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LUMP SUM BENEFITS

2644. Interest on late payments

The Second Schedule to the Income Tax Act, 1962 (the Act), deals with the computation of gross income that a person receives by way of lump sum benefits. On 23 May 2017, the South African Revenue Service (SARS) released Issue Two of Binding General Ruling 31 (BGR 31), with the intention of providing clarity as to when an amount constitutes interest, as opposed to forming part of the lump sum benefit, for purposes of the Second Schedule.

BGR 31 states that different practices currently exist in the retirement fund industry relating to the late payment of a lump sum benefit. Some fund administrators include this interest to form part of the lump sum benefit payable to a member, whereas other administrators pay the amount separately to the member as interest.

Legal framework

In terms of paragraph 1 of the Second Schedule, a "lump sum benefit" includes the following:

- any amount determined in respect of the conversion of an annuity or portion of an annuity payable by or provided in consequence of membership or past membership of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund; and
- any fixed or ascertainable amount (other than an annuity) payable by or provided in consequence of membership or past membership of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund.

The above amounts will constitute a lump sum benefit whether paid in one amount or in instalments, but does not include any amount deemed to be income accrued to a person in terms of section 7(11) of the Act. Section 7(11) relates to amounts paid out of the fund to the person's spouse on divorce.

Lump sum benefits can take the form of a retirement fund lump sum benefit (retirement benefit) or a retirement fund lump sum withdrawal benefit (withdrawal benefit). Separate tax rates apply to amounts received as retirement benefits and amounts received as withdrawal benefits. Any retirement benefit or withdrawal benefit must be included in a person's gross income, in terms of paragraph (*e*) of the section 1 "gross income" definition.

Paragraph 2(1)(*b*) of the Second Schedule states that a withdrawal benefit includes, among others, any amount that is transferred for the benefit of a person to any pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund from any pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund of which that person is or previously was a member. In terms of paragraph 2(2) of the Second Schedule, the amount transferred is deemed to accrue on the date of its transfer.

However, retirement benefits and withdrawal benefits are taxed at a lower rate than the rates that apply to a person's normal taxable income. For example, for the 2018 year of assessment, any withdrawal benefits between R25 000 and R660 000 are taxed at 18% whereas the portion of any retirement benefit up to R500 000, is not subject to any tax. On the other hand, any income that forms part of a person's taxable income is subject to higher rates. For example, for the 2018 year of assessment, if a person's taxable income is R500 000, she will pay R97 225 plus 36% on the difference between R410 460 and R500 000.

In terms of section 10(1)(*i*) of the Act, R23 800 of the interest received from a South African source by a natural person under the age of 65 is exempt from income tax. If the person is older than 65, R34 500 of the interest received will be exempt. Any interest received during a year of assessment in excess of these amounts, is subject to income tax at the normal rates that apply to taxable income.

Ruling

BGR 31 states that interest on the late payment of benefits is any interest that is defined, as such, in terms of the rules of the fund. Any interest that increases a fund's benefit liability does not form a separate component from the benefit that is payable to the member and will be subject to tax under the provisions of the Second Schedule. Where an amount is transferred from one fund to another, the full amount (including fund growth) is considered to be a lump sum benefit and will be subject to the provisions of the Second Schedule.

Interest that arises as a result of late payment of the benefit and therefore in addition to the benefit liability must be reflected separately and an IT3(b) certificate must be issued and submitted to SARS as per the prescribed processes.

Comment

The effect of BGR 31 is that where a person receives a portion of their lump sum benefit late, there will no longer be a risk that the fund administrator will treat the amount as interest, which will be taxed as taxable income instead of being taxed as a withdrawal benefit or a retirement benefit. This is to the benefit of individuals as any interest (above the exempt amount) that a taxpayer receives due to late payment will be subject to a lower tax rate and BGR 31 should therefore be welcomed

Cliffe Dekker Hofmeyr

ITA: Section 1 definition "gross income", sections 7(11), 10(1)(*i*), and Second Schedule, para 1 & 2

BGR 31

TRUSTS

2645. Special trusts

The tax benefits of special trusts

- Section 7C of the Income Tax Act 1962 (the Act) that came into effect on 1 March 2017, and which levies a donations tax liability on the interest forgone on interest-free or 'low interest' loans made to trusts, will not apply to such loans made to special trusts.

- The rate of income tax applicable to special trusts was not increased to the flat rate of 45% after the Budget Speech in February 2017, as was the case with other trusts, but has been kept the same as for natural persons on a sliding scale relevant to the income brackets.

- Type A special trusts – trusts created solely for the benefit of persons with disabilities – enjoy a maximum effective rate of capital gains tax (CGT) of 18% (as is the case for natural persons), instead of the 36% applicable to other trusts.

- Type A special trusts are entitled to an annual exclusion for CGT purposes in the same way as for natural persons.

- A type A special trust that is discretionary must disregard a capital gain or loss not exceeding R2 million on the disposal of a primary residence, just like a natural person.

- A capital gain or loss on the disposal of personal use assets by a type A trust must be disregarded, as is the case with natural persons.

- A capital gain or loss on the disposal of a claim for the receipt of compensation by the trust for personal injury, illness or defamation of the trust beneficiary by a type A trust must be disregarded, as is the case with natural persons.

Types of special trusts

- Type A special trusts are set up for the benefit of one or more persons who is/are disabled as defined in section 6B(1) of the Act and who are relatives.

- Type B special trusts are those set up in a will for the sole benefit of the relatives of a deceased person, and of which the youngest of the relatives is under the age of 18 years.

