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GENERAL

2378. Writing off loans

We are often spoken of as an economy with high levels of debt. Even when interest rates are high, we have never been scared of gearing ourselves so that we can buy that expensive car or holiday house in Hermanus. Companies too often have high levels of debt.

In addition, in virtually every corporate structure there is a multitude of intercompany loan accounts. These loan accounts often arise either through funding being provided by one company to another or in circumstances where, for example, a company provides services or sells goods to another company and the consideration remains outstanding on loan account.

Often such loan accounts are written off, particularly in circumstances where the borrower is not able to repay the loan or, in a group context where the group wishes to “clean up” its inter-group transactions.

Debt is also written off in many other circumstances. One just needs to look at the African Bank scenario to find an example of debt being written off or reducing in value.

This article focuses on certain tax consequences arising from the writing off or waiving of debt. Assume for the purposes of this article that Company A has advanced interest-bearing loans to Company B. It is now proposed that the loan will be waived.

Section 24J of the Income Tax Act No. 58 of 1962 (the Act)

On the basis that the loans are interest bearing, the provisions of section 24J should be considered. A gain on redemption of the loan will arise for the
borrower (Company B) upon the waiver of the loan. This gain will be deemed to accrue to Company B for tax purposes in terms of section 24J(4).

Conversely, a loss on redemption of the loan will arise for the lender (Company A) upon the waiver of the loan. This will be deemed to have been incurred by Company A for tax purposes in terms of section 24J(4). However, section 24J(4) only deems such gain or loss to accrue to, or be incurred by, the taxpayer. It must still be determined whether such gain or loss is of a capital or a revenue nature.

Generally, unless the taxpayer is a money-lender, an adjusted gain or loss should be capital in nature, in which case section 24J should not apply. If the loss is revenue in nature, then Company A may obtain a deduction in relation to such loss.

A gain which is revenue in nature and which has not already been taken into account in terms of section 19 (see below), will be included in Company B’s income.

Finally, section 24J(12) states that section 24J does not apply in respect of a loan, _inter alia_, which is repayable on demand.

Therefore, if the loan is repayable on demand, then no gain or loss arises in terms of the provisions of section 24J.

**Debt reduction provisions**
The “debt reduction provisions” contained in section 19 and paragraph 12A of the Eighth Schedule of the Act should also be considered in the context of any proposed waiver of loans. Essentially, section 19 deals with the income tax
consequences of a loan waiver, while paragraph 12A deals with the capital gains tax (CGT) implications thereof.

Broadly speaking, section 19 applies where:
- A debt that is owed by a person is reduced.
- The amount of the debt was used to fund deductible expenditure, acquire allowance assets or trading stock; and
- There is a difference between the amount advanced under the loan and the amount repaid in terms of the loan (Reduction Amount).

Paragraph 12A of the Eighth Schedule represents the capital gains tax equivalent of section 19. It essentially applies where the debtor applied the loan to acquire an asset which is held on capital account and there is a Reduction Amount.

**Income tax implications for the borrower: section 19**

In order to determine the tax implications in respect of section 19, it must be determined how the debtor applied the debt proceeds and, in particular, whether such proceeds were used to fund:
- Expenditure incurred in the acquisition of trading stock that is held and has not been disposed of by the debtor at the time of the reduction of the debt;
- Expenditure incurred in the acquisition, creation or improvement of an allowance asset; and
- Deductible expenditure other than that set out above.

In summary, section 19 essentially functions on the following “two step” approach:
Step 1 - Cost price reduction
The Reduction Amount will firstly reduce the cost price of the trading stock held by the debtor.

However, this cost price reduction will apply only to the extent that:
• The borrowed funds were used to acquire trading stock still held by the debtor; and
• That trading stock has a remaining cost price.

Step 2 - Ordinary revenue or recoupment
If the Reduction Amount falls outside the cost price reduction rules mentioned above, any residual amount will trigger a taxable recoupment. Amounts of this nature can, for example, represent:
• Debt funding related to trading stock where the cost price has already been reduced to zero, or where the trading stock is no longer held;
• Debt funding for allowance assets to the extent of prior depreciation (after their base cost is reduced to zero in terms of paragraph 12A); or
• Debt relating to operating expenses which have been deducted for tax purposes.

CGT implications
In respect of the borrower (Company B), paragraph 12A(3)(b) provides that in relation to an asset held at the time of the debt reduction, the base cost of the relevant asset held by the borrower must be reduced by the Reduction Amount. Where the Reduction Amount exceeds the base cost, such excess amount must be applied to reduce any assessed capital loss of the borrower for the year of assessment in which the reduction takes place.

