceeds are deemed to have accrued to the taxpayer and fall to be accounted for income tax purposes in the year in which the disposal occurs, even if the proceeds actually fall to be received after that year ...

[2] By reason of the aforementioned incidences of the Eighth Schedule the transaction was accounted for capital gains tax purposes in the assessment of the taxpayer's taxable income for the 2007 tax year as if the proceeds had been received in full in that year. The contract was cancelled during the taxpayer's 2012 year of assessment. The terms of cancellation provided for the return of the

property to the taxpayer, which was entitled to retain that part of the purchase price that had been paid by that stage as pre-estimated damages. In the result, part of the amount of the proceeds of the transaction that had been taken into account in determining the taxpayer's capital gain in respect of the disposal became irrecoverable."

It has been suggested that the annuality of the income tax system is implicitly based on an agricultural model in which the cycle of planting (expenditure) and harvesting (income generation) occurs within the span of the four seasons. The taxpayer argued that the income tax assessment for the year of sale should be re-opened in order to expunge the capital gain that had not in fact eventuated. This would require the taxable income that had been assessed in that year to be re-determined and a new assessment issued which would exclude the portion of the sale price that had never been received.

The first form of relief sought:

The re-opening of the assessment

The taxpayer applied to the High Court for an order that SARS amend its assessment for the year in which the sale had occurred by reducing the "proceeds of the disposal of the property", that is to say, by reducing the recorded selling price.

Predictably, SARS argued that, as the law stands, this is impermissible for–

"[5] …it would be contrary to basic principle to reopen what had been an admittedly correct and unimpeachable assessment of taxable income for a particular tax period on the basis of an event that occurs in a subsequent tax period. Assuming the balance of the purchase price had indeed become irrecoverable as a result of a cancellation of the contract in a subsequent year, the Commissioner's position is that the effect of the cancellation falls to be addressed in the determination of the taxpayer's aggregate capital gain or loss

in the 2012 tax year after a re-determination, in 2012, of the capital gain or loss from the disposal of the asset in 2007, as provided in terms of paragraph 25(2)(b) and (3) of the Eighth Schedule."

The taxpayer's woes were compounded by the fact that it had neglected to object to the assessment for the year of sale, and that all time periods for contesting that the 2007 assessment had long since prescribed.

As matters transpired, the judgment makes clear that an objection would not have availed the taxpayer because the assessment was correct at the time it was issued.

The second form of relief sought:

Withdrawal of the assessment

Another avenue of relief became closed when the taxpayer was advised that a SARS committee had decided that no remedy was available in terms of section 98(1) of the Tax Administration Act, 2011, which provides that SARS can, in certain circumstances, withdraw an assessment.

The third form of relief sought:

Reduction in the proceeds of the sale

SARS took the position that a downward adjustment in the computation of the proceeds of the disposal of an asset, as envisaged in paragraph 35(3)(*c*) of the Eighth Schedule to the Act did not "allow for an adjustment to be made to a capital gain in the year that it arose by an event that occurred in a subsequent year of assessment".

The fourth form of relief sought:

Application to the Tax Ombud for appropriate relief

The taxpayer approached the Tax Ombud for relief, but that official did not see fit to intervene.

The fifth form of relief sought:

Review of the assessment in terms of the Promotion of Administrative Justice Act?

The taxpayer, no doubt growing increasingly desperate at finding all avenues for relief being blocked, applied in terms of the Promotion of Administrative Justice Act, 2000 (PAJA) for the High Court to review and set aside SARS' adverse decisions in this matter.

The High Court held that the taxpayer had not made application for such relief within the 180-day period prescribed in this Act, but allowed the taxpayer's counsel to apply orally, during the hearing, for an extension of time in terms of this Act, and granted the application, in other words, allowed the taxpayer's counsel to argue for relief in terms of this Act.

The court held that a review in terms of PAJA turned on the interpretation of the relevant provisions of the Eighth Schedule. In this regard, the court pointed out that it was not in dispute that the disputed assessment to capital gains tax had been correct when it was issued; it was events that occurred in a later year that had given rise to the controversy.

The court pointed out that the re-determination of a capital gain, as envisaged in paragraph 4(*b*) of the Eighth Schedule, does not involve a re-determination or amendment of a capital gain or loss in a previous year of assessment and does not involve an expunging of that previous determination; instead, this provision lays down–

"…a basis for the result of the redetermination to be taken into account for capital gains tax purposes" in the current year [48].

