Synopsis

Tax today

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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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The Supreme Court of Appeal rules that a vendor who fails to pay over VAT to SARS does not commit common law theft

Nothing makes SARS see red as much as a VAT vendor who charges VAT on his goods or services, collects the VAT from his customers, and then fails to pay it over to SARS.

SARS regards this as nothing less than theft. The VAT collected by the vendor did not belong to him, so the argument goes – it belonged to SARS. If the vendor then puts the VAT into his own pocket, he is stealing the money.

SARS's interpretation of the law was put to the test

The first time that SARS's view that failure to pay over VAT constitutes common law theft has been tested in the courts in a reported judgment (there was apparently an earlier unreported judgment in AJC Olivier v Die Staat) is during the recent decision of the Supreme Court of Appeal in Director of Public Prosecutions, Western Cape v Parker [2014] ZASCA 223, in which judgment was handed down on 12 December 2014.

In this case, at the instigation of SARS, a VAT vendor (the vendor, accused number one, was a close corporation and the second accused was its individual representative), which had collected VAT but failed to remit it to SARS, was prosecuted in the Bellville regional court and found guilty of, inter alia, common law theft. The individual was sentenced to five years' imprisonment on that charge.

However, the jubilation in the ranks of SARS following that conviction – with its massive deterrent effect – has now been given a damper, for the conviction on the charge of common law theft has been quashed, first by the Cape High Court, and then by the Supreme Court of Appeal.

Did the failure to remit the VAT to SARS constitute common law theft?

Although the individual in question had appealed only against the jail sentence and had not appealed against his conviction on the theft charge, the Western Cape High Court of its own accord raised the issue as to whether the admitted conduct did in fact amount to common law theft.

Giving judgment in the appeal, the Western Cape High Court answered that question in the negative. Effectively, therefore,

the conviction and sentence on the charge of common law theft were expunged.

The prosecution lodged an appeal to the Supreme Court of Appeal, which gave judgment on 12 December 2014, dismissing the appeal and affirming that what had transpired did not amount to common law theft.

Why is a failure to remit VAT to SARS not common law theft?

The superficial attractiveness of SARS's argument that:

> VAT collected by a vendor belongs to SARS, and
>
> failure to remit VAT to SARS constitutes theft,

soon dims when placed under the spotlight.


The superficial attractiveness of SARS's argument soon dims when placed under the spotlight.

The Supreme Court of Appeal identified several weaknesses in the argument.

Of major significance is that a VAT vendor is not a trustee vis-à-vis SARS. (If the vendor were, in law, a trustee for SARS, it would have been theft to misappropriate money held in trust.) To the contrary, the court held (at para [9] of the judgment) that the relationship between the VAT vendor and SARS is simply that of debtor and creditor. Thus, if the vendor fails to pay over the VAT, he can be sued by SARS for an unpaid debt.

It is, however, true, as the court pointed out, that, in addition to being sued civilly by SARS for the VAT that was collected but not paid over, the vendor could be criminally charged in terms of section 58 of the Value-Added Tax Act 89 of 1991 for failing to comply with the obligations imposed by the Act – but this is a statutory offence, not common law theft.

Thus, as the court pointed out, when it is sometimes said that a VAT vendor is an involuntary tax collector for SARS, this must not be taken literally – the vendor is not a tax collector for SARS in the formal sense of the word, nor is the vendor an agent of SARS in the strict sense of the word.

The court concluded (at paras [14]–[15]) that –

> the concept of a trust relationship between the vendor and SARS which forms the bedrock of the State's argument is clearly unsustainable . . . . The relationship it creates between SARS and the registered vendor is sui generis – one with its own peculiar nature. The Act does not confer on the vendor the status of a trustee or an agent of SARS.

The implications of the judgment

It is not in dispute that a vendor who fails to remit VAT to SARS commits a statutory criminal offence under s28(1)b) read with s 58 of the Value-Added Tax Act, which is punishable by a sentence of up to two years' imprisonment.

That potential sentence is thus considerably lighter than for common law theft, and the stigma is less, as the misdemeanour can be downplayed as a technical fiscal offence.

