INTERNATIONAL TAX

2417. Global tax surveillance

Even George Orwell, with his prophetic satirical insight, would have been confounded by the level of domestic and global surveillance that characterises our lives today. Indeed, given the objectives of the Organisation for Economic Development and Cooperation (OECD) Base Erosion and Profit Shifting (BEPS) Action Plan - to combat international tax avoidance by multinational enterprises (MNEs) and to secure government revenues - surveillance in the form of the inter-jurisdictional exchange of information and administrative assistance for tax collection purposes is not only justifiable but indispensable.
Nonetheless, it behoves taxpayers to be alert to the rapidly expanding web of tax surveillance in which they operate.

In October 2014 the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum), the world's largest tax organisation comprising 125 member jurisdictions, held its 7th meeting in Berlin, Germany. South Africa was amongst the 101 jurisdictions represented at the meeting, at which the Global Forum members resolved to take “tax transparency to a new level.”

This resolve was evidenced by inter alia:

- the majority of Global Forum members committing to implement the new standard on the Automatic Exchange of Information (AEOI) by 2017; and
- the pledge of support to developing countries through facilitating their participation in AEOI and the launch of the Africa Initiative.

As an aside, it bears mention that Mr Kosie Louw, Chief Legal and Policy Officer of the Legal and Policy Division of the South African Revenue Service (SARS), who was appointed as the Chair of the Global Forum for the period commencing January 2013 to December 2014, was re-elected for a further two year term at the meeting held in October 2014.

Also in October 2014, the Forum on Tax Administration (FTA), the pre-eminent international body concerned with tax administration, comprising heads of tax administrations from the OECD, G20 and large emerging economies, met in Dublin, Ireland and agreed that increased co-operation would be necessary to implement the results of the BEPS project and AEOI. Among other items on the agenda, the FTA concurred on the need to invest resources on the implementation of the new standard on AEOI.
By way of background, in September 2013, G20 leaders endorsed the OECD proposal for a global model for AEOI and tasked the OECD, working in conjunction with G20 countries, to develop a new standard for AEOI to combat tax evasion and ensure tax compliance.

The new global standard on AEOI, which purports to reduce the possibility of tax evasion by enabling governments to recover tax revenue from evasive taxpayers, and bolster international efforts to enhance transparency, cooperation and accountability amongst financial institutions and tax administrations, while simultaneously minimising costs to governments and business - was approved by the OECD Council in July 2014. The new standard is strikingly similar to the model that many jurisdictions will employ to implement the US Foreign Account Taxpayer Compliance Act (FATCA).

AEOI requires jurisdictions to annually obtain non-resident financial account information from their financial institutions (i.e. deposit-taking banks, custodial institutions, certain investment entities and insurance companies) and automatically exchange that information with the tax authorities in the account holders’ (individuals and entities, including trusts and foundations) jurisdictions of residence.

The AEOI sets out the financial account information (including account balances, interest, dividends, and sale and redemption proceeds from financial assets) to be exchanged, the financial institutions required to report, the different types of accounts and taxpayers covered, together with prescribed common due diligence procedures (drawn from international anti-money laundering standards) to be followed by financial institutions.
Further, it is anticipated that the new standard on AEOI will precipitate ancillary benefits by encouraging taxpayers to voluntarily disclose information regarding formerly concealed assets. As information is increasingly disclosed through AEOI, the importance of the existing standard of Exchange of Information on Request (EOIOR) will increase commensurately. EOIOR involves the inter-jurisdictional request by one competent authority for information from another competent authority; typically information relating to an examination of or investigation into a taxpayer's tax liability for a specified period.

The AEOI and EOIOR standards are intended to operate in conjunction with one another to improve the efficacy of tax administrations’ endeavours to counter international tax evasion. The Global Forum has been tasked with monitoring the global implementation of the new standard on AEOI and assisting developing countries to benefit from it, consensus being that its implementation will stimulate the establishment of a global level playing field and ensure that jurisdictions transact on even ground.

At the Global Forum’s 7th meeting, EOIOR was also advanced by the decision to incorporate into its Terms of Reference, the 2012 Update to Article 26 (Exchange of Information) of the OECD Model Tax Convention on Income and on Capital (Model Tax Convention) and its Commentary.

