TAX UPDATE

For period: 1 October 2016 to 31 December 2016

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1. INTRODUCTION

The purpose of this update is to summarise developments that occurred during the fourth quarter of 2016, specifically in relation to Income Tax and VAT. Johan Kotze, a Tax Executive at Shepstone & Wylie Attorneys, has compiled this summary.

The aim of this summary is for clients, colleagues and friends alike to be exposed to the latest developments and to consider areas that may be applicable to their circumstances. The reader is invited to contact Johan Kotze to discuss their specific concerns and, for that matter, any other tax concerns.

As always, the tax cases are of interest, but which may be of specific interest is the Zimbabwean case dealing with employees of taxpayer schools who did not pay the same amount of school fees as other non-staff parents whose children were enrolled at the school.

The case of Wingate-Pearse is also useful, although it seems to deal with a narrow aspect as to the *onus* of proof and the duty to commence leading evidence, Judge Wallis deals with the difficult consept of the appealability against decisions.

Interpretation notes, rulings and guides are all important aspects of the developments that took place, as they give taxpayers an insight into SARS' application of specific provisions. It is however important to note that these publications are not law, but may bind SARS. Taxpayers should nonetheless consider these publications carefully to determine whether, and how, they are actually applicable to their own circumstances.

Enjoy reading on!

I am glad I learned in school about parallelograms instead of how to do tax. It's really come in handy this parallelogram season. (sic.)

2. REGULATIONS / GAZETTE

2.1. Duty to keep the records, books of account or documents in terms of section 29 of the Tax Administration Act

SCHEDULE

1. General

Any term or expression contained in this notice to which a meaning has been assigned in a 'tax Act' as defined in section 1 of the Tax Administration Act, 2011, has the meaning so assigned, unless the context indicates otherwise and the following terms have the following meaning—

'**connected person**' means a 'connected person' as defined in section 1 of the Income Tax Act, read with section 31(4) of the Income Tax Act;

'**potentially affected transaction**' means an 'affected transaction', as defined in section 31 of the Income Tax Act, without regard to paragraph *(b)* of the definition, but excludes any transaction, operation, scheme, agreement or understanding contemplated in section 31(5), (6) or (7) of the Income Tax Act;

'**tested party**' means the party to a potentially affected transaction that has been selected for the application of a transfer pricing method.

2. Persons required to keep specified records, books of account or documents

A person must keep the records specified in paragraph 3 and 4 if the person—

(a) has entered into a potentially affected transaction; and

(b) the aggregate of the person's potentially affected transactions for the year of assessment, without offsetting any potentially affected transactions against one another, exceeds or is reasonably expected to exceed R100 million.

3. Records, books of account or documents to be kept in respect of

structure and operations

A person referred to in paragraph 2 must keep the following records:

(a) A description of the person's ownership structure, with details of shares or ownership interest in excess of 10 per cent held by the person or therein by other persons as well as a description of all foreign connected persons with which that person is transacting and the details of the nature of the connection;

(b) The name, address of the principal office, legal form and jurisdiction of tax residence of each of the connected persons with which a potentially affected transaction has been entered into by the person; and

(c) The person's business operation summary, including—

(i) a description of the business (including the type of business, details of the specific business and external market conditions) and the plans for the principal trading operations (including the business strategy);

(ii) an organogram showing the title and location of the senior management team members;

(iii) major economic and legal issues affecting the profitability of the person and the industry;

(iv) a description of any business restructurings or intangibles transfers that the person has been affected by or involved in;

(v) the person's market share within the industry, analysis of relevant market competition environment and key competitors;

(vi) the key value drivers identified by available industry research findings or reports;

(vii) industry policy or industry incentives or restrictions affecting the person's business;

(viii) the role of the person, as well as the connected persons referred to in subparagraph *(b)*, in the group's supply chain.

4. Records, books of account or documents to be kept in respect of transactions

A person referred to in paragraph 2 must keep the following records in respect of any potentially affected transaction that exceeds or is reasonably expected to exceed R5 million in value:

(a) The nature and terms (including pricing policy) of the potentially affected transactions entered into by the person with each connected person;

(b) Copies of any contracts or agreements related to the potentially affected transactions entered into by the person with each connected person, if such contracts or agreements were prepared in the ordinary course of business;

(c) Any other governance and regulatory documents, such as complete board minutes and South African Reserve Bank applications and approvals, relevant to the potentially affected transactions;

(d) An indication of which party to the potentially affected transaction is the tested party, if applicable, and an explanation of the reasons for the party's selection;

(e) With respect to the tested party—

(i) a detailed allocation of revenues, costs, expenses and profits between its connected person transactions and independent person transactions, including records of the application of the transfer pricing policy and documents showing how the financial data used in applying the transfer pricing method reconciles to the annual financial statements; or

(ii) If the financial data for the purposes of subparagraph (*i*) cannot be directly allocated, an explanation supporting the allocation rationale and documentation that demonstrates how the allocation was carried out;

(f) Where a tested party is tax resident outside the Republic, such documents as evidence the functional and risk classification of the tested party, which include—

(i) a description of the business (including the type of business, details of the specific business, an organogram showing the title and location of staff involved in the affected transaction and external market conditions) and the plans for the principal trading operations (including the business strategy);

(ii) contracts between the tested party and its customers and suppliers; and

(iii) commercial invoices between the tested party and its customers and suppliers; that are relevant to the potentially affected transaction;

(g) A description of the functions performed, risks assumed and assets employed by the person and the connected persons involved in the potentially affected transaction;

(h) A description of the intangible assets involved in the potentially affected transaction, and their influence on the functional and risk classification of the tested party;

(i) Operational flows including information flow, product flow, and cash flow of the potentially affected transactions;

(j) The comparable data and methods considered and used for determining the arm's length return and the analysis performed to determine the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, in respect of the potentially affected transactions, including:

(i) A list and description of selected comparable uncontrolled transactions (internal or external), if any, and information on relevant financial indicators for independent enterprises, if any, relied on in the analysis, including a description of the comparable search methodology;

(ii) Summary schedules of relevant financial data for any other comparables used in the analysis and the sources from which the data was obtained;

(iii) If relevant, an explanation of the reasons for performing a multi-year analysis;

(iv) Any comparability adjustments made and the reasons for making such adjustments;

(k) The assumptions, strategies, policies and price negotiations, if any, that influenced the determination of the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, in respect of the potentially affected transactions;

(l) Details of the adjustments, if any, made to transfer prices to align them with the arm's length return determined under section 31(2) of the Income Tax Act and consequent adjustment made to the total income or expenses for tax purposes;

(m) With respect to potentially affected transactions that are financial assistance transactions, the following records:

(i) A summary of financial forecasts which are contemporaneous with the financial assistance transactions in question, projected as far as is meaningful in relation to the period of the funding transactions, including a clear picture of the expected levels of interest cover, gearing or other relevant measures over the forecast period;

(ii) An analysis of the financial strategy of the business, including how capital is allocated and the relationship between capital and cash flows from operations and any changes relating to the financial assistance transactions and details regarding principal cash flows and the sources of repayment of debt;

(n) With respect to potentially affected transactions that are financial assistance transactions with a term exceeding 12 months, the following additional records:

(i) A description of the funding structure which has been or is in the process of being put in place, including the dates of transactions, a clear statement of the source of the funds (immediate and ultimate), reasons for obtaining the funds, how the funds were or will be applied (the purpose of the financial assistance) and the repayment terms;

(ii) A group structure covering all relevant companies and clearly setting out any changes to the structure taking place over the course of the financial assistance transactions;

(iii) Copies of the financial statements and management accounts prepared most recently before the point in time the financial assistance is obtained and after the financial assistance has been granted; and

(o) Copies of existing unilateral, bilateral and multilateral advance pricing agreements and other tax rulings to which SARS is not a party and which are related to the potentially affected transactions.

5. Persons otherwise required to keep records, books of account or documents

If a person has entered into a potentially affected transaction and paragraph 4 does not apply to the potentially affected transaction, the person must keep the records, books of account or documents that enable the person to ensure and SARS to be satisfied that the potentially affected transaction is conducted at arm's length.

6. Records kept by connected persons

Where the records, books of account or documents required to be kept in terms of paragraphs 4 and 5 are kept in the ordinary course of business by a connected person, a person will comply with the requirement to keep the records, books of account or documents provided the requirements under section 31 of the Tax Administration Act are met.

7. Alternative arrangements with SARS

Where a person reasonably expects to have a high volume of potentially affected transactions that fall under subparagraphs *(m)* and *(n)* of paragraph 4, SARS may agree to alternative records that the person must keep under one or both subparagraphs to enable the person to ensure and SARS to be satisfied that the potentially affected transactions are conducted at arm’s length.

2.2. *Publication of Explanatory Summary of the Tax Administration Laws Admendment Bill, 2016*

The Bill provides for the amendment of the:

- Income Tax Act:
  - so as to provide for delegation of a power to disclose certain information;
  - to provide for exemption from dividends tax of a dividend derived from a tax free investment;
  - to amend a Schedule to include a class of taxpayers as provisional taxpayers;
  - to amend a definition so as to include certain dividends;
  - to further regulate the manner of prescribing an effective date;
  - to further regulate the withholding of employees’ tax; and
  - to effect textual amendments;
- Value-Added Tax Act:
  - so as to amend provisions to align with the Special Economic Zones Act, 2014;
  - to amend provisions relating to acceptable documentary proof;
  - to reinsert a prescription period; and
  - to amend a Schedule;
- Mineral and Petroleum Resources Royalty (Administration) Act,
  - so as to provide greater alignment with the Fourth Schedule to the Income Tax Act, 1962; and
  - to make technical corrections;

- Tax Administration Act
    - so as to amend definitions;
    - to specify payment of monies to the National Revenue Fund;
    - to extend the term of office of the Tax Ombud;
    - to provide for appointment of the staff of the office of the Tax Ombud;
    - to broaden the mandate of the Tax Ombud;
    - to impose an obligation to provide reasons for not following non-binding recommendations by the Tax Ombud;
    - to provide for disclosure of certain approved organisations;
    - to extend the period for retention of records by SARS;
    - to extend a period of limitation;
    - to amend the provision for an additional assessment;
    - to extend a period within which to apply for a condonation of a late objection;
    - to amend the constitution of a tax court;
    - to narrow the application of a provision;
    - to add a definition and make provision for a penalty relating to an impermissible avoidance arrangement; and
    - to amend the provision for voluntary disclosure of a default;

3. DRAFT REGULATIONS

3.1. Income Tax Act: Publication of proposed regulations made in terms of section 12T(8) on the requirements for tax free

investment

SCHEDULE

Definitions

1. In these regulations, 'the Regulations' means the regulations published by Government Notice No. R 172 of 25 February 2015.

Amendment of regulation 4 of Regulations

2. The following regulation is hereby substituted for regulation 4 of the Regulations:

'4. (1) A product provider may not accept any amount in respect of any investor in respect of a tax free investment in excess of the amounts limited as contemplated in section 12T(4)*(a)* and *(c).*

(2) For the purposes of calculating the amounts contemplated in subregulation (1), the total amount of contributions in respect of the tax free investment from which the amount is being transferred—

(a) in respect of the year of assessment during which the amount is transferred for the purpose of section 12T(4)*(a)*; and

(b) (i) contemplated in paragraph *(a)*; and

(ii) contributed in years of assessment prior to the year of assessment contemplated in subparagraph (i),

for the purpose of section 12T(4)*(c)*;

must be taken into account as a contribution.'.

Amendment of regulation 6 of Regulations

3. Regulation 6 of the Regulations is hereby amended by the addition after subregulation (4) of the following subregulation:

'(5) If a tax-free investment consists of an investment with a fixed term and a guaranteed return the product provider must disclose to the investor prior to investing in that tax free investment that the return of that tax free investment shall be calculated be calculated in accordance with the formula:

$$X = A^B - C$$

in which formula—

(a) 'X' represents the amount to be determined

(b) 'A' represents an amount determined in accordance with the formula:

$$Y = E + (F - G)/G$$

in which formula—

(i) 'Y' represents the amount to be determined;

(ii) 'E' represents the number 1;

(iii) 'F' represents an amount equal to the value of the tax free investment at the expiry of the fixed term;

(iv) 'G' represents an amount equal to the value of the tax free investment at the commencement of the fixed term;

(vi) 'B' represents an amount determined in accordance with the formula:

$$Z = H/I$$

in which formula—

(aa) 'Z' represents the amount to be determined;

(bb) 'H' represents the number 1; and

(cc) 'I' represents the number of years to maturity of the tax free investment.

(c) 'C' represents the number 1

Amendment of regulation 8 of Regulations

4. Regulation 8 of the Regulations is hereby substituted for the following regulation:

'8. Any amount in respect of a tax free investment—

(a) that has a maturity date must be paid to an investor by any product provider within seven business days after that investor requests that payment or within seven business days after that maturity date; or

(b) other than a tax free investment that has a maturity date, must be payable within seven business days after that investor requests that payment to an investor by any product provider.'.

Amendment of regulation 9 of the Regulations

5. The Regulations are hereby amended by the substitution for regulation 9 of the following regulations:

'Transfers by product providers

9A. (1) Subject to subregulation (2), a product provider must transfer the amount in cash or assets other than cash in respect of a tax free investment to another tax free investment of that investor administered by another product provider on or after 1 March 2017—

(a) if that tax free investment has a maturity date, within ten business days after that investor requests that transfer or within ten business days after that maturity date; or

(b) other than a tax free investment that has a maturity date, within ten business days after that investor requests that transfer.

(2) Despite subregulation (1) a product provider is not obliged to transfer any amount in respect of a tax free investment in respect of the same natural person more than twice a year.

(3) A product provider that is unable to transfer any amount in respect of a tax free investment to another product provider after receipt of an instruction by an investor to transfer that amount may not administer any tax free investment.

Product providers may refuse to accept certain transfers

9B. A product provider may refuse to accept any transfer contemplated in regulation 9A(1) in respect of any amount in respect of a tax free investment if that transfer does not conform to the requirements of the tax free investment which the product provider to whom the amount is transferred applies to that tax free investment.

Transfer certificates

9C. (1) A product provider that transfers an amount as contemplated in regulation 9A(1) must issue a certificate that contains the particulars stipulated in subregulation (4) when transferring that amount.

(2) A product provider that issues a certificate referred to in subregulation (1) must provide a copy of that certificate, on the date that certificate is issued, to—

(a) the investor; and

(b) the product provider to whom the amount is transferred.

(3) A product provider that issues a certificate referred to in subregulation (1), the investor and the product provider to whom the amount is transferred must respectively retain a copy of that certificate for a period of five years commencing at the end of the year of assessment in which that certificate is issued.

(4) The certificate referred to in subregulation (1) must contain—

(a) the name and identity number, passport number or tax reference number of the investor;

(b) (i) the amount in cash that is transferred; or

(ii) the market value of any assets in respect of the tax free investment where the amount is transferred in respect of an asset other than cash,

on the date that the cash or asset is transferred;

(c) the date on which the amount is transferred;

(d) the name, registration number and tax reference number of the product provider that transfers the amount;

(e) the name, registration number and tax reference number of the product provider that receives the amount;

(f) the total amount of contributions in respect of the tax free investment from which the amount is being transferred in respect of the year of assessment during which the amount is transferred;

(g) the total amount of contributions in respect of the tax free investment from which the amount is being transferred in respect of the years of assessment prior to the years of assessment during which the amount is transferred;

(h) the words 'transfer of tax free savings account';

(i) a description of assets in respect of the tax free investment where the amount is transferred in respect of an asset other than cash; and

(i) the number of assets transferred in respect of an asset other than cash.'.

Insertion of regulation 10A in Regulations

6. The following regulation is hereby inserted in the Regulations after regulation 10 of the Regulations:

'Restriction on maturity date

10A. A product provider may not offer any tax free investment with a fixed term of which the maturity date occurs more than five years after the date that the investment commences.'.

Amendment of Regulation 12 of the Regulations

7. Regulation 12 of the Regulations is hereby amended—

(a) by the deletion of paragraph *(b)*; and

(b) by the substitution in paragraph *(c)* for the words preceding the formula of the following words:

'in the case of a tax free investment with a fixed term with no guaranteed return, subject to regulation 10A, an amount that must be determined in accordance with the formula:'

Insertion of regulation 14A in Regulations

8. The following regulation is hereby inserted in the Regulations after regulation 14:

'Fees must be recovered from tax free investment

14A. A product provider may not recover the amount of any fee in respect of a tax free investment in a manner other than recovering the amount from that tax free investment.'.

Insertion of regulation 16A in Regulations

9. The following regulation is hereby inserted after regulation 16 of the Regulations:

'Tax free investment with underlying performance fees not allowed

16A. A product provider may not offer an investment as a tax free investment if any fee expressed as the value of an investment is directly or indirectly commensurate with or linked to an amount received or accrued from an amount invested by the product provider with a person other than that product provider.'.

Substitution of Parts IX and X of Regulations

10. The Regulations are hereby amended by the substitution for Parts IX and X of the following parts:

'PART IX

Compliance with regulations

Product provider must possess operational and management capabilities

17. A product provider must at all times possess the necessary operational management capabilities to administer a tax free investment in accordance with these Regulations.

Submission of documents by service provider

18. A product provider must, at least one month prior to advertising or allowing members of the public to invest in a tax free investment, submit to the Financial Services Board—

(a) the date from which the tax free investment will be advertised or members of the public will be allowed to invest therein;

(b) the name of the tax free investment;

(c) the nature of the tax free investment;

(d) the legislation under which the tax free investment will be issued together with a confirmation that the tax free investment meets any requirements of that legislation;

(e) a summary of the benefits, terms and conditions and marketing material of the tax free investment; and

(f) a description of how the tax free investment meets the requirements of these Regulations.

Objection of Registrar to implementation of tax free investment

19. Where the Registrar, as contemplated in section 12T(9), of the Income Tax Act objects to the intended implementation of a tax free investment contemplated in paragraph *(a)*, the product provider may not implement the intended tax free investment until such time as the grounds for the objection has been resolved to the satisfaction of the Registrar.

Powers of Registrar if tax free investment fails to comply with regulations or legislation

20. If a tax free investment does not comply with these Regulations or any legislation applicable to that tax free investment, the Registrar, as contemplated in section 12T(9), of the Income Tax Act, may, notwithstanding paragraph *(b)* not having been applied by the Registrar, require any product provider to –

(a) cease advertising the tax free investment; or

(b) cease inviting members of the general public to invest in the tax free investment; and

(c) (i) within 90-days of a date determined by the Registrar terminate any existing tax free investments; or

(ii) by a date determined by the Registrar, amend any of the benefits, terms and conditions and marketing material of the tax free investment in accordance with the requirements of the Registrar.

Part X

Non-compliance with regulations

Non-compliance with regulations

21. Any financial instrument or policy that does not comply with these regulations is not a tax free investment for the purposes of section 12T of the Income Tax Act.

PART XI

Miscellaneous

Short title and commencement

22. These regulations are called the Regulations in terms of section 121(8) of the Income Tax Act, 1962, on the requirements for tax free investments and come into operation on 1 March 2015.

Commencement

11. These regulations come into operation on 1 March 2017.

4. CASE LAW

4.1. ITC 1885

Taxpayers were six private senior schools operating in Zimbabwe in terms of their respective trust deeds.

The second to fourth taxpayers also operated primary schools which were jointly administered with the high schools.

In each appeal and each school certain employees of these schools had their children enrolled at the schools where they worked or at other schools which had mutual agreements with the school at which they were members of staff.

In terms of the aforementioned arrangements the employees of the taxpayer schools, whose children were enrolled at these schools, did not pay the same amount of school fees as other non-staff parents whose children were enrolled at the school and these children were spread across the schools where they were enrolled in various classes.

The aforementioned employees, in either case, were charged by the schools at a rate of between 20% and 25% of the full fees and no taxes were paid on the difference between those fees charged and the full fees payable by other non-staff parents.

The employee parents, like all other non-staff parents, provided all other school items that were not provided by the schools.

Schools asserted that some of their costs were not affected by and did not vary because of the addition of children of staff members and they termed them non-variable costs, including teacher and other employee salaries as well as the capital costs of the buildings and moveable assets such as motor vehicles and buses, the costs related to the repairs and maintenance of buildings and other facilities at each school, and in none of the schools was the salary paid to any teacher dependent on the number of pupils actually taught. Moreover, no additional staff was employed as a consequence of the pupil sponsoring schemes.

