

# Synopsis

**Tax today**

March 2021



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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.

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# Insights into the 'new GAAR'

Although the general anti-avoidance rule ('GAAR') contained in sections 80A to 80L of the Income Tax Act were enacted in 2006 and came into force from 2 November 2006 there do not appear to be any reported decisions on their interpretation. In March, the High Court in Gauteng delivered judgment in a review application in which a taxpayer had challenged the actions of SARS in invoking the GAAR provisions. The judgment provides insight to the interpretation of concepts found in the GAAR provisions.



The matter of *Absa Bank Limited and United Towers (Pty) Ltd v CSARS* (Case No. 2019/21825 [P]) related to a preference share investment made by the taxpayers (the matter involved identical documents and assessments, and therefore the taxpayers are collectively referred to as 'Absa') in a South African company, PSIC 3, in the years 2014 to 2018, from which they derived dividend income. PSIC 3 and Absa were not connected persons.

PSIC 3 used the funds so invested to acquire shares in another South African company, PSIC 4, which made a capital investment in a foreign trust, DI Trust. The funds invested were used by DI Trust to acquire floating rate notes issued by MSSA, a South African subsidiary in an Australian group of companies. From here the facts outlined in the judgment are a little murky. However, it appears that DI Trust entered into arrangements whereby it swapped its interest received from MSSA for interest on Brazilian Government Bonds. The interest on the Brazilian Government Bonds was distributed by DI Trust to PSIC 4.

PSIC 4 declared dividends to PSIC 3, which distributed this income to Absa. The dividends accruing to Absa were exempt from tax.

SARS notified its intention to invoke GAAR against Absa by issuing the prescribed notice under section 80J ('the section 80J notice'). Absa requested that the section 80J notice be withdrawn as it considered that it had not engaged in an avoidance transaction, operation or scheme. SARS refused to withdraw the section 80J notice and issued assessments.

Absa took the decision not to withdraw the section 80J notice and issue the assessments on review. It was accepted that, if the section 80J notice was withdrawn, the assessments would be reversed.

## The issues

The court was called upon to consider these questions:

- Was Absa a 'party' to an impermissible 'arrangement' as contemplated by GAAR?
- Did Absa procure a 'tax benefit' as contemplated by GAAR?

## SARS' contention

By way of background, Article 11(4) of the double tax treaty between South Africa and Brazil provides that interest on government bonds issued by a contracting state are

taxable only in that state. Accordingly, South Africa does not have the right to tax the interest on the Brazilian Government Bonds. This interest is also not taxed in Brazil, with the result that the interest is not taxed in any country. The position taken by SARS was that the Brazilian Investment by DI Trust had been constructed to avoid tax. In unravelling the transactions SARS came to the conclusion that Absa was a party in the series of transactions through which it had received the benefit of a tax-exempt dividend (indirectly derived from the interest on the Brazilian Government Bonds). The proper result, it contended, was that the interest generated in the series of transactions should have been subject to tax in Absa's hands, and for these reasons it had issued a notice in terms of section 80J of the Act ('the section 80J notice') and the subsequent assessment of Absa to tax.

### Absa's contention

In acquiring the preference shares, Absa had been given to understand that the funds would be advanced to MSSA by PSIC 3 in a back-to-back arrangement to enable MSSA to repay group debt. It was unaware of the involvement of PSIC 4 and DI Trust and of the Brazilian transaction. It argued that it "could not, in a state of ignorance, have participated in an impermissible tax avoidance arrangement, nor did it have a tax avoidance motive in mind, and nor did it procure a tax benefit to which it was not entitled" (paragraph [17]).

### The judgment

The substance of the section 80J notice issued by SARS was that DI Trust had utilised the income stream from the MSSA interest to create an additional income stream from the Brazilian transactions and, using a provision of the double tax agreement between South Africa and Brazil, had created a non-taxable income stream. It asserted that every party to each of the arrangements is a "party" as defined in section 80L, which, "for the avoidance of doubt" would include Absa.

It was further contended that the purpose of the transactions should be determined by reference to the transaction objectively and not by reference to the participants subjectively.

As to whether Absa was a "party" to the arrangement, Sutherland ADJP found:

"The section requires a taxpayer to 'participate or take part'. Such conduct requires volition. A taxpayer has to be, not merely present, but participating in the arrangement. The fact that it might be the unwitting recipient of a benefit from a share of the revenue derived from an impermissible arrangement cannot constitute 'taking part' in such an arrangement. SARS elides the notion of sharing with participation ... This is incorrect." (at [39])

Turning then to whether Absa's acquisition of the preference shares was part of any arrangement, the court took issue with SARS' assertion that the series of transactions that commenced with the purchase of the preference shares in PSIC 3 constituted an "arrangement":

"The 'arrangement' contended for must encompass all the transactions described. An arrangement which is alleged to comprise several distinct transactions must therefore be a scheme. It is plain

that the scheme requires a unity to tie the several transactions into a deliberate chain. (*CIR v Louw* 1983 (3) SA 551 (A) at pp 572ff) A mere series of subsequent events does not constitute a chain." (at [40])

The purchase of preference shares would, in any event, scheme or no scheme, have delivered tax-free income to Absa. This appeared to set the Absa transaction apart from the subsequent transactions.

