Fear or Ethics: What is the Real Driver Behind Submitting a Tax Return?
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The first quarter of 2015 is over, and we have started the second quarter. This is an opportune time to reflect on what you have achieved in the first part of the year. Some had set themselves targets at the beginning of the year of growing their practices, client base, and their revenue. Some have set a target of timeliness in everything that they do, while others are aiming for a better work/life balance. Whatever your goals are, at least one quarter should be complete and achieved by now - if not, you have to work hard in ensuring that you achieve this soon.

IFAC recently released the results of the 2014 Global Survey on Small- and Medium-sized Practitioners (SMP) in which close to 500 SAIPA members participated. The survey results identified the following challenges as the highest-ranked challenges facing the SMPs:

1. Attracting new clients
2. Keeping up with new legislation and standards
3. Dealing with pressure to lower fees
4. Rising costs
5. Differentiation from the competition.

There is no argument that the above challenges rank almost the same for our SMPs in South Africa. The biggest question is, “How can we work towards overcoming the challenges”? Practitioners always complain that there is no time left in their busy schedules to even reflect on what is not going well with their practices and businesses. The unfortunate truth is that you need to have good strategies in place that will address the above challenges. Make a point of networking with other practitioners and sharing ideas. Utilise the time at the district and regional forums as well as the CPD workshops to engage with your peers. You could be very surprised that the person sitting next to you holds the answer to the problem that has been with you for days if not weeks and vice versa.

Take this to the rest of the year ahead and undertake to reduce your list or the impact of the highest challenges facing your practice. SAIPA COTE is always available to assist you and ensure that you run a successful practice/business, and when in doubt drop us an email and we will endeavour to assist you as soon as practically possible.

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As the saying goes, few things are as certain in life as death and taxes. And while there is little choice when it comes to paying taxes, there’s an interesting debate around what drives individuals to be tax compliant – is it the moral position that one should do the right thing and fulfil one’s obligations, or is it a fear of the penalties that can incur if we’re not compliant. We spoke to two tax experts to get the inside track.

To start with, one must examine exactly what it means to be tax compliant. It’s not as simple as going to SARS and getting a tax clearance certificate, although it may seem so on the surface.
Essentially, what the tax clearance certificate confirms is that an individual or company has indeed filed a tax return, but what it does not show is whether the information supplied to SARS is correct, and if everything that should have been declared and disclosed is visible on the tax return.

To some degree, SARS uses the individual’s moral compass to encourage people and companies to be tax compliant, believes Etienne Retief, Professional Accountant and Tax Specialist at FTR Tax and Corporate Administration. “SARS’ advertising campaign ‘thank you for filing honestly’ makes the assumption that people are honest when it comes to submitting their tax return, as without all the correct information and full disclosure, a tax assessment cannot be correct,” he says.

Errors are often unintentional, but to the same degree – tax avoidance is rife, and many people are not honest when it comes to filing a tax return. “The rule of thumb is this – the most fundamental aspect when it comes to paying tax is absolute honesty, and this to a large degree relies on the moral integrity of the taxpayer,” Retief continues.

When it comes to tax,宋 had a host of mechanisms in place that ensure tax is paid both honestly and timeously. “This is perhaps where the ‘fear factor’ comes in,” points out Du Plessis. SARS has a number of processes to check whether a tax return is compliant - for example, relationships with third parties such as banks, which allow it to check that the information supplied on a tax return is correct. To this end, SARS is well equipped to police compliance."

Ultimately, from high net worth individuals to multinational companies, there are always two ways to address the issue of tax. “On the one hand, you have individuals who truly are driven by a moral compass and they pay tax because it is the right thing to do. On the other, there will always be those who look to minimise their tax liability and are not averse to being untruthful,” Du Plessis explains.

However, dishonesty comes with its own risks, and SARS is able to impose hefty penalties on those who are found to have discrepancies on their tax returns. “There can be no question that many taxpayers are tax compliant out of fear – and who can blame them when SARS can inflict penalties of up 200%?” Retief stresses.

Of course, not all penalties are this harsh. However, submitting a late tax return could mean paying penalties in the form of interest on your personal tax, while non-compliance creates other penalties which vary in severity. Then come administration penalties which can be as much as R250,000, calculated on taxable income for incorrectly filling in a tax return – and this is over and above the penalty one can incur for late payment.

Using a scale of 0% to 200% SARS uses a table-based penalty system that looks at deliberate versus inadvertent attempts, and considers variables such as frequency and severity. “The fact that SARS can issue penalties encourages people to come clean voluntarily,” Retief believes, adding that this gives the taxpayer the opportunity to come to SARS before SARS comes to them. That said, the
person who fails to pay his tax return is unlikely to find himself behind bars – this is a whole different issue which assumes a criminal offence that must be proved in a court of law. These include deliberate criminal acts such as falsified documentation or false declarations and omitting the disclosure of certain assets.

What the taxpayer needs to disclose to SARS depends largely on the type of tax return that must be completed. That said, on the whole, every disclosure must be truthful, and disclosure must be correct and match up in all documentation. “It’s important to remember that SARS can access vast amounts of information about its taxpayers,” says Du Plessis. “This means the taxpayer is accountable for doing his own due diligence, ensuring that declarations can be supported and that balances reconcile. SARS uses data from third parties to compare disclosures, and mismatches must be avoided as they can lead to penalties. Ultimately, every piece of relevant information, no matter how seemingly insignificant must be disclosed. Overseas assets and investments must be included.

“Taxpayers who are unsure of what is required in terms of compliance should consult a tax professional,” Du Plessis stresses, adding that the new Tax Administration Act can impose penalties of up to 200% and one can end up paying more than the original tax amount in penalties. He points out that SARS’ first point of departure is that an error on a tax return must have been intentional and that, therefore, the burden of proof lies with the taxpayer who will have to motivate that a bona fide mistake has been made and that penalties should not be imposed.

Indeed, in the debate around what drives a taxpayer to pay his tax, it seems that to some degree the moral compass plays a role, while the risk factor - and the consequences of non-compliance - also looms large in the minds of the taxpayer.
With SARS not having disclosed details on the risk analysis tool that can trigger the auditing of a taxpayer, rumours have been spreading about how the authority goes about choosing individuals for audit.

If your employer or clients have been asking you how SARS selects taxpayers for audits, feel free to share this article with them.

Myth 1: SARS officials stalk individuals on social media

Truth: SARS does not have the resources to stalk people on social media, but they will act on tip-offs from the public. SARS will also notice discrepancies and improbabilities on returns compared with those filed in previous tax periods, which might prompt the Receiver to look into the growth of an individual's asset base over the past five years, or the comparison of answers on a lifestyle questionnaire provided by a taxpayer and other sources of information.

Myth 2: Certain demographics are more likely to be targeted for verification

Truth: The verification process isn’t targeted at specific demographic groups, but there are a few areas that seem to trigger the automated system used to identify individuals for verification. These areas, where non-compliance is traditionally highest, include medical expenses, home offices, travel allowances, repairs and maintenance of secondary properties and high-net-worth individuals. In addition to cases being selected for audit on the basis of risk, taxpayers may also be selected for audit on a random or cyclical basis.

Myth 3: Non-disclosure will protect a taxpayer from being selected for an audit

Truth: Non-disclosure does not reduce tax liability. The Tax Administration Act makes provision for SARS to access a wider range of information sources. Information provided by these sources can be used during the verification and auditing process, even on information that has not been disclosed to SARS by the taxpayer under investigation. Should any taxpayer be found guilty of non-disclosure they can expect penalties of up to 200%, as well as criminal charges.