Tax Administration Laws Amendment Bill (B14 of 2014) will effect amendments to the Tax Administration Act 28 of 2011

A significant amendment is to an aspect of the statutory pay-now-argue-later rule.

The pay-now-argue-later rule

The fearsome pay-now-argue-later rule, as currently laid down in section 164(1) of the Tax Administration Act, provides that, unless a senior SARS official otherwise directs, the obligation to pay tax is not suspended by an objection or appeal against a disputed assessment.

Section 164(3) goes on to say that a senior SARS official may, at the request of a taxpayer, suspend the obligation to pay the whole or a portion of the disputed tax that is due in terms of an assessment.

The decision of the SARS official in response to such a request will constitute *administrative action* as envisaged in Promotion of Administrative Justice Act 3 of 2000, and the taxpayer would be entitled to apply for a judicial review of an adverse decision.

Such a resort to the courts would entail a *review* by the High Court of the decision by the senior SARS official, not an *appeal* against that decision.

A review is concerned, not with whether the decision was right or wrong, but with whether it was arrived at by a proper process, inter alia whether relevant factors were taken into account in making the decision, and irrelevant considerations ignored.

Consequently, the statutory criteria that the senior SARS official is required to take into account in reaching his decision will be a central concern of the reviewing court in deciding whether the adverse decision should be set aside.

The Tax Administration Act specifies in section 164(3) what those criteria are, and it is this sub-section that is now to be significantly amended.

Old versus new statutory criteria to be applied in deciding on obligation to pay a disputed tax assessment to be suspended pending a decision by the Tax Court

It is worth bearing in mind that there has to date been no reported judgment in which the court has weighed and applied the statutory criteria for suspension of the taxpayer's obligation to pay assessed but disputed tax.

Several speculative inferences can be drawn from the dearth of reported judgments involving litigation between taxpayers and SARS in regard to a taxpayer's request for suspension of the obligation to pay disputed tax. One possibility is that SARS did not dare take the risk of a pro-taxpayer judgment, which might have opened the floodgates of requests for suspension of the obligation to pay disputed tax.

The new amendments have now made the task of a reviewing court even more difficult.

Firstly, the amended text no longer sets out a closed list of relevant factors. This provision now says that the official must have regard 'to relevant factors *including* …' Hence, the list that follows is not comprehensive, and the range of relevant factors is now unlimited. (No relative weight is assigned to the various factors, nor are they ranked in relative importance.) However, a taxpayer would be entitled, in requesting reasons for an adverse decision by SARS in response to a request for suspended payment, to require SARS to specify each and every factor that was taken into consideration in reaching the decision in question.

The factor of 'the amount of tax involved' has been deleted from the list of relevant factors, presumably because this aspect is covered by the criterion relating to whether the taxpayer will suffer hardship if he has to pay the disputed tax up-front.

A serious ambiguity that has been introduced by making the list of factors merely inclusive is whether the merits of the taxpayer's objection to the assessment must be taken into account.

The most problematic new criterion introduced by the foreshadowed amendments is that account must be taken not merely of *whether payment will result in irreparable financial hardship to the taxpayer* (which was the previous criterion) but whether there will be 'irreparable financial hardship' (and apparently nothing less than 'irreparable' hardship is relevant) that is *not justified by the prejudice to SARS or the fiscus if the disputed tax is not paid or recovered*. The language is strange, for it suggests that it is only in circumstances where there will be 'irreparable' financial hardship to the taxpayer that it becomes necessary to balance such hardship against the potential prejudice to SARS. Since it is scarcely possible that the financial prejudice to SARS could ever be 'irreparable' (if this means prejudice from which SARS could never recover), is it conceivable that the scales could ever tilt against a taxpayer whose prejudice would be irreparable?

Moreover, any balancing of prejudice between the taxpayer and SARS will be difficult, and sometimes impossible. On review, the High Court is going to have to ask itself, for example, what weight to accord to the *non-financial* prejudice to the taxpayer of having to dispose of his principal residence, rely on public transport to reach his workplace, or move his children from private educational institutions, so that he can pay the disputed tax? On what scale can such lifestyle detriment be balanced against the *purely financial loss* that SARS could potentially suffer if the due tax was never recovered? In short, this criterion would require a reviewing court to compare apples with oranges.