The court held that, in the circumstances of this matter, there was no basis in the provisions of the Eighth Schedule for expunging the taxpayer's capital gains tax liability in the year in which the asset in question had been sold.

From this it followed, said the court, that–

"The taxpayer therefore did not have a valid basis to object to or appeal against its 2007 income tax assessment. It has not shown any reason why that assessment should be amended."

The final result decreed by the court:

The taxpayer did not qualify for any relief

In the result, the High Court held that in the circumstances of this case and in terms of the applicable legislation, the taxpayer did not qualify for any of the forms of relief sought in this litigation.

In effect, the court held that, since the 2007 assessment had been correct –that is to say, SARS had properly applied the relevant legal principles – at the time it was issued, there was no legal basis on which the assessment could be re-opened and amended to take account of events that occurred in a later tax year.

A new statutory amendment now provides limited relief

A subsequent amendment to the Eighth Schedule seems to be linked to the troublesome aspects of this judgment.

This amendment provides that, with effect from 1 January 2016 and in terms of paragraph 4(*c*) of the Eighth Schedule, in a situation such as occurred in *New Adventure* (where the taxpayer makes a paper capital gain on the disposal of an asset in year one, and that paper gain comes to nought when the contract is cancelled in year two) the taxpayer must show a capital loss in year two equivalent to the paper capital gain made in year one.

In effect, in terms of paragraph 4(*c*), the taxpayer is deemed in year two to have made a capital loss equal to the capital gain he made in year one. The intent is that the seller is then put back into the same position as if he had not made the capital gain reflected in the year-one assessment, but not with retrospective effect.

In other words, the adjustment is made in the tax return for year two, and the assessment for year one remains unchanged.

This outcome does not completely undo the hardship inflicted on such a taxpayer, in that it may still have had to outlay capital gains tax in year one and it will not gain any off-setting financial relief until the taxpayer subsequently realises a capital gain against which it can set off a capital loss.

A tax-effective solution may lie in astute contractual drafting

The optimum course of conduct for a taxpayer in the kind of situation that occurred in the *New Adventure* matter is for the contract to be drawn –if this is feasible in the particular circumstances –in such a way as to defer the accrual of the proceeds of the profitable sale, or to stagger the timing of the accrual, by making the accrual of the proceeds of the sale dependent on the fulfilment of appropriate suspensive conditions, so that there is no accrual until actual receipt.

PwC
ITA: Paragraphs 4, 25 and 35 of the Eighth Schedule
TAA: Section 98
PAJA

TAX ADMINISTRATION

2595. Bona fide inadvertent error

On 4 November 2016, judgment was handed down by the Tax Court of South Africa (held in Cape Town) in the matter of *ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service,* Case number IT13772.

In this case the court had to consider whether the taxpayer, ABC Holdings (Pty) Ltd, was entitled to claim a deductible allowance of enhancement income of

R9 354 458.00 received in terms of a contract for future expenditure in terms of section 24C of the Income Tax Act, 1962 (the Act) for its 2011 year of assessment. The other issue that arose in this case and which is the focus of this article, was whether the South African Revenue Service (SARS) was correct to levy an understatement penalty in the circumstances.

The facts of this matter, briefly, are that the taxpayer conducts the business of administering and managing retirement villages and their frail care centres. It claimed the section 24C allowance in its 2011 year of assessment. Subsequently, SARS conducted an audit during January 2014 and notified the taxpayer that the section 24C allowance was incorrectly claimed by the taxpayer. As a result of the disallowance by SARS, the taxpayer was held liable for the income tax payable on the above amount as well as an understatement penalty in the amount of R261 924.80.

After the court found that the taxpayer was not entitled to claim a deduction in terms of section 24C, it had to consider whether SARS was correct in levying an understatement penalty in terms of the provisions of section 222 and section 223 of the Tax Administration Act, 2011 (the TAA). The taxpayer submitted that the understatement arose as a result of a bona fide inadvertent error, contemplated in section 222(1), in which case no understatement penalty would be payable by the taxpayer.

In considering whether the understatement penalty arose due to a bona fide inadvertent error, the court noted that the taxpayer was assisted by Mr E of LL Accountants and that a tax opinion was obtained from a Professor T, which was attached to the notice of objection and in which Professor T concluded that the section 24C allowance could be claimed.

