Synopsis

Tax today

July 2022

A monthly journal, published by PwC South Africa, that gives informed commentary on current developments in the tax arena, both locally and internationally.

Through analysis of and comment on new laws and judicial decisions of interest, Synopsis helps executives to identify developments and trends in tax law and revenue practice that may affect their business.

Editor: Al-Marie Chaffey

SARS Watch: Linda Mathatho

The ordering of section 23M and section 31

Both section 23M and section 31 of the Income Tax Act ('the Act') seek to disallow excessive interest deductions by taxpayers.

Numerous comments have been made about the interaction between section 23M and section 31, specifically noting that the Act does not expressly deal with the question of which takes priority over the other.

National Treasury and SARS' view

National Treasury and SARS have noted that in their view, section 31 should be applied prior to section 23M, i.e.

> "Government proposes that companies first apply the arm's length test to financial transactions, followed by the interest limitation rules, i.e. the interest limitation rules should apply to net interest expense that has already passed the arm's length test."[1]

> "Section 23M and section 23N contain certain limitations on the amount of interest which may be deducted. Section 31 applies prior to considering the impact, if any, of section 23M and section 23N. Accordingly, when these sections refer to taxable income in the definition of ' adjusted taxable income' and to the amount of interest which is allowed to be deducted in section 23M(3) and section 23N(2), the reference is to the amount of taxable income and the amount of interest which may be deducted, after section 31 has been applied."[2]

Unfortunately, neither SARS nor National Treasury provide any reasoning to support this view.

We set out our alternative view (i.e. that section 23M should be applied first) and the reasons in support thereof, hereafter.

[1] Discussion paper issued by National Treasury, dated 26 February 2020.

[2] Draft Interpretation Note on section 31 – Determination of the taxable income of certain persons from international transactions: Intra-group loans. Paragraph 14.1 on page 36.

Alternative view

Section 23M defines 'adjusted taxable income' as

> 'taxable income calculated before applying this section …'

Section 1 defines 'taxable income' as

> "the aggregate of
>
> (a) the amount remaining after deducting from the income of any person all the amounts allowed under Part I of Chapter II to be deducted from or set off against such income; and
>
> (b) all amounts to be included or deemed to be included in the taxable income of any person in terms of this Act"

Section 31(2) provides that:

> "Where-
>
> (a) any transaction, operation, scheme, agreement or understanding constitutes an affected transaction; and
>
> (b) any term or condition of that transaction, operation, scheme, agreement or understanding –
>
> (i) <u>is a term or condition contemplated in paragraph (b) of the definition of 'affected transaction'</u>; and
>
> (ii) <u>results or will result</u> in any <u>tax benefit being derived by</u> a person that is a party to that transaction, operation, scheme, agreement or understanding or by any resident in relation to a controlled foreign company contemplated in subparagraph (iv) of the definition of 'affected transaction',
>
> the taxable income or tax payable by any person contemplated in paragraph (b) (ii) <u>that derives a tax benefit contemplated in that paragraph</u> must be calculated as if that transaction, operation, scheme, agreement or understanding had been entered into on the terms and conditions that would have existed had those persons been independent persons dealing at arm's length."
>
> [Our underlining]

Accordingly, section 31 provides that:

a. It must first be determined whether a term/condition is different from any arm's length term/condition (i.e. the terms/conditions should be tested against the arm's length principle).

b. If such a term/condition exists, then it has to be determined whether this term/condition will result in a *tax benefit* derived by that person.

c. If such a tax benefit is in fact derived by the person, then the person's taxable income/tax payable must be calculated with reference to the arm's length terms and conditions.

Note: a person can derive a 'tax benefit' either by reducing taxable income (e.g. for the payor, by obtaining an income tax deduction) or by paying SA tax at a reduced rate.

Tax benefit

Section 1 defines a "tax benefit" as:

> "any avoidance, postponement or reduction of any liability for tax".

The term 'tax benefit' was also considered by the Appellate Division (now the Supreme Court of Appeal) in the *Smith* case (*Smith v CIR* 1964 (1) SA 324 (A)) where a tax benefit was described as a situation where a taxpayer "*gets out of the way and escapes or prevents an anticipated liability*."

The dictionary definition of "anticipate" is:

> "to regard as probable [i.e. likely to happen or to be the case]"
>
> "to expect/predict something"
>
> "to see what might happen in the future and take action to prepare for it"

Accordingly, a tax benefit will arise where a person avoids/postpones/reduces an anticipated tax liability.

In *Hicklin v Secretary for Inland Revenue* [1980] 1 All SA 301 (A) (where shareholders had sold their shares in a dormant company that had undistributed profits) it was held that the anticipated liability for tax can 'vary from an imminent certain prospect to some vague, remote possibility'. The court found it unnecessary in that case to decide whether a vertical line should be drawn to delimit the connotation of an 'anticipated liability'.

> "In Newton's case (supra) Lord Denning spoke of 'a liability which is about to fall on you' (ibid), which suggests one of some imminence. However, it is unnecessary and hence unadvisable to decide here whether a vertical line should be drawn somewhere along that wide range of meanings in order to delimit the connotation of 'an anticipated liability'. It suffices to say merely that, in my view, the liability of appellant and the other shareholders to tax on Reklame's distributable profits, albeit a liability contingent upon their declaring them as dividends, was clearly 'an anticipated liability' within the contemplation of s 103(1). After all they were always mindful that something unforeseen might occur that would compel them to declare them as dividends and incur the ensuing tax liability, as, for example, the early death of one of them. And, as will presently appear, the possibility of some such contingency occurring was sufficiently proximate and pressing to induce them to sell their shares under the RN agreement in order 'to get out of the way of, escape or prevent' such liability from falling on them."