The final requirement is that the taxpayer must have entered into the arrangement with the intention of obtaining a tax benefit. This was not evident from the facts on which SARS relied:

"[There] is no basis to construe the factual basis as supporting an inference that the Absa investment was, in the least, motivated by an intention to obtain relief from an anticipated tax liability, a necessary attribute of an arrangement. The expectation of receiving dividend income which is free of tax is so banal a transaction that it cannot support a suspicion of pursuing (sic) an ulterior motive and thus cannot serve to broaden the compass of the participants in a scheme." (at [41])

### Was there a tax benefit?

This question was dealt with briefly and succinctly (at [42] to [43]):

"[42] Whether a tax liability was evaded is determined by the 'but for' test applied to a future anticipated tax liability. (ITC 1625 59 SATC 383; *Hicklin v CIR* 1980 (1) SA 481 (A) at 492ff.)

[43] SARS' rationale was articulated in the passages cited above. In my view, there is no plausible link demonstrated between Absa and the supposedly nefarious transactions. On the but for test the question must be posed: but for the purchase of preference shares in PSIC 3, how might an anticipated tax liability be evaded? No foundation is set out that demonstrates such a result. Thus, the conclusion is irrational."

It was therefore held that the section 80J notice should be withdrawn and the subsequent assessments set aside on the basis that Absa was not a party to an impermissible arrangement nor did it have an intention to escape a liability to tax.





## The takeaway

The judgment has provided guidance on a part of the Income Tax Act that has not been deeply interpreted since its enactment. The relevant principles are:

- A series of transactions will not constitute an “arrangement” purely because they have occurred in a chronological sequence, there must be a unity indicating a deliberate chain.
- By being a party to a single transaction, a person does not, without more, “participate or take part” in an arrangement.
- The purpose of tax avoidance must be established subjectively by reference to the taxpayer and not objectively by reference to the “arrangement”.
- The avoidance of tax must be established subjectively using the “but for” test. If a person would not have incurred a liability to tax through entering into the same transaction in other circumstances, it is difficult to assert that the person has derived a tax benefit.

It is likely that this matter may be appealed by SARS given the importance of the substantive issues. If it is taken on appeal, we will have the opportunity of obtaining binding guidance on some of the issues of interpretation. That said, the chances of SARS succeeding on appeal appear slim. The bottom line is that SARS appears to have made a strategic blunder by invoking the GAAR against the wrong taxpayer.



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# Unravelling the VAT treatment of a local branch and foreign main business



## In brief

On 19 January 2021, the High Court of South Africa (Gauteng Division, Pretoria) handed down its judgment in the matter of Wenco International Mining Systems Ltd ('First Applicant'), Wenco International Mining Systems Ltd ('Second Applicant') versus The Commissioner for the South African Revenue Service ('Respondent', 'CSARS') [59922/2019].

The matter concerned an application to set aside a VAT ruling issued by the CSARS directing that Wenco SA is not regarded as being separate from its main business (outside of SA) and not regarded as carrying on an "enterprise" in SA. The court

agreed with the CSARS finding on this matter and further held that where a local branch of a foreign entity is set up in SA solely to support the business of its foreign entity, the foreign entity is obliged to register for VAT, and not the local branch.

## Background

Wenco International Mining Systems Ltd ('Wenco Canada') is incorporated and has its principal place of business in Canada. Wenco Canada specialises in the development of software for the mining industry and supplies its clients with management systems software, maintenance, safety and machine guidance to manage mining operations.

Wenco Canada set up Wenco International Mining Systems Ltd, as a local branch in SA ('Wenco SA'). The branch is also incorporated in Canada. However, it has its principal place of business and registered address in Centurion, South Africa. Wenco SA is responsible for rendering services such as training, system support, site visits and installation to South African and other African clients of Wenco Canada. These services are rendered by Wenco SA for and on behalf of Wenco Canada. Wenco SA charges Wenco Canada a management fee for the rendering of these services.

All contracts between Wenco Canada and its clients are concluded and signed in Canada.

The dispute centres mainly on the interpretation of the definition of "enterprise" in section 1(1), read together with section 8(9) of the VAT Act.

## Law

An "enterprise" is defined to include any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration.

Proviso (ii) of the definition of "enterprise" deems a branch and its main business to be separate persons for VAT purposes if the branch or main business:

- Can be separately identified; and
- Maintains an independent system of accounting.

Where the conditions under the above proviso are met, section 8(9) states that if any vendor, in carrying on an enterprise in the Republic, provides any goods or service to or for the purposes of its branch or main business situated outside the Republic, the vendor shall be deemed to have supplied the goods and services in the course or furtherance of that "enterprise".

In the case at hand, Wenco Canada made an application to the CSARS for a VAT ruling confirming that:

- Wenco SA should register for VAT, instead of Wenco Canada, as Wenco SA carries on an "enterprise" envisaged in section 1(1) of the VAT Act; and
- Wenco SA should account for VAT at the zero rate on the services it supplies to Wenco Canada in terms of
  - section 11(2)(o), which deals with the zero rating of services supplied by a

vendor to his main business situated outside of SA; and

- section 11(2)(k), which deals with the zero rating of services physically rendered elsewhere than in SA.

