Synopsis

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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.

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Tax credits in respect of foreign taxes on income and taxable capital gains from sources outside South Africa: the "comparative inclusion limitation" in section 6quat of the Income Tax Act, 1962

Introduction

Broadly, section 6quat of the Income Tax Act, 1962 ('the Act') sets out rules for determining the amount of foreign tax credits available to South African residents in respect of certain amounts that are subject to tax in other countries and also subject to tax in South Africa.

In this article, we examine the apparent difference in treatment (by section 6quat) between, on the one hand, amounts of income from a foreign source and, on the other hand, taxable capital gains from a foreign source.

International juridical double taxation: some general principles

It is not uncommon for an amount to potentially be subject to tax in two countries. In accordance with the residence basis of taxation, South African residents are subject to South African income tax on their worldwide income. This means that, irrespective of the source of the amounts that give rise to a resident's income, a resident will be subject to tax in South Africa thereon. At the same time (as is the case with South Africa) most jurisdictions impose tax on non-residents in respect of amounts that are derived by such non-residents from sources within their countries.

Consequently, where a taxpayer is a resident of South Africa and the relevant amount is derived from a source within another country, double taxation on the same item of income will result.

Fortunately, relief for such double taxation is usually available, and is normally granted by the country of residence of the affected taxpayer.

Such relief commonly takes the form of a tax credit for the foreign taxes imposed. In a South African context, such foreign tax credit relief is provided to South African residents both in terms of double tax agreements (i.e. bilateral relief) and in terms of South Africa's domestic legislation (i.e. unilateral relief).

Where the country of residence and the country of source apply different rates of tax in respect of the amount that is subject to tax in both countries, issues arise relating to the calculation of the amount of the credit. For example, where the rate of tax in the source country is higher than the rate of tax in the country of residence (and the amount that is subject to tax in the source country is equal to the amount that is subject to tax in the country of residence), the quantum of tax payable in the source country on that amount will exceed the quantum of tax payable in the country of residence. In such a scenario, if the country of residence allows a tax credit to the full value of the foreign tax imposed, the relief afforded by the country of residence would be greater than the tax liability in that country (i.e. the country of residence).

Should such relief be afforded by the country of residence, this could give rise to a significant erosion of the tax base of the country of residence, which already has a lower tax rate than the source country. In recognition of this undesirable result, the default position in tax systems that use foreign tax credits to prevent double taxation is that the quantum of the foreign tax that will qualify for foreign tax credit relief is limited to the extent of the tax liability of the taxpayer in the country of residence in respect of the foreign source income.

The South African approach to the prevention of double taxation

In South Africa, aside from bilateral relief afforded to residents in terms of applicable double tax conventions, the main provision of the Act that provides for foreign tax credit relief is section 6quat, subsections (1), (1A) and (1B) of which must be applied in determining the amount of any foreign tax credit (referred to as a 'rebate' in section 6quat) to which a South African resident is entitled.

Subsections (1), (1A) and (1B) of section 6quat are generally consistent with the general principles set out above. Broadly:

1. In terms of subsection (1), where the taxable income of a South African resident includes certain amounts derived from a foreign source, provision is made, in determining the normal tax payable by the resident, for the deduction of a rebate determined in accordance with the section;
2. Subsection (1A) sets out the rules relating to the determination of the amount of the rebate (in this regard, the rules are different depending on the nature of the amount that is included in the taxable income of the resident); and
3. Subsection (1B), which incorporates an 'ordinary credit' limitation, effectively provides that the amount of the foreign tax credit will always be limited to the extent of the South African tax liability of the resident in respect of the foreign source income in aggregate.

More specifically (and insofar as is relevant for the purposes of this article), section 6quat provides as follows:

"(1) … where the taxable income of any resident during a year of assessment includes--

(a) any income received by or accrued to such resident from any source outside the Republic; or

(e) any taxable capital gain contemplated in section 26A, from a source outside the Republic; …

in determining the normal tax payable in respect of that taxable income there must be deducted a rebate determined in accordance with this section.

(1A) For the purposes of subsection (1), the rebate shall be an amount equal to the sum of any taxes on income proved to be payable to any sphere of government of any country other than the Republic … by--

(a) such resident in respect of--

(i) any income contemplated in subsection (1)(a); or

(iii) any amount of taxable capital gain as contemplated in subsection (1)(e); ...

which is so included in that resident's taxable income ...".

These excerpts from section 6quat reflect two sets of rules that apply to determine the amount of the foreign tax credit in respect of amounts derived from a source outside South Africa, i.e.:

- One set that applies where the relevant amount included in the resident's taxable income constitutes income received by or accrued to the resident from a source outside South Africa; and
- Another set that applies where the relevant amount included in the resident's taxable income constitutes a taxable capital gain from a source outside South Africa.

The application of the first set of rules is fairly straightforward. Essentially, in terms of subsections (1)(a) and (1A)(a)(i), where the amount included in the taxable income of the resident constitutes income, the rebate will effectively be equal to the sum of the taxes paid to the government of the source country on that amount of income. Subsection (1B) will then effectively apply to limit the amount of the rebate (as determined in terms of subsections (1) and (1A)) to the extent of the South African tax liability in respect of the amount of income so included in taxable income (i.e. the 'ordinary credit' limitation applies).

However, applying the second set of rules is slightly more complicated and, arguably, gives rise to an anomalous result, the effect of which is that the resident will only qualify for part of the credit that they would otherwise have received had a true (and full) 'ordinary credit' approach applied.