In terms of section 221 of the TAA, an “understatement” means any prejudice to SARS in respect of a tax period as a result of a default in rendering a return, an omission for a return, an incorrect statement in a return, or failure to pay the correct amount of tax where no return is required. Such understatement penalty would not be payable if it arose due to a bona fide inadvertent error, as stated in section 222(1). As the TAA does not define the meaning of the phrase “bona fide inadvertent error” the court considered the dictionary meaning of these words. It concluded from these dictionary meanings that a “bona fide inadvertent error has to be an innocent misstatement by a taxpayer on his or her return, resulting in an understatement, while acting in good faith and without the intention to deceive”.

The court found that on the facts of the present matter, there was no doubt that the taxpayer had acted in good faith and with no intention to deceive. Since Professor T had gone as far as interpreting case law on the interpretation of contracts, some of which was relied on by the taxpayer’s counsel in his argument, it could have given the impression that his interpretation of section 24C would more than likely be upheld in court. It could therefore be argued that Professor T strayed into offering a legal opinion, which, would make the taxpayer’s argument less plausible.

The court held, however, that there was merit in excusing the taxpayer for its reliance on Professor T’s opinion on the basis of it being lay on issues of tax and the law and therefore ordered that the understatement penalty be remitted.

Cliffe Dekker Hofmeyr
ITA: Section 24C
TAA: Sections 221, 222 and 223

Editorial Comment: Also refer to Article 2588 – Penalties: the application of “bona fide inadvertent error” in the March 2017 Issue.

2596. Amending tax rates

Since the first version of the Draft Taxation Laws Amendment Bill, 2016 (the First Draft TLAB) and the Explanatory Memorandum thereto (the Memorandum) were released on 8 July 2016, the proposed amendments applicable to trusts and employee share schemes received most of the attention.

However, another proposed amendment with potentially far-reaching consequences that has received little attention since the release of the First Draft TLAB is one which could lead to a taxpayer paying tax at one rate today and another rate tomorrow, as and when the Minister of Finance (the Minister) says so.

The proposed amendment

In terms of the First Draft TLAB, it was proposed that the Minister would have the power to amend the tax rates applicable in terms of various pieces of legislation, simply by announcing the amendment in the annual national budget speech. Furthermore, this amended rate would come into effect from the date announced by the Minister in the budget speech and will continue to apply for a period of 12 months from that date, unless Parliament passes legislation giving effect to that announcement within that 12-month period.

A similar amendment had already been made to the Transfer Duty Act, 1949, but was now proposed with respect to the following pieces of legislation:

- Income Tax Act, 1962;
- Estate Duty Act, 1955;
- Value-Added Tax Act, 1991 (the VAT Act);
- Skills Development Levies Act, 1999 (the SDL Act);
- Securities Transfer Tax Act, 2007;
- Unemployment Insurance Contributions Act, 2002 (the UIC Act); and
- Mineral and Petroleum Resources Royalty Act, 2008.

Issues raised and National Treasury's response

An obvious shortcoming of the proposal in the First Draft TLAB which was raised during public hearings, as highlighted in the Draft and Final Response Documents from National Treasury and SARS (the Response Document), was that the provision constituted a delegation by Parliament of its legislative power to the Minister. In terms of section 77 of the Constitution of the Republic of South Africa, 1996 (the Constitution), a money bill is required to be passed by Parliament. In the Response Document, the problem was acknowledged and it was indicated that the proposed provisions would be amended to bring them in line with the Constitution.

The wording of the charging provisions was amended and the relevant provisions in the Taxation Laws Amendment Act, 2016 (promulgated on 19 January 2017) state that the rate changes announced by the Minister may be applied from the date announced subject to Parliament passing the relevant legislation giving effect to that rate change within 12 months of the announced effective date.

Comment

The implementation of the amendments could lead to a number of practical problems for taxpayers. An amendment in the rate of VAT in terms of section 7 of the VAT Act, is one example that illustrates the problems that could arise.

In terms of section 27 of the VAT Act, VAT vendors must submit VAT returns every month, every second month, every six months or every twelve months depending on the category in which they fall. In terms of section 28, a VAT vendor must submit its VAT return within 25 days after the end of the relevant period. Currently, section 7 of the VAT Act expressly states that VAT vendors must account for VAT at the rate of 14% on the value of the supply. If the Minister had announced in the 2017 budget speech, that the VAT rate will increase to 15%

from 1 April 2017, Parliament would have had to pass legislation to this effect within 12 months of 22 February 2017.