Type A special trusts

For a special trust to qualify as a type A trust, it has to comply as follows:
The disability requirement:

- A disability is defined in section 6B(1) of the Act as ‘a moderate to severe limitation of any person’s ability to function or perform daily activities as a result of a physical, sensory, communication, intellectual or mental impairment, if the limitation:
  - has lasted or has a prognosis of lasting more than a year; and
  - is diagnosed by a duly registered medical practitioner in accordance with criteria prescribed by the Commissioner.’

- The requirement is that the disability has to significantly restrict the person’s ability to function or perform one or more daily basic activities after maximum correction. Maximum correction means appropriate therapy, medication and use of devices.

The sole benefit requirement:

- The trust deed may not provide for any possibility that any beneficiary who does not have the ‘disability’ as defined, may benefit.

The incapacity and financial management requirement:

- Beneficiaries must not be able to earn sufficient income for their maintenance, or manage their own financial affairs, as a result of their disability. This is very much a factual question to be answered on the specific facts of each case.

The living beneficiaries requirement:

- At least one of the beneficiaries for whose sole benefit the trust has been created should be alive on the last day of February of the relevant year of assessment of the trust.
- The trust will cease to be a type A trust from the start of the relevant year of assessment during which all the beneficiaries for whose sole benefit the trust was created, are deceased.

The relatives requirement:

- A trust that is created for the sole benefit of more than one person must be for the benefit of persons with a disability who are related to each other. A ‘relative’ as defined in section 1(1) of the Act, means:
    - the spouse of that person;
    - anyone related to that person within the third degree of consanguinity;

  - anyone related to the spouse of that person within the third degree of consanguinity; or
  - the spouse of anyone related within the third degree of consanguinity to that person or that person's spouse.

- A 'spouse' is defined in section 1(1) and means a person who is the partner of such person:
  - in a marriage or customary union recognised under the laws of South Africa;
  - in a union recognised as a marriage in accordance with the tenets of any religion; or
  - in a same-sex or heterosexual union that the Commissioner is satisfied is intended to be permanent.

Type B special trusts

A type B special trust has to comply as follows:

- A trust will remain a type B trust if one of the qualifying beneficiaries of the trust dies subsequent to the date of death of the deceased person as long as the trust continues to comply with the other requirements of paragraph (b) of the definition of 'special trust' in section 1(1), namely, that the remaining beneficiaries are related to the deceased person and the youngest beneficiary is under the age of 18.

- Beneficiaries may include persons aged 18 years and older as long as one of the beneficiaries is still under the age of 18 years.

The 'under the age of 18 years' requirement:

- The youngest of the beneficiaries of a type B trust must be under the age of 18 years on the last day of the relevant year of assessment of the trust.

Mode of formation of special trusts

In order to register and form a special trust for income tax and CGT purposes, the trust must complete an IT77TR form to which must be attached the trust deed in the case of an *inter vivos trust* or the last will and testament of the deceased person in case of a testamentary trust.

Additional documentation must be submitted in the case of a type A special trust:

a. Medical report from a medical practitioner or medical institution confirming the nature of the disability of the beneficiary of the special trust.
b. A medical report from a medical practitioner or medical institution confirming that the disability incapacitates the beneficiary from earning sufficient income for that person's maintenance or from managing that person's own financial affairs.

- The trustees must indicate the type of trust on the return of income of the trust (ITR12TR).

- A special trust that derives income other than remuneration or an allowance or advance contemplated in section 8(1) must be registered as a provisional taxpayer.

Sanlam

ITA: section 1(1) definition of "spouse", "special trust" and "relative", and section 6 B(*i*), 7C and 8(1)

VALUE-ADDED TAX

2646. Non-executive director fees

On 4 May 2017, SARS issued an updated BGR 41 in which it determined, in terms of section 23(4)(*b*) of the Value Added Tax Act 1991 (the VAT Act), the VAT registration liability date of Non-Executive Directors (NEDs) to be 1 June 2017. BGR 41 further clarifies that where NEDs are already registered for VAT but have neither levied nor accounted for VAT on their directors' fees, they must start charging and accounting for VAT on such fees by no later than 1 June 2017.

The appointment of a director, including a non-executive director (NED), is a statutory appointment in terms of the Companies Act, 2008 (the Companies Act) and the role, function and duties of directors are prescribed by the Companies Act. The question remains as to whether a NED, in merely performing his or her statutory duties, indeed carries on an "enterprise" as that term is defined in the VAT Act, for which the NED is required to register for VAT. Nevertheless, in view of the SARS ruling, a NED who receives director's remuneration in excess of the R1 million VAT registration threshold will be required to register and account for VAT with effect from 1 June 2017 in accordance with BGR 41 or risk being held liable for the VAT, penalties and interest, until a court may rule otherwise.

In determining the liability date of 1 June 2017, it appears that SARS may not have considered that section 66(9) of the Companies Act provides that directors' remuneration may be paid only in accordance with a special resolution approved by the shareholders within the previous two years. A

company may, therefore, not increase the directors' remuneration without the prior approval of the shareholders by way of a special resolution. The directors' remuneration paid to NEDs who are required to register for VAT from 1 June 2017 will be considered to be VAT inclusive in terms of section 64 of the VAT Act, unless prior shareholders' approval for an appropriate increase is obtained before that date.

Section 67 of the VAT Act provides for a VAT amount to be levied in addition to a fee charged for services where VAT has been imposed for the first time on such services in terms of the VAT Act or the VAT rate has been increased. In SARS's view, directors' fees paid to NEDs have always been subject to VAT; hence no amendment to the VAT Act is required, but SARS has now merely directed in terms of section 23(4)(*b*) that NEDs only need to register and account for VAT from 1 June 2017. Accordingly, the VAT on directors' fees paid to NEDs is not imposed for the first time in terms of the VAT Act as contemplated by section 67, and a NED will thus not be able to rely on this provision.