An illustration of the anomaly

The anomaly may be illustrated by the following example (note that, for purposes of simplification, currency translation issues have been ignored).

Facts and assumptions:

- In March 2021, Mr A, who is a resident of South Africa for tax purposes, disposes of a property that he owns in the United Kingdom and realises a gain of GBP 100,000.
- The gain is subject to tax in the United Kingdom at, say, 20% (tax payable in the United Kingdom on the gain is therefore GBP 20,000).
- Mr A has no other foreign source capital gains and is subject to income tax in South Africa at the maximum marginal tax rate of 45%.
- The gain that is subject to tax in the United Kingdom is equal to the South African capital gain (as defined in para 3 of the 8th Schedule) in respect of the disposal of the property.

Determination of South African tax liability (before the application of s6quat):

- Capital gain (para 3 of the 8th Schedule): GBP 100,000.
- Taxable capital gain (para 10(1)(a) of the 8th Schedule): GBP 100 000 x 40% = GBP 40 000 (this is the amount that is included in Mr A's South African taxable income assuming that no portion of the annual exclusion is attributed to this capital gain (in terms of s26A)).
- South African income tax liability: GBP 18,000 (i.e. 45% of GBP 40,000).
- The effective South African tax rate applicable to the gain is therefore 18%.

Application of s6quat:

As set out above, section 6quat(1)(e) provides as follows:

> " … where the taxable income of any resident during a year of assessment includes … any taxable capital gain contemplated in section 26A, from a source outside the Republic[,] … in determining the normal tax payable in respect of that taxable income there must be deducted a rebate determined in accordance with this section".

Consequently, in terms of section 6quat(1)(e), on the basis that the taxable income of Mr A includes a taxable capital gain from a source outside South Africa, Mr A will be entitled to the deduction of a rebate in determining his normal tax payable.

In this regard, and insofar as is relevant, section 6quat(1A)(a)(iii) again provides as follows:

> "(1A) For the purposes of subsection (1), the rebate shall be an amount equal to the sum of any taxes on income proved to be payable to any sphere of government of any country other than the Republic, … by … such resident in respect of … any amount of taxable capital gain as contemplated in subsection (1)(e) … which is so included in such resident's taxable income ..."

On a literal interpretation of section 6quat(1A)(a)(iii), the rebate is an amount equal to the tax paid by Mr A in respect of the amount of the taxable capital gain that is included in Mr A's taxable income. Consequently, adopting this interpretation, the rebate is an amount equal to the United Kingdom tax payable by Mr A only in respect of that portion of the taxable capital gain that is included in Mr A's taxable income in terms of section 26A. In this regard, the portion of the taxable capital gain that is included in Mr A's taxable income is not the full GBP 100,000, but only GBP 40,000, and only the United Kingdom tax payable on this amount (i.e. GBP 40,000) qualifies for deduction as a rebate in terms of section 6quat(1A)(a)(iii). On the basis that the rate of tax payable in the United Kingdom on the gain was 20%, the rebate will only be GBP 8 000 (i.e. GBP 40,000 x 20%).

The net result is the following:

UK tax payable	GBP 20,000
SA tax payable: (before 6quat)	GBP 18,000
s6quat credit	(GBP 8,000)
Total (UK and SA) tax	**GBP 30 000**

Although the effective South African rate of CGT is 18% and the United Kingdom tax rate is 20%, the effective overall tax rate in respect of the capital gain is 30%.

Effectively, because of the way in which taxable capital gains are included in taxable income (i.e. 40% of capital gains are included in taxable income and taxed at a rate of 45%), 60% of the credit is lost.

Why is this an anomalous result?

The above interpretation is adopted by SARS in Interpretation Note 18 (‘IN18’) (see pages 50 – 51 of IN18). This interpretation seems to run counter to the broad policy underlying section 6quat, which is that a taxpayer should get credit for the taxes paid in the relevant foreign jurisdiction to the extent that those taxes do not exceed the South African taxes on that same income.

It is notable that, in the case of foreign dividends, section 6quat specifically allows for the full foreign tax credit notwithstanding that foreign dividends enjoy a partial exemption in order to reduce the effective tax rate to 20% (paragraph (ii) of the proviso to subsection (1) states that the amount included in the resident’s income for the purposes of subsection (1) “must be determined without regard to section 10B(3)”). There is therefore a specific ‘carveout’ for foreign dividends that has the effect that the exempt portion of a foreign dividend is not taken into account, while there is no corresponding provision for capital gains. It is difficult to understand why there is a different approach in the case of foreign dividends given the similarities in the taxation of these and capital gains, i.e. at a lower effective tax rate.

An alternative interpretation

Although the above interpretation is adopted by IN18 we are of the view that it is open to challenge. In this regard, the following extract from the 2005 Explanatory Memorandum (relating to the insertion of paragraph (iB) of the proviso to section 6quat(1B)(a)) is instructive:

“Currently foreign assets of a resident which are not immovable property and which are not attributable to a foreign permanent establishment of the resident are deemed to be South African sourced assets for purposes of the determination of capital gains or losses. This principle was introduced in the Income Tax Act in 2002. The effect of this rule is that taxes imposed by a foreign tax jurisdiction may not be allowed as a credit against a resident’s South African tax liability in respect of the disposal of the assets described above.

As was announced in the 2005 Budget, the sale of foreign shares by South Africans is problematic if the foreign country taxes this form of sale. It is now proposed that the disposal of foreign assets (including shares) which are subject to foreign taxes but are not attributable to a foreign permanent establishment will be treated to be from a foreign source. South Africans will then be entitled to utilise foreign taxes proved to be payable as foreign tax credits against their South African tax liability. It is, however, proposed that the foreign tax credit be limited to the South African tax on the gain and that the excess not be allowed as an offset against other sources of foreign income or to be carried forward to future tax years.