Schools also asserted that there were some costs, i.e. variable costs, incurred by the schools which were affected by the addition of children of staff members and these comprised stationery and book costs and certain food costs.

Respondent, being the Zimbabwe Revenue Authority (ZRA), contended that the difference between the amount of the fees paid by the employee parents to the schools and the full fees payable at the schools was an advantage or benefit in terms of section 8(1)(*f*) of the Income Tax Act [*Chapter 23:06*] enjoyed by the employee parents arising from their employment relationship with the appellants that fell to be taxed in the relevant period.

ZRA also asserted that the cost of the benefit to the schools in respect of each benefiting child was the same as the costs of every other pupil at the school and had assessed the schools to tax on the basis that the advantage or benefit claimed by ZRA was equivalent to the waived amount.

ZRA had raised and issued tax assessments against the schools in terms of par. 10 of the Thirteenth Schedule to the Income Tax Act for taxes that were alleged to be due from the employee parents and which ZRA had asserted the schools were obliged to pay but had failed to withhold from the incomes of the concerned employee parents.

Schools had disputed the aforementioned assertions and appealed to the Special Court for Income Tax Appeal against the various decisions of the ZRA to disallow their objections.

Schools had disputed both the obligation asserted by ZRA and the application of the legislation in the manner invoked by ZRA, i.e. that ZRA had wrongly valued the benefits in kind received by the employees and they had accordingly objected to the tax assessments in terms of the law.

Schools' professional association had, on 12 October 2011, written to ZRA seeking written guidance on the correct tax treatment of the school fees benefit accruing to their employees and the guidance from RA was based on section 8(1)(*f*) of the Income Tax Act to the effect that the use of any educational and boarding facilities of any of the association affiliated schools by the children of these employees constituted a section 8(1)(*f*) benefit equivalent to the waived amount.

It was common cause that all the schools were non-profit making organisations whose anticipated costs of providing education were derived solely from prospective school fees income. The school fees income was disparately computed between full fee and concessionary paying pupils based on anticipated the non-variable and variable costs of providing education to all these pupils.

The schools had categorised their running expenses into non-variable and variable costs on the basis of their respective accounting policies which, *inter alia*, placed the burden of funding non-variable costs on full fee paying students as long as the maximum enrolment threshold of each school was not breached.

The issues for determination before the court were:

- Whether each employee parent whose children were educated at any of these schools at either a lesser cost than charged to other parents or at a notional cost had received an advantage or benefit as defined in section 8(1)(*f*) of the Income Tax Act subject to the deduction of pay-as-you-earn by each appellant;
- If so, the computation of the value of such an advantage or benefit, that is whether or not it was equivalent to the waived amount;
- Whether ZRA was correct to add back the waived amount into gross income and assess pay-as-you-earn on the aggregate amount.

The court's essential determination, therefore, was whether or not the waived amounts were an advantage or benefit and, if so, how the advantage or benefit was to be computed.

It was common cause that, in terms of sub-par. (1) of par. 3 of the Thirteenth Schedule to the Income Tax Act, each of the schools were employers obligated by law to deduct pay-as-you-earn in respect of benefits forming part of the gross income of their employees, but they did not deduct and remit the full extent of the tax due on the benefit and had rendered themselves liable to make payment in terms of par. 10 of the Thirteenth Schedule to the Act.

The parties had disagreed on what the cost to the employer in respect of the advantage or benefit of paying the concessionary school fees was and the six schools had produced financial statements for each tax year in which they had apportioned costs under two major headings styled non-variable and variable costs. The non-variable or basic costs were divided into six sub-heads of administration, staff, educational, motor vehicles and maintenance while the variable or additional costs were lumped together under a separate subheading of educational and under each sub-head were listed detailed lines of expenditure.

ZRA did not dispute the accuracy of the computations but, rather, it had consistently attacked the legal basis for the apportionment of expenditure into non-variable and variable costs throughout the audit, in the determination of the objection, in the appeal pleadings and in both written and oral heads of argument.

The basis for the apportionment advanced by all the schools was simply that they had crafted their budgets against the backdrop of the full fee paying pupils and the schools were all non-profit making organisations.

In regard to the second and third schools, some of the employees of these two schools had children enrolled at the other school at the concessionary rates offered by the other school and ZRA had taxed the two schools based on the waived amounts availed by the two schools to those employees whose children were enrolled by the schools rather than on the waived amount of the enrolling school and a total of 77 children were involved in this category.

Judge Kudya held the following:

Whether parents in question had received an advantage or benefit as defined in s 8(1)(f)

(i) That the definition of gross income denoted a positive aspect on the one hand and a notional aspect on the other. The positive aspect involved the actual receipt or accrual while the notional aspect deemed such receipt or accrual to be income.

(ii) That the waived amount of the school fees had not been physically received but was deemed to have been received by each affected employee and the amounts in question positively accrued to each employee on enrolment of each child at each of the participating schools. Moreover, it was common cause that the waived amount was regarded by all the schools as a benefit or advantage.

(iii) That all the schools had admitted that the payment of the concessionary fees was a benefit enjoyed by the affected staff members and they had received the benefit by virtue of their status as employees at these schools. In the present matter the right to have children educated at the concessionary rate had derived from employment and it vested in each employee parent and had accrued to him in the year of assessment and was capable of being turned into money, i.e. the right had an ascertainable money value equivalent to the waived amount.

(iv) That the employees in this case obtained the benefit of paying less fees than other parents only because they rendered service to the schools. There was therefore a causal *nexus* between the contract of employment and the benefit, i.e. if it had not been for the employment of their labour, service or wits, they would not be entitled to this benefit. The ordinary and grammatical meaning of the word 'income' therefore included the right which these employees obtained to educate their children at these and other schools at a concessionary fee.

(iv) That the children paid between 20% and 25% of the fees paid by other children whose parents were not employed at these schools and the waived amount was between 75% and 80% of the normal school fees and had an ascertainable monetary value. At the very least it was money notionally received by or at best money that actually accrued to or was in favour of each employee parent by virtue of employment and it clearly fitted into the opening words of section 8(1) of the Income Tax Act and the appeal would fail on this ground.

(v) That the benefit in the present matter was also caught in the tax net by the provisions of section 8(1)(*b*) of the Income Tax Act which provided that any amount so received or accrued in respect of services rendered or to be rendered, whether due and payable under any contract of employment or service or not, and any amount so received or accrued by reason of the cessation of the employment or service of a person other than a benefit (not being a pension or gratuity) received or accrued by reason of contributions made to the Consolidated Revenue Fund are included in gross income and, in the present matter, the waived amount accrued to each of the affected employees on enrolment of their children at each of the participating schools and, consequently, it was on that basis correctly added back to each employee's gross income and assessed for pay-as-you-earn.

(vi) That the right to education at concessionary rates constituted incorporeal property that was used or enjoyed by these children at these schools and it had a monetary value. It was a personal right possessed by the employee and it was capable of enforcement. That the right was intrinsically transferable was underscored by the determined efforts of the schools to prohibit such transfer to other parents. The waived amount would be disqualified for inclusion in gross income had it been utilised in the business operations of the schools or had the employee made any contributions in respect of its grant.

(vii) That, *in casu*, the schools were actually denied use of the monetary value of the waived amounts, nor did any employee pay any amount in respect of its grant and it was therefore not utilised in the business transactions of each school. Viewed from a functional perspective, the waived amounts met the requirements of subpar. (*f*)I(iv) of section 8(1) of the Income Tax Act and constituted an advantage or benefit.

(viii) That the advantage or benefit advanced to the parent employee of paying concessionary fees constituted an amount which accrued to the employee parent and warranted inclusion in his or her gross income. Accordingly, each employee whose children were educated at either a lesser cost than charged to other parents or at a notional cost had received an advantage or benefit as defined in section 8(1)(*f*) of the Income Tax Act which was subject to the deduction of pay-as-you-earn by each school.

As to the computation of the value of such an advantage or benefit

(ix) That the second issue referred to trial was whether the computation of the value of such an advantage or benefit was equivalent to the waived amount and the determination of this issue only arose in respect of a tax liability founded on the provisions of section 8(1)(*f*) of the Income Tax Act. In other words, the issue would not arise in respect of liability based on the main charging portion of s 8(1) or 8(1)(*b*) of the Act.

(x) That it was trite law that all accounting practices, procedures, policies and preferences played second fiddle to the tax legislation in force in any given year of assessment and the distinction between non-variable and variable costs sought by the schools had no force of law in this country and that was laid down by Squires J in *ITC 1336* (1981) 43 SATC 114 at 117. Moreover, the reasoning of the learned judge was unassailable and applied, *mutatis* *mutandis*, with equal force to each of these six appeals.

(xi) That, as this appeal was dismissed on the basis of both the opening words in section 8(1) and section 8(1)(*b*), the method of computation applied by ZRA in arriving at the value of the amount that accrued to the employee parents that was susceptible to inclusion in the gross income of each employee for payment of pay-as-you-earn was the difference between what was paid by full fee paying students and what each of these students paid and, therefore, ZRA had correctly added back the waived amount to the gross income before assessing pay-as-you-earn on the aggregate amount.

As to the pay-as-you-earn liability of second and third appellants

(xii) That some of the employees of the second and third schools had children enrolled at the other school at the concessionary rates offered by the other school and ZRA had taxed the two schools based on the waived amounts availed by the two schools to those employees whose children were enrolled by the schools rather than on the waived amount of the enrolling school and a total of 77 children were involved.

(xiii) That the employees under consideration were not employees of the enrolling schools but they received the benefit from the enrolling school by virtue of the agreement between their employer and the enrolling school. It seemed that section 8(1)(*f*) applied to these employees in that they received the value of the advantage or benefit by virtue of their employment not with the enrolling school whose property their children enjoyed but with the schools who executed these mutual agreements for these employees' benefit.

(xiv) That the schools concerned were caught in ZRA's tax net by the closing words 'granted to an employee, his spouse or child by or on behalf of his employer' perched at the tail end of s 8(1)(*f*)I(*a*). These benefits were granted to these employees by each of the schools on behalf of the other schools, respectively. Consequently, as the value of the advantage or benefit that accrued to each employee was made on behalf of his or her employer, it must be taxed in the hands of that employer.

(xv) That, however, ZRA had wrongly assessed the value of the benefit in respect of these children as equivalent to the amount waived by each employee parent's employer and he should have assessed the benefit on the amount waived by the school at which these children attended.

(xvi) That, in line with the court's earlier findings on the computation of the value of the benefit, it would be equivalent to the *pro rata* share paid by each student at the enrolling school in each tax year calculated by dividing the total costs incurred by the school by all the children enrolled at the school, inclusive of all concessionary fee beneficiaries, less the concessionary fees paid.

(xvii) That, by virtue of the agreement executed between the two schools, which initiated the benefit, the benefit is known and is payable by the employee and each employee's pay-as-you-earn is administered by his own employer, the outstanding pay-as-you-earn in question should for convenience and ease of administration be assessed in the hands of his or her employer. While ZRA had correctly found the employee parents of these 77 children liable for pay-as-you-earn, he had erroneously assessed it on the amount waived by each parent's own employer.

As to costs

(xviii) That the claims made by ZRA were not unreasonable nor were the grounds of appeal frivolous. The appeal was not allowed in full or to a substantial degree as would warrant an imposition of costs in favour of the second and third schools on the issue raised in argument on the correct computation of the waived amount to be included in the gross income of the parent employees of the 77 children and, consequently, the imposition of costs as against either the schools or ZRA was not warranted.

4.2. ITC 1886

The taxpayer, a producer of ferrochrome, and who was ordinarily resident in Zimbabwe, had entered into an agreement with the Minerals Marketing Corporation of Zimbabwe ('MMCZ') and an entity known as Centachrome, a 'sub-agent' based in Switzerland, whereby Centachrome was supposed to facilitate the selling of ferrochrome produced by the taxpayer, but sold through the MMCZ, in terms of the Minerals Marketing Corporation of Zimbabwe Act [*Chapter 21:04*] which required that all minerals mined in Zimbabwe had to be marketed by and through MMCZ.

The Zimbabwe Revenue Authority (ZRA) had made a ruling that the taxpayer was obliged to withhold and remit non-residents' tax on fees that had been paid to the entity known as Centachrome, the agent based in Switzerland.

The taxpayer had thereafter written to ZRA to object to the ruling and ZRA, while disallowing the objection, had reduced the penalty to 60% from the initial 100% that had been imposed.

The taxpayer then noted an appeal to the Special Court for Fiscal Appeals, on the following grounds:

- The appointment of Centachrome as a 'sub-agent' in the aforesaid agreement had the effect of making it an agent of MMCZ and not an agent of the taxpayer;
- The taxpayer was not obliged to pay withholding non-residents' tax since the money paid to Centachrome constituted commission and was not fees as defined in the 17th Schedule to the Income Tax Act [*Chapter 23:06*].
- The money paid to Centachrome was not derived from a source within Zimbabwe as stipulated in the 17th Schedule to the Act.

ZRA contended that the money paid by the taxpayer to Centachrome was indeed commission for the services rendered and such amounts constituted fees in terms of Schedule 17 of the Act and, in the premises, the taxpayer was obliged to withhold non-residents' tax on them.

The Non-residents' tax on fees ('NRTF') provided for in the 17th Schedule to the Act provided that a non-resident recipient of fees from a source in Zimbabwe may be liable to income tax in Zimbabwe on such fees and, in such cases, the NRTF withheld is allowed as a credit against income tax chargeable.

Judge Hlatshwayo held the following:

<u>As to the determination of the agency arrangement</u>

(i) That while the preamble to the agreement between the parties created the impression that Centachrome was the agent of the MMCZ, the rest of the agreement and the facts on the ground clearly showed that the taxpayer was the real principal for Centachrome and the MMCZ only appeared as principal to fulfil the requirements of the law on the sale of minerals, and nothing more.

(ii) That the taxpayer was ultimately responsible for the payment of Centachrome's commission from the proceeds of its chrome and, in terms of the Process Flow Chart, the payment confirmation was sent directly to the taxpayer and only copied to MMCZ.

As to whether commission paid constituted 'fees'

(iii) That, in resolving this dispute, one need look no further than to Schedule 17 of the Act which defines 'fees' as meaning 'any amount from a source within Zimbabwe payable in respect of any services of a technical, managerial, administrative or consultative nature . . .'

(iv) That, from the aforementioned definition, it was clear that the legislature intended 'fees' to cover any sum of money, however described, paid for services rendered of a technical, managerial, administrative or consultative nature, save for those that were expressly excluded and, accordingly, ZRA was correct in its interpretation of the words 'any amount' to include commission.

(iv) That, as far as the method of payment was concerned, fees were deemed to have been paid to the payee if they 'are credited to his account or so dealt with that the conditions under which he is entitled to them are fulfilled whichever occurs first.'

(v) That, accordingly, the fees in question could be held to have been directly paid to Centachrome, or, at the very least, are deemed to have been so paid by the taxpayer.

As to the source of the commission

(vi) That the facts in this case were distinguishable from those in *Sunfresh Enterprises (Pvt) Ltd t/a Bulembi Safaris* v *Zimra* 2004 (1) ZLR 506 (H) as, *in casu*, the taxpayer clearly qualified as the 'payer', i.e. 'any person who or partnership which pays or is responsible for the payment of fees' and was ordinarily resident in Zimbabwe whereas in *Sunfresh* the payment of fees or commission was ostensibly done by foreign clients to a foreign marketing agent.

As to penalties

(vii) That ZRA had indicated that it had taken into account the relevant mitigating factors in arriving at the partial reduction of the penalty and that its decision was in line with previous cases of a similar nature. Moreover, the court was not referred to any authorities to justify interference with the discretion exercised by the respondent.

Appeal dismissed with costs.

4.3. ITC 1887

The taxpayer was the operating company of the X Fishing Group which operated as owners and charterers of fishing vessels and producers and wholesalers of fresh and frozen fish products.

The taxpayer had been an owner and/or charterer of fishing vessels for thirty-five years and had operated twenty-five deep sea fishing vessels which had operated year-round at maximum output and could fish for up to eighteen hours a day and this contributed to the vessels having to be continuously repaired.

The taxpayer's fishing vessels were initially repaired by outside engineering contractors but over time the taxpayer developed its own in-house facilities to assist with the repair of its fishing vessels in keeping with industry norms and this proved to be more efficient and cost-effective.

The taxpayer's engineering and repair workshops were situated at its premises and the engineering division included physical infrastructure and employees equipped with the skills necessary to carry out vessel repairs.

The primary task of the engineering division was the repair and maintenance of the taxpayer's fleet of fishing vessels and the engineering division operated at full capacity year-round as there were always vessels in port that required repairs.

In order to calculate the cost of the in-house repairs done by it, the taxpayer worked out standard engineering charge-out rates and these rates were calculated with effect from 1 July of each year and specific rates were set for different categories of persons employed in the engineering division.

The taxpayer, in order to arrive at these charge-out rates, took into account the costs incurred by or associated with its engineering division and these costs included the proportion of the rental paid by the taxpayer to its landlord, the electricity, water and similar associated costs incurred by the engineering division, the costs of repairing and maintaining the workshops and the equipment situated therein and all the salary and associated costs of the staff employed in the engineering division.

The sole issue for determination in the case was whether the allocation by the taxpayer of the charge-out rates applicable to internal repairs by its engineering division would constitute '*expenditure . . . on repairs to any ship*' for the purposes of calculating the allowance referred to in section 14(1)(*c*) of the Income Tax Act in respect of the taxpayer's 2011 year of assessment or, in other words, was the taxpayer, as a matter of law, precluded from taking into account as part of its future estimate of expenditure the estimated cost of effecting future repairs through its own in-house repair facilities (such costs being the taxpayer's workshop infrastructure and operating costs, which in turn included the costs of employment attributable to those facilities) to the extent that such future repairs would be conducted utilising those facilities, as the taxpayer contended that it was entitled to do.

Section 14(1)(*c*) of the Act was applicable to the taxpayer's 2011 year of assessment and provided at the relevant time that a resident who carried on business as owner or charterer of a ship would be allowed a deduction in respect of any expenditure which such person satisfied SARS he was likely to incur within five years from the end of the year of assessment in question on repairs to any ship used by him for the purpose of his trade, such allowance as SARS, having regard to the estimated cost of such repairs and the date on which they were likely to be incurred, may grant each year, provided that any such allowance in respect of any year of assessment had to be included in the income of the taxpayer for the following year of assessment.

The evidence revealed that each employee in the engineering division compiled a worksheet each day which recorded the type of repair and the time which he spent on each vessel. The taxpayer's accounts department then utilised the work sheets together with the charge-out rate sheet in order to calculate the cost of the repairs which were done to each vessel by its engineering division.

The taxpayer kept separate ledger accounts for each vessel and each ledger account for each vessel recorded both the cost of repairs which were done by its engineering division as well as the cost of repairs effected by third parties and, at the end of each year, and with reference to each ledger account for each vessel, it was possible to assess the total costs incurred by it on repairs for each such vessel.

The aforementioned costs had two components: the costs of the in-house engineering division and the costs paid to third parties and in order to calculate the section 14(1)(*c*) estimate in respect of future expenditure to be incurred during the forthcoming five years on repairs to the taxpayer's vessels, the methodology adopted in 2011 was the same methodology which had been used for the previous sixteen years, i.e. utilising a standard framework that identified the major components of each of the fishing vessels and the estimated costs were then allocated in respect of each of these components on a year-by-year basis.

The taxpayer, when calculating its section 14(1)(*c*) deduction, drew no express distinction between what it regarded as the cost of the anticipated repairs which would be attributable to its engineering division and those which would be attributable to third parties.

SARS had, prior to his audit of the 2010 and 2011 years of assessment, never objected to the aforementioned methodology or the estimated amounts which the taxpayer produced for purposes of determining the allowance claimed, notwithstanding that the estimated repairs may be done either in house by the taxpayer's engineering division or by third parties and SARS did not subject the taxpayer to an adverse assessment in regard to those claims.