On 21 February 2019, the CSARS issued a VAT ruling to the following effect:

- Wenco Canada (being a non-resident of SA) carries on an activity partly in the Republic that is continuous or regular;
- The training services rendered by Wenco Canada, while situated outside of SA, constitute a supply, as its clients are in SA;
- The services are required to be supplied to any other person for a consideration in the course of furtherance of that "enterprise" or activity. Accordingly, the second proviso to the definition of "enterprise" in section 1(1) of the VAT Act must be satisfied in order to regard the "branch enterprise" (i.e., Wenco SA) in SA as a separate person from its main business situated outside of SA;
- The provisions of section 8(9) of the VAT Act are applicable only where there is an "enterprise" and therefore supplies resulting from section 8(9) of the VAT Act cannot create an "enterprise"; and
- The second proviso to the definition of "enterprise" in section 1(1) of the VAT Act never intended to create a situation where a branch is registered or required to register in SA purely for supplies that it makes to its business permanently situated outside of SA.

In essence, the CSARS concluded that Wenco Canada must register as a VAT vendor in SA in respect of its own activities. Further, Wenco Canada, once registered for VAT, must charge VAT at 15% to its SA clients and VAT at 0% to its clients outside of SA, subject to complying with the zero-rating provisions and retention of documents.

### Grounds for review

The Applicants relied on section 8(1)(c) (ii)(aa) of the Promotion of Administrative Justice Act, 2000 ('PAJA') which provides for a court to grant an order that is just and equitable in exceptional cases to substitute, vary or correct a defect resulting from administrative action (in this case, the administrative action refers to the ruling issued by the CSARS).

The Applicants argued that –

- The content of and conclusions reached in the VAT ruling are materially influenced by error or interpretation and application of the law to the information that was provided in the application;
- The VAT ruling is not rationally connected to the purpose as envisaged in the relevant provisions of the VAT Act, the information and reasons provided to SARS; and
- If the VAT ruling is to be implemented, it would render the VAT registration of Wenco SA nugatory and it will not be able to deduct input tax on expenses incurred.

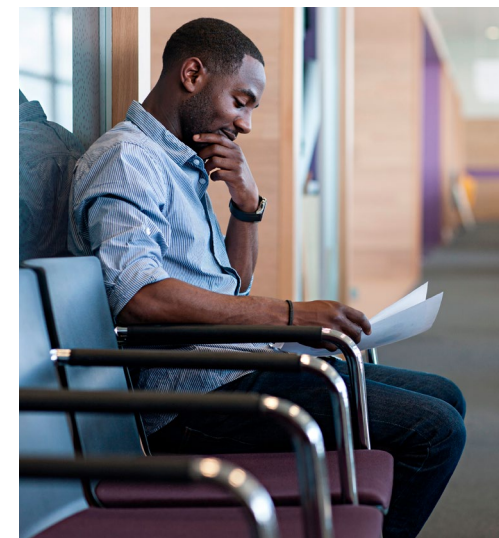
In support of its grounds for review, Wenco Canada and Wenco SA (collectively referred to as the Applicants) stated that it can be separately identified, as Wenco SA has a distinct company registration and income tax registration in SA. Further, the balance sheet and income statement of Wenco SA is evidence that they maintain an independent system of accounting.

The Applicants stated that the CSARS failed to consider the activities of Wenco SA in the context of section 1(1) and the deeming provisions of the VAT Act which separates the activities of Wenco SA and Wenco Canada for VAT purposes. The Applicants contended that in the context of the proviso to the definition of 'enterprise', the business of Wenco Canada is excluded from the definition of an "enterprise" and that the CSARS attempted to rely on the activities of Wenco SA in the VAT ruling issued, which is incorrect as Wenco SA and Wenco Canada function separately.

The Applicants submitted that the approach followed by the CSARS in the VAT ruling runs counter to the definition of "enterprise", read together with section 8(9) of the VAT Act.

### The Commissioner's case

According to the CSARS, the legal person (Wenco Canada) conducts an "enterprise" in SA in the sense that, by using locally situated resources, it continuously and regularly carries on activities in the course or furtherance of which it provides software and training services to clients in and outside of SA, in exchange for consideration.



The primary question was whether Wenco SA can be regarded as conducting an enterprise, separately from Wenco Canada. The CSARS was convinced that this was not the case, as it was in fact Wenco Canada conducting an enterprise in SA and this enterprise cannot be separately attributed to the local branch.

In support of its contentions, the CSARS reviewed the Service Level Agreement (SLA) between the Applicants and contended that Wenco SA only "serves" Wenco Canada in SA and it is no more than an extension of the Wenco Canada (i.e., a single legal entity). Accordingly, Wenco SA cannot be separately registered as conducting an "enterprise" separate or different from that of Wenco Canada. Based on this finding, the CSARS stated that Wenco Canada must register as a VAT vendor in SA.



## The court's discussion and findings

Judge D S Fourie found it important to understand the Applicants' structure, and in doing so relied on the case of *CSARS v Respublica (Pty) Ltd* [2018] ZASCA 109 at par [12] which referenced the general principle (as recognised in other VAT jurisdictions):

"that the VAT consequences of supply must be assessed by reference, first and foremost, to the contractual arrangements under which the supply is made".