Paragraph 12A(6)(d) provides that the provisions of paragraph 12A do not apply to, inter alia, any debt owed by a person to another person where that
person and that other person are companies that form part of the same group of companies, unless they form part of any transaction, operation or scheme entered into to avoid any tax imposed by the Act. The waiver of a loan by a lender should constitute a disposal of an asset in the hands of the lender.

It should then be determined whether a capital loss arises from such disposal. Paragraph 56(1) of the Eighth Schedule provides that where a creditor disposes of a debt owed by a debtor who is a connected person in relation to the creditor, that creditor must disregard any capital loss determined in respect of the disposal.

However, paragraph 56(1) does not apply to the extent that the amount of that debt so disposed of represents, *inter alia*, an amount which is applied to reduce the expenditure in respect of an asset of the debtor or any assessed capital loss of the debtor in terms of paragraph 12A, or an amount that must be or was included in the gross income of the debtor.

**Donations tax**
A donation is defined as any gratuitous disposal of property including the gratuitous waiver or renunciation of a right. A waiver of a loan may constitute a donation. However, section 56(1)(r) of the Act provides that no donations tax shall be payable in respect of a donation by a company to another company that is a resident and is a member of the same group of companies as the company making the donation.

**Conclusion**
In respect of the example set out above, it is unlikely that Company A will make a tax deductible loss on redemption or Company B will make a taxable gain on redemption in terms of section 24J. This is because Company A and Company
B will likely hold the loans on capital account and potentially also because section 24J does not apply since the loan is repayable on demand.

The capital gains tax provisions of paragraph 12A should also not apply if the loans are waived between group entities. However, the income tax provisions of section 19 may apply to the loan if Company B used the loan proceeds to acquire allowance assets and/or fund deductible expenditure. To the extent that any amount is included in the gross income of Company B in terms of section 19, Company A would then obtain a capital loss on the loan waiver.

No donations tax implications should arise from the waiver of the loan if, *inter alia*, Company A and Company B form part of a group of companies.

It can be seen from the above high-level analysis that a multitude of tax issues must be considered before writing off a loan.

**ENSafrica**

**ITA: Section 19, 24J, 56(1)(r), paragraphs 12A and 56(1) of the Eighth Schedule**

**EXCHANGE CONTROL**

**2379. Shuttleworth’s victory – repayment of exchange control exit levy**

In 1999 Mark Shuttleworth, a South African born entrepreneur, sold his internet consultancy company for $575 million. He then formed a venture capital company that was to compete in the world-wide marketplace. He also founded the Shuttleworth Foundation, a non-profit organisation that supported social
innovation in education, to which he donated R180 million. In 2001 Shuttleworth emigrated to the Isle of Man, a tax-efficient jurisdiction, and said that he had emigrated because the system of exchange control in South Africa was severely restrictive and impeded investment outside its borders.

The imposition of the ten per cent exit levy
When Shuttleworth emigrated, South Africa’s Exchange Control Regulations, which had been published in the Government Gazette on 1 December 1978 in terms of section 9 of the Currency and Exchanges Act No. 9 of 1933, had the effect of blocking the expatriation of his assets. At that juncture, his blocked loan accounts were valued at over R4 billion.

The Reserve Bank granted him permission to remit interest on his blocked loan accounts out of South Africa, but there could be no transfer of capital without separate Reserve Bank permission. When he applied to the Reserve Bank to transfer R1.5 billion of his blocked loan accounts (an application that he could not make directly, but that had to be made through an authorised dealer bank, which was Standard Bank in this case), his application was granted subject to the payment of a ten per cent exit levy.

The payment of the exit levy was made under protest
At the time, Shuttleworth believed that this exit levy was lawful. However, when he decided to transfer his remaining funds out of South Africa, he applied to the Reserve Bank under protest, in order to preserve his right to challenge the imposition of the exit levy (which amounted to some R250 million) in respect of those funds. In imposing the ten per cent exit levy, the Reserve Bank relied exclusively on Exchange Control Circular D375 of 26 February 2003 which, at that juncture, explicitly provided that any approved transfer of funds in excess of R750 000 would be subject to a ten per cent exit charge.
The legal challenge to the constitutionality of the exit levy

Shuttleworth challenged the constitutionality of the ten per cent exit levy, first in the North Gauteng High Court and then on appeal to the Supreme Court of Appeal. The judgment of the Supreme Court of Appeal was delivered on 1 October 2014. (*Shuttleworth v South African Reserve Bank* [2014] ZASCA 157).

