Synopsis

Tax today

September 2013

A monthly journal published by PwC South Africa providing informed commentary on current developments in the tax arena, both locally and internationally. Through analysis and comment on new law and judicial decisions of interest, it assists business executives to identify developments and trends in tax law and revenue practice that might impact their business.

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OECD Promotion of tax transparency

Big brother will be watching you!

On 5 September 2013, the summit meeting of the leaders of the G20 nations came to a close and the leaders issued a declaration of their commitment to work together to strengthen the global economy. A section of the declaration was concerned with "Addressing Base Erosion and Profit Shifting, Tackling Tax Avoidance, and Promoting Tax Transparency and Automatic Exchange of Information".

The OECD plan to tackle base erosion and profit shifting (BEPS) had been outlined to the leaders by the secretary general of the OECD during the summit, and the leaders endorsed the project and summarised their concern in the following terms:

"In a context of severe fiscal consolidation and social hardship, in many countries ensuring that all taxpayers pay their fair share of taxes is more than ever a priority. Tax avoidance, harmful practices and aggressive tax planning have to be tackled"

In the eyes of the world's leaders:

"Profits should be taxed where economic activities deriving the profits are performed and where value is created. In order to minimize BEPS, we call on member countries to examine how our own domestic laws contribute to BEPS and to ensure that international and our own tax rules do not allow or encourage multinational enterprises to reduce overall taxes paid by artificially shifting profits to low-tax jurisdictions."

Of particular interest in the promotion of tax transparency is the work that is being carried on to facilitate the exchange of information. The leaders fully endorsed the OECD proposal for the establishment of a truly global model for the multilateral and bilateral exchange of information.

The work of the OECD on transparency and exchange of information is conducted through the Global Forum on Transparency and Exchange of Information for Tax Purposes, a consultative body that now has 119 member countries (including South Africa). This body has been reviewing the law and practices of the various member jurisdictions to evaluate their preparedness for exchange of information and recommend changes to enable the exchange of information. It reports to the G20 Finance Ministers and Central Bank Governors, who meet annually ahead of the G20 leaders' summit. Approximately 87% of member countries have undergone or are undergoing the Phase I reviews while some 47% have been subjected to or are undergoing Phase 2 analysis.

The review of the Global Forum's work revealed that transparency has been enhanced by jurisdictions:

- improving legislation to ensure that accounting and ownership information is available;
- enhancing access to information, particularly bank information, for purposes of exchange of information; and
- improving the procedures and capability for timely exchange of information.

Of greater interest however is the plan for the automation of exchange of information.

OECD promotion of tax transparency

The plan is to develop a global model for the exchange of information with a broad scope, focusing on:

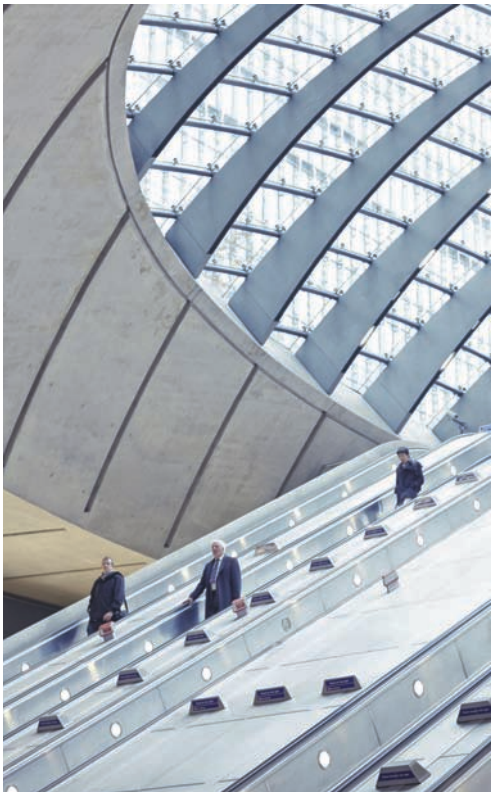
- the nature of income that is the subject of evasion;
- the identity and characteristics of account holders engaged in evasion; and
- the range of financial institutions that would be compelled to report.

A comprehensive due diligence methodology is envisaged by which financial institutions would identify reportable accounts and obtain the information concerning the account holder that would be required for the exchange of information.

A sound and universally acceptable legal basis will require that there be rules for domestic reporting and for the exchange of the information reported. Within these rules provision must be made to observe the confidentiality of information that is reported by limiting the persons to whom the information may be disclosed and the purpose for such disclosure. Both the reporting and the receiving jurisdictions must have the legal framework, administrative capacity and processes that ensure protection of information.