And how is the countervailing financial prejudice to SARS going to be quantified, given that the amount involved in any single tax dispute, even the largest, is a mere drop in the ocean in relation to the overall amount of tax collected by SARS?

If a taxpayer can provide security for payment of the disputed tax, would it ever be rational for SARS to insist on payment?

And how is the countervailing financial prejudice to SARS going to be quantified, given that the amount involved in any single tax dispute, even the largest, is a mere drop in the ocean in relation to the overall amount of tax collected by SARS?

In short, the criteria for the suspension of the obligation to pay disputed tax will present a reviewing court with great difficulties of interpretation and application.

It is arguable that this provision should simply have said that SARS can suspend the obligation to pay the disputed tax if liability is bona fide disputed on reasonable grounds (admittedly not an easy criterion, since it requires at least some consideration of the merits of the taxpayer's objection to the assessment) or where there are reasonable grounds to believe that the taxpayer may dissipate assets to defeat the claim of the fiscus.

Further than this the law can't realistically go without becoming mired in quicksand.

The major remedy available to a taxpayer where SARS seeks to take and execute a fast-track 'judgment' in respect of a disputed assessment

The taxpayer's right to request a suspension of the obligation to pay an assessed but disputed amount of tax is his major defensive stratagem where SARS has taken a fast-track 'judgment' against the taxpayer in terms of section 172 of the Tax Administration Act 28 of 2011, which provides that –

> If a person has an outstanding tax debt, SARS may, after giving the person at least ten business days' notice, file with the clerk or registrar of a competent court a certified statement setting out the

Tax Administration Laws Amendment Bill (B14 of 2014) will effect amendments to the Tax Administration Act 28 of 2011

amount of tax payable and certified by SARS as correct.

Section 174 goes on to say that –

> A certified statement filed under section 172 must be treated as a civil judgment lawfully given in the relevant court in favour of SARS for a liquid debt for the amount specified in the statement.

Notwithstanding the draconian nature of SARS's powers in this regard, the constitutionality of the similar powers and process provided for in the Value-Added Tax Act was upheld by the Constitutional Court in *Metcash Trading Ltd v Commissioner, South African Revenue Service* 2001 (1) SA 1109 (CC).

Where the taxpayer has requested that his obligation to pay a disputed amount of tax be suspended, pending a decision by the Tax Court in relation to the assessment, SARS is required to take a decision in response to that request.

Such a decision constitutes *administrative action* as envisaged in the Promotion of Administrative Justice Act 3 of 2000. Consequently, where SARS gives a negative response to the request, that response can be taken on review to the High Court in terms of that Act.

As Binns-Ward J said in *Capstone 556 (Pty) Ltd and Kluh Investments (Pty) Ltd v CSARS* [2011] ZAWCHC 297 at para [11] –

