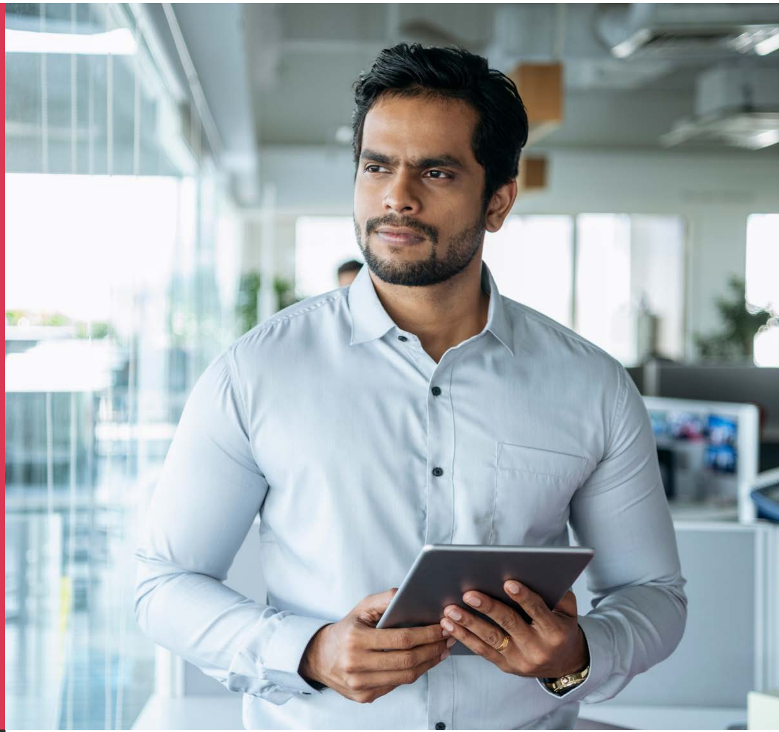
Synopsis

Tax today

March 2022



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

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

Editor: Al-Marie Chaffey

SARS Watch: Linda Mathatho

The revenue (as opposed to capital) nature of ‘other finance’ charges – a plausible argument

Introduction

Oftentimes, when taxpayers secure funding for capital projects, such funding attracts interest as well as other finance charges (e.g. raising fees, front-end fees, upfront fees, guarantee fees and commitment fees).

The circumstances under which interest and other finance charges may be deducted in the determination of taxable income is legislated in the Income Tax Act, 58 of 1952 (‘the Act’), specifically sections 11(*a*) and 24J, both of which must be read with section 23(*g*).

While sections 11(*a*) and 24J of the Act are generally similar in terms of the requirements which must be satisfied before an amount may be deducted, the sections differ on the capital versus revenue nature of the amount in question. Section 11(*a*) permits a deduction provided such amount is ‘not of a capital nature’ (i.e. it must be revenue in nature). Section 24J, on the other hand, does not require the amount in question to be revenue in nature.

Broadly speaking, section 24J deals with the deductibility of interest while section 11(*a*) deals with the deductibility of ‘other finance charges’. When the funding for which the other finance charges are incurred is utilised for capital projects (i.e. the income earning structure or fixed capital), the ‘not of capital nature’ requirement under section 11(*a*) presents a hurdle. A taxpayer may, depending on the facts and circumstances, overcome this hurdle through the application of section 24J, the mechanics of which may sometimes allow for a deduction of other finance charges.

This article focuses on the instance where ‘other finance charges’ may be treated as deductible in terms of section 11(*a*) even where the underlying funding was used for capital projects.

Detailed analysis

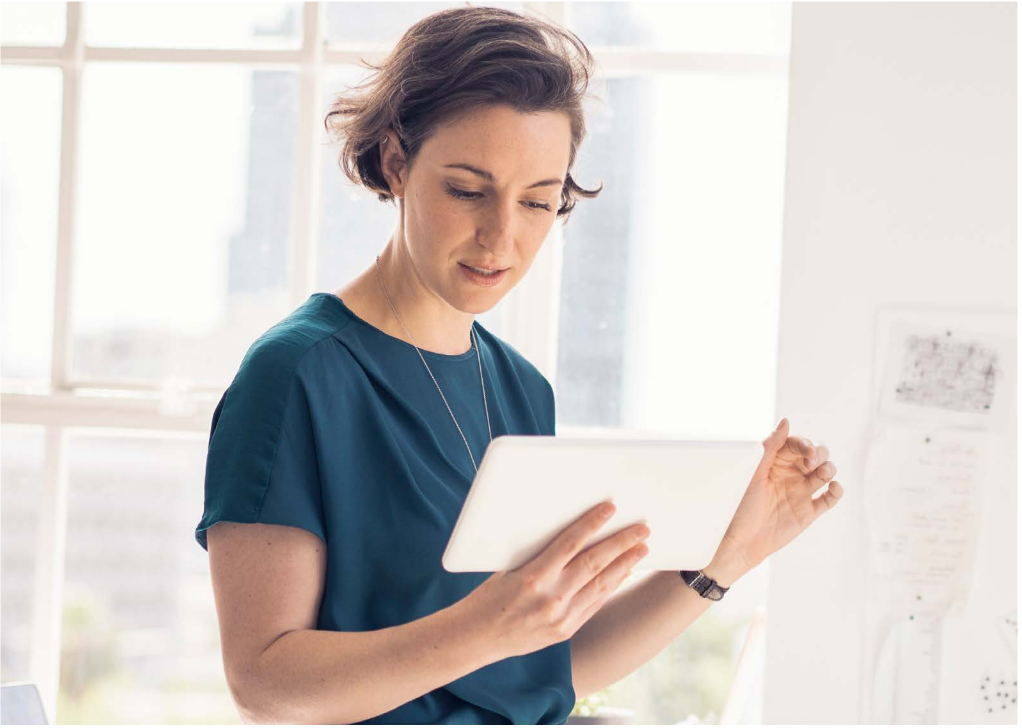
Section 11(*a*) read with section 23(*g*) is commonly referred to as the general deduction formula. It is well-known and as a result, does not warrant repetition. It contains specific requirements with which any particular expenditure can be eligible for a deduction. For the purposes of this article, we focus solely on the requirement that the expenditure ‘must not be of a capital nature’ in order for it to be deductible.

We will firstly apply this formula to interest to determine whether the ‘not of capital nature’ presents a hurdle when the expenditure in question is interest, and thereafter consider its application in the context of other finance charges, i.e., can a plausible argument be made for other finance charges to be deemed revenue in nature for purposes of claiming a deduction under section 11(*a*)?

Section 24J was not always a charging provision. Prior to the amendment in 2004, interest expenditure incurred fell to be deducted under section 11(*a*), with section 24J merely guiding the timing of the deduction.

Presently, section 24J is a charging provision, however it is not always applicable to the deductibility of interest because of the carve-out provision contained in section 24J(12). Distilled to its effect, section 24J(12) precludes the deductibility of any interest in terms of section 24J with regard to an instrument that is repayable on demand unless it provides for the payment of deferred interest. Where this is the case, the interest incurred in terms of such instrument falls to be deducted under section 11(*a*).

This is relevant for this article as the deductibility of interest prior to section 24J becoming a charging provision, as well as deductibility of interest under section 11(*a*) where section 24J(12) is applicable will shed light on how other finance charges may be considered in this context. In effect, the answer to the question ‘can interest expenditure be of capital nature?’ is relevant in this regard.



The 'in the production of income' test

Before addressing this question, we briefly explain the 'in the production of income' requirement. The requirement is set out under both section 11(a) and section 24J of the Act, and requires that the expenditure be incurred in the production of income before a deduction can be taken. While the phrase 'in the production of income' is not defined in the Act, there is a plethora of South African case law[1] dealing with this requirement and the golden thread is that, in the context of interest deduction, one needs to look at the purpose[2] for which the money was borrowed to ascertain whether the interest expenditure is in the production of income.

This begs the question whether in the context of the 'not of a capital nature' requirement, the purpose of the loan needs to be considered.

1 CIR v Allied Building Society 25 SATC 343; CIR v Standard Bank of South Africa Limited 47 SATC 179.
2 Even though in certain instances the ultimate use of the money may have to be considered.

Can interest expenditure be of a capital nature?