The court interrogated the contractual arrangements between the Applicants as contained in the SLA, which stated that Wenco Canada appointed Wenco SA as the "service provider" to "solely and exclusively" ... "provide the services".

The services were defined in the SLA as "services provided by the Service Provider to Wenco for the operation of Wenco's business". The judge took into account the aforesaid contractual arrangements under

which the supply was made and found that it did not appear that Wenco SA (as the service provider) provided services to South African and other African clients of the foreign company. Instead it provided services solely to Wenco Canada.

The court also looked at the geographical arrangement between the Applicants and stated that the rendering of services by Wenco SA may constitute a physical act of doing so in SA, but viewed from a legal viewpoint it seemed that the position of Wenco SA was merely that of an agent acting on behalf of the Wenco Canada "*for the operation of Wenco's (first applicant) business*" in SA.

### Analysis of the VAT ruling

The court found it necessary to understand the context within which the VAT ruling was obtained and asked the question as to whether it was the idea that only one of the Applicants should register for VAT, and

if so, with regard to which enterprise was a ruling sought? The court found that, in relation to a previous ruling sought on 7 April 2017, what the Applicants had in mind was to:

- Remove Wenco Canada from the VAT arena; and
- Register Wenco SA, who would then zero rate its supply of services to the foreign company.

The above result would be that neither Wenco Canada nor Wenco SA would be liable for the payment of any VAT on the supply of services to the mining industry in SA. The judge was not convinced that this approach can be justified in terms of the relevant provisions of the VAT Act.

Both parties accept that the interpretation of statutes is a unitary exercise to be conducted in accordance with the approach as set out in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 at para [18], where it was explained that the process entails attributing meaning to the relevant statutory provision, in the light of the language used, the context in which the provision is set, including the material known to the drafters, and the purpose which the provision is intended to serve. In addition, an interpretation that is sensible and businesslike is to be preferred over one that leads to insensible consequences or those that appear to frustrate the statutory objective.

The court found it difficult to conclude that Wenco SA was carrying on an enterprise, since it only rendered services to Wenco

Canada in exchange for consideration. On the basis that Wenco Canada had a sole and direct contractual relationship with clients and in accordance with the SLA, the court stated that the only activity being conducted by Wenco SA was to Wenco Canada for the operation of the foreign company's business. Wenco SA did not make supplies to end-clients and did not render services "to any other person" as required by the definition of "enterprise". The court found that Wenco SA was therefore not regarded as conducting an "enterprise" in SA.

Lastly, taking into account the wording "*in the Republic or partly in the Republic*" in the definition of "enterprise", the judge stated that one cannot contend that the second proviso to the definition contemplates a situation where a branch is registered in SA purely for supplies that it makes to its business permanently situated outside of SA.

The court agreed with the CSARS that section 8(9) presupposes the existence of an "enterprise" and was therefore not applicable in the case at hand, since Wenco SA is not regarded as conducting an "enterprise" in SA.

Based on the above, the court held that there was no basis to set aside the VAT ruling issued by the CSARS and found that there was no basis to further consider the applicability of the zero-rating provisions under section 11.

The application was dismissed with costs.



## PwC commentary and takeaway

The judgment has certainly come as a surprise, since it was the past practice of the CSARS to allow for similar business structures to be arranged in such a manner to that of the Applicants. The impact of the judgment has significant VAT implications for entities that have adopted structures similar to that of the Applicants who will now have to consider their VAT obligations going forward.

The court raised concerns that neither Wenco Canada nor Wenco SA will charge VAT to SA customers and saw this as being contrary to the objective of the VAT Act and an ultimate objective by the Applicants not to levy SA VAT. However, this is not an unusual outcome and is definitely within the confines of the VAT Act when one considers the scope of section 11(2)(l) of the VAT Act.

Further to the above, if SA had a full reverse charge mechanism, the SA mining clients would be required to account for VAT on services acquired from Wenco Canada and also entitled to a corresponding input tax deduction. However, the SA VAT Act is practical in nature and implemented a watered-down reverse charge rule in SA – i.e., VAT is payable only on imported services to the extent that these services are used for non-taxable purposes. Imported services used wholly for taxable purposes will not trigger a VAT liability for SA mining clients.

The court ruled that Wenco Canada being the entity that is conducting an enterprise in SA does not alter the VAT position of

the Applicants, as VAT neutrality will still be maintained; that is, Wenco Canada is obliged to charge VAT at 15% to its SA clients who are in any case registered VAT vendors in SA and entitled to deduct the VAT charged by Wenco Canada.