Myth 4: SARS tricks sources into divulging information

Truth: SARS officials will not lie about their identity during the verification process, but questions might be stated in a way that catches the respondent unawares. The information source will divulge the information they have on hand, not the information as filed by the taxpayer under suspicion. It remains surprising how much information SARS officials gain from ex-partners, unhappy employees, and wronged family members. It is, therefore, of utmost importance that all tax returns are filed in a compliant and honest manner.

Myth 5: Misunderstandings and unintentional errors exempt taxpayers from penalties

Truth: Unintentional errors will be treated the same as intentional non-compliance, but overall tax behaviour will be taken into account by SARS when deciding on penalties. It is, therefore, of utmost importance for taxpayers to make use of qualified and SARS-registered tax practitioners to submit their tax returns. Tax professionals in turn must stay up-to-date with the latest regulations, as any tax practitioner that has filed incorrect or fraudulent information on behalf of a client can become liable for the resulting tax debt.
Tax professionals can often feel that they are stuck between the proverbial rock and hard place, having to juggle multiple obligations to clients and the law - and ensure that SARS’s deadlines are met. SARS’s drive to certify tax professionals is also raising the bar.

Tax regimes and guidelines are always changing, as are clients’ businesses, but following some simple guidelines can help tax professionals ensure they don’t lie awake worrying about whether they have everything under control.

In this article we’ve listed 10 common challenges that worry tax professionals - and some ideas for overcoming them.

1. **Meeting deadlines.** Taxes have to be filed at certain times, so it’s important for tax professionals to ensure they can meet their commitments timeously. Tax professionals should be good delegators and have trusted business partners to whom they can outsource some work. Learning to say ‘no’ is something that every business owner finds hard to do, but it’s vital to prevent oneself from getting overwhelmed or falling behind.

   The other side of the coin is to educate clients about when they need to pay taxes, and act proactively to steer them away from trouble. Build solid working relationships with clients so they work together with you to meet deadlines.

2. **Getting VAT returns filed accurately and on time.** There are tax deadlines and then there are the regular VAT returns. Because they occur so frequently and are complex, VAT returns can become a real and ongoing challenge for tax professionals. The only solution is to train clients to make sending
the information you require part of the routine. Give clients a template or checklist that will help make their lives - and your life - easier. Agree on regular submission dates and communicate immediately when they are not met.

3. **Implementing strong systems and processes.** A related point is that time spent making sure the practice has strong business processes and systems in place will go a long way towards ensuring smooth operations and deadlines that are met. It is vital to have the right human resources in place to do the various tasks and to check the work.

4. **Streamlining filing.** Accurate records are the backbone of a successful tax practice, but they can easily become a prime consumer of time and shelf space. The ‘one touch’ rule should be a part of the way tax professionals operate: scan each document first, so that it’s easily accessible when it’s needed. It makes sense to build in efficiency measurements to give employees a yardstick, and to enable you to make sure that continuous improvement is the name of the game.

5. **Becoming a trusted business advisor.** A common theme is the need to build a strong working relationship with clients to assist in meeting deadlines and, more generally, to enhance loyalty. In particular, tax professionals should ensure they have the information to help clients make the right business decisions at their fingertips.

6. **Communicating effectively with SARS.** Dealing with SARS has its frustrations, but communication is an important tool for making life easier for everybody. Understand SARS’s communications guidelines and abide by them - and keep your clients up to date with what you are communicating to SARS. Another piece of good advice is to develop templates to reduce time spent filing formal communications like objections.

7. **Delivering top-notch services to clients.** Meeting client requirements is critical to business success, but many tax professionals struggle to do everything. Sometimes they lack sheer manpower, sometimes it is specialised skills. You don’t have the time or skills to do everything. The critical thing is to recognise this fact and put robust partnerships in place to provide access to the skills needed. Smaller businesses in particular are using this kind of extended business model to help them compete - it can work well.

8. **Staying current.** Tax regimes, rules and regulations are subject to changes that are often significant, and are certainly frequent. Tax professionals need to be generally conversant with changes, but specialisation is a must. In one practice, individuals should have different specialities in order to ensure that the practice can deliver the advice clients need. Knowledge is the basis of good advice, and advice is what clients pay for.

9. **Applying tax and professional rules consistently and accurately.** Tax professionals deal with highly confidential and sensitive information. Protecting client information is key. Knowing what the rules are is the first step. As important, tax professionals should devote much of their energies to putting in place a range of systems, methodologies, templates and processes that will build following the rules into the way the practice does business. Automation is one important tool. The ultimate aim is to reduce the risk of client data being compromised, either by internal or external agencies.

10. **Protecting the business.** The cobbler’s children with no shoes; the doctor’s children with runny noses… Tax professionals are regulated and must ensure their SARS registrations are not rescinded due to the fact that their own tax affairs are irregular. If you’re not registered with SARS, you can’t file clients’ tax returns, so you will soon be without a business. Treat the business and yourself as clients and make sure your taxes are up to date. It’s something that’s essential to ongoing business success as a tax professional.
Introduction

The IT14SD is a supplementary declaration in which a company must reconcile Income Tax, Value-Added Tax (VAT), Pay-As-You-Earn (PAYE) and Customs declarations after the initial submission of the Return of Income (IT14/ITR14) for the applicable financial year end as specified in the verification letter.

Consequently, accountants and tax practitioners are faced with a daily dilemma:

- When to recognise and record revenue for financial reporting (accounting purposes),
- When to recognise revenue for income tax purposes and, lastly,
- When to recognise revenue for Valued-Added tax purposes.

Financial reporting (Accounting), income tax and valued-added tax (‘VAT’) are governed by different norms and standards. Each of these disciplines is a convention on its own right and, therefore, governed by vastly different legislation and standards.

Revenue recognition for financial reporting is governed by International Accounting Standards (IAS 18), while for income tax purposes it is governed by the Income Tax Act (‘ITA’) and, more specifically, by the definition of Gross income. Revenue recognition for the VAT, however, is governed by the Value-Added Tax Act (‘VAT Act’) and, specifically, the value and time of supply rules.
Financial reporting purposes (accounting)

The IAS defines ‘revenue’ as the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

For financial reporting purposes, revenue arises from sale of goods; when services are rendered; or when using someone else’s assets. When we consider revenue from sale of goods, revenue is only recognised once all the following has been met:

(a) When it is probable that the economic benefits will flow to the entity and these benefits can be measured reliably;

(b) The entity has transferred to the buyer the significant risks and rewards of ownership of the goods; and

(c) The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold

(d) In situation (i) it is necessary that the amount of revenue can be measured reliably in order for the revenue to be recognised for financial reporting purposes.

When a company sells goods, revenue should be recognised when it is probable that the economic benefits associated with the transaction will flow to the purchaser of the goods.

Income tax

For income tax purposes, an amount will be recognised as income as per the definition of ‘gross income’ as defined in the ITA.

‘Gross income’, in relation to any year or period of assessment, means –

i. In the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or

ii. In the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic, during such year or period of assessment, excluding receipts or accruals of a capital nature, but including, without in any way limiting the scope of this definition, such amounts (whether of a capital nature or not) so received or accrued as are described hereunder, namely -

(a) any amount received or accrued by way of annuity, including any amount contemplated in the definition of ‘living annuity’ or the definition of ‘annuity amount’ in section 10A(1), other than an amount contemplated in paragraph (d)(ii);

Therefore, an amount will be recognised for income tax purpose in relation to any year or period of assessment if the total amount, in cash or otherwise, received by or accrued to, or in favour of a person, from anywhere, in the case of a person who is a resident of South Africa. The income must not be of a capital nature.