Results in/will result in

The Act does not provide for a formal test to determine whether or not a 'tax benefit' (derived by a person), *resulted from* a term/condition of the specified transaction.

The dictionary definition of "result in" is:

> "to cause a particular situation to happen; to make something happen (i.e. cause, bring about, lead to …)"

The question of 'causation' was decided in case law with reference to the 'but for' test. In ITC 1625 1996 59 SATC 383, the court held that a taxpayer would be regarded as obtaining a tax benefit if the taxpayer would have been obligated to pay taxes, but for the transaction, he did not.

The test to be applied in determining whether a transaction had the effect of avoiding tax was to ask whether "*the taxpayer would have suffered tax but for the transaction*."

The court stated that –

> "if the transaction in issue had not been entered into, the taxpayer would not have acquired the property, it would not have earned the income and it would not have incurred the interest expenditure" and thus the court could find "no basis on which it can successfully be argued that by incurring expenditure on interest in order to earn the income on which it has to pay tax the taxpayer avoided tax or reduced tax."

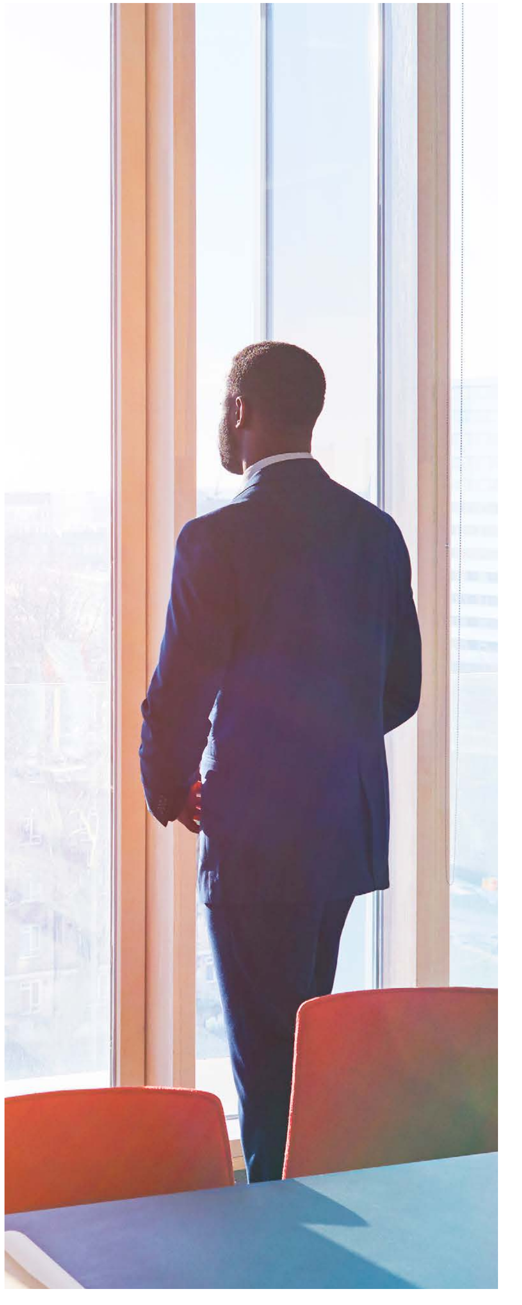
This approach was also followed in the *ABSA Bank Ltd and Another v Commissioner for South African Revenue Service* (2021 (3) SA 513 (GP)) 83 SATC 401, where it was held that "*whether a tax liability was evaded by a taxpayer had to be determined by applying the 'but for' test to a future anticipated tax liability*".

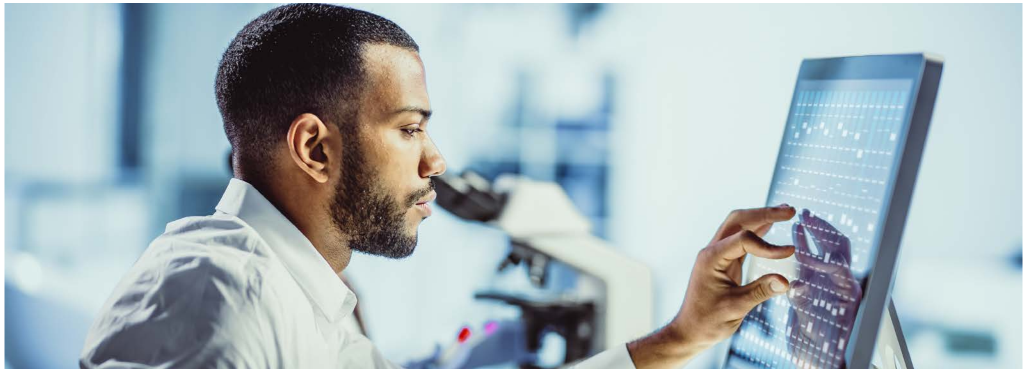
Conclusion – tax benefit derived from a reduced taxable income

The taxpayer could only ever anticipate a reduced tax liability from an interest expense to the extent that the deduction/portion of the deduction is not disallowed by section 23M.

Tax is an annual event, accordingly, even if the cross-border arrangement (with the non-arm's length term/condition) was entered into in a previous year of assessment when the anticipated tax benefit may have been greater (i.e. prior to section 23M coming into effect/amendments to section 23M coming into effect) for the taxpayer, the taxpayer would have to reconsider the potential tax liability on an annual basis and will have to take the impact of section 23M into account.

When considering the 'but for' test, the question is whether the taxpayer would





have been obligated to pay the (additional) tax, but for the non-arm’s length term/condition, he did not pay the tax.