There are two major concerns with the judgment, namely:

- The judgment appears to give preferential treatment to an insourced versus an outsourced model. For example, if Wenco Canada appointed a SA subsidiary or third-party SA service provider, the supply by the SA subsidiary or third-party SA service provider to Wenco Canada would reasonably qualify to be zero-rated under section 11(2)(l). Further to this, the supply by Wenco Canada to mining clients in SA would not be subject to SA VAT unless in respect of goods that were required to be imported into SA.
- This judgment raises a further complication regarding which portion of the fee charge by Wenco Canada to its SA Clients must be subject to SA VAT. In our experience, it is common for non-resident entities to contract with clients on a single price basis, and this may comprise the supply of multiple goods and/or services. In some instances no specific fee is allocated to each element and the non-resident entity will therefore be required to split the price between the various elements to determine the price attributable to the goods and separately to any services element which may be subject to SA VAT (i.e., on the basis that it performed as part

of the taxpayer's SA 'enterprise'). The splitting of the fees will soon be an area of contention, as SARS will likely seek to recover VAT on a market-related service element even though the contract price may not be based on a market-related price.

The impact of the judgment will also encourage offshore businesses to adopt different structures and models to conduct business in SA.

Finally, what is important to note is that the courts have again emphasised the importance of the contractual arrangements between the parties. It is therefore imperative that offshore businesses that wish to conduct business in SA ensure that the agreement between the parties is clear and represents the true intention, responsibilities and obligations of the parties.



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# Recent case law on the withholding of value-added tax refunds by SARS



A recent case which demonstrates the contentious nature of section 190 of the Tax Administration Act, 2011 ('**TAA**') is that of *Rappa Resources (Pty) Ltd v Commissioner for SARS 20/18875*, which was heard in the Johannesburg division of the Gauteng High Court. As an exporter of gold bearing bars and other precious metals, Rappa Resources (Pty) Ltd ('**Rappa**') pays value-added tax ('**VAT**') on its purchases, while its exports are zero-rated for VAT purposes. Therefore, Rappa claims VAT refunds for the VAT paid to suppliers, and the timeous payment of such refunds are essential for its commercial survival.

SARS notified Rappa that it was being audited and stopped the payment of the Rappa's VAT refunds while the audit was in progress. SARS asserted that the basis of the audit was that there was reason to believe that Rappa was either directly or indirectly involved in unlawful activities, including the possible disposal of illegally mined gold or smelted down Krugerrands. As a result, VAT refunds amounting to R1.6bn had been withheld by SARS from Rappa since February 2020. Due to Rappa's contention that it would not be able to operate its business without the refunds, it approached the court for relief on an urgent basis. To add fuel to the fire, Rappa's bank had also terminated its overdraft facility on which it had been reliant. This was based on a combination of the withholding of the VAT refunds by SARS and a period of five weeks during March and April 2020 when it was unable to operate due to the hard lockdown imposed as a result of the Covid-19 pandemic.

At paragraph 33, the court commented that:

"While the prejudice to Rappa in the withholding of the refunds (and future refunds while the audit is proceeding) is astronomical, the prejudice to the fiscus if the audit or inquiry discloses that Rappa is in fact colluding with others in the supply chain is also astronomical. The TAA seems to seek to balance the interests of the taxpayer and the fiscus

by allowing SARS to retain the refunds pending the outcome of the audit. If this is not done the taxpayer who claims refunds based on the self-assessment system that is used would always have an advantage and SARS would be able to do nothing until it has clear evidence that there is something untoward at play."

The court then turned to section 190 of the TAA which deals with refunds of excess payments and states, most relevantly, that:

- "(1) SARS must pay a refund if a person is entitled to a refund, including interest thereon under section 188 (3) (a), of—
- (a) an amount properly refundable under a tax Act and if so reflected in an assessment....
- (2) SARS need not authorise a refund as referred to in subsection (1) until such time that a verification, inspection, audit or criminal investigation of the refund in accordance with Chapter 5 has been finalised.
- (3) SARS must authorise the payment of a refund before the finalisation of the verification, inspection, audit or criminal investigation if security in a form acceptable to a senior SARS official is provided by the taxpayer."

Section 190(1) of the TAA requires SARS to pay a refund if a taxpayer is entitled to it. However, section 190(2) provides that if the taxpayer is under audit, SARS need not pay a refund until such time as the audit is finalised. Section 190(3) goes on to state that SARS must pay the refund – even if the taxpayer is under audit – provided that the taxpayer provides acceptable security to a senior SARS official. This palisade of caveats has clearly been designed in light of the reality that the payment of a refund is effectively final in nature and not an interim decision, as without security, SARS has no guarantee that the funds will be preserved following finalisation of the audit.

In considering the facts at hand, the court found that Rappa had not demonstrated a clear right to the relief sought. However, SARS' refusal to accept security for anything less than the full amount of the refunds was found to be unreasonable. In this regard, the court held that Rappa was immediately entitled to a refund for as much as it has been able to provide acceptable security. In addition, SARS was not permitted to withhold refunds in respect of any periods which were not under audit.

Interestingly, at paragraph 51, the court said that:

"Taking the scheme of the TAA as a whole, where SARS has withheld a refund, particularly where the refund is as integral to the business model of the taxpayer as in this matter, it cannot be allowed to take an indefinite time to complete an audit. This would mean that the TAA is inherently unfair towards the taxpayer. The audit has to be completed in a reasonable time, taking into account the circumstances."

The court rejected both SARS' contention that it required six months to complete the audit (since SARS could not provide an explanation of why it needed six months), as well as the taxpayer's request for a *mandamus* that SARS complete the audit within a period of just 15 days (as the court acknowledged that SARS must be afforded sufficient time to carry out the audit).