In the case of a non-resident, revenue will be recognised for income tax purposes only from a South African source, other than receipts of a capital nature. Further investigation of these terminologies will not be necessary for this briefing.

Valued-added tax

With reference to VAT, the registration basis of the vendor is relevant. If a vendor is registered on an invoice basis, a taxable supply arises (the time of supply) at the earlier of the time an invoice issued by the supplier or the time any payment of consideration is received.

If a vendor is registered for VAT on the payment basis, the payment for the supplies by the customer triggers the timing of the VAT incidence and not the earlier of invoice or payment.

This the general rule for the time of supply as per the VAT Act. There are different times of supply rules for the following situations:

- Connected persons
- Rental agreement,
- Instalment credit agreement,
- Successive and progressive supplies
- Fixed property,
- Fringe benefits, and
- Lay-by agreements

Connected person

Where the supplier and the recipient are connected persons, a supply of goods or services is deemed to take place as follows:

- Where the supply is of goods to be removed, at the time of removal.
- Where the supply is of goods not to be removed, at the time the goods are made available to the recipient.
- Where the supply constitutes services, at the time the services are performed.
Rental agreement
When goods or services are supplied under a rental agreement which provides for periodic payment, each period is a separate supply which is deemed to take place at the earlier of
- When payment is due, or
- When payment is actually made.

Instalment credit agreement
When goods and services are supplied under an instalment credit agreement, the supply is deemed to take place the earlier of the time the goods are delivered or any payment of the consideration is received by the supplier.

Successive and progressive supplies
If the time of supply rule for successive and progressive supplies is applicable and the services are supplied to vendor in the construction, repair, improvement, assembly or alteration of goods, then the payment becomes due and payable in relation to the progress made. As a result, the time of supply is the earliest of the date when payment is due or is received, or any invoice relating to the payment is issued. So if the invoice is issued in the following year, then output tax is declared in the tax period when invoice was issued and assuming that no payment was made in the interim period.

Fixed property
In the case of VAT, goods consisting of fixed property or any real right therein are deemed to be supplied upon registration of transfer of the property in a deeds registry, or the date upon which any payment is made in respect of the consideration (whichever occurs first).

Fringe benefits
Where the cash equivalent of the benefit is required to be included in the remuneration of the employee who has received a benefit or advantage in terms of the Fourth Schedule to the Income Tax Act, the time of supply is the end of the month in which such benefit is required to be included as remuneration.

Lay-by agreements
When goods are supplied in terms of a lay-by agreement, the supply is only deemed to take place when the goods are delivered. A lay-by agreement is one where the consideration for the supply is R10 000 or less and the supply is reserved by the payment of a deposit. In these types of transactions, delivery usually only takes place when the full purchase price, or agreed portion thereof, is paid. The supplier is therefore not liable to account for any VAT on the amount received as a deposit unless and until delivery has taken place.

“...taxpayer does not have a choice in deciding when an amount accrued should be taxed. If a service was rendered in a prior year and that the monetary amount was also accrued in the prior year, then the accrued amount may be included in the gross income of the prior tax year.”

Conclusion
Generally, if the sale of goods was invoiced before year-end, such will be recognized as gross income for income tax, and a supply for VAT purposes. However, the risk and reward of ownership of the goods have not yet transferred at year-end, such will not be ‘revenue’ as per IAS18. The taxpayer does not have a choice as to whether an amount must be taxed at the time of receipt or at the time result in increases in equity, other than increases relating to contributions from equity participants. However, only the profit arising from the sale of fixed property will be included as income for accounting purposes. It is also not relevant for income tax purposes because the sale of property is of a capital nature, and only the recoupments will be included in the ‘gross income’ for income tax purposes.
of accrual. If the amount is accrued to a taxpayer, it must be included in the gross income at the date accrued corresponding to the appropriate tax-year. Essentially, gross income is triggered at the earlier of the date
- An amount is received, or
- An amount is accrued.

The taxpayer does not have a choice in deciding when an amount accrued should be taxed. If a service was rendered in a prior year and that the monetary amount was also accrued in the prior year, then the accrued amount may be included in the gross income of the prior tax year. If the taxpayer is a vendor, the amount to be disclosed for financial reporting and income tax purposes should not include the amount for VAT.

### Comprehensive example

**Examples of transactions and the revenue recognition in terms of Financial Reporting (Accounting); Income Tax and VAT**

<table>
<thead>
<tr>
<th>Transactions</th>
<th>Accounting</th>
<th>Income tax</th>
<th>VAT</th>
<th>Explanation</th>
<th>Income Tax</th>
<th>VAT</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bill &amp; Hold sales: delivery is delayed at the buyer’s request</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Buyer acknowledges deferred delivery instruction usual payment period applied</td>
<td>Either payment received or income accrued</td>
<td>Payment is received or invoice issued</td>
<td></td>
</tr>
<tr>
<td>Lay away sale: good delivered only when buyer makes final payment</td>
<td>Y</td>
<td>Y</td>
<td>Depends</td>
<td>When goods delivered or when a substantial deposit has been paid</td>
<td>Payment is received</td>
<td>If supply is less than R10 000 account for VAT only when delivery takes place</td>
<td></td>
</tr>
<tr>
<td>Payment received in advance of delivery where goods are not yet manufactured</td>
<td>N</td>
<td>Y</td>
<td>Y</td>
<td>Recognised when the goods are delivered to the buyer</td>
<td>Payment received</td>
<td>Payment received (or invoice issued)</td>
<td></td>
</tr>
<tr>
<td>Sale &amp; repurchase agreement - on assets</td>
<td>Depends</td>
<td>Depends</td>
<td>Depends</td>
<td>Whether risks and ownership are transferred</td>
<td>Either payment received or income accrued</td>
<td>Contracts agreement and invoice issue</td>
<td></td>
</tr>
<tr>
<td>Sale to intermediate parties: distributors &amp; wholesalers</td>
<td>Depends</td>
<td>Depends</td>
<td>Depends</td>
<td>If risks and ownership are transferred</td>
<td>Either payment received or income accrued</td>
<td>Payment received or invoice issued</td>
<td></td>
</tr>
<tr>
<td>But if sold on a consignment basis at date of sale</td>
<td>N</td>
<td>N</td>
<td>Depends</td>
<td>Only recognise revenue when goods have been sold to 3rd party</td>
<td>Not received and not accrued</td>
<td>Whether payment or invoice issued</td>
<td></td>
</tr>
<tr>
<td>Subscription to publications and similar items</td>
<td>Y</td>
<td>Y</td>
<td>Depends</td>
<td>On a straight line basis over the period of the subscription</td>
<td>Either payment received or income accrued accrued</td>
<td>Time of supply is the earliest of the date when payment is due or invoice relating to payment is issued</td>
<td></td>
</tr>
<tr>
<td>Installment sales under which the consideration is receivable in instalments</td>
<td>Y</td>
<td>Y</td>
<td>Depends</td>
<td>Revenue attributable to sale price - date of sale</td>
<td>If accrued or if received</td>
<td>Time of supply is the earliest of the date when payment is due or invoice relating to payment is issued</td>
<td></td>
</tr>
<tr>
<td>But the interest</td>
<td>Y</td>
<td>Y</td>
<td>N</td>
<td>Recognised as earned</td>
<td>If accrued or if received</td>
<td>Exempt from VAT</td>
<td></td>
</tr>
</tbody>
</table>
The need for medical aid, or at least a hospital cover, has become an essential for most people. However, the decision to join a scheme or not is greatly dependent on affordability, cash flow, tax deduction or credits, and health cover needs. This article is not intended to give financial advice, but only to consider the tax perspective with regards medical insurance and medical aid top-up policies.