If the legislation is not passed in time, in accordance with section 77 of the Constitution, VAT vendors will in theory be entitled to refunds on the basis that they should have levied VAT at the rate of 14% during this period instead of at the rate of 15%. The challenges that taxpayers face in obtaining their refunds from SARS, has been widely reported. Similar problems could arise if the rates in terms of the SDL Act and UIC Act were amended and the necessary legislation is not passed in time, considering that payments in terms of this legislation must be paid by employers on a monthly basis.

Furthermore, the retrospective application of the legislation may also be open to constitutional challenge. In terms of section 77(3) of the Constitution, all money bills must be considered in accordance with the procedure established by section 75 of the Constitution and an act of Parliament must provide for a procedure to amend money bills before Parliament. The Money Bill Amendment Procedure and Related Matters Act, 2009 (the Money Bill Act) was passed by Parliament in this regard. Section 11 of the Money Bill Act states that a revenue bill, being one which amends tax rates, among other things, must be referred to the National Council of Provinces, as stipulated in section 75 of the Constitution.

Neither sections 75 and 77 of the Constitution, nor the provisions of the Money Bill Act allow for implementation of legislation prior to the process in terms of these sections being followed. The consequences of not complying with the constitutional provisions regarding the enactment of legislation could be far-reaching and could even lead to the entire legislation being declared invalid as was the case in *Tongoane and Others v Minister for Agriculture and Land Affairs and Others* 2010 (8) BCLR 741 (CC), where the Communal Land Rights Act, 2004 was declared invalid by the Constitutional Court as the incorrect procedure had been followed in enacting the legislation.

Cliffe Dekker Hofmeyr

Draft TLAB, 2016

Final Response Document on TLAB, 2016 and TALAB, 2016

Taxation Laws Amendment Act, 2016

VAT: Sections 7, 27 and 28

Money Bill Act: Section 11

The Constitution: Sections 75 and 77

TRANSFER PRICING

2597. Record-keeping

On 1 July 2016, the Commissioner for the South African Revenue Service (SARS) released a Draft Notice of the duty to keep records, books of account or documents in terms of section 29 of the Tax Administration Act, 2011 (the TAA). Following a round of public comments in relation to the Draft Notice, on 28 October 2016, SARS released a Final Notice, setting out the documents required to be kept specifically for transfer pricing purposes.

Documents in respect of structure and operations

In terms of the Final Notice, a person is required to keep records where the person has entered into a "potentially affected transaction" and the aggregate of the potentially affected transactions for the year of assessment exceeds or is reasonably expected to exceed ZAR100 million. This threshold was amended from the Draft Notice's threshold of the higher of 5% of the person's gross income or ZAR50 million.

A "potentially affected transaction" is, essentially, a transaction, operation, scheme, agreement or understanding where that transaction has been directly or indirectly entered into by or with a South African resident, a permanent establishment in South Africa, or a controlled foreign company of a resident and a non-resident and those persons are "connected persons" in relation to one another.

In terms of the Final Notice, a person who has entered into a "potentially affected transaction" is required to keep, *inter alia*, the following records in relation to its structure and operations:

- a description of its structure, detailing shareholding and other persons with which the person is transacting;
- details of each connected person with which a potentially affected transaction has been entered into; and
- a summary of the business operations including a description of the business, an organogram, an industry analysis and the role of the person and its connected persons in the group's supply chain.

Documents in respect of transactions

A person that has entered into a "potentially affected transaction" must keep records in respect of any such transaction that exceeds or is reasonably expected to exceed ZAR5 million in value (previously a threshold of ZAR1 million).

In terms of the Final Notice, a person who has entered into a potentially affected transaction, as set out above, is required to keep, *inter alia*, the following records in relation to its transactions:

- a description of the potentially affected transactions entered into;
- copies of the agreements as well as any governance or regulatory documents in relation to the potentially affected transactions;
- a description of the selection of the tested party;
- a segmentation of the revenues, costs, expenses and profits between transactions with connected persons and independent persons, including records of the application of the transfer pricing policy that shows how the financial data used reconciles with the annual financial statements;

- a description of the functions performed, risks assumed and the assets employed in the potentially affected transactions, together with a description of any intangible assets involved;
- where the tested party is a tax resident outside of South Africa, details of the functional and risk classification of the tested party;
- operational and cash flows of the potentially affected transactions;
- the comparable data and methods used for determining the arm's length return and the analysis performed to determine the arm's length prices or the allocation of profits and losses;
- details of adjustments made to transfer prices to align them with the arm's length return determined under section 31(2) of the Income Tax Act, 1962 and consequent adjustments made to the income or expenses for tax purposes.