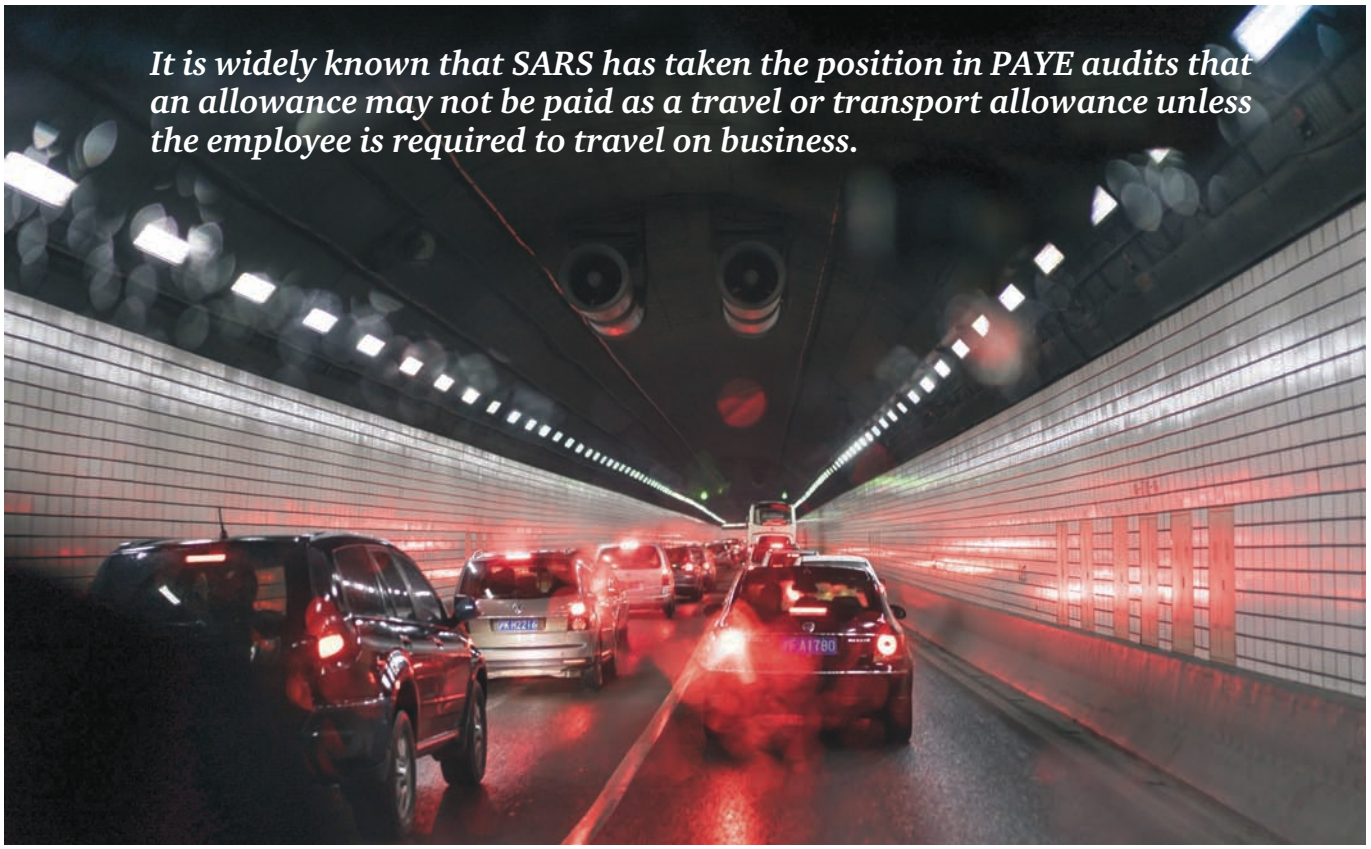
> The exercise of the power to grant a suspension in terms of [what is now s 164(2) of the Tax Administration Act] constitutes administrative action within the meaning of s 33 of the Constitution and of the Promotion of Administrative Justice Act 3 of 2000 ('PAJA'). Any decision by the Commissioner in the exercise of the power is accordingly susceptible to judicial review in terms of s 6 of the Promotion of Administrative Justice Act.

In that judicial review, the issue will be, not whether the refusal of the request to suspend the obligation to pay the tax in question was 'right' or 'wrong', but whether the decision was rational, for if it was not, the court can set it aside.

The rationality or otherwise of the decision will be greatly influenced by the criteria laid down in section 164(3) of the Tax Administration Act, which SARS is required to apply in responding to a request for a suspension of the obligation to pay the disputed tax.

Travel allowance – debunking the myths

In a recent judgment handed down in the Gauteng Tax Court (Tax Case No. 12984, judgment delivered 5 September 2014), the Court (Mavundla J) made findings on the basis upon which employees' tax (PAYE) should be determined in respect of transport or travel allowances.



It is widely known that SARS has taken the position in PAYE audits that an allowance may not be paid as a travel or transport allowance unless the employee is required to travel on business.

