Synopsis

Tax today

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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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The Constitutional Court adjudicates another tax issue

A second matter dealing with the interpretation of the provisions of section 24C of the Income Tax Act was recently considered in the Constitutional Court, which delivered judgment in the matter of *Clicks Retailers (Pty) Ltd v Commissioner for the South African Revenue Service* [2021] ZACC 11 (21 May 2021).

The issues and decision of the Supreme Court of Appeal in the matter of *Commissioner for the South African Revenue Service v Clicks Retailers (Pty) Ltd* [2019] ZASCA 187 were reported in an earlier edition of *Synopsis*. To summarise, the question at issue was whether loyalty points were awarded in terms of the loyalty card contract or in terms of an agreement of sale to a customer holding a loyalty card.

The SCA determined that the obligation to award loyalty points arose from the loyalty card contract. It found that the obligation to grant benefits in the future to loyal customers did not arise in terms of the agreements for the sale of merchandise. As a result, Clicks was denied the deduction in respect of future expenditure to be incurred in terms of a contract, because the revenue was earned in respect of the sale contract, whereas the obligation to provide future benefits arose from a separate contract, namely the loyalty card contract.

Subsequent to the SCA decision, the Constitutional Court entertained an appeal on the interpretation of section 24C of the Income Tax Act in the matter of *Big G Restaurants (Pty) Ltd v Commissioner for the South African Revenue Service*. The judgment of Madlanga J, supported by the majority of the Justices, contained the following statement (at paragraph [18]):

> "On my interpretation, it is a requirement of the section that the contract in terms of which the income that is to finance future expenditure is received or accrues must be the *same* contract under which the expenditure is incurred. So, there is a requirement of 'sameness'. But I do not read the sameness requirement to connote that there must, for example, in the case of a written contract, be one piece of paper stipulating for the earning of income and the imposition of future expenditure. Two or more contracts may be so inextricably linked that they may satisfy this requirement."

Based on the *dictum* of Madlanga J, Clicks took the decision of the SCA on appeal to the Constitutional Court, urging that the SCA decision was wrong because the loyalty programme and sale contracts were inextricably linked and satisfied the criterion of sameness.

Was the issue a question of law?

SARS contended that the issue had been decided in the *Big G Case*, and that the matter at issue did not involve a question of law. To this, Theron J, who delivered the judgment of the Court, responded (at paragraph [25]):

> "This argument must be rejected. The legal question of contractual interpretation is not the same question this Court answered in *Big G* and neither is the question of statutory interpretation. In this case, we must go further and ask: what does it mean for two or more contracts to be so inextricably linked that they meet the requirement of 'sameness', as introduced in *Big G*? In other words, this Court must 'put meat on the bones' of the sameness test in the context of inextricably linked contracts. In the same way common law rules are developed incrementally through their application to novel factual scenarios, we must now determine how, if at all, the interlinked contracts at issue here meet the requirement of sameness."

The issue before the court was arguable, based on the divergent decisions between the Tax Court and the SCA. Furthermore, the relationship between the contracts in this matter was much closer than in *Big G*. It was therefore of general importance that the issue be considered and adjudicated.

The judgment

The essential issue for decision was whether the contracts met the requirement of 'sameness'. As Theron J noted (at paragraph [39]):

> "The import of *Big G* is that a taxpayer can now claim a section 24C allowance even if the income and the paired obligation to finance future expenditure are generated by different interlinked contracts, as long as those contracts satisfy the requirement of sameness. The operative word is therefore *sameness*."

In establishing sameness, it is not enough to show that the contracts are inextricably linked. What the law requires is that there should be sameness. The judgment stated the position at paragraph [45] as being:

> "Thus, within the context of the loyalty programme, the two contracts are inextricably linked to the extent that (a) obligations under the ClubCard contract are triggered by the sale contracts; (b) Clicks' obligation to finance expenditure when ClubCard points are redeemed is determined with reference to the amount of income earned in terms of one or more contracts of sale; and (c) there is a significant factual overlap and nexus between them. But do the links between the two contracts give rise to a sameness between them?"