Briefly, Article 26 of the Model Tax Convention provides for the exchange of information by the competent authorities of Contracting States “foreseeably relevant” for carrying out the provisions of (the Model Tax) Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is
not contrary to the Convention.” The EOI is not restricted by Article 1 (Persons Covered) and Article 2 (Taxes Covered).

The Commentary provides that the standard of “foreseeable relevance” is intended to provide for EOIOR in tax matters to the broadest conceivable extent, while simultaneously clarifying that Contracting States are precluded from conducting “fishing expeditions”, by requesting information unlikely to be relevant to the tax affairs of a particular taxpayer, or submitting speculative requests that have no apparent causal link to an open investigation or inquiry.

The standard requires that at the time the request is submitted, a reasonable possibility exists that the requested information will be relevant. It is immaterial whether the information is actually proved to be relevant upon provision. As such, a request may not be denied in circumstances where a definitive assessment as to the relevance of the information to an investigation can only be made pursuant to the receipt of such information. Contracting States are encouraged to consult in situations where the content of the request, the circumstances precipitating the request, and/or the foreseeable relevance of the requested information are opaque to the State subject to the request. However, once the State submitting the request has provided an explanation as to the foreseeable relevance of the information requested, the State subject to the request may not deny the request or withhold the requested information because it believes that the requested information is irrelevant to the investigation process.

In line with the OECD Model Agreement on Exchange of Information on Tax Matters, a request for information does not amount to a fishing expedition merely because it fails to provide the name and/or address of the taxpayer under investigation. However, in the absence of such information, the State submitting the request must include other information sufficient to identify the taxpayer.
Further, although it may be more difficult to establish that a requesting State is not conducting a fishing expedition in relation to a group of taxpayers not individually identified, it may nevertheless meet the standard of “foreseeable relevance” by providing a detailed description of the group of taxpayers, together with the specific facts and circumstances precipitating the request, supplemented by an explanation of the applicable law such group of taxpayers are believed to have contravened or evaded.

Recently considered is SARS’ considerable power to request relevant material under section 46 of the Tax Administration Act 28 of 2011 (TAA) and the extension of such power through the amended definition of “relevant material” provided for in the Tax Administration Laws Amendment Act 44 of 2014 (TALAA), with effect from 1 October 2012, which now means "any information, document or thing that in the opinion of SARS is foreseeably relevant for the administration of a tax Act ....”

The Explanatory Memorandum related to the TALAA provides that the standard for what is foreseeably relevant should have a low threshold. It states that it is sufficient that there is a reasonable possibility that the material is relevant for the purpose for which it is sought at the time the request is submitted. It is immaterial whether the information is actually proved to be relevant upon provision. As such, a request may not be denied in circumstances where a definitive assessment as to the relevance of the material to an investigation can only be made pursuant to the receipt of such information.

The approach to adopt is to first produce the material and then allow for the subsequent determination as to relevance.
In conclusion the following sobering facts should be noted:

- South Africa has exchange of information relationships with jurisdictions through 74 Double Taxation Agreements (DTAs), 11 Tax Information Exchange Agreements (TIEAs) and 1 multilateral mechanism, Convention on Mutual Administrative Assistance on Tax Matters.

- On 3 February 2015, South Africa gazetted the Protocol amending its DTA with India (signed 4 December 1996) in terms of which Article 25 (Exchange of Information) was deleted and replaced with a new Article 25 which broadens the scope thereof through the introduction of the OECD Model Tax Convention standard of "foreseeable relevance" and brings it into alignment with the 2012 updated version of Article 26 of the Model Tax Convention.

Cliffe Dekker Hofmeyr

Article 26 of the Model Tax Convention

TAA: Section 46

US Foreign Account Taxpayer Compliance Act

TAX ADMINISTRATION

2418. Understatement penalties

The understatement penalty (USP) regime in terms of the Tax Administration Act 28 of 2011 (the TAA), which is still in its infancy stages, has led to some uncertainty as to when a USP should be levied by SARS. An “understatement” is defined in section 221 of the TAA to mean “any prejudice to SARS or the fiscus as a result of –

(a) a default in rendering a return;

(b) an omission from a return;

(c) an incorrect statement in a return; or
(d) if no return is required, the failure to pay the correct amount of ‘tax’.”

