Synopsis

Tax today

July 2014

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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Rectification of an agreement in order to secure zero-rated VAT

The issue before the court in* Milner Street Properties (Pty) Ltd v Eckstein Properties (Pty) Ltd *[2001] ZASCA 95 was whether an agreement that was intended by the parties to be a zero-rated VAT disposal from one VAT vendor to another of an enterprise as a going concern but which failed to satisfy the formal requirements imposed by section 11(1)(e) of the Value-Added Tax Act 89 of 1991 could be rectified, with retrospective effect, so as to satisfy those requirements.

In this regard, section 11 of the VAT Act provides as follows –

> Zero rating.—(1) Where, but for this section, a supply of goods would be charged with tax at [14%], such supply of goods shall, subject to compliance with subsection (3) of this section, be charged with tax at the rate of zero per cent where—
>
> [. . .]
>
> (e) the supply is to a registered vendor of an enterprise or of a part of an enterprise which is capable of separate operation, where the supplier and the recipient have agreed in writing that such enterprise or part, as the case may be, is disposed of as a going concern: Provided that—
>
> (i) such enterprise or part, as the case may be, shall not be disposed of as a going concern unless—
>
> (aa) such supplier and such recipient have, at the time of the conclusion of the agreement for the disposal of the enterprise or part, as the case may be, agreed in writing that such enterprise or part, as the case may be, will be an income-earning activity on the date of transfer thereof; and
>
> (bb) the assets which are necessary for carrying on such enterprise or part, as the case may be, are disposed of by such supplier to such recipient; and
>
> (cc) in respect of supplies on or after 1 January 2000, such supplier and such recipient have at the time of the conclusion of the agreement for the disposal of such enterprise or part, as the case may be, agreed in writing that the consideration agreed upon for that supply is inclusive of tax at the rate of zero per cent;

The necessity to satisfy the statutory formal requirements

In order to satisfy these requirements, it does not suffice that the subject of the disposal was *in fact* an income-earning enterprise as at the date of transfer. The *formal requirements* imposed by these provisions must also be satisfied – in other words, the agreement must be expressed in the form required by the Act.

The need to satisfy the formal requirements is reiterated by SARS in its publication entitled *VAT 404*, which summarises the requirements of the VAT Act in this regard as follows:

> It must be clearly evident, and stated in the wording of the written agreement that –
>
> • the enterprise is sold as a going concern;
>
> • the business is or will be an income-earning activity on the date of transfer;

Rectification of an agreement in order to secure zero-rated VAT

• the whole business or a part of it which is capable of separate operation is disposed of to the purchaser, including all the assets necessary for carrying on the enterprise or part thereof; and

• the consideration includes VAT at the rate of 0%.

Where any of the above requirements are not met, the supply of the enterprise will be subject to VAT at the standard rate of 14%. [Emphasis added.]

Rectification of a non-compliant agreement

In *Milner Street Properties* the court said (at para [26]) that an agreement that is void for lack of compliance with the applicable statutory formalities – in other words, where non-compliance with the applicable statutory formalities renders an agreement a complete nullity – it cannot be salvaged by rectification, for there is nothing to be rectified.

By contrast, said the court (at para [26]), in the present case, compliance with the formalities prescribed by the Act was not a prerequisite for the conclusion of a *valid agreement*, but merely impacted on the *fiscal consequences* of the agreement, namely the rate at which VAT was to be levied.

In his judgment, Nienaber J said (at paras [29] and [31]) that there was no reason in principle why rectification should not be granted in the present case, because–

> The purpose of rectification in circumstances such as the present is not to avoid the payment of a tax which would otherwise be due to the Commissioner. Nothing would prevent the Commissioner, even if the document should be rectified, from going behind its terms to determine for himself whether the supply of the goods was to be charged with VAT at zero per cent.