Although SARS had allowed the taxpayer's section 14(1)(*c*) allowance for the 2010 year of assessment in its entirety, he had disallowed in its entirety the taxpayer's section 14(1)(*c*) allowance for the 2011 year.

SARS did not dispute that the taxpayer envisaged carrying out 'repairs' to its ships in the succeeding five years and that it actually and reasonably envisaged spending the amounts on which the allowance was calculated in connection with those repairs.

The narrow question in issue was merely whether any costs which were projected to be incurred in regard to the in-house salary or wage costs of persons employed for purposes of conducting the repairs, and the other costs incurred to support the taxpayer's in-house engineering infrastructure constituted '*expenditure . . . on repairs to any ship*' for purposes of section 14(1)(*c*) of the Act.

SARS contended, *inter alia*, that the attribution of the 'charge-out rates' to the repairs effected by the taxpayer internally represented notional expenditure which was not deductible at all and, once the inter-relationship between sections 11(*a*), 11(*d*) and 14(1)(*c*) is understood, it became clear that certain types of expenditure are deductible only under section 11(*a*) whereas others are deductible only under some other specific provisions of the Act.

SARS had accepted that amounts envisaged to be paid to third party contractors or external service providers or suppliers in conducting or assisting with repairs to the taxpayer's vessels constituted '*expenditure . . . on repairs to any ship*.'

Judge Dlodlo held the following:

(i) That in truth section 14(1)(*c*) of the Act empowered SARS to exercise a discretion in granting an allowance based on the expenditure which he was satisfied that the taxpayer was likely to incur in the next five years on repairs to any ship used by the taxpayer for the purposes of its trade.

(ii) That SARS' decision was, however, made subject to objection and appeal in terms of section 3(4)(*b*) of the Income Tax Act 58 of 1962 and this in effect meant that the court was empowered to stand in the shoes of SARS and to exercise the same discretion *de novo* and substitute its own decision for that of SARS and the matter proceeded by way of an appeal rather than a review notwithstanding the fact that SARS' decision in terms of section 14(1)(*c*) constituted the exercise of a discretionary power.

(iii) That, therefore, for present purposes, the key question pertained to the framework within which the discretion was to be exercised and, more particularly, the question was rather whether the expenditure which the taxpayer envisaged incurring on its engineering division in the five succeeding years was 'any expenditure . . . on repairs to any ship for the purposes of his trade . . .'

(iv) That expenditure, ordinarily, on repairs is indeed where a taxpayer contracts with another person or an entity to repair something and incurs expenditure on repairs by agreeing to pay the other party for effecting the repairs and this would also include the purchase of parts that will be used by the taxpayer to repair its own assets.

(iv) That the purpose of section 14(1)(*c*) is rather to grant an allowance in respect of estimated future '*expenditure on repairs to any ship used for the purposes of trade*' in the form of (*a*) expenditures that will be paid to third parties to effect repairs to the taxpayer's ships and (*b*) expenditure on parts to be purchased for use in repairing the taxpayer's ships. At the same time the section 14(1)(*c*) allowance accords favourable tax treatment to owners and charterers of ships which was not available to taxpayers generally in the form of an allowance in respect of estimated future expenditure and of course this is a class privilege and the question is how must section 14(1)(*c*) be construed.

(v) That there was a marked difference between section 14(1)(*c*) of the Act and section 11(*a*) and (*d*) thereof. Section 14(1)(*c*) did not deal with and had no impact on the deduction of actual expenditure incurred in the actual tax year in question as it was and remains an allowance which is permitted to be deducted in the current year of assessment with reference exclusively to estimated expenditure likely to be incurred in future years.

(vi) That it was of importance to remain aware that the section 14(1)(*c*) deduction allowed in one year was reversed in the next year and, therefore, if the taxpayer's projection of expenditure likely to be incurred in the next five years is identical to that on which the last year's allowance was based, the taxpayer will be in a neutral position in that year by operation of section 14(1)(*c*). It is also in that year that the actual taxable income for that year is calculated and it is in that year that various deductions under section 11 are dealt with.

(vii) That the words of section 14(1)(*c*) were broad and inclusive and what may be taken into account was 'any expenditure . . . on repairs to a ship'. The word 'any' is a word of wide import and 'it may be restricted by the subject-matter of the context, but *prima facie* it is unlimited'. Moreover, the plain language of section 14(1)(*c*) warrants a non-restrictive approach towards the types of expenditure that may be taken into account in claiming the allowance.

(ix) That indeed there was a contextual limitation in section 14(1)(*c*) of the words 'any expenditure' in that such expenditure must be incurred 'on' repairs to a ship. However, no distinction is drawn in the section in relation to different types of 'expenditure' which may be incurred 'on the repairs' and 'repairs' is similarly a wide term, the meaning of which depended on the context in which it was used.

(x) That clearly the focus of the case law pertaining to what constituted a repair was on what conduct or activity amounted to a repair of an item of property and, obviously, the term was limited by the nature of the work done and the impact that work had on the property in question – more particularly whether the property was thereby merely returned to its previous state or whether it was improved. The court was unaware of an authority to the effect that 'expenditure incurred . . . on repairs' for purposes of either section 11(*d*) or section 14(1)(*c*) was limited by the nature of the expenditure.

(xi) That, therefore, in applying the ordinary language of the statute, there was no doubt that any expenditure incurred by a taxpayer primarily for purposes of effecting repairs of its own property was accommodated under the phrase 'any expenditure . . . on repairs', irrespective of whether it was paid to an employee or a third party.

(xii) That expenditure was and should be included if it bore a sufficiently close relationship or connection with anticipated repairs so as to be regarded as being expended ‘on’ those repairs rather than on something else.

(xiii) That amounts spent by a taxpayer in acquiring parts or materials from third parties to enable a repair to be conducted on a ship was ‘expenditure . . . on repairs’ of the ship and the same must be true of amounts spent in contracting with a third party to carry out the repair itself including the provisions of spare parts and it is a known practice that the third party will typically charge a fee which builds in the cost of both the materials and labour required to carry out the repair as well as general overheads and will add a profit margin.

(xiv) That there was no principle which differentiated external expenditure on repairs of the taxpayer’s vessels from ‘internal’ or in-house expenditure on such repairs and there was plainly no basis in the statutory language for such a distinction.

(xv) That expenditure incurred on the independent contractor is just as directly related to the repairs as expenditure incurred on an employee who would be dedicated entirely to carrying out repairs and there was no reason in principle why the two should carry different consequences for purposes of section 14(1)(*c*).

(xvi) That clearly the exclusion of the internal costs of employment would not meet the legislative purpose of allowing a deduction of what is expended on or in relation to repairs of assets. It could not be denied that the purpose of the legislature was to assist the ship-owning or chartering taxpayer with an allowance based on its anticipated future repair expenditure and there seemed to be no basis to even think that the legislature would have intended to deprive the taxpayer of this benefit simply because it invested in resources and facilities that would enable it to conduct the expected repairs itself in a rather more cost-effective way than by contracting third parties.

(xvii) That the approach adopted by the Commissioner would undoubtedly have the further unsatisfactory result that an entity such as the taxpayer which for good commercial reasons and to operate its business more efficiently, sets up an entire dedicated engineering division to enable it to carry out repairs being disadvantaged *vis-à-vis* its competitor that simply outsources its repairs to third parties, often at a higher cost. This would result in a most un-businesslike interpretation being accorded to the section and this would frustrate or undermine the legislative purpose in making the allowance available to a taxpayer such as the taxpayer and such an interpretation will as far as possible be avoided.

(xix) That the only way in which section 14(1)(*c*) can be practically and fairly applied is to permit the allowance to be determined in relation to all expenditure that is reasonably anticipated to relate to the envisaged repairs but this of course must always depend on the facts of each taxpayer's business.

(xx) That where, as here, it was undisputed that the taxpayer's in-house repair facility is and will in future be dedicated exclusively and continually to repairing ships owned or chartered by the taxpayer, the expenditure so incurred or expected to be incurred must be treated in exactly the same way as outsourced repair expenditure, and included in the determination of the section 14(1)(*c*) allowance.

Appeal allowed and the assessment in issue set aside.

4.4. Avenant v C:SARS

Avenant was a wine farmer who conducted agricultural operations, being 'pastoral, agricultural or other farming operations' as contemplated in section 26(1) of the Income Tax Act and had filed tax returns which showed a portion of his overall taxable income, being derived from his farming operations, which were described as 'wingerd boerdery'.

Avenant's farming income consisted of payments that he had received from the co-operative, of which he was a member, in respect of grapes that he had delivered to the co-operative for the purpose of being made into wine.

On delivery, the grapes of Avenant were pressed into a pulp and mixed with the pulp from pressing grapes of the same cultivar and class delivered by other farmers who were also members of the co-operative.

As at midnight on 28 February 2009, the end of Avenant's 2009 year of assessment, all of Avenant's harvested grapes had been delivered to the co-operative and had been pressed into pulp to begin the process of wine making and the co-operative thereafter bottled or packaged the wine and marketed and sold it.

Each farmer who participated in a pool received payment from the co-operative of his or her *pro rata* share of the net proceeds of the sale of the wine, after the deduction of the co-operative expenditure incurred in making and marketing the wine and the *pro rata* share was calculated by reference to the ratios in which each individual farmer delivered grapes to the pool.

Three payments were made to Avenant by the co-operative, as follows: A '*voorskot*' was paid in July (after each February to April harvest), a '*middelskot*' and an '*agterskot*' was paid respectively in March and November of the following year. The '*voorskot*' was paid by the co-operative out of borrowed money before any income was earned from the sale of wine and the '*middelskot*' was based upon ongoing estimates and the final amount owed to Avenant was only calculated when the '*agterskot*' was paid.

The members of the co-operative did not sell their produce, or transfer ownership to the co-operative and, accordingly, the co-operative did not become the owner of the produce.

The issue in this appeal was whether harvested grapes delivered by Avenant to the co-operative winery, which had been pressed into pulp and then mixed with the pulp of other members of the co-operative, for processing into wine, constituted 'produce held and not disposed of' at the end of a tax year for the purposes of par. 2 of the First Schedule to the Income Tax Act.

SARS was of the view that the pulp in issue constituted 'produce held and not disposed' of at the end of the 2009 year of assessment and this resulted in Avenant being assessed to tax in the 2009 tax year and an amount of R789 338 was included as taxable income in respect of 'closing stock from farming operations' in terms of par. 2, 3(1) and 9 of the First Schedule to the Act.

Avenant had unsuccessfully objected to the assessment and thereafter had appealed to the Cape Town Tax Court (see *ITC 1873* (2014) 77 SATC 93 *per* Allie J) where it was held that the grapes in issue delivered to the co-operative at the end of February 2009 had been 'produce on hand that was not disposed of as at the end of the 2009 year of assessment that should have been included' as income being the value of wine grapes.

As regards the assessed amount of R789 338, the court *a quo* concluded that it had been 'manifestly erroneous, unfair and unreasonable' and set it aside and had referred it for re-assessment to SARS.

The court *a quo* had granted Avenant leave to appeal to the Supreme Court of Appeal in terms of section 135(1) of the Tax Administration Act.

Avenant contended, *inter alia*, that after the grapes had been pressed they no longer existed at midnight on 28 February 2009 and once the resultant pulp was mixed with the pulp from other farmers' grapes, the mixture was work-in-progress in a process of manufacture, namely the manufacture of wine by the co-operative and therefore not Avenant's produce at all.

SARS contended that the concept of 'wine in process' fell comfortably within the concept of the 'produce' of a wine grape farmer as envisaged by the First Schedule to the Act and the fact that the grapes had been pressed into a pulp and the process of fermentation had begun, did not mean that Avenant's produce had disappeared as it was still there, albeit in a different form.

The following issues arose for determination in the Supreme Court of Appeal:

- Whether the income received by Avenant, which was generated by the sale of wine, constituted income 'derived from such operations' for the purposes of section 26(1) of the Income Tax Act;
- Whether the pressing of the grapes delivered by Avenant to the co-operative resulted in the pulp no longer constituting 'produce' as contemplated by par. 2 of the First Schedule to the Income Tax Act;
- Whether the pressing into a pulp of Avenant's grapes and its subsequent mixing with the pulp of other members of the co-operative, resulted in what was delivered by him no longer being 'produce held and not disposed of by him', in terms of par. 2 of the First Schedule to the Income Tax Act;

- Whether the pulp had a value as at midnight on 28 February 2009 and, if so, how that value should be calculated.

Judge Swain held the following:

<u>As to the relevant statutory requirements</u>

(i) That, as pointed out by Silke on South African Income Tax, if the trading stock in issue is not sold in the same year that it was acquired, a taxpayer who only deducts the costs of acquiring the stock without taking into account the value of the stock, will not include a 'balancing' amount in gross income and therefore section 22(1) of the Income Tax Act requires 'the value of the trading stock held and not disposed of' at the end of the year of assessment, to be taken into account in the calculation of taxable income and the value of the closing stock is added to taxable income to 'balance' the tax calculation.

(ii) That, while historically, trading stock denoted goods acquired by a trader or dealer and held for sale, both in Australia and South Africa the narrower view of what constituted trading stock gave way to the wider view to include raw materials acquired for purposes of manufacture, components and partly manufactured goods (C:SARS v Foskor 72 SATC 174) and, therefore, trading stock for the purposes of s 22(1) of the Act includes partly manufactured goods, also referred to as 'work-in-progress'.

(iii) That although section 22 of the Act excluded from its ambit taxable income derived by a taxpayer from the activity of 'farming', section 26 of the Act provided that the taxable income of any person carrying on 'pastoral, agricultural or other farming operations' shall be determined in accordance with the Act, but 'subject to the provisions of the First Schedule.' Par. 2, 3(1), 4(1) and 9 of the First Schedule, which have as their object the valuation of 'livestock and produce held and not disposed of' by a taxpayer at the end of the year, accordingly form part of the Act. It would be anomalous if the meaning attributed to 'trading stock held and not disposed of' in terms of s 22 of the Act, differed from the meaning to be attributed to 'livestock and produce held and not disposed of' in terms of paras 2, 3(1), 4(1) and 9 of the First Schedule to the Act. 'Trading stock' has been construed for the purposes of section 22 as work-in-progress and stock which need not be in a saleable form.

<u>As to the application of section 26(1) of the Act</u>

(iv) That the transformation of the grapes into wine did not result in the income earned from the sale of wine being removed from the ambit of income derived from Avenant's agricultural operation and, as stated in Ko-Operatiewe Wynbouers Vereniging van Zuid-Afrika Bpk v Industrial Council for the Building Industry 1949 (2) SA 600 (A) at 614: 'Wine farming consists of a number of different operations, such as cultivation of vineyards, pruning of the grape vines, rendering the vines free from disease, gathering the crop, pressing the grapes into wine and probably delivering the finished product to the 'first buyer.'

<u>As to whether the pulp constituted 'produce'</u>

(v) That in regard to whether the pressing of the grapes delivered by Avenant to the co-operative resulted in the pulp no longer constituting 'produce' as contemplated by par. 2 of the First Schedule to the Act, the concept of 'wine in process' fell comfortably within the concept of the 'produce' of a wine grape farmer as envisaged by the First Schedule to the Act and the fact that the grapes had been pressed into a pulp and the process of fermentation begun, did not mean that Avenant's produce had disappeared as it was still there, albeit in a different form.

(vi) That the extent to which the identity of a natural product may be transformed by some form of treatment until it no longer exists as produce, must depend upon the product as well as the nature and extent of the processing, or treatment, to which it is subjected and each case must be decided upon its own facts.

(vii) That the physical processing that Avenant's grapes had undergone by being pressed into a pulp and the natural fermentation process that had begun (even if chemicals had been added at that stage) by midnight on 28 February 2009, did not make them essentially different from the produce of the harvest and they could not be said to have lost their identity by being ‘mixed up with numerous other commodities’ and to ‘survive’ only as an inseparable portion of a ‘factory product.’

(viii) That the word ‘produce’ in par. 2 of the First Schedule to the Act must be interpreted in the context in which it appeared, as well as the apparent purpose to which it was directed. Because ‘produce’ as in the case of ‘trading stock’ included work-in-progress and did not need to be in a saleable form to qualify as such, it was clear that the pulp produced by pressing the grapes fell within the definition of ‘produce’. If this were not so, the purpose of including ‘produce’ as part of the closing stock of a farmer at the end of the tax year, would not be achieved. The deduction by Avenant of the costs of producing the grapes will not be ‘balanced’ unless the value of the grapes (albeit in the form of pulp) is added to ‘balance’ the tax calculation for that tax year. Because of the delay between the harvesting of grapes and the sale of the wine, and the consequent delay between when expenses are incurred in producing trading stock and realising the proceeds thereof, no balancing can take place unless the existence of the pulp is taken into account in that tax year.

<u>As to whether Taxpayer’s ‘produce held and not disposed of by him’</u>

(ix) That, according to Silke, ‘held’ encompassed ownership or dominium although it was wide enough to include ‘possession without legal ownership’. Trading stock is ‘held and not disposed of’ if the taxpayer has dominium in it, that is if he is the owner of it. SARS accordingly had submitted that ‘disposed of’ connoted conduct by which a trader had parted with ownership of the goods. Meyerowitz was of the view that ‘hold’ is not synonymous with owned and was wide enough to include occupation or possession without legal ownership, but that a disposal occurred when goods were sold unconditionally but not yet delivered. In the present case where ownership is retained by Avenant but possession is not, the produce was clearly ‘held’ for the purposes of par. 2 of the First Schedule.

(ix) That a complete answer to Avenant’s submissions lay in the fact that he had retained joint ownership, in an undivided share, of the pooled pulp and at a later stage the pooled wine, pro rata to the extent of his contribution of grapes to the pool. This was the effect of mixing or the mingling of the pulp with the pulp of other members without the intention of transferring ownership, where identification of the pulp contributed is not possible. That ownership was retained by Avenant meant that the pulp could never have been held by the co-operative for the purpose of sale by itself. The pulp had to have been held by the co-operative for Avenant.

(x) That, as regards Avenant's contention that the resulting mixture of pulp could not be regarded as 'own produce derived from his or her farming operations', the fact that Avenant owned an undivided share in the resultant pulp, would not absolve him from having to account for this produce and, if this were not so, farmers could mix their produce together before the year end to avoid having to account for closing stock.

(xi) That an interpretation of par. 2 and 3(1) of the First Schedule to the Act that includes fractional ownership of pooled produce, gives effect to the purpose of the legislation, is in accordance with the language used and achieves sensible and business-like results and Avenant therefore had 'produce on hand and not disposed of' in the form of an undivided share in the pulp.

<u>As to whether the pulp had a value on 28 February 2009</u>

(xii) That Avenant had submitted that, based on the provisions of section 22(1) of the Act, for the purposes of par. 2, 3(1), 4(1) and 9 of the First Schedule to the Act, 'value' meant market value and the pulp had no market value. However, par. 9 of the First Schedule did not prescribe the method of fixing a value for the purposes of par. 2 and simply provided that the value must be 'fair and reasonable.' SARS was not bound to apply a market value to the pulp, but may adopt another method, provided that it was fair and reasonable.

(xiii) That the cross-examination of Avenant's witnesses before the court a quo focussed on two potential ways of valuing the pulp: the application of the distilling wine price and a determination of the cost of production and SARS submitted that, on either basis, the value of the pulp was greater than zero. When regard is had to the fact that the pulp represented the accumulated work and cost of a year of farming activities, the wine to be produced was intended to be sold at a profit and in each year Avenant had received positive returns from the pool, to say the pulp is entirely valueless was unrealistic.

(xiv) That the evidence established that the distilling wine price was an ascertainable value, reflected in wine statistics and publications and a known concept in the industry and this method was employed by Avenant's accountant when he completed Avenant's 2007 and 2008 income tax returns and in 2009 a similar calculation was initially included in the return to reflect produce held and not disposed of, but these accounting entries were then reversed by the accountant to reflect the value of produce on hand as zero.

(xv) That the use of the distilling wine price as a minimum price operates to the advantage of the taxpayer, as most of the wines destined to become wine are of far superior quality than distilling wine. Because distilling wine attracts no real costs save for transport, the danger that it will return a negative value after cellar costs have been deducted, is not real. The evidence showed that in 2008–2009 'D' quality grapes used for distilling wine realised a positive return for the farmer of R450 per ton and this method was practical, workable and realises a positive value for the stock and it placed a fair and reasonable value upon the stock.