Medical/health insurance policies (also marketed as hospital cash plans) typically will be cheaper than medical aid or hospital cover and will pay the insured an amount for each day in hospital. This type of policy could be sold by either long-term or short-term insurance providers.

Gap cover (also referred to as medical aid top-up policies) generally covers the shortfall between the actual medical costs and what the medical scheme pays towards such costs. Considering that medical schemes have predefined cover and prescribed rates, this type of policy could be sold by a short-term insurance provider.

Both are constantly criticised to be limited by means of regulation. The greatest issue has been that these insurance policies are priced based on risk, while avoiding have the same onerous regulations and minimum benefits that a medical scheme would have. The medical scheme has to spread the risk, provide minimum benefits, and is left to cover the bad risk and the struggle to compete for the good risks. This all is expected to push up the medical scheme contributions, which are already regarded as being high.

In order to understand the tax implications, one must first distinguish between a ‘medical scheme’ that is registered under the Medical Schemes Act 131 of 1998, and a ‘medical insurance policy’ that falls outside the provisions of the Medical Schemes Act. For the premiums paid, a medical scheme has prescribed minimum benefits that must be provided, whereas a medical insurance policy has no such legislative requirement.

Premiums paid to a medical scheme (which includes hospital cover, and not only full medical aid) qualify for a medical tax credit (previously a deduction). However, premiums paid on a medical insurance policy do not qualify for medical tax credit (or deduction) as such a policy is not a scheme registered under the Medical Schemes Act.

Benefits paid from either medical scheme or medical insurance policy is tax free in the hands of the beneficiary of such scheme or policy.
So, while medical insurance policy premiums may be cheaper than the premiums of a medical scheme, the premium paid for the medical insurance policy does not qualify for the medical tax credits, and no other deduction is available.

When claiming medical expenses, other than premiums to medical scheme or medical insurance policy, with regards to the medical tax credits (previously deductions), the Income Tax Act prescribes such medical expenses to be actually incurred and ‘not recovered’. So, does the cover provided by a medical insurance policy constitute recovery? If you incurred R50,000 of medical expenses, and you received R20,000 from the medical insurance policy, will you only be entitled to claim R30,000 as an out of pocket medical expense?

Section 18 of the Income Tax Act (with regards deduction for out-of-pocket medical expenses) was repealed and replaced with section 6B, with effect from 1 March 2014, allowing a medical tax credit for qualifying medical expenses.

Section 6B(1) provides a definition for ‘qualifying medical expenses’ in determining the medical tax credit, which includes medical expenses ‘which were paid by the person during the year of assessment’, and with regards physical impairment or disability must be ‘necessarily incurred and paid …’. However, the definition restricts the ‘qualifying medical expenses’, as only expenses paid ‘other than amounts recoverable by a person or his or her spouse’ will be considered. This means that any recovery will reduce the medical expenses that qualify for the medical tax credit. Similar wording was contained in section 18, previously applied with regards deductions.

This limitation effectively limits the medical tax credits to the net out-of-pocket medical expenses, after recognizing the recovery from a policy. If this limitation is not applied to medical insurance policy pay-outs, the taxpayer will be allowed a medical tax credit and a tax-free receipt of policy proceeds, which ignores the actual net outflow for the taxpayer.

It is important to note that the limitation ‘other than amounts recoverable by a person or his or her spouse’ is based on ‘recoverable’ and not ‘recovered’. If the limitation was based on ‘recovered’ then any recovery not received during the year of assessment could be ignored. However, the use of ‘recoverable’ does not require the recovery to actually be made during that year of assessment, but the accrual of or right to claim recovery should be recognized.

When claiming the medical tax credit with regards medical expenses (section 6B) you should not only consider what medical expenses was not covered or paid for by a medical scheme, but also consider any recoverable (not only medical insurance policies) with regards those medical expenses.

UIF UPDATE

Ettiene Retief, Head of SAIPA-CoTE Tax Committee

The Minister of Finance presented the National Budget during February 2015, which included a proposed temporary reduction of UIF contribution, funded by a surplus held by the Labour Department. The proposal was subject to consultation and after considering public comment.

The Minister announced at the end of April 2015 that the proposed UIF threshold reduction will not be implemented, following engagement with NEDLAC and other labour and business constituencies.

The consultation process also highlighted various concerns, such as the need to implement the UIF Amendments Bill that was tabled in 2014, which aims to extend benefits to workers who contribute towards the Fund.

The statement made by the Minister of Finance also indicated that further consultation with stakeholders is required, which will focus on:

- Implementation of the agreed UIF Amendments Bill to extend benefits to workers who contribute towards the Fund;
- Review of earmarked taxes (UIF, RAF, Skills Development Levy) to address fiscal imbalances that have emerged, whether in the form of surpluses and or deficits; and
- The process for social security reform, and the need to initiate broader consultations on the road ahead, and the challenges facing such reforms.

The Labour Minister recently commented that when the Unemployment Insurance Amendment Bill is promulgated by Parliament, the period in which people can draw unemployment benefits will be extended from eight months to a year.
Medical expenses are divided into two distinct categories:

- Contribution paid to a registered medical aid scheme (Section 6A of the Income Tax Act of 1962 (as amended).
- Other qualifying medical expenses (usually referred to as out-of-pocket expenses) - Section 6B of the Income Tax Act of 1962 (as amended).

Section 6A of the Income Tax Act of 1962 (as amended) – Medical Scheme fees tax credit

Section 6A of the Income Tax Act refers to the medical scheme tax credit (MTC). The contributions to a medical aid scheme will be used to determine the MTC and tax credit the taxpayer is entitled to claim.

The contributions must have been paid by the taxpayer to any medical scheme registered under the provisions of the Medical Schemes Act (Act 131 of 1998).

This section of the Income Tax Act relies on a broader definition of the term ‘dependent’ as defined in Section 1 of the Medical Schemes Act 131 of 1998. ‘Dependants’ are defined as

(a) the spouse or partner, dependent children or other members of the member’s immediate family in respect of whom the member is liable for family care and support; or

(b) Any other person who, under the rules of a medical scheme, is recognised as a dependent of a member

The term ‘immediate family’ refers to a person’s spouse or life partner, parents (including adoptive and step-parents), children (including adopted and step-children) and siblings. This means that the taxpayer may make any contributions for him- or herself, his or her spouse and any dependent, to any medical scheme. The requirement is explicit.
that only the contribution personally paid by the taxpayer to a registered medical aid scheme will be taken into account in determining the medical tax credit (MTC). As long as the taxpayer pays the medical aid contribution for any of these aforementioned people from the taxpayer’s own financial resources, the taxpayer may claim the medical scheme’s fees tax credit. In other words, the amount paid on behalf of a dependent person by the taxpayers entitles the taxpayer to deduct a medical tax credit from normal tax.

The taxpayer will qualify for a medical deduction based on the number of dependents for whom the taxpayer contributes to a medical scheme.