In the absence of section 31(2), section 23M(2) would potentially prevent the interest deduction as this provision is a mechanical provision (not dependent on any discretion or interpretation) which means that the taxpayer will not have the option to disregard it. Thus, in assessing whether or not an interest expense would have constituted a ‘tax benefit’, the taxpayer’s point of departure must be that the interest is not deductible to start with, assuming that section 23M denies the deduction.

Note that in the context of potentially ‘excessive’ interest paid to a connected non-resident, section 23M(2) is essentially a restraint/limitation on the section 24J or section 11(a) deduction for interest incurred.

Section 23M(2) unambiguously provides that “the amount of interest allowed to be deducted may not exceed …”

To clarify, it would be technically incorrect to first attempt to take the full interest deduction and subsequently “add back” the excessive interest (even though this is often how it is dealt with in practice). Rather, from the outset, the amount of the interest to be deducted should be limited/restricted by the application of section 23M(2) before the deduction (of the restricted amount) is claimed.

In our view, in the context of interest expenses, the above would imply that there has to be an income tax deduction after applying all other provisions of the legislation, including the interest deduction limitation rules, for the taxpayer to derive a tax benefit.

Failing the person incurring the interest getting a deduction, there would be no tax benefit for that person as contemplated in section 31(2) and hence no adjustment to be made in determining taxable income.

The only exception could potentially be where a (portion of the) interest deduction is disallowed in the current year but carried forward to potentially be deducted in a future year.

Whether this (potential future interest deduction) would qualify as a “tax benefit”, will turn on whether the future deduction could be ‘anticipated’, i.e. is it likely to happen.

This will depend on the facts and circumstances of each respective taxpayer and although no conclusive view can be expressed in this regard, it is arguable that an interest expense that is disallowed and potentially ranks for deduction in a subsequent year (subject to a host of uncertainties) is not a tax benefit in the current year, but only becomes a tax benefit when the deduction arises, and it is at that point that section 31 then applies to disallow the interest deduction under section 31 and not in an earlier year.

This is an attractive outcome as it aligns with the ‘but for’ test and eliminates the subjective assessment of whether a tax benefit that may arise in the future depending on uncertainties is a tax benefit as contemplated in the definition.

Accordingly, it is submitted that a tax benefit does not extend to a vague possibility as highlighted in the *Hicklin* case, but that it must have a degree of certainty associated with it, whether because of the facts or because the taxpayer is able to control the ability to access the tax benefit. For example, in *Hicklin*, the taxpayer was able to determine whether or not a dividend would be paid and whether the sale of the shares was to avoid the liability that would have arisen on the dividend. In that case it was inevitable that a dividend would have to have been paid at some point at which this would give rise to a tax liability. In the context of section 23M, the taxpayer has no clear ability to control whether interest will be deductible or not, as the deduction limitation is entirely based on the profitability of the taxpayer.

Conclusion – tax benefit derived by a non-resident recipient of interest where withholding tax is payable at a lower rate on interest (when compared to withholding tax on a dividend distribution)

Section 31(2) applies –

> “Where-
>
> (a) any transaction, operation, scheme, agreement or understanding constitutes an affected transaction; and
>
> (b) any term or condition of that transaction, operation, scheme, agreement or understanding –
>
> > (i) is a term or condition contemplated in paragraph (b) of the definition of ‘affected transaction’; and
> >
> > (ii) results or will result in any tax benefit being derived by a person that is a party to that transaction, operation, scheme, agreement or understanding or by any resident in relation to a controlled foreign company contemplated in subparagraph (iv) of the definition of ‘affected transaction’,
>
> the taxable income or tax payable by any person contemplated in paragraph (b) (ii) that derives a tax benefit contemplated in that paragraph must be calculated as if that transaction, operation, scheme, agreement or understanding had been entered into on the terms and conditions that would have existed had those persons been independent persons dealing at arm’s length.”

Paragraph (b) provides that –

> “any term or condition of that transaction, operation, scheme, agreement or understanding is different from any term or condition that would have existed had those persons been independent persons dealing at arm’s length.”

This brings us to the question of whether a tax benefit would arise in the following example:

The parties (e.g. a non-resident shareholder and wholly owned SA tax resident subsidiary) entered into an interest-bearing loan transaction and the interest is subject to zero or a reduced withholding tax on interest by virtue of a tax treaty, whereas a dividend would have attracted dividends tax at a higher rate (i.e. where the same person would have been the recipient of said interest/dividend).

We are of the view that this will not result in a 'tax benefit' as on the plain reading of the above wording of section 31, it is concerned with the terms and conditions of the actual (affected) transaction entered into by the parties, i.e. whether these terms and conditions meet the arm's length test and, if not, whether this non arm's length term/condition will result in a tax benefit derived by the taxpayer.

As section 31 does not recharacterize a transaction, but only requires tax to be determined as if that transaction had not been entered into at arm's length, there is no need to consider whether an alternative transaction to the actual affected transaction would have resulted in a higher tax liability for the parties.

Rules of statutory interpretation

The rule of law proposes that law should not be formulated in wide general terms, but should be reasonably clear and precise; otherwise a decision by discretion is imported.

Interaction of section 31 with other sections of the Act

Section 31 does not only have to operate in conjunction with section 23M, but with every other provision of the Act to determine whether there is a tax benefit from the non-arm's length pricing.

In the context of interest, that would include section 23N, section 24J, section 8F, etc.

To illustrate further, if excessive interest is incurred in respect of an affected transaction, but that interest is not deductible by virtue of section 24J because it is not productive, there is clearly no tax benefit for the paying entity resulting from the excessive interest and therefore no adjustment to be made to taxable income in terms of section 31. This position seems pretty clear and uncontroversial.