The court held that the agreement in the present case was capable of retrospective rectification

Nienaber J concluded (at para [33]) that –

> There are accordingly in my opinion no obstacles, legal or factual, to allowing the respondent to meet the appellant's case by a plea of rectification. Rectification, once granted, operates *ex tunc*, as if the document at its inception read as it has now been reconstructed to read. Rectification does not alter the terms of the agreement, it perfects the written memorial so as to accord with what the parties actually had in mind.

Litigation with SARS – levelling the playing field

New rules governing the procedures to be followed in respect of objections and appeals, which are now prescribed in terms of section 103 of the Tax Administration Act, were published in the Government Gazette on 11 July 2014.

One of the frustrations experienced by taxpayers involved in litigation with SARS is the fact that SARS frequently fails to deliver documents or decisions within the time limits prescribed in the rules governing the conduct of disputes. In the event of such failure the taxpayer could apply to court for an order compelling the submission of the relevant document or decision, but there appeared to be no remedy whereby the taxpayer could apply for judgment in his favour. Many taxpayers have felt powerless to compel the resolution of disputes where SARS has been in lengthy default of its obligation to deliver a decision on objection or the statement of grounds of assessment (under Rule 10 of the old rules – now referred to as 'a reply to the statement of grounds of appeal' under Rule 33).

The new rules provide taxpayers with a means to change this unfortunate position. This is found in Rule 56, which is headed 'Application for summary judgment in the event of non-compliance with rules'.

Rule 56 gives either party the right, in the event of the failure of the other party to comply with a period or obligation prescribed by the rules or an order of the tax court, to apply to the tax court for judgment, without the court hearing the matter further.

The non-defaulting party is required to notify the defaulting party that it intends to make application to the tax court for a final order if the default is not remedied within 15 days (for the purposes of the rules, 'day' means a business day). If the defaulting party should fail to remedy the default within 15 days, then the non-defaulting party may, on notice to the defaulting party, make application to the tax court for a final order by notice of motion within 20 days of the expiration of that period.

The application to the tax court must be signed by the applicant or the applicant's representative, set out in full the nature of the order that is sought and be supported by an affidavit specifying the facts on which the applicant relies for the relief. In

Many taxpayers have felt powerless to compel the resolution of disputes where SARS has been in lengthy default of its obligation to deliver a decision on objection or the statement of grounds of assessment

the case of a failure to comply with a time limit for the submission of pleadings in an appeal, the affidavit would:

- set out the procedural history of the appeal, specifying the document which the defaulting party was required to submit and the latest date upon which that document should have been submitted in terms of the rules;
- state that due notice had been given to the defaulting party of the intention to apply for an order of court in the event of failure to remedy the default within 15 days, attaching a copy of the notice and proof of delivery of the notice in support; and
- state that, notwithstanding the notice, the defaulting party had failed to remedy the default within the specified time limit.

The notice would also specify a date, being not less than 10 days after delivery of the notice, by which the defaulting party is required to give notice of intention to oppose the application, and in the event that the application is not opposed, the matter will be set down for hearing on the first available date, being not less than 15 days after delivery of the notice.

The defaulting party, if it chooses to oppose the application, must give notice of intention to oppose the application and deliver an answering affidavit within 15 days after delivery of the notice of intention to oppose.

If no notice is given of intention to oppose the application or if no answering affidavit is received, application may be made for the matter to be set down for hearing.

If an answering affidavit is received, the applicant may file a replying affidavit within 10 days of delivery of the answering affidavit. Thereafter application may be made for the matter to be set down for hearing. The registrar of the tax court must deliver notice to the parties that the matter has been set down for hearing not less than 10 days before the date of hearing.

The tax court may, on hearing the application:

- Make a final order in terms of section 129(2) of the Tax Administration Act; or
- Give the defaulting party further time to remedy the default, failing which a final order will be made.