From this, the critical question in determining sameness emerged (at paragraph [46]):

> "Whatever the outer limits of the concept of sameness in this context may be, at a minimum both the earning of income and the obligation to finance future expenditure must depend on the existence of both contracts. If either contract can be entered into and exist without the other, they can hardly achieve sameness."

In the analysis that followed, Theron J was able to demonstrate that the contracts were able to exist side by side without one being dependent on the other (at paragraph [47]):

> "Clicks earns income through the sale of merchandise and not through entering into ClubCard contracts with its customers. Of course, the existence of a ClubCard contract may drive sales of Clicks merchandise, but income that accrues, in legal terms, is attributable to the relevant contract of sale. Clicks would earn the income regardless of whether there is a ClubCard contract in place."

The finding of the court was therefore that the requirement of sameness could not be established and the conclusion (at paragraph [49]) was as follows:

> "The two contracts relied on to found Clicks' claim for a section 24C allowance function in tandem to give effect to the loyalty programme. This functional relationship manifests in a number of factual and legal links between the two contracts, but these links do not render either contract dependent on the other for its existence, nor is their effect that income can only accrue to Clicks if both contracts are in place. The contract under which income accrues (the contract of sale) and the contract under which the obligation to finance future expenditure arises (the ClubCard contract) are simply too independent of each other to meet the requirement of contractual sameness. Whilst they may operate together within the context of the loyalty programme, and in that sense are inextricably linked or connected, this link is not sufficient to render the contracts the same for the purposes of section 24C. The contracts therefore fall short of the sameness that is required by section 24C."

The takeaway

There is now an authoritative body of law which has been developed as a result of the recent appeals to the Constitutional Court in Big G and Clicks. The findings in the Constitutional Court have advanced the interpretation of the law, but the burden of proof remains with the taxpayer to show that the contract that requires the taxpayer to incur expenditure in the future is the contract under which the income has been derived or is so inextricably linked to the income-earning contract that it satisfies the legal requirement of sameness.

For sameness to be established, it must be shown that the one contract cannot be entered into or exist without the other.

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The concept of modification gains or losses – what should you take note of?

Over the past two years or so, the South African Revenue Service ('SARS') has embarked on a journey to rebuild a new and modern SARS with the intent to become an institution of unquestionable integrity, trust and admiration. As part of this journey, SARS has developed nine strategic objectives, which includes *inter alia*,

- detecting taxpayers and traders who do not comply, thus making non-compliance hard and costly; and
- developing a high performing, diverse, agile, engaged and evolved workforce.

In the current tax landscape and with the emergence of the 'new SARS', it is becoming increasingly imperative for taxpayers to keep abreast of developments in the tax arena and to seek advice to assess the impact of such developments on their businesses. This is ultimately to ensure that taxpayers have their tax affairs in order, are fully compliant and disclose correct and accurate information to SARS.

An interesting aspect which taxpayers should take note of is the impact of the change from IAS 39 to IFRS 9, particularly in the aftermath of Covid-19, in terms of which taxpayers have modified and restructured their debt/financial liabilities, resulting in a modification loss or gain. This article sets out how modification losses or gains should be treated for accounting and tax purposes as well as measures which could be taken, to the extent that taxpayers discover that they may not have disclosed the correct information to SARS.

Accounting considerations

For financial liabilities, IFRS 9 requires that an exchange between an existing borrower and lender of debt instruments with substantially different terms should be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

If the contractual cash flows of a financial liability measured at amortised cost are modified (changed or restructured, including distressed restructures), the company should determine whether this is a substantial modification, which could result in the derecognition of the existing liability and the recognition of a new liability. If the change is simply a non-substantial modification of the existing terms it would not result in derecognition and a modification gain or loss would be accounted for.

The terms of a liability are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cash flows of the original liability (IFRS 9.B3.3.6).