With the enactment of the TAA, it was envisaged by SARS that the USP regime would be a prime means of safeguarding itself with an arsenal of extensive financial sanctions in a bid to punish errant taxpayers whose actions result in any of the four aforementioned misdemeanours. The levying of a USP, which is predicated on the taxpayer’s behaviour, ranges from a mere 5% to an astronomical 200%, particularly in instances of repeated intentional tax evasion.

The crucial issue is whether the taxpayer’s behaviour resulted in a prejudice to SARS or the fiscus. The term “prejudice” which is the fulcrum of the definition of an understatement has not been defined in the TAA. It follows that the ordinary dictionary meaning must be espoused; this in itself creates the uncertainty as to whether the levying of the USP by SARS is warranted. This is best illustrated by way of example. A taxpayer submits a Value-Added Tax (VAT) return for a refund of R10m on 1 September 2014 and a day later the taxpayer notifies SARS that the refund was erroneously inflated (i.e. the refund should have been R8m and this was the amount actually refunded by SARS).

The crisp issues at hand are as follows:

- Whether or not SARS is justified in levying a USP on the R2m, if SARS assessed the return on 4 September 2014 and paid out the reduced refund on 6 September 2014?
- Whether or not SARS has been prejudiced in this instance?
- Whether or not an administrative action by SARS (i.e. SARS raising an assessment to correct the refund amount) falls into the ambit of “prejudice”?

To shed light on the above, one needs to first understand the interplay between sections 221, 222(1), 222(2), and 222(3) of the TAA. More specifically, in the
event of an understatement by the taxpayer, the taxpayer must pay, in addition to the tax payable for the relevant tax period, the USP determined in terms of section 222(1), unless the understatement results from a *bona fide* inadvertent error (for the purposes of the example, assume that there was no *bona fide* inadvertent error prevalent). Section 222(2) states that the understatement penalty is the amount resulting from applying the highest applicable understatement penalty percentage in accordance with the table in section 223 to each shortfall determined under subsections (3) and (4) in relation to each understatement in a return. In the present case the shortfall is the sum of –

- the difference between the amount properly refundable for the tax period and;
- the amount that would have been refundable if the understatement were accepted.

The ordinary dictionary meaning of “accepted” is: (verb) “to agree or consent to; accede to...”. Surely, what is envisaged by “accepted” and “prejudice” is the notion that SARS has accepted the erroneous claim submitted by the taxpayer when SARS processes the VAT return and pays the refund to the taxpayer. Stated differently, the word prejudice used in the context (of law) means to “cause harm to (a state of affairs)....” It follows that harm would be caused to SARS if SARS consented to the erroneous refund and subsequently made payment of that refund to the taxpayer (SARS would have been out of pocket to the *quantum* of the incorrect amount i.e. the difference between the amount properly refundable and the amount that was refunded).

In the context of the above, it is prudent to say that no prejudice to SARS or the *fiscus* is evident or prevalent as the erroneous refund (i.e. the R10m) was not paid out to the taxpayer. Furthermore, by notifying SARS of the error, this could be deemed as being synonymous with a voluntary disclosure before notification of audit/investigation as per section 223(1) of the USP percentage
table in the TAA. It follows from this that it cannot be deemed acceptable for an administrative action to warrant classification as “prejudice” to SARS.

On the other hand, if the taxpayer had not notified SARS that the refund was erroneously inflated, yet SARS carried out the same steps outlined above (that culminated in SARS raising an assessment to correctly reflect the amount properly refundable), would this justify the levying of a USP under these circumstances? On one hand, the USP would not be justifiable for the very same reasons stated in the above example; i.e. the incorrect refund was not paid out and therefore no actual monetary prejudice came into existence. In contrast to this, it could also be argued that SARS could proceed from the point of view that the lack of disclosure was intentional and that the assessment resulted in a thwarting of the taxpayer’s attempt to understate its tax liabilities. In turn, the attempt to understate would be punishable in the same manner as the successful execution thereof. Therefore, a taxpayer who unknowingly declared an incorrect refund – and thus preventing it from notifying SARS timeously – would only be left with the exceptional argument of a *bona fide* inadvertent error as a remedy, from the levying of a USP. However, the shortcoming of this argument would be that it would require the definition of an understatement to be read as “any prejudice, or the threat thereof, to SARS or the *fiscus*”. Such an interpretation would thus need to either be confirmed by the legislature or by SARS through a published Interpretation Note.