In response to Shuttleworth’s challenge, the Reserve Bank (see para [12] of the Supreme Court of Appeal judgment) stood by the aforementioned Exchange Control Circular as the basis for its decision to impose the levy.

Also significant was Reserve Bank ruling section B 5(E)(iii)(e) of the Exchange Control Rulings as reflected in Circular D380, which reads – “Any other assets belonging to the emigrants at the time of their departure or accruing to them thereafter will require to be brought under the control of an Authorised Dealer. The Exchange Control Department of the South African Reserve Bank will, on application, consider requests for the unblocking of the emigrant’s remaining assets. Any approval will be subject to an exiting schedule, at the discretion of the Exchange Control Department of the South African Reserve Bank, and an exit charge of 10%.”

It was common cause that the ten per cent exit levy was applied by the Reserve Bank on a generalised basis and without any exercise of discretion. Shuttleworth’s counsel argued that the exit levy therefore ‘operated as a generally applicable revenue raising mechanism’ – which the Reserve Bank (see para [13]) of the judgment ) denied, though it admitted that, as a matter of history, there had been no instance in which it had not imposed the exit levy.

The basis of the constitutional challenge to the exit levy
The core of the argument advanced by Shuttleworth’s counsel (see para [15]) was that the exit levy was a tax and that taxation can be imposed only in terms of an Act of Parliament, which must be passed in accordance with the special procedure required by the Constitution for a ‘money bill’.

It was further argued (see para [15]) that the regulation relied on by the Reserve Bank did not authorise the raising of revenue because it had not been approved by Parliament. Nor, it was argued, did the regulations in question provide that the powers of the Minister that had been delegated to the Reserve Bank must be exercised in accordance with the requirements of procedural fairness, thus creating an unbridled discretion inconsistent with the constitutional right to procedurally fair administrative action.

The High Court had not been persuaded by these arguments. Legodi J held that the ten per cent exit levy did not amount to a revenue-raising mechanism but was intended to be a disincentive to the exporting of capital from South Africa and that there was a legislative underpinning to its imposition in the form of the regulations.

Shuttleworth’s counsel argued (see para [132]) that the regulations in question infringed everyone’s constitutional rights because the prohibition contained in the regulations on transactions involving currency, gold or other foreign currency interfered with everyone’s right to deal with his property as he chose and infringed on the freedom to trade in placing a limit on the transactions that can be undertaken in relation to his property and in the pursuit of his trade.

**The decision of the Supreme Court of Appeal**

The Supreme Court of Appeal judgment noted (see para [21]) that Shuttleworth did not challenge the principle of exchange control, for he accepted that controls were necessary; rather, he contended that many facets of the exchange control
regime were unconstitutional. The Reserve Bank defended the flat rate exit levy of ten per cent on the basis, *inter alia* (see para [23]) that the levy was imposed at a flat rate in the interests of consistency and certainty. The Reserve Bank rulings and circulars, it was argued, were administrative measures that did not have the force of law, but facilitated the application of the legislation and the execution of the policy directives of government. In the Supreme Court of Appeal, the Reserve Bank (see para [26]) relied exclusively on regulation 10(1)(c) as the basis of its professed enabling power to impose the exit levy.

This regulation provided that –

“No person shall, except with permission granted by the Treasury and in accordance with such conditions as Treasury may impose enter into any transaction whereby capital or any right to capital is directly or indirectly exported from the Republic.”

The Court ruled in this regard that, even though this regulation ‘served a legitimate purpose’, it did not follow that it could be used as a revenue-raising mechanism for the collection of revenue – taxes or levies had to follow a prescribed procedure.

Given that the imposition of a ten per cent exit levy was applied rigidly and as a blanket condition that did not involve Treasury in ‘assessing the peculiar facts of the application before it’ and that it involved a mechanical application of the policy decision of the Minister, it followed, said the court (at para 28]), that –

“It can thus hardly be in dispute that the levy was a revenue-raising mechanism for the State.”

Consequently, said the court, regulation 10(1)(c) would be *intra vires* only if it legitimately authorised the raising of revenue for the State. In this regard, it was
not in dispute (see para [29]) that the regulation had not been approved in terms of section 9(4) of the Currency and Exchanges Act No. 9 of 1933, which reads as follows –

“The Minister of Finance shall cause a copy of every regulation made under this section to be laid upon the Table of both Houses of Parliament within fourteen days after the first publication thereof in the Gazette . . .