The question then arises as to why the situation should be different simply because the interest is denied as a deduction in terms of section 23M rather than under any other provision of the Act.

Applicable rules of interpretation:

- *Generalia specialibus non derogant*
- Purposive approach
- *Contra fiscum*

Generalia specialibus non derogant

The legal maxim *generalia specialibus non derogant* requires that where a specific provision applies to a particular set of circumstances, which is also covered by a broader or more general principle, then the specific provision is unlikely to be subservient to the more general provision and must take preference.

The specificity of section 23M, compared to section 31's relative generality, is manifest in the following respects, namely:

a. In relation to the types of transactions/events to which the rules apply. Section 23M applies specifically to "an amount of interest" whereas section 31 applies to "any transaction …" which is clearly more general and is intended to also include other types of transactions;

b. Section 23M is also narrower in that it requires a controlling relationship whereas section 31 is broader in requiring only a connected person relationship (which is also broader than the section 1 definition thereof);

c. Section 23M also only applies to untaxed interest whereas section 31 does not concern itself with this; and

d. In relation to the action/impact of the provisions. Section 23M imposes a precisely calculated (formulaic) limitation, whereas section 31 prescribes a restatement of the taxable income/tax payable in observance of the arm's length principle (involving broad and general concepts).

In other words, the more specific interest deduction limitation rule (applying where a creditor is in a 'controlling relationship' and the interest is not subject to income tax or withholding tax at the full domestic rate) should always apply before the more general transfer pricing rule (applying to all cross-border transactions between connected persons) unless the legislation expressly stipulates otherwise, which is currently not the case.

It follows that even if it is argued that there is a potential tax benefit for the taxpayer (i.e. section 31 might find application), section 23M should still be applied in preference to section 31.

Purposive approach

The modern approach to statutory interpretation was formulated by the Supreme Court of Appeal (the SCA) in *Natal Joint Municipal Pension Fund v Endumeni Municipality* where the court held that:

> “The present state of the law can be expressed as follows: Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible, each possibility must be weighed in the light of all these factors. The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document.” [Our underlining]

The Constitutional Court confirmed on a number of occasions that the correct approach to statutory interpretation is not to ascertain the intention of the legislature, but rather to undertake an objective, independent interpretation of the legislation to ascertain the purpose of the legislation, which is more suitable to a constitutional democracy.

Accordingly, the purposive approach is all-encompassing in considering the background and surrounding facts which inform the purpose of a provision.

The purpose of both section 23M and section 31 is apparently to combat base erosion and profit shifting.

Section 23M has the further specific purpose of addressing the bias for debt funding over equity funding, and hybrid entity mismatches, by imposing a hard limit on interest deductions in certain circumstances by applying objective criteria and does this regardless of whether the terms are arm’s length or not. On the other hand, section 31 requires the determination of arm’s length terms which is inherently complex and subjective, resulting in significant uncertainty.

In the *Endumeni* case, the SCA held that where a person is faced with two or more possible interpretations of a statute, the one which gives rise to impractical, unbusinesslike or oppressive consequences must preferably be avoided.

It goes without saying that it is inherently more sensible, efficient and businesslike to apply the objective and more certain section 23M before applying section 31.

In conclusion, where the provisions of section 23M and section 31 of the Act apply to the same inbound loan, the approach should be to first attempt to read the provisions of these sections together. This would mean firstly applying the statutory formula set out in section 23M.

The provisions of section 31(2) of the Act would then be applied to the same debt and a determination made as to whether there is a tax benefit (after applying section 23M and any other provisions of the Act) and whether the arrangement constitutes an affected transaction. A further adjustment to the taxable income may be necessary having regard to the provisions of section 31(2).

Contra fiscum

Finally, the *contra fiscum* rule can be invoked (*Shell’s Annandale Farm (Pty) Ltd v Commissioner for South African Revenue Service* [2000] 62 SATC 97) where a statutory provision is ambiguous and if such ambiguity is reasonably “implied from the wording of the legislation and such legislation implies a burden upon the subject then that interpretation must be adopted which is in favour of the taxpayer”. [Our underlining]

The courts have held that the ambiguity must be “neither contrived nor artificial and…follows a reasonable reading of the text.”

In the *Telkom* case (*Telkom SA SOC Limited v The Commissioner for the South African Revenue Service* (Case no 239/19) [2020] ZASCA 19), the judge quoted (at para 19) the following paragraph (with which he agreed) from a dissertation:

> “It is submitted that the contra fiscum rule still applies in South African law and that it would be incorrect to conclude that the contra fiscum rule has no application in the context of an interpretation of fiscal provision, anti-avoidance or otherwise…, to the extent that following analysis, a purposive approach ultimately yields two constructions which are equally plausible, it is submitted that the contra fiscum rule should apply and the court should ultimately conclude in favour of the taxpayer.” [Our underlying]

Accordingly, in the event that a court should find that, when following the purposive approach, there exist two constructions which are equally plausible for the ordering of the sections, we would argue that the *contra fiscum* rule should apply and that section 23M should accordingly apply first.

The takeaway

As detailed in this article, there are sound reasons in support of a view that section 23M should be applied prior to section 31.

Accordingly, if National Treasury and SARS remain of the view that the construct should be that section 31 should apply prior to section 23M, a legislative amendment would be required in order to make this explicit.

In the absence of such an explicit rule, taxpayers should guard against simply accepting the view advanced by SARS and National Treasury and should consider challenging this view where appropriate.