Questions also arise with regard to the VAT position of non-resident NEDs. A person is required to register for VAT if the person carries on an "enterprise', ie an activity on a continuous or regular basis in or partly in South Africa in the course of which goods or services are supplied for a consideration. This means that only activities carried on in South Africa will give rise to VAT registration, and in the absence of any specific place of supply rules in the VAT Act, it is open to interpretation as to where activities in relation to the supply of services are rendered.

SARS has ruled that a NED carries on an enterprise in the form of the supply of services. However, the nature of these services is not described. If the services rendered are considered to be the preparation for and attendance at board meetings, it seems that certain services such as the review of papers in

preparation for a board meeting whilst the NED is not present in the country, could be regarded as being supplied outside South Africa. If the non-resident NED attends a board meeting in a foreign country by way of video conference, a further question arises as to where such services are rendered. The "enterprise" of the NED could therefore be considered to be rendered partly within and partly outside South Africa, and where the director's fees attributable to the services rendered in South Africa are less than R1 million for a 12 month period, the non-resident NED may not be required to register for VAT.

The VAT position of a South African NED serving on a foreign company's board is equally uncertain with regard to the obligation of such NED to register for VAT. If required to register, such directors' remuneration may qualify for the zero rate, but the burden of the VAT registration and submission of VAT returns will remain.

Although BGR 41 does not provide clarity with regard to these aspects, NEDs may apply to SARS for a binding private ruling to clarify their VAT status and obligation to register for VAT where their scenario is not specifically dealt with in BGR 41.

Cliffe Dekker Hofmeyr
VAT Act: section 1 definition of 'enterprise', sections 23(4)(*b*), 64 and 67
The Companies Act, 2008: section 66(9)
BGR 41

TAX ADMINISTRATION

2647. Public officers

The Tax Administration Act 2011 (the TAA) sets out the requirements for the public officer of a company. A public officer is an individual who is residing in South Africa and must be a registered taxpayer with SARS. The individual representative who is approved by SARS must be a senior official of the

company. Should the company not have a senior official residing in South Africa, then any suitable person can fulfil this role.

Furthermore the individual must be duly appointed as the public officer by the directors of the company within one month after it begins to carry on business or acquires an office in South Africa.

The public officer is responsible for all acts, matters or things relating to the company under the various tax Acts.

These duties could include the following:

- attending to the various tax registrations such as VAT, payroll taxes, Customs and Excise;
- attending to all tax matters of the entity, including submission of the tax returns for VAT, employees' tax, employee tax reconciliations, income tax, dividends tax and provisional taxes;
- the individual is also responsible for the timeous payment of taxes due to SARS; and
- notifying SARS of any change of the registered particulars such as registered address, year-end change, name change and verifying bank details.

When it happens that the senior official or director who is appointed as the public officer resigns from the company, a new public officer must be appointed and SARS must be notified of the change within 21 business days of it taking effect.

Another practical aspect that is often overlooked occurs in circumstances when the company is no longer required to be registered for a tax type or ceases trading completely. It is also the duty of the public officer to attend to the necessary deregistration for the relevant tax types with SARS. It is important to

bear in mind that even when a company has been finally deregistered by the Companies and Intellectual Property Commission, its tax registrations with SARS are not automatically terminated.

In conclusion, it is important that the company at all times has a duly appointed person fulfilling the duties required of a public officer.

RSM

TAA: Section 1 Definition of 'public officer'

2648. SARS right to information

In the matter of *BP Canada Energy Company v Minister of National Revenue (CPA of Canada intervening)* 2017 FCA 61 (judgment delivered 30 March 2017), the Court had to consider a lower court judgment in terms of which BP Canada Energy Company (BP) had been ordered to provide unredacted copies of its 'tax account working papers' to an auditor conducting a tax audit.

Background

BP had to produce estimates for inclusion in its UK holding company's annual financial statements of 'uncertain tax positions' and determine the potential liability if the positions should not be accepted by the tax authority, including any penalty or interest. These papers supported an account called the 'Tax Reserve'. The judgment summarises their purpose and content in paragraph 6, in the following terms:

'They reflect, among other things, the uncertain tax positions adopted by BP Canada in filing its tax returns, also referred to as "soft spots", as well as the corresponding analyses behind the contingent tax reserves.'

The auditor had asked for information supporting the Tax Reserve balance. BP had responded by providing redacted copies of the tax account working papers reflecting the estimated liability if the uncertain positions should not be accepted. The amount of the liability so reflected was greater than the liability reflected in the Tax Reserve account. BP provided an explanation for the

differences that was apparently accepted. However, the auditor insisted that she had a right to demand an unredacted copy of the tax account working papers.
In addition to the tax account working papers demanded under the audit, the auditor also demanded the tax account working papers for years of assessment that were not part of the audit.

The Federal Court held that the Minister of National Revenue had an unrestricted right to demand the information.

The arguments

BP argued that the relevant provision of the Canadian law is a fact-finding tool. Its purpose is to identify facts relevant to the assessment of a taxpayer's liability to tax. The Minister's stated intention was that the documents were required to provide a roadmap for subsequent audits. This was not permitted by the regulation.

Alternatively, BP said, the lower court had discretion as to the nature and extent of the information to be disclosed and its failure to exercise that discretion *'would bestow upon the Minister an "unqualified right" to require taxpayers to disclose any issues identified in preparing their tax returns... Such a right would be available even in the absence of a reasonable basis for considering that the information sought is relevant in determining whether the tax return under audit is correct.'*

CPA Canada was largely concerned with the integrity of audited financial statements if National Revenue had unrestricted access to the tax account working papers, as this would undoubtedly lead to a reluctance on the part of companies to prepare such documents and share them with auditors.