(xvi) That, as regards the method based upon production costs, Avenant's accountant had advised SARS that Avenant's average production costs were R580 per ton. Although this was an industry average, from his evidence Avenant's costs in relation to his wine farming activities were objectively ascertainable and this exercise could be carried out by SARS

(xvii) That an issue initially advanced by Avenant was that the court a quo had erred in referring the matter back to SARS for further consideration and re-assessment. At the hearing SARS, however, had properly conceded that if the appeal failed on the merits the court a quo correctly referred the re-assessment to SARS and it followed that SARS would be entitled to re-assess Avenant to tax in accordance with the principles set out in this judgment.

Appeal dismissed with costs.

4.5. Wingate-Pearse v C:SARS

Wingate-Pearse was a taxpayer who had submitted returns of income for the tax years ending on the last day of February from 1998 to 2005.

SARS in April 2006 had issued revised assessments for each of those years and once interest and penalties had been taken into account, these amounted cumulatively to some R41 million.

Wingate-Pearse objected to the revised assessments and further revised assessments were issued reducing his tax liability to slightly less than R23 million.

Wingate-Pearse, having been dissatisfied with these, lodged an appeal with the Johannesburg Tax Court in terms of section 83 of the Income Tax Act on 1 August 2007 and this prompted further consideration of his objections to the assessments and some downward adjustment in the form of further revised assessments but the accrual of interest substantially increased his overall liability.

Only in February 2015 was the appeal to be set down in the Johannesburg Tax Court before Khumalo J.

In the interim a number of sections of the Income Tax Act having a bearing on the issues in this appeal were repealed and replaced by provisions in the Tax Administration Act and in terms of section 270(2)(*d*) thereof the appeal had to be continued and determined under that Act.

Prior to the hearing the parties held a pre-trial conference at which they had agreed that, while there was some dispute over where the *onus* lay, Wingate-Pearse would commence by leading his evidence. However, at the commencement of the hearing, Wingate-Pearse sought leave to argue a point *in limine* concerning the *onus* of proof and the duty to commence leading evidence and the purpose underlying this argument was to secure a situation where SARS would have to commence the appeal by leading its evidence.

Notwithstanding opposition by SARS, the Tax Court permitted argument to proceed on the point *in limine* and in April 2015 it handed down its ruling.

The Tax Court's ruling confirmed that the initial burden of proof lay with Wingate-Pearse to discharge the *onus* that lay upon him in terms of section 102(1) of the Act to show that the decision of SARS against which he was appealing was wrong and consequently the *onus* to establish that the return or information to SARS was correct or adequate remained with Wingate-Pearse and therefore he had the *onus* to begin to adduce evidence cast upon him as a result of the aforementioned *onus* and consequently he had to commence the proceedings.

Thereafter the Tax Court granted leave to Wingate-Pearse to appeal the aforementioned ruling to the Supreme Court of Appeal in terms of sections 134 and 135 of the Tax Administration Act.

The sole issue for determination by the Supreme Court of Appeal was whether the aforementioned ruling or decision of the Tax Court was appealable.

Judge Wallis held the following:

(i) That the Tax Court was constituted in terms of the Tax Administration Act and, as such, the scope of its jurisdiction, its powers and the ambit of any right of appeal from its decisions were defined in that Act and it was therefore to its provisions that the court had to look in order to determine whether the Tax Court's ruling on the onus and the duty to begin to lead evidence was appealable and not to the statutory provisions that ordinarily govern appeals to the Supreme Court of Appeal and this was clear from the provisions of section 2(3) of the Superior Courts Act 10 of 2013.

(ii) That in terms of section 107(1) of the Tax Administration Act a taxpayer objecting to an assessment or a 'decision' is entitled to appeal to the Tax Court. The expression 'decision' is defined in section 101 as meaning a decision referred to in section 104(2) of the Tax Administration Act and three decisions are referred to in that section, namely a decision not to extend the period for lodging an objection; a decision not to extend the period for lodging an appeal; and any other decision that may be objected to or appealed against under any tax statute and none of these applied to Wingate-Pearse's appeal, which was an appeal against the revised assessments issued to him.

(iii) That the Tax Court's jurisdiction is set out in section 117 of the Tax Administration Act and it has jurisdiction over tax appeals lodged under section 107 and, in terms of section 117(3), may hear any interlocutory application, or any application in a procedural matter relating to a dispute under Chapter 9 of the Tax Administration Act, which is the chapter dealing with disputes and appeals and its powers in regard to an assessment or 'decision' under appeal or in relation to an application in a procedural matter referred to in section 117(3) are set out in section 129(2). Conspicuously absent from section 129(2) is any provision dealing with the Tax Court's powers when dealing with an interlocutory matter under section 117(3) and no doubt this was because these involve a range of largely procedural issues that it was commonplace for courts to dispose of in the course of litigation to secure the expeditious disposal of the cases before them and there was no need to make special provision for a court's powers in disposing of such procedural issues but the absence of such an express provision is highly relevant to the question whether any decision on an interlocutory issue is appealable.

(iv) That the right to appeal from a decision of the Tax Court is dealt with in section 133(1) of the Tax Administration Act and the issue of appealability in this case was therefore whether the decision by the Tax Court on the point in limine was a decision in terms of section 129 of the Tax Administration Act. If it was, then it was appealable in terms of section 130. If not, then it was not appealable at all. An inability to appeal at this stage of proceedings would not have prejudiced the taxpayer. Any interlocutory decision adverse to the taxpayer, will be remediable on appeal once the Tax Court had delivered judgment and made one or other of the orders contemplated in section 129(2) of the Tax Administration Act.

(iv) That the correct question was whether the decision by the Tax Court on the question of onus and the duty to begin was a decision in terms of section 129 of the Tax Administration Act. In order to answer that question the provisions of section 129 must be examined. In terms of section 129(1) the Tax Court must decide any appeal after hearing Wingate-Pearse's appeal against an assessment or 'decision' and, in both instances, section 129(1) is concerned with a decision by the Tax Court that finally resolves the point in issue, that is, the correctness of the assessment or the 'decision' as the case may be. It is not concerned with decisions on interlocutory matters and that is a clear indication that the right of appeal may only arise once the appeal on the merits has been finalised.

(v) That the point is put beyond debate by a consideration of section 129(2), and that section refers to decisions by the Tax Court in three circumstances only. These are decisions on, firstly, an appeal in respect of an assessment; secondly, an appeal against a 'decision' of the type already referred to in par. 7 of this judgment and, thirdly, an application in a procedural matter referred to in section 117(3). A decision on questions of onus and the duty to begin is none of these. That it is not a decision under section 129 is further reinforced by considering the nature of the decisions that may be made by the Tax Court under section 129. These are spelled out in section 129(2) as being a decision confirming an assessment or 'decision'; a decision ordering that an assessment or 'decision' be altered; or a decision referring an assessment or a 'decision' back to SARS for further examination and assessment. Once again a decision on questions of onus and the duty to begin is none of these.

(vi) That the endeavour by Wingate-Pearse to elide interlocutory applications and procedural applications under the dispute resolution rules could not therefore succeed.

(vii) That the decision by the Tax Court was accordingly not appealable in terms of the Tax Administration Act and, in any event, it would not have been appealable if the conventional criteria for identifying decisions that are subject to an appeal were applied. The reason is that such decisions must be final decisions incapable of being altered during the course of the proceedings. If the judge may alter a decision it lacks the necessary requirement of finality and cannot dispose of any issue in the case.

(viii) That the decision in this case on the onus of proof and the duty to begin was alterable was apparent from the fact that it was made in terms of Uniform Rule 39(11) where the proviso made it clear that such an order was susceptible of alteration and, accordingly, it was not an appealable order on conventional principles.

The appeal was struck from the roll.

4.6. Republica (Pty) Ltd v C:SARS

Republica, being a registered VAT vendor, had entered into a five-year lease agreement with Tshwane University of Technology ('TUT') in respect of an immovable property that it owned in Gauteng and the property in question was let to TUT for the sole purpose of accommodating its students.

The property was divided into smaller units which were fully furnished with a kitchenette, bathroom and bedroom.

Republica also supplied domestic goods and services in the form of water and electricity, maintenance costs, management of the building, TV room and laundry services.

It was recorded in the lease agreement that an amount was payable for utilities and was to be included in the monthly bed rentals.

The aforementioned lease agreement allowed TUT to accommodate persons other than students during school holidays and they were referred to as holiday users.

In terms of the lease agreement the letting of accommodation by Republica to TUT comprised a taxable supply of commercial accommodation for VAT purposes and Republica was obliged to levy and account for VAT in accordance with the Value-Added Tax Act on the rental payment that it received as consideration and, as a consequence of the letting of accommodation by Republica to TUT, Republica was liable to account for VAT on only 60% of the rental income that it received in accordance with the provisions of section 10(10).

Republica applied to the High Court for a declaratory order to the effect that its supply to TUT was that of commercial accommodation as defined in section 1 of the Act and that it was liable to account for only 60% of the rental that it received in accordance with section 10(10) of the Act.

SARS opposed Republica's application on the grounds that the High Court lacked the necessary jurisdiction to hear the present matter as such matters should be dealt with in terms of the Tax Administration Act and he also contended that the supply made by Republica in terms of the lease agreement did not constitute 'commercial accommodation' as defined in the Act.

The parties were in agreement that the issues to be determined revolved around the interpretation of the relevant sections of the Value-Added Tax Act including the definitions of the terms 'commercial accommodation' and 'domestic goods and services' as found in the Act.

SARS contended, *inter alia*, that Republica did not supply 'lodging' to TUT as the meaning of the word 'lodging' as it appeared in the definition of 'commercial accommodation' had to be interpreted to refer to a natural person only and, on that basis, TUT, not being a natural person could not lodge in the premises supplied by Republica.

SARS also contended that there was no *nexus* or connection between Republica and the students upon which ground it could be argued that the students were lodgers in the leased premises and TUT should be regarded as a tenant and not as a lodger.

SARS further contended that since the dictionary meaning of lodging was 'temporary accommodation' it could not be said that a contract between TUT and Republica, which was for a period of five years, qualified as lodging.

Republica contended, *inter alia*, that the students were an integral part of the lease agreement and were required to abide by its terms and the premises were let to TUT for the sole purpose of accommodating its students.

Republica further contended that the students only occupied the rooms during the term and returned to their respective homes during holidays hence making their stay a temporary one.

Judge Semenya held the following:

(i) That the provisions of the Tax Administration Act did not oust the High Court's jurisdiction to hear the present application as it involved a question of law and also because there was no disputed assessment in respect of which Republica could raise an objection – Metcash Trading Ltd v C: SARS and Another 63 SATC 13.

(ii) That, as the issues in the case revolved around the interpretation of the Value-Added Tax Act, the correct approach in casu would be to interpret its relevant sections in conjunction with the terms of the lease agreement entered into between Republica and TUT.

(iii) That SARS' reliance on the sterile dictionary meaning of the word 'lodger' and 'lodging' was faulty as it ignored the purpose for which the property was let to TUT, which was to accommodate students and that the students were indeed lodging in the property was not in dispute.

(iv) That a nexus between the lessor and the end user was not a requirement for the supply of commercial accommodation.

(iv) That the argument that the lease was for a fixed period of five years and not temporary in line with the meaning of the word 'lodging' cannot stand as it lost sight of the purpose for which the agreement was entered into – it was an undisputed fact that the students went home during holidays and did not occupy the same room during their stay with TUT and hence the students did not occupy the property continuously for the entire period of the lease.

(v) That it was common cause that Republica supplied domestic goods and services as defined in the Value-Added Tax Act for use by the lodgers.

(vi) That the agreement of lease between Republica and TUT clearly stipulated that the amount of R275 payable for utilities was part of the all-inclusive charge and there was no reason why the court should disregard the intention as per the lease agreement.

(vii) That the method of interpretation suggested by SARS was indeed restrictive and, if applied, would result in absurdity. It cannot be said that the legislature imagined a situation where educational institutions would be in a position to own sufficient properties to accommodate all their students and a need to outsource this function from those who deal in property would always arise.

(ix) That the words used in the definition of 'commercial accommodation' must be read in conjunction with the purpose for which the property was let to

TUT and this would result in the most sensible meaning which was in the interests of commerce – Natal Joint Municipal Pension Fund v Endumeni Municipality [2012] 2 All SA 262 (SCA). A literal manner of interpretation alone, as suggested by SARS, will not make the business of TUT and other educational institutions easy and it also overlooked the expenses that landlords incur in maintaining buildings occupied by students.

(ix) That, accordingly, the letting of accommodation by Republica to TUT in terms of the lease agreement comprised of a taxable supply of commercial accommodation for value-added tax purposes and Republica was obliged to levy and account for VAT in accordance with the Act on the rental payments that it received as consideration.

(x) That Republica was liable to account for VAT on only 60% of the rental that it received in accordance with s 10(10) of the Act.

5. INTERPRETATION NOTES

5.1. The Taxation of Foreign Dividends – No. 93

This Note provides guidance on the interpretation and application of various provisions of the Act relating to foreign dividends. The Note does not deal with the income tax consequences of a dividend paid by a headquarter company, since this topic is addressed in Interpretation Note 87 dated 19 February 2016 'Headquarter Companies'.

With effect from 1 January 2011 a definition of 'foreign dividend' was introduced into section 1(1) and, combined with the insertion of the definition of 'foreign company' and changes to the definition of 'dividend', had the result that on or after that date foreign dividends no longer fell within the definition of 'dividend' in section 1(1). A dividend and a foreign dividend are mutually exclusive. A dividend relates solely to certain amounts transferred or applied by a resident company. A foreign dividend relates solely to certain amounts paid or payable by a foreign company, which by definition is a non-resident.

Broadly speaking, a foreign dividend is included in a person’s gross income but may qualify for a full or partial exemption from normal tax under section 10B. With effect from March or April 2012(1)(*i*)(xv)(*aa*)2 for foreign dividends and foreign interest not otherwise exempt, was deleted and an alternative partial exemption was introduced under section 10B(3). The partial exemption under section 10B(3) was intended to ensure that the effective rate of tax on taxable foreign dividends would generally not exceed the 15% rate of tax applicable to local dividends under dividends tax, which was introduced on 1 April 2012. 1 the exemptions available for foreign dividends meeting the relevant criteria under section 10(1)(*k*)(ii)(*aa*) to (*dd*) were moved to section 10B(2) and underwent some amendment. In addition, the basic exemption available to natural persons of R3 700 under section 10

This Note discusses the current gross income inclusion, exemptions and other provisions applicable to foreign dividends.

A foreign dividend received by or accrued to a person is included in that person's gross income under paragraph (*k*) of the definition of 'gross income' in section 1(1).

Section 10B provides for exemptions of foreign dividends received by or accrued to a person. The exemptions under section 10B(2) are applied separately to each foreign dividend received or accrued while the partial exemption under section 10B(3) applies to the aggregate amount of foreign dividends not exempt under section 10B(2). The partial exemption is determined by applying the applicable ratio to a specific type of person. The exemptions will not apply to the extent that section 10B(4), (5) or (6) applies.

Foreign dividends received by or accrued to a person constitute income from a foreign source under section 9(4)(*a*). Foreign tax paid on foreign dividends potentially qualifies for a tax rebate under section 6*quat*(1).

Under section 25D a foreign dividend received by or accrued to a person is translated from a foreign currency to rand at the spot rate, or at the average exchange rate if a natural person or non-trading trust so elects. Special rules apply to foreign permanent establishments, CFCs, headquarter companies, domestic treasury management companies and international shipping companies. Foreign tax payable on a foreign dividend is translated to rand on the last day of a year of assessment at the average exchange rate for that year of assessment under section 6*quat*(4).

Section 23(*q*) prohibits the deduction of expenditure incurred in the production of foreign dividends.

For the purposes of determining the net income of a CFC, a CFC is deemed to be a resident for purposes of the definition of 'gross income' in section 1(1). Foreign dividends received by or accrued to a CFC are therefore included in its gross income. Section 10B also applies to foreign dividends received by or accrued to a CFC for purposes of determining its net income for inclusion in a resident's income. Special rules apply to a CFC in calculating its net income and in determining the cost price or base cost of the right in a CFC when foreign dividends are distributed by the CFC or by another CFC in which the first-mentioned CFC has an interest.

The anti-avoidance provisions of sections 8E, 8EA, 22B and paragraphs 19 and 43A are relevant when entering into share or dividend transactions.

5.2. Documentary Proof Prescribed by the Commissioner (VAT) – No. 92

This Note prescribes the documentary proof required under section 16(2)(*f*) that must be obtained and retained by a vendor (or the vendor's agent) to substantiate the vendor's entitlement to a deduction as contemplated in section 16(3)(*c*) to (*n*).

A deduction may be made in a later tax period if the vendor is unable to obtain the documentary proof required by the Commissioner at the time the return is furnished. This deduction is however, subject to the prescription periods set out in proviso (i) to section 16(3). If the Commissioner is satisfied that the deduction was not permissible in accordance with the practice generally prevailing, the five-year period is limited to six months.

The vendor must be in possession of the relevant documentary proof set out in the abovementioned table at the time that the return is furnished in which the deduction is made.

A vendor that experiences difficulties in obtaining the documentary proof, may apply to SARS under section 16(2)(*g*) for approval to use alternative documentary proof. In this regard, refer to Binding General Ruling (VAT) No. 36 dated 24

October 2016 'Circumstances Prescribed by the Commissioner for the Application of Section 16(2)(*g*)'

5.3. Reduction of debt – No. 91

This Note provides guidance on the interpretation and application of section 19 and paragraph 12A which deal with the reduction of debt. The Note does not address section 22 of the VAT Act dealing with irrecoverable debt.

Debt relief occurs in, for example, insolvency, business rescue, similar statutory proceedings or informal workouts, and can occur within and outside of a group of companies.

The reduction of debt during years of assessment commencing before 1 January 2013 was subject to the following income tax, CGT and donations tax provisions:

- Section 8(4)(*m*)
- Paragraph (ii) of the proviso to section 20(1)(*a*)
- Section 54
- Paragraph 2(*h*) of the Seventh Schedule
- Paragraph 3(*b*)(ii)
- Paragraph 12(5)
- Paragraph 20(3)(*b*)

Under the previous legislation listed above, the various taxes imposed upon persons receiving the benefit of debt relief may have effectively undermined the economic benefit of the relief. A new uniform system that provides relief to persons under financial distress in certain circumstances was introduced in the form of section 19 and paragraph 12A with effect from years of assessment commencing on or after 1 January 2013. Section 8(4)(*m*), paragraph (ii) of the proviso to section 20(1)(*a*) and paragraph 12(5), which previously dealt with the reduction of debt, were simultaneously deleted. The new rules also provide clarity on the ordering of the various provisions and a more explicit set of demarcations between the different provisions.

The new rules are aimed at ensuring that a reduction of debt is subject to only one of the following taxes:

- estate duty
- donations tax
- income tax on a fringe benefit received by an employee
- income tax on income
- CGT

Sections 8(4)(*a*), 9C(5), 24J(4A)(*b*) and paragraphs 3(*b*)(ii), 20(3)(*b*)(iii) and 56(2)(*a*) have been amended with effect from years of assessment commencing on or after 1 January 2013 to prevent the recoupment of the same amount, or the reduction of the base cost of an asset, under more than one provision when a debt has been reduced. In essence, these provisions ensure that the same reduction amount of a debt does not result in double taxation.

Section 19 and paragraph 12A contain ordering rules for dealing with debt reduction and replace the previous rules that were contained in section 8(4)(*m*), the proviso to section 20(1)(*a*) and paragraph 12(5).

The new ordering rules apply to trading stock, other deductible expenditure, allowance assets and capital assets financed by debt that is subsequently reduced. Briefly the rules provide as follows upon a reduction of such debt:

- Trading stock held and not disposed of:

  Any section 11(a) deduction or the value of opening stock under section 22(2) as well as any closing stock under section 22(1) is reduced by the reduction amount of a debt under section 19(3). Any excess reduction amount is treated under section 19(4) as a recoupment for the purposes of section 8(4)(a).