**Monthly tax credit**

Monthly tax credits for medical scheme contribution were increased from 1 March 2015:

<table>
<thead>
<tr>
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<th>2015/16</th>
<th>2014/15</th>
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<tbody>
<tr>
<td>For the first two beneficiaries</td>
<td>R257</td>
<td>R270</td>
</tr>
<tr>
<td>For each additional beneficiary</td>
<td>R172</td>
<td>R181</td>
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</table>

It is irrelevant whether or not the spouse is employed because the broad definition of dependent makes no reference to the employment status of a ‘dependent’ wife or spouse. Therefore, in terms of the definition of ‘dependents’, the husband should be able to claim the tax credit in terms of section 6A of the Income Tax Act.

It does not necessarily mean that both the taxpayer’s dependent and the taxpayer must belong to the same medical aid scheme in order to claim the section 6A medical tax credit. Only contributions paid to a medical aid scheme by the taxpayer personally will be taken into account in determining the medical tax credit.

Medical costs incurred and paid by a person other than the taxpayer will not be taken into account when the medical tax credit is determined for the taxpayer, except for –

- Qualifying medical costs paid by the estate of a deceased taxpayer for the period up to the date of the taxpayer’s death. These costs are deemed to have been paid by the taxpayer on the day before the taxpayer’s date of death; and
- Qualifying medical costs paid by an employer of the taxpayer, to the extent that the amount has been included in the income of the taxpayer as a taxable benefit.

It is important to note that the medical scheme contributions are actually paid by the taxpayer and must not be due and still payable.

**Section 6B of the Income Tax 58 of 1962 (as amended) – Additional Medical expense tax credit (also known as out-of-pocket expenses)**

Section 6B of the Income Tax Act has its ‘own’ definition of a ‘child’ and ‘dependent’ which is much narrower than definition applicable to Section 6A above. It reads as follows:

**6A Additional medical expenses tax credit**

For the purposes of this section

‘Child’ means a person’s child or child of his or her spouse who was alive during any portion of the year of assessment, and who on the last day of the year of assessment:

(a) Was unmarried and was not or would not, had he or she lived, have been -

- Over the age of 18 years;
- Over the age of 21 years and was wholly or partially dependent for maintenance upon the person and has not become liable for the payment of normal tax in respect of such year; or
- Over the age of 26 years and was wholly or partially dependent for maintenance upon the person and has not become liable for the payment of normal tax in respect of such year and was a full-time student at an educational institution of a public character; or

(b) In the case of any other child, was incapacitated by a disability from maintaining himself or herself and was wholly or partially dependent for maintenance upon the person and has not become liable for the payment of normal tax in respect of that year;

‘Dependent’ means:

(a) A person’s spouse;
(b) A person’s child and the child of his or her spouse;
(c) Any other member of a person’s family in respect of whom he or she is liable for family care and support; and
(d) Any other person who is recognised as a dependent of that person in terms of the rules of a medical scheme or fund contemplated in section 6A(2)(a) (i) or (ii), at the time the fees contemplated in section 6A(2)(a) were paid, the amounts contemplated in paragraph (a) and (b) of the definition of ‘qualifying medical expenses’ were paid or the expenditure contemplated in paragraph (c) of that definition was incurred and paid;
To qualify for a deduction for medical expenses, the taxpayer must meet all the aforementioned requirements.

The following persons are not included in the definition of a ‘child’:

- A foster child (regardless of the period the child is in the taxpayer’s care).
- A child who has not yet been legally adopted.
- A child who is under the taxpayer’s custodianship.

If, for example, the child is 21 years old, but is liable for income tax, the taxpayer cannot claim any medical expenses for the ‘child’. If the child is under 18, but is married, the taxpayer may not be able to claim the medical expenses paid for the ‘child’.

Medical expenses relating to services and prescribed medical supplies (out-of-pocket expenses) paid by the taxpayer during the year of assessment will be taken into account in determining the tax deduction, provided these expenses have been paid for the benefit of the taxpayer, taxpayer’s spouse, taxpayer’s children or the children of the taxpayer’s spouse or any of the taxpayer ‘dependents’ as defined in section 6B (1) of the Income Tax Act.

In order to be considered for a tax deduction, the expenses must not be

- Recoverable from the taxpayers’ medical scheme; and
- Must have been incurred and paid before any claims for tax deduction may be made.

"Medical expenses relating to services and prescribed medical supplies (out-of-pocket expenses) paid by the taxpayer during the year of assessment will be taken into account in determining the tax deduction, provided these expenses have been paid for the benefit of the taxpayer and/or the taxpayer’s dependents."

The contributions to the medical aid scheme must not be simply due and payable. It is observed that some medical aid societies list both the contribution paid to it and the amounts ‘not recovered by the taxpayer for medical services’. The amount ‘not recovered by the taxpayer for medical services’ is not proof that the taxpayer has paid for these medical services. The taxpayer must provide proof of payment for these medical services, such as receipts from the actual supplier, copy of the cheque issued to the supplier and any other documentation confirming beyond doubts that payment was actually made by the taxpayer for medical services supplied beyond.

In addition to the medical tax credit (MTC) available to taxpayers in term of section 6A of the income Tax Act, the taxpayer will be entitled to a tax credit in terms of Section 6B of the Income Tax act. These additional tax credits are based on the following taxpayer’s situation:

- An individual who is 65 and older, or if that person, his or her spouse or child is a person with a disability, 33,3% of qualifying medical expenses paid and borne by the individual and an amount by which the medical scheme contributions paid by the individual exceed three times the medical scheme fees tax credits for the tax year.
- Any other individual, 25% of an amount equal to qualifying medical expenses paid and borne by the individual and an amount by which the medical scheme contributions paid by the individual exceed four times the medical scheme fees tax credits for the tax year.

Only the ‘excess’ medical scheme contributions are taken into account for the section 6B credit, meaning that if the difference of medical scheme contributions paid and three or four times section 6A tax credits may not be negative, and is therefore limited to nil.

In order to qualify as a ‘disability’ for purposes of the tax credit, such must be a qualifying ‘disability’ as defined per section 6B(1), which is a moderate to severe limitation of a person’s ability to function or perform daily activities as a result of a physical, sensory, communication, intellectual or mental impairment, if the limitation:

- Has lasted longer or has a prognosis of lasting more than a year, and
- Is diagnosed by a duly registered medical practitioner and the said medical practitioner has completed the prescribed SARS form ITR-DD.

*This article replaces pages 47 – 49 of the 2015/16 SAIPA Tax Guide.
The OECD’s adoption of country-by-country reporting (CbCR) was issued in September 2014 as part of the ongoing review of base erosion and profit shifting (‘BEPS’).

CbCR is intended as a tool for tax authorities to risk assess MNEs’ transfer pricing. This will greatly increase transparency for local tax authorities through the reporting of key financial metrics across a group. It is anticipated that this, together with the wider changes in the transfer pricing documentation requirements contained in the new Chapter V of the OECD Guidelines, should contribute to reducing the tax fiscal deficit in 2015.

Although South Africa is not a member of the OECD, we do have observer status, and transfer pricing legislation contained in section 31 of the SA Income Tax Act is modelled on the OECD Guidelines. The David Tax Committee, in their interim report addressing BEPS in South Africa, have indicated in their recommendations for South Africa that preparation of a master file, local file and country-by-country reporting should be compulsory for large Multinational businesses. A recommended threshold is businesses over R1 billion group turnover. As the OECD recommends, with regard to compliance matters under the heading ‘materiality’, disproportionate and costly documentation requirements should not imposed on SMEs.