Example

A South African resident invested in shares in a Tanzanian company. The resident has no presence in Tanzania. On disposal of the shares tax of Ts 180 000 (R1 000) was paid to the Tanzanian Revenue Authority. The capital gain on the disposal of the shares is also subject to tax in South Africa. As the source of the capital gain is not deemed to be from a South African source the resident is entitled to utilise the R1 000 Tanzanian tax as a credit against the resident’s South African tax liability. If the resident’s tax liability attributable to the gain is R900 the R100 excess credit will be forfeited and may not be set off against the tax liability in respect of any other foreign sourced income in the current or future tax years”.

In the example used, no account is taken of the excluded portion of the capital gain in determining the amount of the foreign tax qualifying for the rebate. Accordingly, adopting a purposive approach to the interpretation of section 6quat(1A)(a)(iii) (which takes into account the purpose of section 6quat generally) may result in a different outcome.

Takeaway

The limitation of foreign tax credits in terms of section 6quat in the case of foreign sourced taxable capital gains is more complicated than most seem to recognise, and appropriate advice and assistance should be obtained when determining the amount of a foreign tax credit that is available in the case of such gains.

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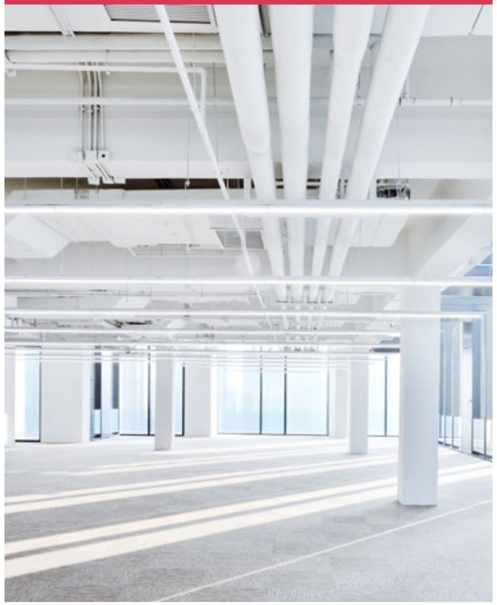

The exchange of currency & apportionment of input tax

In brief

The Supreme Court of Appeal ('SCA') handed down its judgment in the matter of the *Commissioner for the South African Revenue Services v Tourvest Financial Services (Pty) Ltd* (435/2020) [2021] ZASCA 61 on 25 May 2021.

This judgment overturned the decision of the Tax Court in *ABC (Pty) Ltd v Commissioner for the South African Revenue Service (1626) [2020] ZATC*.

These cases concern the nature of the sale of foreign currency in return for a commission by Tourvest Financial Services (Pty) Ltd ('Tourvest') and its corresponding entitlement to input tax. In short, the SCA found that the sale of foreign currency constitutes an exempt activity and as such, where a commission is charged, the activity does not lose its exempt nature, but a dual supply is created, i.e. an exempt supply of currency and a taxable supply of exchange services. As a result, Tourvest is not able to directly attribute its expenses to either the making of exempt or taxable supplies and is therefore required to apply apportionment to input tax incurred.

General

On 25 May 2021, the SCA handed down its judgment in the matter of Commissioner for the South African Revenue Services v Tourvest Financial Services (Pty) Ltd (435/2020) [2021] ZASCA 61 concerning an appeal against a Tax Court Ruling made in favour of Tourvest.

Tourvest's business comprises the buying and selling of currency to inbound and outbound travellers. Tourvest structured its business into three divisions, namely:

- head office,
- treasury; and
- a branch network,

with each division having a separate operational function.

The Treasury function is responsible for setting exchange rates for the buying and selling of foreign currencies to customers. The rate (inclusive of a margin which was earned in addition to commission) is displayed on the board in the branch for customers to buy and sell currency.

The branches are responsible for the sale and exchange of foreign currencies to customers, and the head office provides a supporting role.

When a customer buys or sells currency, the relevant branch processes the transaction and charges the customer a commission or fee for its services.

For many years Tourvest was of the view that it made both taxable and exempt supplies and therefore apportioned its input tax. Tourvest applied the standard turnover-based method of apportionment to determine the extent of input tax it was entitled to deduct for its business as a whole. Tourvest subsequently reviewed its business and determined that it could directly attribute the VAT incurred by it to the respective business units/activities. Tourvest adjusted its VAT returns to claim the portion of input tax which was previously not deducted in full by the branches on the basis that the branches made wholly taxable supplies.

SARS disagreed with this approach and insisted that the VAT in question must be apportioned in accordance with the standard turnover-based method of apportionment. SARS accordingly issued an assessment. Tourvest appealed this assessment in the Tax Court.

Arguments raised in the Tax Court

It is an established principle in our law that only the arguments which were raised in the court a quo can be considered by a court which is hearing an appeal of the case. It is therefore important to carefully consider on what basis Tourvest and SARS based their cases in the Tax Court to better understand the element on which the SCA disagreed with the Tax Court.

Tourvest's arguments

In the Tax Court, Tourvest based a portion of its argument on the interpretation of section 2(1)(a) and its proviso. Tourvest contended that the exchange of currency is a financial services activity. However, in terms of the proviso, this activity is no longer deemed to be financial services where, or to the extent, the consideration payable is a fee or commission.