The Minister maintained that the disclosure of details of uncertain tax positions with which the Minister may disagree promotes efficiency and falls within the

ambit of ‘administration or enforcement of the Act’. The Act requires broad powers to obtain information and make use of available risk assessment techniques. He therefore urged that the lower court’s finding was consistent with the relevant regulation.

The judgment

The judgment, delivered by Noël CJ, first examined the policy statement of Canadian National Revenue (at paragraph 21). This stated clearly that the Minister had the power to request tax account working papers, but that such requests are not made routinely.

The extremely broad language of the provision gave the Minister access to any documented information …. However, Noël CJ explained, the issue was not whether the information could be accessed … but whether the subsection allowed general and unrestricted access to this information…’

The judgment then went on to state the facts. Noël CJ identified that the tax account working papers contained the following:

1. A statement of the issue;
2. The analyses that led to the issue being identified as uncertain;
3. The amounts by which the liability to tax would increase if the minister assessed the transactions and succeeded on appeal; and
4. The reserve reflecting the total of those contingencies.

BP had supplied the auditor with the relevant working papers but had redacted the identification and analysis components. In other words, items 3 and 4 were supplied and items 1 and 2 were redacted.

However, the facts had to be assessed on an interpretation of the law in its context. At paragraph 57, Noël CJ expressed the canons of interpretation to be applied:

‘As in all such cases, the words of subsection 231.1(1) must be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act and the intention of Parliament...’

In considering the relevant legislation, it was considered that, on a literal reading of the words in the regulation, the use of the information on uncertain tax positions to plan audits appears to be a permitted purpose.

The next question is whether the information falls within the scope of the regulation. To do so, it has to meet three tests:

1. Is it part of the books and records?
2. Does it relate to information that is or should be in the books and records?
3. Does it relate to any amount that may be payable by the taxpayer under the Act?

The court was of the view that the uncertain tax positions likely met the second and third tests.

The extremely broad language of the provision gave the Minister access to any documented information that may assist in carrying out auditing functions. However, Noël CJ explained, the issue was not whether the information could be accessed (at paragraph 67):

‘The real issue is whether subsection 231.1(1) allows general and unrestricted access to this information...’

The court outlined the context in which the demand for the tax working papers had arisen. The background shows that the auditor had asked for the papers related to the tax reserve and had noted that there was a difference between the *quantum* reflected in the redacted papers presented to her and the amount of the

tax reserve recorded in the financial statements. BP had responded by explaining the difference to her satisfaction.

Noël CJ then concludes by summarising these circumstances in the following terms (at paragraph 74):

‘The record further reveals that when apprised of this demonstration, the auditor commended BP Canada for making it available, but took the position that BP Canada’s Tax Reserve Papers had to be produced whether or not the “tax at risk” amounts were a cause for concern ... Therefore, the auditor insisted on compliance in order to complete the 2005 audit. Similar requests were made for the 2006 and 2007 taxation years. The auditor made it clear that these requests were made in order to make the conduct of the audits for those years more cost efficient and confirmed that similar requests would be made for future ... As noted, requests have since been issued for 2008, 2009 and 2010.’ (Notes to Appeal record removed)

The Minister’s argument that the auditor had raised legitimate questions and therefore was entitled to the papers was rejected by Noël CJ. The production of information showing the quantum of the uncertain tax positions and the amount of the tax reserve had been followed by a reconciliation explaining the difference between the respective amounts. The auditor had not verified the reconciliation but pressed for production of the tax account working papers.

Herein lay the true issue, as Noël CJ explained (at paragraph 76):

‘However, the fact that BP Canada’s analysis effectively puts this concern to rest cannot be questioned as the analysis is part of the record … and the Minister has not seen fit to challenge it nor the conclusion which BP Canada draws from it. ’ (Notes to Appeal record removed)

The final issue then was whether the Minister had the right to demand tax account working papers 'without restriction'. If the order of the lower court were to stand, BP Canada would be compelled annually to hand over its tax account working papers and every company that prepared such papers could be similarly compelled to hand them over.

This was not the true purpose of the provision, and the Court concluded (at paragraph 80):

'In my view, subsection 231.1(1), properly interpreted, does not make papers such as these compellable "without restriction". When one examines the context and purpose of subsection 231.1(1), it is clear that Parliament intended that the broad power set out in subsection 231.1(1) be used with restraint when dealing with TAWPs. It follows that the decision of the Federal Court judge must be set aside.' (Notes to Appeal record removed)

The court then added comment on the self-assessment system, at paragraph 82, emphasising that there is a distinction between self-audit and self-assessment:

'However, this obligation to "self-assess" does not require taxpayers to tax themselves on amounts which they believe not to be taxable. Faced with an issue that is reasonably open to debate –I emphasize this point insisting on the fact that the case law is replete with decisions which illustrate the coexistence of arguable issues on both sides of the debate –taxpayers are entitled to file their tax return on the basis most favourable to them. This explains why auditors in conducting audits must engage in extensive poke-and-check exercises, and are essentially left to their own initiative in verifying the amounts reported by the taxpayer.'

The lower court's order effectively compelled BP Canada to self-audit. Noël CJ rejected the lower court's assertion to the contrary (at paragraphs 84 to 85):

'[84] The Federal Court judge did not believe that his order imposed on BP Canada an ongoing obligation to self-audit. He explained that he did not order BP Canada to prepare documents listing its uncertain tax positions, but to turn over existing ones which reflect this information...