It has been noted by the Committee that ‘the OECD recommends that it uses the most reliable information which is usually local comparables over the use of regional comparables where such local comparables are reasonably available. In this regard, it is important that SARS builds a database of comparable information. In this respect:

- SARS needs to establish a highly skilled transfer pricing team to include not only lawyers and accountants, but also business analysts and economists, to ensure an understanding of commercial operations. This will require that measures are taken to identify, employ and retain skilled personnel, especially in the regions.
- Information required from corporates via the IT14 submissions needs to be improved so that timely decisions can be made on the tax assessment of companies.
- The collection and sharing of data should be extended to include other holders of vital information such as exchange control information about capital outflows collected by the South African Reserve Bank’.

BEPS will impact on the way companies do business in 2015, creating greater transparency and visibility which could potentially increase the number of tax audits and corresponding revenues to government coffers. This would particularly impact on the larger multinational businesses. It is anticipated that there will be a significant increase in taxpayer costs in terms of compliance and reporting systems.

SARS will be focusing on establishing teams and sharing of data to recognise anticipated revenue and reduce the tax deficit in 2015. Although it is anticipated that SARS will be taking great strides to do so, the effect of these changes to the fiscus may not be fully realised in 2015.
In order to reduce poverty levels, government facilitates ownership of residential property to low-income South Africans. Therefore, government has crafted tax legislation to support employers who provide low-cost housing to low-income employees.

It is given that the sale of low-cost houses to employees at below market value would result in a taxable fringe benefit for employees in receipt of low-cost housing. Commensurate with government’s overall anti-poverty objectives and with effect from 1 March 2014, no fringe benefit tax will be payable for houses sold to employees at below market value if:

- The employee earns remuneration of less than R250 000 (‘remuneration’ includes salary, bonus, fringe benefits, overtime, etc.) in the preceding year of assessment in which the acquisition takes place.
- The market value of the property does not exceed R450 000.

It is expected that the employer would provide the required loans to their low-income earning employees in order to finance the acquisition of residential property. It is noted that the below-the-official rate of interest loans provided by employers to employees still remains a taxable fringe benefit under the new tax legislation. It is hoped that future tax legislation would rectify this anomaly.

The purpose of this article is to examine the capital gains tax (CGT) implications of when a company disposes of a residential property to its low-earning employee. What are the tax consequences for the employer if the property is sold to the low-earning employee at market value?

The relevant section of the Income Tax Act 1962, as amended is section 13sept. This section refers to the permissible deduction for income tax purposes in respect of the sale by an employer of low-cost residential units to an employee. A synopsis of Section 13sept is as follows:
An employer is allowed a deduction when low-cost residential units are sold to employees if the following requirements are met:

- The disposal of the low-cost property has to be to an employee;
- The sale of the property must not exceed the employer’s actual cost of the low-cost housing unit (the market value of the property must not exceed R450 000);
- The acquisition of the residential property by an employee must be facilitated through an interest-free loan from the employer;
- Upon termination of employment, the employee is required to sell the property back to the employer for an amount equal to or less than the actual cost;
- If the employee does not pay an amount owing to the employer for a minimum period of three months, then the property must be sold to the employer.

The employer is allowed a 10% deduction of any amount owing to the employer by the low-income-earning employee at the end of the tax-year.

Section 13sept of the Income Tax Act

In Section 13sept (3) (a) (ii) it is explicit that the employer is not permitted to sell the unit above its cost price including the cost of the land.

It is given that the sale of a low-cost residential unit by employer to the employee is a ‘disposal of’ an asset and, therefore, a CGT event is triggered. However, there cannot be a capital gain, because the sale of the unit, in terms of section 13sept, may not be sold at a price above the cost price including the cost of the land (but excluding the finance charges).

Furthermore, it is noteworthy that the SARS Interpretation Note 67 on ‘connected persons’ (February 2014 edition) does not list an employee as a connected person in relation to the employer.

Therefore, both paragraph 38¹ and 39² of the Eighth Schedule of the Income Tax Act would not be applicable. The employer would be able to dispose of the property at less than market value and the capital loss would be recognised, and the ‘closed clogged’ rules for capital loss would not apply as implicit in paragraph 39 of the Eighth Schedule. Therefore, the taxpayer (employer in this situation) could deduct the capital loss against the capital gain in the current or future tax-year depending on which tax-year there is a capital gain, and would not be restricted by the ‘connected parties’ rules for capital losses.

Taxpayers must be mindful that section 13sept applies to low-cost residential units only. This is an important limitation of section 13sept. Low-cost residential unit is defined in section 1 of the Income Tax Act and the following is a summary of what constitutes low-cost housing:

- A building qualifying as a residential unit located in South Africa and the cost of the building does not exceed R300 000; or
- A residential apartment in a building located in the Republic where the cost does not exceed R350 000;
- The cost of the land and infrastructure is excluded;
- If the apartment is let, the owner may not charge a rental that exceeds 1% of the cost of the apartment and the building;
- The monthly rental can be increased by 10% each year.

The tax relief for the employer is not based on the cost of the unit, but on the amount owed by the employee.

Furthermore, the proceeds from the sale is not reduced either. The special recoupment rules, crafted specifically for section 13sept, is not linked to the disposal of the residential unit, but only to the payment made by the employee to the employer. However, there could be a capital loss arising if the residential unit is sold to the employee at a price less than the actual cost to the employer.

1) Paragraph 38 refers to disposal by way of donation and transactions between connected persons not at arm’s length price and therefore requires the seller (employer in this situation) to treat the disposal as having been disposed of at market value.

2) Paragraph 39 refers to capital losses determined in respect of disposal to certain connected parties.
Given the poor economic climate that South Africa (and much of the world) has endured for the last six years, it is not surprising that many companies have assessed losses. It is often tempting for a group of companies to utilize assessed losses of a particular entity in the group by, for example, transferring certain business operations to such entity.

In this regard the provisions of section 103(2) of the Income Tax Act must be considered.

Section 103(2) is an anti-avoidance provision which essentially allows the Commissioner of the South African Revenue Service (‘the Commissioner’) to disallow the setting off of an assessed loss or balance of an assessed loss against the company’s income if certain requirements are met.

In this regard, section 103(2) provides that:

‘Whenever the Commissioner is satisfied that—

(a) any agreement affecting any company …; or
(b) any change in —
   i. the shareholding in any company; or
   ii. …. as a direct or indirect result of which—

G
A income has been received by or has accrued to that company … during any year of assessment; or

B …has at any time been entered into or effected by any person solely or mainly for the purpose of utilizing any assessed loss, any balance of assessed loss, any capital loss or any assessed capital loss, as the case may be, incurred by the company …, in order to avoid liability on the part of that company … or any other person for the payment of any tax, duty or levy on income, or to reduce the amount thereof—

(aa) the set-off of any such assessed loss or balance of assessed loss against any such income shall be disallowed;

In light of the above, two requirements must be met in order for section 103(2)(b) to apply, i.e. the Commissioner must be satisfied that , inter alia,

- Any agreement has been entered into which directly or indirectly gave rise to income being received by such company (“the first requirement”); and

- That such agreement has been effected solely or mainly for the purpose of utilizing any assessed loss incurred by the company in order to avoid any tax liability, or to reduce any tax liability (“the second requirement”).

The first requirement
‘As a direct or indirect result’

Juta’s Commentary on the Income Tax Act provides that there is no limitation on the meaning of an ‘indirect result’, and the chain of causation may therefore be long and involved, so long as not broken.

In the case of New Urban Properties Ltd vs. SIR 1966 (1) SA 215 (A), it was held that it will always be a question of fact whether a company has derived income ‘directly or indirectly’ as a result of the change of shareholding.

