

Synopsis

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Tax today

The green light for strategic
industrial projects

In this issue

The green light for strategic industrial projects 2

Trustees – proceed with caution 4

Promotion of Administrative Justice Act - When is a decision a 'decision'? 6

Anti-dumping duty - Constitutional Court rules High Court's order unconstitutional . 8

The green light for strategic industrial projects

The provisions of section 12I of the Income tax Act were promulgated more than a year ago. However, the criteria for application and project adjudication are governed by the Regulations and, in their absence, potentially qualifying projects have been unable to proceed with applications.

The Regulations under section 12I of the Income Tax Act were gazetted published in *Government Gazette* No. 33385 No. R. 639 (23 July 2010), opening the door to additional investment and training allowances for qualifying industrial projects.

The benefits afforded by section 12I

Typically, plant and machinery used in a process of manufacture (or a process similar to a process of manufacture) will qualify for an allowance under section 12C of the Income Tax Act. Where the plant is new and unused, section 12C provides for an accelerated allowance over a four year period in the ratio: 40%; 20%; 20%; 20%. Manufacturing buildings qualify for allowances under section 13 at a rate of 5% per annum.

Section 12I provides for a once-off additional investment allowance over and above the sections 12C and 13 allowances. The additional investment allowance is either 35% or 55% (in the case of projects with preferred status) of the cost of the manufacturing assets.

The allowance may be claimed in full in the year in which the manufacturing assets are commissioned, i.e. total allowances in respect of approved projects will be 135% (or 155% in the case of projects with preferred status) of the cost of the manufacturing assets, with 75% or 95%, respectively, being deductible in the year the plant is first brought into use.

As with the section 12C and 13 allowances, there is no apportionment of the section 12I allowance for assets brought into use part-way through the year.

A further feature of the additional investment allowance is that any assessed loss that arises to the extent of the allowance is increased by an "interest factor" on an annual basis for a period of 4 years from the date of approval of the project so as to preserve the real value of the tax incentive.

In addition to the once-off additional investment allowance, section 12I provides for an additional training allowance. Training costs may be deducted under section 11(a) of the Income Tax Act, and, where the training costs satisfy the provisions of section 12H (learnership agreements) an additional deduction may be claimed under that section. Section 12I incentivises the provision of training even further by providing an additional training allowance in respect of qualifying industrial projects. i.e. in certain circumstances a triple allowance in respect of training costs can be achieved.

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Qualification criteria

Pre-requisites for approval

The pre-requisites for a project to qualify for approval, in addition to the project spend requirements, are energy efficiency and skills development. These are the over-arching requirements of the industrial policy programme and the Regulations detail specific targets which must be met before a project can claim to have met these requirements.

Project spend requirements

Minimum spend thresholds apply: in the case of greenfield projects a minimum spend on manufacturing assets of R200 million must be incurred in order to qualify. In the case of brownfield projects the minimum spend is the lesser of R200 million and 25% of the expenditure incurred on existing assets with a floor of R30 million.

Pre-approval

Approval must be obtained from the Minister of Trade and Industry through the adjudication process before the manufacturing assets are contracted for. The Department of Trade and Industry has stipulated that, notwithstanding the period between the promulgation of the provisions of section 12I and the gazetting of the Regulations, they will only consider projects where the manufacturing assets have yet to be contracted for. They will, however, consider projects which have already been adopted, but which are to be implemented in phases, provided the manufacturing assets in respect of future phases have not been contracted for.

Balanced scorecard approach

A number of additional requirements are detailed in the Regulations. In order

to meet approval a project must achieve a minimum of 5 points (8 in order to achieve preferred status) out of a maximum of 10, against a scorecard that covers:

Innovation within the manufacturing processes employed;

Energy efficiency;

General business linkages;

Procurement of goods and services from small, medium or micro enterprises;

Direct job creation; and

Skills development.

PricewaterhouseCoopers has established a project team to assist clients with applications under section 12I. If you have any queries please contact Gert Meiring on 011 797 5506, Terry McCarthy on 031 271 2014 or Leon Swanepoel on 021 529 2376.

Although a minimum of 5 points must be achieved to obtain approval (8 in the case of projects seeking preferred status), a minimum of 2 points must be achieved out of a possible 4 for direct job creation and skills development.