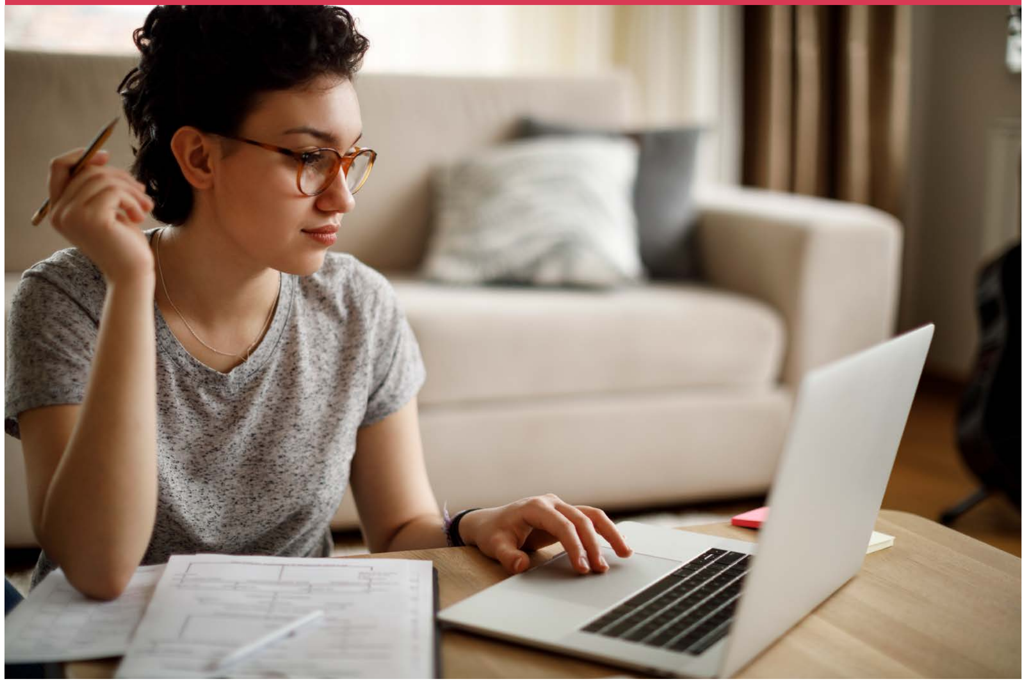
Adelheid Reyneke
Senior Manager
+27 (0) 83 557 2526

Kyle Mandy
Partner/Director: National Tax Technical
+27 (0) 11 797 4977

Taxpayer M v CSARS: Application for default judgment - “slight” non-compliance with judicial timelines and closing the doors to justice

In *Taxpayer M v CSARS* (Case Number VAT1826) heard by the Gauteng Tax court, Windell, J handed down an important decision regarding the validity of a default notice (and the resultant impact on the default judgment application) and the application of judicial precedent to the facts under consideration for condoning an application for the late filing of court documents.

This article sets out the facts before the court and the applicable legal principles considered by the court in reaching its decision.



Legal framework

The legal provisions considered in this case relate to the tax dispute provisions in Chapter 9 of the Tax Administration Act 28 of 2011 (‘the TAA’), and the Rules governing the procedures to be followed by a taxpayer and SARS in the event of a dispute (published in terms of section 103 of the TAA).[3] These Rules are of equal status to regulations and similar subordinate legislation.

Specifically, this case was concerned with the application of Rules 31, 52 and 56, as well as section 129(2) of the TAA. In short –

- When a taxpayer has lodged a notice of appeal against SARS’ disallowance of an objection, Rule 31 requires SARS to deliver to the taxpayer a statement of the grounds of assessment and opposing the appeal (‘the Statement’) within 45 days after receiving the documentation.
- In terms of Rule 56 the taxpayer may deliver a notice to SARS if it has failed to comply with the aforementioned period informing SARS of the intention to apply to a tax court for a final order under section 129(2) (‘the Default Notice’), and to subsequently approach the tax court if the default is not remedied by SARS within 15 days of that Notice.
- Rule 52(6) provides that if a party (i.e. SARS) failed to deliver a Statement as and when required under Rule 31, they may apply to the tax court for an order condoning the failure to deliver the Statement and the determination of a further period within which the Statement may be delivered.
- Section 129(2) empowers a tax court to order that an assessment is altered (together with alternative orders which are not relevant for the current purposes).
- The tax court may then either make a decision in terms of Section 129(2) or require the defaulting party to remedy the default within a time which the court deems appropriate in terms of Rule 52(6) or Rule 56(2).

3 https://www.sars.gov.za/legal-counsel/dispute-resolution-judgments/dispute-resolution-process/

Matters for consideration before the court

The parties' requests to the court were as follows:

- The taxpayer (the Applicant) requested that SARS' understatement penalty assessments totalling R175 million should be set aside.
- SARS (the Respondent) opposed the request for default judgment and brought a counter-application requesting condonation for its failure to file the Statement timeously.
- The taxpayer opposed SARS' application for condonation.

The main legal issues for determination by the court were:

- Whether SARS has shown good cause for its default to timeously file the Statement and whether the court should condone this late filing and direct that the taxpayer's appeal (against the imposition of understatement penalties) should proceed on the merits.
- If SARS' failure is not condoned, whether default judgment (in terms of rule 56(1)(a), read with section 129 of the TAA) should be granted in favour of the applicant.