[85] With respect, this is a distinction without a difference. BP Canada has no choice but to document its uncertain tax positions annually and the Federal Court judge has confirmed the Minister's access to these documents through legal compulsion every year from 2005 onwards. However one looks at the matter, the decision of the Federal Court judge allows the Minister to compel BP Canada to self-audit.'

The final assertion of the lower court that the Minister's request was not contrary to policy was also rejected, at paragraphs 102 to 103, where Noël CJ states:

'[102] The Federal Court judge dismissed this argument based on his reading of the policy. In his view, the Minister, by bringing the application, was "adhering to, and implementing the policy that, without restriction, [TAWPs] are compellable under the Act".

[103] With respect, this turns the policy on its head. I agree with the appellant that the policy, as it presently stands, states that the power to access TAWPs, although available to the Minister, will not be used routinely. This is what the words say (see paragraph 21 above) and when regard is had to the tension which the policy was intended to address, they cannot be read otherwise.' (Notes to the Appeal Record removed)

The court therefore concluded that the Federal Court judge erred in finding that the regulation afforded the Minister unrestricted access to tax account working

papers. The policy actually recorded the constraint that is imposed by law on the exercise of the powers.

Does the BP decision have relevance to South Africa?

This is a welcome judgment that may well have relevance to the exercise of powers by SARS under section 46 of the Tax Administration Act, 2011 (the TAA). Although the wording of the Canadian regulation and the terminology used in the TAA are not identical, there is sufficient similarity for comparison.

It is useful to compare the wording of the Canadian law with that of the TAA. Regulation 231.1.(a) in Canada states:

'An authorized person may, at all reasonable times, for any purpose related to the administration or enforcement of this Act:

- *inspect, audit or examine the books and records of a taxpayer and any document of the taxpayer or of any other person that relates or may relate to the information that is or should be in the books or records of the taxpayer or to any amount payable by the taxpayer under this Act …'*

Section 46(1) of the TAA provides:

'SARS may, for the purposes of the administration of a tax Act in relation to a taxpayer, whether identified by name or otherwise objectively identifiable, require the taxpayer or another person to, within a reasonable period, submit relevant material (whether orally or in writing) that SARS requires.'

The term in section 46 that causes concern is that SARS may require a person to produce 'relevant material'. This term is defined in section 1 of the TAA as follows:

*'"**relevant material**" means any information, document or thing that in the opinion of SARS is foreseeably relevant for the administration of a tax Act as referred to in section 3.'*
Section 3, in its turn describes what constitutes administration of a tax Act, and powers (a) and (b) of section 3(2) would be relevant to the comparison:
Administration of a tax Act means to—
(a) obtain full information in relation to—
(i) anything that may affect the liability of a person for tax in respect of a previous, current or future tax period;
(ii) a taxable event; or
(iii) the obligation of a person (whether personally or on behalf of another person) to comply with a tax Act;
(b) ascertain whether a person has filed or submitted correct returns, information or documents in compliance with the provisions of a tax Act…'

Factual data

The High Court has pronounced on the application of the definition of 'relevant material' in relation to the provision of factual data. In the matter of *C:SARS v Brown* [2016] 78 SATC 255, it was held in the context that a request for information in the form of data was within the scope of section 46. Smith J, at paragraphs 40 to 42, made this abundantly clear:

'[40]It is in my view similarly manifest that the information sought in the questionnaire constitutes 'relevant material' since it pertains to the respondent's assets, liabilities and expenses. Furthermore, the questionnaire could hardly have been more specific regarding the information which the respondent is required to provide, and I am accordingly satisfied that adequate specificity has been provided as required by the Act.

[41]There can also be little doubt that the issuing of the questionnaire was done in the course of the 'administration of a tax Act' since the information sought

therein manifestly relate to "the liability of a person or persons for tax in respect of a previous, current or future tax year". (Section 3(a)(i))

[42]I am accordingly of the view that the applicant has established all the requisite jurisdictional facts mentioned in section 46. The respondent's contention that the issuing of the questionnaire was a "fishing expedition" is thus untenable. The questionnaire was issued against the background of information to the effect that there may have been non-disclosure of relevant information by the respondent, coupled with the fact that he did not register as a taxpayer or submit tax returns. In my view these factors constituted a sound basis for the issuing of the questionnaire and cannot by any stretch of the imagination be regarded as "a fishing expedition".'

Can SARS demand opinions issued by advisors?

The question at this point that has not yet been interpreted in our courts is the application of the term 'relevant' to the extent that the information may contain or consist of an opinion on the application of the law to a specific set of facts. Paradoxically, an opportunity arose for a South African court to interpret and apply the term, but the point was not argued in the court. In *A Company & Others v C:SARS* [2014] 76 SATC 321, an application was made to the High Court to restrict the content of information contained in a law firm's invoices to a taxpayer that was to be disclosed to SARS.

The background was that a SARS auditor had requested details of the line item 'Professional Fees' in the trial balance. In response, the taxpayer had provided a breakdown of the fees specifying the supplier and providing copies of the invoices. However, it had not, at the time of submitting the response, located the lawyer's invoices, and undertook to provide them. When the invoices were located it was discovered that they contained information concerning transactions to which the company or a group entity had been a party.

The taxpayer therefore wrote to SARS and stated that the invoices were protected by legal professional privilege and that they were not obliged to deliver the invoices. SARS rejected this assertion and demanded the production of the invoices. The taxpayer provided SARS with redacted copies of the invoices. At the same time the SARS auditor was informed that no deduction had been claimed in respect of the expenditure incurred in respect of the invoices. SARS again demanded production of the invoices in unredacted form.

The taxpayer then applied to the High Court for an order that the information in the invoices was protected by legal professional privilege.