Tourvest was further of the view that the only consideration payable and/or received was the fee or commission for its services of exchanging currency. Tourvest based its view on the following aspects:

- The terms of the contract entered into with a customer were for the exchange of currency at a particular rate for a commission;
- The customer contract does not include any provision relating to the margin that may be built into the rate of exchange. Customers were therefore completely unaware of the margin;
- The definition of 'consideration' for VAT purposes relates only to a supply of goods or services, and the exchange of currency is neither a supply of goods nor services. Tourvest argued that currency as envisaged in section 2(1)(a) and money, as defined, are virtually the same; and
- Furthermore, the margin and/or amounts exchanged did not constitute consideration. It was argued that the exchange of money for money is not consideration as it merely replaces one currency with another of equal value.

SARS' arguments

SARS argued that although the business of Tourvest operated in separate divisions, it was one entity and that the activities of such divisions were so interwoven and interdependent that the split was in essence artificial. This point was argued with emphasis on the fact that without customers contracting with the branch for the exchange of currency no income or commission would have been earned by any of the divisions of the company.

SARS held the view that the exchange of currency took place at the branch and that such exchange of currency constituted financial services as envisaged in section 12(a) read with section 2(1)(a) and was therefore an exempt supply.

SARS concluded that Tourvest made mixed supplies and could therefore only directly attribute to the extent that it was possible within the branches to allocate expenses to wholly taxable purposes.

Tax Court decision

The Tax Court considered the above arguments and based its reasoning on two questions:

- whether the exchange of currency by the branches constituted a 'financial services' activity under section 2(1), which qualified in terms of section 12(a) to be exempt from VAT; and
- whether the payment of a commission/ fee is 'consideration' as contemplated in the proviso to section 2(1).

In doing so the Tax Court focused on the definitions of 'input tax', 'taxable supply', 'output tax', 'goods' and 'services'. It also had to consider the application of sections 7(1), 2(1) and 12(a).

In determining the nature of the supplies made by Tourvest, the Tax Court accepted and applied the principle that the VAT consequences of a transaction must be determined by having regard to the contractual arrangements under which the supply is made. The Tax Court stated that the margin (whether notional or not) does not form part of the agreement between the parties and that it was unknown to Tourvest (i.e. the treasury and branch network) and the customer at the time of the transaction.

The Court held that the only payment the customer makes to Tourvest for the exchange of currency is the commission/ fee paid by the customer and the margin earned on the currency does not detract from this. The commission/fee charged by Tourvest is 'consideration' as envisaged in the proviso to section 2(1). The Tax Court found that the correct interpretation of section 2(1) is that the consideration earned, in this case the commission/fee, removes the activity of the 'exchange of currency' from being deemed financial services. Tourvest is therefore required to charge output tax and deduct any input tax on expenses incurred for the exchange and sale of foreign currencies to customers by its branches.

The result is that the branches were deemed to only make taxable supplies, and, accordingly, Tourvest was correct to apply direct attribution as opposed to apportioning the VAT incurred by its branches.

SCA decision

The matter for consideration before the SCA was whether Tourvest, in conducting its enterprise of the exchange of currency through its branch network, made both taxable and exempt supplies or whether it made taxable supplies only. In answering this question, the SCA considered the definitions of 'input tax', 'taxable supply', 'exempt supply', 'financial services' and 'consideration' per the VAT Act.

The pivotal definition in the SCA's analysis was the definition of 'financial services'. The SCA stated that the exchange of currency has been regarded as a financial service and therefore an exempt supply since the VAT Act was first introduced. The SCA further observed that when the VAT Act was introduced there was no proviso to the definition of 'financial services', which essentially took activities out of the financial services definition to the extent that the consideration payable in respect thereof constitutes any fee, commission or similar types of remuneration. The proviso was, however, introduced later on as a result of a recommendation by the Katz Commission to bring fee based financial services into the VAT net.

The SCA confirmed that the sale of foreign currency constitutes an exempt activity, whether or not a fee/commission is charged. The court found that the fact that a fee/commission is charged does not affect the nature of the activity of the exchange of currency. That is, the activity does not lose its exempt nature. The court went on to explain that the activity which, in the absence of the proviso, would have been an exempt financial service does not lose its exempt nature merely because it makes taxable supplies to the extent of the fee/commission. The court concluded that due to the wording of the proviso, a mixed supply is created.

The outcome was that the exchange of currency remains an exempt financial services activity and the proviso merely adds a taxable component to it. Input tax must therefore be apportioned and direct attribution of branch expenses was not possible. As a result, the appeal was upheld and the Tax Court judgment was set aside.

Commentary

The two judgments in question have very contrasting approaches. The Tax Court followed a very structured approach in reaching its conclusion and spent a great deal of effort in determining that the exchange of currency does not comprise the supply of either goods or services. The SCA on the other hand placed significant emphasis on the objectives of the VAT Act with regard to financial services and the explanatory memorandum. Whilst it is understood that the courts are not called upon to create law and are merely there to give effect to the intention of the legislation, it is expected that in doing so the courts must also have regard to the wording of the relevant statutes. In doing so, it would be unreasonable to expect a court to strain the wording of a statute to give effect to the legislative policy intent. This view has previously been confirmed by the SCA in Natal Joint Municipal Pension Fund v Endumeni Municipality 2012 (4) SA 593 (SCA) wherein it was established that when interpreting the provisions of an Act, the language used, the apparent purpose of the provision and the context in which it occurs are important guides to the correct interpretation of the provision. Importantly, a sensible meaning is to be preferred to an interpretation which gives rise to unbusinesslike results. In this case the SCA warned against merely considering the ordinary grammatical meaning of words or using the intention of the legislature as the sole main guiding principle in statutory interpretation, noting that:

> "The sole benefit of expressions such as 'the intention of the legislature' or 'the intention of the parties' is to serve as a warning to courts that the task they are engaged upon is discerning the meaning of words used by others, not one of imposing their own views of what it would have been sensible for those others to say. Their disadvantages, which far outweigh that benefit, lie at opposite ends of the interpretative spectrum. At the one end they may lead to a fragmentation of the process of interpretation by conveying that it must commence with an initial search for the 'ordinary grammatical meaning' or 'natural meaning' of the words used seen in isolation, to be followed in some instances only by resort to the context. At the other it beguiles judges into seeking out intention free from the constraints of the language in question and then imposing that intention on the language used. Both of these are contrary to the proper approach, which is from the outset to read the words used in the context of the document as a whole and in the light of all relevant circumstances." (at paragraph 24)

In our analysis of the judgment, we have considered the following statement by the SCA:

> "… the activity of the exchange of currency as envisaged in s 2(1), which is, on the face of it, a defined financial service under s 2(1)(a) and is accordingly an exempt supply by virtue thereof."

This statement by the SCA, whilst it may align with the legislative policy and relevant explanatory memorandum, in our view does not align with the wording of section 2. The wording of section 2(1), in our view, does no more than deem certain activities to be financial services. The proviso to section 2(1), however, deems certain listed activities not to be financial services to the extent that the consideration payable in respect of such services is in the form of any fee, commission, merchant's discount or similar charge. The purpose of the proviso in this instance is to cause a separation and creation of a non-financial services activity.

As discussed in our previous article relating to the Tax Court judgment on this matter, section 2 does not, nor is it intended to, deem these financial services activities to be an exempt or non-enterprise activity for VAT purposes. It is the taxable nature of the supplies of goods or services in the course or furtherance of these financial services activities which will determine whether the financial services activity is a non-enterprise or exempt activity; that is, if the supply of goods or services qualifies to be exempt under section 12(a), then this financial services activity will be deemed to be a non-enterprise activity to the extent of making exempt supplies by virtue of proviso (v) to the definition of 'enterprise'. If this were not the case, and as a default the financial services activity is an exempt activity, then financial services could never be zero rated as provided for in section 12(a) read with section 11(2). That is, the zero rating [by the construct of section 7(1)(a) and 11(2)] can apply only to goods or services supplied in the course or furtherance of an enterprise. Or, in other words, goods or services supplied in the course or furtherance of an exempt activity will never fall to be taxable under section 7(1)(a).

To determine whether this activity is a non-enterprise activity, we therefore need to consider whether there is a supply of goods or services which qualifies to be exempt under section 12(a). In this regard, we consider the definition of 'goods' and 'services' and note that these definitions specifically exclude 'money'. Therefore, the exchange of currency (i.e. money exchanged for money) constitutes neither a supply of goods nor services, and cannot therefore be exempt under section 12(a).

It is unfortunate that the SCA did not deal with the Tax Court rationale and conclusion in upholding the appeal, and in setting down its decision referred to the policy intent in its judgment.

In our view, it would be more appropriate for the SCA to conclude that despite this activity not resulting in taxable supplies, the activity comprising the exchange of currency (excluding the commission or service fees charged) remains a financial services activity which does not result in the supply of goods or services. As a result, this financial services activity falls outside the definition of enterprise, as it does not make a supply of goods or services for a consideration. This would then give it the desired result to conclude that the branch has two activities, namely:

- a financial services activity which does not make taxable supplies; and
- an activity which makes taxable supplies.

These two activities being conducted at the branch will therefore require the VAT incurred for mixed purposes to be apportioned in accordance with section 17(1).

Lastly, this judgment must not be construed to mean that all VAT incurred for mixed purposes must be apportioned in accordance with section 17(1). The principle of direct attribution as contemplated in the definition of input tax must first be applied before apportionment is required. The SCA did not deal with this aspect but merely accepted that the VAT in question was subject to apportionment.

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The doubtful debt allowance regime: an opportunity to claim an increased allowance

From an accounting perspective, impairment losses on loans and receivables are required to be recognised on a forward-looking basis (i.e. before the occurrence of any credit event). Generally, the amount of the impairment so recognised will depend on, inter alia, the recoverability of the relevant loan or receivable and any underlying security.

From a tax perspective, although impairments relating to loans and receivables are generally not deductible for income tax purposes, paragraphs (j) and (jA) of section 11 of the Income Tax Act, No. 58 of 1962 ('the Act') are special deductions which entitle a taxpayer to claim the deduction of certain allowances calculated with reference to such impairments ('the doubtful debt allowances').

In order to claim the doubtful debt allowance provided for by paragraphs (j) and (jA) of section 11, one of the key criteria is that the relevant debt would have been deductible under an applicable provision of the Act had that debt become bad. It should be noted that any allowance claimed in terms of paragraph (j) or (jA) is required to be included in the income of the taxpayer in the subsequent year of assessment.

The doubtful debt allowance regime has seen a number of changes over the years. Prior to changes that took effect in January 2018, it had become the practice that taxpayers would claim (and were allowed) an allowance equal to 25% of the amount of certain specified doubtful debts. A special dispensation was granted to banks that permitted allowances to be claimed at a higher rate. In the case of non-bank lenders, rulings were in some instances obtained by taxpayers from SARS, and where rulings were not obtained allowances were simply claimed applying the higher rate applicable to banks as per the special dispensation granted to banks. Even though some of the non-bank lenders claimed the higher allowances which were permitted only for banks, it generally became accepted that such allowances would not be denied by SARS upon assessment.