There is no equivalent guidance in IFRS 9 for the derecognition of renegotiated financial assets. A sensible approach is to apply the principle applied to modifications and exchanges of financial liabilities to determine whether the revised terms give rise to the expiry of all or part of the contractual rights to the cash flows from the financial asset. Judgment is required to assess whether a change in the contractual terms is substantial enough to represent an extinguishment.

When a financial instrument measured at amortised cost is modified without this modification resulting in derecognition, an entity recalculates the amortised cost of the financial instrument as the present value of the future contractual cash flows that are discounted at the financial instrument's original effective interest rate. As a result, a one-off gain or loss is recognised in profit or loss (IFRS 9.B5.4.6).

Tax considerations

A modification loss or gain is akin to a fair value adjustment on an asset.

South African courts have held the following: "at the outset it must be pointed out that the Court is not concerned with deductions which may be considered proper from an accountant's point of view or from the point of view of a prudent trader, but merely with the deductions which are permissible according to the language of the Act" (see *Joffe & Co., Ltd. v Commissioner for Inland Revenue* (1946, A.D. 157 at p. 165).

A modification loss is not an incurred loss or expenditure; thus it follows that a modification loss will not qualify for a deduction in terms of the Income Tax Act, No. 58 of 1962 ('ITA'), as it is an adjustment recognised from an accounting perspective and none of the provisions of the ITA permits a deduction thereof. Similarly, a modification gain will not qualify to be included in the gross income of the taxpayer as it has neither accrued to nor received by the taxpayer.

In this regard, taxpayers will be required to make the relevant adjustment in calculating their taxable income in order to ensure that any modification loss or gain is accordingly excluded. It is important to note that the mechanism of adjusting for impairment provisions (by adding back closing impairment balance and deducting opening impairment balance) does not result in an adjustment in calculating the taxable income due to how the modification loss or gain is accounted for.

In this regard, taxpayers will be required to assess where the modification loss or gain is recognised in the accounting records and make the relevant adjustment.

Taxpayers' remedies

To the extent that a taxpayer discovers that it has not made a full or accurate disclosure to SARS with regard to the modification loss or gain, such taxpayer could utilise one or more of the following remedies to regularise its position.

A taxpayer could request a correction of its income tax return ('ITR14') via the Request for Correction ('**RFC**') button on SARS' e-filing system. This can be a cost-effective and efficient solution. This mechanism will allow a taxpayer to edit and correct the ITR14 which was initially submitted to SARS. However, the RFC button is not always available and usually greyed out once an IT14SD (supplementary declaration) has been issued. Furthermore, this will not be a viable option where an audit/verification is pending, as the RFC button will not be functional, and the position might then have to be disclosed as part of the audit process, which could result in potential understatement penalties.

Alternatively, a taxpayer could utilise the Voluntary Disclosure Programme ('VDP'), provided for in the Tax Administration Act, No. 28 of 2011 ('TAA'). This essentially enables a taxpayer to regularise its tax position, whilst obtaining relief from administrative non-compliance penalties, understatement penalties and criminal prosecution. However, in order to make a valid voluntary disclosure to SARS, certain requirements will need to be met by the taxpayer, as set out below:

- The disclosure must be voluntary. In other words, there must be no audit/ verification/open IT14SD for the year of assessment (if the default is, *inter alia*, one which would not otherwise have been detected during the course of the audit/investigation, then it is arguable that the disclosure is voluntary);
- The disclosure must involve a 'default', i.e. the submission of inaccurate or incomplete information to SARS, failure to submit information or the adoption of a tax position, where such submission, non-submission or adoption resulted in an understatement;
- The default must not have occurred within five years of the disclosure of a similar default;
- The disclosure must be full and complete in all material respects;
- The disclosure must involve a behaviour as contained in column 2 of the understatement penalty percentage table of the TAA i.e. (i) substantial understatement, (ii) reasonable care not taken in completing the tax return, (iii) no reasonable grounds for the tax position taken, (iv) impermissible avoidance arrangement, (v) gross negligence or (vi) intentional tax evasion;
- The disclosure must not result in a refund due by SARS; and
- The disclosure must be made in the prescribed form and manner, which includes completing the VDP01 form and submitting the VDP application to the VDP Unit via SARS' e-filing system.