- Trading stock not 'held and not disposed of' at the time of the reduction of the debt and other deductible expenditure excluding allowance assets:

  The reduction amount of a debt is deemed to be a recoupment under section 19(5) for the purposes of section 8(4)(a) to the extent that the expenditure that was funded by the debt was allowed as a deduction.

- Allowance assets

  The reduction amount of a debt first reduces any base cost expenditure under paragraph 12A(3) after which any excess is deemed to be a recoupment under section 19(6) for the purposes of section 8(4)(a). Future capital allowances will be limited to the cost of the asset less the reduction amount and any previous allowances claimed on the asset, under section 19(7).

- Capital assets that are not allowance assets

  The base cost of the asset is reduced by the reduction amount of the debt under paragraph 12A(3). Any excess reduction amount reduces an assessed capital loss under paragraph 12A(4).

A special rule applies to debt that financed the acquisition of a pre-valuation date asset. The effect of the rule in paragraph 12A(5) is to treat the asset as a post-valuation date asset by re-establishing its base cost as expenditure which can be reduced by the reduction amount of the debt.

The ordering rules do not apply to tax debt or debt that has been reduced by donation, bequest or by an employer [section 19(8) and paragraph 12A(6)(*a*), (*b*) and (*c*)]. Paragraph 12A(6)(*d*) and (*e*) contain additional exemptions for debt reduced within a group of companies and debt reduced in the course or in anticipation of liquidation, winding up, deregistration or final termination of a company when the debtor company and the creditor are connected persons in relation to each other.

Consequential amendments to prevent double taxation have been made to sections 8(4)(*a*), 9C(5), 24J(4A)(*b*) and paragraphs 3(*b*)(ii), 20(3)(*b*)(i) and (iii) and 56(2)(*a*).

Section 19, paragraph 12A and the consequential amendments referred to above apply to years of assessment commencing on or after 1 January 2013.

The reduction amount of a debt that is denominated in a currency other than the currency of the Republic must be translated to the currency of the Republic (the rand) on the date on which the debt is reduced by applying the applicable exchange rate under section 25D.

A foreign exchange loss may have been claimed as a deduction under section 24I(3)(*a*) in one or more earlier years of assessment upon annual translation of the outstanding debt to rand or upon realisation of the debt in the current year of assessment. These losses must be recouped under section 8(4)(*a*) when the debt is reduced (see **4.10.1**). Foreign exchange gains included in the income of a debtor before the reduction of debt or as a result of such reduction remain taxable.

The amount of expenditure contemplated in section 19(2) or paragraph 12A(2) that was funded by a debt that is reduced must be determined:

- exclusive of VAT for a debtor that is a vendor and that is or was entitled to a deduction of input tax under section 16(3) of the VAT Act; and
- inclusive of VAT for a debtor that is not a vendor.

6. DRAFT INTERPRETATION NOTES

6.1. Unclaimed benefits

This Note explains the treatment of unclaimed benefits that accrued to members (both before and from 1 March 2009) for income tax purposes.

This Note replaces General Note 35 dated 8 April 2004.

Historically some members of a retirement fund did not, after exiting the fund, claim the lump sum benefit to which they became entitled to in terms of the rules of the fund.

These lump sum benefits were classified as an 'unclaimed benefit' if it was not claimed after a reasonable period of time.The legislation did not regulate when and how a lump sum benefit should be classified as an 'unclaimed benefit'. Fund administrators, as a result, applied different rules to determine when a lump sum benefit was classified as an 'unclaimed benefit

In many instances, fund administrators only applied for a tax directive for an unclaimed benefit when the member or the member’s beneficiaries claimed the unclaimed benefit, as opposed to when the lump sum benefit accrued.

The tax treatment of a lump sum benefit, classified as an 'unclaimed benefit', depends on the date on which the benefit accrued to the member.

7. BINDING PRIVATE RULINGS

7.1. BPR 248 – Deduction of interest on asset backed notes

This ruling determines the deductibility of interest to be incurred in respect of notes issued by a special purpose vehicle. The capital receipts for the notes are to be invested in commercial debt.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 23 August 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of:

- section 8FA; and
- section 24J(2).

Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa

The Investees: Companies incorporated in and residents of South Africa that will issue debt instruments to the Applicant

The Note Holders: Tax exempt pension funds and/or untaxed policyholder funds of South African life insurers, incorporated in and residents of South Africa

Description of the proposed transaction

The Applicant was incorporated as a special purpose vehicle to issue asset backed notes (notes) to the Note Holders.

The Applicant will utilise the proceeds received from the issuance of the notes to invest in debt instruments (underlying investments) issued by the Investees.

Interest on the underlying investments will be calculated with reference to a base lending rate linked to the consumer price index plus a fixed interest rate. Interest will be paid by the Investees to the Applicant in quarterly or bi-annual instalments together with the return of the principal debt amortised over the period of the investment.

In terms of the notes, interest will accrue to the Note Holders, calculated at the same interest rate as that at which interest accrues to the Applicant from the underlying investments. All interest that accrues to the Applicant from the underlying investments is to be distributed to the Note Holders.

The Applicant will receive management, advisory and administration services over the life of the underlying investments from its holding company. As consideration for these services, the holding company will be entitled to a management fee from the Note Holders, that the Applicant will be authorised to withhold from monies due by the Applicant to the Note Holders.

The notes will embody obligations of the Applicant and will be redeemed as and when the underlying investments are redeemed.

In the event that the Applicant is unable to recover amounts in respect of an underlying investment, the Note Holders will suffer a loss in respect of the notes concerned.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions or assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The underlying investments will constitute interest bearing arrangements for purposes of section 24J. Consequently, section 24J(3) will apply to the interest to be received by or accruing to the Applicant.
- Each note will constitute an instrument for purposes of section 24J. On this basis, the amounts payable in excess of the original subscription price will constitute interest for purposes of section 24J.
- The Applicant will be entitled to deduct interest incurred in respect of the

notes, limited to the amount of the interest included in its income.

- Interest to be received by or accruing to the Applicant in respect of the underlying investments will not constitute 'hybrid interest', as defined in section 8FA(1).
- Interest payable by the Applicant in respect of the notes will not constitute 'hybrid interest' as defined in section 8FA(1).
- Interest to be received by or accrued to the Applicant in respect of the underlying investments will not deemed to be a dividend *in specie* for the Applicant in terms of section 8FA and will not prohibit the Applicant from deducting the interest payable in respect of the notes from its income under section 24J(2).

7.2. BPR 249 – Corporate group restructuring involving multiple transactions

This ruling determines the tax consequences of a corporate group restructuring involving multiple transactions including successive asset-for-share transactions, an amalgamation transaction and unbundling transactions as contemplated in the Act.

In this ruling references to sections and paragraphs are to sections of the relevant Act and paragraphs of the Eighth Schedule to the Act applicable as at 14 December 2015. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of the provisions of:

- The Act:
    - section 1(1) – definition of 'contributed tax capital';
    - section 42;
    - section 44;
    - section 46;

- paragraph 1 – definition of 'base cost';
- paragraph 13; and
- paragraph 20(1)(*a*).

- the STT Act:
  - section 1 – definition of 'security';
  - section 2(1); and
  - section 8(1)(*a*)(i), (ii) and (iv).

Parties to the proposed transaction

The proposed transaction involves numerous resident and non-resident companies, some of which are Co-Applicants and others not. The Applicant and Co-Applicants are:

The Applicant: A company incorporated in and a resident of South Africa

Co-Applicant 1: A company incorporated outside of South Africa but a resident of South Africa that will be used as an intermediary holding company

Co-Applicant 2: A company incorporated in and a resident of South Africa

Co-Applicant 3: A company incorporated in and a resident of South Africa that will become the ultimate holding company

Co-Applicant 4: A company incorporated outside of South Africa and not a resident of South Africa that is indirectly held by Company I

Co-Applicant 5: A company incorporated in and a resident of South Africa that is a subsidiary of Co-Applicant 2

Co-Applicant 6: A company incorporated outside of South Africa and not a resident of South Africa that is wholly-owned by Co-Applicant 5

Co-Applicant 7: A company incorporated in and a resident of South Africa that is a wholly-owned subsidiary of the Applicant

Co-Applicant 8: A company incorporated in and a resident of South Africa

The other parties to the proposed transaction that are not the Applicant or Co-Applicants are:

Company A: A company incorporated outside of South Africa and not a resident of South Africa

Company B: A company incorporated in and a resident of South Africa that is wholly-owned by Company G

Company C: A company incorporated in and a resident of South Africa that is indirectly held by Company A

Company D: A company incorporated in and a resident of South Africa that is a wholly-owned subsidiary of Company B

Company E: A company incorporated in and a resident of South Africa

Company F: A company incorporated in and a resident of South Africa that is wholly-owned by Company B

Company G: A company incorporated in and a resident of South Africa that is indirectly held by Company A

Company H: A company incorporated in and a resident of South Africa that is wholly-owned by Company B

Company I: A company incorporated and listed outside of South Africa and not a resident of South Africa

Company J: A company incorporated in and a resident of South Africa that is wholly owned by the Applicant

Company K: A company incorporated in and a resident of South Africa in which 32.4% of its issued share capital is held by the Applicant

Description of the proposed transaction

Company A is a multinational owner of numerous brands and operates a distribution model in various jurisdictions. Company I is also a multinational company that operates in various jurisdictions.

Company A intends to consolidate certain of its operations on the African continent to separate the ownership of brands from its distribution operations.

Company A, Company I and Co-Applicant 2 will consolidate their various interests, held directly or indirectly on the African continent, into one South African holding company, Co-Applicant 3.

The proposed transaction will be preceded by two pre-acquisition transactions.

- The first pre-acquisition transaction will consolidate certain companies held indirectly by Company A into Co-Applicant 1. The steps for this transaction will be the following:
  - Company B will incorporate Company D and contribute one of its businesses to Company D in exchange for the issue of shares in Company D, in terms of an asset-for-share transaction as contemplated in section 42.
  - Company B will contribute certain other business assets to Company H in exchange for the issue of shares in Company H in terms of an asset-for-share transaction as contemplated in section 42.
  - Company B will contribute certain other business assets to Company F in exchange for the issue of shares in Company F in terms of an asset-for-share transaction as contemplated in section 42.
  - The subsidiaries of Company A that are not residents of South Africa will dispose of their shares in Co-Applicant 5, Company C and Company G to Co-Applicant 1 at market value, in exchange for the issue of shares in Co-Applicant 1.
  - Company B will unbundle its shares in each of Company D, Company F and Company H to Company G in terms of an unbundling transaction as contemplated in section 46.
  - Company G will unbundle its shares in Company B to Co-Applicant 1 in terms of an unbundling transaction as contemplated in section 46.
- The second pre-acquisition transaction will consolidate certain companies held indirectly by Company I directly and indirectly into Co-Applicant 4 and transfer a division of the Applicant and other assets held by the Applicant to

Co-Applicant 7. The steps for this transaction will be the following:

- Co-Applicant 4 will be incorporated and capitalised by a wholly-owned subsidiary of Company I.
- Co-Applicant 4 will acquire shares held in businesses in various African jurisdictions (phase 1B assets).
- The Applicant will dispose of some of the assets of one of its divisions (division assets) in terms of an asset-for-share transaction as contemplated in section 42 to Co-Applicant 7 in exchange for the issue of shares in Co-Applicant 7. The disposal of the remainder of the division assets will not be made subject to section 42.
- The Applicant will dispose of all of its shares held in Company J to Co-Applicant 7 in exchange for the issue of shares in Co-Applicant 7 in terms of an asset-for-share transaction as contemplated in section 42.
- The Applicant will dispose of its 32.4% shareholding in Company K to Co-Applicant 7 in exchange for the issue of shares in Co-Applicant 7 in terms of an asset-for-share transaction as contemplated in section 42.

- The proposed transaction will consolidate certain of the companies acquired by Co-Applicant 1, in terms of the first pre-acquisition transaction and the restructured companies under Company I, into Co-Applicant 3 together with companies held by Co-Applicant 2. The proposed transaction will be implemented as follows:
  - Co-Applicant 4 will incorporate and capitalise Co-Applicant 3 in South Africa. Co-Applicant 3 will issue ‘D’ class shares to Co-Applicant 4.
  - Foreign affiliate companies of the Applicant will sell all brands related to the distribution model to affiliate companies of Company A incorporated outside of South Africa that will acquire the brands and trademarks in exchange for cash.

- Co-Applicant 4 will dispose of the phase 1B assets to Co-Applicant 3 in exchange for the issue of 'D' class shares in Co-Applicant 3 and will immediately thereafter move its place of effective management to South Africa.
- Co-Applicant 1 will dispose of its 100% shareholding in Company B and its 30% shareholding in Company C to Co-Applicant 3 in exchange for the issue of 'A' class shares in Co-Applicant 3 in terms of an asset-for-share transaction as contemplated in section 42.
- Co-Applicant 1 and Co-Applicant 2 will each dispose of their shares held in Co-Applicant 5 to Co-Applicant 3 in exchange for the issue of 'A' and 'B' class shares respectively in terms of an asset-for-share transaction as contemplated in section 42.
- The Applicant will dispose of its shares held in Co-Applicant 7 to Co-Applicant 3 in exchange for the issue of 'C' class shares in terms of an asset-for-share transaction as contemplated in section 42.
- Co-Applicant 5 will unbundle its shares in Co-Applicant 6 to Co-Applicant 3 in terms of an unbundling transaction as contemplated in section 46.
- Co-Applicant 3 will contribute its phase 1B assets to Co-Applicant 6 in exchange for the issue of shares in Co-Applicant 6 in terms of an asset-for-share transaction as contemplated in section 42.
- Co-Applicant 3 will dispose of its shares held in Co-Applicant 7, Company B and Company C to Co-Applicant 5 in exchange for the issue of shares in Co-Applicant 5 in terms of an asset-for-share transaction as contemplated in section 42.
- Co-Applicant 5 will dispose of its shares held in Co-Applicant 7 and Company B to Company E in exchange for the issue of shares in Company E in terms of an asset-for-share transaction as contemplated in section 42.
- Co-Applicant 5 will incorporate Co-Applicant 8. Co-Applicant 1 and Co-Applicant 5 will each dispose of their shares held in Company C

to Co-Applicant 8 in exchange for the issue of shares in Co-Applicant 8 in terms of an asset-for-share transaction as contemplated in section 42.

- Co-Applicant 8 will dispose of its shares held in Company C to Company E in exchange for the issue of shares in Company E in terms of an amalgamation transaction as contemplated in section 44. Co-Applicant 8 will dispose of the shares acquired in Company E to Co-Applicant 1 and Co-Applicant 5 respectively in anticipation of liquidation.
- Co-Applicant 1 will acquire the 30% shareholding of Co-Applicant 5 held in Co-Applicant 8 for nominal consideration prior to the de-registration of Co-Applicant 8.
- Co-Applicant 3 will acquire shares in the indirect subsidiary companies of Co-Applicant 4 from affiliates of Co-Applicant 4 in exchange for the issue of 'D' class shares in Applicant 3.

Conditions and assumptions

This binding private ruling is subject to the following additional conditions and assumptions:

- The market value of each asset to be disposed of in terms of an asset-for-share transaction will be equal to or exceed the base cost of that asset.
- The consideration given in the asset-for-share transactions, amalgamation transaction and unbundling transactions will be determined between independent parties dealing at arm's length.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The shares acquired by Co-Applicant 1 in Company B and Company C in terms of the first pre-acquisition transaction will be regarded as having been acquired and held by Co-Applicant 1 on capital account, even though they will be disposed of to Co-Applicant 3 shortly after acquisition. The facts and circumstances of this transaction indicate that Co-Applicant 1 and Co-Applicant 3 will not acquire the assets as trading stock.

Section 42(2) will apply to this transaction and:

- Co-Applicant 1 will be deemed to have disposed of its shares held in Company B and Company C for an amount equal to their respective base costs;
- Co-Applicant 1 and Co-Applicant 3 will be deemed to be 'one and the same person' for purposes of determining the base cost of the shares in Company B which Co-Applicant 3 will acquire;
- Co-Applicant 1 and Co-Applicant 3 will be deemed to be 'one and the same person' for purposes of determining the base cost of the shares in Company C which Co-Applicant 3 will acquire; and
- the transfer of the shares in Company B and Company C will be exempt from securities transfer tax (STT).

- The shares acquired by Co-Applicant 1 in Co-Applicant 5 in terms of the first pre-acquisition transaction will be regarded as having been acquired and held by Co-Applicant 1 on capital account, even though they will be disposed of to Co-Applicant 3 shortly after acquisition. The facts and circumstances of this transaction indicate that Co-Applicant 1 and Co-Applicant 3 will not acquire the assets as trading stock.

  Section 42(2) will apply to this transaction and:

  - Co-Applicant 1 and Co-Applicant 2 will be deemed to have disposed of their shares held in Co-Applicant 5 for an amount equal to their respective base costs;
  - Co-Applicant 1 and Co-Applicant 3 will be deemed to be 'one and the same person' for purposes of determining the base cost of the shares in Co-Applicant 5 which Co-Applicant 3 will acquire;
  - Co-Applicant 2 and Co-Applicant 3 will be deemed to be 'one and the same person' for purposes of determining the base cost of the shares in Co-Applicant 5 which Co-Applicant 3 will acquire; and

- the transfer of the shares in Co-Applicant 5 will be exempt from STT.

- The shares acquired by the Applicant in Co-Applicant 7 in terms of the second pre-acquisition transaction will be regarded as having been acquired and held by the Applicant on capital account, even though they will be disposed of to Co-Applicant 3 shortly after acquisition. The facts and circumstances of this transaction indicate that the Applicant and Co-Applicant 3 will not acquire the assets as trading stock.

  Section 42(2) will apply to this transaction and:

  - the Applicant will be deemed to have disposed of its shares held in Co-Applicant 7 for an amount equal to their base cost;
  - the Applicant and Co-Applicant 3 will be deemed to be 'one and the same person' for purposes of determining the base cost of the shares in Co-Applicant 7 which Co-Applicant 3 will acquire; and
  - the transfer of the shares in Co-Applicant 7 will be exempt from STT.

- The contributed tax capital (CTC) created by Co-Applicant 3 will be 'ring-fenced' in respect of each class of share so that:

  - The CTC of the 'A' class shares issued by Co-Applicant 3 to Co-Applicant 1 in exchange for 100% of the shares in Company B, 20% of the shares in Co-Applicant 5 and 30% of the shares in Company C, will be an amount equal to the base cost of all the shares disposed of by Co-Applicant 1 to Co-Applicant 3.
  - The CTC of the 'B' class shares issued by Co-Applicant 3 to Co-Applicant 2 in exchange for 80% of the shares in Co-Applicant 5 will be an amount equal to the base cost of all of the shares disposed of by Co-Applicant 2 to Co-Applicant 3.
  - The 'C' class shares issued by Co-Applicant 3 to the Applicant in exchange for 100% of the shares in Co-Applicant 7 will be an amount equal to the base cost of all the shares disposed of by the

Applicant to Co-Applicant 3.

- Section 46(2) will apply when Co-Applicant 5 unbundles its shares in Co-Applicant 6 to Co-Applicant 3 in terms of the unbundling transaction and:
    - Co-Applicant 5 must disregard the distribution of the shares in Co-Applicant 6 for purposes of determining its taxable income, as well as any liability for dividends tax;
    - Co-Applicant 3 must allocate a portion of the base cost of its shares in Co-Applicant 5 to the shares in Co-Applicant 6 as follows: The proportionate amount of the expenditure and market value to be allocated to the shares in Co-Applicant 6 will be determined in accordance with the ratio that the market value of the shares in Co-Applicant 6, as at the end of the day after the distribution, bears to the sum of the market value, as at the end of that day, of the shares in Co-Applicant 5 and the shares in Co-Applicant 6; and
    - The CTC of Co-Applicant 5 immediately after the distribution of the shares in Co-Applicant 6 will be deemed to be an amount which bears to the CTC of the shares of Co-Applicant 5 immediately prior to the distribution the same ratio as the aggregate market value, immediately after the distribution of the shares in Co-Applicant 5, bears to the aggregate market value of the shares in Co-Applicant 5 immediately before the distribution.
- The shares acquired by the Applicant in Co-Applicant 7 in terms of the second pre-acquisition transaction will be regarded as having been acquired and held by the Applicant on capital account, even though they will be disposed of to Co-Applicant 3 shortly after acquisition. The facts and circumstances of this transaction indicate that the Applicant and Co-Applicant 3 will not acquire the assets as trading stock.

