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Over the years we have heard budget speeches from various ministers of finance. However, the 2016 budget speech was the most anticipated one. This was fuelled by a number of key developments that took place towards the end of last year, including the President’s decision to remove Finance Minister Nhlanhla Nene and the appointment of Des van Rooyen in his place. As South Africans we are faced with possible tough times, especially with the increase in interest rates, increase in Eskom tariffs, an unstable currency, and companies planning retrenchments.

We trust that SARS personnel will continue impressing us with their ability to achieve and exceed their revenue target, hence contributing to the growth of the country. As South Africans we are faced with possible tough times, especially with the increase in interest rates, increase in Eskom tariffs, an unstable currency, and companies planning retrenchments.

On a lighter note, the Centre of Tax Excellence (CoTE) is always on a journey of continuous improvement - you have noticed the monthly E-filing webinars, improved time in answering your queries, and the various tax seminars taking place that are in line with your needs. There will also be more webinars taking place covering a range of other tax topics scheduled throughout the year. Furthermore, CoTE will be distributing the 2016/2017 Tax Guides to all members. You are requested to ensure that we have your correct postal address for distribution purposes.

Please enjoy this latest issue of the Tax Professional magazine, especially our Budget Breakfast special, which includes SAIPA’s commentary on Budget 2016.

All the best,

Sibusiso Thunga
Tax Manager, SAIPA-CoTE
Finance Minister Pravin Gordhan’s 2016 budget speech was a landmark for a number of reasons, most notable of which was the need to put concerns of a downgrade to junk status to rest, while introducing the necessary fiscal constraints to decrease the budget deficit. The focus was predominantly on targeting civil servant expenditure, not borrowing beyond South Africa’s ability to repay, and increasing wealth and sin taxes to aid revenue collection.

Delivering this year’s budget was never going to be an easy task, but Gordhan offered a balanced view that enabled him to propose government expenditure cuts and strict financial discipline to stabilise debt, said Ngwenya. In line with this, he noted the need for more professional accountants in South Africa. “If the country doesn’t have accountants able to give sound advice, we will not see the expected growth,” she said.

Another particularly important area to focus on is capacity-building in small and medium-sized enterprises. For the first time, a portion of the budget (R475 million) was allocated to the Department of Small Business Development, which Ngwenya argued was a good start in facilitating the growth of SMMEs, where there is a dire need to build understanding of how to run a successful business.
Gordhan spoke of reducing red tape surrounding SMMEs in order to stimulate economic growth, pointed out Ngoepe, as well as the need for financial discipline in all areas by cutting down on unnecessary expenditure. Government’s expenditure ceiling was reaffirmed as being sacrosanct, and in line with this Gordhan announced new guidelines concerning limiting the value of vehicle purchases and introducing a cost-cutting travel and accommodation policy.

Despite these proposals, however, Ngoepe identified what he called two elephants in the room: the size of the Cabinet and the wage increase announced by President Zuma just prior to the budget speech. “There is a huge mismatch between their salaries and the value we get,” he argued. “There are too many young and inexperienced people being placed in high-paying civil servant jobs, and I am not sure Gordhan dealt with that adequately,” he commented.

On the whole, however, Ngoepe noted that it was a reasonable budget on paper, but that South Africans would need to watch how events unfold moving forward. “A vital aspect for a budget to work well is for the Finance Minister to be respected, and while it was true that the rand fell while Gordhan was delivering the speech, I am confident that it will stabilise as the markets absorb the budget.”

For Rossouw, the budget was high on promises but actually offered no real roadmap to delivery. He argued that South Africa still faces a looming fiscal cliff, and that the budget in no way averted it. Additionally, he maintained that the country’s civil service has become unaffordable, accounting for 45% of government spend as opposed to the emerging market average of 20%.

Further, he said, Gordhan failed to proclaim specific savings that government could implement with regard to cost-cutting. With the travel and accommodation policy, for instance, Gordhan could have taken it a step further and said that Ministers can only drive South African-manufactured vehicles.

Additionally, he could have announced an increase in personal income tax for higher-income earners, Rossouw commented, as the money raised would assist with the current social upheaval taking place across the country. “Overall, too little has been done to ensure that South Africa avoids a downgrade,” he said.

By choosing, however, to curb government spending rather than charging the tax base unduly, Singh commented, Gordhan showed his commitment to assisting low and middle-income earners. His focus was on indirect taxes rather than personal taxes – such as the fuel and tyre levy and the newly introduced sugar tax. The revenue collected from these indirect taxes are expected to alleviate social concerns such as alcohol abuse and sugar-related illnesses. “Gordhan put forward a budget with solid, achievable objectives and a focus on the medium-term,” he noted. “It was a balanced budget that South Africans could get on board with.”

Retief agreed that the introduction of the sugar tax was a commendable step in the right direction based on the empirical evidence of a reduction in health problems in countries that have introduced it. If governments target alcohol and cigarettes, Retief said, then it is only logical that they should also include sugar as it is an addiction like any other. However, he did note that these indirect taxes could all impact heavily on inflation and drive it up.

Despite the announcement that there would be no increases in personal tax, Retief was concerned that without it, it would be nearly impossible to fund social and health concerns. It therefore makes it inevitable that there will be an increase in future. The same applies to VAT, which remained at 14% this year but is likely to increase in 2017 or 2018 – and while it is an effective tax, noted Retief, it has a large impact on lower-income citizens.

Other issues of importance for Retief was the need to close loopholes on legislation for SMMEs, as the country requires these kinds of businesses to stimulate growth, as well as the need to encourage and build the services industry, as services do not require a heavy capital injection to start up and add a large amount of value to the economy.

What was most important to come out of the budget speech though, said Retief, was the need to work together. “Gordhan was right when he said South Africans are resilient, but it’s necessary to have a common goal that we all strive towards. There is a lot still to do,” he concluded.

“Gordhan put forward a budget with solid, achievable objectives and a focus on the medium-term”
The 2016 Budget was eagerly anticipated, not only in South Africa but globally, in a hostile political and economic environment against the background of the threats of credit rating downgrades to junk status. The Budget that was presented satisfied both the local population and the global investors and economists.

South Africans are resilient and have a reputation of gracefully overcoming their hurdles and have the ability to rise to the occasion when required to do so. There are no reasons to feel different about our ability and capacity to exit from our current difficulties. In fact, the Minister of Finance and his team can only perform well when facing a crisis. Ask anyone that knows the current Minister of Finance, Mr Pravin Gordhan well; give him a smooth-sailing Ministry and he will fall asleep with boredom! South Africans have produced many leaders with credibility and these public-personalities are recognised globally for their public service. In this regard, the retired Anglican Bishop Desmond Tutu, amongst the many, must be mentioned.

Budget 2016 – The critical detail

Is the National Budget an elixir for the taxpayer?

Extension of objection and condonation periods

National Treasury, in its document also released on Budget Day, concedes that the current period for lodging an objection under the Tax Administration Act is 30 business days from the date of assessment. In fact, SAIPA is aware that revenue authorities in other countries, such as Australia, allow their taxpayers up to three months to table an objection against a decision of their revenue authority. It is
given that the period of objection for all practical purposes especially in complex tax matters, in South Africa, is simply too short. The fact that National Treasury is considering proposing a longer period for lodging an objection, gives hope that this Budget may, after all, be an elixir for taxpayers. The extension of objection date, many would argue, is the most welcome proposal this Budget has to offer. Although, it is only a proposal at this stage, SAIPA must ensure that the proposal becomes a reality and enacted in the appropriate tax legislation.

**Bursary and scholarship grants**

The important feature of the 2016 South African Budget, is that it addresses the major socio-economic concerns of our current times, thereby enhancing its credibility.