Disqualified industrial projects

Any project which falls outside Major Division 3 of the Standard Industrial Classification Code will not be considered for approval. In addition, the following manufacturing projects are excluded: the manufacture of alcoholic beverages, tobacco products, arms and ammunition and bio-fuels

which impact negatively on food security.

Further, any project which receives certain concurrent benefits may be denied approval. Concurrent benefits include any benefit received in terms of the Automotive Production and Development Programme (excluding automotive component manufacturers), the Small Medium Manufacturing Development Programme, the Productivity Asset Allowance, the Small Medium Enterprise Development Programme, the Enterprise Investment Programme or any other programme of any national sphere of Government which provides grants, subsidies, rebates or interest-free loans unless these are immaterial.

Application process

Applications are to be submitted to The Enterprise Organisation (TEO) within the Department of Trade and Industry (DTI).

Projects are presented to a monthly meeting of the Adjudication Committee, administered by TEO, comprising representatives of the DTI, National Treasury, and the South African Revenue Service, which is responsible for making recommendations to accept or reject the status of approved projects. The final decision lies with the Minister of Trade and Industry.

Under section 12I taxpayers have until 31 December 2014 to apply. However, it is possible that the benefits set aside (R20 billion) will be consumed before the legislative window closes. For this reason taxpayers should consider their pipeline of projects over the next 4 year period and give thought to applying for approval as soon as possible where their projects potentially satisfy the criteria above.



Trustees – proceed with caution

Trustees should consider the extent of their powers under the deed of trust before taking resolutions, to ensure that the actions that they intend taking are permitted.

The salient issues of fact were as follows:

A parent had formed a trust in 1973, The capital beneficiaries of the trust were his six children, but, in terms of the trust agreement, they could not receive the capital until after the death of the parent.

In 1994, the parent formed six separate trusts, one for the benefit of each of the children. The trustees then sold one-sixth of the trust assets to each of the children's trusts with the consideration left outstanding on loan account.

In 1996 the trustees of the 1973 trust made distributions of the loan accounts to the children's trusts, which resulted in the 1973 trust having no assets and no liabilities. The trustees of the children's trusts accepted the distributions. As a result the loan accounts were extinguished.

SARS sought to tax the distributions as donations made in 1996 and issued an assessment for the amount of donations tax of approximately R79 million plus interest.

In 2006, the trustees were informed by senior counsel that the distributions to the children's trust were probably void because they were not permitted under the provisions of the agreement of trust, on the basis that the children's trusts were not beneficiaries of the trust and, in addition, they represented distributions of trust capital which could not be distributed until after the death of the parent.

The trustees did not take action to treat the transactions as void, but decided to await the outcome of the appeal against the assessment to donations tax and continued to sign financial statements to the effect that the trust had no assets and no liabilities.

The Court was called upon to determine whether the distributions were donations. In this respect the Court needed to consider two aspects.

Trustees stand in a fiduciary relationship between the donor and the beneficiaries. In accepting appointment as such they assume a duty to act in accordance with their mandate in the interests of the beneficiaries. As with company directorships, persons invited to act as trustees should consider carefully the responsibilities that accompany such an appointment.

A decision from the Tax Court in the Western Cape in Income Tax Case No 1840 72 SATC 79 highlights yet again the importance to trustees of observing the limits of their powers in the exercise of their mandate.

First, it was necessary to consider whether the distribution was a valid transaction or void.

The Court found:

“The 1996 awards were ultra vires because the 1994 children’s trusts were not beneficiaries of the appellant, whose trustees could only make awards to the beneficiaries of the appellant. The appellant’s trustees were, in my view, not empowered to make awards of capital until after the death of X.”

The second issue was whether the illegal contracts were donations.

In this regard, the Court indicated that all distributions by trusts are prima facie donations, being gratuitous. In this instance the effective waiver of the loans for no consideration was clearly a gratuitous waiver of a right as contemplated in the definition of “donation” in section 55(1) of the Income Tax Act. The transaction was however not entitled to exemption afforded to trust distributions in terms of section 56(1)(f), as the transactions were *ultra vires*.