The point of interest in the judgment delivered by Binns-Ward J is found in paragraph 13:

SARS explained its annexure of the material as having been to deal with what the Commissioner had apprehended to be a contention by the applicants that the content of the invoices was not relevant to the investigation being undertaken by SARS. Lack of relevance would have afforded a separate ground for resisting its disclosure, quite discrete from that of legal professional privilege. Having regard to the tenor of the correspondence exchanged between the parties, which was annexed to the founding papers, and in which the applicants' right to contend that the information sought was irrelevant was reserved, I consider that the respondent's apprehension of the applicants' position in this respect was reasonably formed. The answering papers were handled sensitively to prevent any unwarranted invasion of the applicants' privacy and, by agreement between the parties, the court was requested to hear the application in camera, which duly happened. In the event, the applicants did not persist at the hearing with any argument that they were entitled to withhold the invoices, or any of the content thereof, for want of relevance. For the purposes of the declaratory relief that they seek in these proceedings the

applicants confined the basis of their alleged entitlement to withhold part of the content of the documents to legal advice privilege.

It is evident that the parties contemplated that a challenge lay against the request for want of relevance. After all, the SARS auditor had requested information relevant to determining the liability to tax in a particular year of assessment and had received sufficient information to satisfy him or her that there had been no unauthorised deduction in relation to the invoices.

There are similarities between these facts and the facts in the *BP Canada* appeal. In the case of *A Company,* the auditor required information to audit a particular line item in the trial balance and identify how the information had been reflected for tax purposes. The response that the amounts reflected on the invoices in question had not been claimed as a deduction should have been sufficient to settle the inquiry and allow the auditor to move on. The auditor, nevertheless, insisted on production of the invoices in unredacted form.

However, the issue of relevance was not argued before the court. Had it been argued, it is submitted that the outcome may well have been that the information contained in the invoices was indeed not relevant material in the context.

Subsidiaries of foreign listed companies

The requirement for BP Canada to prepare TAWPs stemmed from the fact that it was a subsidiary of a foreign listed company and, in terms of the accounting standards applicable to the parent company, the latter company was compelled to quantify 'uncertain tax positions'. BP Canada therefore prepared the TAWPs in order to harmonise its accounting principles with those of its parent company. Similar requirements fall on SA subsidiaries of foreign listed parent companies.

Where a company adopts a filing position in relation to a transaction which may not accord with the interpretations of SARS, it will prepare a document setting

out the facts; the possible conflicting interpretations of law in relation to the facts; the reasons for its adoption of an interpretation; a quantification of the potential additional tax, penalty and interest that might be incurred if its interpretation is overturned; and an estimate of the probability that the interpretation might be overturned.

The question whether SARS is entitled to treat such a document as 'relevant information' is yet to be determined under our law. There is an argument that statements of opinion are not 'information'. This was not accepted in the Canadian Federal Court of Appeal, which took the view that the term was to be interpreted broadly. The issue will therefore likely turn on the question whether the contents of such a document are relevant.

SARS' rights

The extent of SARS' rights turns on the question whether SARS has an automatic right to be apprised of more than the factual data in order to assess a person to tax. The Canadian judgment takes the view that this is a form of enforcement of self-audit, and is contrary to the principle that a taxpayer may *reasonably* adopt a filing position that exposes it to a lesser tax liability.

The relevance of the information must be determined in the light of the facts and circumstances, having regard to '… the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production.' (per Wallis JA *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) at paragraph 18).

The *Explanatory Memorandum on the Objects of the Tax Administration Bill, 2011* summarises the purpose and known information in its discussion on what constitutes 'relevant material' at paragraph 2.2.1.8:

'The term ''relevant material'' is important for information gathering under Chapter 5 and means any information, document, or thing that is foreseeably relevant for tax risk assessment, assessing tax, collecting tax, or showing noncompliance with an obligation under a tax Act or showing that a tax offence was committed.

The standard of foreseeable relevance, which is inter alia regarded by the OECD as the standard in the context of specifying the information that should be exchanged between countries, is intended to provide for the procurement of information in tax matters to the widest possible extent and, at the same time, to clarify that revenue authorities are not at liberty to engage in ''fishing expeditions'' or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. This is a narrower term than ''may be relevant'', which is the standard used in some tax jurisdictions.

Risk assessment, as reflected in clause 44, is one of the premises of SARS' audit selection process and involves assessing the risk profile of taxpayers (''risk assessment'') and then allocating resources in accordance with the risk profiles (''risk-led resource allocation'') which should result in more targeted audits. Risk assessment also assists in addressing emerging tax risks in real-time, which should enable SARS to provide tax certainty to taxpayers sooner and quicker guidance on tax matters and to reduce the need for protracted forensic audits (typically some years after targeted transactions occurred). Risk-driven processes should also limit disputes and reduce the incidence of tax underpayments and understatement penalties or administrative non-compliance penalties. Obtaining real-time ''relevant material'' from taxpayers is key to effective risk management of taxpayers.'

Far from asserting an unrestricted right, the explanation emphasises the need for foreseeable relevance and the avoidance of unwarranted requirements to obtain information by way of so-called ‘fishing expeditions’.

SARS guide on access to audit files

In December 2016, SARS issued an external guide relating to access to audit files. The contents of this document provide indications of SARS’ policy stance. It is noteworthy that SARS views itself as having an unrestricted right to information in audit files, but states that, as a matter of policy, it will exercise the rights with restraint, as illustrated in the following extract from page 4:

‘There is no general restriction on SARS requiring information contained in an audit file. However SARS respects the unique relationship between the taxpayer and its statutory auditors; and therefore undertakes not to call for audit files as a matter of routine or without obtaining approval from a senior official. Policies and procedures have been put in place within SARS to govern such requests…’

It is vital to financial markets that corporate reporting is as open and transparent as possible. The assertion that SARS has an unrestricted right to information in audit files has a negative connotation. It places auditors and their clients in a difficult position. The client may be less inclined to communicate candidly with the auditor if it considers that SARS has *carte blanche* to inspect the audit files. In turn, the withholding of information adversely affects the integrity of the financial statements and the auditor’s opinion in relation to such statements.