Every such regulation calculated to raise any revenue shall cease to have the force of law from a date one month after it has been laid on the Table unless before that date it has been approved by resolution of both Houses of Parliament.”

It was undisputed, said the court (at para [29]), that regulation 10(1)(c) had not followed the procedure for the imposition of tax prescribed by section 9(4) of the Currency and Exchanges Act, quoted above.

The court said that –

“A founding principle of Parliamentary democracy is that there should be no taxation without representation and that the executive branch of government should not itself be entitled to raise revenue but should rather be dependent on the taxing power of Parliament, which is democratically accountable to the country’s tax-paying citizenry.”

The court went on to point out (see para [30]) that ‘Our constitution is careful to ensure that the power of taxation is tightly controlled in that section 77(1) of the Constitution defines what constitutes a ‘money bill’ and section 73(2) provides that only the Minister of Finance may introduce a money bill in the National Assembly’.
Thus, said the court –
“the ordinary power of the National Assembly and the National Council of Provinces to initiate and prepare legislation does not extend to the initiation or preparation of money bills . . . . All of these constitutional provisions thus render it unconstitutional for taxes or levies to be raised by delegated legislation which is not specifically authorised in a money bill enacted in accordance with the money bill provisions of the Constitution.”

The court noted (at para [31]) that the exit levy raised revenue for the state and that while it was in force it had generated approximately R2.9 billion. The court went on to say that –

“The levy thus fell within the category of ‘taxes, levies or duties’ contemplated by sections 75 and 77 of the Constitution. The reference in regulation 10(1)(c) to the power of Treasury to impose conditions on the export of capital from the Republic cannot be construed to include the power to impose a tax or levy on such export of capital. It must follow that the imposition of the ten per cent levy was inconsistent with sections 75 and 77 of the Constitution and invalid and ultra vires regulation 10(1)(c).”

The court concluded (at para [38]) that –

“In the light of the conclusions reached it follows that the appeal in relation to the imposition of the ten per cent exit levy must succeed.”

**Shuttleworth’s right to repayment of the exit levy**

Having established that the imposition of the ten per cent exit levy was unconstitutional, the court turned to the question of whether Shuttleworth had a legal right to repayment. Such a claim is categorised as a *condictio indebiti*, and the issue was whether the legal prerequisites for such a claim were, in the
circumstances of this case, satisfied. In this regard, it was of critical importance that Shuttleworth had paid the levy under protest, thereby reserving the right to seek a reversal of the payment.

The Supreme Court of Appeal held (at para [35]) that there was no legal bar to the court’s making an order that the exit levy be repaid to Shuttleworth with interest, and proceeded (at para [39]) to make such an order.

**The implications for other persons who have paid in the past**

Whilst the ten per cent exit levy was in force (see the judgment at [31]), it raised approximately R2.9 billion for the *fiscus*. Clearly, therefore, many people have, over the years, paid a levy that has now, in hindsight, been declared unconstitutional and therefore invalid.

It is unlikely, however, that any of these other persons have a legal claim for repayment.

Firstly, the exit levy was abolished as from November 2010 – some four years ago – as part of the liberalisation of exchange controls. Claims for the repayment of any exit levy imposed whilst it was in force will thus have prescribed (which is to say that the right to claim repayment will have been extinguished by the effluxion of time, the prescriptive period in this case being three years) unless legal proceedings for repayment had been instituted before the claim prescribed. Even then, no legal claim for repayment will lie unless the claimant had paid the levy under protest.

**The wider implications of the judgment**

The judgment did not hold – and indeed Shuttleworth did not argue – that exchange controls are *per se* unconstitutional. Nor did the Supreme Court of Appeal rule that the regulations in terms of which the exit levy was imposed
were inherently unconstitutional – their flaw was that the levy constituted a tax and that the legislation in terms of which the regulations had been issued had not been passed in the manner required by the Constitution in respect of a money bill.

**Conclusion**

It is clear from the judgment that any levy imposed by the Reserve Bank or other organ of state will be, in substance, a tax and consequently will be unconstitutional unless the empowering legislation was passed in the manner required of a money bill.