Specific requirements in respect of financial assistance

Specific requirements have been included in the Final Notice with respect to potentially affected transactions, including those with a term exceeding 12 months, which are financial assistance transactions. For these transactions, *inter alia*, the following records are required:

- a summary of financial forecasts;
- an analysis of the financial strategy of the business;
- a description of the funding structure, with the source of the funds and the reasons for the funding;
- change to the group structure over the course of the financial assistance transactions; and
- copies of financial statements before and after the financial assistance has been granted.

Some relief is provided in respect of transactions involving financial assistance. In particular, where a person expects to have a high volume of potentially affected transactions involving financial assistance, SARS may agree to alternative records that the person may keep to enable the person to satisfy SARS that the transactions are conducted at arm’s length.

Interaction with other provisions relating to transfer pricing documentation

OECD Action 13 Report

The Organisation for Economic Cooperation and Development (OECD) published its report on Base Erosion and Profit Shifting, Action 13, *Transfer Pricing Documentation and Country-by-Country Reporting* (Action 13 Report), which recommended a three-tiered approach to transfer pricing documentation, requiring a global master file, a local file and a country-by-country (CbC) report.

The briefing note which accompanied the Final Notice provides that the “master file” and “local file” returns will be submitted under section 25 of the TAA. Similarly, CbC reports will also be submitted under section 25 of the TAA, read with the regulations issued by the Minister of Finance. The Minister of Finance has previously issued draft regulations for public comment in respect of CbC reporting, however, the final regulations, which will entrench CbC reporting in domestic legislation, were published on 23 December 2016.

Section 25 of the TAA essentially requires a person to submit a return in a prescribed form and manner and by a date specified in a tax Act or a date specified by public notice. Although it is not clear what the form or manner is in which SARS will require the master file and local file return to be submitted, nor by which date SARS will require such master and local files to be submitted, it is assumed that the documents that are required to be retained in terms of the Final Notice will form the basis of the master file and local file returns required by SARS. Further guidance is therefore required from SARS in respect of the submission of master and local file returns.

Practice Note 7

In terms of the briefing note, Practice Note 7 of 1999 (Practice Note 7) (which sets out SARS' approach to transfer pricing, and is based on the version of the transfer pricing legislation which applied prior to 1 April 2012), is overridden by paragraphs 1 – 4 and 6 – 7 of the requirements set out in the Final Notice. The Final Notice, presumably, only overrides paragraph 10 of Practice Note 7, which deals with transfer pricing documentation, and presumably does not override Practice Note 7 in its entirety.

As paragraph 5 of the Final Notice (which deals with the record keeping requirements where a transaction is below the ZAR5 million transactional threshold) does not override Practice Note 7, the provisions of Practice Note 7 will presumably still apply to smaller transactions, which fall below the ZAR5 million threshold.

ENSAfrica
ITA: Section 31(2)
TAA: Sections 25 and 29
OECD BEPS Action Plan 13
SARS Practice Note 7
Government Notice R 1598, Government Gazette 40516, 23 December 2016
Government Notice 1334, Government Gazette 40375, 28 October 2016

VALUE-ADDED TAX

2598. Consequences of tax avoidance

When disputing a tax debt, especially one involving the complex issue of unlawful tax avoidance, taxpayers should always exercise great caution. This sentiment is echoed by the recent judgment in *Dale v Aeronastic Properties Ltd (Commissioner for the South African Revenue Service and Others Intervening)* (9297/2016) [2016] ZAWCHC 160 (25 October 2016). Although the court, in this case, was concerned with whether an order to place the respondent taxpayer, Aeronastic Properties Ltd (Aeronastic), under business rescue, its precarious financial situation was caused, largely, by a substantial tax debt. In the course of its judgment, the court made reference to the taxpayer's dispute with the South African Revenue Service (SARS), which dispute is the subject of this article.

Background

During November 2009, SARS issued an assessment against Aeronastic relating to its claim for input tax in terms of the Value-Added Tax Act, 1991 (the VAT Act). The assessment disallowed Aeronastic's claim in the amount of R14 million which resulted in it being liable for an amount of R28 million to SARS. After SARS took judgment against Aeronastic for an outstanding tax debt of almost R48 million in March 2011, pursuant to section 40(2)(*a*) of the VAT Act, it applied for the liquidation of Aeronastic on 24 May 2013, on the basis that it was factually and commercially insolvent. On 28 August 2013, Aeronastic appealed against the assessment to the Tax Court, which dismissed the appeal on the strength of an agreement entered into between Aeronastic and SARS.