Instead, the court permitted SARS a period of four months from the date on which it received the requested information to finalise its audit. This was just over a month from the date of handing down judgment.

### Key takeaways:

- Many tax-compliant taxpayers rely on refunds from SARS for business continuity purposes. The withholding of refunds by SARS can directly affect the taxpayer's liquidity. In some cases, in order to obtain the timeous release of a refund from SARS, the taxpayer may have no other option but to provide SARS with acceptable security.
- The purpose of the provision requiring payment of the refund on the provision of acceptable security is to preserve the funds until it is clear who is entitled to them (i.e., SARS or the taxpayer).
- On the basis of this judgment, the positive news is that a partial provision of security should be sufficient to secure a partial release of the refund.
- SARS is not entitled to conduct audits in a manner and at a pace that is entirely at SARS' discretion. Rather, SARS is obliged to adopt an approach which gives due consideration of fairness to the taxpayer. In the absence thereof, taxpayers do have grounds to seek a *mandamus* order from the court compelling SARS to finalise its audit within a period of time that is reasonable and fair to the taxpayer.



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# Taxpayers' right to interest on delayed VAT refunds: Does SARS' current practice constitute non-compliance with its legal obligation?

The Value-Added Tax Act, 89 of 1991 ('VAT Act') places an obligation on SARS to pay interest on a delayed VAT refund, being where SARS fails to pay a VAT refund to a vendor within 21 business days from submission of its VAT201 return (subject to certain exceptions).



It is generally accepted that the principle behind the payment of interest is that it constitutes consideration for the use of money. In accordance with this principle, where SARS withholds an amount of money due to a vendor, SARS would be required to pay interest on such amount, as it has use of the vendor's money.

## Suspension of interest-free days

There are certain exceptions where SARS' obligation to pay interest is suspended and the 21 business days from when interest must be paid will only run once remedied – that is, the 21-day interest-free period is extended. This includes the following:

- where the refund return is incomplete or defective in any material respect;
- where the vendor is in default in respect of any of his obligations under the VAT Act or any other Act administered by the Commissioner, to furnish a return as required by such Act;
- where the Commissioner is prevented from satisfying himself as to the amount refundable due to being unable to gain access to the books and records of the vendor concerned after having requested access to such records;

- where the vendor has not furnished the Commissioner with the particulars of its bank account.

In our experience SARS' interpretation of the aforementioned circumstances allowing it to suspend the requirement to pay interest is, naturally, extremely wide. Limited guidance is available on the correct interpretation of these provisions, and in many instances uncertainty exists when determining whether interest is due in the circumstances. Furthermore, SARS' decision not to pay interest based on its wide interpretation of the relevant legal provisions is not subject to objection or appeal, leaving vendors with limited (and costly) remedies.

In addition, we have seen various instances where SARS automatically requires a vendor to validate its banking details again when a refund is due to it, thereby automatically suspending SARS' liability to pay interest in the circumstances.

## SARS system

Since the VAT Act explicitly places an obligation on SARS to pay interest on a delayed VAT refund, a reasonable expectation is that SARS' internal processes and systems would be aligned

to automatically calculate and pay interest in the appropriate circumstances. Sadly, in our experience, this is not the case. Similar to the above, the VAT Act makes provision for SARS to levy interest where a vendor is late in making the payment of its VAT liability. Contrastingly, SARS' system is aligned to this obligation and the system will immediately and automatically levy and calculate interest on the late payment by a vendor.

## SARS practice

Despite this legal obligation on SARS to pay interest on delayed VAT refunds, in practice we hardly ever see that SARS automatically pays the interest due to vendors. It is only when the vendor submits a formal request for interest to SARS that SARS will consider the request and pay such interest to the vendor. This however is done only when SARS agrees with such a request, and in many instances, we have seen SARS request the vendor to provide SARS with additional information, including instances where it has requested a calculation of the interest due to it.

It is interesting to note that there is no provision in the VAT Act nor the Tax Administration Act, 28 of 2011 ('TAA'), that explicitly makes provision for a



vendor to submit a request to SARS to pay interest on a delayed VAT refund. This is understandable, as SARS is required to automatically pay the interest on the delayed VAT refund, and, accordingly, there is no prescribed timeframe that determines when such a request must be made to SARS following payment of a delayed VAT refund.

Despite the above, the value of interest that is due to the taxpayer is in many instances too low to justify the cost and effort by the taxpayer to request the interest or to challenge SARS' decision not to pay the interest.

### Interest on overpayments

The current provisions of the VAT Act also do not make provision for interest to be paid where a taxpayer overpaid an amount to SARS. While provision is made for interest to be payable to a taxpayer in respect of erroneous overpayments to SARS in certain circumstances in terms of the TAA, these provisions are not yet effective. It follows that, currently, taxpayers are unable to receive interest on amounts erroneously paid to SARS.

The contrary applies where SARS makes an overpayment to the vendor, however, as SARS will deem such overpayment a tax debt due to it and automatically levy interest on the amount overpaid to the vendor from the date of overpayment until the amount is recovered from the vendor.