The findings are set out in paragraph [28] of the judgment:

> The respondent further took into account that a number of employees received travel allowances and are entitled to elect this allowance as a percentage of their package. The policy limits the allowance to 25% of the package. Depending on the employees' grade, allowance became an automatic elective and in some instances the quantum of the allowance is unrealistic or considered excessive, e.g. Havenstein—R680 000 p.a. It further took into account the fact that the provisions of Section 8(1)(b)(ii) of the Income Tax provides that the principal (employer) has made payment a payment to recipient (employee) to be utilised for the defrayment of expenditure with regards to any motor vehicle for business purposes. The advance or allowance is based on actual expected business travel. An example, a person has been in the same position for two years, on the average the employee travel 20 000 km for that year, no material change has occurred to duties and obligations, thus an allowance based on 32 000 km would be viewed as excessive. Clause 3.2 of the car allowance scheme reads 'the full value of the amount required by the employee to finance and run his car is paid via the payroll as a car allowance. Fifty per cent (50%) of this allowance is subjected to PAYE and the *onus* is on the individual to justify business travel to render the remainder of allowance tax deductible at the end of the tax year. The applicant makes use of a percentage methodology to quantify the travel allowance. It is a requirement that the allowance or advance be based on expected business travel. The respondent took the view that the

> allowance subjected to tax at fifty per cent is not expended on actual business travel as contemplated in section 8(1)(b) of the Act.' (*sic*)

The Court upheld the arguments of the respondent (i.e. SARS).

It is widely known that SARS has taken the position in PAYE audits that an allowance may not be paid as a travel or transport allowance unless the employee is required to travel on business. This view appears to have found support from the Court in this matter. However, a close examination of the law reveals that the argument of SARS is flawed, and that it should be considered that the Court erred in accepting and applying the argument.

The purpose myth

The core of SARS's argument, and the decision of the Court, is found in the assertion that:

> the provisions of Section 8(1)(b)(ii) of the Income Tax [Act] provides that the principal (employer) has made payment a payment [*sic*] to recipient (employee) to be utilised for the defrayment of expenditure with regards to any motor vehicle *for business purposes*. (Our emphasis)

As this is a PAYE matter, SARS has to have a basis for justifying the principle upon which the PAYE assessment was raised. If one examines the relevant provisions of the Fourth Schedule to the Income Tax Act, the definition of 'remuneration' in paragraph 1 (as it provided at the relevant time) included:

(c) 50 per cent of –

(i) the amount of any allowance or advance in respect of transport expenses referred to in section 8(1)(b)…

Therefore, the argument made by SARS is that the amount of the allowance was ordinary salary and not an allowance or advance in respect of transport expenses referred to in section 8(1)(b)(ii).

Section 8(1)(b)(ii) referred to the allowance in the following terms:

> 'any allowance or advance in respect of *transport expenses*' (section 8(1)(b)(i)); and
>
> where *such allowance or advance* has been paid to the recipient in order that it may be utilised for defraying the costs of any motor vehicle used by the recipient (section 8(1)(b)(ii))
> (Emphasis added)

Section 8(1)(b)(ii) refers to an allowance in respect of transport expenses ('such allowance or advance') and does not provide that a payment that the employer makes for defraying the costs of operating a motor vehicle should be confined to a vehicle used for business purposes.

The quantum myth

The second argument accepted by the Court was that:

The advance or allowance is based on actual expected business travel.

It should be emphasised that section 8(1)(b) provides clarification in respect of section 8(1)(a), which deals with the amount to be included in income in respect of any allowance or advance. Section 8(1)(b) identifies the portion of an allowance in respect of transport expenses which may escape taxation by reason that it is expended for purposes of business. It seeks to distinguish between portions that may be regarded as having been expended for private purposes and portions that may have been expended for business purposes. It is therefore implicit that an allowance may have been expended for private purposes.

However, it is clear that the allowance *referred to in section 8(1)(b)* is an allowance in respect of transport expenses. This allowance may be used for the purposes of transport by any means (road, rail or air), and is not necessarily restricted to the use of a motor vehicle. Section 8(1)(b) then identifies the circumstances in which the amount of the allowance will not be included in taxable income, and section 8(1)(b)(ii) deals specifically with a sub-class, namely an allowance utilised to defray the expenses of a motor vehicle operated by the employee.

