DEALING WITH SARS Value-Added Tax and PAYE Audits

Johan Heydenrych

The Tax Faculty

Extract from 2021_2022 National Budget Speech delivered by Finance Minister Tito Mboweni

"We owe a lot of people a lot of money. … We must shore up our fiscal position in order to pay back the massive obligations we have incurred over the years."

"SARS has started to deepen its technology, data and machine learning capability. It is also expanding specialised audit and investigative skills in the tax and customs areas to renew its focus on the abuse of transfer pricing, tax base erosion and tax crime.

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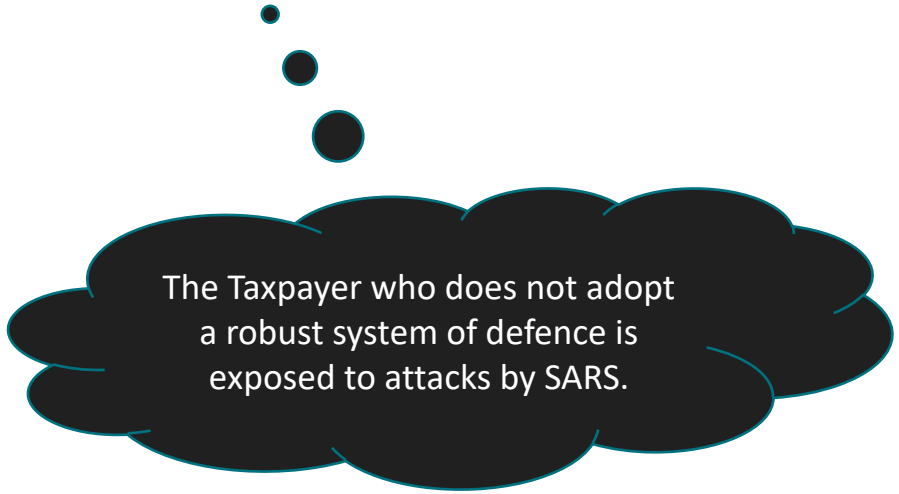
SARS vs the Taxpayer

The winner will be the party

- who is best prepared
- who has the best defensive systems
- who has the best ammunition and weapons in the arsenal
- Who has the most resolve to defend its position

SARS Weaponry
The onus of proof rests on the taxpayer that an amount is not subject to tax or deductible
Benefit of hindsight in considering the impact of transactions
Power to levy significant Understatement, Late Payment, administrative penalties. (Yet, there are no penalties on SARS for failure to comply with Tax laws)
Pay now, argue later legislation. SARS have access to significant resources – technical and financial
Ability to employ delaying tactics with impunity.
Power to influence legislator
Reportable Arrangement legislation
3rd party disclosure legislation
Lack of external oversight – mostly judge, jury and executioner. Tax Ombud has value on macro basis but not really for the man in the street.
Controls ADR process. Court process too expensive for average man in the street. One-sided interpretation of VDP
Virtually no consequences when contravening TAA, yet holds the taxpayer to comply.
Armed with significant appeal court successes, very litigious.

Taxpayer Defensive systems
The Taxpayer writes the initial “narrative”. (ITR 14, VAT 201, EMP 201 etc)
Protection found in S223 opinions
Preventative approach to tax risk management



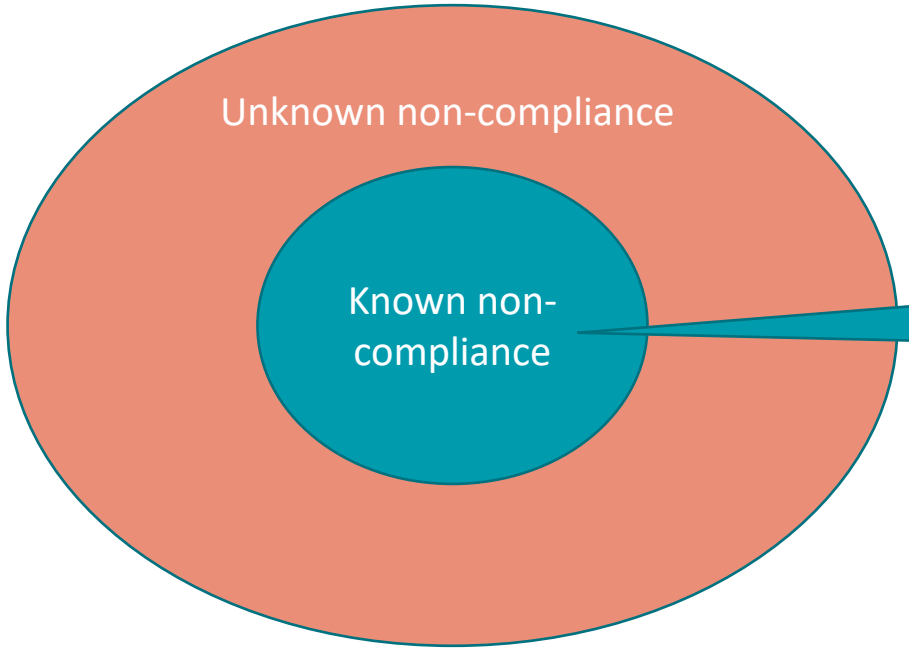
Tax Uncertain positions

One can never reduce tax risks to zero. However, one should employ good practices of tax risk management to limit the number of “unknown tax risks”.