In November 2013, a close corporation of which the applicant, Dale, is the sole member, applied to place Aeronastic under business rescue, which application was dismissed in February 2014. In August 2014, Aeronastic was placed under final liquidation and its subsequent appeals against the liquidation order were rejected by the Supreme Court of Appeal and the Constitutional Court. The applicant then brought the present business rescue application on 31 May 2016.

The dispute between Aeronastic and SARS

The judgment setting out the reasons for granting the liquidation order in August 2014 was handed down in October 2014 and provides some insight into the circumstances giving rise to the dispute between Aeronastic and SARS. In February 2009, Aeronastic purchased helicopters, helicopter components and spares from a company called Summer Days Trading 709 (Pty) Ltd (Summer Days) and claimed input tax in the amount of R14 million. However, SARS had rejected Aeronastic's claim as it had concluded that the transaction between Summer Days and Aeronastic was a scheme to obtain an undue tax benefit in terms of section 73 of the VAT Act.

In the matter involving the granting of the liquidation order, Aeronastic argued that while the debt relied upon by SARS was presently owed, it would fall away once the order of the Tax Court had been rescinded, the appeal was reheard and it was found that SARS had incorrectly applied section 73 of the VAT Act. In developing its case, Aeronastic largely relied on a tax opinion it had received, in which it was advised that SARS had misapplied section 73 of the VAT Act. In the reasons for granting the liquidation order, the court held that SARS was correct in contending that the objection to its assessment had been finalised, and that there was no application to review the Tax Court's order, which had been granted by agreement, and in which Aeronastic had been represented by counsel.

Importantly, the court remarked in the present matter that the tax opinion that Aeronastic relied upon, did not properly appreciate the implications and consequences of section 73 of the VAT Act. Furthermore, it stated that section 73 creates a reverse onus, which constituted a "significant hurdle" that Aeronastic needed to overcome. The court concluded that the tax dispute was not an issue that it could adjudicate on as it was clear that it had been settled.

Section 73 of the VAT Act

Section 73 of the VAT Act is an anti-avoidance provision, similar to the GAAR provisions in section 80A of the Income Tax Act, 1962 (the Act). In *Mpande Foodliner CC v Commissioner for the South African Revenue Service and*

Others [2000] 63 SATC 46, the court stated that there are four requirements that need to be met before section 73 can be invoked by SARS:

- whether a scheme has been entered into or carried out;
- which has the effect of granting a tax benefit to any person;
- by means or in a manner not normally employed for bona fide business purposes, other than obtaining of a tax benefit, or it has created rights or obligations that would not normally be created between persons dealing at arm's length; and
- it was entered into or carried out solely or mainly for the purpose of obtaining a tax benefit.

Section 73(3) of the VAT Act states that a decision by SARS under section 73 is subject to objection and appeal. The section further states that if it is proved in proceedings concerning the scheme, that it does or would result in a tax benefit, there is a rebuttable presumption that it was entered into solely or mainly for the purpose of obtaining a tax benefit.

Practical importance of the judgment

Section 73 of the VAT Act is a fairly complex provision and is a powerful weapon at SARS's disposal. Although the remark was only *obiter*, it is noteworthy that the court described the reverse onus of section 73(3) as a significant hurdle which had to be overcome in the circumstances. One would hope, however, that such a finding would not give SARS licence to apply section 73 as and when it pleased. From the taxpayer's perspective, the judgment should serve as a caution to take an assessment based on section 73 seriously and to obtain expert advice in responding thereto.

Taxpayers must always keep in mind the time periods within which objections and appeals must be lodged, which are laid down in the Tax Administration Act, 2011 (TAA) and in the dispute resolution rules. A taxpayer confronted by an assessment in terms of section 73 of the VAT Act should also bear in mind that, under certain circumstances, it can make use of section 164 of the TAA and apply to SARS to suspend payment of the tax debt in terms of the assessment.

In terms of section 164, SARS may not take any recovery proceedings within less than 10 business days after it has notified the taxpayer of its decision to grant or reject the application, unless SARS has a reasonable belief that the person might dissipate their assets.

Cliffe Dekker Hofmeyr
ITA: Section 80A
TAA: Section 164
VAT: Sections 40 and 73

SARS NEWS

2599. Interpretation notes, media releases and other documents

Readers are reminded that the latest developments at SARS can be accessed on their website http://www.sars.gov.za.

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