So long as a levy imposed by an organ of state is categorised as a revenue-raising measure, and thus as a tax (in other words, any levy for the benefit of the *fiscus*) that is imposed on a blanket basis – that is to say, without the exercise of a discretion that takes account of the individual circumstances of the applicant – it will not be constitutionally valid unless two conditions are satisfied. Firstly, the relevant regulation (such as regulation 10(1)(c) in relation to the exit levy in issue in the Shuttleworth litigation) will have to be approved in the manner required by section 9(4) of the Currency and Exchanges Act, as explained in para [28] of the judgment. Secondly, the legislation underpinning the regulation in question will have to have been passed in accordance with the process applicable to a money bill.

Conversely, any current or future levy that is sanctioned by ordinary legislation (that is to say, legislation that has not been passed as a money bill) and is imposed on a discretionary basis – that is to say, a levy that is imposed on the basis of a discretionary decision by the Reserve Bank or National Treasury or its agents on the basis of the circumstances of the particular applicant – will be constitutionally valid if the empowering legislation has been passed by
Parliament in the ordinary way, that is to say, not in the particular manner required for a money bill.

**Further appeal to the Constitutional Court**
The Reserve Bank is no doubt mulling over whether to take the Supreme Court of Appeal judgment on further appeal to the Constitutional Court, which has the power to overturn that judgment and substitute its own.

PwC

**CONSTITUTION: Sections 73, 75 and 77**
**CURRENCY AND EXCHANGES ACT: Section 9**
**EXCHANGE CONTROL RULINGS AND CIRCULARS: D375 and D380**

**PUBLIC BENEFIT ORGANISATION**

**2380. Increased compliance burden**
In the first draft of the Taxation Laws Amendment Bill of 2014 (the Bill) that was released in July, it was proposed that public benefit organisations (PBOs) that provide assets or funding to other PBOs would have to comply with a prescribed investment regime.

In terms of the current law, such PBOs have to distribute or incur the obligation to distribute at least 75% of the donations received during the year of assessment for which section 18A receipts were issued, within 12 months of the end of the year of assessment (section 18A(2A)(b)). The Commissioner is given the discretion to vary this requirement, having regard to the public interest and the purpose for which the PBO wishes to accumulate the funds.
Presently there is no stipulation regarding the form in which undistributed funds have to be held, for example whether accumulated in savings accounts, unit trusts or other types of accounts. In terms of the first draft of the Bill, it was proposed that the 75% distribution requirement would be reduced to a 50% distribution requirement. The undistributed balance in respect of donations for which section 18A receipts had been issued would have to be:

- Distributed (or the obligation to distribute would have had to be incurred) within a period of five years. The five year period was to be calculated from the date of the coming into operation of the Taxation Laws Amendment Act of 2014 if the PBO was incorporated prior to 1 January 2015. In the case of PBOs that are only incorporated after 1 January 2015, the five year period is calculated from the date on which the Commissioner issued a reference number to the PBO.

- Invested in prescribed investments. These were to include financial instruments issued by collective investment schemes, long-term insurers, banks, mutual banks, the government or financial instruments in listed companies. Any amounts received or accrued in respect of such financial instruments were to be included in the compulsory distribution requirement in the previous paragraph.

In the latest draft of the Bill, which was released on 16 October 2014, the prescribed investment regime has been scrapped. However, the adjustment to a 50% distribution requirement has been retained.

In respect of the undistributed amounts, i.e. which amounts would have arisen from receipted donations, the PBO has to incur the obligation to distribute all amounts received in respect of ‘investment assets’ held by it (other than amounts received in respect of disposals of those investment assets to a PBO) by no later than six months after every five years from 1 March 2015, if the PBO was formed and issued with a reference number prior to 1 March 2015. If
the PBO was formed on or after 1 March 2015, then the five year period is calculated with reference to the date on which the Commissioner issued the reference number.

Failure to comply with the five year distribution requirement will result in such amounts being included in the taxable income of the PBO.

The effective date of the above amendments is 1 March 2015. Many challenges are likely to arise due to the above-mentioned amendments. Firstly, the term ‘investment assets’ is not defined. It is uncertain whether, for example, a current banking account would be regarded as an ‘investment asset’ in circumstances where no interest is paid on credit balances. According to the Chambers 21st Century Dictionary, the word ‘invest’ means ‘to put money into a company or business’, e.g. by buying shares in it, in order to make a profit. Where no profit can be made it may be argued that money has not been ‘invested’.

In our view, savings accounts, shares and properties should be regarded as ‘investment assets’. If rental income accrues in respect of a property, for example, it would seem that no running or other expenses may be paid in respect of the property from funds in respect of which section 18A donations were originally issued.