Turning to the question 'can interest expenditure be of a capital nature?', what is the test to be applied? Does one need to look at the purpose for which the money was borrowed in ascertaining the capital versus revenue nature of interest?

The term 'capital' is neither defined for the purposes of section 11(*a*) of the Act, nor is there a definitive test for determining whether expenditure is revenue or capital in nature. Accordingly, guidance as to what constitutes capital expenditure may be sought in case law, where various tests have been laid down by the courts in order to distinguish between the two. In *New State Areas Ltd v CIR*[3], Watermeyer CJ, after citing a number of South African and English cases, stated at 170 that:

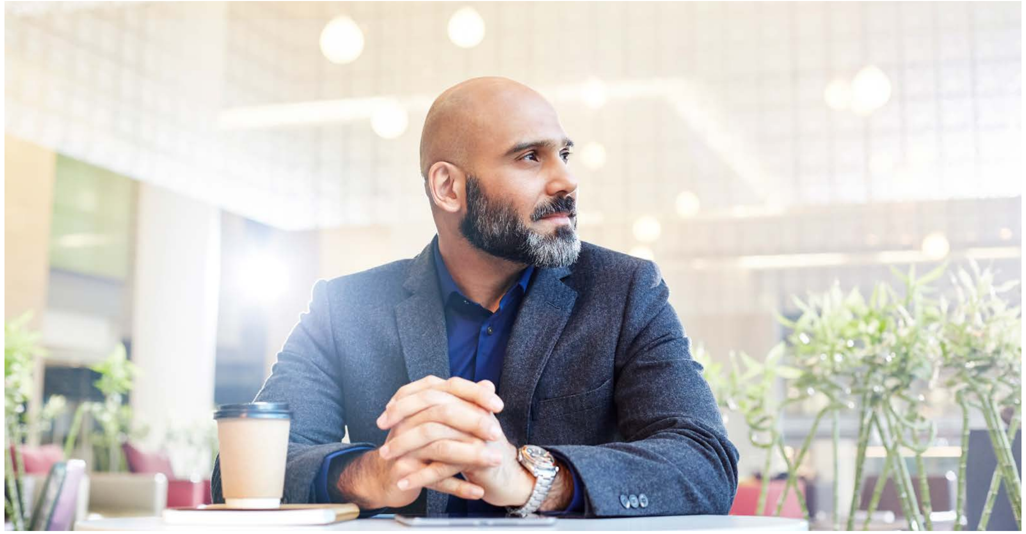
'The conclusion to be drawn from all of these cases seems to be that the true nature of each transaction must be inquired into in order to determine whether the expenditure attached to it is capital or revenue expenditure. **Its true nature is a matter of fact and the purpose of the expenditure is an important factor; if it is incurred for the purpose of acquiring a capital asset for the business it is capital expenditure even if it is paid in annual instalments; it is in truth no more than part of the cost incidental to the performance of the income producing operations, as distinguished from the equipment of the income producing machine, then it is a revenue expenditure even if it is paid in a lump sum'** [own emphasis]

In the context of interest incurred, what purpose is referred to in this regard? Does Watermeyer CJ refer to the purpose of the loan or the purpose of the interest itself? Does the interest have a purpose distinct from the purpose of the loan? Interest is generally the compensation for an amount owed to a creditor for allowing the debtor the use of the creditor's money[4] — isn't this the sole purpose of interest? How then does the incurral of interest result in the creation, preservation or acquisition of a capital asset? Surely the answer to this is that it cannot.

In ITC 1126[5], the appellant sought to deduct interest incurred on loan to purchase shares in a company on the basis that his income as a result of the acquired shares had increased. The court held that the interest was of capital nature as the underlying loan had been used to acquire a profit-making concern and not merely to earn a salary.

The court used the purpose of the loan — being the acquisition of a capital asset — to conclude that the interest is of a capital nature. With respect, did the court not err in reaching this conclusion?

3 14 SATC 155.
4 CIR v Genn & Co (Pty) Ltd [1955] 3 All SA 382 (A).
5 [1968] 31 SATC 111(T).



An opposing view was taken in ITC 1604[6]. The taxpayer entered into a series of agreements which enabled him to purchase a 49 percent stake in a close corporation where he was also to be employed as a managing director. The taxpayer acquired the stake partly with cash and partly with an interest-bearing loan. It was held that the interest incurred is of a revenue nature as the acquisition of the stake in the close corporation was closely connected to earning income by way of an increased salary and substantial bonus. Importantly, it was noted that the loan liability incurred in acquiring the stake in the close corporation was of a capital nature, but the interest incurred did not improve, augment or preserve the value of the corporation or the stake acquired, nor did it add to the costs of acquiring or enhancing the value of the stake acquired.

The court in this instance seems to have severed the purpose for which the money was borrowed in performing the assessment of the capital versus revenue nature of underlying interest incurred. In effect, even though the purpose of the loan was to acquire a capital asset, the interest was still held to be of revenue nature.

In *CIR v Genn & Co (Pty) Ltd*[7], Schreiner, J.A noted the following:

'There might of course be the further question whether or not, because of its association with the fixed capital into which the loan is turned, interest on such a loan may not properly be said to be expenditure of a capital nature.' [own emphasis]

6 [1995] 58 SATC 263.
7 [1955] 3 All SA 382 (A).

In *Genn*[8] the court seems to have suggested tacitly that interest can be of a capital nature. However, in ITC 1124[9], Trollip J (as President of the Transvaal Income Tax Special Court) relying on the *Genn*[10] case held the following, which was approved[11] by E M Grosskopf JA in *Burgess v CIR*[12]:

'Undoubtedly the loan liability incurred by the appellant company for acquiring and retaining the shareholdings in the said two private companies was of a capital nature, for it enabled the appellant company to acquire capital assets in the form of the shares and the possible enduring advantage of a constant supply of timber to the saw-milling company. **But it does not necessarily follow that the interest paid on the loan must also be of a capital nature** … in the present case, the interest paid was the recurrent or periodical charge or 'rental' payable for the continued use by the appellant company of the money lent to it. **Such interest was not intended or calculated to, nor did it in fact improve, augment or preserve those aforementioned capital assets, or form part of or add to the cost of acquiring them or enhance their value**. Consequently, we do not think that in the circumstances of this case the interest was so closely identified' [own emphasis]

Trollip J clearly did not consider the purpose of the loan when assessing whether the interest itself is of a capital or revenue nature. Importantly, the crisp point made was that when one looks at the interest itself, it must be considered whether the interest improves, augments, or preserves the capital assets funded by the loan. If the answer is not in the affirmative, the interest cannot be capital in nature. This may appear to be the correct test to be applied, and is buttressed by the judgment in *Australian National Hotels Limited v. FC of T*[13]. Bowen CJ and Burchett J said (at ATC 4633; ATR 1582):

'… If the capital is raised by loan, an investment of the borrowed moneys in a business will ordinarily remain an investment of capital, and the same consequences will follow. But there is a special feature of loan capital, which flows from the ephemeral nature of a loan. **The cost of securing and retaining the use of the capital sum for the business, that is to say, the interest payable in respect of the loan, will be a revenue item. It creates no enduring advantage, but on the contrary is a periodic outgoing related to the continuance of the use by the business of the borrowed capital during the term of the loan … Rent, … and interest are both periodic payments for the use, but not the permanent acquisition, of a capital item.**' [own emphasis]

8 Supra.
9 [1968] 31 SATC 53(T).
10 Supra.
11 Even though in that case E M Grosskopf JA was of view that the asset concerned (i.e. insurance policy) was not of a capital nature.
12 [1993] 55 SATC 185(A).
13 88 ATC 4627; (1988) 19 ATR 1575.

The Australian case, even though at best has only a strong persuasive authority in South Africa, drives the point home that the interest needs to be looked at in isolation from the purpose for which the money was borrowed. Importantly, interest does not create an enduring advantage.

The following is noted in Tax Ruling 2004/4[14] issued by the Australian Taxation Office:

'Outgoings of interest are a recurrent expense. **The fact that borrowed funds may be used to purchase a capital asset does not mean the interest outgoings are therefore on capital account** (see Steele 99 ATC 4242 at 4249; (1999) 41 ATR 139 at 148)' [own emphasis]

Taxation Ruling 2004/10 cements the position taken in the *Australian National Hotels Limited*[15] case.