The plan takes account of the technical aspects of the exchange of information and notes that information is currently exchanged between jurisdictions from one country's exchange of information portal to another country's exchange of information portal or through a secure network. The information that is exchanged needs to be encrypted and the adoption of compatible encryption and decryption methods is a priority.

The process is gathering pace. The USA and five European jurisdictions have implemented Model 1 IGA, which "provides for reporting by financial institutions to their local tax authorities, which then exchange the information on an automatic basis with the residence jurisdiction tax authorities." By way of example, a bank in Germany will report on non-resident account holders to the German tax authorities and the German tax authorities will automatically disseminate details of account holders who are resident in the USA, UK, France, Italy and Spain to the respective tax authorities. This model represents a logical basis for the development of a global tool for this purpose.



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The OECD has demonstrated that considerable progress has been achieved and is committed to pressing forward with this project with the utmost haste, and the G20 leaders sought to push the programme aggressively by setting milestones:

"… we are committed to automatic exchange of information as the new global standard, which must ensure confidentiality and the proper use of information exchanged, and we fully support the OECD work with G20 countries aimed at presenting such a new single global standard for automatic exchange of information by February 2014 and to finalizing technical modalities of effective automatic exchange by mid-2014. In parallel, we expect to begin to exchange information automatically on tax matters among G20 members by the end of 2015."

It was perhaps recognised by the summit that a number of countries that have not committed to membership of the Global Forum are developing countries, and the leaders sought to encourage their participation:

"Developing countries should be able to reap the benefits of a more transparent international tax system, and to enhance their revenue capacity, as mobilizing domestic resources is critical to financing development. We recognize the importance of all countries benefitting from greater tax information exchange. We are committed to make automatic exchange of information attainable by all countries …"

Exchange of information is becoming increasingly relevant in the tax enforcement arena. With the rapid advances in technology and the growing focus on combating tax evasion and money laundering, it is only a matter of time before the automatic exchange of information between the tax jurisdictions of the world becomes a reality.

SARS refund intercepted

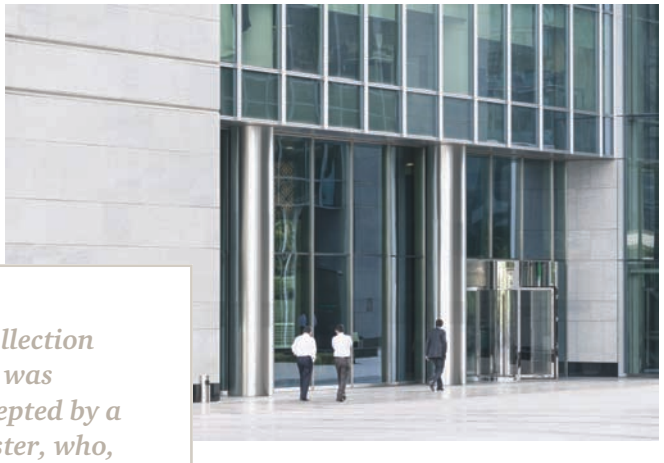
The cheque is (not) in the mail

Paying by cheque and using the mail to deliver the cheque can carry unpleasant risks. This is well illustrated in a recent decision of the Supreme Court of Appeal which dealt with the payment by SARS of a substantial refund.

SARS issued an assessment which reflected that a substantial refund was due to the taxpayer. The notice of assessment advised that the refund would be processed "soon". The notice reflected that SARS did not have the taxpayer's banking details and went on to state that, if it should be found when the refund was processed for payment that the bank details were incorrect, the refund would be paid by means of a cheque which would be sent to the taxpayer's nearest post office for collection.

When the time for payment came, SARS drew a cheque on its bank account and delivered it in a sealed envelope to Secure Mail (a division of the South African Post Office), requesting that it be held for collection at the Menlyn Post Office. A collection notice was issued for delivery to the taxpayer.

The collection notice was intercepted by a fraudster, who, using a forged authorisation purporting to have been issued by a firm of chartered accountants, collected the cheque. Thereafter, the statutory records relating to the company at the Registrar of Companies were amended by removing the names of the directors of the taxpayer company and replacing them with the name of an accomplice of the fraudster. The accomplice then, purporting to be authorised to do so, opened a bank account in the name of the company, deposited the cheque which was duly honoured by SARS' banker, and withdrew the funds over a short period of time.