The one obvious example is the 2016 National Budget response to the #feesmustfall campaign which is critical to the sustainability of the economy. The 2016 National Budget has not failed South African citizens in this regard. The new tax proposal, in relation to Bursary and Scholarship Grant, as announced in on 2016 Budget Day, contributes immensely to the solution of learner’s fees crisis by encouraging both state and private sector commitments. When companies and employers award bursaries and scholarship to the children of their employees, companies will receive a deduction against their taxable income, whilst the employees receive 100% tax-free benefits when certain requirements are met. The details of the improvised dispensation are as follows:

- The bursary is granted to an employee’s relative and employee who do not earn more than R400 000 (2016: R250 000) per annum, or
- The value of the bursary or scholarship does not exceed R40 000 (further education National Qualifications Framework – NQF level 5 onwards) or R15 000 (basic education – NQF Grade R up to NQF level 4) per relative per annum.
- Only if the bursary exceeds R40 000 (higher education) or R15 000 (basic education), the excess is taxed in the hands of the employee.

The underlining importance of this tax proposal is that employers are encourage to fund the basic and further education needs of employees’ their sibling, thereby contributing to the education needs of the lower income group, that is, those whose annual income is below R400 000. Whilst the private sector is called to the party, it is the fiscus that actually funds the education costs of employee’s dependants. Of course, this tax relief does not solve our education problems and it is just one-step in the correct direction. This commentary is not unmindful of the need to pursue other innovative measures to completely resolve the students’ crisis. It is also noted an additional R16 billion will be allocated to higher education over the next three years.

**The aged**

The Budget also addressed the financial consideration of the Aged by promoting their financial security and dignity through the Retirement and planning provisions and through retirement income provisions.

SAIPA members, who are practising tax accountants and personal advisors to their clients, should encourage all their aging clients (those approaching 75) to spend their retirement days in South Africa and not seek greener pastures abroad.

The new tax threshold limit for senior citizens who are 75 and over is R164 350 (this includes the interest exempt income of R34 500 but does not include the tax-free savings accounts). This implies that those citizens 75 years and older earning less than R164 350 (also have a savings account) will not pay tax at all! This is the most welcome relief for our very senior citizens.

**Government social grants: An unorthodox view**

The awarding of social grants to the elderly, children, peoples with disabilities and war veterans constitutes a huge burden on the fiscus. The expenditure on social grants for the 2016/17 is expected to be R141 billion in the new financial year commencing 1 April 2016. This huge expenditure is a source of stress to taxpayers who consequently argue that SARS imposes impossible deadlines and colossal interest and penalties in order to meet the fiscus requirement and exorbitant burdens undertaken by the state.

However, there is another aspect relating to the awarding of these government grants. These grants are essentially, what economist refer to as ‘disposable income’ and are used to purchase commodities that are sold by clients (companies and SMMEs) of many SAIPA members. In other words, the beneficiaries of government grants are consumers of products supplied by clients of
SAIPA members. There is a virtuous cycle of income-generation by government investment in social grants. Hence the Minister of Finance, Mr Gordhan, quotes the economist Dani Rodrik, who recently noted that in those countries that are still growing rapidly, despite global economic headwinds, ‘public investment is doing much of the work’.

It is further argued that the income-generation capacity of social grants will be enhanced if only the true and worthy beneficiaries are in receipt of these grants.

**The Budget Deficit: another orthodox view**

It is appreciated that government is keen to reduce its deficit to 2.4% of the national budget. Government deficits are referred to as the amount by which a government’s spending is more than the money it receives. SAIPA members, attending the budget breakfast were uncompromising in that citizens must hold government to its pledge of 2.4%.

However, what happens if in the intervening period government decides to build a brand new much-needed electricity power station that will increase our electricity generation capacity to such an extent that load shedding becomes ancient history in this country. It is given that additional electricity capacity will stimulate the productive capacity of the private sector as well. It is likely that the 2.4% budget deficit may not be maintained because the cost of a new power station runs into billions of rands. The point of the argument is that dogmatic and principled attachment to numerical pronouncement should not be the only means of assessing performance but also the qualitative spending by a government that has no room for off-sets.

**Key take-out from the 2016 National Budget**

- It is not only a Budget for the youth but also for the aged.
- It favours individual taxpayers by reducing the individual tax rates – a most unexpected outcome.

This commentary does recognise need to elevate the country away from the current ‘junk’ international credit rating status but takes the view that although tax commentators must tell their stories that demonstrate the challenges and ugliness on the dark sides, they must start telling stories that show the beauty and brightness of the light sides.

Is it the role of tax commentators to exclusively expose the dark sides of our tax environment? If tax commentators espouse a narrative that exclusively and relentlessly reinforces the dark’s side, then how are we supposed to believe in our capacity to do good things and be successful? It is given that the difference between revenue authorities and taxpayers is a natural conflict anywhere in the world.

“Is it the role of tax commentators to exclusively expose the dark sides of our tax environment? If tax commentators espouse a narrative that exclusively and relentlessly reinforces the dark’s side, then how are we supposed to believe in our capacity to do good things and be successful?”

The income tax rates for companies between the 80s and early 90s was between 40 and 50 percent. Today the tax rates for companies is 28%. The electronic submission of tax returns, which commenced in 2001, is a blessing. If currently, you are an aggrieved taxpayer, try using the Complaints Management Office (CMO) procedure (recently introduced). A taxpayer will receive an acknowledgement within 24 hours and it is likely that a resolution of the grievance will take place within three days (depending on the nature of the grievance) will be forthcoming.

This extraordinary commentary assesses the 2016 Budget but its assessment is not based on dread alone!
The right to review and appeal is an important factor in ensuring a fair tax system. In the event of a dispute to an assessment, taxpayers have a right to lodge an objection which must be finalised by SARS within reasonable time.

Chapter 9 of the Tax Administration Act, read with the Rules promulgated under Section 103, sets out the procedure for taxpayers who are aggrieved by an assessment raised by SARS. It is important to note that the obligation to pay the disputed assessment is not suspended by the objection against the assessment. Any mention of the term ‘days’ in this article refer to business days as defined in Section 1 of the Tax Administration Act.

Dispute Resolution – Objections and Appeal

When SARS raises an assessment they must issue a taxpayer with a notice of assessment which must advise taxpayers of the dispute resolution procedure. In terms of the dispute resolution rules, the taxpayer must file an objection within 30 days after the date of the assessment. Objections that are not lodged within this prescribed period will be invalidated. The taxpayer can, however, request reasons for the assessment within 30 days of the notice of assessment, in which case the period to lodge an objection will be suspended until SARS provides the requested reasons. SARS must provide the taxpayer with the reasons for the assessment within 60 days of the request. Where SARS refuses to grant an extension within which reasons for an
assessment may be requested (Rule 3) or within which information must be provided (Rule 5), the taxpayer may apply to the Tax Court for an order extending the period as requested by the taxpayer.

Taxpayers who file the objections late must provide SARS with reasonable or exceptional reasons for the late objection. Exceptional reasons are required when the objection is filed more than 21 days after the 30 day period lapses. If it is filed less than 21 days late the taxpayer must provide reasonable reasons. SARS will then consider whether or not to condone reasons for the late objection. As it might be difficult to establish reasonable grounds for the late objections, it is important that taxpayers ensure that their objections are timeously lodged. If SARS does not condone the late filing, the taxpayer must lodge an objection to that decision resulting in two parallel objections for the same assessment. It is, therefore, important for taxpayers to ensure objections are submitted timeously in order to resolve the dispute timeously and without confusion. A taxpayer’s right to lodge an objection prescribes three years after the date of the assessment. SARS is not allowed to attend to objections that have prescribed as the assessments have become final and any such objections must accordingly be invalidated.