The second requirement
Section 103(2) can only apply if the relevant change in shareholding was entered into with the sole or main purpose of utilizing an assessed loss to reduce or avoid tax.

‘Sole or main purpose’

The word ‘purpose’ is not defined in the Income Tax Act, but is generally defined to be ‘something set up as an object or end to be obtained’ (refer Merriam Webster Online Dictionary), ‘the reason for which something exists or is done, made, used, etc.’ and ‘an intended or desired result, end, aim, goal, practical result, effect’ (refer Dictionary.com).

The test as to ‘purpose’ is a subjective test and, although not decisive, the taxpayer’s ipse dixit as to his state of mind or the purpose of the transaction is the most important factor.

In ITC 1347 (1981) 44 SATC 33, a taxpayer acquired a company with an assessed loss. In considering the taxpayer’s ipse dixit, two of the factors considered by the court were that, although it was assumed that the company had an assessed loss, no specific enquiries were made by the taxpayer to determine the extent of such loss and nothing was paid for the acquisition of the assessed loss.

Furthermore, in ITC 1388 (1983) 46 SATC 126, a taxpayer acquired the shares in two separate entities and attempted to utilize their respective assessed losses. In allowing such utilization pertaining to one of the companies, a number of factors were taken into consideration. Although the accounting statements reflected that the company had an assessed loss, this loss had at no time been mentioned during the negotiations and played no part in the determination of the purchase price. Since sufficient commercial reasons were advanced for the transaction and the fact that the determination of the extent of the assessed loss was not one of the major considerations, it was found that the taxpayer could utilize such assessed loss.

“...there is no abnormality requirement in section 103(2) and that if, for example, it could be shown that a company was acquired for good commercial reasons and that the set-off of income against the assessed loss was merely incidental to the main purpose then section 103(2) would not apply.”

The first requirement
‘As a direct or indirect result’

It has been pointed out by Philip Haupt in Notes on South African Income Tax 2014, at page 656, that there is no abnormality requirement in section 103(2) and that if, for example, it could be shown that a company was acquired for good commercial reasons and that the set-off of income against the assessed loss was merely incidental to the main purpose then section 103(2) would not apply.
loss, since the main or sole purpose in entering into the transaction was not to acquire such loss. Section 103(2) was therefore not applicable.

Similarly, in *ITC 983* (1961) 25 SATC 55, the court found that, where a clothing manufacturing company had acquired a subsidiary with a balance of assessed loss and had then introduced income into that subsidiary, the sole or main purpose of the acquisition was not the acquisition of the assessed loss but rather to enable the company to obtain a productive manufacturing unit that could go into immediate operation to supplement its own productive capacity. Section 103(2) was therefore not applicable.

In *ITC 989* (1961) 25 SATC 122 the taxpayer company, had carried on business for a considerable period as a timber merchant and had incurred trading losses which resulted in an assessed loss. All the shares in the taxpayer company were then offered to and acquired by another company (i.e. the holding company) in the timber business. This holding company produced items made from wood such as doors which were marketed through a subsidiary company.

Prior to the acquisition of the shareholding of the taxpayer company, the holding company also utilized this subsidiary company to sell timber to builders, and tried to utilize it to sell timber to merchants also, but experienced difficulties in doing so because the practice of selling direct to builders led to the undercutting of merchants who consequently refused to buy from the subsidiary. After the acquisition, the holding company revised its selling arrangements and effected its sales of timber to builders through the taxpayer company. The timber was sold to it at the normal prices charged to merchants and was in turn resold by it to builders at retail prices.

In determining the liability for normal tax of the taxpayer company for the first year after the sale of its shares, the Commissioner applied s 90(1)(b) of the Income Tax Act 31 of 1941 (the equivalent of s 103(2)) and disallowed the set-off of the balance of its assessed loss against its income.

The court held that, on the facts, the taxpayer company had shown that neither its sole nor its main purpose was the avoidance of liability for tax. While there was some advantage derived by the holding company in purchasing the shares of the taxpayer company and thus acquiring the benefit of its assessed loss, the holding company was able to show that material benefits accrued to it, for example, benefits flowing from the separation of the wholesale and retail trades. Accordingly there appeared to be good reason to believe that the purchase of the shares would, in fact, have been a profitable and advantageous purchase even if there had been no assessed loss. Section 103(2) was therefore not applicable.

In light of the cases set out above, it is therefore a subjective and factual enquiry as to whether, for example, the acquisition of a business by an assessed loss company has been entered into solely or mainly for the purpose of utilizing its assessed loss.

In terms of section 103(4) of the Income Tax Act, the taxpayer bears the onus of proving or showing that the relevant change in shareholding was not entered into with the sole or main purpose of utilizing an assessed loss to reduce, postpone or avoid tax.

As set out in *ITC 989* it should be ensured that there are sufficient business-related reasons for entering into the transaction, i.e. that these business reasons constitute the main reason for the transaction. It should also be ensured that, as a factual matter, the assessed loss company would, for example, acquire the business from the other entity even if it did not have an assessed loss.

The word ‘purpose’ is not defined in the Income Tax Act, but is generally defined to be ‘something set up as an object or end to be obtained’ (refer Merriam Webster Online Dictionary), ‘the reason for which something exists or is done, made, used, etc.: and “an intended or desired result, end, aim, goal, practical result, effect” (refer Dictionary.com).

The test as to ‘purpose’ is a subjective test and, although not decisive, the taxpayer’s ipse dixit as to his state of mind or the purpose of the transaction is the most important factor.
The judgment of the Supreme Court of Appeal in Commissioner SARS vs. Bosch (394/2013) [2014] ZASCA 171 (19 November 2014) (Bosch case) dealing with the fiscal consequences of a deferred delivery transaction is not only important in the context of the meaning of simulation, but also with reference to the way in which legislation should be interpreted.

In the Bosch case the question arose as to the meaning of s8A of the Income Tax Act, No 58 of 1962, which read that there was to be included in a taxpayer's income an amount of any gain made by him by the exercise, cession or release during a year of assessment of any right to acquire a marketable security.

The issue in dispute was whether the right to acquire shares arose when the taxpayer exercised the option to acquire shares or only when the time for payment and delivery of the shares arrived. It was indicated that, as a starting point, the words of the section must be considered in the light of their context, the apparent purpose of the provision and any relevant background material. It was indicated that there may be ‘rare’ cases where the words in the statute are only capable of bearing a single meaning. However, outside those types of scenarios, it was indicated that it is ‘pointless’ to refer to a statutory provision having a plain meaning. It was indicated that one meaning may strike the reader as syntactically and grammatically more plausible than another. However, as soon as more than one possible meaning is available, the determination of the proper meaning depends as much on context, purpose and background as on dictionary definitions or even ‘excessive peering’ at the language to be interpreted without sufficient attention to the historical contextual scene.

In the context, reference was made to a right to acquire a marketable security. It did not refer to the acquisition of a marketable security. It was indicated that, if an offer is made to sell a marketable security, in circumstances where the offer is not linked to keep the offer open for a defined period, the offeree has a right to acquire the marketable security for so long as the offer remains open for acceptance.

Apart from the fact that the fiscal legislation was amended subsequently in order to address the apparent anomaly, the court specifically referred to the explanatory memorandum that accompanied the amending legislation that indicated that the previous wording ‘fail to fully capture all the appreciation associated with the marketable security as ordinary income’.