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The taxpayer contacted SARS and demanded payment. SARS refused and stated that it had paid the refund by mailing the cheque and that the risk of misappropriation had thereafter rested with the taxpayer.

The taxpayerdid not take this lying down and instituted proceedings to compel payment. In the High Court, his claim was rejected. The Court held that the notification on the notice of assessment gave the taxpayer a choice as to the mode of payment and, by not supplying bank details, it had authorised that payment be made by cheque through the mail.

The decision was taken on appeal to the full bench of the North Gauteng High Court. In a split decision, the majority upheld the earlier decision, finding that:

". . the only plausible inference to be made was that there was a tacit agreement that remittance of payment should be done through registered post."

Thus it was that the matter finally came before the Supreme Court of Appeal, in the matter of *Stabilpave (Pty) Ltd v SARS* [2013] ZASCA 128 (26 September 2013).

The well-reasoned judgment of Meyer AJA, in which the other four Justices of Appeal concurred, summarised the law relating to the payment of a debt by way of delivering a cheque using the mail citing extensively from the judgment of *Nienaber J in Mannesmann Demag v Romatex* 1988 (4) SA 383 (D) at 389 -390.

The points made in that judgment indicated that when a debtor tenders payment by cheque and the creditor accepts it, payment is not effected until the cheque is honoured and the risk of

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The law relating to payment through the post was then summarised in the following terms:

"It is clear from this passage that any agreement 'about the particular mode of performance' or 'as to the manner of payment' is reached only if the creditor stipulates (or requests or authorises) a particular mode of payment and the debtor accedes to the request."

This then set the scene for considering the effect of the statement in the notice of assessment. Did the notice give the taxpayer a choice as to the mode of payment, and, if so, did the failure of the taxpayer to respond by providing banking details constitute an agreement that SARS was authorised to make payment through the post?

On examining the notice, Meyer AJA found the following:

- The notice informed the taxpayer of the position as at a particular date;
- It informed the taxpayer that a refund of the amount standing to the credit of its account would be paid in the near future;
- It advised the manner of payment, namely that payment would be by way of a cheque which could be collected from the nearest post office or by means of an electronic funds transfer;
- The banking particulars that would be used are those reflected on the notice, and if these were incorrect at the date of processing of the refund, payment would be made by cheque.

Importantly, Meyer AJA found (at paragraphs [12] and [13]):

"[12] There is no invitation, expressly or by implication, to the taxpayer to furnish banking particulars should the taxpayer wish to be paid by means of electronic transfer. If there was such invitation one would have expected the taxpayer to be informed that payment would be effected by means of an electronic transfer, if valid banking particulars were available or furnished by the taxpayer. A further and clear indication that the notice does not afford a choice as to the manner of payment is the absence of a cut-off date on or before which the taxpayer might furnish its banking particulars to SARS. Instead, the taxpayer is informed that payment will be made soon. The notice is merely for the information of the taxpayer.

[13] The clear implication of the notice is an advice from SARS that the tax record of Stabilpave reflected no banking particulars and that payment would therefore be effected by means of a cheque through the post. No choice was afforded to Stabilpave. The method of payment was dictated by SARS. The mere fact that a creditor knows or expects to be paid by cheque through the post or that it does not raise an objection does not in itself give rise to an implied request or election by the creditor to be paid in such manner."

It was therefore held that the risk of loss had not passed to the taxpayer, but had remained with SARS and judgment was given in favour of the taxpayer.

One can sympathise with SARS, which had used apparently secure means to ensure that payment reached the taxpayer, and had fallen victim to a fraud scam that bears the hallmarks of a sophisticated, collusive crime. However, the decision emphasises the principle that the creditor is the person who has the right to elect the manner in which payment may be made and that there must be clear evidence that the creditor has agreed to accept payment by cheque through the post.

ABC (Pty) Ltd v CSARS

Attention to detail is vital in high value transactions

The judgment of Davis J in the Cape Town Tax Court in ABC (Pty) Ltd v CSARS (19 August 2013 unreported) concerned a single, crisp question – whether the proceeds of the disposal of a plantation by the appellant taxpayer had been correctly included in its gross income for the 2004 tax year of assessment in terms of s 26 (1) of the Income Tax Act 58 of 1962 read together with paragraph 14 (1) of the First Schedule to the Act.

We reported on this decision in the August issue of *Synopsis* in which we dealt with the merits and issues. The decision warrants further consideration as a reminder to tax practitioners and businesspersons alike that attention to detail is of vital importance where high value transactions are involved.