However, in practice there are some challenges with the VDP process, including the fact that the TAA does not contain definitions of certain key terms, which then leads to the inconsistent interpretation and application of the VDP legislation.

A final mechanism that the taxpayer could utilise would be to lodge an objection, in the prescribed form and manner, to the assessment which was issued by SARS post the submission of the initial ITR14. However, certain timeframes must be adhered to – i.e. the objection must be lodged within 30 days from the date of the income tax assessment, or an extended date as agreed between SARS and the taxpayer, if the taxpayer can demonstrate reasonable grounds for the delay/exceptional circumstances which caused the delay (depending on how long the taxpayer takes to lodge the objection). Further, there is a risk that the taxpayer could be subject to understatement penalties.

The takeaway

- Taxpayers must ensure that in calculating their taxable income, any modification loss or gain is reversed. Taxpayers must assess where the modification loss or gain is recognised in the accounting records in order to make the relevant adjustment, as the mechanism of adding back closing impairment balance and deducting opening impairment balance does not result in an adjustment of the modification loss or gain in calculating the taxable income.
- To the extent that a taxpayer discovers that it has not made a full or accurate disclosure to SARS, there are remedies which the taxpayer could utilise, including the RFC channel, the VDP as well as objecting to the assessment issued by SARS. Given the intricacies associated with each potential remedy, it is important for taxpayers to seek advice on how to appropriately regularise their tax position. It is worth mentioning that a combination of the aforementioned remedies could be utilised, depending on the circumstances.

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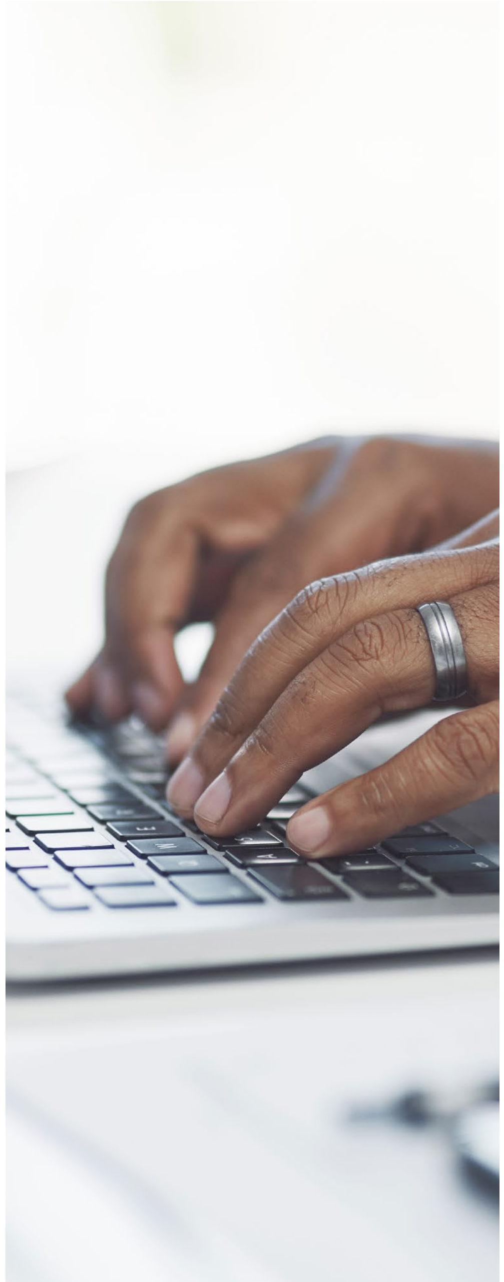