RC Williams[16] stated the following with regards to the capital nature of interest:

'If the argument of SARS were to gain acceptance by the courts, the implications for taxpayers nationwide would be little short of "cataclysmic". Almost every capital project is financed wholly or largely with borrowed funds and if the interest is not tax deductible, many of these capital projects would be still born… **it is difficult to see how the payment of interest can ever improve or augment the capital assets of the borrower any more than the payment of rent by a lessee can ever augment or improve the leased premises … rent and interest are examples par excellence of the "fruit" (revenue) as opposed to the "tree" (capital), seen from the point of view of both incomings and outgoings.**' [own emphasis]

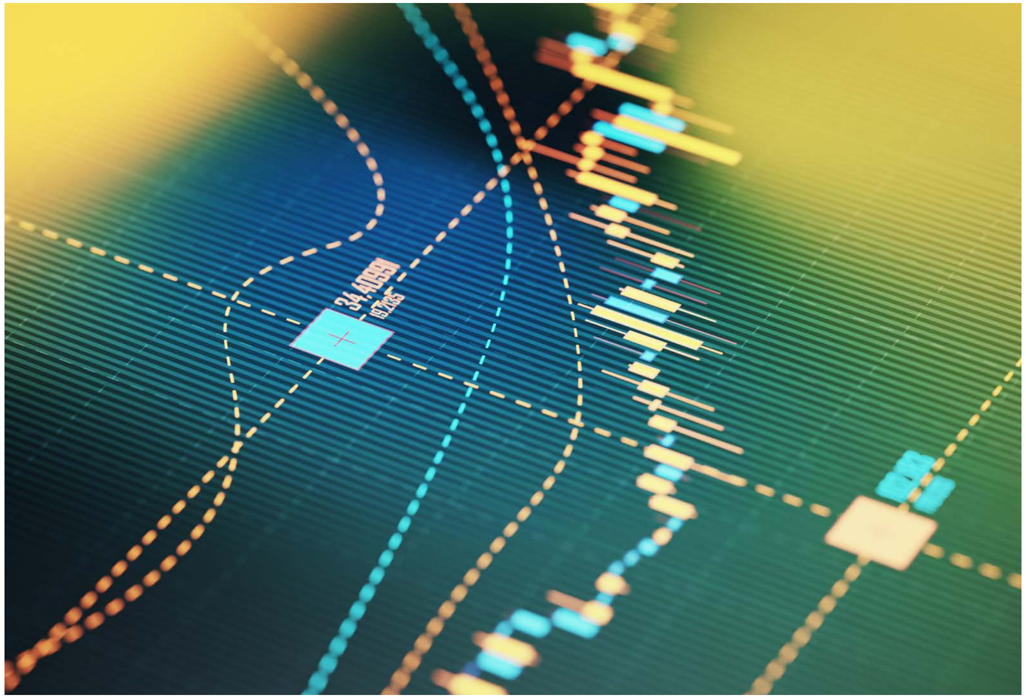
The remarks by RC Williams were referenced to in ITC 1827[17] as support for the conclusion reached by the court. In that case, a partnership sold its business to a company and the purchase price was left outstanding on an interest-bearing loan account. Subsequently, third party bank loans were obtained to discharge a portion of the shareholders' loans. It was held that, notwithstanding the fact that the newly established company acquired capital assets, the interest incurred on the loan was still of a revenue nature.

14 Taxation Ruling Income tax: deductions for interest incurred prior to the commencement of, or following the cessation of, relevant income earning activities published by the Australian Taxation Office on 4 August 2021 [link: https://www.ato.gov.au/law/view/document?docid=TXR/TR20044/NAT/ATO/00001&PiT=20210804000001] accessed on 1 March 2021.
15 Supra.
16 Can expenditure on interest be 'of a capital nature' and on that ground be non-deductible for income tax purposes? (1997) South African Law Journal 641 at 643 as stated in Income Tax in South Africa Cases & Materials RC Williams 4th edition at pg. 478.
17 [2007] 70 SATC 81.

As mentioned at the outset, prior to section 24J being a charging provision, the deductibility of interest was determined with the general deduction formula, with section 24J merely guiding the timing of the deduction. Section 24J was, however, subsequently amended such that the deductibility of interest and the timing of such deduction are now determined with reference to the provisions of section 24J read with section 23(g). The amendment to section 24J to make it a charging provision was brought about by the Revenue Laws Amendment Act, 2004 (Act No. 32 o 2004). The Explanatory Memorandum attendant thereto stated the following:

'Currently section 24J does not provide for the inclusion in gross income of a taxpayer of interest accrued or the deduction from the income of a taxpayer of interest incurred. In order to provide certainty as to the tax treatment of interest and to introduce the principle **that interest should always be treated on revenue account it is proposed** that section 24J be restructured to specifically provide for the inclusion in gross income of interest deemed to have been accrued or the deduction from income of interest deemed to have been incurred in terms of that section. Section 24J(2) and (3) are to be amended to give effect to this principle. **This would bring the tax treatment of interest in line with the treatment of exchange differences, which is not subject to the capital nature test. However, the deduction of interest should still be subject to the trade and production of income tests.**' [own emphasis]

No reason was provided as to why interest should always be treated on a revenue account. It is however clear that the intention of the policy is for interest to be treated on a revenue account as opposed to capital account, regardless of the purpose for which the money was borrowed. This policy intent is supported by the remarks of Trollip J as well as the Australian case referred to above.



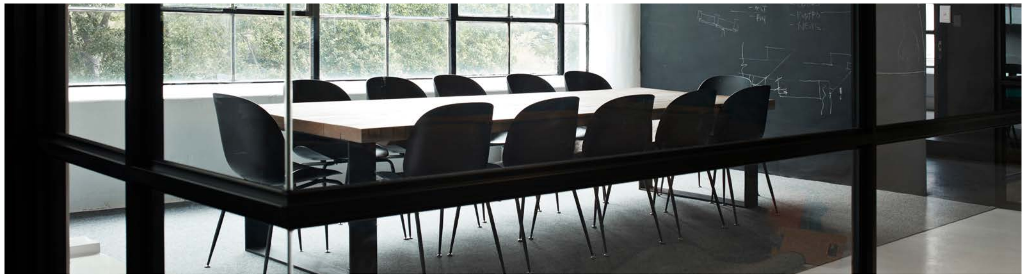
Is there a plausible argument to be made that other finance charges are of revenue nature when one considers the principles applied in the context of another finance charge being interest?

This begs the question: what is the nature of the other finance charges (e.g. commitment fees, raising fees, participation fees, utilisation fees) incurred on loans secured by taxpayers; capital or revenue? Should one consider the purpose for which the money was borrowed in assessing whether the other finance charges are of capital or revenue nature? Clearly, in the context of interest, this may not be the case. In certain instances, the other finance charges are periodic payments similar to interest. Can the same principle and policy intent also be applied on the basis that these finance charges do not improve, augment or preserve capital assets?

When one considers the policy intent and the cases referred to above, there may be a strong case to be made that the other finance charges do not improve or preserve any capital assets, particularly when one dissociates the purpose for which the money was borrowed in performing that assessment. Each finance charge needs to be assessed on its own merits.

For example, commitment fees which generally fall to be deducted under the general deduction formula (as opposed to section 24J) is payment to a lender for the set aside of money. The moment the borrower draws on the full amount set aside, the commitment fees fall away. A case may therefore be made that the commitment fees should be dissociated from the purpose and use of the money as it ceases to exist once the borrower uses the money. Therefore, the commitment fees need to be looked at in isolation with the focus being on what it actually affects as opposed to the purpose and use for which the money was borrowed. And on the basis that it does not create or preserve any capital assets, it may be of a revenue nature.

Whilst this may be the case for commitment fees, it may be different for other finance charges. For example, raising fees. In ITC 1019[18], the appellant derived his income mainly from renting out four immovable properties which he had purchased with loans. The appellant incurred raising fees on a new loan used to repay the previous loan which financed one of the properties secured by a bond, and also incurred fees to secure the renewal of an existing mortgage bond upon another property. The appellant deducted these fees from its income which was disallowed by the Commissioner of SARS[19] and, as a result, appealed to the Special Court of Natal. The court dismissed the appeal on the basis that those fees were attached to the loans which were a portion of the capital of the enterprise and, as a result, capital in nature. Here, it appears that the court linked the capital versus revenue analysis of the fees incurred to the purpose/use for which the money was borrowed without looking in isolation at what these fees actually affect. Similarly, in ITC 85[20], the facts of which are almost similar to those of ITC 1019[21], the raising fees were disallowed on the basis that they are closely identified with the raising of the loan, and therefore were expenditure connected with capital asset and consequently of a capital nature. Again, in ITC 882[22] and 1723[23], the court held the view that the raising fees incurred was closely connected to the appellant's fixed capital, as opposed to floating capital, and was of a capital nature unlike the interest.