Apart from prescribed objections SARS may invalidate the objection if one or more of the requirements as set out in Rule 7(2) are not complied with. SARS must notify the taxpayer within 30 days of the date of the objection if it is not valid and allow the taxpayer 20 days to file an amended objection without the need to provide reasons for late filing. Once the objection has been validated SARS may request the taxpayer to submit additional information or documents. SARS then has a turnaround time of 60 days in which to deal with the objection and issue a taxpayer with the outcome thereof. SARS may extend making a decision on the objection by no longer than 45 days only if it notifies the taxpayer of the extension before the initial 60 day period lapses. The objection can be allowed in full, partially allowed or disallowed. Where the objection is partially allowed or disallowed, grounds for the decision must be provided to the taxpayer together with a summary of the appeal process. A taxpayer cannot appeal if an objection has been allowed in full.

In terms of the Tax Administration Act, if the taxpayer is not satisfied with the outcome of the objection they can lodge an appeal within 30 days. SARS does not have discretion to extend this period by more than 45 days and any appeal lodged beyond this restriction must be automatically invalidated. Matters subject to appeal can be referred to Alternative Dispute Resolution (ADR), Tax Board or Tax Court. Appeal matters will be referred to an ADR through a consensus by both parties. SARS must, within 30 business days of the appeal, notify the taxpayer if the matter is suitable for appeal, in which case the taxpayer will have to notify SARS within 30 business days if they agree. The ADR must be finalised by SARS within 90 business days of notifying the taxpayer that the matter is suitable for ADR.

Any non-compliance with the time frames and obligations set out in the dispute resolution procedure can be enforced by following the procedure as set out in Rule 56 to obtain a Tax Court order either confirming or altering the assessment.

**Tax Board and the Tax Court**

The Tax Board and the Tax Court are the available remedies for the taxpayer, where the ADR procedure was not successful with SARS. The Tax Board was established by section 83a of the Income Tax Act 1962, which deals with tax appeals amounted to tax of less than R500 000. In terms of Rule 8, the appeal must be placed within 40 days of the termination of the ADR process or where there was no ADR in place, after receipt of the notice of appeal by SARS. The chairperson of the board, who is independent from SARS, will hear the arguments from both parties and make a decision must be given within 60 days. The clerk will furnish the commission and the taxpayer with a copy of the board’s decision within ten days of the receipt of the decision from the chairperson.

If the taxpayer or SARS does not accept the decision of the ruling, they may refer the matter to the Tax Court. A notification must be sent to the Tax Board within 30 days of receiving the decision from the chairperson.

The ‘PAY NOW, ARGUE LATER’ principle is a common practice in most countries across the globe, and taxpayers who are in dispute with their tax assessment must apply for a suspension of payment. The request for suspension of payment...
can be lodged prior to submitting an objection, but an objection must be lodged or the request will be revoked. On submission of the request for suspension, SARS has to provide feedback to the taxpayer advising of the outcome of the suspension. There is a 10-day moratorium in which no collection steps are to be initiated against the taxpayer. In the instance that the request is granted, payment will be suspended until the dispute has been finalised. Interest in this case will continue to be accumulated on any taxes owing and a written request can be send to SARS requesting remittance of interest and penalties.

Escalation process in SARS

It is important that taxpayers indicate clearly their intentions to lodge a complaint, SARS will only classify a complaint as such if the taxpayer states that they want to complain. A distinction must be made between a case follow-up and a complaint.

Taxpayers who already have an existing case with SARS and wish to enquire on the status or progress of such a case will be issued with a case number for a follow-up case. The turnaround time in this instance will be 21 days and should a taxpayer make another follow-up before the 21 days lapses, a Repeat Call Escalation will be linked to the original follow-up case. The Repeat Call Escalation case will have a further turnaround time of 21 days. A case follow-up is thus not a complaint. Once the 21 days on the original follow-up cases has lapsed a taxpayer can lodge a complaint with the SARS Complaint Management Office. Taxpayers must state that they want to lodge a complaint.

The office of the Tax Ombud (OTO) was established to achieve redress for the taxpayer and taxpayer representatives, of which their complaints were unable to be resolved by SARS. The Tax Administration Act empowers the Office of the Tax Ombud to review a complaint and resolve it.
through mediation or conciliation where necessary. Through the office acting as a mediator between SARS and the complainant, it insures independency and impartiality based on virtuously facts, laws and the constitution. A taxpayer must attempt to resolve an issue with SARS by going to the branch or contacting the contact centre first. SARS will issue a reference number for this query which must be quoted with all further interactions. If the matter is not resolved within 21 days, that reference number must be used to lodge a complaint with the SARS Complaint Management Office via eFiling, by phoning 0860 12 12 16 or by going into a branch.

It is important to note that the taxpayer must be clear that their intentions are to lodge a complaint and not follow up or query as they will be given further reference numbers and a complaint will not be lodged in SARS’ systems. If the CMO does not resolve the issue within 21 days the taxpayer can lodge a complaint with the Office of the Tax Ombud. It is important to note that the taxpayer must exhaust the SARS Complaints procedure as explained above before it can approach the OTO with its complaint. The OTO will only be allowed to review a complaint if the complainant is able to advance compelling circumstances that can be factually substantiated. Compelling circumstances would include situations where exhausting the complaints resolution mechanisms in SARS will effectively prejudice the taxpayer. Circumstances can only be regarded as compelling if the complainant can justify why it needs to be treated differently from all other complainants.

Office of the Tax Ombud

The mandate of the Tax Ombud is to review and address any complaint regarding a service, procedural or administrative matter arising from the application of the provision of the Act by SARS. The office will investigate the matter and notify the complainant of the outcome of the review and any action to be taken. The office will provide the complainant with an opportunity to substantiate the necessary evidence. The office will endeavour to resolve the complaints within 15 business days from the time a complaint is received.

The OTO complaint form may be obtained by visiting the office or contacting the Office by telephone 0800 662 837 (toll-free) or (+27) 12 431 9105, fax (+27) 12 452 5013, e-mail complaints@taxombud.gov.za or obtained on the website www.taxombud.gov.za.

The complainant must ensure that the form is fully completed, signed and dated, to be attached with any factual supporting documents. Taxpayer representatives must confirm their authority to act on behalf of their clients by submitting a fully completed power of attorney. The complaint must be submitted within a reasonable time after SARS has completed its review of the complaint.

“It is important that taxpayers indicate clearly their intentions to lodge a complaint, SARS will only classify a complaint as such if the taxpayer states that they want to complain. A distinction must be made between a case follow-up and a complaint.”
It is horrifying to hear the many occasions that taxpayers have had their bank accounts emptied by SARS for amounts equivalent to their tax liability. More devastating is the fact that taxpayers are not even aware that funds have been removed from their bank accounts. How dreadful is this behaviour by a veritable monster? The indignant taxpayer is confronted by voluminous cash flow problems so that the payments to suppliers and staff are delayed. This frequently plunges the taxpayer into financial distress and/or even liquidation.

The question posed by taxpayers is: whether this unsympathetic behaviour by SARS is constitutional and legal? The first point to understand is that it is absolutely constitutional for SARS to collect tax revenue that is due to it. SARS is constitutionally obliged to collect all tax revenues due to it. International tax case law exists1 that this right to collect tax debt by a revenue authority is also accompanied by awarding SARS wide-ranging tools, such as garnishing – the removal of resources from taxpayers account – to collect its tax receipts.

Garnishee order vs. taxpayer’s rights

This constitutional obligation of SARS to collect taxes due should not encroach on taxpayer’s rights. The granting of rights to SARS to collect tax revenues co-exists with taxpayers’ rights. Taxpayer-rights are guaranteed by the Constitution of the Republic of South Africa, 1996. Section 33 of the Constitution guarantees that every taxpayer has the right to fair administrative action. Therefore, taxpayers will always have rights – taxpayer’s rights are guaranteed and are inalienable.