Background facts

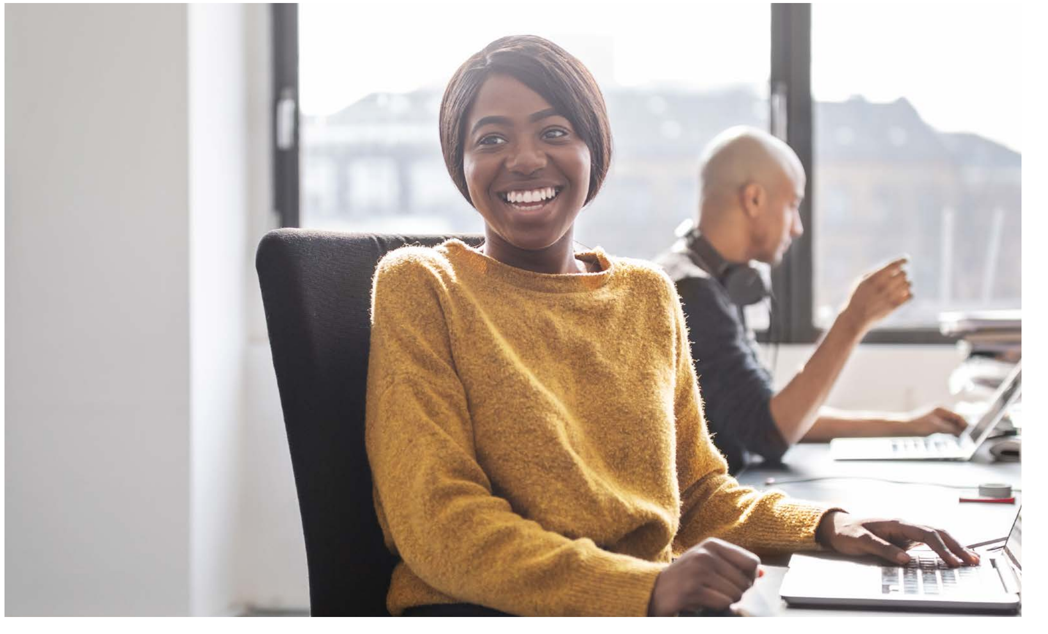
SARS raised VAT assessments for the taxpayer's 2013/11 and 2014/07 tax periods resulting in understatement penalties amounting to R175 million being levied by SARS. The taxpayer objected to these assessments which SARS disallowed. The taxpayer thereafter delivered a notice of appeal against the disallowance of objection letter on 3 June 2019. The parties then suspended litigation on this matter so that the legal representatives of each of the parties could meet to ventilate the issues as outlined below.

After some time, the taxpayer applied for a default judgment to set aside the understatement penalties, claiming that SARS failed to file the Statement for a period of nearly two years (i.e. the period between August 2019 and July 2021) and was accordingly in default of the period prescribed by the Rules. SARS disputed that it was in default for this full period as they (SARS and the taxpayer) had an agreement (reached on 1 August 2019) to suspend litigation, which agreement only lapsed in April 2021 (i.e. when the taxpayer filed the Default Notice).

The court considered in detail the timeline of events as from the date when the notice of appeal against SARS' disallowance of the objection letter was delivered by the taxpayer.

In summary:

- The taxpayer delivered a notice of appeal against SARS' disallowance of objection letter on 3 June 2019.
- The parties agreed to suspend litigation until the parties' legal representatives had a meeting to ventilate the issues to be considered in the dispute.
- The taxpayer then sent a without prejudice settlement of disputes proposal to SARS (on 14 October 2020) which was rejected by SARS (on 12 April 2021).
- The taxpayer subsequently proceeded to deliver the Default Notice to SARS on 15 April 2021, giving SARS 45 days to file the Statement (i.e. on or before 21 June 2021). The notice was however delivered to an incorrect attorney's address and SARS was only made aware of the delivery of this notice on 22 April 2021.
- As SARS' attorney of record and junior counsel who were tasked with this dispute each contracted COVID separately over different times spanning from the beginning of June to 19 July 2021, the preparation and filing of the Statement was delayed and the Statement was ultimately filed by SARS on 21 July 2021.
- The taxpayer alleged that the requirements of Rule 56 had been met and requested the court to grant an order with the effect of precluding SARS from raising the understatement penalties as a result of their delay in filing the Statement for a period of almost two years.



We provide a schematic summary below of the relevant dates that were considered by the court in determining whether there was a default by SARS, the validity of the taxpayer's Notice and whether SARS' default warranted a condonation.

Default and validity of the Notice

3 June 2019	31 July 2019	1 August 2019	6 August 2019	14 Oct 2020	12 April 2021	15 April 2021	22 April 2021	21 June 2021	28 June 2021	21 July 2021
Notice of Appeal delivered by Applicant	Request to suspend litigation	Suspension of litigation agreed to	Rule 31 originally due (after initial notice of appeal)	Without prejudice settlement sent by the applicant	Respondent rejects settlement	Notice of default delivered to incorrect email address	Respondent becomes aware of notice of default	Date on which the statement is due if 15 April is used as start date	Date on which the statement is due if 22 April is used as start date	The statement is filed by the respondent

Explanation of the default

22 April 2021	4 June 2021	Beginning of June	23 June 2021	24 June 2021	25 June 2021	28 June 2021	29 June 2021	19 July 2021	20 July 2021	21 July 2021
Notice is received by the respondent	Counsel of respondent receives the notice	Attorney of respondent contracts COVID	Attorney returns to office	Respondent requests extension for statement from applicant	Applicant rejects request for extension	Junior counsel of respondent contracts COVID	Applicant served application for default judgment	Junior counsel returns to office	Application for condonation submitted	The statement is filed by the respondent

Decision of the court

The court set out the different elements which needed to be considered in arriving at its decision regarding the SARS condonation application, namely:

1. *Was there an agreement to suspend litigation?* On the objective facts the court found that there was an agreement and therefore SARS was not, as alleged by the taxpayer, in default of filing its Statement for a period of almost two years.

2. *When did the suspension lapse?* On the facts, the court found that there was no default by SARS prior to 21 June 2021 due to the agreement for all litigation to be suspended. The agreement was only terminated (at best) on 15 April 2021 (when the Default Notice was served to the incorrect address).