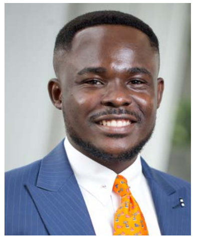
18 [1962] 25 SATC 411(N).
19 South African Revenue Service.
20 [1927] 3 SATC 146(U).
21 Supra.
22 [1959] 23 SATC 239(T).
23 [1999] 64 SATC 165.

A careful reading of these cases seems to suggest that, as long as the purpose or use for which the money was borrowed is associated with fixed capital, the raising fees will be of a capital nature. Interestingly, although not specifically dealt with in these cases, we speculate that the interest on these loans were deductible regardless of the loans being used for capital projects (i.e. fixed capital). In the *Genn* case however, Schreiner, J.A observed that '...it should I think be observed at the outset that, whatever might be the position on other facts, **it is not possible in the present case to justify a difference in treatment between the interest on the loans and the commissions [raising fees]**; the circumstances mentioned above show that in each case **the commission, together with the interest, formed in effect one consideration which the Company had to pay for the use of the money for the period of the loan.**' [own emphasis]. It is noteworthy to mention that in the *Genn* case, the raising fee was calculated with reference to the outstanding capital, as well as the term, of the loan. In effect, the raising fee was qualitatively similar to interest. Unfortunately (but in favour of the appellant), in that case, the money borrowed was applied to a floating capital (i.e. of revenue nature) and as a result, this may present a hurdle for one to rely on the *Genn* case to justify a deduction of the raising fee where the money borrowed was applied to a fixed capital. The presence of a hurdle notwithstanding, can this present a basis that, if the raising fee is qualitatively similar to interest, should the purpose for which the money was borrowed be dissociated from the capital versus revenue analysis of the raising fees, thereby leading to the conclusion that the raising fee is of a revenue nature? And furthermore, on the basis that the raising fee itself does not preserve, augment or create a capital asset? Can this be a plausible argument to be made?

In terms of paragraph 20(2)(*a*) of the Eighth Schedule to the Act, the expenditure incurred by a person in respect of an asset does not include any of the following: borrowing costs, including any interest (except as catered for in paragraph 20(1)(*g*)) as contemplated in section 24J, raising fees, bond registration costs or bond cancellation costs. This implies that in an instance where other finance charges are considered to be of a capital nature on the basis that they are closely associated with capital assets, they cannot be added to the base cost of such assets which in the first stance prompted the argument that they are of a capital nature. A very punitive outcome!

Key takeaway

In closing, when one considers the capital versus revenue nature of an expenditure, the purpose of the expenditure is an important factor. However, with regards to interest expenditure, it appears that the purpose of the money borrowed on which the interest is incurred should be dissociated from the capital versus revenue analysis as part of the deductibility assessment of the interest expenditure. The indispensable question raised is why the deductibility of interest should be treated differently from the other finance changes, particularly where such interest and other finance charges are qualitatively similar. We highlight a plausible argument to be made in respect of the capital versus revenue analysis of other finance charges when one considers the principles applied to another finance charge being interest. There is a strong case to be made that these finance charges do not improve, augment or preserve capital assets, particularly when one dissociates the purpose (and/or use) for which the money was borrowed in performing that analysis. Regardless of the plausibility of the argument, each finance charge needs to be assessed within the correct provisions of the Act and on its own merit as there is no standard rule. Where such a finance charge falls to be deducted under section 11(*a*) read with section 23(*g*), one may have to consider the potential application of section 23H[24]. Taxpayers are advised to obtain tax opinion dealing with the specific facts and circumstances in this regard.

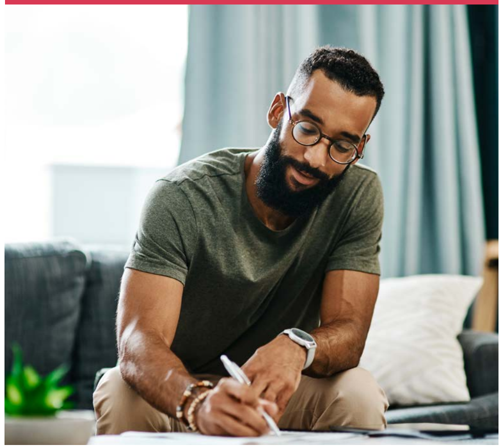


Stephen Boakye
Director, Tax
+27 (0) 11 287 0578

24 Section 23H of the Act is an anti-avoidance provision which is broadly aimed at matching the deductibility of expenditure over the period that the goods, services or any other benefit relating to such expenditure will be delivered, rendered or enjoyed respectively.

Challenging SARS judgment debt

The Tax Administration Act contains provisions which effectively enable SARS to convert a tax debt into a judgment debt. This procedure enables SARS to execute the 'judgment' using the services of officers of the court to attach property in execution. The Constitutional Court has recently delivered a decision which confirms that taxpayers retain the right to challenge a tax judgement after it was granted.



In the matter of *Barnard Labuschagne Inc v South African Revenue Service and Another* [2022] ZACC 8 (11 March 2022), SARS had alleged that the taxpayer (referred to in the judgment as 'BLI') was indebted to it in respect of amounts related to value-added tax, PAYE, UIF contributions and skills development levies. BLI did not dispute the correctness of the assessments (which were self assessments). It asserted that SARS had failed to allocate payments that it had made to the taxes in question.

In December 2017, pursuant to section 172(1) of the Tax Administration Act (TAA), SARS had filed with the Registrar of the High Court, Western Cape Division, a certified statement which recorded that BLI owed it the amount specified in the notice. Section 174 of the TAA provides that a certified statement filed in this manner 'must be treated as a civil judgment lawfully given in the relevant court in favour of SARS for a liquid debt for the amount specified in the statement'. For convenience, the effect of the filing of the statement is referred to as a 'tax judgment'.

Generally, in legal proceedings, where a judgment is taken in the absence of the debtor an aggrieved person (i.e. the debtor) may seek and obtain rescission of the judgment if it may be shown that the judgment was taken without his knowledge, that the judgement was erroneously granted and that there is a reasonable defence to the action. BLI brought an application for rescission of the judgment in the High Court.

The application was dismissed. The High Court accepted SARS' argument that a tax judgment is not susceptible to rescission. BLI's alternative ground, that the provisions of the TAA that permitted SARS to take a judgment that was not rescindable are unconstitutional and should be declared invalid was also rejected.

BLI filed an application with the High Court for leave to appeal against its decision. The High Court dismissed the application. The taxpayer then applied for leave to appeal in the Supreme Court of Appeal, which also dismissed the application. Application for leave to appeal was then made to the Constitutional Court.