In light of the above, it follows that in the absence of an express definition of the word “prejudice”, it is debatable as to whether or not a USP should be levied by SARS in respect of issues where there is clearly no monetary prejudice to SARS; this opens the door to legal wrangles as to the intention of the legislature. Hopefully, SARS will assist in clarifying the issue in the not too distant future by way of an Interpretation Note or legislative changes.
In conclusion, the USP regime, in our view, was designed to protect SARS and/or the *fiscus* against any prejudice, emanating from any of the four actions underpinning an “understatement” that results in an actual monetary prejudice and not an administrative prejudice.

**ENSafrica**

**TAA: Sections 221, 222 and 223**

2419. Relevant material

Section 46(1) of the Tax Administration Act 28 of 2011 (the TAA) gives the South African Revenue Service (SARS) the power, for purposes of the administration of a tax Act in relation to a taxpayer, to request a taxpayer *or another person*, within a reasonable period, to submit relevant material (whether orally or in writing) to SARS. This subsection applies to taxpayers whether identified by name or objectively identifiable. Subsection (2) gives a senior SARS official the authority to request relevant material in respect of taxpayers in an objectively identifiable class of taxpayers.

Section 46 often creates difficulties for the ‘other persons’ referred to in this section, such as banks, who may be the recipients of requests for relevant material from SARS in respect of their own clients, being the taxpayers in question.

Banks owe a duty to their clients not to disclose information concerning their clients’ affairs, which duty is qualified. The English case of *Tournier v National Provincial and Union Bank of England* [1924] 1 KB 461 laid down the principle that a banker may disclose information regarding his client’s affairs where, *inter alia*, the disclosure is under compulsion of the law. Section 234 of the TAA provides that a person who wilfully and without just cause:
• refuses or neglects to furnish, produce or make available any information, document or thing;
• fails to comply with a directive or instruction issued by SARS to the person under a tax Act;
• fails or neglects to disclose to SARS any material facts which should have been disclosed under the TAA or to notify SARS of anything which the person is required to notify SARS under a tax Act; or
• obstructs or hinders a SARS official in the discharge of the official’s duties,

is guilty of an offence and, upon conviction, is subject to a fine or imprisonment for a period not exceeding two years.

Section 46(3) limits any request for relevant material from a person other than the taxpayer to relevant information related to the records maintained or that should reasonably be maintained by the person in relation to the taxpayer. In this regard, SARS cannot request banks to provide it with material which the banks are not required or cannot reasonably be required to maintain. Section 46(6) further requires these requests to refer to the relevant material with reasonable specificity.

However, whereas banks could previously have refused to provide SARS with material requested in terms of section 46 on the basis that the bank did not consider the material to be relevant, the Tax Administration Laws Amendment Act 44 of 2014 (the TALAA) has now, retrospectively to 1 October 2012, amended the definition of “relevant material” in the TAA to mean “any information, document or thing that in the opinion of SARS is foreseeably relevant for the administration of a tax Act….”

It is therefore no longer within a bank’s discretion to decide whether material is relevant. The Explanatory Memorandum related to the TALAA states that the
reason for this amendment is to “prevent protracted disputes around entitlement of information and the consequent waste of resources… the term foreseeable relevance does not imply that taxpayers may unilaterally decide relevance and refuse to provide access thereto, which is what is happening in practice”.