The latest draft is likely to be enacted in its current form and although the change from a 75% distribution requirement to 50% is welcomed, the need to track amounts received in respect of the ‘investment assets’ is likely to create a significant compliance burden. In order to minimise headaches, a clear separation should exist between assets that represent donations for which section 18A receipts were issued and other assets, for example representing exempt trading income of the PBO. It would seem that a reconciliation of the
PBO’s assets at 28 February 2015 will have to be performed in order to separate assets that arose from such donations from other assets.

The increased compliance burden associated with these above-mentioned changes is unfortunate and is likely to detract from funds available for public benefit purposes.

**BDO**

**ITA: Section 18A(2A)(b)**

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**TAX ADMINISTRATION**

2381. **SARS guide on the new dispute resolution rules**

On 28 October 2014, the South African Revenue Service (SARS) released a guide on the rules promulgated in terms of section 103 of the Tax Administration Act No. 28 of 2011 (the TAA) dealing with the resolution of disputes in South Africa (the Guide).

The rules, promulgated on 11 July 2014 (new Rules), replaced the rules promulgated under section 107A of the Income Tax Act No. 58 of 1962 (the Act) (old Rules). The new Rules prescribe the procedures to be followed in respect of objections and appeals in respect of assessments or certain administrative decisions by SARS. The new Rules also deal with procedures to be followed in respect of alternative dispute resolution and various other issues relating to the Tax Court.

Some of the most noteworthy departures from the old Rules are the following:
SARS now has 45 days to provide the taxpayer with reasons for an assessment where adequate reasons were not provided. Under the old Rules, SARS was afforded 60 days;

- SARS now has 60 days after the delivery of a taxpayer’s objection to notify the taxpayer of the outcome of the objection. Under the old Rules, SARS was afforded 90 days; and

- The introduction of the notion of ‘test cases’.

Having regard to the new Rules as read with the newly published Guide, the discussion below serves as a guideline to the practical interpretation and application of the new Rules.

**Reasons for an assessment**

Section 96 of the TAA provides that in the case of an assessment based on an estimation or an assessment that is not fully based on a return submitted by the taxpayer, SARS must issue a statement of grounds of assessment. The statement of grounds of assessment should generally enable the taxpayer to understand the basis of the assessment and to object thereto.

In terms of rule 6 of the new Rules, a taxpayer who is aggrieved by an assessment may request SARS to provide reasons for the assessment to enable the taxpayer to formulate an objection. The Guide specifically provides that the effect of such a request by the taxpayer is that the taxpayer need not lodge an objection until a response is received from SARS. The Guide also provides that after SARS receives such a request and it is satisfied that the reasons required to enable the taxpayer to formulate an objection have been provided, SARS must notify the taxpayer within 30 days after the delivery of the request for reasons.

However, where, in the opinion of a SARS official, the reasons required to enable the taxpayer to formulate an objection have not been provided, SARS
must provide such reasons within 45 days after the delivery of the request for reasons.

Importantly, the period for providing reasons may be extended by SARS if a SARS official is satisfied that due to exceptional circumstances, the complexity of the matter or the principle or the amount involved, additional time is required by SARS to provide reasons to the taxpayer.

**Objection**

Rule 9 of the new Rules further provides that when a taxpayer lodges an objection, SARS is required to notify the taxpayer of the allowance or disallowance of the objection, either in whole or in part, and the basis thereof. SARS must notify the taxpayer of its decision in writing within 60 days after delivery of the taxpayer’s objection.

If, however, SARS requires more time to deal with the objection due to exceptional circumstances, the complexity of the matter or the principle or the amount involved, SARS may extend the initial period by a period not exceeding 45 days.

The Guide provides that if SARS fails to notify the taxpayer of the outcome of the objection within the prescribed period, the taxpayer may:

- pursue a complaint within the SARS internal administrative complaints resolution process and if unsuccessful, submit a complaint to the Tax Ombud; or
- apply for default judgment under rule 56 of the new Rules.
Exchange of pleadings

A taxpayer who lodges an appeal must deliver a notice of appeal within 30 days after SARS has delivered the notice of disallowance of the objection. In the notice of appeal, the taxpayer must specify in detail –

- which of the grounds of objection are being taken on appeal;
- the grounds for disputing SARS’ basis of the decision to disallow the objection as set out in the notice of disallowance; and/or
- any new ground on which the taxpayer is appealing.