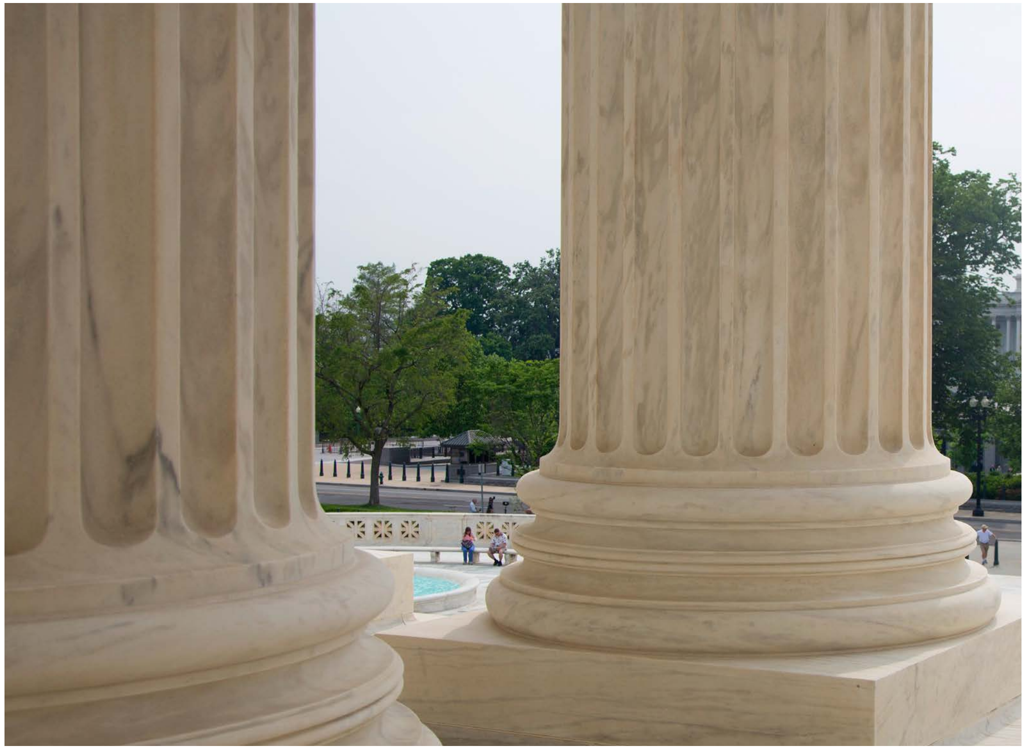
Stare decisis

The Constitutional Court will not hear a matter unless it has jurisdiction. Before the Constitutional Court will adjudicate the merits of a dispute, applicants must first establish that the Court has jurisdiction.

The judgment of Rogers AJ (who delivered the unanimous decision of the Court) confirmed jurisdiction (at paragraph [6]) in these terms:

> 'BLI's application, on the question of rescindability, raises an arguable point of law of general public importance. This is because several recent High Court judgments, of which the High Court's judgment in the present matter is the third, appear to have failed to apply binding precedent, a core component of the rule of law, which is a founding value of our Constitution. This is an issue which this Court must redress. We thus have jurisdiction.' (*Footnotes removed*)

Certainty in law is a fundamental principle underpinning our legal system. The meaning and application of our law is established through the process of judicial interpretation. The rule of law requires that judicial officers must observe and apply the principles of stare decisis. Simply stated, there is a hierarchy of authority of the courts. A subordinate court is bound to apply the principles embodied in judgments of superior courts. The principles must go to the reason for the decision ('*ratio decidendi*') and must not be observations made in passing ('*obiter dicta*'). A court is bound to apply the principles from decisions which it has made in the past where the issue has not yet been decided in a higher court, unless it is clear that the decision in question



was wrong. Where courts are of equal authority (for example, divisions of the High Court), one court is not bound to apply the previous decisions of another court of equal authority. In the case of courts of superior jurisdiction (for example the Supreme Court of Appeal) the court is bound to apply its previous decisions unless the decision was wrong.

Before a court may depart from an earlier decision of the same court, it must be satisfied that the earlier decision is clearly wrong.

In accepting jurisdiction, the Constitutional Court gave clear notice that judicial officers must consider all relevant cases to which they are referred by litigants and, if the circumstances of the matter are not so different as to justify a departure, apply the principles enunciated in those judgments that have binding authority.

The judgment makes it clear that the Constitutional Court found that it had jurisdiction under the Constitution because of a breakdown in the rule of law.

The available precedent

The judgment on the merits proceeded by examining the judicial precedent that had been placed before the High Court in the initial application. Before so doing, Rogers AJ set out the relevant provisions of the TAA and the predecessor provisions that had been contained in the Income Tax Act ('ITA') and the Value-added Tax Act ('VATA') prior to the enactment of the TAA. Certain of the judgments to which the High Court had been referred had involved interpretation of the predecessor provisions. The provisions of sections 172, 174, 164(1), 175 and 176 of the TAA were found to have replicated the essential features of provisions of the ITA and VATA on which the earlier decisions had been based and which were repealed when the TAA came into force. These were:

- Sections 91(1)(a), 91(1)(bA), 92 and 94 of the ITA; and
- Sections 40(2)(a), 40(2)(b), 40(5) and 42 of the VATA as well as section 36 of the VATA.

The decisions to which the High Court had been referred were systematically analysed.

In *Kruger v Commissioner for Inland Revenue* 1966 (1) SA 457 (C) (referred to as '*Kruger I*'), the full court found that a tax judgment obtained under the ITA was rescindable in terms of section 36 of the Magistrates Courts Act which empowered a Magistrate's Court to 'rescind or vary any judgment granted by it in the absence of the person against whom that judgment was granted'. The taxpayer in that matter failed in the appeal on procedural grounds.

A subsequent appeal involving the same parties was heard by the Appellate Division in *Kruger v Sekretaris van Binnelandse Inkomste* 1973 (1) SA 394 (A) ('Kruger II'). In that matter, the principal argument for the Secretary had been that the judgment could not be rescinded because section 94 of the ITA provided that the assessment was conclusive evidence of the facts. Rogers AJ observed (at paragraph [14]:

> 'In response to this argument, Jansen JA said that the taxpayer's counsel had rightly not argued that Kruger I was wrong in holding that a tax judgment was rescindable. As to the limits imposed by section 94, Jansen JA said that the "conclusive evidence" only related to the making and correctness of the assessment. "Assessment" was a defined term. Various matters going to the merits of a tax judgment could still be contested, for example the computation of the tax, the question of the date from which interest ran, and the lawfulness of the levying of tax. Notwithstanding section 94, therefore, there was a wide field of defences available to a taxpayer in rescission proceedings.' (*Footnotes removed*)

In *Traco Marketing (Pty) Ltd v Minister of Finance* 1998 (4) SA 74 (SE) ('*Traco Marketing*') it was held that a common law right to rescission exists in the case of a tax judgment taken in terms of section 40(2)(a) of the VATA. The application failed for lack of cause and not on the principle of rescindability.

In *Barnard v Kommissaris van Binnelandse Inkomste*, unreported judgment of the Cape Provincial Division, Case No A127/97 (19 May 2000) ('*Barnard*'), the Cape Provincial Division determined that a Magistrate had jurisdiction to entertain an application for rescission of a tax judgment taken in terms of section 40(2)(a) of the VATA and referred the matter back to the Magistrate.

The Constitutional Court was called upon in *Metcash Trading Ltd v Commissioner, South African Revenue Service* 2001 (1) SA 1109 (CC) ('Metcash') to consider whether sections 36, 42(2)(*a*) and 42(5) of the

VATA should be declared unconstitutional because they denied a person's right to approach the courts. The Constitutional Court found that the provisions were not unconstitutional. Rogers AJ summarised the view of the Constitutional Court at paragraph [18]:

> 'Kriegler J said that the decisions in *Kruger I and II* provided "clear judicial authority" at odds with the applicant's argument. In these cases the courts found (a) that a tax judgment was in principle susceptible of rescission; and (b) that despite the "conclusive evidence" section of the IT Act, there was a wide field of defences available in rescission proceedings.'

In considering the principles set out in *Metcash*, Rogers AJ (at paragraph [27]) explained why *Metcash* was a relevant precedent, and that the principle that rescission was an available remedy was integral to finding that the provisions in the VATA were not unconstitutional:

> 'The fact that tax judgments are susceptible of rescission, and that certain defences remain available to a taxpayer in rescission proceedings, was an integral part of this Court's reasoning in finding that the cumulative effect of the statutory provisions was not constitutionally repugnant.'

The Gauteng High Court found, in *Mokoena v Commissioner, South African Revenue Service* 2011 (2) SA 556 (GSJ) ('*Mokoena*') that *Kruger II* and *Metcash* were authority for the proposition that a tax judgment is rescindable.

Rogers AJ then turned to the judgments that were considered by the High Court. He noted at paragraph [22]:

> 'The High Court was referred to the authorities discussed above yet did not deal with them. Instead, so BLI complains, the High Court followed more recent provincial decisions which were adverse to BLI's contentions on rescindability.'

The High Court, Western Cape Division, in *Capstone 556 (Pty) Ltd v Commissioner, South African Revenue Service* 2011 (6) SA 65 (WCC) ('*Capstone*') had found contrary to *Mokoena* (as it was entitled) on the issue of the right to challenge a tax judgment pending objection and appeal. It found that a tax judgment was 'not in itself a judgment in the ordinary sense … [and] does not determine any dispute between the taxpayer and the Commissioner'. In so finding, the Court did not deal with the question of rescindability nor did it question that a tax judgment was, in principle, rescindable.