The impression is created that the determination of relevance is apparently the exclusive domain of SARS. The definition of ‘relevant material’ refers to the items in question being those which ‘*in the opinion of SARS* are foreseeably relevant’.

This somewhat paradoxical requirement bears examination –

- The opinion of SARS is subjective, in the sense that it reflects a conclusion at which SARS, through its officials, has arrived.
- On the other hand, foreseeability is, by nature, objective. It indicates that something is 'able to be foreseen or predicted' (www.en.oxforddictionaries.com).

Conclusion

It is therefore submitted that SARS does not have an unrestricted right to call for access to audit files. Firstly, it is a matter of record that the power is to be exercised with restraint. Secondly, before it may exercise the power, it must be able to establish that the information in the audit files is foreseeably relevant to the determination of a liability to tax or establishing compliance with a tax Act.

To do so, SARS must be in a position to identify with reasonable specificity the information required and the reasons that make the information predictably relevant.

PwC

TAA: section 1 definition of 'relevant material', sections 3 and 46

EM of Objects to the Taxation Laws Amendment Bill, 2011

SARS external guide: Access to audit files

2649. Early payment demands

There have been instances in which SARS has demanded taxes before these were due and payable. In the current tough economic climate, where cash flow is tight, this is something to watch out for.

Part 1: Email requiring payment

When SARS issues an income tax assessment, the "due date" is frequently the first day of the month, in the month following next. In this example, SARS

issued an additional income tax assessment in March 2017, with a "due date" of 1 May 2017, and a "second date" of 31 May 2017. Underneath the "assessment summary information" block on the notice of assessment, the following fairly standard wording appeared: "*Thank you for submitting your income tax return for the [x] year of assessment. Your assessment has been concluded and reflects an amount payable by you of [Rx]. Payment should be made by 2017-05-31 after which interest will accrue on this assessment as from 2017-05-01.*"

Then, a few days after the assessment was issued in March, and long before any potential due date, a SARS collections official sent through a statement of account, with a request that payment be made in full. This email also purported to require a response within three business days, although there is no basis for this requirement – there are no timelines or other provisions for this type of communication, where there is no requested information or documentation.
This initial request for payment was dealt with by means of an email pointing out that the assessment had only just been issued, with a due date only in May; that the amount was accordingly not yet due and payable, and that the taxpayer would settle the tax as and when this falls due.

Part 2: "Final demand" letter

This was not the end of the story. On 1 May 2017, SARS issued a "final demand" letter. The final demand letter is necessary because SARS is not allowed to appoint a third party as agent to satisfy tax debts (for example appointing your bank as your tax agent, to pay SARS directly) without having issued a final demand at least 10 business days in advance. SARS' powers to obtain a civil judgment are also constrained by having to give the taxpayer at least 10 business days' notice. In the circumstances, SARS typically issues an "all purpose" final demand letter, warning a taxpayer that SARS may take either of these two actions if the taxpayer fails to make payment.

The problem with the issue of the final demand letter on 1 May 2017 relates to the definition of "outstanding tax debt" in the Tax Administration Act 2011 (the TAA), which is "*tax debt not paid by the day referred to in section 162*". Section 162, in turn, states that "*tax must be paid by the day and at the place notified by SARS…"* In this case, SARS had patently directed that payment should be made by 31 May 2017. This meant the tax was not yet an "outstanding tax debt", regardless of the "due date" of 1 May 2017 on the notice of assessment. Accordingly, SARS was not authorised by the TAA to take any further recovery processes.

This legal position was brought to SARS' attention, and the relevant SARS official was requested to intervene as appropriate, and ensure that no further actions take place in the interim period before the "second date", which SARS had specified as the date for making payment.

Exception: jeopardy

Throughout the TAA, there are exceptions to the normal processes and standards that protect taxpayers, for situations where the collection of tax is in jeopardy. These apply equally to the recovery proceedings, where SARS can in a jeopardy situation require a taxpayer to pay immediately upon assessment. However, this must be done by a senior SARS official, and the taxpayer notified as such.

Conclusion

SARS' standard processes and automated notices are not always fully aligned with the actual tax legislation. Specifically as regards demands for taxes, be careful that SARS does not demand these before they are actually due and payable, placing undue strain on your business's cash flows.

Bowmans Gilfillan

TAA: section 1 definition of 'outstanding tax debt' and section 162

2650. Third party appointments – taxpayers' rights

The Tax Administration Act 2011 (the TAA) came into effect on 1 October 2012, the main objective of which was to align the tax administration provisions of most of our tax Acts and consolidate these into one piece of legislation.

The TAA introduced significant new concepts, powers and obligations. In this respect, the Objects Memorandum claims that "the TAA seeks to achieve a balance between the powers and duties of SARS, on the one hand, and the rights and obligations of taxpayers, on the other".

Some observers claim that this "balance" has not been achieved and that the TAA favours SARS and compliant taxpayers do not (in some cases) have sufficient protection against potential abuses of power by individual SARS officials. One such power given to SARS is the ability to appoint a third party to settle a tax debt owing to SARS by a taxpayer. Examples of third parties are banks, employers and life insurers who hold or owe money to the taxpayer. On receipt of a notice from SARS, the third party must pay the money to SARS in satisfaction of the taxpayer's outstanding tax debt.