  Section 42(2) will apply to this transaction and Co-Applicant 3 and Co-Applicant 6 will be deemed to be 'one and the same person' in respect of the base cost which Co-Applicant 6 will acquire in the phase 1B assets.
- The shares acquired by Co-Applicant 3 in Co-Applicant 7, Company B and

Company C in terms of the proposed transaction will be regarded as having been acquired and held by Co-Applicant 3 on capital account even though they will be disposed of to Co-Applicant 5 shortly after acquisition. The facts and circumstances of this transaction indicate that Co-Applicant 3 and Co-Applicant 5 will not acquire the assets as trading stock.

Section 42(2) will apply to this transaction, and:

- Co-Applicant 3 will be deemed to have disposed of its shares held in Co-Applicant 7, Company B and Company C for an amount equal to their respective base costs;
- Co-Applicant 5 and Co-Applicant 3 will be deemed to be 'one and the same person' for purposes of determining the base cost of the shares in Co-Applicant 7, Company B and Company C which Co-Applicant 3 will acquire; and
- the transfer of the shares in Co-Applicant 7, Company B and Company C will be exempt from STT.

- The shares acquired by Co-Applicant 5 in Co-Applicant 7 and Company B in terms of the proposed transaction will be regarded as having been acquired and held by Co-Applicant 5 on capital account, even though they will be disposed of to Company E shortly after acquisition. The facts and circumstances of this transaction indicate that Co-Applicant 5 and Company E will not acquire the assets as trading stock.

  Section 42(2) will apply to this transaction and:

  - Co-Applicant 5 will be deemed to have disposed of its shares in Co-Applicant 7 and Company B for an amount equal to their respective base costs;
  - Company E and Co-Applicant 5 will be deemed to be 'one and the same person' for purposes of determining the base cost of the shares in Co-Applicant 7 and Company B which Company E will acquire; and
  - the transfer of the shares in Co-Applicant 7 and Company B will be

exempt from STT.

- The contracts embodying the 'asset-for-share transactions' mentioned in point 4 paragraph (c)(vi), (ix) and (x) above will give rise to disposals of the relevant assets on the date on which they are concluded.

- The shares acquired by Co-Applicant 1 and Co-Applicant 5 in Company C in terms of the first pre-acquisition transaction and the proposed transaction will be regarded as having been acquired and held by Co-Applicant 1 and Co-Applicant 5 on capital account, even though they will be disposed of to Co-Applicant 8 shortly after acquisition. The facts and circumstances of this transaction indicate that Co-Applicant 1, Co-Applicant 5 and Co-Applicant 8 will not acquire the assets as trading stock.

  Section 42(2) will apply to this transaction and:

  - Co-Applicant 1 and Co-Applicant 5 will be deemed to have disposed of their shares in Company C for an amount equal to their respective base cost;
  - Co-Applicant 8 and Co-Applicant 5 will be deemed to be 'one and the same person' for purposes of determining the base cost of the shares in Company C which Co-Applicant 8 will acquire;
  - Co-Applicant 8 and Co-Applicant 1 will be deemed to be 'one and the same person' for purposes of determining the base cost of the shares in Company C which Co-Applicant 8 will acquire; and
  - the transfer of the shares in Company C from Co-Applicant 5 and Co-Applicant 1 will be exempt from STT.

- The shares acquired by Co-Applicant 8 in Company C in terms of the proposed transaction will be regarded as having been acquired and held by Co-Applicant 8 on capital account, even though they will be disposed of to Company E shortly after acquisition. The facts and circumstances of this transaction indicate that Co-Applicant 8 and Company E will not acquire the assets as trading stock.

  Section 44(2) will apply to this transaction and –

- Co-Applicant 8 will be deemed to have disposed of its shares in Company C for an amount equal to their base cost;
- Company E and Co-Applicant 8 will be deemed to be ‘one and the same person’ for purposes of determining the base cost of the shares in Company C which Company E will acquire; and
- the transfer of the shares in Company C from Co-Applicant 8 to Company E will be exempt from STT.

7.3. BPR 250 – Definition of 'Risk Policy'

This ruling determines whether a life policy in respect of which the policyholder propose to select the refund option, in terms of which all paid premiums are refundable after 15 years without any claim against the life policy, constitutes a risk policy as defined in section 29A(1).

In this ruling references to sections are to sections of the Income Tax Act applicable as at 26 August 2016. Unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of section 29A(1) – definition of 'risk policy'.

<u>Parties to the proposed transaction</u>

The Applicant: A long term insurance company incorporated in and a resident of South Africa

<u>Description of the proposed transaction</u>

The Applicant carries on a registered long-term insurance business that issues life policies that provide an individual with comprehensive death, disability and critical illness cover in return for a pre-defined premium.

In terms of these life policies both the premium and the sum assured may escalate by a predetermined percentage as chosen by the policyholder from a range of options. The selection occurs at inception and remains unchanged for the duration of the life policy.

As an additional benefit to the life policy, the policyholder may select to receive the premium refund (refund option) at an additional cost. In terms of the refund option, the amount of all paid premiums becomes refundable after a 15 year claim-free period. The value of the refund is independent of any rate of return. Inflation is not taken into account. The terms of the life policy do not include any investment product. The refund is forfeited on cancellation of the life policy. Only one refund per life policy will be payable.

Conditions and assumptions

This binding private ruling is subject to the additional condition and assumption that it will apply only to life policies issued subsequent to the date of the ruling letter upon terms similar to the terms provided and considered in support of this ruling.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- Despite a policyholder's selection of the refund option, the life policy will constitute a 'risk policy', as defined in section 29A(1).

7.4. *BPR 251 – Cancellation of reinsurance agreement*

This ruling determines the tax consequences resulting from the disposal of assets by a long-term insurer to a collective investment scheme (CIS) in securities in exchange for the issue of participation units in the CIS and the *in specie* transfer of such units, pursuant to the cancellation of a reinsurance agreement.

In this ruling references to sections and paragraphs are to sections of the relevant Act and paragraphs of the Eighth Schedule to the Act applicable as at 8 September 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of the provisions of:

- the Act:
    - section 1(1) – definition of 'person' and 'company';
    - section 24BA;

- section 41(1) – definition of 'equity share';
- section 42;
- paragraph 10(*b*)(ii);
- paragraph 20;
- paragraph 31(1); and
- paragraph 35.

- the STT Act:
  - section 1(1) – definition of 'security';
  - section 2; and
  - section 8(1)(*a*)(vi).

Parties to the proposed transaction

The Applicant: A CIS 'manager' as defined in section 1 of the Collective Investment Schemes Control Act No. 45 of 2002

Company A: A company incorporated in and resident of South Africa

Company B: A company incorporated in and resident of South Africa

Fund X: A 'portfolio of a collective investment scheme in securities' as defined in section 1(1) of the Act

Description of the proposed transaction

Company A and Company B are both long term insurers.

Company A offered policies (linked plans) to selected retirement fund policyholders. The premiums of these linked plans in whole or in part fund its obligations to its members. The assets held by Company A under these linked plans are allocated to its untaxed policyholder fund (UPF). The benefits of these linked plans are linked to investments in a portfolio managed by a specific third party investment manager (investment manager) and financial services provider.

Company A reinsured its obligations to pay policy benefits under these linked plans. Company A pays reinsurance premiums to Company B in terms of a reinsurance agreement. Company B invested these premiums in a pooled investment portfolio (portfolio B) held by it, which enables Company B to meet its obligations in terms of the reinsurance agreement.

Company A wishes to terminate the reinsurance agreement by following these steps:

- The Applicant has already established Fund X.
- An investment manager will be appointed for Fund X.
- Company B will dispose of the underlying investments comprising portfolio B to Fund X at market value in exchange for units in Fund X (X units).
- Company A will terminate the reinsurance agreement and Company B will transfer the X units to Company A in settlement of its liability under the reinsurance agreement.
- Company A will own the X units as assets supporting its liability under the linked plans.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- Section 42 will not apply to the disposal of the assets underlying portfolio B in exchange for the issue of the X units.
- Any capital gain that may arise as a result of the disposal of the assets underlying portfolio B attributable to the UPF of Company B to Fund X will be subject to an inclusion rate of 0% in accordance with the provisions of paragraph 10(*b*)(ii).
- The X units will constitute proceeds from the disposal of the assets underlying portfolio B according to paragraph 35, the market value of which will have to be determined according to paragraph 31(1)(*c*).
- The value of the assets underlying portfolio B will constitute expenditure actually incurred by Company B to acquire the X units from Fund X for

purposes of paragraph 20, the market value of which will have to be determined according to paragraph 31.

- The issue of the X units that represents the liability of Fund X to Company B will constitute the expenditure incurred by Fund X to acquire the assets underlying portfolio B for purposes of paragraph 20, the market value of which will have to be determined according to paragraph 31.
- Section 24BA will not apply to the disposal of the assets underlying portfolio B.
- All assets underlying portfolio B, comprising of securities falling within the ambit of the STT Act, to be disposed of by Company B to Fund X, will qualify for the exemption under section 8(1)(*a*)(vi) of the STT Act.
- On the basis that the X units will be allocated to the UPF of Company B, any capital gain that may arise in Company B upon the disposal of the X units to Company A will be subject to an inclusion rate of 0% in accordance with the provisions of paragraph 10(*b*)(ii).
- Company B will dispose of the X units to Company A for proceeds equal to Company B's liability in terms of the reinsurance agreement according to paragraph 35.
- Company A will acquire the X units for a cost or expense equal to the amount of its claims in terms of the reinsurance agreement as determined in paragraph 20.
- No STT will be payable on the transfer of the X units by Company B to Company A in settlement of Company B's liability in terms of the reinsurance agreement.

7.5. BPR 252 – Donations tax and capital gains tax consequences of the part waiver of a loan and reduction of the interest rate

This ruling determines the donations tax and capital gains tax consequences of the waiver of part of a loan to an employee share trust and the reduction of the interest rate on the remaining balance of the loan to 0%.

In this ruling references to sections and paragraphs are to sections of the Income Tax Act and paragraphs to the Eighth Schedule to the Act applicable as at 2 September 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of:

- section 54;
- section 58; and
- paragraph 12A.

Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa

The Trust: A trust established in and a resident of South Africa

Description of the proposed transaction

The Applicant processes mining residues and waste material to extract precious metals which are sold to third parties. In order to conduct the processing activities the Applicant has a precious metals refining licence (licence) as required in terms of the Precious Metals Act No. 37 of 2005.

The Applicant established the Trust to achieve its Black Economic Empowerment objectives. The beneficiaries of the Trust are employees of the Applicant who are historically disadvantaged persons as contemplated in the broad-based socio-economic empowerment Charter for the South African Mining and Minerals Industry.

The Applicant issued some of its ordinary shares to the Trust at market value. The subscription was financed by the Applicant on loan account, on which interest is levied at the 'official rate of interest' prescribed by the Seventh Schedule to the Act.

To date the loan balance has not reduced significantly due to the capitalisation of interest. The Applicant is of the view that the outstanding loan balance exceeds the market value of the shares held by the Trust. Based on current forecasts, it will take the Trust approximately 41 years to repay the loan.

In terms of Regulations published under the Precious Metals Act, the Applicant is, amongst others, required to provide 'meaningful economic participation' to the beneficiaries of the Trust, in order to maintain the licence. In view of the current anticipated repayment period, two empowerment agencies have confirmed to the Applicant that the Trust may not provide the required meaningful economic participation. Accordingly, there is a risk that the Applicant will lose its licence.

The Applicant intends to waive approximately one third of the loan (which includes capitalised interest) and to reduce the interest rate on the loan to 0%.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- Section 58 will not apply to the part waiver of the loan.
- Donations tax will not be levied under section 54 in respect of the part waiver of the loan.
- Section 58 will not apply to the amendment of the loan agreement to reduce the interest rate to 0%.
- Donations tax will not be levied under section 54 on the amendment of the loan agreement to reduce the interest rate to 0%.
- The Trust will be required, under paragraph 12A read with paragraph 20, to reduce its expenditure for the shares in the Applicant to the extent that the original loan capital is to be waived.

7.6. BPR 253 – Donation tax consequences of a transaction to introduce a BEE shareholder into a group

This ruling determines whether the disposal of shares in a company at a discount and the subsequent acquisition of shares by the seller in the acquiring company at a nominal subscription price, to introduce the acquiring company into the seller's existing group structure for Black Economic Empowerment (BEE) purposes, will constitute a donation.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 2 September 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of:

• section 54;

• section 55(1) – definition of 'donation';

• section 57; and

• section 58.

Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa

The Seller: A trust founded in and a resident of South Africa that holds all the shares in the Applicant

Company A: A non-profit company incorporated in and a resident of South Africa

The Acquirer: A company incorporated in and a resident of South Africa whose shares are wholly owned by Company A

Description of the proposed transaction

The Applicant and the Seller wish to introduce the Acquirer into their group structure as a BEE shareholder. The purpose is to benefit the Applicant and the group as a whole from a BEE scorecard perspective and to increase the Applicant's profitability.

The Acquirer has no assets or liabilities. The Seller and the Acquirer propose to enter into the following transactions as an indivisible transaction:

- While the Acquirer is still a wholly-owned subsidiary of Company A, the Seller will dispose of 26% of the issued equity shares in the Applicant to the Acquirer for a purchase price which is the lower of:

- the market value of the shares at the date of disposal less a 10% discount; or
- a capital sum of 40% of the Applicant's future dividends that will be received by or accrued to the Acquirer over the eight year period following the disposal.

The Seller's outstanding claim for the capital sum of the purchase price will be payable in instalments over those eight years and will not attract interest.

- Immediately after the disposal by the Seller of 26% of the issued equity shares in the Applicant to the Acquirer but as part of the same indivisible transaction, the Seller will subscribe for 49% of the issued equity shares in the Acquirer for a nominal subscription price.

Conditions and assumptions

This binding private ruling is subject to the additional condition and assumption that the Seller and the Acquirer are independent parties dealing at arm's length.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- Neither the disposal by the Seller of 26% of the issued equity shares in the Applicant to the Acquirer at a discount as contemplated in **4** a)(i) or (ii) nor the subsequent acquisition by the Seller of 49% of the equity shares in the Acquirer at a nominal subscription price will constitute a 'donation' as defined in section 55(1). Neither of these transactions will be deemed to be a donation as envisaged in section 58(1).
- Section 57 will not be applicable to the proposed transaction.

7.7. BPR 254 – Consequences of cross-border and domestic asset for share transactions

This ruling determines, amongst other things, the interpretation and application of section 24BA of the Act in the context of three simultaneous asset-for-share transactions between a domestic company and its three prospective shareholders, two of whom are non-residents for tax purposes.

In this ruling references to sections are to sections of the relevant Act applicable as at 16 September 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of the provisions of:

- the Income Tax Act
  - section 24BA;
  - section 42; and
  - section 64FA.
- the STT Act –
  - section 8(1)(*a*)(i) and (vi).

<u>Parties to the proposed transaction</u>

The Applicant: A private company incorporated in and a resident of South Africa, with none of its share capital issued as yet

Company A: A private company incorporated in and a resident of South Africa, holding approximately 32% of the shares in Company C

Company B: A company established and effectively managed in Mauritius and a non-resident of South Africa, holding approximately 14.3% of the shares in Company C

Company C: A private company incorporated in and a resident of South Africa

Individual 1: An individual that is a non-resident of South Africa, holding approximately 20.1% of the shares in Company C

Individual 2: An individual that is a resident of South Africa, holding approximately 20.5% of the shares in Company C

The balance of the share capital of Company C is held by various employees of the company.

<u>Description of the proposed transaction</u>

Individual 1, Company A and Company B (Co-Applicants) intend to become three equal shareholders in the Applicant (each holding one third of the share capital) by transferring their respective interests in Company C to the Applicant, in exchange for shares in the Applicant (the proposed share exchange transactions). Company A and the Applicant intend to apply the provisions of section 42 of the Act to their proposed transaction.

At the same time, these Co-Applicants will subscribe for further shares in the Applicant, paying the subscription price in cash, in order to provide the Applicant with sufficient capital to acquire the shares in Company C of Individual 2. These cash subscriptions will not be equal to the value of the Co-Applicants' investments in the Applicant *inter se*. This is due to the pricing to be used for each proposed transaction (see below).

A series of transactions that occurred outside South Africa culminated in Company B acquiring its interest in Company C at a premium price if compared to a discounted cash flow valuation performed by a third party a few months prior to the acquisition.

Approximately a year later, Company A (a black economic empowerment investor) acquired shares through the efforts of Individual 1 and Company B in Company C from several individuals, separately. The purchase price for these shares represented a significant discount, if compared to the price paid by Company B a year before, and if compared to the third party valuation.

The agreed strategy amongst the Co-Applicants was that they would pool their investments into a controlling vehicle (the Applicant) in order to hold the controlling stake in Company C. The pricing of the proposed share exchange transaction between the Applicant and Company A will reflect the discounted price at which Company A acquired its shares in Company C. Similarly, the proposed share exchange transaction between Company B and the Applicant will occur at a price equal to Company B's historical premium acquisition price. The Co-Applicants agreed that the proposed share exchange transaction between Individual 1 and the Applicant will reflect the same premium pricing that will be used for Company B's transaction. Therefore, having had the benefit of acquiring its shares

in Company C at a discount, Company A proposes to give up value in favour of Company B and Individual 1.

The Co-Applicants consider their past dealings prior to the proposed transaction, that is to say, those dealings that resulted in Company A acquiring its shares in Company C, to be dealings undertaken between parties who were independent of each other and at arm's length. SARS has not given any consideration to this fact, and does not express any view in this regard.

Conditions and assumptions

This binding private ruling is subject to the following additional conditions and assumptions:

- Company C does not own immovable property, situated in South Africa.
- Less than 80% of the market value of Individual 1's and Company B's interests in Company C is attributable to South African immovable property, held directly, or indirectly, as capital assets by Company C.
- The shares in Company C, owned by Company B, are not effectively connected with a permanent establishment of Company B in South Africa.
- Immediately prior to the proposed transaction, the market value of Company A's interest in Company C will exceed the base cost thereof.
- The shares to be issued by the Applicant in exchange for the shares in Company C to each of the Co-Applicants carry voting rights in the same proportion as the relevant share interests. In other words, 10% of the shares in the Applicant will entitle the holder to 10% of the voting rights.
- Company A holds its interest in Company C as a capital asset and will hold the interest in the Applicant as a capital asset.
- The market value of the shares in Company C to be sold to the Applicant, will immediately before that disposal exceed the market value of the consideration shares to be issued to Company A in exchange therefor, immediately after that issue. (excess asset value)
- The market value of the consideration shares to be issued by the Applicant, will immediately after their issue to Company B and Individual 1, exceed the market value of the shares in Company C to be sold by them to the Applicant, immediately before that disposal (excess consideration).

Ruling

The ruling made in connection with the proposed transaction is as follows:

- Section 24BA of the Act will apply to the proposed transaction.
- Under section 24BA(3) of the Act, the following consequences will arise –
    - Company A's base cost of the consideration shares will be reduced by the excess asset value, whilst the Applicant will be deemed to have realised a corresponding capital gain equal to the excess asset value in respect of a disposal of the shares; and
    - the excess consideration will be deemed to be a dividend, that is, the distribution of an asset *in specie*, paid by the Applicant on the issue date of the consideration shares to Company B and Individual 1.
- In relation to the proposed transaction between Company B and the Applicant, as well as the proposed transaction between Individual 1 and the Applicant, the dividends tax rate reduction in section 64FA(2) of the Act will not apply. Dividends tax at the rate of 15% will be payable by the Applicant under section 64EA(*b*) of the Act in relation to the excess consideration. The amount of the excess consideration will be deemed to be a dividend, that is, a distribution of an asset *in specie* and paid by the Applicant on the issue date of the consideration shares, under section 24BA(3) of the Act.
- Section 42 of the Act will apply to the proposed transfer by Company A of its shares in Company C to the Applicant only to the extent that section 24BA of the Act does not create deemed consequences for these parties.
- The proposed transfer of the shares in Company C by Company B and Individual 1 to the Applicant will be exempt from STT under section 8(1)(*a*)(vi)(B) and (C), read with section 8(1)(*a*)(i) of the STT Act.