The question is: how must taxpayers’ exercise their rights when resources are removed from their bank account by SARS without their knowledge? It is given that garnishing practices are utilised under the following circumstances:

1) The taxpayer was informed of the tax debt but took no action to either object to a SARS decision, or to apply for a financial instalment plan with SARS. The SARS assessment simply remained unchallenged! In this situation, SARS is an undisputed creditor, or when

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1) Australian case: (Industrial equity Ltd v Deputy Commissioner of taxation (1990) 170 CLR 649
ii) The taxpayer has objected to the tax assessment, or has appealed against a SARS ruling on the outstanding tax debt. The taxpayer is under an erroneous understanding that a mere submission of an objection or an appeal against a SARS decision automatically suspends the obligation to pay a tax.

The contention of this brief is that the taxpayers’ rights are inalienable. Moreover, taxpayers’ rights are easily exercisable under these circumstances and without resorting to litigation.

The solution and observance of taxpayer’s rights
With reference to the situation, where the taxpayer was informed of the tax debt but took no action in terms of tabling an objection to a SARS decision, the taxpayer should do the following:

- Apply in writing for the uncontested tax debt to be paid in instalment. There is no formal application form. Therefore, the tax practitioner, on behalf of the taxpayer, should write a letter motivating reasons in favour of an instalment agreement.

Essentially, the taxpayer must be able to satisfy SARS that he or she has a cash flow problem and is unable to settle the tax in one payment and that the financial problem is likely to improve in the short term. If the application is successful, then SARS usually grants an extended payment period spread over three and six months.

The taxpayer is required to complete a SARS form, namely SARS Collection Information Statement – Business, CIB001, which calls for extensive financial information and submit it together with the letter.

Appealing against a SARS ruling
With reference to the situation whereby the taxpayer has objected to the tax assessment, or has appealed against a SARS ruling on the outstanding tax debt, the tax practitioner, on behalf of the taxpayer, must write a letter requesting the suspension of the payment of tax or a portion thereof, due under an assessment if the taxpayer intends to dispute the liability to pay the tax. If the objection against a SARS assessment is unsuccessful, the taxpayer will be liable for the tax.

Only a senior SARS official may decide to suspend payment of the tax while an objection or an appeal is tabled. A decision whether or not to suspend the tax payment will be based on the following factors:

- Compliance history of the taxpayer;
- Amount of tax involved;
- Risk of dissipation of assets by the taxpayer concerned during the period of suspension;
- Whether the taxpayer is able to provide adequate security for the payment of the amount involved;
- Whether payment of the amount involved would result in irreparable financial hardship to the taxpayer;
- Whether sequestration or liquidation proceedings are imminent; and
- Whether fraud is involved in the origin of the dispute.

Be advised that a senior SARS official may deny a request to suspend payment if either of the following occurs:

- After the lodging of the objection or appeal, the objection or appeal is considered frivolous or vexatious;
- The taxpayer is perceived as to be employing dilatory tactics in conducting the objection or appeal;
- On further consideration of the factors on which the original suspension was based, the suspension should not have been given; or
- There is a material change in any of the factors on which the suspension was based.

Conclusion
If the taxpayer has successfully applied for an instalment payment plan or has successfully applied for a suspension (or postponement) of the payment of the tax, then SARS cannot apply its garnishing practices. If the taxpayer has been successful in obtaining either an instalment payment plan or a postponement of the tax, the removal of funds from the taxpayers’ account would be unconstitutional and the taxpayer ought to take the matter to the Tax Ombud or submit a formal complaint to SARS via its recently introduced Complaint Management Office (CMO) and obtain a reference number.

To view a step-by-step guide on the process, click the link:
http://www.sars.gov.za/Contact/How-Do-I/Pages/Lodge%20a%20complaint.aspx
Retirement reforms, throughout the world, are considered politically charged. There is no reason for retirement reforms in South Africa to be excluded from the international perception.

In the 1980s, senior staff belonging to a group retirement fund were members of a provident fund. The less senior staff of the same company were members of a pension fund. Why was this so? Members of the provident fund were permitted, in terms of the fund rules, to withdraw their full lump-sum benefit at retirement age. The argument then was that the senior staff had good financial sense and, consequently, were better equipped to manage large sums of retirement benefits.

The less senior staff, belonging to the lower-income group, belonged to the pension fund, although both groups were employed by the same company. The less senior staff belonging to the pension fund were permitted, in terms of the fund rules, to withdraw only a third of their lump-sum benefit at retirement age. The argument then was that the less-senior staff did not have extensive financial management skills and as a result, were not well-placed to manage large sums of retirement benefits received at retirement age. So pension fund members were permitted to receive only a third of the lump-sum retirement benefit at retirement age – the balance (two-thirds) was paid monthly to fund members in the form of an annuity until the death of a lower-income member of a pension fund.

In the 1990s, new retirement fund rules emerged which permitted staff within the lower-income group to belong to provident funds. The reason for the change of fund rules was that staff of the lower income group had a voluminous urgent need to meet their current consumption requirements. The mere thought of providing for their future needs (in the form of future monthly payment) was ill-conceived in the light of current high volume of unmet basic needs. The idea of protecting future needs when current basic needs were difficult to meet seemed atrociously illogical for the very person facing disastrous current circumstances. Hence, lower-income retirement fund members were, under the 1990s dispensation, permitted to belong to provident funds.

However, if the retirement benefit of a member belonging to a pension was less than R75 000, then a pension fund member, under these circumstances, was allowed to withdraw their full lump-sum benefit at retirement age.

In the 2000s, we witnessed fundamental changes; the introduction of democracy, new international imperatives and the need to treat the tax outcome...
of different retirement vehicles in the same way. Currently, members of retirement funds (there are three vehicles: pension funds, provident funds and retirement annuity funds) are permitted to receive a certain tax deduction for contribution (premiums) paid to any of these funds against their taxable income and, in the case of provident funds, the premium deduction was recognised only when the lump-sum retirement benefit was received (at retirement age). The tax consequences for contribution of premiums paid to each of the retirement vehicles were not the same. The tax consequences were different – depending on the type of retirement vehicle selected – but the objective of the retirement vehicles were all the same, that is, to protect the income of members at post-retirement. The tax treatment was, in a sense, discriminatory although the objectives of the retirement vehicles are the same.


The purpose of the new proposal, now enacted, is to ensure uniform tax treatment of retirement, irrespective of the type of retirement vehicle selected. The new proposal which became effective 1 March 2016 and will be reflected in the 2017 income tax returns for individual, allows for a 27.5% tax deduction up to a maximum of R350 000 per annum for all retirement fund contributions. This is considered to be a very generous tax deduction and implies that the state is covering most of the costs of belonging to a retirement vehicle. All citizens, irrespective of their income-earning capacity, are the beneficiaries of this new retirement vehicle premium tax deduction.

Example 1

Background

Employee A is a member of a provident fund. Employee A has a total cost to company (remuneration) of R300 000, which includes a basic salary of R180 000. Pursuant to the fund's rules, the employer contribution represents 20% of Employee A's basic salary, and Employee A's contribution represents 5% of Employee A's basic salary. In monetary terms, Employer makes a contribution of R36 000 (R3 000 per month) to the fund in the name of Employee A, whilst Employee A makes a contribution of R9 000 (R750 per month) to the fund.

Tax result

Employee A will be deemed to have contributed the R36 000 to the provident fund, together with Employee A's own contributions (R9 000), totalling R45 000. Therefore, Employee A will be entitled to a deduction of R45 000 against income earned. Neither the percentage limit (27.5% of R300 000 = R82 500) or the monetary limit of R350 000 will limit the tax deduction.

Example 2

Background

Employee B is a member of a pension fund. Employee B has a total remuneration of R300 000, which includes a basic salary of R180 000 and a travel allowance of R80 000 (taxable at 80% for remuneration purposes). Employee B has a taxable income of R250 000 (including net rental profit of R30 000). The employer contribution represents 20% of Employee B's basic salary, and Employee B's contribution represents 5% of B's basic salary. In monetary terms, Employer B makes a contribution of R36 000 to a South African approved pension fund in the name of Employee B, while Employee B makes a contribution of R9 000. Employee B also makes a further contribution of R51 000 (R4 250 per month) to an RA fund. Employee B has provided proof to the employer.