Rule 10 of the new Rules provides that a taxpayer may add new grounds when lodging a notice of appeal. However, this rule is limited by rule 10(3) which provides that a taxpayer may not appeal on a ground that constitutes a new objection against a part or amount of the disputed assessment not objected to in the notice of objection.

For example, a taxpayer may not object to the imposition of an understatement penalty in the same assessment, if this was not included in the notice of objection. The taxpayer may, however, specify a new ground explaining why the disallowed expenditure was, for example, in the production of income which was not specified in the notice of objection.

The taxpayer must produce any documentation requested by SARS relating to the new ground in order to decide on the further progress of the appeal.

Following the taxpayer’s notice of appeal, SARS must deliver to the taxpayer a statement of grounds of assessment and opposing appeal. Such statement would contain the consolidated grounds of assessment, the facts in the notice of appeal that are admitted to and opposed to by SARS as well as the material facts and legal grounds upon which SARS bases its assessment.
The Guide provides that SARS may include new grounds in its statement of assessment and opposing the appeal.

However, SARS may not include any grounds which constitute a novation of the whole of the factual or legal basis of the disputed assessment or which require the issue of a revised assessment.

If SARS includes new grounds in the statement of grounds of assessment, the taxpayer may deliver a notice of discovery to SARS requesting any documents material to the new grounds of assessment to the extent that such documents are required by the taxpayer to formulate its grounds of appeal. The taxpayer will only need to deliver its statement of grounds of appeal following the discovery by SARS.

Following SARS’ statement of grounds of assessment, the taxpayer may include a new ground to its statement of grounds of appeal, subject to the limitation in rule 10(3).

SARS may similarly deliver a notice of discovery to the taxpayer requesting any documents material to the new ground of appeal. The taxpayer may then, in its reply to SARS’ statement of grounds of assessment, deal with any new ground of assessment and amend its statement of grounds of appeal to deal with the grounds of assessment.

If the matter has been set down for hearing, rule 45(2) makes provisions for either party to seek a postponement to deal with any new ground raised by the other party.
Test cases

Section 106(6) of the TAA states that if a senior SARS official considers that the determination of an objection or an appeal, whether on a question of law or question of fact or both, is likely to be determinative of all or a substantial number of issues involved in one or more other objections or appeals, the official may:

- designate that objection or appeal as a test case; and
- stay the other objections or appeals by reason of the taking of a test case on a similar objection or appeal before the tax court.

Rule 12(2) of the new Rules provides that a SARS official who designates an objection or appeal as a test case must provide the taxpayer with a notice informing such taxpayer of the number and common issues involved in the objections or appeals that the test case is likely to be determinative of, the questions of law or fact or both, and the importance of the test case to the administration of the relevant tax Act.

In response to the notice, the taxpayer may, within 30 days of receiving the notice, oppose the decision to designate an objection or appeal as a test case or alternatively oppose the staying of an objection or appeal pending the final determination of a test case. If the objection or appeal is to be stayed, the taxpayer may request a right of participation in the test case.

A test case is heard by the tax court. In terms of section 129 of the TAA, the court may confirm or order the assessment or decision to be altered, or alternatively refer the assessment or decision back to SARS for further examination and assessment.
Having regard to the above, in order to ensure that taxpayers are treated in an administratively fair manner when engaged in disputes with SARS, strict compliance with the new Rules by both SARS and taxpayers is required.

Cliffe Dekker Hofmeyr
ITA: Section 107A
New Dispute Resolution Rules
SARS Dispute Resolution Guide
TAA: Section 96, 103, 106(6) and 129

TRUSTS

2382. New income tax return
The South African Revenue Service (SARS) released a notice on 23 September 2014 which stated that a modernised income tax return for trusts (ITR12T) would be introduced to replace the trust tax return (IT12TR). SARS confirmed that with effect from 3 October 2014, the IT12TR return will no longer be accepted.

What are the prominent features of the new ITR12T?
• Trust details will be pre-populated and a customised tax return will be created based on answers to various questions.
• There are expanded financial and legal reporting requirements.
• Full details of all parties contributing funds and assets into the trust have to be provided, as well as details of the actual transactions undertaken.
• Full details of any party benefitting in any way from the trust as well as details of the benefits received or enjoyed have to be provided in respect of each beneficiary.
• Assessment results will be obtainable faster than before.