SARS Watch

SARS Watch 1 May 2021 – 31 May 2021

Legislation		
31 May 2021	Announcing the determined amount for purposes of paragraph (b)(x)(cc) of the proviso to the definition of 'retirement annuity fund' in section 1 of the Act. All previous notices withdrawn with effect from 1 March 2021	Income Tax Notice 474 published in Government Gazette 44640 with an implementation date of 28 May 2021.
31 May 2021	Prohibited, restricted and counterfeit goods. Amendment made to tariff heading – 2902.30 – Tolune	ITAC import and the export control regulations: requires an import and an export permit.
28 May 2021	Amendment to Part 1 of Schedule No. 1, to amend the rate of duty column headed 'EU' to read as 'EU/UK' in order to clarify the applicability of goods imported from the EU to also be applicable to goods imported from the UK and Ireland as per the SACU-M UK EPA agreement	Notice R461 published in Government Gazette No. 44635 with an implementation date of 28 May 2021.
28 May 2021	Amendment to the General Notes to Schedule No. 1, to change the reference from 'EU' to read as 'EU/UK' in order to clarify the applicability of goods imported from the EU to also be applicable to goods imported from the UK and Ireland as per the SACU-M UK EPA agreement	Notice R460 published in Government Gazette No. 44635 with an implementation date of 28 May 2021.
28 May 2021	Amendment to Part 6 of Schedule No. 1, to amend the rate of duty column headed 'EU' to read as 'EU/UK' in order to clarify the applicability of goods imported from the EU to also be applicable to goods imported from the UK and Ireland as per the SACU-M UK EPA agreement, 28 May 21	Notice R459 published in Government Gazette No. 44635 with an implementation date of 28 May 2021.
28 May 2021	Amendment to the Schedule No. 10, to change the reference from 'EU' to read as 'EU/UK' in order to clarify the applicability of goods imported from the EU to also be applicable to goods imported from the UK and Ireland as per the SACU-M UK EPA agreement, 28 May 21.	Notice R458 published in Government Gazette No. 44635 with an implementation date of 28 May 2021.
28 May 2021	Amendment to Part 1 of Schedule No. 3, by the insertion of rebate item 320.01/6005.3/01.05 in order to create a rebate facility for warp knit fabrics classifiable in tariff heading 60.05, for use in the manufacture of upholstered furniture – ITAC Report No. 647	Notice R457 published in Government Gazette No. 44635 with an implementation date of 28 May 2021.
21 May 2021	Customs & Excise Act, 1964: Draft amendment to rules under sections 59A, 60 and 120 – Registration and Licensing	Comments must be submitted to SARS by Monday, 14 June 2021.
19 May 2021	List of Qualifying Physical Impairment or Disability Expenses (Draft for Public Comment)	Comments must be submitted to SARS (SARSDisabilityTeam@sars.gov.za) by Monday, 31 May 2021.
14 May 2021	Notice in terms of section 25 of the Tax Administration Act, 2011, for submission of income tax returns for the 2021 tax year	Notice 419 published in Government Gazette No. 44751 with an implementation date of 14 May 2021.
14 May 2021	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 increase the rate of customs duty on wheat and wheaten flour from free of duty to 19,17c/kg and 28,76c/kg respectively, in terms of the existing variable tariff formula – Minute 01/2021	Tariff amendment notice R426, as published in Government Gazette No. 44578 with an implementation date of 14 May 2021.