As part of SARS' effort to strengthen the self-assessment regime and do away with provisions of the Act which required the exercise of discretion of the Commissioner, paragraph (jA) was introduced into section 11 in January 2018. The purpose of paragraph (jA) is to make provision for the rules for the doubtful debt allowance for 'covered persons' (i.e. generally banks). The introduction of paragraph (jA) was necessitated by the coming into effect of IFRS 9, which replaced (and is significantly different to) IAS 39.

Subsequent to the introduction of paragraph (jA), certain amendments (which took effect in January 2019) were made to paragraph (j). Broadly, the purpose of these amendments was to ensure that non-bank lenders (and other qualifying taxpayers) get similar allowances as the banks are entitled to in terms of paragraph (jA).

Paragraph (jA) of section 11 generally applies only to banks and permits an allowance of 85%, 40% or 25% of the amount of a doubtful debt provision (depending on how the particular doubtful debt provision is classified). Notably absent from paragraph (jA) is any element of discretion on the Commissioner's part in the determination of the amount of the allowance. On the basis that paragraph (jA) applies only to banks, non-bank lenders (and similar taxpayers) are not entitled to the allowances provided for by paragraph (jA).

Paragraph (j) of section 11, on the other hand, applies to non-bank lenders and other taxpayers and permits an allowance of 40% or 25% of the amount of a doubtful debt provision (depending on how the particular provision is classified in terms of IFRS 9, or – where IFRS 9 is not applied to the measurement of the doubtful debt provision – the number of days that the debt remains outstanding).

Notably, whilst the banks are entitled to an allowance of up to 85%, non-bank lenders and other taxpayers are entitled only to an allowance of up to 40%. As per the Explanatory Memorandum relating to the introduction of paragraph (jA), the policy rationale for this difference in treatment was that banks are subject to more intensive prudential regulation and stringent capital requirements. However, in order to ensure that all taxpayers are treated fairly, paragraph (j), as part of the amendment (effective January 2019), made provision for affected taxpayers to apply for an increased allowance of up to 85%.

Benefit of the increased allowance

There is definitely an immediate cash benefit attached to an increased allowance depending on the quantum of impairment. For example, for a Stage 2 or 3 impairment of R100 million, an increased allowance of just 10% will result in a cash tax saving of R2.8 million; an increased allowance of up to 85% (i.e. 45% additional allowance) will result in a cash tax saving of R12.6 million. It is worth mentioning that this benefit is applicable for the first year of assessment that the increased allowance is granted, and to the extent that the quantum of impairment keeps increasing in subsequent years of assessment, will continue to be applicable.

Application process

In order for non-bank lenders and other taxpayers to apply for the relevant directive, the following information in relation to the doubtful debts must be submitted to SARS:

- The history of the debts owed to the taxpayer, including the number of repayments not met and the duration of the debt.
- Steps taken to enforce repayment of the debt.
- The likelihood of the debt being recovered.
- Any security available in respect of that debt.
- The criteria applied by the taxpayer in classifying debt as bad.
- Other considerations as the Commissioner may deem relevant.

This information is mainly grouped into qualitative and quantitative data. The qualitative data deals with policies around the recognition of doubtful debts, whilst the quantitative data deals with the numbers associated with the doubtful debts.

How we can help

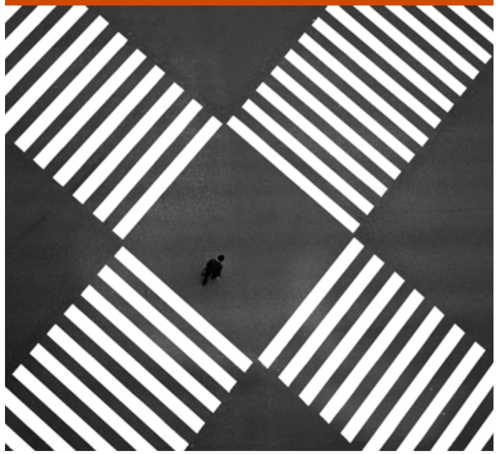
PwC can provide all necessary assistance in relation to applying for the directive. In this regard:

- We can write a letter on your behalf to SARS requesting the increased allowance.
- Upon receipt of the letter, SARS may request certain qualitative and quantitative information on impairments. We can assist with compiling and presenting the required information, as well as reviewing the underlying data to ensure that the data is consistent with the relevant annual financial statements (which is a key requirement).
- We can then submit the requested information to SARS on your behalf.
- Finally, we can liaise with SARS in respect of any related correspondence.
- Whilst we wait for SARS to issue the directive, we can apply for a temporary directive which can be used in the interim, for purposes of filing provisional tax returns and income tax returns.

The takeaway

- Qualifying taxpayers have a unique opportunity to apply for the increased allowance. As we have demonstrated above, the granting of the allowance can result in substantial cash tax savings.
- We have assisted many of our clients to successfully apply for the increased directive and are uniquely positioned to leverage our experience in this regard to assist other clients seeking to apply for such directives.