**What does this mean for trustees?**

Trustees now have far more onerous obligations in terms of the comprehensive record-keeping responsibilities expected of them. The following details regarding the actual transactions that took place during the tax year will be required to be provided to SARS:

• Details of all parties benefitting from the trust. These details include the ID number and demographic information in respect of the beneficiaries.
• Capital or revenue distributed to or vested in beneficiaries.
• Distributions or vesting of non-taxable income.
• Distribution or vesting of capital or assets.
• Loans granted and received.
• Donations and contributions made or received.
• Distributions received from other trusts or foundations.
• Refunds received of contributions made to the trust.
• The right of use of assets granted.

The information regarding distributions to beneficiaries is mandatory for the new ITR12T. The other information referred to above will only be required with effect from the 2015 tax year.

Trusts with more than ten beneficiaries are required to submit the tax return via eFiling. Trusts with ten beneficiaries or less have the option to submit their returns at a SARS branch or via eFiling.
Supporting documents required:

- Financial statements and/or administration deductions.
- All documentation pertaining to income and deductions.
- Proof in relation to tax credits claimed.
- Particulars of assets and liabilities.

The following schedules must be completed, if applicable:

- If the trust was engaged in mining operations as defined in section 1 of the Income Tax Act, Schedules A and B have to be completed.
- If the trust together with any connected person holds at least 10% of the participation rights in any controlled foreign company, an IT10 Schedule must be completed.

Trustees should therefore ensure that they maintain the necessary records in order to fulfil their responsibilities in relation to the information required by SARS.

Deadline for submission

It is furthermore important to note that the submission deadline for the 2014 tax return for trusts is 30 January 2015.

ENSafrica

ITA: Section 1(1) “definition of mining operations”
2383. Entertainment expenses

It is well-established that, in terms of section 17(2)(a) of the Value-Added Tax Act No. 89 of 1991 (the VAT Act), a vendor is not entitled to deduct any amount of input tax in respect of goods or services acquired for the purposes of 'entertainment', unless certain exceptions apply.

The Tax Court recently gave judgment in the case of AB (Pty) Ltd v Commissioner for the South African Revenue Service (Case no 1015, as yet unreported) concerning input tax deductions and entertainment expenses.

The appellant was a registered vendor that provided services in the mining industry, such as the sinking of shafts and other construction work. The fact that the services usually had to be rendered at mining sites, and that many of the appellant’s employees were not from South Africa, meant that the appellant had to provide accommodation and meals for its employees while working on particular projects.

The appellant generally outsourced the provision of the said accommodation and meals by contracting with third parties operating close to the relevant mines (in this matter a particular third party). The third party was a registered vendor and levied VAT in respect of the supply of the accommodation and meals.

The appellant claimed input tax deductions in respect of the VAT paid on the accommodation and meals. However, the South African Revenue Service (SARS) subsequently raised assessments against the appellant, disallowing the input tax deductions on the basis that accommodation and meals constituted 'entertainment'. The appellant objected, but SARS disallowed the objection, and the appellant appealed to the Tax Court.
The term 'entertainment' is defined in section 1 of the VAT Act as meaning “the provision of any food, beverages, accommodation, entertainment, amusement, recreation or hospitality of any kind by a vendor whether directly or indirectly to anyone in connection with an enterprise carried on by him”.

The court seemed to accept that the purpose of section 17(2)(a) is to prohibit input tax deductions where the supply “…involves a strong element of personal enjoyment, especially in circumstances where there is room for abuse”.

The appellant’s argument was essentially that, under the circumstances in question, the provision of the accommodation and meals should not be construed as 'entertainment' because there was no personal enjoyment by the appellant. Also, the employees only received basic food and accommodation and there was no intention of providing personal enjoyment. The mischief that the VAT Act intended to address by prohibiting the deduction of input tax was accordingly not present in the appellant’s circumstances. A restrictive interpretation should therefore apply in respect of section 17(2).

The court found the appellant’s arguments to be without merit because, in the court’s view, the legislature could not have intended for the provision of accommodation and meals to be categorised into basic or luxurious, and to so determine whether it should be exempt from the prohibition (presumably on the basis that luxury accommodation or meals would imply that there is an element of personal enjoyment).

The court further found that the term 'entertainment' is defined and is unambiguous. It is clear that meals and accommodation are included in that term, and there is no problem with that interpretation that would warrant “a
resort to other canons of interpretation”, presumably a purposive and restrictive interpretation.

Without elaborating on the details, the court also found that none of the exceptions to the prohibition in section 17(2)(a) applied.

Cliffe Dekker Hofmeyr
VAT ACT: Sections 1 “definition of entertainment” and 17(2)(a)

SARS NEWS

2384. Interpretation notes, media releases and other documents

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

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