The Explanatory Memorandum states that the test for what is foreseeably relevant should have a low threshold, and that the following considerations should be applied:

- whether, at the time of the request, there is a reasonable possibility that the material is relevant to the purpose for which it is sought; whether the material, once provided, actually proves to be relevant is immaterial;
- a request may not be declined in cases where a definite determination of the relevance of the material requested for an ongoing audit or investigation can only be made following receipt of the material;
- there need not be a clear and certain connection between the material requested and the purpose for which it is requested, but a rational possibility that the material will be relevant to the purpose; and
- the approach is to first produce the material and allow a definite determination to occur later.

Businesses, and banks in particular, are therefore urged to take note of these new amendments to the TAA, particularly in light of the criminal offences created by section 234 of the TAA.

**Cliffe Dekker Hofmeyr**
**TAA: Sections 46 and 234**
TRANSFER PRICING

2420. Documentation required
On 17 July 2013 the Minister of Finance appointed a tax review committee, headed by Judge Dennis Davis (the Davis Tax Committee) to make recommendations for possible tax reforms in South Africa (SA).

The Davis Committee was required to take into account recent international developments and, in particular, to address concerns about base erosion and profit shifting (BEPS) which was identified as a risk to tax revenues, tax sovereignty and the tax fairness of countries by the Organisation for Economic Co-operation and Development (OECD) in its report published on 12 February 2013. A 15-point Action Plan was developed by the OECD to address BEPS and to ensure that profits are taxed where the economic activities generating the profits are performed and where value is created. The purpose of the OECD ‘Action Plan 13: Re-examine Transfer Pricing Documentation’ was to re-assess transfer pricing documentation requirements with the purpose of obtaining information from taxpayers so as to enable tax administrations to identify transfer pricing risks.


South Africa’s transfer pricing legislation came into effect on 1 July 1995 and was followed by Practice Note 2 and Practice Note 7 which provided taxpayers with guidance on how the South African Revenue Service (SARS) intended to apply the legislation. Practice Note 2 covered thin capitalisation whilst Practice Note 7 dealt with transfer pricing. As of 1 April 2012, SARS made several
amendments to the transfer pricing legislation and Practice Note 2 was withdrawn (it is now only applicable to years of assessment commencing before 1 April 2012). A draft Interpretation Note was subsequently issued by SARS on thin capitalisation but it has not yet been finalised.

The fundamental change that was made to SA’s transfer pricing legislation was that a taxpayer must make any transfer pricing adjustments that might be required in the calculation of its taxable income itself whereas previously transfer pricing adjustments could only be made by SARS in terms of the exercise of discretion by SARS itself. This places a significantly greater onus on taxpayers to confirm the arm’s length nature of its connected party transactions. This onus exists on taxpayers, regardless of whether or not the taxpayer has transfer pricing documentation, but the OECD’s view is that one of the purposes of transfer pricing documentation guidelines is to ensure that taxpayers can make an assessment of their own compliance with the arm’s length principle.

In this regard, in terms of the Report, the Davis Committee is of the view that the current Practice Note 7 contains unclear documentation guidelines for taxpayers in SA and consequently, the Report makes the following recommendations to revise the transfer pricing documentation guidelines in SA:

- Practice Note 7 must be revised and updated to be in line with the OECD revised Transfer Pricing Documentation Guidelines and the finalisation of the draft Interpretation Note must be prioritised.
- The OECD’s recommendation that countries should adopt a standardised approach to transfer pricing documentation that follows a three-tiered structure consisting of a master file, a local file and country-by-country reporting should also be adopted in SA.
- The three-tiered structure should, however, only be compulsory for large multinational businesses with a group turnover of over R1 billion.
• SARS should balance requests for transfer pricing documentation against the expected cost and administrative burden to the taxpayer of creating it.
• SA should implement objective materiality standards for local file purposes which are commonly understood and accepted in commercial practice.
• The country-by-country report for SA should contain additional transactional data regarding related party interest payments, royalty payments and especially related party service fees so that SARS may perform risk assessments where it is difficult to obtain information on the operations of a multinational group.
• In respect of the timing for each of the three reports, SARS should set out what its expectations are, as the OECD recommends that the local file should be finalised no later than the due date for the filing of the tax return; the master file should be updated by the tax return due date for the ultimate parent of the group; and the country-by-country report should be submitted when the final statutory financial statements are finalised (which may be after the due date for tax returns).
• The master file, the local file and the country-by-country report should be reviewed and updated annually and database searches for comparables should be updated every 3 years.
• SARS should start to build a database of comparable information as the OECD recommends that the most reliable information is usually local comparables.