The introduction of a procedure to enable a party to apply for summary judgment will, hopefully, speed up the processing of appeals to the tax court. The procedural rules cut both ways in this regard. Both taxpayer and the Commissioner have the right to bring applications for summary judgment. That said, the new rules provide a welcome opportunity for taxpayers locked in long-standing unresolved litigation with SARS to force the pace of proceedings.

New tax filing requirement for certain non-resident persons

Government Notice No. 506 ('the Notice') of 23 June 2014 sets out the requirements for filing tax returns in South Africa ('SA') for the 2014 year of assessment. The inclusion of a new requirement for filing returns should make foreign companies, trusts and juristic persons with dealings in SA sit up and take notice.

The tax filing season started on 1 July 2014. For most SA tax filers, it is 'business as usual', and appropriate arrangements must be made to ensure compliance. However, any foreign company, trust or other juristic person that derives service income from a source within SA is required to file a return. The requirement to file a return applies regardless of whether that foreign person has a SA permanent establishment or not.

The Income Tax Act does not define what is regarded as service income, and therefore the term must be understood to refer to services in their usual grammatical sense. Further, the filing requirement extends only to service income from a source within SA. The source of income from services is not prescribed in the Income Tax Act, and therefore the determination of source in the case of services is subject to judicial interpretation. Our case law indicates that the source of income from the supply of services is the performance of the services (the act giving rise to the income) and that the source is located at the place where the services are rendered. However, where the services are rendered in more than one jurisdiction, our law does not apportion the service income between jurisdictions, but requires that the source should be located where the dominant cause of the income is situated.

Many foreign entities provide services to SA customers and where these services are rendered, or even partly rendered, from within SA there may be a requirement to file a tax return in respect of the income generated from those services. This will be the case even if there is a double taxation agreement in force which would deny SA a right to tax the income in the absence of a permanent establishment.

The reasoning behind the inclusion of these persons for filing tax returns for the 2014 year of assessment is unclear, but it must be remembered that SA is set to introduce a withholding tax on service fees on 1 January 2016 and has already included certain foreign electronic services in the SA VAT net to increase its overall taxpayer base.

What is clear, however, is that non-resident juristic persons who generate service income from SA should evaluate whether, and to what extent, that service income may be from a SA source. Only after this determination has been made can a requirement to file a SA tax return be identified. Further, in order for many foreign juristic persons to be aware of this potential filing requirement they may have to rely on the SA customers to inform them thereof.

SA subsidiaries of multinational corporations should examine the nature of service payments made to group companies to identify whether foreign group companies may be at risk in regard to the requirement to file returns with SARS.

The proper forum and process for contesting a tax assessment

The Constitution of the Republic of South Africa provides that –

Everyone … has the right to equal protection and benefit of the law [and]

Everyone has the right to have any dispute that can be resolved by the application of law, decided in a fair public hearing before a court or, where appropriate, another independent and impartial tribunal or forum.

These fundamental constitutional rights are, of course, as applicable to disputes between the South African Revenue Service and taxpayers as they are to any other civil dispute.

However, the courts have been explicit that, where *disputed tax assessments* are concerned, a specific process must be followed in any legal challenge, with specific statutory time limits.

If the taxpayer does not institute legal proceedings in relation to a disputed tax assessment within the stipulated time period, and does not bring the matter before the correct court or tribunal via the proper process, he will find himself without a legal remedy for the perceived wrong that he has suffered as a result of the allegedly incorrect assessment – and no appeal to the above-quoted constitutional provisions will avail him.

Nowhere have these principles been more clearly articulated and affirmed than in the recent judgment of the Pretoria High Court in *Medox Limited v Commissioner for the South African Revenue Service* [2014] ZAGPPHC 98, in which judgment was given on 20 February 2014.

The taxpayer sought a High Court order that certain tax assessments were void as being *ultra vires*

In this case, the taxpayer was seeking to have all income tax assessments issued after its 1997 tax year declared null and void.