The judgment in *Modibane v South African Revenue Service*, unreported judgment of the South Gauteng High Court, Johannesburg, Case No 09/9651 (20 October 2011) ('*Modibane*'), which Rogers AJ summarised (at paragraph [23]):

> 'The Court quoted the passage in Capstone mentioned in the previous paragraph as if it were authority for the proposition that a tax judgment is not rescindable, and did not refer to the *Kruger* cases or *Traco Marketing*. Although the Court cited *Metcash*, it only mentioned the paragraphs dealing with the "pay now, argue later" rule; it did not heed paragraphs 65 and 66, which approved the *Kruger* cases and accepted that tax judgments are in principle rescindable. The Court mentioned *Mokoena*, but only to say that, like *Capstone*, it disagreed with it. As I have said, *Capstone* does not provide authority for the view that a tax judgment is not susceptible of rescission.'

The third and final recent judgment relied upon in the High Court was *South African Revenue Service v Van Wyk*, unreported judgment of the Free State High Court, Bloemfontein, Case No A145/2014 (5 June 2015) ('*Van Wyk*'). This matter dealt with the application of the TAA. Rogers JA noted that the High Court stated in its judgment that 'the Magistrate's Court was not entitled to entertain the rescission application "as it was not a civil judgment in the ordinary sense" and that the certified statement "could not be regarded as having the character of a judicially delivered judgment"'. Again, it is noted that the *Kruger* decisions were not cited and citations from *Metcash* did not make reference to the issue of rescindability.

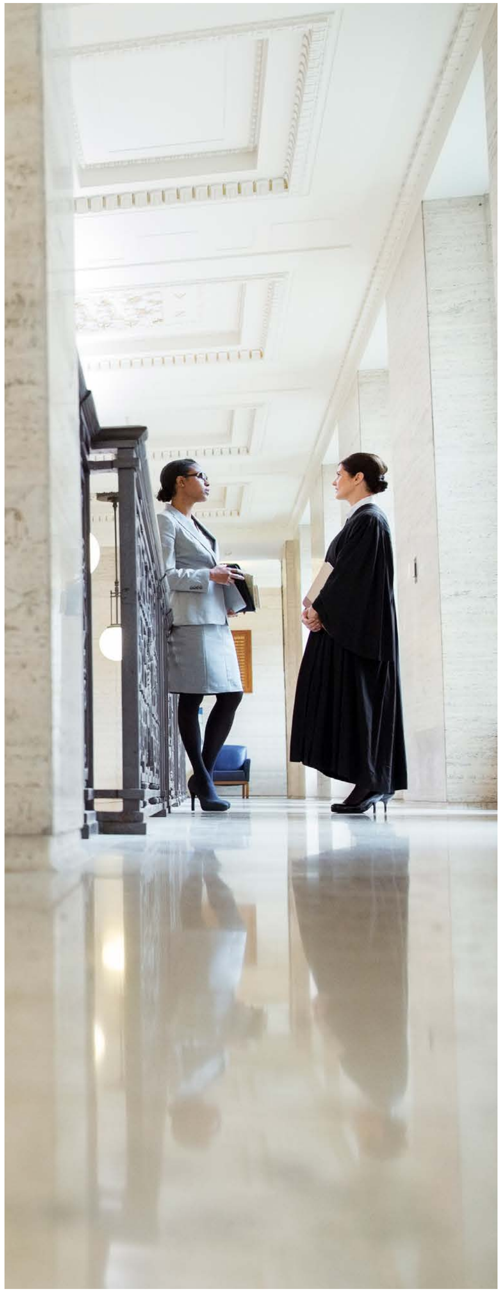
The decision

The decision required an examination of the rejection by the High Court of the alternative arguments presented by BLI. The first was that it was entitled to claim rescission of the tax judgment and the second was that, if it was denied the right to claim rescission, the relevant provisions of the TAA were unconstitutional.

On the issue of the right to apply for rescission, Rogers AJ found at paragraph [27]:

> 'The courts in *Modibane* and *Van Wyk* were bound by the decisions in *Kruger II* and *Metcash*. Since *Kruger II* was not mentioned at all, and since the relevant passages in *Metcash* were overlooked, there was no attempt to distinguish them or to suggest that the pronouncements on rescindability were non-binding observations made in passing (*obiter dicta*). While it might be argued that the discussion of rescission in *Kruger II* was obiter, the same cannot be said of *Metcash*.'

The fact that the TAA grants a power to SARS to withdraw or amend a tax judgment under sections 175 and 176 of the TAA had been relied upon by the High Court to indicate that a tax judgment is not a final judgment. Rogers AJ pointed out that the power to withdraw a tax judgment and to replace it, which had



been afforded under the ITA and the VATA prior to their repeal on promulgation of the TAA, was practically to the same effect as a power to amend and had been a power which SARS was able to exercise when the earlier matters had been decided. In effect, the express power to amend did not alter powers that SARS had been able to exercise in relation to tax judgments.

The judgment underscored the requirement that the statements in court decisions must be carefully examined to establish whether they are integral or incidental to the reason for the decision. The High Court had failed to appreciate that the findings of the Constitutional Court on rescindability were binding precedent when it referred to them as *obiter dicta*. The judgment states (at paragraph [30]):

'The reasoning in *Metcash* on rescindability was not "merely . . . an observation", it was an integral part of this Court's reasoning. And *Metcash* in turn endorsed the two judgments in *Kruger*. Observance of the rules of precedent is not a display of politeness to courts of higher authority; it is a component of the rule of law, which is a founding value of the Constitution.'

In response to a suggestion that the Constitutional Court is not bound to follow its own decision in *Metcash*, the judgment records, at paragraph [34]:

> '… this Court will not depart from an earlier binding statement of the Court unless satisfied that the earlier statement was "clearly wrong". In applying this rule of precedent to itself as the country's apex Court, the Court must tread with caution: it "must not easily and without coherent and compelling reason deviate from its own previous decisions, or be seen to have done so".' (*Footnotes removed*)

At paragraph [37], Rogers AJ was astute to explore the provisions in the TAA which limit the circumstances in which an application for rescission of a tax judgment may be instituted. Section 170 provides that a certificate on which a tax judgment is issued is conclusive evidence of an assessment. Section 104 limits the issues upon which a taxpayer may file an objection. If a taxpayer's grievance falls within the scope of section 104(2), then section 105 stipulates that the procedure that must be followed is the dispute resolution process set out in Chapter 9 of the TAA, unless the High Court otherwise directs. The combined effect of these sections is that, in rescission proceedings, it will be difficult for a taxpayer to demonstrate that there is a *bona fide* prospect of success where the dispute is subject to objection and appeal.

The BLI appeal was not against an assessment. Nor was it against a decision against which a taxpayer may object, as specified in section 104 of the TAA. Rogers AJ concluded (at paragraph [39]):

> 'Rescission is only of practical significance where a tax judgment is impeached on grounds which cannot be pursued by objection and appeal, because it is only in such cases that an applicant for rescission can potentially establish a bona fide defence.'