The Court then considered whether a transaction that is void as between the parties can give rise to a liability to donations tax. Here it placed reliance on the decision of the Supreme Court of Appeal in *MP Finance Group CC (in liquidation) v C:SARS 69 SATC 141 at 144* that the illegality of an act did not render the act immune from tax.

Finally there was a question when the donation took effect. Here the Court, paradoxically, took the view that the donation must have taken effect from the date that the trustees became aware of the apparent illegality at which

time they were first afforded the opportunity of reversing the earlier transactions and reinstating the loans. However, the Court found:

“The fact that the appellant in the present matter, after discovering the ultra vires point, did nothing or adopted a supine attitude to the whole transaction, other than awaiting the outcome of the tax appeal, cannot assist it because the trustees signed the financial statements in 2006 and 2007 and behaved as if the loan debts and 1996 awards were valid.”

In the event, it was found that the donation took effect in 2006. It appears that the Court took the view that, for so long as the trustees were not aware that the transactions were a nullity, they had a right to reinstate the loan accounts and that the donation therefore took effect only when that right was effectively waived. The conclusion is summarised thus:

“I conclude that the appellant by its conduct either waived or renounced its right to reinstate the 1994 loan debts and its inaction amounted to a donation giving rise to liability for donations tax because, on its own version, the ultra vires point came to the attention of the trustees on or after 14 February 2006 and not later than 21 June 2006, the date of the appellant’s objection in which it relied on the fact that the 1996 awards were a nullity.”

Valuable lessons

Two valuable lessons emerge from this matter. First, persons entrusted with the responsibility of trusteeship should consider the extent of their powers under the deed of trust before taking resolutions to ensure that the actions that they intend taking are permitted. Secondly, it is vital that action to rectify error be taken immediately the error becomes apparent.

Review of administrative decisions under the Promotion of Administrative Justice Act

When is a decision a “decision”?

Taxpayers and their advisers have, in general, been slow to realise the important supplement to their rights vis-a-vis SARS that has been accorded them by the Promotion of Administrative Justice Act 3 of 2000 (PAJA).

The Act provides in section 3(1) that –

Administrative action which materially and adversely affects the rights or legitimate expectations of any person must be procedurally fair.

The Act defines “administrative action” as –

any decision taken, or any failure to take a decision, by-

- a) an organ of state, when-
 - i) exercising a power in terms of the Constitution or a provincial constitution; or
 - ii) exercising a public power or performing a public function in terms of any legislation; or
- b) a natural or juristic person, other than an organ of state, when exercising a public power or performing a public function in terms of an empowering provision,

which adversely affects the rights of any person and which has a direct, external legal effect.

At the heart of the definition of administrative action is the concept of a decision, which the Act defines as any decision of an administrative nature.

Since the South African Revenue Service is an “organ of state” it follows that many of its decisions affecting a particular taxpayer will constitute administrative action, with the result that the taxpayer in question will have the right to take on judicial review any such action which he believes does not comply with procedural fairness as laid down in the Act.



At the heart of the definition of administrative action is the concept of a decision, which the Act defines as any decision of an administrative nature.

What constitutes a “decision” reviewable in terms of the Act?

The decision in *Bhugwan v JSE Ltd* 2010 (3) SA 335 (GSJ) is the first High Court decision to focus on what, for purposes of PAJA, constitutes a decision reviewable under the Act, as distinct from a decision that is inchoate and hence not reviewable.

While this particular case did not concern an issue that arose between SARS and a taxpayer, the principles that the judgment lays down are of considerable significance in determining the applicability of PAJA in this context.

This is because the actions of SARS and the communications between SARS and taxpayers can take a variety of forms, and can go through various intermediate phases. It is only when SARS’s conduct constitutes a decision vis-à-vis a particular taxpayer that the provisions of PAJA will come into play.

The characteristics of a “decision” that is reviewable in terms of PAJA

The decision in Bhugwan’s case illustrates that a person who is seeking relief in terms of PAJA must be careful not to jump the gun (as it turned out that the applicant in this case had done) in applying for a review. If an application for review is premature, it is doomed to failure.

The Promotion of Administrative Justice Act defines “decision”, but in circular terms (“any decision of an administrative nature made, proposed to be made or required to be made ...”) that do not assist in determining the core meaning of the word.