The factual background

The common cause factual background to the litigation was as follows.

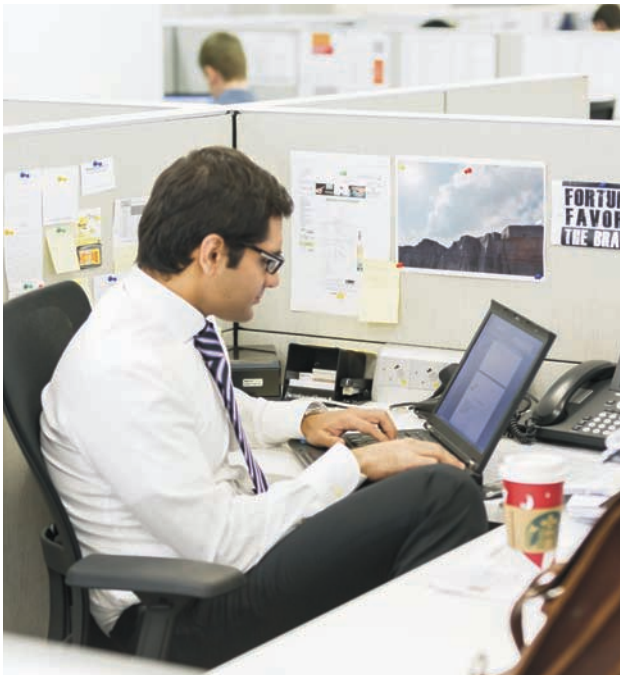
The appellant had purchased a plantation business in terms of a 'sale of business agreement' dated 3 October 2001. The purchase price of R11 956 121 was attributed to the standing timber. The appellant later disposed of the plantation to E (Pty) Ltd in terms of certain 'heads of agreement' dated 21 February 2003,read with a 'settlement agreement' dated 29 July 2004. The consideration for the plantation over and above the cost of the land was R144 700 000.

The appellant's argument

The appellant argued that –

- it had acquired ownership of a plantation as an investment and
- it had contracted with E on terms whereby the farming operations regarding the plantation would be carried on for E's benefit on E's behalf and for E's account,
- in due course, the appellant had disposed of the plantation to E,

and that the plantation was never part of its business operations as the appellant was not, itself, engaged in farming.



In short, the appellant argued that it had been a mere passive investor; that after acquiring the land it retained the bare dominium of that land and granted E a usufruct; that the appellant had earned no income from the land and that the farming operations in relation to the plantation had been undertaken exclusively by E for the latter's benefit.

Such an arrangement was not only legally feasible, but was, in principle, entirely credible. In the context of farming operations, it is common for ownership of the land to be vested in one legal entity, while the farming operations are carried on by another entity.

The question was whether this was what had actually occurred in the present case or, more precisely, whether the appellant had discharged the onus of proof in this regard by showing that this had been the actual arrangement in legal and fiscal terms.

The evidence adduced in the Tax Court

The oral evidence led by the appellant sought to establish that there had been an oral agreement between representatives of the appellant and E to the effect that the company would acquire the property and that it would permit E to farm the property and retain the income so derived.

When cross-examined on the accuracy of the information recorded in the written heads of agreement, the witnesses indicated that the heads of agreement did not reflect the actual agreement that they had made. In particular, the heads of agreement for the sale of the property recorded that E had managed the business on *behalf of the appellant*; however, E's director denied that this had been the case, and the director of the appellant protested that he had seen that there were errors in the heads of agreement, but had signed on the understanding that the heads of agreement constituted a preliminary document that would be superseded by a subsequent formal agreement.

The evidence then dealt with a settlement agreement that had been subsequently drawn up to resolve issues of interpretation of the heads of agreement. In this agreement, the

appellant agreed to pay a "bonus management fee" to E in recognition of the exemplary manner in which it had performed its stewardship obligations towards the appellant's plantations. The parties under examination regarded the term "management fee" to be an inappropriate description. The one witness described it as a "rebate on the value of the forest" and the other stated that it was a misnomer, and that the fee recognised stewardship rather than management.

SARS attacked the witnesses' evidence by comparing what they asserted with the terms of agreements, resolutions and other documents. They dealt first with the agreement for the original acquisition of the property by the appellant and noted that it had agreed to purchase the business of the seller as a going concern. The business was described in that agreement as "the business of forestry, timber growing, plywood manufacturer and property leasing as conducted by the sellers..." They then turned to the heads of agreement in which the appellant warranted that it was the lawful owner of "the business", which it agreed to sell as a going concern. The directors of the company subsequently resolved to approve of "the sale of the forestry business as a going concern". Finally, the annual financial statements contained a note that the growing of timber was one of the main objectives of the appellant.