Then, recognising that the basis for the rescission application related to whether the amounts in dispute had been paid, Rogers AJ made it clear that no statutory relief was available (at paragraph [42]):

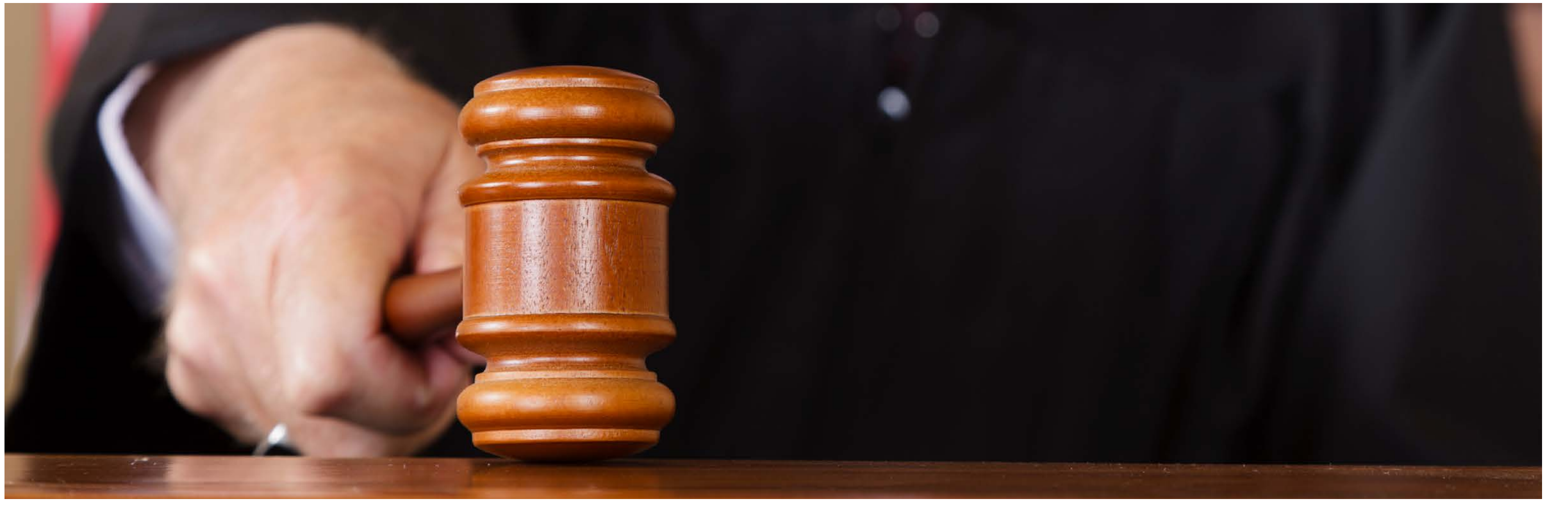
> 'There is no provision in any relevant tax legislation stating that a dispute about whether an assessment has been paid is subject to objection or appeal.'

The inevitable decision, at paragraph [46], was succinct:

> 'It follows that the High Court should have found that the tax judgment was susceptible of rescission and should have considered whether BLI had made out a case for rescission at common law. This Court recently repeated the well-known requirements: first, the applicant must give a reasonable and satisfactory explanation for its default; and second, it must show that on the merits it has a bona fide defence which prima facie carries some prospect of success.'

The judgment did not undertake a review of the failure by the High Court properly to address the constitutional challenge. In view of the principal finding that a tax judgment is indeed rescindable, the constitutional issue was not addressed further.

The matter has therefore been referred back to the High Court for consideration. Now that it is settled that the tax judgment is, in principle, rescindable, the High Court is required to consider whether BLI has reasonable grounds.



The takeaway

For taxpayers

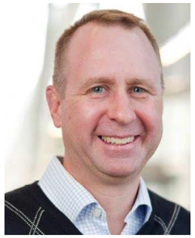
The filing of a certificate in terms of section 172(1) of the TAA is a step that is typically not taken lightly by SARS. It is usually the final throw of the dice when collection of a tax debt has proven difficult owing to obdurate refusal to pay on the part of the taxpayer. That said, sight should not be lost of the right of a taxpayer to retain certain remedies, such as the objection and appeal processes under the TAA or to apply for the rescission of a tax judgment by SARS.

Where taxpayers are confronted by a tax judgment which has been obtained against them in their absence, they should be aware that they are still entitled to apply for rescission of the tax judgment if they can show that the tax judgement was granted erroneously or that they have reasonable ground for raising such a challenge. For a challenge to be successful, the challenge must not relate to the merits of the assessment (i.e., the amount of the assessment and the grounds on which it was made). Those issues must be pursued by way of objection and appeal. If there are other grounds for challenging the taking of the tax judgment, a taxpayer is entitled to consider and, if satisfied that there is a *bona fide* defence which, on the face of it, reflects a prospect of success, bring an application for rescission of the tax judgment.

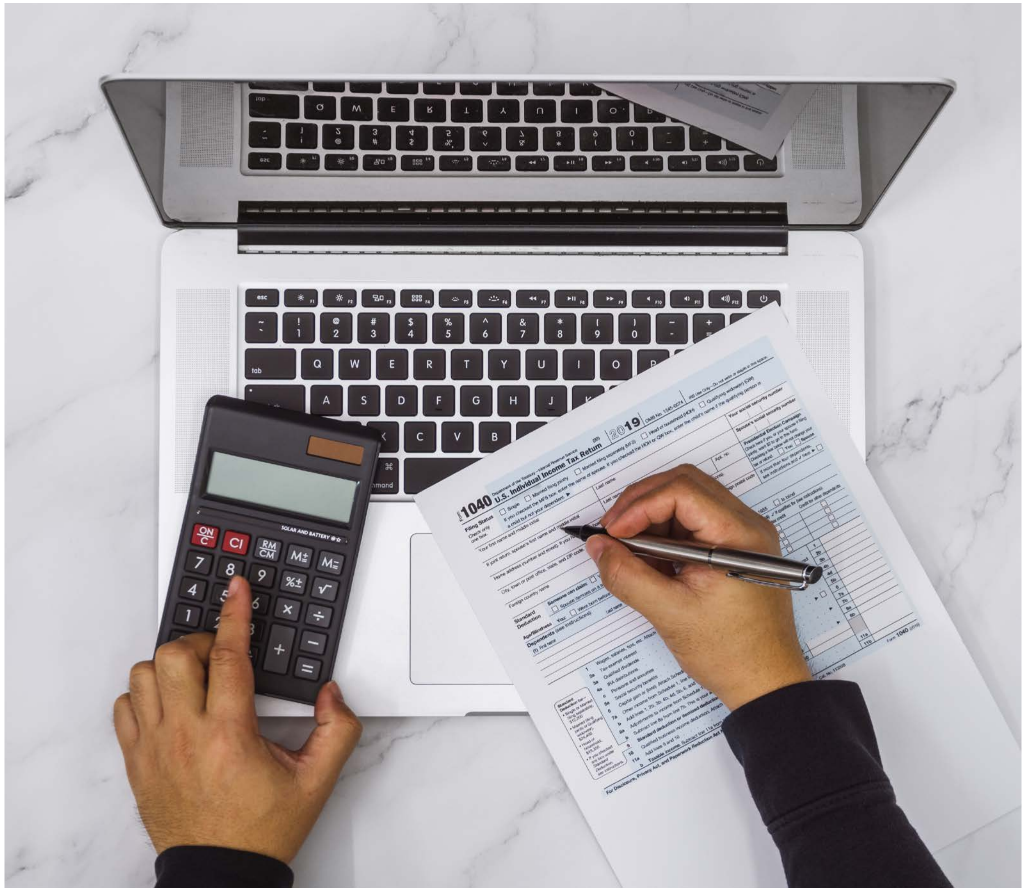
For tax advisors

A second takeaway is the masterclass that the judgment provides, in addition to stressing the function of precedent in the rule of law, by way of a comprehensive review of relevant authority on the legal issue in dispute and the distillation from each authority of the principles of law on which the decisions were based. In the precedent reviewed, it is noteworthy that the applicant was not always successful in its case, but the legal principle underpinning all of the cases referred to was that a judgment is in principle rescindable and that this principle extends no less to tax judgments.

It is evident that experienced legal minds in the High Court and the Supreme Court of Appeal erred in their treatment of the principles of *stare decisis* in evaluating the applications by BLI for leave to appeal. This is a cautionary reminder of the high degree of care that must be taken by tax practitioners when advising clients on tax positions. Advice is typically provided on the basis that positions espoused by the advisor would 'more likely than not' be upheld if the matter were to proceed to court. Failure to identify or apply relevant precedent appropriately may place the practitioner's evaluation of the likelihood of success in question.