Notwithstanding the recommendations above, the Report reiterates the general rule that the compliance costs related to the preparation of transfer pricing documentation should not be disproportionate to the benefits thereof. However, taxpayers choosing not to prepare documentation will be at risk, as it may be more difficult to discharge the onus of proving that an arm’s length price has
been established, especially in light of the fact that such onus is now to be placed on taxpayers in SA.

ENSafrica
Draft Interpretation Note on thin capitalisation
ITA: Section 31
Practice Notes 2 and 7

VALUE-ADDED TAX

2421. Legal effect of non-payment
The Supreme Court of Appeal (SCA) recently handed down judgment in the matter of Director of Public Prosecutions, Western Cape v Parker (103/14) [2014] ZASCA 223 (12 December 2014).

In this matter a close corporation, being a registered vendor for purposes of value-added tax (VAT), together with its sole representative, Mr Parker, were charged in the regional court on several counts.

The charges included:
• breaching section 28(1)(a) of the VAT Act 89 of 1991 (the VAT Act) by failing to submit certain VAT returns; and
• common law theft for failing to pay certain amounts of VAT to the South African Revenue Service (SARS).

The close corporation and Mr Parker pleaded guilty and were convicted and sentenced.
Mr Parker was sentenced to a fine in respect of breaching section 28(1)(a) of the VAT Act, and was sentenced to five years’ imprisonment in respect of the common law theft conviction.

Mr Parker appealed to the Western Cape High Court in respect of his sentence of imprisonment. However, after certain questions were raised by the High Court as to whether Mr Parker should have been charged with common law theft in the first instance, Mr Parker also appealed against his conviction. The close corporation did not appeal.

The High Court held that Mr Parker did not commit common law theft because the money belonged to the vendor and not to SARS, and set the conviction (and sentence) aside.

The State subsequently approached the SCA on a point of law. The SCA was tasked with answering the following question:

“Whether a VAT vendor who has misappropriated an amount of VAT which it has collected on behalf of SARS can be charged with the common law crime of theft?”

The State argued that:

- A vendor acts as an agent for SARS.
- A vendor effectively holds VAT in trust for SARS.
- If the vendor uses such VAT for another purpose, the vendor is guilty of theft, irrespective of whether the vendor is the owner of the money.
- Only if the vendor is not obliged to keep the VAT in a separate account, and it has sufficient liquid funds available to cover the VAT, would it not be theft to use the VAT amount for other purposes.
The SCA disagreed with SARS:
“I do not believe, however, that section 7(1) of the VAT Act either expressly or impliedly creates a relationship of trust. On the contrary, it is clear to me that the relationship created by the VAT Act is one of a debtor and his creditor.”

The SCA further described the relationship between a VAT vendor and SARS as follows:
“It is clear that the VAT Act is a scheme with its own directives, processes and penalties. The relationship it creates between SARS and the registered vendor is *sui generis* – one with its own peculiar nature. The VAT Act does not confer on the vendor the status of a trustee or an agent of SARS. If it did, the vendor would either have to keep separate books of account or alternatively, would have to be sufficiently liquid at any given time in order to cover the outstanding VAT. The VAT Act makes no provision for this situation nor does it seek to compel a vendor to keep separate books of account in respect of VAT.”

It became clear during the hearing that the reason for the State having charged Mr Parker with theft, and for approaching the SCA to rule on the matter, was that it sought to procure more severe penalties where transgressions involving VAT are concerned. The penalties contemplated in the VAT Act were too lenient. The SCA was not in favour of extending the crime of common law theft to apply to the failure to pay VAT, and suggested that the appropriate solution for the State would be to approach the legislature to amend the VAT Act. Accordingly, the State’s appeal failed. The State was also ordered to pay the costs of Mr Parker in opposing the appeal.