7.8. BPR 255 – Debt reduction by means of set-off

This ruling determines the tax consequences relating to the settlement of shareholder funding loans owed to the shareholder, being set-off against that shareholder's share subscription obligation in the same amount.

In this ruling references to sections and paragraphs are to sections of the Income Tax Act and paragraphs of the Eighth Schedule to the Act applicable as at 18 July 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of:

- section 8(4)(*a*);
- section 19;
- paragraph 12A; and
- paragraph 20(3)(*b*).

Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa

Co-Applicant: A company incorporated in and a resident of South Africa that is a shareholder of the Applicant

Description of the proposed transaction

The Co-Applicant advanced interest bearing loans (shareholder funding loans and administration loans) to the Applicant. There are no fixed terms of repayment and the loans are repayable on demand.

The shareholder funding loans were applied by the Applicant for the acquisition of allowance assets or trading stock in prior years of assessment. All the allowances have been written off or deducted for income tax purposes.

The shareholder funding loans include capitalised interest which has been deducted for income tax purposes by the Applicant.

The Applicant does not have sufficient cash reserves to meet its financial obligations and it is unlikely that the Applicant will be in a position to repay the shareholder funding loans from its operating cash flows in the foreseeable future. The balance sheet of the Applicant has the potential to impair the company's ability to obtain credit for working capital requirements.

The proposed steps for achieving the settlement of the shareholder funding loans are as follows:

- The Co-Applicant, through a rights issue, will subscribe for equity shares in the Applicant.
- The Co-Applicant will settle its subscription obligation by way of set-off against its shareholder funding loans owed to it by the Applicant.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- Section 19 and paragraph 12A will not be applicable to the proposed transaction to the extent that it relates to the settlement of the Applicant's shareholder funding loans owed to the Co-Applicant, being set-off against the share subscription obligation in the same amount.
- No amount will be included in the Applicant's income under section 8(4)(*a*) and no expenditure relating to an asset will be reduced as envisaged under paragraph 20(3)(*b*).

Note

This ruling does not cover the application of any general anti-avoidance provision to the proposed transaction.

8. BINDING CLASS RULING

8.1. BCR 55 – Income tax and value-added tax consequences of a customer loyalty scheme

This ruling determines the income tax and value-added tax (VAT) consequences for suppliers making customer loyalty bonus payments.

In this ruling references to sections are to sections of the relevant Act applicable as at 24 August 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of the provisions of:

- the Act
  - section 1(1) – definition of 'gross income';
  - section 11(*a*) read with section 23(*g*); and
  - section 23H.
- the VAT Act:
  - section (1)(1) – definitions of 'consideration', 'input tax', 'supply' and 'services';
  - section 7(1)(*a*);
  - section 10(23); and
  - section 21.

Class

The Class Members to whom this ruling will apply consists of the Applicant, its subsidiaries and the joint ventures in which the Applicant or its subsidiaries have an interest, that will participate in the customer loyalty scheme.

Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa

The Class Members: The entities described above

The Settling Entity: A company to be incorporated that will function as the Settling Entity on behalf of the Class Members, duly represented in this application by the directors of the Applicant

Customers: Customers of the Class Members

Description of the proposed transaction

Each Class Member is incorporated in and is a resident of South Africa, and is also registered as a vendor for VAT purposes.

The Class Members seek to implement a customer loyalty scheme (scheme) to protect their existing customer base and possibly expand the businesses carried on by them. The framework for the implementation of the scheme will be contained in the scheme rules.

The salient terms of the scheme will be as follows:

- The board of directors of the Applicant (the board), as custodian of the scheme, will approve the scheme that will involve the loyalty bonus allocations (allocations) to customers conducting business with the Class Members.
- The board may annually authorise and determine
    - the entities that will be Class Members in a particular bonus scheme period;
    - the amount available to pay the allocations and the basis or eligibility criteria for the allocations; and
    - the manner in which the allocations will be settled.
- A customer can choose whether or not to participate in the scheme. Participating customers will formally accept the rules as binding on them when electing to participate.
- The Class Member will charge the same price for the goods or services provided to all customers, whether they are participating customers or not.
- During the scheme period, the board may on or before the expiry of the annual allocation period, but shall by no later than three months thereafter, determine each participants' allocation based on the value of business conducted with the Class Member.
- In order to simplify the administration of the scheme the allocations will be settled by the Settling Entity, as opposed to being administered and settled by each Class Member. To achieve this outcome:

- Each Class Member will incur an obligation towards the customer for the allocations for the annual allocation period.
- The Settling Entity will settle this obligation on behalf of the Class Member in its capacity as agent of the Class Members.
- The Class Member will incur an obligation to reimburse the Settling Entity equal to its obligation towards the customers that has been settled on its behalf.

Conditions and assumptions

This binding class ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The Act:
  - The allocations made by the Class Members will be deductible under section 11(*a*) read with section 23(*g*) in the year of assessment in which the board has determined all the participants' allocations as contemplated in the scheme rules. Should the board make such determination after the end of the year of assessment relating to the annual allocation period, the allocations will fall to be deductible in the latter year of assessment.
  - Section 23H will not apply to the deduction mentioned above.
  - The Settling Entity will not be entitled to a deduction under section 11(*a*) read with section 23(*g*), in respect of payments made on behalf of the relevant Class Member to a participating customer.
  - The Settling Entity will not be required to include in its 'gross income' the value of the right to be reimbursed by the Class Member in respect of payments made by it to customers on behalf of the relevant Class Member.
- The VAT Act:

- The allocation is not 'consideration' as defined in section 1(1) in respect of any supply of goods or services made by the participating customer, and the Class Member may not deduct any amount as input tax in relation to it.
- The allocation by the Class Member does not have any VAT implications in relation to that Class Member.
- The allocation is determined based on the overall business conducted and the availability of profits for the allocation. It therefore does not result from an agreement envisaged under section 21(1)(*c*) to alter the previously agreed consideration for any taxable supply of goods or services. Consequently, no adjustment must be made under section 21(2) and no credit note must be issued under section 21(3) on a tax invoice previously issued by the Class Member concerned for the supply of goods or services.

9. BINDING GENERAL RULING

9.1. BGR 36 – VAT – Circumstances prescribed by the Commissioner for the application of section 16(2)(g)

For the purposes of this ruling:

• **'alternative documentary proof'** means documentary proof other than the documents listed in section 16(2)(*a*) to (*f*) that contains the information acceptable to the Commissioner;

• **'section'** means a section of the VAT Act;

This BGR prescribes the circumstances under which SARS will allow a vendor to use alternative documentary proof to substantiate the vendor's entitlement to a deduction under section 16(3).

<u>The circumstances prescribed by SARS where the vendor is unable to obtain the requisite documentation</u>

A vendor may only apply for approval under section 16(2)(*g*) to rely on documentary proof, other than the documents prescribed under section 16(2)(*a*) to (*f*) if the vendor:

- has sufficient proof that it made reasonable attempts to obtain the documentary proof required by the Commissioner under section 16(2)(*a*) to (*f*);
- was unable to obtain and maintain the documentation prescribed under section 16(2)(*a*) to (*f*) due to circumstances beyond the vendor's control; and
- no other provision of the VAT Act allows for a deduction based on the particular document in the vendor's possession.

<u>Circumstances beyond the vendor's control</u>

The circumstances beyond the vendor's control may include, but are not limited to the following:

- The supplier fails to issue a tax invoice, debit note or credit note;
- The supplier was contacted but failed to respond to the vendor's request(s) to be furnished with a complete tax invoice or correct document;
- The supplier or vendor's place of business has suffered damage as a result of, for example, a natural disaster, *vis major*; criminal activity or fire, causing damage to its accounting records, with no possibility of the said records being retrieved or re-issued; or
- The supplier has been deregistered as a vendor.

<u>Alternative documentary proof in respect of a deduction as contemplated in section 16(3)(*c*) to (*n*)</u>

A vendor seeking to rely on the use of alternative documentary proof for these deductions, must demonstrate and substantiate the circumstances beyond the vendor's control, giving rise to, the vendor's difficulty in obtaining the documentary proof prescribed by SARS as set out in Interpretation Note No. 92 dated 24 October 2016 'Documentary Proof Prescribed by the Commissioner'.

<u>The vendor's application for a VAT ruling</u>

In order to obtain SARS' approval to use alternative documentary proof in substantiating a deduction under section 16(2)(*g*), a vendor must apply for a VAT ruling or VAT class ruling under section 41B. The application must demonstrate that the vendor falls under the circumstances prescribed above, together with the relevant proof and the details of the alternative documentary proof the vendor seeks to rely on in order to support the vendor's entitlement to make the deduction. In this regard, a clearly motivated application complying with the provisions of section 79 of the Tax Administration Act, excluding section 79(4)(*f*) and (*k*) and (6), must be submitted.

A deduction under section 16(2)(*g*) may only be made where the vendor is in possession of the relevant approval granted by SARS as well as the relevant documents at the time the return is submitted in which the deduction is made.

10. DRAFT BINDING GENERAL RULING

10.1. BGR 36 – Associations: Meaning of 'annual or other long-term members'

This BGR provides clarity on the meaning of 'annual or other long-term member' referred to in section 30B(2)(*b*)(ix).

SARS must approve an entity for purposes of section 10(1)(*d*)(iii) or section 10(1)(*d*)(iv)(*bb*) if that entity has submitted a copy of its constitution or written instrument under which it has been established that provides for the conditions and requirements set out in section 30B(2)(*b*).

A requirement for obtaining such approval is that substantially the whole of the entity's funding must be derived from, amongst other things, its annual or other long-term members.

<u>Application of the law</u>

<u>Membership requirement</u>

The term 'annual or other long-term members' is not defined in the Act and should therefore be interpreted according to its ordinary meaning as applied to the subject matter relating to which it is used unless the ordinary meaning creates an absurdity or ambiguity. It is important when giving words and expressions their ordinary meaning, to consider the context in which such words or expressions are used.

Member

A 'member' is defined in section 30B(1) only for purposes of a fidelity or indemnity fund to include a contributor to that fund.

The ordinary meaning of 'member' is 'a person or organisation belonging to a group or society'.

A member includes any natural person or any other person such as companies or other incorporated entities, statutory bodies or associations of persons.

A member generally qualifies for membership under the constitution or written instrument under which the entity is established and governed if certain qualifying criteria and requirements are met. The qualifying criteria and requirements will depend on the type of entity as well as the nature of the activities the particular entity carries on.

A member may or may not be required to pay a registration fee and an annual membership or subscription fee to belong to an entity. Membership and subscription fees may vary from entity to entity and may also vary depending on the category of membership the member holds within an entity.

Annual member

The ordinary meaning of 'annual' is 'occurring or recurring once in each year; continuing for the period of a year'.

An annual member is therefore a member that belongs to an entity for 12 months.

Long-term member

The ordinary meaning of 'long-term' is 'occurring over or involving a relatively long period of time'.

A long-term member is therefore a member that belongs to an entity for longer than 12 months.

Ruling

The requirement for approval as an association under section 30B is that the member of the entity must be an annual or long-term member.

'Annual', 'long-term' and 'member' referred to in section 30B(2)(*b*)(ix) are interpreted as follows:

- 'Annual' is 12 months.
- 'Long-term' is more than 12 months.
- 'Member' is any person8 that holds membership.

It is not a requirement for approval as an association under section 30B that the members of an entity must pay a membership or subscription fee to belong to, or to benefit from, the activities of the entity.

11. GUIDES

11.1. Guide to the exemption from Normal Tax of Income from Films

This guide provides general guidance on the exemption from normal tax for the receipts and accruals of income derived from the exploitation rights of a film.

South Africa's income tax system contains an incentive aimed at stimulating the production of films within the Republic.

The incentive was previously contained under section 24F. Section 24F provided an upfront deduction, or in some circumstances a deduction which was spread over 10 years, for certain production or post-production costs actually incurred by the taxpayer. This incentive has been replaced by the provisions of section 12O which provides for the exemption from normal tax of income derived from the exploitation rights of approved films. Section 12O came into effect on 1 January 2012 and applies to all receipts and accruals of approved films if principal photography commenced on or after this date but before 1 January 2022.

Section 24F was repealed with effect from 12 December 2013.

Section 12O effectively eliminates income tax on qualifying film receipts and accruals for a 10-year period from the date the film is completed. It applies to films that have been approved by the NFVF as a local production or a co-production. The NFVF has introduced a set of qualifying criteria, the South African Film Criteria, that are used to determine whether a film constitutes a local production or a co-production based on a point system. The exemption is limited to investors who acquired the exploitation rights held before the completion date of the film.

Taxpayers may claim a net loss on a film in a year of assessment commencing at least two years after the completion date of the film. The deduction of a net loss also results in a taxpayer being unable to claim the exemption on the particular film going forward.

Section 12O(6) provides that any grant received by or accrued to an SPCV from the state under the DTI incentive will be exempt from normal tax but subject to the general recoupment provision under section 8(4). In certain cases, if the grant is passed on to an investor, the investor will also qualify for the exemption. A taxpayer who receives or to whom an exempt DTI incentive accrues must consider the provisions of section 12P(3) to (6) as there are consequences on the cost, deductions and allowances available to a taxpayer in respect of related expenditure.

11.2. Guide to the Urban Development Zone (UDZ) Tax Incentive (Issue 5)

This guide is a general guide about the urban development zone (UDZ) tax incentive provided for in section 13*quat* of the Income Tax Act 58 of 1962 (the Act). It is not meant to deal extensively with the precise technical and legal aspects associated with the incentive, but is intended merely as a general guide for potential investors. Moreover, urban development zones should not be confused with 'special economic zones' under sections 12R and 12S which will become effective on a date still to be determined.

In line with many countries, South Africa has a number of urban areas that are impoverished and suffering from extensive urban decay. In order to address these concerns and maintain existing infrastructure, governments internationally have increasingly used tax measures to support efforts aimed at regenerating these urban areas.

In 2003, the Minister of Finance announced a tax incentive (the UDZ incentive) in the form of an accelerated depreciation allowance under section 13*quat* to promote investment in 16 designated inner cities, 15 of which now have demarcated UDZs within its boundaries. The core objectives of the incentive are to address dereliction and dilapidation in South Africa's largest cities and to promote urban renewal and development by promoting investment by the private sector in the construction or improvement of commercial and residential buildings, including low-cost housing units, situated within demarcated UDZs. The UDZ incentive also intends to encourage investment in highly populated areas, central business districts or inner city environments and areas with existing urban transport infrastructure for trains, buses or taxis.

The allowance, when claimed, reduces the taxable income of a taxpayer. Further, it is not limited to the taxable income of a taxpayer and can create an assessed loss. This deduction was originally only available until 31 March 2014 but has been extended for a further six years until 31 March 2020.

Municipalities will be given the opportunity to apply for extensions to already existing designated zones and to apply for an additional demarcated UDZ in that municipal zone. Only areas which have a specific and necessary need for an extra zone will be granted UDZ status, and will be subject to Ministerial approval.

11.3. VAT 409 – Guide for Fixed Property and Construction

This guide is a general guide concerning the application of the VAT Act in connection with fixed property and construction transactions in South Africa.

The fixed property industry consists of many role-players, including architects, builders, developers, property speculators, quantity surveyors, engineers, plumbers, electricians, municipalities, public entities, financial institutions, estate agents etc. Although these role-players are mentioned in this guide, the content deals primarily with vendors that are involved in transactions concerning the development, construction and selling of fixed property.

VAT is an indirect tax which is levied on the supply of any 'goods' or 'services' supplied by a 'vendor' in the course or furtherance of any enterprise carried on by that vendor. 'Goods' is defined to include 'fixed property' and any real right in any such fixed property, but excluding any right under a mortgage bond or pledge of any fixed property. The scope of transactions with which this guide is concerned with is therefore those described in the definition of 'fixed property', which means:

- land (together with improvements affixed thereto);
- any unit as defined in section 1 of the Sectional Titles Act No. 95 of 1986;
- any share in a share block company which confers a right to or interest in the use of immovable property under the Share Blocks Control Act No. 59 of 1980;
- in relation to a property time-sharing scheme, any time-sharing interest as defined in section 1 of the Property Time-sharing Control Act No. 75 of 1983; and
- any real right in any such land, unit, share or time-sharing interest.

It will therefore be found that most transactions which have some connection with the acquisition of rights to fixed property (excluding rights under a mortgage bond or pledge of fixed property) will fall within the ambit of the definition and will be subject to VAT if the supplier is a vendor.

Other examples of rights falling within the definition include:

- Certain rights of use such as usufructs, *usus* or *habitatio.*
- Bare dominium rights of ownership.
- Servitudes, encroachments and other encumbrances.

- Exclusive use areas in sectional title developments.
- Rights to minerals or rights to mine for minerals.
- Leases or sub-leases of rights to minerals, or to mine for minerals.

Although most supplies of fixed property by a vendor will be subject to VAT, there are certain instances when such supplies will not be. In these cases, the transactions will be subject to transfer duty. It is therefore important that vendors are able to distinguish between the different types of supplies to establish whether VAT or transfer duty applies. The VAT Act and the Transfer Duty Act therefore both contain special rules to deal with these situations. (See *The Transfer Duty Guide*.)

The approach of this guide in dealing with the topics is set out below:

Chapter 1: This chapter sets out the scope of the most common transactions falling within the definition of 'fixed property'.

Chapter 2: Introduces the reader to the most important concepts, terms and definitions mentioned in the guide so that the VAT treatment of supplies which are explained in later chapters can be understood. A key point addressed in this chapter is the concept of an 'enterprise' and the different circumstances under which certain activities conducted will render a person liable to register for VAT.

Chapter 3: Deals with the interaction between VAT, transfer duty and securities transfer tax. This chapter explains which types of transactions are subject to VAT and when the other taxes will apply.

Chapter 4: Explains the VAT treatment of the different types of supplies and the VAT accounting in respect thereof. The chapter includes a discussion on the application of the special time and value of supply rules with regard to the declaration of output tax and input tax. It also explains the rules which apply for deducting notional input tax on the acquisition of second-hand goods constituting fixed property.

Chapter 5: Deals with a number of adjustments which apply in connection with fixed property based on the extent of taxable use. These include annual adjustments in regard to the use of capital goods and services as well as situations which give rise to a change in use or application, or change of intention with regard to the taxable use of the fixed property after the initial acquisition.

Chapter 6: Explains the specific application of the VAT law which has been set out in previous chapters to transactions in the construction industry. The focus is specifically on those vendors that supply construction services only and deals mainly with quoting of prices, costing of projects, invoicing, agent and principal relationships, and certain other aspects such as penalties and retentions which are unique to the construction industry.

Chapter 7: Deals mainly with the issues faced by developers and property speculators. The focus is therefore on supplies of newly constructed properties and second-hand properties that have been renovated before being sold, or properties that are bought and sold on a speculative basis. Included is a discussion on the consequences of temporarily applying properties for exempt supplies (residential purposes). Other topics dealt with include subsidised low cost housing developments, fractional ownership type developments and land restitution transactions.

Chapter 8: Deals with the VAT treatment of rental pools. The chapter contains a detailed explanation of the special rules set out in section 52 and how these apply in practice to override what would otherwise be viewed as supplies made by an agent as set out in 2.11.

Chapter 9: Discusses other aspects regarding the supply of fixed property which are not dealt with in the other chapters.

11.4. VAT 420 – Guide for Motor Dealers

This guide concerns the application of the value-added tax (VAT) legislation in respect of vendors that supply motor cars and other vehicles (motor dealers).

For the most part, the general VAT principles as set out in the *VAT 404 – Guide for*

Vendors will apply to motor dealers. The information in this guide should therefore be read together with the *VAT 404 – Guide for Vendors*. This guide expands on the application of the normal VAT principles with regard to specific types of transactions which are of interest to motor dealers and the motor industry in general.