Stephen Boakye
Associate Director



SARS Watch

SARS Watch 1 June 2021 – 30 June 2021

Legislation		
25 Jun 2021	Amendment to Notes 5 and 8 to Chapter 98 in Part 1 of Schedule No. 1, in order to include reference of new rebate item 307.04, to implement APDP Phase II – ITAC Minute M10/2020	Notice R.554 published in Government Gazette No. 44759 with an implementation date of 1 July 2021.
25 Jun 2021	Amendment to Part 2 of Schedule No. 4, in order to include new rebate item 317.04 and to remove the reference to “production rebate credit certificate (PRCC)” and insert production rebate certificate (PRC) as well as the insertion of various new rebate items, to give effect to APDP Phase II – ITAC Minute M10/2020	Notice R.553 published in Government Gazette No. 44759 with an implementation date of 1 July 2021.
25 Jun 2021	Amendment to Part 1 of Schedule No. 3, by the insertion of new Notes and item 317.04, to provide for APDP Phase II – ITAC Minute 10/2020	Notice R.552 published in Government Gazette No. 44759 with an implementation date of 1 July 2021.
25 Jun 2021	Amendment to Part 3 of Schedule No. 5, in order to amend Notes to item 537.00 to include new rebate item 317.04 and make provision for production rebate certificate (PRC) as well as insertion of new refund items 537.04, to give effect to APDP Phase II – ITAC Minute M10/2021	Notice R.551 published in Government Gazette No. 44759 with an implementation date of 1 July 2021.
25 Jun 2021	Amendment to Part 1 of Schedule No. 4, by the substitution of Note 2 to Rebate Item 407.00, in order to correct the reference to rebate item 407.01/00.00/01.02 to 407.01/00.00/02.00	Notice R.550 published in Government Gazette No. 44759 with an implementation date of 25 June 2021.
25 Jun 2021	Amendment to Part 5 of Schedule No. 5, by the substitution of Note 5, in order to correct the reference to rebate to read as refund	Notice R.549 published in Government Gazette No. 44759 with an implementation date of 25 June 2021.
25 Jun 2021	Amendment to Part 6 of Schedule No. 5, by the substitution of Note 4, in order to correct the reference to rebate to read as refund	Notice R.548 published in Government Gazette No. 44759 with an implementation date of 25 June 2021.
24 Jun 2021	Customs $ Excise Act, 1964: Draft amendments to rules relating to the amendments to rules – under section 77H and 120	Comments must be submitted to SARS by Friday, 7 July 2021.
19 Jun 2021	Renewable energy premium in respect of any tax period ending on 31 December 2019 for the purposes of symbol ‘B’ in section 6 (2) of the Carbon Tax Act, 2019	Notice R.692 published in Government Gazette No. 43451 with an implementation date for any tax period ending on 31 December 2019.

19 Jun 2021	Regulations on the greenhouse gas emissions intensity benchmark prescribed for the purpose of section 11 of the Carbon Tax Act, 2019	Notice R.691 published in Government Gazette No. 43451 with an implementation date of 1 June 2021.
19 Jun 2021	Regulations on the allowance in respect of trade exposure in respect of carbon tax liability under section 10 of the Carbon Tax Act	Notice R.690 published in Government Gazette No. 43451 with an implementation date of 1 June 2021.
16 Jun 2021	Customs & Excise Act, 1964: Correction Notice to Government Gazette No. 44705 Notice No R. 525 (DAR216)	Notice R.531 published in Government Gazette No.44716 with an implementation date of 16 June 2021.
14 Jun 2021	Customs & Excise Act, 1964: Amendment to rules under sections 21, 60, 119A and 120 – Insertion of Rule 21.05 relating to Special Shops for Diplomats (DAR216)	Notice R.525 published in Government Gazette No. 44705 with effect from 1 August 2021, except for rule 21.05.12 and Form DA 185.4B4 which comes into effect on the date of publication.
14 Jun 2021	Customs & Excise Act, 1964: Amendment to Notice No. R.368 of Government Gazette No. 44473, in order to change the effective date to 1 August 2021, the substitution of Notes 5 and 7 and header of rebate item 406,05 to the Schedules of the Customs and Excise Act, 1964	Notice R.523 published in Government Gazette No. 44705 with an implementation date of 1 August 2021.
14 Jun 21	Amendment to Notices Numbers R.360, 361, 362, 363, 364, 365, 366, and 367 of Government Gazette No. 44473, in order to change the effective date to 1 August 2021 to the Schedules of the Customs and Excise Act, 1964	Notice R.524 published in Government Gazette No. 44705 with an implementation date of 1 August 2021.
14 Jun 2021	Amendment to VAT Notice No. R.369 of Government Gazette No. 44473	Notice R.526 published in Government Gazette No. 44705 with an implementation date of 1 August 2021.
8 Jun 2021	Income Tax Act, 1962: Table B: A list of the monthly average exchange rates to assist a person whose year of assessment is shorter or longer than 12 months	Updated until 31 May 2021.
8 Jun 2021	Income Tax Act, 1962: Table A: A list of the average exchange rates of selected currencies for a year of assessment as from December 2003	Updated until 31 May 2021.
8 Jun 2021	Custom & Excise Act, 1964: Draft amendments to the Schedules and Correlation tables relating to the Harmonized System 2022	Comments must be submitted to SARS by Friday, 30 July 2021.
3 Jun 2021	Tax Administration Act, 2011: Draft Public Notice – Electronic form of record keeping in terms of section 30(1)(b).	Comments must be submitted to SARS by Friday, 25 June 2021.
1 Jun 2021	Unemployment Insurance Contributions Act, 2002: Determination of limit on amount of remuneration for purposes of determination of contribution in terms of section 6 of the Act	Notice 475 published in Government Gazette 44641 with an implementation date of 1 June 2021.