It is important to understand that SARS can issue a collection notice to a third party without any judicial oversight. It is understood that the original intention was for SARS to use this power for problematic collection cases but it appears that in some cases it is being used as the first port of call. It is therefore critical that taxpayers understand their rights and obligations in this regard.

Most importantly, before SARS can recover any tax debt, the taxpayer must have received an assessment-: There can be no debt without an assessment. Assessments come in the form of original, additional, reduced, estimated or jeopardy assessments. Assessments can be issued by SARS or can be self-assessments. An income tax assessment is an example of an assessment issued

by SARS. A VAT assessment is an example of a self-assessment. Assessments contain crucial deadlines and missing those deadlines could result in SARS making a third party appointment to recover the tax debt owing to it.

However, upon receiving an assessment, a taxpayer "who is aggrieved by an assessment" has a right to lodge an objection against the assessment. Conversely, if a taxpayer is informed of a tax debt and takes no action i.e. by not lodging an objection, then SARS is legally obligated to collect the debt due to it.

Another important factor is the "pay-now-argue-later" principle which applies to all tax debts. In terms of this principle, the obligation to pay tax is not automatically suspended by an objection or appeal. It is therefore imperative that upon receipt of an incorrect assessment, a taxpayer follows these procedures:

- submits a "Request for Suspension of Payment" of the purported taxes; and
- lodges an Objection to the assessment to dispute all or part of the liability to pay the tax.

By lodging the request for suspension of payment, a taxpayer is protected from all SARS collection procedures from the date the request is received by SARS through to 10 business days after SARS issues its decision to the taxpayer. If SARS denies the request for suspension of payment the taxpayer has bought some time in which to make payment. In the case where SARS agrees to the request for suspension of payment it may not commence collection procedures for the tax debt in dispute while the objection or appeal is in progress.

Only a senior SARS official can decide to suspend payment after taking the following factors into account:

- risk of recovery will be put in jeopardy or there will be a risk of dissipation of assets;

- compliance history of the taxpayer;
- whether fraud is involved in the origin of the dispute;
- whether payment will result in irreparable financial hardship to the taxpayer not justified by the prejudice to SARS or the fiscus if the disputed tax is not paid or recovered; and
- whether the taxpayer is able to provide adequate security for the payment of the amount involved.

If the senior SARS official denies the request to suspend payment, it is advisable that the taxpayer apply to SARS for a payment plan. An application for the payment of the tax in instalments can assist a taxpayer while the objection or appeal is ongoing.

Once the objection or appeal has run its course and finality has been reached, either by the issue of a reduced assessment, or the objection or appeal being denied, the resulting assessed tax becomes due and payable. The due date for payment will be reflected on the revised assessment. If the taxpayer disregards the stipulated payment date, then SARS may commence collection proceedings which includes collecting the tax debt from a third party.

SARS must follow due process when issuing a notice to a third party:

- a senior SARS official must authorise the issue of the notice to a third party;
- if requested, SARS must extend the period over which the amount must be paid to SARS, to allow the taxpayer to pay basic living expenses;
- SARS may only issue the notice after 10 business days of delivery to the taxpayer of a final demand for payment;
- the final demand must set out the following:
  - recovery steps that SARS may take if the tax debt is not paid;
  - available debt relief mechanisms contained in the TAA;

    - if the taxpayer is a natural person he or she may within 5 business days of receiving the final demand, apply to SARS for a reduction of the amount to be paid to SARS based on the living expenses of the taxpayer and his or her family; and
    - if the taxpayer is not a natural person it may within 5 business days of receiving the final demand, apply to SARS for reduction of the amount to be paid to SARS based on serious financial hardship; and
- SARS may issue the notice to a third party without issuing a final demand only if a senior SARS official is satisfied that to do so would prejudice the collection of the tax debt.

In the event that the taxpayer cannot afford to settle the tax debt owing to SARS another relief mechanism afforded by the TAA is a compromise agreement. A senior SARS official must authorise the compromise of a tax debt (or a portion of the debt) upon the request of the taxpayer provided the compromise secures the highest net return from the recovery of the tax debt, and the compromise is consistent with good management of the tax system and administrative efficiency. In addition to other details, the request must be accompanied by evidence supporting the taxpayer's claims for not being able to make the payment of the full amount of the tax debt.

Notwithstanding a taxpayer having successfully applied for a suspension of payment or applied for an instalment payment plan or reached a compromise, SARS might press ahead and issue a notice to a third party to collect the tax debt. In this case SARS is clearly in contravention of the TAA and has acted illegally. If the taxpayer does not want to institute legal action to remedy the situation, another option is to lodge an official complaint to SARS via the Complaint Management Office (CMO). This office has recently replaced the previous SSMO (SARS Service Monitoring Office). These complaints are either lodged using the taxpayer's or registered Tax Practitioner's eFiling profile or by contacting SARS directly.

Should the CMO not resolve the taxpayer's complaint satisfactorily, the next step would be for the taxpayer to take the matter to the office of the Tax Ombud. The Tax Ombud is independent of SARS and may only review a request once the taxpayer has exhausted all the normal SARS complaint mechanisms available.

In conclusion, it is vitally important that taxpayers understand the procedures that SARS must follow in order to collect tax debts and take action within the strict timelines should SARS breach the authority afforded it by the TAA. Missing any deadline could seriously affect the outcome of any objection, appeal or complaints lodged with the CMO or Tax Ombud.

It is advisable that taxpayers seek immediate professional assistance in matters of this nature.

RSM

The Objects Memorandum of the TAA

2651. 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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