Tax result

Employee B will be taxed on the R36 000 employer contribution as a fringe benefit. However, for the purposes of determining potential contributions deductions, Employee A will be deemed to have contributed the R36 000 to the pension fund, together with Employee B's own contributions to the pension fund totalling R45 000. Employee B's total retirement fund contributions are R96 000 (R45 000 + R51 000). The percentage limit (27.5% of R300 000 = R82 500) will limit the tax deduction in respect of the contribution of R96 000 to R82 500. Therefore, B will be unable to deduct R13 500 in the current year of assessment. The R13 500 will be available for deduction in future years subject to the percentage and monetary limits applicable in those years.

Taxpayers are reminded that these tax harmonisation reforms for the retirement funds continue to be implemented as scheduled on 1 March 2016 and are
Retirement Reforms: New dispensation and the resulting contestation

The present socially contentious element of the new dispensation is not aimed at the aforementioned new dispensation, but is aimed at the unification of the pension and provident rules in relation to the amount of lump-sum withdrawal at retirement age.

For pension funds and retirement annuity funds, there will be no change. For provident funds, one-third of the retirement benefit lump sum may be taken as cash, and the remaining two-thirds has to be annuitised with respect to contributions made after 1 March 2018 for those below 55 years of age. For example, with a retirement benefit of R300 000, the amount that may be taken as a lump sum is R100 000 and the remaining R200 000 would be annuitised, meaning, that the member would get a monthly income from this latter amount.

Members of provident funds will, in a similar treatment of members of pension and retirement annuity funds, be able to claim a tax deduction on their contributions to their funds. Also, the contributions their employers make to their provident funds will become visible on their payslips. As a result, most fund members who make contributions to their provident funds, will see their take-home pay increase.

Further, all new contributions into provident funds after 1 March 2018 by those younger than 55 years, will be subject to the annuitisation requirement if the value of the retirement benefits exceeds the de minimis threshold at retirement age. All provident fund members will still be able to take all their retirement savings that would have been accumulated as at 1 March 2018, and the growth thereon, as a cash lump sum when they go into retirement age if their lump-sum retirement benefit is less than R247 500. Originally, that is, in the 80s this lump-sum threshold was R75 000.

So the question is whether the current authorities are sensitive or insensitive to the fact that the lower-income group have a voluminous need to meet their current consumption requirements, and may need to withdraw all of their retirement lump-sum at retirement age. National Treasury produces its own statistics in this regard and their response is as follows:

Reforms do not take away the right of provident fund members to take their benefits before or at retirement. Instead, the reforms enable a slower use of such benefits in retirement, by requiring annuitising from a certain amount. The data indicates that 83.5% of provident funds members earn R160 000 or less, and that the majority of these retire with an average retirement benefit of R300 000 or less. These data, coupled with protection of vested rights and a higher de minimis amount of R247 500 (i.e. the amount below which you do not require annuitising) mean that most, if not all, low-income earners approaching retirement in at least the next two to five years (and probably much longer), will not be affected by the annuitisation requirement.

So National Treasury, in other words, argues that by raising the minimum of lump-sum withdrawal to R247 500, they have taken cognisance of the fact many lower income earners have a desire to satisfy their current basic needs since a majority of lower income earners will have retirement benefits less than the threshold of R247 500. Taxpayers are further reminded that the new retirement reforms (effective 1 March 2018) will not be affected by these changes if on 1 March 2018 they have attained the age of 55.

Conclusion

The constitutionality concerns have been raised in respect of the retirement reforms relating to the requirement to purchase an annuity at retirement (i.e. to receive a regular monthly income during retirement instead of a lump sum) for provident fund members.

As a result, the annuitisation requirement for provident funds has been postponed by two years, that is until 1 March 2018.
that the failure to provide information or that information entitlement disputes are often tactical or even vexatious, given the fact that taxpayers, particularly large corporates, are very much aware of the period within which SARS must finalise the audit and issue additional assessments.

As a result of the tactics employed by taxpayers to frustrate the audit process undertaken by SARS, section 99 of the Tax Administration Act 28 of 2011 “Period of limitations for issuance of assessments” has been amended in terms of the Tax Administration Laws Amendment Act 23 of 2015, promulgated on 8 January 2016.

The position prior to amendment: SARS was not permitted to make an assessment three years after the date of the original assessment, or five years in the case of self-assessment (such as VAT and PAYE). The only exception being that the prescription period would not apply in circumstances where the full amount of tax chargeable was not assessed correctly by SARS due to fraud, misrepresentation or the non-disclosure of material facts. This left SARS with little recourse in circumstances described in the Memorandum.

The position after the amendment: SARS may now extend the prescription period by a period approximate to a delay arising from the failure by the taxpayer to provide all relevant material requested under section 46 of the TAA; or a delay arising from the resolution of any dispute pertaining to information entitlement including legal proceedings. Although not explicitly referred to in the legislation, information entitlement disputes denote disputes where the taxpayer claims legal professional privilege in terms of section 64 and/or advocates the relevance aspect in terms of section 46.

The amendment seems to have the desired effect by discouraging taxpayers from resorting to methods of frustrating the course of an audit. However, the converse has not been thoroughly examined as yet. Could SARS exhaust the taxpayers’ resources by requesting volumes of documents in a scatter gun approach when it is evident that it has not identified what it is looking for in the audit process?
We have noticed that there is still a lot of confusion as far as withholding tax on interest is concerned, hence the need to revisit this legislation.

The definition of interest in s50A (withholding tax on interest) was updated to refer to the definition of interest under Section 24J (1), but only refers to paragraphs (a) or (b). The biggest question remains, what is WTI?

**What is Withholding Tax on Interest?**

The withholding tax on interest is a form of tax that is charged on interest paid on or after 1 March 2015 at a rate of 15%. This tax is paid by any person to or for the benefit of a foreign person. This includes an individual, trust, companies and others from a source within South Africa. In other words the foreign person is responsible for the tax, but it must be withheld by the person making the interest payment to or for the benefit of the foreign person.

To illustrate the above, Company A took a loan from company B (Foreign entity). As part of the loan agreement an interest of 11% is payable monthly. Based on this example the interest will be paid in benefit of Company B who is a non-resident, therefore Company A will have a duty to deduct the withholding tax on interest paid and pay over to SARS.

**Exemptions applicable for this tax**

- Any interest paid by the Government of South Africa: this applies to national, provincial or local sphere.
Any bank including the South African Reserve bank, Development Bank of South Africa or Industrial development corporation

A headquarters company relating to financial assistance where the headquarters company directly or indirectly holds 10% of the equity and voting rights

Interest payable on listed debts is also exempt from WTI notwithstanding the nature of the person paying the interest. The issue of listed debt can be perplexing. However to simplify it, this refers to bonds listed on the JSE, and therefore can either be a Government bond or Corporate, as long as they are listed on the JSE

Interest payable to any foreigner that is a client, to whom a regulated person provides securities, services, or acts as an agent for another person about those services, in which case it will include the agent or exclude the other person. This will be possible only if the contractual arrangement between the parties shows this to be the intention.

A foreign person (recipient of the interest) is also exempt from WTI under following circumstance:

(i) They are a natural person who was in South Africa for a period more than 183 days in aggregate during the 12 months before the date the interest is paid,

(ii) The debt claim for which interest is paid is effectively connected with the permanent establishment of the foreign person who is registered as a taxpayer in South Africa. It must be noted that there is no need for completion of the withholding tax on interest declaration before the payment of interest. However, practitioners or persons responsible for WTI must see to it that in the case of foreign receipts, the exemption will not apply prior to the submission of the Withholding Tax on Interest Declaration (WTID) to the payor (person paying interest). This must be done before the payment of interest is made.