The central issue in Bhugwan was whether the JSE had made a decision, as defined in PAJA, as to whether Bhugwan was a “fit and proper person” as contemplated in the Equity Rules.

The court quoted various dictionary definitions of the word decision and held that, for a decision to have been taken that was amenable to judicial review, “all or at least some” of the following steps must have been completed, namely –

1 Save where an authority legitimately acts coercively or of its own accord, a final application, request or claim must have been addressed by a subject to an authority which exercises statutory or public powers to exercise those powers in relation to a set of factual circumstances applicable to the subject.

2 All relevant information, either presented by the subject or otherwise reasonably available must have been gathered (which may require an investigative process) and placed before the authority which is to make the decision.

3 There must have been an *evaluative process* where the authority considers all of the information before him or her, identifies which components of such information are relevant and which are irrelevant and in which the authority assigns, through a process of value judgments, a degree of significance to each component of the relevant information, regard being had to the relevant statute or other empowering provision in terms of which the authority acts.

4 A *conclusion* must have been reached by the authority, pursuant to the evaluative process, as to how his or her statutory or public power should be exercised in the circumstances.

5 There must have been an *exercise of the statutory or public power* based on the conclusion so reached.

It is, with respect, not clear why points 2 and 3, above, can in any sense be regarded as prerequisites for a “decision”, as defined, having been made. Indeed, it may be the absence of these factors that is the basis for the application to review the decision in question.

Significantly, section 1 of PAJA defines *administrative action* as connoting “any decision taken or failure to take a decision”, and goes on to define *decision* as “any decision of an administrative nature made or proposed to be made ...”.

A *decision*, as defined, therefore includes a decision *proposed to be made*.

It would therefore have sufficed for *Bhugwan* to show that what the JSE had done was to notify him, not of a decision already taken, but of a decision *proposed to be made*.

Thus in determining whether SARS has taken a *decision* as contemplated in PAJA in relation to a particular taxpayer, the critical distinction is between, on the one hand, a decision actually *made or proposed to be made* (either of which would fall within the scope of the definition) and a decision *deferred*, (which would fall outside of the definition).

Anti-dumping duty

Constitutional Court rules High Court's order unconstitutional

As a member of the World Trade Organisation, South Africa's international obligations on tariffs and trade are honoured through domestic legislation that governs the imposition of anti-dumping duties and other trade remedies.

Act 71 of 2003 established the International Trade Administration Commission and charged this body with the duty to make recommendations to the Minister of Trade and Industry. The latter could in turn ask the Minister of Finance to impose or lift anti-dumping duties on specific goods introduced into the Republic.

The background to the decision of the Constitutional Court in *International Trade Administration Commission v Scaw South Africa (Pty) Ltd* (2010) 72 SATC 135 was that, in consequence of a request by Scaw South Africa (Pty) Ltd – which was the largest manufacturer of steel products in South Africa – an anti-dumping duty had been imposed by the International Trade Administration Commission on certain steel products imported into the Republic by a United Kingdom company.

Anti-dumping duties generally remain in force for a period not exceeding five years.

Prior to the expiry of the anti-dumping duty in question, Scaw had applied to the Commission for a review of the duty with a view to securing an extension of its duration. The Commission had acceded to the application, but came to the conclusion in the course of its review that the lifting of the duty would not result in further dumping, and decided to recommend to the Minister that the existing anti-dumping duty in question should be terminated.

The High Court, on the application of Scaw, granted an interim interdict restraining the Minister of Trade and Industry from accepting a recommendation by the International

Trade Administration Commission that the anti-dumping duty in question be terminated. The interdict also restrained the Minister of Finance from terminating that duty in respect of certain products.

A constitutional issue was at stake

The order of the High Court was held to raise a constitutional issue in that it restrained two members of the Cabinet from exercising executive powers conferred on them by the Constitution and national legislation.

The Constitutional Court held that the formulation and implementation of trade policy was pre-eminently within the domain of the executive arm of government, and that it was not constitutionally permissible or appropriate for the High Court to have made such an order, inter alia because the order breached the doctrine of the separation of powers which is an integral part of the Constitution.

It was held that the order of the High Court had invaded the terrain of the national executive function without appropriate justification.

The Constitutional Court therefore upheld the Commission's appeal and set aside the order of the High Court.