### Pay now argue later

It is also worth noting that, in accordance with the principle commonly known as the 'pay now argue later rule', when a taxpayer is not in agreement with an assessment raised by SARS and disputes such assessment by submitting an objection and/or appeal, that taxpayer is required to make payment of any outstanding tax, penalties and interest pending the outcome of the dispute (i.e., SARS will be in possession of these amounts while the dispute is pending). If the dispute is successful, and SARS subsequently reverses the assessment, penalties and interest (where applicable), SARS is required in terms of the TAA to refund the amount paid by the taxpayer as well as interest on such amount calculated from the date payment was made by the taxpayer until the date that SARS refunds the amount. The previously mentioned provisions allowing SARS to suspend its liability to pay interest as discussed above do not apply to interest payable on an amount paid to SARS pending the outcome of a dispute.

Once again, it would be expected that SARS' system would automatically calculate the interest due to the taxpayer and refund the amount paid with interest to the taxpayer following the successful dispute, as this is a legislative obligation on SARS. Unsurprisingly, this is not the

case and SARS will pay interest due only when the taxpayer explicitly requests for interest to be paid. Given the length of time that SARS takes to process objections and appeals (and which is largely outside the timeframes allowed for this in terms of the rules), such interest amounts due to taxpayers are likely to be significant and may be worth pursuing.

### Conclusion

With that being said, the question remains: *Does SARS' failure to automatically pay interest in the above circumstances constitute non-compliance with its legal obligations?* If so, SARS needs to fix this, and a very welcome action will be SARS automatically correcting this non-compliance retrospectively and prospectively and refunding all taxpayers affected, as this is the right thing to do.

Taxpayers are legally entitled to receive this interest and it is not fair or reasonable for taxpayers to have to incur additional time, costs and effort to obtain this interest which is due.



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# SARS Watch

SARS Watch 1 March 2021 – 31 March 2021

Legislation		
26 March 2021	Customs and Excise Act, 1964: Draft rule amendments under sections 59A, 60 and 120 – Registration and Licensing.	Comments must be submitted to SARS by Friday, 9 April 2021.
24 March 2021	Customs and Excise Act, 1964: Draft rule amendments under sections 76 and 120 – Deletion of rule 76.02	Comments must be submitted to SARS by Wednesday, 7 Apr 2021.
19 March 2021	Customs and Excise Act, 1964: Draft rule amendments under sections 64E and 120 – Accreditation	Comments must be submitted to SARS by Friday, 9 April 2021.
17 March 2021	Customs and Excise Act, 1964: Draft Excise forms: DA 260 Tobacco products (SOS) & (VM)	Comments are due to SARS by Wednesday, 31 March 2021.
10 March 2021	Customs and Excise Act, 1964: Amendment to Part 1 of Schedule No. 1, by the substitution of tariff subheadings 1001.91 and 1001.99 as well as 1101.00.10, 1101.00.20, 1101.00.30 and 1101.00.90, to reduce the rate of customs duty on wheat and wheaten flour from 10,27c/kg and 15,41c/kg to Free respectively, in terms of the existing variable tariff formula – Minute 11/2020	Tariff amendment notice R190 published in Government Gazette 44251 with an implementation date of 10 March 2021.
5 March 2021	Income Tax Act, 1962: Fixing of rate per kilometre in respect of motor vehicles – section 8(1)(b)(ii) and (iii)	Notice 174 published in Government Gazette No. 44229 with an implementation date of 1 March 2021.
5 March 2021	Customs and Excise Act, 1964: Amendment to Part 1 of Schedule No. 1, by the substitution of tariff subheadings 1701.12, 1701.13, 1701.14, 1701.91, and 1701.99, to reduce the rate of customs duty on sugar from 527,75c/kg to 414,85c/kg in terms of the existing variable tariff formula – Minute M09/2020	Notice R181 published in Government Gazette No.44230 with an implementation date of 5 March 2021.
3 March 2021	Customs and Excise Act, 1964: Amendment to Schedule No. 1, to implement the revised Tariff Rate Quota in terms of the Economic Partnership Agreement (EPA)	Tariff amendment notice R166 published in Government Gazette No. 44220 with retrospective effect from 1 January 2021.
1 March 2021	Income Tax Act, 1962: Determination of the daily amount in respect of meals and incidental costs for purposes of section 8(1)	Notice 173 published in Government Gazette No. 44229 with an implementation date of 1 March 2021.
1 March 2021	Legislative Amendments to Retirement Funds	A summary of several amendments to retirement funds that were promulgated and became effective on 1 March 2021.