This begs the question – 'why would the definition of "remuneration" include 50% of an allowance or advance if the allowance was based solely on the use of a vehicle for business purposes?' Surely, none of this amount would be included in taxable income, and there would be no necessity to withhold tax in those circumstances.

The answer appears self-evident. The allowance or advance referred to in section 8(1)(b) is an allowance in respect of transport expenses. Where it relates to the operation of a private vehicle, it is referred to as an allowance 'utilised for defraying the costs of any motor vehicle used by the recipient'. Section 8(1)(b) then describes circumstances in which travel or use of the motor vehicle will be regarded as not being for purposes of business.

Section 8(1)(b)(ii) does not prescribe that the purpose for which the allowance is granted must be to defray the costs of business travel; it merely identifies the extent to which such allowance may be treated as having been expended for business purposes.

On the basis that, on assessment, the allowance or advance may be found not to have been expended exclusively for business purposes, the legislation required that a portion of the allowance be included in remuneration and PAYE be withheld and paid in respect of such amount. This is the context in which the inclusion of an allowance for transport expenses as an element of remuneration for PAYE purposes was introduced into the Fourth Schedule to the Income Tax Act in 1991, and this view was expressed at the time by the editors of the noted authority, *Silke on South African Income Tax*, in the commentary on the 1991 tax changes in their *1991-92 Yearbook*.

There is therefore no basis in law, either in the Fourth Schedule to the Income Tax Act or in section 8(1)(b), for a finding that 'the amount of the allowance is based on actual expected business travel'. If this were so, paragraph (c) (now paragraph (cA)) of the definition of 'remuneration' in the Fourth Schedule) would not have been necessary.

It submitted that the Court was wrong in holding that allowances to defray the cost of travelling must be paid in respect of business use and must be based upon the anticipated business use.

However, where there is a clear indication that the amount of the allowance exceeds the reasonable operating costs in respect of the vehicle, it will be difficult to resist an assertion that the allowance is excessive and, to the extent of the excess, should have been subjected to PAYE in full.

SARS Watch 21 November 2014 to 20 January 2015

Legislation

24 Nov	Notice to amend tariffs in Part 1 and in Part 3 of Schedule No. 1 of the Customs & Excise Act, 1964, in relation to plastic bags and environmental levy	The notice was published in Government Gazette No. 38239.
27 Nov	Notice of the annual phase-downs in terms of the EFTA Trade Agreement to amend tariffs in Schedules No. 1, 2, 3 and 4 to the Customs & Excise Act, 1964	The notice was published in Government Gazette No. 38240.
28 Nov	Notice of promulgation of the TIEA between Argentina and South Africa	The notice was published in Government Gazette No. 38208 and became effective on 28 November 2014.
12 Dec	Notice of the agreement between the Government of the Republic of South Africa and the African Tax Administration Forum ('ATAF') for the hosting of the Secretariat of ATAF in the Republic of South Africa	The notice was published in Government Gazette No. 38310 and became effective on 2 December 2014.
18 Dec	Notice of promulgation of the Employment Tax Incentive Act, 2013	The notice was published in Government Gazette No. 38346 and became effective on 19 December 2014.
18 Dec	Notice of Regulation R.1038, which demarcated Emfuleni Local Municipality as an urban development zone, in terms of s13quat(8) of the Income Tax Act, 1962	The notice was published in Government Gazette No. 38345.
19 Dec	Notice to amend tariffs in Schedules No. 1, 2 and 3 of the Customs & Excise Act, 1964	The notice was published in Government Gazette No. 38365 and No. 38355.
12 Jan	Notice of promulgation of the exchange of information agreement between Cook Islands and South Africa	The notice was published in Government Gazette No. 38378 and became effective on 8 January 2015.
20 Jan	Notice of promulgation of rates and monetary amounts, and amendment of Revenue Laws Act 42 of 2014	The notice was published in Government Gazette No. 38404 and became effective on 20 January 2015.
20 Jan	Notice of promulgation of Taxation Laws Amendment Act 43 of 2014	The notice was published in Government Gazette No. 38405 and became effective on 20 January 2015.
20 Jan	Notice of promulgation of Tax Administration Laws Amendment Act 44 of 2014	The notice was published in Government Gazette No. 38406 and became effective on 20 January 2015.