The judgment is a welcome clarification of the position that a VAT vendor holds in relation to SARS. It is clear that a VAT vendor does not ‘collect’ VAT ‘on behalf of’ SARS from the recipients of goods or services, but that VAT (at
least in terms of section 7(1)(a) of the VAT Act) is a tax imposed on the VAT vendor itself, which the VAT vendor is obliged to pay as debtor to SARS.

This analysis is however not necessarily applicable to, for example, the relationship between an employer and SARS in respect of employees’ tax. It is submitted that in such circumstances, an employer may very well be regarded as an agent for SARS, holding amounts deducted from the remuneration of employees in trust for SARS. Where such amounts are misappropriated, a charge of common law theft could very well succeed.

Cliffe Dekker Hofmeyr
VAT Act: Sections 7(1)(a) and 28(1)(a)

2422. Input tax and tax invoices
An attack by SARS backfired in an appeal in the Western Cape High Court when the Court delivered its judgment in South Atlantic Jazz Festival (Pty) Ltd v Commissioner for the South African Revenue Service [2015] ZAWCHC 8 (judgment delivered on 6 February 2015).

The facts
The appellant, a registered VAT vendor, had, for a number of years, been the organiser of an international jazz festival. In order to finance and facilitate the holding of the festival, it sought sponsorships from large enterprises. The enterprises undertook to provide cash, goods or services to an agreed value, in consideration for which they were given preferential advertising and branding rights. In the matter before the Court, the enterprises concerned were South African Airways, the City of Cape Town, Telkom and the South African Broadcasting Corporation.
In the course of an audit of the appellant’s tax affairs, SARS raised an assessment for value-added tax (VAT) by reason that the granting of rights to the enterprises constituted a taxable service which was subject to VAT. The appellant had not issued a tax invoice, and SARS accordingly determined the amount of the liability by reference to the value of goods and services that were to be supplied, as specified in the relevant sponsorship agreements.

The items stipulated in the sponsorship agreements were supplied to the Appellant, and the rights granted were exercised.

The appellant did not dispute that it was required to account for VAT, but contended that it had purchased goods and services from the sponsors to an agreed value and that, in the determination of its liability to VAT, it should be allowed a deduction for input tax in respect of the VAT on those supplies. It argued that the sponsorship agreements that were the source of the assessment should equally serve as the source for allowing a deduction for input tax.

SARS countered the appellant’s contention by holding that a deduction in respect of input tax may not be claimed unless the vendor is in possession of a valid tax invoice from the supplier. The appellant had repeatedly requested the issue of tax invoices from the sponsors but had not been provided with the tax invoices that it had requested. As the appellant was unable to produce valid tax invoices, the claim for deduction was disallowed.

After the appellant’s objection had been disallowed, it appealed to the Tax Court, which dismissed the appeal. The matter was then taken on appeal to the Full Bench of the Western Cape High Court.
The issue
The issue that the Court was called upon to adjudicate was whether the sponsorship contracts could be regarded as tax invoices.

Section 16(2)(a) of the Value-Added Tax Act 89 of 1991 (the VAT Act) sets out the basic principle governing the right to deduct input tax:

“(2) No deduction of input tax in respect of a supply of goods or services, the importation of any goods into the Republic or any other deduction shall be made in terms of this Act, unless-

(a) a tax invoice or debit note or credit note in relation to that supply has been provided in accordance with section 20 or 21 and is held by the vendor making that deduction at the time that any return in respect of that supply is furnished….”

There follow a number of sub-items in (b) to (f) which specify circumstances where a document other than a tax invoice may be accepted by SARS in lieu of a tax invoice. Section 16(2)(f) of the VAT Act stated, at the relevant time:

“(2) No deduction of input tax in respect of a supply of goods or services, the importation of any goods into the Republic or any other deduction shall be made in terms of this Act, unless –

…

(f) the vendor, in any other case, is in possession of documentary proof, as is acceptable to the Commissioner, substantiating the vendor’s entitlement to the deduction at the time a return in respect of the deduction is furnished.”

The appellant urged that the sponsorship agreements, which had been the source from which SARS had determined the amount of VAT to be assessed, were
documentary proof substantiating its entitlement to a deduction, and that the agreements should have been recognised as being acceptable.