Furthermore, the provision of WTI makes an allowance for reduced rates of WTI in circumstances wherein the provisions of DTA (Double Taxation Agreement) apply. In a nutshell, the DTA may reduce the rate South Africa is allowed to charge or, in some circumstances, deny South Africa the right to tax the interest payments. It must be noted that this reduction concession will not automatically apply but require the WTID to be submitted to the person paying interest prior to the payment of interest. It will be imperative to visit the summary of the DTA rates on Withholding Tax on Interest should the above apply to your taxpayer.

Payment method and when to pay

WTI is payable to SARS via e-filing. A payor is required to submit the return for withholding tax on interest (WT002). WT002 is a summary of all the total of all interest payments made and tax withheld during the month to SARS. Both the return and payment must be submitted to SARS before the end of the month after the month in which the interest was paid. The taxpayer will be required to register for a WTI account in order to be able to file a return and make the necessary payments. It must be noted that if the last day of the month is a public holiday or weekend, the payment must be made on the last business day before the public holiday or weekend. Furthermore, upon registration or activation of WTI, taxpayers must ensure that the personal details and banking details provided are the same as the information on the income tax registration. Using any other information will result into your registration and activation request being rejected.

“It must be noted that there is no need for completion of the withholding tax on interest declaration before the payment of interest. However, practitioners or persons responsible for WTI must see to it that in the case of foreign receipts, the exemption will not apply prior to the submission of the Withholding Tax on Interest Declaration (WTID) to the payor (person paying interest). This must be done before the payment of interest is made.”
The Supreme Court of Appeal (SCA) in Lagoon Beach Hotel v Lehane (235/2015) [2015] ZA SCA 2010 (21 December 2015) recently considered the granting of a preservation order to a foreign trustee and the recognition of a foreign trustee by our courts in exceptional circumstances.

The facts of the matter concerned an insolvent of Irish descent that resided in the USA and conducted business through an intricate web of holding and subsidiary companies registered in different parts of the world, including tax havens. However, the insolvent’s immense wealth was short-lived as he was first declared bankrupt in USA on 23 March 2013 and thereafter declared bankrupt in Ireland. Pursuant to the two bankruptcy orders, a trustee was appointed in USA (American trustee) and another was appointed in Ireland (Irish trustee).

One of the particular assets that the insolvent held was an interest in the Lagoon Beach Hotel (Pty) Ltd (Lagoon Beach Hotel), situated in Cape Town. In fulfilling his duties, the Irish trustee, acting with
the support of the American trustee, uncovered two handwritten contracts entered into between the insolvent and his wife wherein the shareholding of the Lagoon Beach Hotel was transferred by the insolvent to his wife for purposes of frustrating the insolvent’s creditors. According to the Irish trustee’s investigations, he believed that the insolvent had been insolvent at the time that he concluded the handwritten agreements and made the dispositions to his wife. The Irish trustee therefore instituted proceedings in Ireland to have the dispositions made under these handwritten agreements set aside and in effect to recover the Lagoon Beach Hotel as an asset in the insolvent’s estate.

Apart from the written agreements between the insolvent and his wife, a sale was underway for Lagoon Beach Hotel to a third party. As such, the Irish trustee applied to the Western Cape High Court (WCC) for an order recognising him as a foreign trustee in South Africa (SA) and further interdicting the proposed sale. Yekiso J in the WCC granted the interdict and further granted Lagoon Beach Hotel leave to appeal to the SCA, which it did.

The SCA ultimately had to decide whether the Irish trustee had the authority to act given that the USA bankruptcy order was granted first and whether the Irish trustee should be afforded recognition within SA to effectively deal with the assets of the insolvent that were situated in SA.

Lagoon Beach expressed the view that the effect that the USA bankruptcy order was to bring about a worldwide stay which applies extraterritorially. This worldwide stay operates to bar any person from obtaining possession of, or commencing action to obtain control over property falling within the bankrupt estate of the insolvents.

The SCA found against this and noted that it was important to consider the fact that the American and Irish bankruptcy officials were ‘working hand in glove to attempt to recover assets for the benefit of the insolvent’s creditors’ and the Irish trustee’s efforts in seeking a preservation of the assets, was to ensure the integrity of the legal process in both Courts in the USA as well as in Ireland. In any event, the SCA found that the USA worldwide stay can be lifted and is not absolute.

Pertinent to the issue of recognition as a foreign trustee within SA, was the question of the insolvent’s domicile. The SCA reiterated the established principle that a foreign trustee who seeks to deal with assets present in this country, must first obtain the active assistance of a South African Court by obtaining recognition of the foreign bankruptcy order. The grant of recognition by a South African Court to deal with that insolvent’s immovable property situated in this country is permissible only where the insolvent was domiciled in the foreign state, the Court of which sequestrated his estate and the foreign trustee was appointed pursuant to the sequestration order.

“...the SCA ultimately had to decide whether the Irish trustee had the authority to act given that the USA bankruptcy order was granted first and whether the Irish trustee should be afforded recognition within SA to effectively deal with the assets of the insolvent that were situated in SA.”

However, the SCA stated that this was not a law set in stone. In exceptional circumstances, the requirement of domicile will not be strictly insisted upon. The SCA therefore concluded that given the uncertainty as to the insolvent’s domicile and the fact that the American Courts have invoked the justice system of Ireland to assist in tracing assets and administering bankruptcy proceedings, there are in any event exceptional circumstances present that justify a South African Court also rendering assistance by taking the necessary steps to recognise the Irish trustee in order to protect the interests of the insolvent’s creditors.

Accordingly, the SCA found that there was no reason to interfere with the Court a quo’s recognition of the Irish trustee as a foreign trustee within SA and further that the Court a quo properly exercised its discretion to grant an interim interdict to preserve the assets of the insolvent pending the litigation in Ireland.
Short-term insurance taxation moves to SAM

The main driver for the changes in the short-term insurance industry relates to the anticipated introduction of the Solvency Assessment and Management (“SAM”) framework by the Financial Services Board. The provisions of the Act which govern the tax treatment of short-term insurers have been amended to align the tax treatment of insurance liabilities to the treatment.

Refinements to section 28(3) of the Act

A short-term insurer that is a resident will be allowed to deduct from its income the sum of amounts recognised as insurance liabilities relating to premiums and claims, in accordance with IFRS as disclosed in its audited annual financial statements. This amount will be reduced by amounts recognised as recoverable under policies of reinsurance in accordance with IFRS.

Treatment of cash-back bonus

The word ‘unearned’ in the term ‘unearned premium’ has been removed, resulting in the cash-back bonus provision being included as part of the deductions allowed in the hands of the insurer. This amendment has provided clarity as to the treatment of the cash-back bonus provision.

Treatment of amounts received from the owner of a cell in a cell-captive insurance arrangement

All amounts treated as reinsurance for IFRS purposes which relate to amounts receivable from the cell owner in terms of a cell-captive arrangement must now be disregarded.

CFC conducting short-term insurance business outside the Republic

A resident who holds a qualifying participation in a CFC needs to determine the CFC’s net income for the purposes of inclusion in its taxable income and, as a result, a CFC that conducts short-term insurance business outside South Africa will be treated as a resident for purposes of determining the CFC’s net income.

Micro-insurance business

Micro-insurance business will be treated on the same basis as a normal short-term insurer in accordance with the provisions of section 28 of the Act. The amendments to section 28(3) of the Act will apply on the date on which the new Insurance Act comes into effect and will apply in respect of years of assessment ending on or after that date. It is expected that the new Insurance Act will be promulgated in 2017. The amendments in relation to micro-insurance business will come into effect on the date on which an insurer qualifies as a micro-insurer as defined in the new Insurance Act, in terms of that Act, and will apply to years of assessment ending on or after that date.