What had transpired (see para [2.1] of the judgment) was that, before issuing the assessment for 1997, SARS had issued assessments for the 1998 and following tax years, and that the assessments for the latter years had failed to set off the balance of assessed loss that had been incurred in the 1996 year.

The taxpayer averred that, because SARS had failed to set off the balance of assessed loss that was incurred in the 1996 tax year, the assessments issued for the following years were 'void' in that SARS had acted 'ultra vires' in disregarding the mandatory provisions of section 20(1)(a) of the Income Tax Act that govern the treatment of assessed tax losses that had been incurred in previous years and that qualified to be carried forward.

However (see the judgment at para [7.2]), the facts were that the taxpayer had lodged its 1998 tax return before submitting its 1997 tax return, and had then failed to lodge an objection for the 1998 tax year. Nor (it seems – see para [7.2]) did the taxpayer ever assert, even outside of an objection, that it had incurred an assessed loss. Further, it appears that the taxpayer did not file a return for the 1997 tax year.

The time limit for objecting to the assessments had expired

By the time the dispute came to court, the assessment for the 1998 year of assessment had been issued more than three years previously and the statutory time limit for objecting to the assessment had therefore expired; see section 104(5)(b) of the Tax Administration Act 28 of 2011.

However, the taxpayer decided (so the judgment says – see para [7.2]) to 're-submit' its 1997 return in 2011. 'Re-submit' does not seem to be the appropriate word, given that there had apparently been no prior submission of its 1997 return.

SARS's response (see para [2.3] of the judgment) was that the High Court did not have jurisdiction to hear the application because the dispute between the parties concerned the merits of the assessment in question, and that this was an issue falling within the exclusive domain of the Tax Court.

The court pointed out (at para [7.3]) that the Income Tax Act –

> makes it clear that the lawfulness and correctness of disputed assessments must be dealt with by the Tax Court

and said that, in dealing with the application for a declaratory order, the High Court would have

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had to deal with 'the merits of the assessment'.

The taxpayer conceded (see para [8.4]) that its right to object to the 1998 assessment in terms of the Income Tax Act had expired, and argued that, *since no internal remedies were now available*, its only remedy was to bring the matter to the High Court on review or by seeking a declaratory order.

The judgment

The court quoted from the judgment in *Van Zyl NO v Master* 1991 (1) SA 874 (E) where Eksteen J said at 877-878 that–

> The only way in which these assessments can be questioned is in the manner provided for in the Act, viz, by objecting to the [Commissioner] in terms of s 81 of the [Income Tax] Act and then appealing to the Special Court [now called the Tax Court] in terms of s 83 of the Act.

The judgment in the present case is explicit (see para [23]) that a taxpayer who fails to avail himself of remedies provided for in the Income Tax Act in relation to a disputed assessment (namely, objection and appeal in respect of a disputed assessment) cannot – when the time limits applicable to such remedies have passed – thereafter claim relief from the High Court on the basis that he has no internal remedies in terms of that Act.

In particular (see para [27]), he cannot seek a declaratory order in the High Court that would have the same effect as a review of the Commissioner's decision such as occurs where administrative action is brought under judicial review in terms of the Promotion of Administrative Justice Act 3 of 2000.

In the present case, the court said (at para [28]) that the application now being made by the taxpayer could not be entertained without going into the merits of the dispute's assessments, and that those merits fell within the competency – by which the court meant the exclusive competency – of the Tax Court.

Overall, the court held (at para [29]) that once SARS has issued an assessment, the parties 'are locked into the jurisdiction of the Tax Court' and must exercise their rights in the Tax Court, from which they can appeal to the Supreme Court of Appeal and the Constitutional Court.

In the result, the court held (at para [31]) that the High Court did not have jurisdiction to entertain this particular dispute, which ought to have been pursued by way of an objection and appeal to the Tax Court.