Interpretation

10 Dec	Interpretation Note 45 (Issue 2) - Deduction of security expenditure	The issue updated references to s18A and amended a reference to Practice Note 39, to update to Interpretation Note 47 (Issue 3) instead. Clarity is given that directors are included under references to an employee.
19 Dec	Interpretation Note 48 (Issue 2) - Instalment credit agreements and debtors' allowance	The issue updated the interpretation of section 24 of the Income Tax Act and stresses the requirement of supporting evidence where the allowance is discretionary.

SARS Watch 21 November 2014 to 20 January 2015

Binding rulings

4 Nov	Binding Private Ruling 181: Withholding Tax on Interest in Relation to a Foreign Government	This BPR deals with the withholding tax on interest arising from loans made by a funding scheme related to a foreign government, specifically the Kingdom of Denmark, to a resident of South Africa.
11 Dec	Binding Private Ruling (BPR) 185: Corporate Rules: Disposal of assets and liabilities as part of a group restructure	This BPR deals with the disposal of assets (including the equity shares held in various subsidiaries) and liabilities (including contingent liabilities) from one company to another under section 42 of the Income Tax Act, 1962.

Case law

21 Nov	Tax Court - IT 13472	The Tax Court dismissed the appeal. The court found that there is no link between proceeds from sale of shares and damages paid due to breach of fiduciary right to prior year's sale of the same shares in terms of para 35(3)(c) of the 8th Schedule. The court ordered that an understatement penalty of 10% be levied but to waive interest levied due to the taxpayer relying on advice.
21 Nov	Tax Court - VAT 1132	The Tax Court upheld the appeal in favour of the taxpayer. The court ordered the Commissioner to set aside a 200% additional tax levied to nil, due to it failing to discharge the onus of proving why it was rightful to do so in the first place.
19 Dec	Tax Court - IT 13132	The Tax Court dismissed the appeal. The court found that wine grapes (partially processed stock) are produce held and not disposed of at the end of the year. Due to the co-operative structure, the taxpayer retained legal ownership in the partially processed product in undivided shares. The court ordered that SARS determine the amount to be included in gross income based on the facts.
23 Dec	Tax Court - VAT 1005	The Tax Court upheld the appeal. The court ordered that the appellant correctly accounted for VAT at the zero rate in terms of s11(2)(s) of the VAT Act, where the supply was in terms of the Housing Subsidy Scheme, and is entitled to a refund from SARS.

SARS publications

25 Nov	Draft Binding General Ruling (BGR) on Unbundling Transactions	The Draft BGR was published for comment that has to be submitted no later than 30 January 2015.
28 Nov	Updated the summary of information exchange agreements	Barbados has ratified the exchange of information agreements on their side.
8 Dec	Draft Rule Amendment under section 47 of the Customs & Excise Act, 1964 relating to the compulsory tariff determinations for alcoholic beverages	The Draft Rule Amendment was published for comment that had to be submitted no later than 9 January 2015.
10 Dec	Tables A and B to the Income Tax Act, 1962, relating to the average exchange rates	Updated for the last quarter of 2014.
17 Dec	Draft FATCA Guide	The Draft Guide relates to the implementation of an intergovernmental agreement to improve international tax compliance. This was published for comment that has to be submitted no later than 27 February 2015.
18 Dec	Draft Customs Control Rules for Chapters 32 to 41	The Draft Rules were published for comment that has to be submitted no later than 30 January 2015.
19 Dec	Draft Chapter 37 Amendments to be read with the Draft Customs Control Rules for Chapters 32 to 41	The Draft Chapter amendments were published for comment that has to be submitted no later than 30 January 2015.
23 Dec	Draft Comprehensive Guide to CGT (Issue 5)	The Draft Guide was published for comment that has to be submitted no later than 31 May 2015.
19 Jan	Updated the summary of information exchange agreements	Grenada signed on 10 December 2014 in St Georges, Grenada.