3. *The validity of the Default Notice:* The court considered whether the Default Notice was in fact a notice as envisaged in Rule 56[4]. On the facts, the court found that the notice was invalid as:

   3.1. There must have been a default by SARS **prior to** the delivery of the Rule 56 notice (i.e. the Default Notice). The taxpayer should have served a formal Rule 56(1) notice on SARS to give it 15 days to file its Statement. The taxpayer failed to give SARS the further 15 day period required in terms of Rule 56(1), instead the taxpayer immediately filed the default application. Accordingly, the applicant's default application was premature and fatally defective; and

   3.2. The Default Notice relied on SARS' failure to advise whether alternative dispute resolution ('ADR') proceedings would be appropriate instead of relying on SARS' failure to file a Rule 31 statement. The court held that the taxpayer's case advanced in the default application was in conflict with its "Rule 56 notice". As the understatement penalty dispute could never qualify for ADR, the Default Notice does not constitute a valid notice and SARS was not placed in default by this notice.

[4] (1) If a party has failed to comply with a period or obligation prescribed under these rules or an order by the tax court under this Part, the other party may-

(a) deliver a notice to the defaulting party informing the party of the intention to apply to the tax court for a final order under section 129(2) of the Act in the event that the defaulting party fails to remedy the default within 15 days of delivery of the notice; and

(b) if the defaulting party fails to remedy the default within the prescribed period, apply, on notice to the defaulting party, to the tax court for a final order under section 129(2).

4. *Explanation by SARS for the default:*

SARS had to file its Statement on 21 June 2021, but only filed it on 21 July 2021. SARS explained that the late filing resulted from delays caused by SARS' attorney of record falling ill with COVID-19 and SARS' counsel incorrectly diarising the filing date (as 25 June 2021).

SARS requested an extension for the filing at this time, which was refused by the taxpayer. During this time SARS' counsel contracted COVID-19 and was out of office until 19 July 2021 and on 20 July 2021 SARS attempted to serve the application for condonation for late filing electronically.

In the meantime, the taxpayer had served the application for default judgment on 29 June 2021. The court found that on this timeline, SARS was only in default for a short period of time and that the delay did not result from any non-compliance on SARS' part, but rather as a result of the conduct of its attorney and counsel.

The court was careful to not create a precedent in which the conduct of legal practitioners excused litigants from the relevant statutory timelines (it was expressly stated that this would not be the case), but it held that considering that the non-compliance by the legal practitioners was not severe nor attributable to any fault of the litigant, "*the court will be loath to close the doors of the court to such litigant. Specifically, where the blame on the part of the [legal] representative is slight and the prejudice to the litigant would be severe.*"

5. *Prospects of success in the tax appeal:* Based on legal precedent[5], the test for condonation is whether it is in the interests of justice to grant condonation.

Relevant factors for consideration include (but are not limited to)[6]:

a. the extent and cause of delay;
b. prejudice to other litigants;
c. reasonableness of the explanation for the delay;
d. importance of the issues to be decided in the intended appeal; and
e. prospects of success.

None of the abovementioned factors are however decisive, the court has to weigh these against each other and determine what the interests of justice dictate. Whether it is in the interests of justice to grant condonation will depend on the facts and circumstances of each case.

[5] Bertie van Zyl (Pty) Ltd and Another v Minister for Safety and Security and Others 2010 (2) SA 181 (CC).
[6] Bernert v Absa Bank Ltd 2011 (3) SA 92 (CC).

The court held that the interest of justice requires that a dispute be adjudicated by an impartial forum, in accordance with the Rules and the provisions of the TAA.

The court considered the facts and circumstances of this case and found that:

a. the potential prejudice to SARS, should the condonation for late filing of the Statement not be condoned will be manifest as it will preclude them from defending the imposition of the understatement penalties;

b. the taxpayer's opposition to the condonation application was unreasonable as the period for which condonation was sought was slight and SARS provided a satisfactory explanation for the default; and

c. there will be no significant prejudice to the taxpayer.

Accordingly, the court found in favour of SARS and granted the condonation application with costs.

The takeaway

Parties in legal proceedings should follow due process when filing the (correct) legal documentation timeously, this clearly depends on the facts of each case and parties should carefully consider the applicable legislation (including the provisions of the TAA and the Rules).

When considering a condonation application for the late filing of legal documentation (whether it is filed by SARS or a taxpayer), the main consideration remains whether the interest of justice will be served by the court granting the condonation. In the present case, the court held that the importance for litigants to have access to a court of law outweighs a default resulting from a slight time delay (where a satisfactory explanation can be provided for that delay) and where the prejudice to the litigant will be severe if the condonation is not granted.