SARS, in its Reasons for Assessment, had offered no explanation for its conduct, save to assert that the appellant was not in possession of the relevant tax invoices. No other reason was given, and the statement was not expanded upon.

The decision

The Court considered initially whether an alternative procedure might have been adopted by the appellant, for instance self-invoicing, as contemplated in section 20(7) of the VAT Act. However, it found that this was appropriate only where there was sufficient documentary evidence available and it would be impractical to require that a full tax invoice be issued. In the circumstances, the Court was not persuaded that it was impractical to require that a full tax invoice be issued.

The Court had established, correctly, it is submitted, that the transaction was a barter transaction between persons dealing at arm’s length. Thus, it had stated (at paragraph [4] of the judgment):

“In an ordinary arms’ length barter transaction the value that the parties to it have attributed to the goods or supplies that are exchanged seems to me, in the absence of any contrary indication, to be a reliable indicator of their market value. It is thus plain that the value of the goods and services provided to the taxpayer by the sponsors was equally determinable from the sponsorship contracts.”

Binns-Ward J (who delivered the unanimous judgment of the Court) found it appropriate that the contents of the sponsorship agreements should be looked to
as a reliable source of documentary proof. The learned Judge stated (at para graph [15]):

“… [It] is evident that the Commissioner predicated his calculation of the output tax on the information provided in the contracts. The appellant’s contention is that the contracts also serve as proof of its entitlement to a deduction for input tax. In my judgment the contention is well-made. If the documents were good enough for the Commissioner to assess the appellant’s output tax liability, it is impossible to conceive, having regard to the character of the particular transactions, why they should not also have been sufficient for the purpose of computing the input tax which should have been deemed to have been levied by the sponsors. The appellant had invoked the provisions of section 16(2)(f) in its representations to the Commissioner. In the circumstances he was bound to take them into account in making the assessment. I do not think that the Commissioner could reasonably have decided that the information in the contracts did not in the circumstances provide sufficient proof substantiating the appellant’s entitlement to the deductions claimed.”

In short, the Commissioner was ‘hoist with his own petard’. Having insisted that the values set out in the sponsorship agreements were sufficiently reliable to establish the tax to be assessed on the taxpayer’s supplies to the sponsors, SARS could scarcely argue with conviction that the sponsorship agreements were not acceptable documentary proof from which to identify the amount of input tax that could be claimed as a deduction in respect of the supplies received by the taxpayer from the sponsors – after all, there was a barter transaction, and it would be assumed, in the absence of contrary evidence, that the consideration given should reflect the value of the supply received.
The vigorous defence of its position by SARS rested on three main points.

First, it argued, the value of the services received from the sponsors had not been established. This was a new argument that had not been raised in any correspondence or in the pleadings and was summarily dismissed. The value of the supplies to the taxpayer had never been placed in issue in the proceedings. The Court was hasty to point out that SARS had been quite prepared to rely upon the information in the documents for its own purposes in assessing the appellant’s liability.

Secondly, SARS argued that the document should contain all of the information required to be reflected in a valid tax invoice, and that the sponsorship agreements did not meet this requirement.

Again the Court gave short shrift to this contention. If that were the case, said Binns-Ward J (at paragraph [20]), there would be no need for section 16(2)(f), which was intended to cover ‘other circumstances’. In any event the sponsors were known to SARS, who (the Court had noted at paragraph [4]) was aware that they had failed to supply tax invoices, despite being obliged to do so, and yet had made no attempt to compel the issuing of the tax invoices or prosecute the sponsors for their failure to respond to the appellant's requests.

The third argument was an attack on the forum selected for resolution of the dispute. SARS argued that the process of appeal to the Tax Court was procedurally incompetent, in that the refusal to recognise the information in the sponsorship agreements as acceptable documentary proof was an administrative decision that could only be challenged on review to the High Court. Here the Court found that the process was indeed an appeal against an assessment and not an application for review and setting aside of a decision under section 16(2)(f) of the VAT Act.
Appeal allowed
The appeal was accordingly allowed and the assessments were referred back to SARS for reconsideration.

PwC
VAT Act: Section 16(2), 20 and 21

SARS NEWS

2423. Interpretation notes, media releases, rulings 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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