Changes to legislation: Deemed disposal for long-term insurers

The amendment of the CGT rates came into effect on 1 March 2016 and is applicable in respect of years of assessment ending on or after that date. As a result of this change in the CGT rates, another tax change was introduced by the Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill published on 24 February 2016. This change is applicable to long-term insurers and requires a deemed disposal of certain policyholder assets effective from 29 February 2016.

The CGT inclusion rates for an insurer, in respect of each policyholder fund, are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Previous inclusion rates</th>
<th>New inclusion rates</th>
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<tbody>
<tr>
<td>IPF</td>
<td>33.3%</td>
<td>40%</td>
</tr>
<tr>
<td>UPF</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>CPF</td>
<td>66.6%</td>
<td>80%</td>
</tr>
<tr>
<td>RPF</td>
<td>66.6%</td>
<td>80%</td>
</tr>
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Deemed disposal

The amendment of the CGT rates has resulted in another deemed disposal event for long-term insurers in terms of Section 29B of the Income Tax Act No. 58 of 1962. Section 29B provides relief to policyholders on unrealised gains that exist by locking in these gains at the ‘old’ CGT rates and deeming all policyholder assets (with some exclusions) to be disposed of at the old CGT rates. Section 29B will be amended to state that an insurer is deemed to have disposed of each asset held in respect of all its policyholder funds (excluding certain asset types) on 29 February 2016, for an amount equal to the market value on the that date. The insurer is then deemed to have immediately required those assets at an expense equal to this market value. The phase in period of this resulting realised gain will be amended to be a period of three years, instead of the 4-year period as currently provided for in section 29B.

Source: Tax Alert, PwC
Carbon tax update: priority air pollutants have been declared

**Helen Dagut, Director: Environmental Practice, Cliffe Dekker Hofmeyr**

The Draft Carbon Tax Bill, 2015 (Bill) provides for a carbon tax to be imposed on greenhouse gas (GHG) emissions. Carbon tax is one of the mechanisms that government seeks to employ to control and ultimately mitigate GHG emissions, as part of its response to climate change. Carbon tax will be levied against certain industries which perform specified activities which emit GHGs that have been declared ‘priority air pollutants’.

The Department of Environmental Affairs published two draft notices, most recently in January 2016, in which priority air pollutants have been declared. The first refers to various emission sources and certain activities undertaken by GHG emitters. The second contains a list of production processes in which GHGs are produced. The activities subject to carbon tax are therefore uncertain at this stage, although the Department has advised that the production processes referred to in the January 2016 notice will apply.

Who does it affect and what are the obligations?

Carbon tax will be imposed only in respect of activities which produce ‘scope 1’ or ‘direct’ emissions, which include emissions from stationary combustion of fossil fuels, mobile combustion of fossil fuels, and process and fugitive emissions. Carbon tax will be levied on the amount of the input of the fossil fuel multiplied by specific emission factors which are set out in Schedule 1 to the Bill, at a rate of R120/CO2e for that specific GHG.

The Bill imposes various reporting and accounting obligations that are integrated with various other regulations in the air quality legal regime, which may impose further obligations on taxpayers. A thorough understanding of the air quality legal regime and accounting practices will be needed in order to effectively manage one’s carbon tax liability.

Deadlines for compliance

Carbon tax will be payable in accordance with tax periods, the first of which is proposed to run from 1 January 2017 until 31 December 2017.

The Bill is broadly framed and has the potential to affect all industries which release emissions that result from fuel combustion activities, industrial processes and fugitive sources. Entities affected by the tax will have to keep accurate records of their emissions, report to the Department of Environmental Affairs on emissions and account to SARS. Entities may start considering carbon offset mechanisms and other allowances in anticipation of the carbon tax.

Mining, electricity generation, fuel production and process industries are likely to be most affected by the proposed carbon tax.
Generally, an international or cross-border transaction involves the interaction between a South African taxpayer and a party (or parties) in a foreign country. The first task is to determine which country should levy the tax on the international transaction. The following must be taken into consideration:

- The residency of an individual or a company, transacting with South African taxpayer, and moreover;
- The closeness of the income to the country.

The complexity of international transactions, coupled with the methods of financing, make the determination of the closeness of the income to a single country a daunting task. However, if a foreign individual is physically present for 183 days or more in South Africa, or if a foreign company has permanent establishment in South Africa, then the foreign individual and the foreign company could lose their income tax status as non-resident as defined by the Income Tax Act. So if the business activities of a non-resident are linked to a permanent establishment in South Africa, then SARS could tax the income attributable to the permanent establishment as business profits.

The taxation of business profits may only be taxed in the source country if the taxpayer carries on business through a permanent establishment in the source country. Usually, a permanent establishment is established through a presence in the source country of a fixed base from which it conducts its primary business on a regular basis. This begs the question: what is permanent establishment? This article aims to define the concept of permanent establishment, and aims to provide practical examples, thereby, further clarifying the concept as applied in practice.

**Definition of Permanent Establishment (PE)**

The South African Income Tax Act relies on Article 5 of the Model Tax Convention on Income and on Capital of the Organisation for Economic Co-operation and Development (OECD) for its definition of permanent establishment. It reads as follows:

"The term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partially carried on."
Inclusion Exclusion

The term ‘permanent establishment’ includes especially:

a) A place of management;
b) A branch;
c) An office;
d) A factory;
e) A workshop; and
f) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources

Furthermore, a building, site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.

However, the term ‘permanent establishment’ shall not include the following:

- The use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
- The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
- The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
- The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
- The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

Commentary

1. Fixed place of business

Essentially, the term ‘permanent establishment’ refers to a ‘fixed place of business’; a place through which the business of an enterprise is wholly or partly carried out on. The following are the requirements of a ‘fixed place of business’:

- The existence of a ‘place of business’, i.e. a facility such as premises or, in certain instances, machinery or equipment;
- This place of business must be ‘fixed’, i.e. it must be established at a distinct place with a certain degree of permanence;
- Implies that persons are dependent on the enterprise and conduct the business of the enterprise in the country in which the fixed place is situated.

The place of business has to be a ‘fixed’ place of business, implying that there must be a link between a place of business and a specific geographical point. In practice, however, activities occur within neighbouring locations; consequently, there may be difficulties in establishing a single place of fixed business. Under these circumstances, a single place of business will exist within a location within which the activities ‘move’. An ‘office hotel’ which a company regularly hires, is a single place of business.

The term ‘place of business’ covers any premises, facilities or installation used for carrying on a business – it does not have to be used exclusively for business purposes. In addition, it is immaterial whether the premises, facilities or installations are owned or rented by the ‘permanent establishment’. It is sufficient if the place is merely at the disposal of the enterprise in order to constitute a place of business. No formal legal right to use a place is therefore required. It is, however, necessary that the place has a productive character. This implies that the place must contribute to the profits of the enterprise, and the profits are unambiguously attributed to the fixed establishment for tax purposes.

2. Permanency of place of business

While it is recognised that the place of business must be fixed, the logical implication is that the permanent establishment will arise only if the place of business has a degree of permanency. A permanent establishment will not arise if the place of business is of purely temporary nature. Generally, practice indicates that permanent establishment will not arise in situations where a business has been carried on in a country through a place that was maintained for less than six months (for example, the soccer World Cup and the Grand Prix). However, there are exceptions to the norms. If the business activity is of a recurrent nature, each period of time during which the place is used must be considered in combination with the number of times the place is used. In other words, when a place of business is used for short periods only, but such usage occurs frequently over long periods of time, the place of business is a permanent establishment. The Grand Prix is again cited as an example because the event is held annually at the same venue and, therefore, its place of business is a permanent establishment.