SARS Watch 21 June to 20 July 2014

Legislation		
25 Jun	Notice to furnish returns for the 2014 year of assessment in terms of s66(1) of the Income Tax Act, read together with s25 of the Tax Administration Act.	Notice was published in Government Gazette No. 37767.
27 Jun	Amendment of Customs and Excise Act, 1964, in Part 1 of Schedule No. 1 - Reduction in rate of customs duty on sugar in Chapter 17.	The notice was published in Government Gazette No. 37780.
27 Jun	Notices 508 and 509 in terms of sections 26, 29 and 30 of the Tax Administration Act, 2011 prescribe the returns to be submitted by third parties; the dates therefor; the duty to keep the records, books of account or documents; and the form in which those should be kept to comply with the agreement on the automatic exchange of information.	The notice was published in Government Gazette No. 37778.
3 Jul	Tariff Amendment Notices of Customs and Excise Act, 1964, in relation to a reduction in the alcoholic strength of wine from 6.5% to 4.5% by volume.	The notice was published in Government Gazette No. 37784.
3 Jul	Tariff Amendment Notices of Customs and Excise Act, 1964, in relation to a reduction in the minimum power rating on electronic ballasts for the manufacture of compact fluorescent lamps from 8W to 5W.	The notice was published in Government Gazette No. 37784.
4 Jul	Tariff Amendment Notices of Customs and Excise Act, 1964, in relation to a provisional payment on the alleged dumping of frozen bone-in portions of fowls of the species gallus domesticus, classifiable in tariff subheading 0207.14.90, originating in or imported from Germany, the Netherlands and the United Kingdom.	The notice was published in Government Gazette No. 37801.
10 Jul	The Customs Duty Act, 2014 has been promulgated and will come into operation on a later date as prescribed by s229 of this Act.	The notice was published in Government Gazette No. 37821.
11 Jul	Notice of consequential deletion of rules 46.05 and 49B.16 as a result of the deletion of rebate items in Schedule No. 4 of s120 of the Customs and Excise Act, 1964.	The notice was published in Government Gazette No. 37806.
11 Jul	Notice to prescribe the rules under s.103 of the Tax Administration Act and replace those under s.107A of the Income Tax Act, 1962 with immediate effect.	The notice was published in Government Gazette No. 37819.
17 Jul	Notice of amendment in Part 1 of Schedule No. 1 of the Customs and Excise Act, 1964 to insert TH 7312.10.10 to reduce rate of customs duty on certain stranded wires from 5% to 'free'.	The notice was published in Government Gazette No. 37831.
Binding rulings		
25 Jun	Binding Private Ruling 172: Plant used in the production of renewable energy.	This BPR deals with the deduction allowed in respect of the cost of machinery, plant, implements, utensils or articles owned and used in the generation of electricity from solar energy.
2 Jul	Binding Private Ruling 173: Repayment of shareholder loan from proceeds of a new issue of ordinary shares.	This BPR deals with the income tax consequences arising from the repayment of shareholder loans from the proceeds of a new issue of ordinary shares in a company.
SARS publications		
1 Jul	1 July marks the start of tax season 2014 for individuals.	The annual tax season refers to the requirement to submit an income tax return (ITR12) to SARS. Refer to PwC Tax Alert issued on 3 July for more detail.
17 Jul	Draft 2014 Taxation Laws Amendment Bill released for comment.	The draft TLAB was published for comment to be submitted no later than 17 August 2014.
17 Jul	Draft 2014 Tax Administration Laws Amendment Bill released for comment.	The draft TALAB was published for comment to be submitted no later than 17 August 2014.
17 Jul	Draft 2014 regulations linked to the 2014 draft TLAB released for comment.	The draft regulations were published for comment to be submitted no later than 17 August 2014.
17 Jul	Draft 2014 Notice released for comment.	The draft Notice was published for comment to be submitted no later than 17 August 2014.
PwC publications		
3 Jul	Tax Alert - 2014 tax filing season.	This document provides a summary of all the categories of persons that have to furnish an income tax return for the 2014 tax filing season.