**Case law***In accordance with date of judgment*

26 March 2021	Massmart Holdings Limited v CSARS (84/2020) [2021] ZASCA 27	Taxpayer implementing a share incentive scheme for its key management personnel, scheme conducted through a trust. Whether taxpayer suffering capital losses for CGT purposes by virtue of its dealings with, and in relation to, the trust.
18 March 2021	Samsung Electronics SA (Pty) Ltd v CSARS (2018/68900) [2021] ZAGPPHC 130	Whether the product should be classified under tariff heading (TH) 8517.62.90 as contended by the applicant or under TH 8517.12.90.
18 March 2021	SARSTC IT 24918 (IT) [2021] (Johannesburg)	Whether the appellant was liable for capital gains tax under section 25B of the Income Tax Act.
11 March 2021	ABSA Bank Limited and another v CSARS (2019/21825 [P]) [2021] ZAGPPHC	Whether a taxpayer can approach the High Court under section 105 of the Tax Administration Act to review decisions of SARS, thereby bypassing the dispute resolution provisions in the Tax Administration Act.
22 January 2021	Nyhonyha and Others v Venter N.O and Others (35508/20) [2021] ZAGPJHC 20	Whether Regiments Capital was solvent and should be taken out of final winding up. SARS as a potential creditor opposed the relief sought on the basis that it was still auditing the company.
19 January 2021	Wenco International Mining Systems Ltd and Another v CSARS (59922/2019) [2021] ZAGPPHC 70	Value-added tax, sections 1(1), and section 11(2)(k) and (o), whether VAT Ruling issued by Commissioner for the SARS to first applicant should be declared unlawful and set aside, whether respondent should be directed to issue a VAT Ruling allowing second applicant to register for VAT as envisaged in the definition of 'enterprise' in section 1(1), and whether second applicant should be directed to, upon registration, account for VAT at the zero rate on services supplied to the first applicant under section 11(2)(o) and (k).

**Interpretation notes**

30 March 2021	Interpretation Note 14 – Allowances, advances and reimbursements	This Note provides clarity on the tax treatment of allowances, advances and reimbursements granted to employees and office holders, and gives guidance on the record-keeping requirements relating to motor vehicles.
23 March 2021	Draft interpretation note: deduction of medical lump sum payments	Comments must be submitted to SARS by Friday, 28 May 21.
3 March 2021	IN 113 Apportionment of surplus and minimum benefit requirements: Pension Funds Second Amendment Act	This Note provides clarity on the tax treatment of the actuarial surplus allocations or distributions made to members, former members, existing pensioners and employers by funds under the provisions of sections 15B, 15C, 15D or 15E of the Pension Funds Act.
2 March 2021	IN 114 – Interaction between section 25B(1) and section 7(8) in case of conflict, inconsistency or incompatibility	This Note provides clarity on only the interpretation and application of the words 'subject to the provisions of section 7' in section 25B(1) and, more specifically, whether section 7(8) or section 25B(1) applies if there is a conflict, inconsistency or incompatibility between the sections.
1 March 2021	Draft interpretation note: deductions in respect of improvements to land or buildings not owned by a taxpayer	Comments must be submitted to SARS by Friday, 30 April 2021.



**Rulings**

19 March 2021	BPR 361 – Asset-for-share transaction followed by an unbundling transaction, the issue of capitalisation redeemable preference shares and the sale of shares to a third party	This ruling determines the tax consequences of an internal restructuring involving corporate rules.
17 March 2021	BPR 360 – Internal restructure followed by a disposal of shares to a BBBEE investor	This ruling determines the tax consequences of an internal restructure aimed at consolidating the operating entities involved in a particular type of business (the target business) under a single intermediate holding company (company G) (the internal restructuring), as well as the sale of a 25% interest in company G by the ultimate holding company (the applicant) to a third-party B-BBEE investor (the investor) (the BEE transaction).
16 March 2021	BPR 359 Transfer of reinsurance business from a resident company to a local branch of a foreign company.	This ruling determines the tax consequences, for a resident company that conducted reinsurance business, of the transfer of its business as a going concern to a local branch of the foreign holding company of the applicant.
15 March 2021	BPR 358 Amalgamation of short- and long-term insurers	This ruling determines the tax consequences of an amalgamation of life and non-life reinsurers.
15 March 2021	BPR 357 – Donations to a foreign trust of property situated outside the Republic	This ruling determines the tax consequences of the donation by resident natural persons to a foreign trust of property situated outside the Republic originally acquired by donation from a foreign person.

**Guides and forms**

30 March 2021	Transfer Duty Guide (Issue 5)	This document contains a discussion of the application of the Transfer Duty Act 40 of 1949, in respect of transactions involving immovable property such as land, buildings and other real rights in connection with immovable property situated in South Africa.
26 March 2021	How to complete and submit your country-by-country information	The guide is updated to include the OECD CBC XML schema version 2.
2 March 2021	Clearance declaration	When goods in a customs warehouse are sold, the current Customs Procedure Codes (CPCs) provide for a change of ownership customs clearance declaration (CCD). Change of ownership information has been added to the policy to define obligations.
2 March 2021	How to complete the Income Tax Return ITR14 for Companies	The Corporate Income Tax guide has been updated to provide taxpayers with more clarity regarding the Contributed Tax Capital section to capture only the movement for the current year or the aggregation of all movement since 1 January 2011.

**Other publications**

30 March 2021	Tax Alert: VAT treatment of foreign entities with branches in South Africa	This alert discusses the Wenco judgment, where the High Court held that, where a local branch of a foreign entity is set up in South Africa solely to support the business of its foreign entity, the foreign entity (and not the local branch) is required to register for VAT.
25 March 2021	OECD: 30 country profiles applying arbitration under the multilateral BEPS Convention	The arbitration profiles have been developed to provide taxpayers with additional information on the application of Part VI of the MLI for each jurisdiction choosing to apply that Part.



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