In addition, temporary interruptions of activities do not give rise to a termination of permanent establishment. Temporary interruptions caused by bad weather, labour disputes, or shortage of materials do not give rise to a closure of permanent establishment.

With reference to construction or installation projects, the definition of permanent establishment requires the site to last more than 12 months. However, when roads, or canals, for example, are being constructed, or when there are salvage operations to remove oil spill, it is unlikely the site will be stationed at a single place for twelve months. Under these circumstances, the activities are performed at a particular area as part of a single project, and the totality of the project must be granted the status of permanent establishment if the whole project lasts more than twelve months.

3. Commencement of permanent establishment

When does a permanent establishment commence? A permanent establishment begins to exist as soon as the entity commences it business through a fixed place. A permanent establishment does not include the time during which the fixed place of business is being prepared, unless the preparatory activity does not differ substantially from the activity for which the place of business is to serve permanently (for example, medical facilities for the treatment of Ebola).

4. Nature businesses

With reference to exclusions from the definition of permanent establishment, the use of facilities for storing, displaying or delivering its own goods or merchandise will not be recognised as permanent establishment. It is given that a ‘permanent establishment’ arises when the place of business is used for enterprising purposes and not for storing, displaying or mere delivery of goods. The example of Stuttafords Storage is cited as an exception, because its core business is to provide storage facilities and has fixed structure from which it conducts its business – Stuttafords Storage is a permanent establishment. In addition, if a fixed place of business delivers spare parts to its customers, provides after-purchase services which are categorically not auxiliary services or a preparatory function, the place of business is a permanent establishment.

5. Managerial function

Furthermore, a fixed place of business engaging in preparatory or auxiliary tasks but undertakes the following tasks, includes:

- Managing function - a venue for shaping, formulating and implementing company decisions,
- Location where a company's board regularly meets, and,
- The board is the authoritative structure to make key management and commercial decisions necessary for the conduct of the company's business as a whole

Under these circumstances, the place of business is a permanent establishment although auxiliary and preparatory functions are also undertaken in the same place of business.

Illustrative examples

If an employee of a company (Company A) who, for a long period of time, is allowed to use an office in the headquarters of another company (Company B) in order to ensure that the Company B complies with its obligations under contracts concluded with Company A. In that case, the employee is carrying on activities related to the business of Company A and the office that is at his disposal at the headquarters of Company B will constitute a permanent establishment of his employer, provided that the office is at his disposal for a sufficiently long period of time so as to constitute a ‘fixed place of business’.
Another example is that of a painter who, for two years, spends three days a week in the large office building of its main client. In that case, the presence of the painter in that office building where he is performing the most important functions of his business (i.e. painting) constitute a permanent establishment of that painter.

The third illustrative example makes reference to an enterprise that operates computer equipment at a particular location. A permanent establishment may exist even though no personnel of that enterprise is in attendance at the physical location for the operation of the equipment. The presence of personnel is not necessary to consider that an enterprise wholly or partly carries on its business at a location when no personnel are in fact required to carry out business activities at that location. This conclusion applies to electronic commerce to the same extent that it applies with respect to other activities in which equipment operates automatically, e.g. automatic pumping equipment used in the exploitation of natural resources.

The unreported case of AB LLC and BD Holdings LLC, case number 13276, is insightful in demonstrating the practical application of ‘permanent establishment’ concept. The court case refers to a foreign company that renders professional services to a South African company in South Africa. Article 7(1) of the DTA concluded between South Africa and the USA provides that profits of an enterprise of the USA shall be taxable only in the USA, unless that enterprise conducts business in South Africa through a permanent establishment located in South Africa. The DTA furthers establishes that where business is carried on through a permanent establishment, the profits of the enterprise may be taxed in South Africa, but only to the extent that they are attributable to that permanent establishment. Briefly, SARS argued that the foreign company was in South Africa for two years, in the boardroom of their South African client, and as a result the court ruled that a fixed place of business had been established in South Africa while rendering services to its clients in South Africa.

Conclusion

Business income earned from a ‘permanent establishment’ illustrates the circumstances under which the ‘source’ country that hosts the permanent establishment may tax the income generated from business activities within its borders. More generally, it is argued that the taxability of cross-border activity will be determined by the interaction between the presence (through a permanent establishment), and business activity. If the income is generated by the business activity attributed to the permanent establishment, it would be taxed in the jurisdiction where that ‘permanent establishment’ is physically located.

The challenge is to determine the existence of a ‘permanent establishment’ and practice confirms that this is a daunting task. The illustrative examples are not exhaustive, but indicate the complexities of determining the presence of a ‘permanent establishment’. The aforementioned discussions are based on a ‘model’ definition of permanent establishment as crafted by the Organisation for Economic Co-operation and Development (OECD). Taxpayers need to view the definition of permanent establishment as defined in the DTA between affected governments. The DTAs could marginally deviate from model definition of permanent establishment.

1) See article by Dr Ben Croom, Executive Tax, ENSafrica, ‘Tax court rules on creation of permanent establishment in South Africa’ page 24 of Tax Professional Issue 25.
On 22 May 2015 representatives of the South Africa and Mauritius revenue authorities signed a memorandum of understanding on the factors to be considered in applying Article 4(3) of the treaty between the two countries. There had been uncertainty about the application of this Article since the new treaty was signed in May 2013. Article 4(3) provides that where a person other than an individual is a resident of both countries, the competent authorities of both countries will endeavour to determine by mutual agreement where the person is deemed to be resident for purposes of the treaty. The memorandum sets out the factors they will consider in arriving at their decisions.

The treaty is important for both countries, because Mauritius is a favourite location for South Africans wishing to establish structures through which to conduct their foreign business activities. Not only are the two countries only a few hours apart by plane, but they are both members of the African Union and SADC, the Southern African Development Community. Mauritius has a sophisticated financial services sector and attractive tax legislation. It has close historical ties and a favourable double tax treaty with India. It also has treaties with a number of other countries, like China, that are attractive to South African businesses.

The 2013 treaty introduced a more stringent definition of ‘resident’, seemingly to assist the South African tax authorities in retaining their taxing rights over South African businesses despite attempts to locate profits in Mauritius by using Mauritian companies as conduits to the rest of Africa, and to the Asian giants. The provision in Article 4(3), that the competent authorities would be the ultimate tie-breaker where there is uncertainty, invited the question: what factors would they use to make their decisions? The memorandum of understanding seeks to answer this question and it reflects the current OECD position.

The factors include:

- Where the board of directors or equivalent body usually meets;
- Where the CEO and other senior executives usually carry on their activities;
- Where the senior day-to-day management is conducted;
- Where the headquarters are located;
- Which country’s laws govern the legal status of the entity;
- Where the accounting records are kept;
- Any other factors listed in the 2014 OECD Commentary as may be amended in the forthcoming OECD/BEPS Action 6 final report. (Action 6 deals with the prevention of the use of treaty benefits in inappropriate circumstances); and
- Any other factors that the competent authorities may identify and agree on.

The OECD Commentary essentially states that the most important criterion in determining the residence of an entity is the place of effective management (POEM), and the factors listed in the memorandum reflect the OECD comments. A new OECD report on base erosion and profit shifting (BEPS) is expected in the near future. Paragraph (g) of the memorandum appears to leave the way open for the respective tax authorities to apply these factors to the extent that they do not feature in the current list.

How useful the list of factors will be in practice as a guide for planning international business structures remains to be seen. None of these factors on its own will provide an instant answer, and there is nothing revolutionary about them, so the uncertainty about determining the residence of an entity will continue. However, they will at least provide some guidelines and, at least, a less arbitrary process is encouraged.

The remaining actions required to bring the treaty into effect include the completion of certain Mauritian domestic procedures and the exchange of a diplomatic instrument of ratification between South Africa and Mauritius. If these actions are completed in the near term, the treaty is expected to have effect as from 1 January 2016.

Source: Norton Rose Fulbright South Africa
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