The court also indicated that, in the case of a marginal question of statutory interpretation, ‘evidence that it has been interpreted in a consistent way for a substantial period of time by those responsible for the administration of the legislation is admissible and may be relevant to tip the balance in favour of that interpretation’. It was indicated that the conduct of SARS that administered the legislation provides evidence of how reasonable persons in their position would understand and construe the legislation. It is thus a valuable pointer to the correct interpretation of the legislation. Given the fact that the South African Revenue Service (SARS) interpreted the legislation in a specific manner (contrary to the argument that was presented in the Bosch case, the court thus accepted the interpretation contended for by the taxpayer.

The Bosch case is clear authority for the fact that one should not adopt a literal interpretation to legislation as the so-called plain meaning approach is not helpful. The moment more than one meaning is possible; one should look at all the surrounding circumstances, including:

- Subsequent legislation and the reason for the subsequent legislation; and
- The way in which SARS has interpreted the legislation previously.
**SALE OF PROPERTY IN A CC - CAPITAL GAINS TAX, INCOME TAX AND DIVIDEND TAX LIABILITY**

**Facts supplied:**
- CC owned one commercial property it uses to produce rental income.
- Base cost is R1 million.
- Subsequently the property was sold for R5 million.
- R500 000 was paid as fees to the estate agent for the sale of the property.
- It is given that the CC is not registered for VAT.
- Retained income of the CC up to the beginning of the financial year was R250 000.
- The net loss of the CC up to date and before sale of the property is R200 000.
- Members were paid out R3 500 000 being the net proceeds of the sale of the property less a random amount of R1 million thumbsuck held back for CGT and Dividends Tax. The calculation thereof is yet to be finalised.
- Any balance remaining will be distributed to members once the calculation of CGT and dividend tax is finalised.

**Normal income tax calculation**
- Net loss before taking into account capital gain: R200 000
- Taxable capital gain: R2 331 000
- Taxable income: R2 131 000
- Normal tax @ 28% = R596.68k

**Assumptions**
- Net loss above is calculated from an accounting perspective but it equates to net loss based on tax rules, i.e. no add backs or deductions need to be made.

**Dividends tax implication**
- Unless considered contributed tax capital (‘CTC’) for tax purposes, the full R3.5 million falls within the dividend definition in section 64D and is thus subject to dividends tax at a rate of 15% which must be withheld and paid over to SARS by the end of the month following the dividend declaration/payment (earlier of date paid or due and payable per section 64E), unless an exemption applies (refer section 64F) or a reduced rate as a result of a double taxation agreement, or there is no obligation to withhold (refer section 64G). There is no reference to retained income or profits or losses under the dividends tax rules, these are accounting principles. Tax does provide for payments of CTC (essentially ‘pure’ share capital and premium), which is not subject to dividends tax. However, this must be decided by the directors or those with comparable authority and preferably recorded in the minutes or the declaration itself. It is possible for an amount to be a dividend for accounting and company law purposes, but a payment of CTC for tax purposes. Please note that the solvency and liquidity requirements per the Companies Act need to be met.

If the R3.5 million or any portion thereof is not a payment of CTC, then the dividends tax liability is as follows (assuming there are no STC credits available):
- Dividend declared: R3.5 million
- Dividends tax @ 15%: R525 000

The dividends tax liability is therefore dependent on what amount is treated as a payment of CTC and what amount a payment of a dividend, specifically for tax purposes.

**Question:**
- With reference to the aforementioned transactions
  1. What is the CGT liability?
  2. What is the normal income tax liability?
  3. What is the dividend tax liability?

**Answer:**

**Capital gains calculation**
- Proceeds: R5 million
- Base cost: R1 million + R500 000 = R1.5 million
- Capital gain: R3.5 million
- Taxable capital gain: R3.5 million x 66.6% = R2.331 million

**Assumptions**
- Property was held as a capital asset. No other amount received or accrued that should be included as proceeds. No other amount incurred as expenditure in acquiring or disposing of the property. No other capital gains or losses realised during the current period and no brought forward capital losses from previous periods.
Although the author is a professor at the Paris School of Economics, what makes this publication a must-read? One answer is that the book was cited by the Chairperson of South Africa Tax Commission, Judge Dennis Davis, at a national tax conference last year. Secondly, there is a thought-provoking chapter entitled ‘Rethinking progressive income tax’. Some readers would be intimidated by this title, while others would be curious. Whatever the reaction, this chapter is indispensable and is a must-read for tax specialists and practitioners.

Tax researchers would also benefit from reading this publication. This 685-page book is loaded with technical data, yet is accessible to people without any technical training.

The author argues that the future of progressive income tax is to be questioned. It is threatened by international tax competition. It is likely that the author is suggesting that international transfer pricing and the erosion of national tax bases, widely known as base erosion and profit shifting (BEPS) erodes the effects of progressive income tax. Both the transfer pricing and BEPS are the subject of a major investigation by the tax commission.

We are reminded that progressive income tax owes its origin to the two World Wars. The rate for the high-income earners remained at insignificant levels until 1914, and skyrocketed after the war. So what should the progressive income tax be replaced by? An entire chapter is devoted to this question.

The author offers a well-researched and compelling argument, calling for a global tax on capital. Opponents will be hard pressed to provide arguments contesting this proposal. This debate confirms the robustness of a discourse on tax. The author supplies a blueprint for European tax on capital, and demonstrates that if a stateless currency in Europe were possible, then an all-European tax on capital is feasible. The case is well-argued and presented. This book has a place in the private library of a tax specialist.
Imagine a tax story with a virtuous ending!
Imagine a tax story that saves your marriage – hardly ever likely! But let a couple bound hand and foot in a relationship sue for divorce, then bank notes hit the fan and blow the dandruff off the judge’s hair!

When couples, long tied in a marriage, sue for divorce, the bid for separation is often marked by an ugly acrimonious battle in court. The seed of the battle is the distribution of the accumulated wealth garnered during their glory days, but now in the post separation days transform into an adder ready to strike. The spouse - gob-smacked by the shockingly, startlingly, unfair distribution that the judge in his wisdom declared has an ace up the sleeve - that hidden bank account only known to the spouses.

Unknown to everybody in the court gallery sits a revenue clerk. He can’t wait to get back to the office with this breaking news - there’s a hidden account to track down. Needless to say, these accounts have escaped the tax net.

What a shock is in the unintended consequences!

If the spouse had only known better. The cost of separating from a partner is enormous. Rather forget the other woman (or man - depending on which spouse is pursuing the divorce). Try your damnedest to rekindle the love of old. Be happy, don’t make the receiver happy. Re-discovering the magic that originally brought the pair together is one alternative with little impact on the tax liability.

The possibility of a huge tax liability accompanying separation is a good reason for couples to revive their days of love and sunshine. So in order to maintain a low tax liability position, stay loyal to your long-standing spouse.

This conclusion is substantiated with moving clarity in the movie the Blue Jasmine directed by Woody Allen.

Jasmine (Cate Blanchett) drops out of college to marry Hal (Alec Baldwin), a wealthy and philandering Wall Street wheeler-dealer. Eventually, the ever-philandering Hal’s extra-marital affairs became too much for Jasmine to bear. As a result, bitterly hurt by the flamboyant Hal, reported the hidden wealth of husband to the FBI. Hal goes to prison for tax evasion and eventually commits suicide while in prison. Jasmine, once a jet-set member of the Winning Class, eventually falls from glory after losing her husband and all their money and possessions and suffers a nervous breakdown.

So if you want to be unfaithful to your spouse, first think about the income tax consequences.
LOOK AFTER WHAT’S IMPORTANT AND WE WILL LOOK AFTER YOU

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