Case law		
In accordance with date of judgment		
25 May 2021	CSARS v Tourvest Financial Services (Pty) Ltd (435-2020) [2021] ZASCA 61	Value-Added Tax Act, 1991: vendor conducting a currency exchange business through its branches, inputs acquired for use partly in making taxable supplies and partly in making exempt supplies, only entitled to deduct a portion of the input tax.
21 May 2021	Clicks Retailers (Pty) Limited v Commissioner for the South African Revenue Service [2021] ZACC 11	This matter concerns the tax treatment of retail loyalty programmes that are common in South Africa; whether an allowance under section 24C of the Income Tax Act, 1962, is available to Clicks Retailers (Pty) Limited (Clicks), a retailer which operates one such loyalty programme.
23 April 2021	SARSTC 13395	Whether the appellant was liable for capital gains tax.
31 March 2021	SARSTC IT 13178	Whether the appellant should be taxed on unexplained deposits in its bank account.
30 March 2021	SARSTC VAT 1999	Whether the appellant could amend its Rule 32 Statement.
25 February 2021	SARSTC IT 24606	Whether the appellant could claim capex in terms of section 15(b) of the Income Tax Act.
27 January 2021	SARSTC IT 24578	Whether the appellant was entitled to amend its Rule 32 Statement.
Interpretation note		
17 May 2021	IN 117 – Taxation of the receipts of deposits	This Note provides guidance on the words ‘received by’ in the definition of ‘gross income’ in section 1(1) and the treatment of the receipt of a deposit in the ordinary course of business.
17 May 2021	IN 93 (Issue 3) – The taxation of foreign dividends	This Note provides guidance on the interpretation and application of various provisions of the Act relating to foreign dividends.
14 May 2021	Draft IN 28 (Issue 3) – Deductions of home office expenses incurred by persons in employment or persons holding an office	Comments must be submitted to SARS by Monday, 14 June 21.
Rulings		
26 May 2021	BPR 364 – Extraordinary dividend followed by the dilution of shareholders’ interest	This ruling determines the capital gains tax consequences of a proposed special dividend, followed by a dilution of shareholders’ interest.
26 May 2021	BPR 363 – Value of a supply of services	This ruling determines the income tax and value-added tax consequences of the provision of certain services to employees.
26 May 2021	BPR 362 – Transfer of assets between share incentive trusts	This ruling determines the income tax consequences of the transfer of shares and cash from existing share incentive trusts to new share incentive trusts.
Guides		
20 May 2021	RLA Customs Trader Portal: External User-Manual	The guide aims to assist users who are required to apply electronically via eFiling.
13 May 2021	Guide to the Employment Tax Incentive (Issue 4)	This guide provides general guidance on the incentive.
Other publications		
31 May 2021	Tax Alert: The exchange of currency and apportionment of input tax	This alert discusses the judgment delivered on 25 May 2021, by the Supreme Court of Appeal in the matter of the Commissioner for the South African Revenue Services v Tourvest Financial Services (Pty) Ltd (435/2020) [2021] ZASCA 61.
27 May 2021	Tax Alert: 2021 Filing season	This Alert discusses the announcement made on 25 May 2021 by SARS as well as the schedule and submission requirements.
26 May 2021	Tax Alert: Changes to SARS eFiling	This alert discusses the recently made changes to SARS’ eFiling platform. The changes will have a significant impact on how tax practitioners and taxpayers interact with SARS on the platform relating to how tax types are transferred.
26 May 2021	OECD: Tax Transparency in Africa 2021	The report highlights the role of tax transparency and exchange of information in helping African governments stem illicit financial flows and increase domestic resource mobilisation.

20 May 2021	OECD: Opinions of the Conference of the Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting	The opinion that sets out a series of guiding principles for addressing questions about the interpretation and implementation of the MLI.
19 May 2021	OECD Tax Co-operation for Development: Progress report in the COVID-19 era	This report sets out the range of the OECD's work with developing countries in 2020.
11 May 2021	South African Revenue Service Strategic Plan 2020/21 – 2024/25	This sets out SARS's Strategic Intent "to follow the internationally recognized approach of Voluntary Compliance", and further translates this intent into nine clear strategic objectives.
10 May 2021	SARS Annual Performance Plan 2021/22	The SARS 2021/22 Annual Performance Plan seeks to ensure that SARS continues to build on the foundation already established, to rebuild its internal capacity and focus its efforts aggressively on addressing the tax gap and dealing with non-compliance more effectively.