Case law		
In accordance with date of judgment		
18 Jun 2021	LDC Taxpayer v Commissioner for the South African Revenue Service (IT 24888) [2021] ZATC 6	Whether there was an understatement, properly classified (in the form of an omission from a return), which caused prejudice to SARS or the fiscus as provided in the definition of "understatement" in s 221 of the Tax Administration Act, No. 28 of 2011.
1 Jun 2021	CSARS v Toneleria Nacional RSA (Pty) Ltd (445/2020) [2021] ZASCA 65	Customs Duty: classification of wooden items for use in wine making to impart flavour to the wine.
10 May 2021	PFC Properties (Pty) Ltd v Commissioner for the South African Revenue Service and Others [2021] ZAGPPHC 237	The first ground of appeal is that the court erred in finding that when liquidation proceedings have commenced, business rescue proceedings begin when an affected person applies to the court for an order placing the company under supervision in terms of s 132(1)(b) of the Companies Act, No. 71 of 2008 and the second ground of appeal is that the court erred in finding that because of the pending business rescue application and despite the granting of a final winding-up order, the liquidation proceedings will be suspended.
4 Mar 2021	Commissioner for the South African Revenue Service v Louis Pasteur Investments (Pty) Ltd and Others [2021] ZAGPPHC 89	First, the applicant seeks an order in terms of section 132(2) (ii) of the Companies Act, No. 71 of 2008 for the conversion of the business rescue proceedings relating to the first respondent, Louis Pasteur Investments (Pty) Ltd ("LPI") to liquidation proceedings and for the final liquidation of LPI.
1 Mar 2021	Commissioner for the South African Revenue Service v Hamiltonn Holdings (Pty) Ltd and Others [2021] ZAGPPHC 138	On 20 September 2020. the applicant, (SARS) obtained, ex parte, from Potterill ADJP, a provisional preservation order against all six respondents, as contemplated in section 163 of the Tax administration Act, No 28 of 2011.
Rulings		
8 Jun 2021	Draft Binding General Ruling – Purchase of different types of annuities at retirement	Comments must be submitted to SARS by Friday, 30 July 2021.
3 Jun 2021	Draft Binding General Ruling – Disqualification as a qualifying company under section 12R(4)(b)	Comments must be submitted to SARS by Friday, 3 September 2021.

Guides		
18 Jun 2021	Guide on the Determination of Medical Tax Credits (Issue 12)	This guide provides general guidelines regarding the medical scheme fees tax credit and additional medical expenses tax credit for income tax purposes.
18 Jun 2021	Guide: How to complete the Registration, Amendments and Verification form (RAV01)	This guide is underpinned by the SARS strategic objectives, the SARS Intent, and the SARS values, code of conduct and applicable legislation.
11 Jun 2021	Comprehensive guide to dividends tax (Issue 4)	The purpose of this guide is to assist users in gaining a more in-depth understanding of dividends tax.
3 Jun 2021	Guide for Employers in respect of Employment Tax Incentive	These guidelines have been compiled to assist employers in understanding the fundamentals of the Employment Tax Incentive Act No. 26 of 2013 (the ETI Act) and must be read in conjunction with the Fourth Schedule to the Income Tax Act, No. 58 of 1962 (the Income Tax Act) and the Expanded Employment Tax Incentive Annexure.
3 Jun 2021	Guide to the Employer Reconciliation Process	The purpose of this document is to assist employers with their reconciliation submission to fulfil their tax responsibilities and to ensure a smooth employer reconciliation process (interim and annual), and this external guide must be read in conjunction with 'Business Requirement Specifications for PAYE Employer Reconciliation' for all validation rules published on the SARS website.
3 Jun 2021	Guide for Validation Rules Applicable to Reconciliation Declarations 2021	The purpose of this guide is to assist employers in understanding the validation rules for completion of Employees' Income Tax certificates for 2021.
3 Jun 2021	Guide for Employers in respect of Allowances	This basic guide explains the methods to be applied by the employers in respect of allowances paid or payable to employees and includes the legislation requirements as well as examples.
Other publications		
24 Jun 2021	OECD: Global Forum on Transparency and Exchange of Information for Tax Purposes: South Africa 2021 (Second Round, Phase 1)	The peer review report underlines the scope for improvement in respect of beneficial ownership information, especially in the case of partnerships and trusts.
24 Jun 2021	ATAF: The Efficient Taxation of the informal sector in Africa	This guidebook offers guidelines and tools on how to implement, evaluate and monitor an optimal, realistic and efficient taxation model for the informal sector in Africa in line with its needs and realities.
24 Jun 2021	ATAF: The proposed ICT tax system model for Africa: A guide to a more efficient acquisition, implementation, and maintenance of integrated ICT tax systems	This guidebook offers guidelines and tools on how to strategise, plan, operationalise, sustain, and evaluate the effectiveness of African tax administration ICT solutions in line with revenue authorities and client needs.

22 Jun 2021	OECD: Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy	Activities facilitated by digital platforms may not always be visible to tax authorities or self-reported by taxpayers. At the same time, the platform economy also permits increased access to information by tax administrations, as it brings activities previously carried out in the informal cash economy onto digital platforms.
18 Jun 2021	Tax Alert – Exchange Control: Recent developments	In this Alert, we explore some of the changes brought about by these Circulars.
3 Jun 2021	OECD: Public comments received on proposed changes to Commentaries in the OECD Model Tax Convention on Article 9 and on related articles	The OECD secretariat has published the public comments received on proposed changes to the commentaries on Article 9 and related articles of the OECD Model Tax Convention.