The approach to the topic and the layout of the material in this guide is set out as follows:

Chapter 1: This chapter sketches the general VAT principles concerning the VAT treatment of the supply of motor vehicles in the Republic. An important aspect in this regard is that, as a general rule, a vendor may not deduct input tax on the acquisition of a 'motor car' as defined in the VAT Act. However, this rule does not apply to a vendor that supplies motor cars for a consideration in the ordinary course of conducting an enterprise. A brief overview is also provided on the basic principles of VAT and how it applies to motor dealers.

Chapter 2: This chapter introduces the reader to some of the more important concepts and definitions contained in the VAT Act. It also deals with terminology used in the motor industry which is relevant for the purposes of certain topics to be discussed in later chapters.

Chapter 3: In this chapter the various types of supplies which are made by motor dealers are discussed in some detail. In particular, the focus is on the nature of the supplies and whether output tax must be declared by the motor dealer, or by some other vendor in the case where the motor dealer has acted as agent.

Chapter 4: It is important for motor dealers that are involved in exporting vehicles to draw a distinction between direct and indirect exports, as well as new and second-hand motor vehicles exported, as the VAT treatment differs. This chapter therefore discusses the rules for applying the zero rate of VAT to different types of exports, the applicable documentation which a vendor is required to hold to justify the charging of VAT at the zero rate on exports, and the possible VAT adjustments which may be required when the export documentation is not received timeously.

Chapter 5: The different circumstances under which goods are imported into the Republic are discussed. As the normal rules in this regard are discussed in the *VAT 404 – Guide for Vendors*, this chapter focuses on specific types of imports which may apply to motor dealers. For example, the temporary import of vehicles for the purpose of servicing or repair, trans-shipment of vehicles destined for export countries, and certain aspects concerning warranties.

Chapter 6: This chapter focuses on the different types of supplies acquired or goods imported by motor dealers in the course of conducting an enterprise, and sets out the rules with regard to the deduction of input tax in that regard.

11.5. Transfer Duty Guide

This document contains a discussion of the application of the Transfer Duty Act in respect of transactions involving immovable property such as land, buildings and other real rights in connection with immovable property situated in South Africa.

The Transfer Duty Act was promulgated in *Gazette Extraordinary* 4193 on 28 July 1949. It came into effect on 1 January 1950 and applies to all acquisitions of property on or after that date. Any acquisitions before 1 January 1950 remain liable to duty under the relevant laws operative at the date of the transaction. Particulars as to any liability and/or rates of duty or exemptions relevant to any such acquisitions may be obtained by referring the matter to the office of the Commissioner.

Transfer duty is a tax levied by the national sphere of government and is paid into the National Revenue Fund.

As mentioned in the Preface, this document includes a discussion on the meaning of various definitions, how the imposition of transfer duty works, whether a transaction is subject to VAT or transfer duty, how to calculate the transfer duty which is payable, and how to establish if an exemption applies.

Some areas of the transfer duty law have been explained in more detail than others because of the degree of complexity of the particular topic concerned. It has also been necessary to deal with other taxes such as VAT, Capital Gains Tax (CGT) and income tax to a certain extent, particularly when it concerns the transfer duty exemptions. These other taxes are only dealt with in so far as it is necessary to obtain a basic understanding of their link with transfer duty. The reader will therefore find numerous references to other legislation, case law and guides issued by SARS for more details relating to the tax type concerned.

The main purpose of this guide is therefore to assist the reader to:

- determine if 'property' has been acquired, or if a transaction or event is otherwise subject to transfer duty in principle, or if an exemption from duty applies;
- determine if a transaction is subject to VAT or transfer duty;
- identify the factors which SARS must (or may) take into account when determining the 'fair value' of property as well as which amounts must be included or excluded from the consideration which is subject to duty;
- calculate the amount of duty (including any interest thereon) for different types of property transactions and determine the period within which transfer duty is payable;
- determine the administrative requirements which apply and the documents which must be submitted to SARS so that the transaction can be processed efficiently to allow the Registrar of Deeds to record the transaction (where applicable); and
- generally understand the application of the Transfer Duty Act with regard to property transactions.

Some aspects with regard to policies and procedures on the processing of transactions are mentioned in this guide, but this is not the focus of the publication. More details regarding the submission of returns and the processing of documents and payments can be found in the *Transfer Duty eFiling Guide*.

The approach of this guide in dealing with the topics is set out below.

Chapter 1: Provides a brief historical perspective and some background information relating to transfer duty. It also describes the scope of topics that will be covered in the guide and the approach adopted.

Chapter 2: This chapter explores some of the main definitions and concepts which underpin the application of the Transfer Duty Act in the context of the law of property, the law of contract and various other legislative acts which govern property transactions in South Africa. The most fundamental definition is that of 'property' which has a particular meaning in the legal context as well as a specific defined meaning in section 1(1) of the Act. The definition also has a link with the definition of the term 'fixed property' as defined in section 1(1) of the VAT Act which is explained in some detail in the guide.

Chapter 3: Describes the transactions and events which make up the tax base of transfer duty, being acquisitions of 'property' either by way of a transaction or in any other manner, as well as renunciations of interests in 'property' which has the effect of enhancing the value of property. As most of the important definitions and concepts would have already been explained in Chapter 2, this chapter provides a summary of the meaning of those terms and puts them into context within the meaning of the term 'acquisition'. Also dealt with in this chapter is the cancellation of transactions and transactions which are concluded through representatives or agents who act on behalf of, or for the benefit of others.

Chapter 4: Briefly sets out aspects which relate to the date of liability for transfer duty and the period in which the duty must be paid. This chapter focuses on the practical aspects relating to the definition of the terms 'date of acquisition' and 'acquisition' which are explained in Chapters 2 and 3.

Chapter 5: Deals with determining who is liable to pay transfer duty in any particular situation. The general rule is that the transferee is liable, but the Act also contains provisions which make other persons liable for the duty in certain types of transactions.

Chapter 6: Focuses on the determination of the dutiable value of the property acquired or the value by which property is enhanced by the renunciation of an interest therein. The applicable valuation rules as set out in the definition of the term 'fair value' are discussed in the context of the different transactions and events. The chapter includes a discussion of different valuation factors that the Commissioner may consider (or which must be considered) when an inadequate consideration is paid or where the declared value is less than the fair value of the property acquired or renounced. This chapter also sets out what is to be included and excluded from the consideration paid (or payable) which will be subject to duty.

Chapter 7: Sets out the rules for calculating transfer duty and the rates of duty that have applied over the years. Included are a number of different examples of how to calculate duty for past and current transactions as well as the application of the formula in section 2(5) for calculating the duty on an acquisition of an undivided share in property. The examples also demonstrate how to establish whether transfer duty or VAT is payable on a transaction.

Chapter 8: Deals with exemptions from duty. One of the most important of these is section 9(15) which provides for an exemption from transfer duty when a property transaction constitutes a taxable supply of 'fixed property' as defined in section 1(1) of the VAT Act. This exemption, amongst others, are explained in more detail, mainly as a result of other legislation or legal principles which apply in certain transactions, or as a result of the complexity of the wording of the exemption itself.

Chapter 9: Deals with matters associated with the payment and recovery of duty. It covers the period for payment, the issuing of receipts and penalties or interest payable on late payments.

Chapter 10: Deals with compliance matters concerning the administration of the Act generally in the context of the TA Act. It includes a discussion on how these aspects impact on the interpretation of definitions, the submission of returns and payments, recovery of unpaid duty, objections, appeals and dispute resolution.

12. DRAFT GUIDES

12.1. Special voluntary discolure programme

- This is a preliminary guide, which is subject to Parliamentary legislative processes. This version is based on the proposals to Parliament following the latest round of public comments.
- The guide is meant to assist prospective applicants in preparing for the commencement of the Special Voluntary Disclosure Programme that was proposed by the Minister of Finance in his 2016 Budget.
- Depending on the final outcome of the Parliamentary legislative process, the guide will be updated if necessary. An updated guide may differ from this guide in form and content. Please regularly check the VDP page on the SARS website for updates, at: http://www.sars.gov.za/Legal/VDP/Pages/default.aspx
- The current draft tax-related SVDP legislation is available here: http://www.treasury.gov.za/public%20comments/RMTAB2016/
- Historical exchange rates against selected foreign currencies are available here: http://www.resbank.co.za/Research/Rates/Pages/SelectedHistoricalExchangeAndInterestRates.aspx
- For information regarding the Exchange Control SVDP, please visit the following web page: http://www.resbank.co.za/RegulationAndSupervision/FinancialSurveillanceAndExchangeControl/Pages/Special-Voluntary-Disclosure-Programme.aspx
- For SVDP guidance by the Financial Intelligence Centre please visit: http://www.fic.gov.za/Documents/160928%20Website%20Notice%20Final.

pdf

- For SVDP guidance by the Independent Regulatory Board for Auditors please visit: http://www.irba.co.za/upload/report_files/20160905022438_39.-Reportable-Irregularities.docx
- Enquiries regarding the Exchange Control SVDP may be directed to SARB-SVDP@resbank.co.za
- Enquiries regarding the Tax SVDP may be directed to vdp@sars.gov.za

Background

In terms of the new global standard for the automatic exchange of information between tax authorities, it is expected that the SARS will start receiving offshore 3rd party financial data from other tax authorities from September 2017 on a regular basis. This created a window to propose a Special Voluntary Disclosure Programme (SVDP) to give opportunity for non-compliant taxpayers to voluntarily disclose offshore assets and income, thereby regularising both their tax and exchange control affairs. The SVDP will be open for applications from 1 October 2016 until 30 June 2017.

The SVDP will run concurrent to the permanent Voluntary Disclosure Programme (VDP) of SARS.

SARS and the South African Reserve Bank (SARB) are working together to ensure that SVDP applications are evaluated and processed through one joint process, i.e. for both tax non-compliance and exchange control contraventions.

SVDP Legislative Design

Window

- Applications for relief under the SVDP will apply for a limited window period of nine months starting on 1 October 2016 and closing on 30 June 2017;
- Applications submitted prior to 1 October 2016 or after 30 June

2017 will be processed under the normal VDP rules, i.e. the SVDP rules cannot be applied.

Eligibility

- Individuals and companies may apply.
- Settlors, donors and beneficiaries of foreign discretionary trusts (including deceased estates) may participate in the SVDP if they elect to have the trust's offshore assets and income deemed to be held by and accrued to them. These also include persons who, despite the form, are in substance settlors, donors or beneficiaries.
- Amounts in respect of which SARS obtained information under the terms of any international exchange of information procedure will not be eligible for the SVDP. An applicant will be informed by SARS if this is the case.
- Disclosures where it is argued by the applicant that all or part of the seed money / subsequent deposits / funding of foreign assets are not taxable in South Africa or have already been taxed in South Africa, are excluded from the SVDP. The normal VDP channel remains open for disclosures of this nature.

Relief Granted

	SARS	SARB
Capital that funded the asset ('seed money' , capitalised returns and subsequent deposits)	The undeclared income that originally gave rise to the foreign asset will be exempt from income tax, donations tax and estate duty liabilities arising in the past. 40% of the highest value of the aggregate of all assets situated outside South	A levy of 5% on the value of the unauthorised foreign assets or the sale proceeds thereof as at 29 February 2016, if such assets are repatriated to the Republic of South Africa. The 5% levy must be paid from foreign sourced funds. A levy of 10% the value of

	Africa between (or deemed to be between) 1 March 2010 and 28 February 2015 that were derived from undeclared income will be included in taxable income and subject to tax in South Africa in the 2015 tax period. The value referred to above is the highest market value as at the end of each tax period, in the relevant foreign currency translated to South African Rand at the spot rate at the end of the tax period in which the highest value fell.	the unauthorised foreign assets as at 29 February 2016, if such assets are retained abroad. The 10% levy must be paid from foreign sourced funds. A levy of 12% on the value of the unauthorised foreign assets as at 29 February 2016 in circumstances where the 10% levy is not paid from foreign sourced funds.
Investment returns & other taxable events	Investment earnings & other taxable events prior to 1 March 2015 will be exempt from tax	Not applicable
Interest on SARS debt	Interest on tax debts arising from the disclosure only commence from the 2015 year of assessment	Not applicable
Understatement penalties	No understatement penalties will be levied	Not applicable
Other SARS penalties	Same as current VDP	Not applicable
Criminal Prosecution	Same as current VDP	Not applicable

Where the disclosure is in respect of an asset that was both acquired and disposed of prior to the 2011 tax period, the asset must be treated as if it was held during the five year period ending 28 February 2015 for purposes of determining the value described above. Special valuation rules apply.

Required supporting documentation for SVDP applications

- Supporting documentation must be submitted as attachments to the SVDP application forms. The functionality to attach is available on the SARS eFiling VDP platform.

- For information relating to supporting documents required when submitting exchange control SVDP applications and a copy of the prescribed declaration to be completed by prospective applicants, please visit the SARB SVDP webpage at: http://www.resbank.co.za/RegulationAndSupervision/FinancialSurveillanceAndExchangeControl/Pages/Special-Voluntary-Disclosure-Programme.aspx

- To determine the amount of relief for tax purposes, information in the table format below must be submitted together with the VDP01 application form. In this regard:

    - **Part A** is used by SARS to determine the amount that must be exempt from tax in terms of section 15 of the draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2016;

    - **Part B** is used by SARS to determine the amount that must be included in taxable income terms of section 16 of the draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2016.

Table To Determine Tax Relief				
Tax Period	**Part A** Asset acquisition value and subsequent additional funding		**Part B** Market value of aggregate of all foreign asset(s)	
	Per foreign curency	Per South African Rand	Per foreign currency	Per South African Rand
Pre-2011 * ** ***				
2011				
2012				
2013				
2014				
2015				

* Sum of the highest value(s) per asset up to 28 Feb 2010, translated to South African Rand at the spot rate at the end of the tax period in which the highest value was held

** Where accurate figures are not practically possible to determine, use a reasonable estimate & explain

*** It is not necessary to attach the calculations, but it should be kept in case SARS requests it

- A description of the source of the undeclared income that gave rise to the foreign asset.

- Documentation in evidence of the existence of the foreign asset (e.g. bank account details, property registration papers);

- Confirmation of the date on which the asset was acquired (e.g. letter from the bank in case of a bank account, shareholder certificates, property registration papers). If it is practically impossible to obtain the date then a reasonable estimate of the date, together with an explanation of why it is impractical and how the date was estimated, can be submitted;

- Nature of the applicant's connection to the asset (e.g. owner, shareholder, beneficiary);

- A description of the structure that was utilised to create the asset;

- Power of attorney (where required).

SVDP application and processing

Application process

For SVDP purposes, SARS & SARB have agreed to a single point of entry for applications, which is the SARS eFiling VDP application process. The current VDP application form (VDP01) has been enhanced to accommodate the SVDP tax related disclosures, while a second form (SVDP01) form is available for exchange control disclosures. Both forms will be available on-line on the SARS eFiling platform.

Typically, an applicant will complete both forms, but if only tax relief is required, or if only exchange control relief is required, then only one form needs to be completed.

Resources

In addition to the SARS VDP staff, a complement of SARB staff will be seated at the SARS VDP office. Enquiries regarding the Exchange Control SVDP may be directed to 012 647 2243 or alternatively SARB-SVDP@resbank.co.za .

Evaluation of applications

Tax-related disclosures will be routed to SARS staff and exchange control disclosures will be routed to SARB SVDP unit.

Approval / Rejection of applications: Process

- Tax-related disclosures will be approved or rejected by following normal VDP processes;

- SVDP Agreements and tax assessments arising from SVDP disclosures will be held over until the SVDP legislative framework is promulgated (expected towards the end of the 2016);

- Exchange control SVDP applications will be dealt with in terms of Exchange Control Regulation 24, read in conjunction with exchange control Circular No. 6/2016 dated 13 July 2016

Examples

Example A:

SVDP applicant discloses an offshore interest-producing asset that was acquired in January 2011 at a cost price of US$5m. In January 2013 the applicant disposed of US$4m. Assuming investment returns at an average of 6% per year, the market value of the asset for SVDP purposes is determined as follows:

Tax Period	Transactions	Tax Periods	Investment returns	Market value	US$ / Rand spot rate (per SARB published)	Rand Value
1 Jan 2011	$5 000 000				$6.62	R33 100 000
		28 Febr 2011	$50 000	$5 050 000	$6.98	R35 249 000
		29 Febr 2012	$303 000	$5 353 000	$7.47	R39 986 910
1 Jan 2013	-$ 4000 000				$8.44	-R33 760 000

		28 Febr 2013	$283 857	$1 636 857	$8.84	R14 469 811
		28 Febr 2014	$98 211	$1 735 068	$10.71	R18 582 577
		28 Febr 2015	$104 104	$1 839 172	$11.50	R21 150 478

In this example, the highest value is R39 986 910. For SVDP purposes, 40% of this amount (i.e. R15 994 764) must be included in the applicant's taxable in the 2015 year of assessment.

During the application process, the applicant must complete the Table below as follows (using this example), and upload it as an attachment to the VDP application

Table To Determine Tax Relief				
Tax Period	**Part A** Asset acquisition value and subsequent additional funding		**Part B** Market value of aggregate of all foreign asset(s)	
	Per foreign curency	Per South African Rand	Per foreign currency	Per South African Rand
Pre-2011				
2011	$5 000 000	R33 100 000	$5 050 000	R35 249 000
2012			$5 353 000	R39 986 910
2013	-$4 000 000	-R33 760 000	$1 636 857	R14 469 811
2014			$1 735 068	R18 582 577
2015			$1 839 172	R21 150 478

Example B:

SVDP applicant discloses two offshore interest-producing assets that were acquired in January 2007 and January 2011, at a cost price of US$4m and US$5m respectively. The asset that was acquired in January 2007 was disposed of in January 2008 for a consideration of US$4,5m. In January 2013 the applicant disposed of US$4m. Assuming investment returns at an average of 6% per year, the market values of the assets for SVDP purposes are determined as follows:

Tax Period	Transactions	Tax Periods	Investment returns	Market value	US$ / Rand spot rate (per SARB published)	Rand Value
1 Jan 2007	$4 000 000			$4 000 000	$6.94	R27 760 000
1 Jan 2008	-$4 030 000		$30 000	$4 030 000	$6.86	R27 645 800
1 Jan 2011	$5 000 000				$6.62	R33 100 000
		28 Feb 2011	$50 000	$5 050 000	$6.98	R35 249 000
		29 Feb 2012	$303 000	$5 353 000	$7.47	R39 986 910
1 Jan 2013	-$4 000 000				$8.44	-R33 760 000
		28 Feb 2013	$283 857	$1 636 857	$8.84	R14 469 811
		28 Feb 2014	$98 211	$1 735 068	$10.71	R18 582 577
		28 Feb 2015	$104 104	$1 839 172	$11.50	R21 150 478

In this example there are two assets, which must be treated separately for SVDP purposes, namely Asset A (acquired and disposed of prior to the 2011 tax period), and Asset B (acquired and partially disposed during the five year period ending on 28 February 2015).

For Asset A, the value as at 1 January 2007 must be included in the taxable income of the applicant in the 2015 tax period. Because of the exchange rate difference between the date of acquisition and the date of disposition, the highest value is R27 760 000, despite the fact that the market value in US$ terms in

January 2008 was higher than what it was in January 2007.

For asset B, the taxable income is the same as in Example A above.

In this example, 40% of the sum of the amounts (40% of R67 746 910) will be included as taxable income in the 2015 year of assessment.

The Table that must accompany the SVDP application will look like this:

Table To Determine Tax Relief				
Tax Period	**Part A** Asset acquisition value and subsequent additional funding		**Part B** Market value of aggregate of all foreign asset(s)	
	Per foreign curency	Per South African Rand	Per foreign currency	Per South African Rand
Pre-2011	$4 000 000	R27 760 000	$4 000 000	R27 760 000
2011	$5 000 000	R33 100 000	$5 050 000	R35 249 000
2012			$5 353 000	R39 986 910
2013	-$4 000 000	-R33 760 000	$1 636 857	R14 469 811
2014			$1 735 068	R18 582 577
2015			$1 839 172	R21 150 478

13. INDEMNITY

Whilst every reasonable care has gone into the preparation and production of this update, no responsibility for the consequences of any inaccuracies contained herein or for any action undertaken or refrained from taken as a consequence of this update will be accepted.