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



SARS Watch

SARS Watch 1 March 2022 – 25 March 2022

Legislation		
14 March 2022	Table 1 – Interest rates on outstanding taxes and interest rates payable on certain refunds of tax	From 1 May 2022 the interest rate will increase to 7.5% from 7.25%.
14 March 2022	Table 2 – Interest rates payable on credit amounts	From 1 May 2022 the interest rate will increase to 3.5% from 3.25%.
10 March 2022	Multilateral Convention to implement tax treaty-related measures to prevent base erosion and profit shifting (MLI)	Romania has been added to the list of treaty partners that ratified the MLI.
8 March 2022	Fixing of rate per kilometre in respect of motor vehicles – section 8(1)(b)(ii) and (iii)	Income tax notice no. R.1848 published in Government Gazette no. 46015 with an implementation date of 1 March 2022.
8 March 2022	Table A – A list of the average exchange rates of selected currencies for a year of assessment	The table has been updated to include the average exchange rate as of February 2022.
8 March 2022	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	The table has been updated to include the average exchange rate as of February 2022.
4 March 2022	Determination of the daily amount in respect of meals and incidental costs for purposes of section 8(1)(c)(ii) (overnight allowance)	Income tax notice no. R.1844 published in Government Gazette no. 46000 with an implementation date of 1 March 2022.
Customs and excise		
23 March 2022	Customs – Prohibited and Restricted Goods List	New tariffs were added to the existing list for the Department of Mineral Resources and Energy.
18 March 2022	Imposition of provisional payment in relation to anti-dumping duties against the alleged dumping of laminated safety glass, classifiable under tariff subheading 7007.29, originating in or imported from the People's Republic of China – ITAC Report 687	Tariff notice no. R.1894 published in Government Gazette no. 45056 with an implementation date up to and including 17 September 2022.
18 March 2022	Amendment to Part 3 of Schedule No. 6, by the substitution of Note 6, to give effect to the review of the diesel refund system	Tariff notice no. R.1893 published in Government Gazette no. 45056 with effect from a date to be determined by notice in the Gazette.
18 March 2022	Amendment to rules under sections 7, 59A, 75 and 120 – Review of diesel fuel refund tax system (DAR230)	Tariff notice no. R.1892 published in Government Gazette no. 45056 with effect from a date to be determined by notice in the Gazette.
17 March 2022	Amendment to Part 1 of Schedule No. 2, by the insertion of various anti-dumping items under item 204.04, in order to impose anti-dumping duties on pasta originating in or imported from Egypt, Latvia, Lithuania and Turkey classifiable under tariff heading 1902.11 1902.19 – ITAC Report 669	Tariff notice no. R.1888 published in Government Gazette no. 46054 with an implementation date of 17 March 2022.
4 March 2022	Amendment of provisional payment in relation to anti-dumping duties against the alleged dumping of frozen bone-in portions of fowls of the species Gallus Domesticus, classifiable under tariff subheading 0207.14.9, originating in or imported from Brazil, Denmark, Poland and Spain, to amend the references made in the preceding Notices from 'exported by' to read 'produced by' – ITAC Report 678	Tariff notice no. R.1846 published in Government Gazette no. 46001 with retrospective effect from 17 December 2021 up to and including 14 June 2022.
4 March 2022	The draft amendments are proposed in Parts 1, 2B and 3E of Schedule No. 1, Schedule Nos., 3, 5 and 6 to the Customs and Excise Act	Comments were due to SARS by Friday, 18 March 2022.

3 March 2022	Draft amendment to paragraph 8 of Schedule 1 to the Value-Added Tax Act, 1991 as a consequence to the amendment in Part 1 of Schedule No. 4 to the Customs Act	Comments were due to SARS by Friday, 25 March 2022.
3 March 2022	Amendment to rules under sections 21 and 120 – Duty free sale of motor vehicles to diplomats	Comments were due to SARS by Friday, 25 March 2022.
3 March 2022	The draft amendments are proposed to the Customs and Excise Act as follows: Substitution of rebate items 406.02, 406.02/00.00/01.00, 406.03, 406.03/00.00/01.00, 406.04, 406.04/00.00/01.00, 406.05, 406.05/00.00/01.00, 406.07 and 406.07/00.00/01.00 in Part 1 of Schedule No. 4; and Substitution of rebate item 631.00 000.00.00 01.00 in Part 2 of Schedule No. 6	Comments were due to SARS by Friday, 25 March 2022.
Case law		
In accordance with date of judgment		
11 March 2022	Cell C (Pty) Ltd v Commissioner for the South African Revenue Service (30959/2019) [2022] ZAGPPHC 152	In this case the court considered whether it had the review jurisdiction to review SARS' tariff determination in light of the wide appeal afforded to Cell C in terms of section 47(9)(e) of the Customs and Excise Act. The court considered the legal principles applicable to ‘review’, ‘appeal’ and ‘wide appeal’.
	F Taxpayer v Commissioner for the South African Revenue Service (IT 45842) [2022] ZATC 1	This matter involves two interrelated applications. The first being that of the taxpayer for a final order against SARS due to its failure to deliver its rule 31 statement timeously. The second is SARS’ counter-application for condonation and the determination of a further period for delivery of that statement.
	Commissioner for the South African Revenue Service v Van Zyl and Others (37351/2020) [2022] ZAGPPHC 34	At issue in this application was the confirmation of a provisional preservation order in terms of section 163 of the Tax Administration Act.
	Square Root Logistics (Pty) Ltd v The Commissioner for the South African Revenue Services and Others [2022] ZAKZDHC 11	The applicant, Square Root Logistics, issued a vindicatory application against SARS and two companies (referred to as ‘the tax debtors’). The subject matter of the application was certain motor vehicles, attached by SARS, which it believed were owned by the tax-debtors, and which were in the possession of the tax-debtors.
	L'Avenir Wine Estate (Pty) Ltd v Commissioner for the South African Revenue Service (16112/2021) [2022] ZAWCHC 28	The matter stemmed from a change in the taxpayer's financial year-end and the taxpayer approached the court for an order to allow it to submit an income tax return for the disputed period and for SARS to assess the return. The court considered the relevant provisions of the Tax Administration Act and the Promotion of Administrative Justice Act.
	Barnard Labuschagne Incorporated v South African Revenue Service and Another (CCT 60/21) [2022] ZACC 8	The matter resulted from a certified statement by SARS (i.t.o section 172 of the TAA) on the taxpayer's self-assessments for VAT, employees’ tax, UIF and SDL – the taxpayer argued that SARS failed to appropriate the payments to the correct taxes. In terms of section 174 of the TAA, the certified statement must be treated as a civil judgement. The taxpayer brought an application to rescind this judgement. The court considered whether the judgement is susceptible to rescission.
Interpretation notes		
4 March 2022	IN 28 Deductions: Home office expenses incurred by persons in employment or persons holding an office	This Note provides clarity on the deductibility of home office expenses incurred by persons in employment or persons holding an office.
Guides and forms		
25 March 2022	Excise Tax essential tax guide for Small Businesses	The purpose of this guide is to assist small businesses with their excise duty obligations.
22 March 2022	Guide for Employers in respect of Employees Tax for 2023	The guide has been updated to include the new table of rates per kilometre for motor vehicles.
17 March 2022	Guide for Employers in respect of Fringe Benefits	The guide has been updated with the 2022 National Budget Speech announcements.
17 March 2022	Guide for Employers in respect of Allowances	The guide has been updated with the 2022 National Budget Speech announcements.
17 March 2022	AEOI (FATCA) US Reporting TIN Codes	The purpose of this document is to clarify the application of the supplied codes for the Taxpayer Identification Number (TIN) data fields for Automatic Exchange of Information (AEOI) and Foreign Account Tax Compliance Act (FATCA) submissions.

Other Publications		
22 March 2022	OECD: Transparency framework for crypto-assets reporting framework and amendments to the Common Reporting Standard	Comments (in Word Format) are due to taxpublicconsultation@oecd.org by Friday, 29 April 2022.
21 March 2022	OECD: Prevention of Tax Treaty Abuse – Fourth Peer Review Report on Treaty Shopping	This report reflects the outcome of the fourth peer review of the implementation of the BEPS Action 6 minimum standard on treaty shopping.
14 March 2022	OECD: Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)	The Commentary explains the intended outcomes under the Global Anti-Base Erosion ('GloBE') Rules and clarifies the meaning of certain terms, as well as illustrating the application of the rules to certain fact patterns.
14 March 2022	OECD: Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) Examples	This document contains several examples that illustrate application of the GloBE Rules.
14 March 2022	OECD: Taxation of part-time work in the OECD	This paper presents a summary of the taxation of part-time work in OECD countries.
8 March 2022	OECD: Tax challenges arising from digitalisation: Public comments received on the draft rules for tax base determinations under Pillar One Amount A	This document contains the public comments on the Draft Rules for Tax Base Determinations under Pillar One Amount A received by the OECD.