SARS therefore urged that:

"... the court should not consider what he referred as 'litigation-focus semantics' but rather examine carefully the substantive evidence as to the continuous and close link between appellant and the farming operations, supported by various unguarded statements made by the parties themselves describing the relationship accurately in terms of it being a plantation business."

Documents are a contemporaneous record of events ... memory fades and the recollection of events that occurred a decade earlier is difficult and prone to potential inaccuracy.

The approach of the Court

The Court (Davis J) took the approach suggested by Miller J in ITC 1185 35 SATC 122 at 123, where it was stated:

"The Court's function is to determine, on an objective overview of all the relevant facts and circumstances, what the motive, purpose and intention of the taxpayer were. The Court added:

'In other words, whatever a taxpayer may tell the Court has to be analysed through the prism of the objective facts presented to the Court.'"

Thus, Davis J felt compelled to seek corroboration for the statements made by the witnesses from the documentary evidence that was before the Court.

'When the objective evidence, particularly the range of documents to which I have references [sic] including contracts and financial statements are considered. They all indicate in the direction that appellant was conducting a business of plantation farming. Even in the event that beneficial consideration is given to appellant's case by virtue of amendments to various documents, it would appear that the thrust of contemporaneous documentation supports respondents' case to the extent that appellant has not discharged the onus of proving that its intention differed from that which is recorded in these financial documents, contracts, minutes and resolutions, namely that it had bought and sold the plantation businesses as a going concern and that it employed E to manage its plantation business on its behalf.'

The Tax Court was therefore not persuaded by the oral evidence and found that the evidence suggested that the appellant was indeed carrying on farming operations.

The lesson

It appears that the heads of agreement may well have been prepared on the basis that the disposal should be structured as a zero-rated transaction for VAT purposes, namely a sale of a going concern. This intention may well have coloured the manner in which the heads of agreement were drawn. The parties were subsequently advised that the transaction was a standard rated transaction, but it appears that there was no subsequent rectification made to the heads of agreement or resolutions authorising the transaction.

The matter again emphasises that the documentary evidence is crucial in establishing the reliability evidence given in a Court. Documents are a contemporaneous record of events. On the other hand memory fades and the recollection of events that occurred a decade earlier is difficult and prone to potential inaccuracy.

SARS Watch 20 August to 20 September 2013

Legislation		
10 September	Draft legislation issued for public comment	Proposed amendments to the Customs and Excise Act and VAT Act relating to importation of goods issued for comment by 30 September 2013
11 September	SARS and National Treasury response to public comment on draft Taxation Laws Amendment Bill	SARS and National Treasury briefed the Standing Committee on Finance on the legislative process for the 2013 Taxation Laws Amendment Bill and their response to public comment on the draft legislation
20 September	Draft legislation issued for public comment	The Draft Employment Tax Incentive Bill was issued for public comment to be submitted y 11 October 2013.
Interpretation		
28 August	Interpretation Note No. 8 (Issue 3)	Has been amended to take account of the law relating to insolvent estates as contained in the Tax Administration Act.
20 September	Guide to the determination of medical tax credits and allowances (Issue 4)	The guide is updated to take account of changes to the legislation that came into effect for years of assessment commencing 1 March 2013 in respect of individuals.
Binding rules		
30 August	Binding Private Ruling 153 - Residence status of a non-resident who applies for a temporary residence permit	This BPR provides that an application for a "retired persons" temporary residence permit will not of itself be sufficient for the person to be regarded as ordinarily resident in the Republic.
3 September	Binding Private Ruling 154 - Debtors' book acquired in intra-group transaction	The BPR rules that the transferor and transferee in a transaction under section 45 of the Income Tax Act are deemed to be one and the same person for purposes of the doubtful debt allowance and that the historical financial information of the transferor may be used to determine the allowance.
6 September	Binding Private Ruling 155 - Oil and gas incentive	The BPR states that expenditure related to a floating production unit for offshore processing and transport of gas will be eligible for the additional incentive deductions under the Tenth Schedule to the Income Tax Act.
Case law		
16 September	Association of Meat Importers v ITAC (Supreme Court of Appeal)	The case deals with the interpretation of regulations published under the International Trade Administration Act 2002 relating to anti-dumping duties.