Miron Sarembock
Senior Associate
+27 082 4611288

SARS Watch

SARS Watch 1 July 2022 – 31 July 2022

Legislation		
29 July 2022	2022 Draft Tax Laws Amendment Bill	Comments must be submitted to National Treasury and SARS no later than Monday 29 August 2022.
29 July 2022	Draft Explanatory Memorandum on the 2022 Draft Tax Laws Amendment Bill	Comments must be submitted to National Treasury and SARS no later than Monday 29 August 2022.
29 July 2022	2022 Draft Tax Administration Laws Amendment Bill	Comments must be submitted to National Treasury and SARS no later than Monday 29 August 2022.
29 July 2022	Draft Memo on objects of 2022 Draft Tax Administration Laws Amendment Bill	Comments must be submitted to National Treasury and SARS no later than Monday 29 August 2022.
29 July 2022	2022 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill	Comments must be submitted to National Treasury and SARS no later than Monday 29 August 2022.
29 July 2022	Draft Explanatory Memorandum on the 2022 Draft RLAB	Comments must be submitted to National Treasury and SARS no later than Monday 29 August 2022.
26 July 2022	Table 3: Rates at which interest-free or low interest loans are subject to income tax	Effective from 1 August 2022 the interest rate will increase to 6,5% from 5,75%
Customs and excise		
28 July 2022	Offences and Penalties Policy	The Policy document has been revised to explain how to apply PAJA when a client elects to be dealt with departmentally in terms of Section 91 and the client has supporting documents to prove their mitigating circumstances.
15 July 2022	Amendment to Part 3 of Schedule No. 2 by the substitution of items 260.03/7318.15.41/01.08; 260.03/7318.15.42/01.08 and 260.03/7318.16.30/01.08 in order to include imports originating in or imported from Belarus, Indonesia and Turkey – ITAC Minute M09/2021	Tariff amendment notice R2284 published in Government Gazette No. 47015 with effect from15 July 2022 up to and including 23 July 2022.
15 July 2022	Amendment to Part 2 of Schedule No. 4 by the insertion of various items under rebate item 460.15 in order to provide for a temporary rebate provisions for the importation of primary flat steel products classifiable in tariff headings 72.08, 72.09, 72.10, 72.11, 72.12, 7225.1, 7225.99 and 7226.9. – ITAC Report No. 667	Tariff amendment notice R2283 published in Government Gazette No. 47015 with effect from 15 July 2022.
15 July 2022	Amendment to Part 3 of Schedule No. 2 by the substitution of items 260.03/7318.15.41/01.08; 260.03/7318.15.42/01.08 and 260.03/7318.16.30/01.08 in order to include imports originating in or imported from Belarus, Indonesia and Turkey – ITAC Minute M09/202	Tariff amendment notice R2282 published in Government Gazette No. 47015 with effect from 24 July 2022 up to and including 23 July 2023.
3 July 2022	Amendment to rules under sections 19, 60 and 120 – Insertion of rules numbered 19.09 in relation to the monitoring of certain customs and excise warehouses through CCTV equipment (DAR235)	Rule amendment notice R2215 published in Government Gazette No. 46648 with effect from 1 August 2022.
Case law		
In accordance with date of judgment		
14 July 2022	SACS (Louis Trichardt) (Pty) Ltd v CSARS (40420/2020; 17064/2021) ZAGPPHC	Whether SARS should be precluded from auditing, assessing or “performing tax computations” in respect of the taxpayer’s tax liabilities for the 2013 to 2016 tax years.
4 July 2022	Eskom Pension and Provident Fund v Brian Molefe and Others (93895/2019)	Compliance with repayment of benefits received as a result of unlawful membership of pension scheme.

Guides		
28 July 2022	Tax Exemption Guide for Public Benefit Organisations in South Africa (Issue 6)	This guide provides general guidance on the following items: • the approval as a public benefit organisation under section 30; • the partial taxation of public benefit organisations under section 10(1)(cN); and • approval of public benefit organisations under section 18A to issue section 18A receipts for donations, which potentially entitles the donor to an income tax deduction for bona fide donations made.
25 July 2022	Guide to Complete the Tax Directive Application Forms – External Guide	The guide has been updated with the requirement for ‘Emigration withdrawal’.
25 July 2022	Tax Directive for Emigration, Ceasing to be resident and Expiry of visas – External Guide	The additional requirements for the ‘Emigration withdrawal’ tax
Directive applications were added to the guide.		
1 July 2022	How to submit your individual income tax return via eFiling	This guide is updated with the 2022 Tax Filing Season changes.
1 July 2022	Comprehensive Guide to the ITR12 Income Tax Return for Individuals	This guide has been updated for the 2022 Filing Season (automatic assessment, additional voluntary pension/provident fund contributions, remuneration from foreign employer(s) for services rendered in RSA, section 12J VCC, long service awards, SARS interest, CGT disposals to connected persons, income on IRP5/IT3(a) regarded as trading income, UDZ, farming operations, medical expenditure, s10(1)(o)(ii) exemption relating to s8A/8C gains).
1 July 2022	Guide for Provisional Tax	This guide is published for information purposes only, so that provisional taxpayers can understand their tax obligations.
1 July 2022	How to eFile your Provisional Tax Return	This guide provides guidelines on how to file your provisional tax return.
1 July 2022	Guide to the Individual ITR12 Return for Deceased and Insolvent Estates	This guide has been updated with Tax Season 2022 enhancements.
1 July 2022	Services offered by SARS via the SARS MobiApp	The purpose of this guide is to describe how to use the services offered to you via the SARS MobiApp.
1 July 2022	How to register for the use of the SARS MobiApp	The purpose of this guide is to describe how to register for the use of the SARS MobiApp and for Personal income Tax via the SARS MobiApp.
1 July 20222	How to submit your individual Income Tax return via the SARS MobiApp	The guide has been updated with the Personal Income Tax requirements for the 2022 Tax Filing season for a successfully filed return.
1 July 2022	How to make payments to SARS via the SARS MobiApp	The purpose of this guide is to describe how to make payments related to your Income tax via the SARS MobiApp.
Other Publications		
28 July 2022	OECD: Lesotho deposits an instrument for the ratification of the Multilateral BEPS Convention	The BEPS Convention will enter into force on 1 November 2022 for Lesotho.
21 July 2022	OECD: Housing Taxation in OECD Countries	The report shows that while housing taxes play an important role in OECD countries, there is substantial room for reforms to enhance their equity, economic efficiency and revenues.
11 July 2022	OECD: Progress Report on Amount A of Pillar One	The report presents a comprehensive draft of the technical model rules to implement a new taxing right that will allow market jurisdictions to tax profits from some of the largest multinational enterprises (“Pillar One”).

pwc