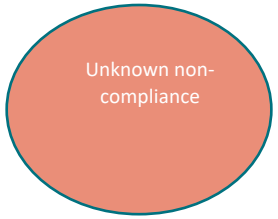
The role of the internal accountant, the internal and external tax practitioner, the financial manager and the financial director is to limit the “unknown tax risks” to the bare minimum.

For “known tax risks” the taxpayer should ANTICIPATE an attack from SARS and ensure that robust defensive system is in place so that it can be successful in dealing with the RFI, Audit, ADR and if necessary, the Courts.

Non-Compliance positions



There is a difference between a “tax uncertain” position and a “tax illegal” positions.
Normalise tax illegal positions with the VDP process



Unknown areas of non-compliance must be reduced to as close to zero as possible

Course content

The taxpayer should not underestimate the resolve of SARS to collect taxes, penalties and interest wherever possible. The dispute resolution process (even though technically sound) favours SARS from a cash flow and a timing perspective and many taxpayers can simply not afford the cost of disputes and the time to resolve tax uncertain positions. This course focuses on an anticipatory and precautionary approach to avoid costly disputes with SARS. By adopting the principles discussed in this course, an investment is made into tax certainty where disputes with SARS are avoided. Where tax uncertain positions are progressed through the legal system, the chances of success will be improved exponentially if the principles discussed in this course are adopted.

Course content (Continued)

Dealing with SARS VAT audit

VAT revenue is estimated to be 25% of the Gross National Tax Revenue for the 2021/22 fiscal year making it 56% more important than Corporate Income Tax that constitutes 16% of Gross National Tax Revenue. From a vendor's perspective, VAT is arguably the single most important tax to manage in an organisation since errors can occur on output tax and input tax and affects each element of the business process. It is a transactional tax with limited exclusions. In this course we will discuss each element of the VAT lifecycle which starts with a VAT friendly ERP system and ends with the dispute resolution process. We will discuss how to avoid understatement penalties by adopting a robust system of tax management.

In addition to the VAT 201 preparation lifecycle, we will discuss VAT risk management policies and procedures with regards to the following processes:

- Corporate structure, loan funding, capital funding, reorganisations.
- Fixed asset management
- Purchases and stock management
- Sales and debtor management, including bad debts
- VAT and payroll management
- Shared services centres and recovery of costs.

We will also discuss practical case studies of disputes with SARS highlighting VAT risks including but not limited to the following:

- IT 14SD
- Apportionment rules
- Deemed supplies
- Documentary requirements on exports
- Entertainment
- Cost recoveries

Course content (Continued)

Dealing with SARS PAYE audit

South Africa's budgeted gross tax revenue for the 2021/2022 fiscal year is R1.5 trillion of which Personal Income Tax makes up 38%. The vast majority of personal income tax is collected through the PAYE system making this the single most important tax collection mechanism for SARS. Despite the importance of PAYE, the risks associated with non-compliance is often underestimated.

Employers are often unable to recover non-deducted PAYE from employees in which case the PAYE liability must be grossed up with the underlying taxes paid on behalf of the employee (which is a fringe benefit in itself). Assuming a 45% marginal rate, the tax liability on a fringe benefit where the PAYE is not recovered from the employee will be 81.81%. (In order to provide an after-tax benefit to an employee of R1 000, the total pre-tax amount must be R1 818.18 on which 45% tax is R818.18 (81.81%))

In this course we will discuss each element of the PAYE lifecycle which starts with a tax friendly employment letter and Employee Benefit Form that provides tax certainty on all elements of remuneration. The PAYE lifecycle ends with the dispute resolution process, which risk should be minimised if appropriate attention is given to all elements of the PAYE lifecycle. We will discuss how to avoid understatement penalties by adopting a robust system of tax management.

In addition, we will discuss practical case studies of disputes with SARS highlighting PAYE risks including but not limited to the following:

- Salary Sacrifice Principles and Cost to Company principles
- Setting travel allowances including the reimbursement of fuel, maintenance, eToll and business related km.
- Bursaries and study loans
- Relocation allowances
- Section 8C gains and losses
- Section 7C variable remuneration.
- Home study costs, wi-fi, cell phones and computers.
- Gifts, awards and incentive trips
- IT 14SD reconciliations.
- The employee spending significant time away from home (e.g. construction workers and expatriates)

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Dealing with SARS VAT Audit

The Tax Faculty

What are the main reasons why Taxpayers are exposed to liabilities upon VAT Audit?

What are the main reasons why Taxpayers are exposed to liabilities upon VAT Audit?

Reason 1

Misconceptions about VAT

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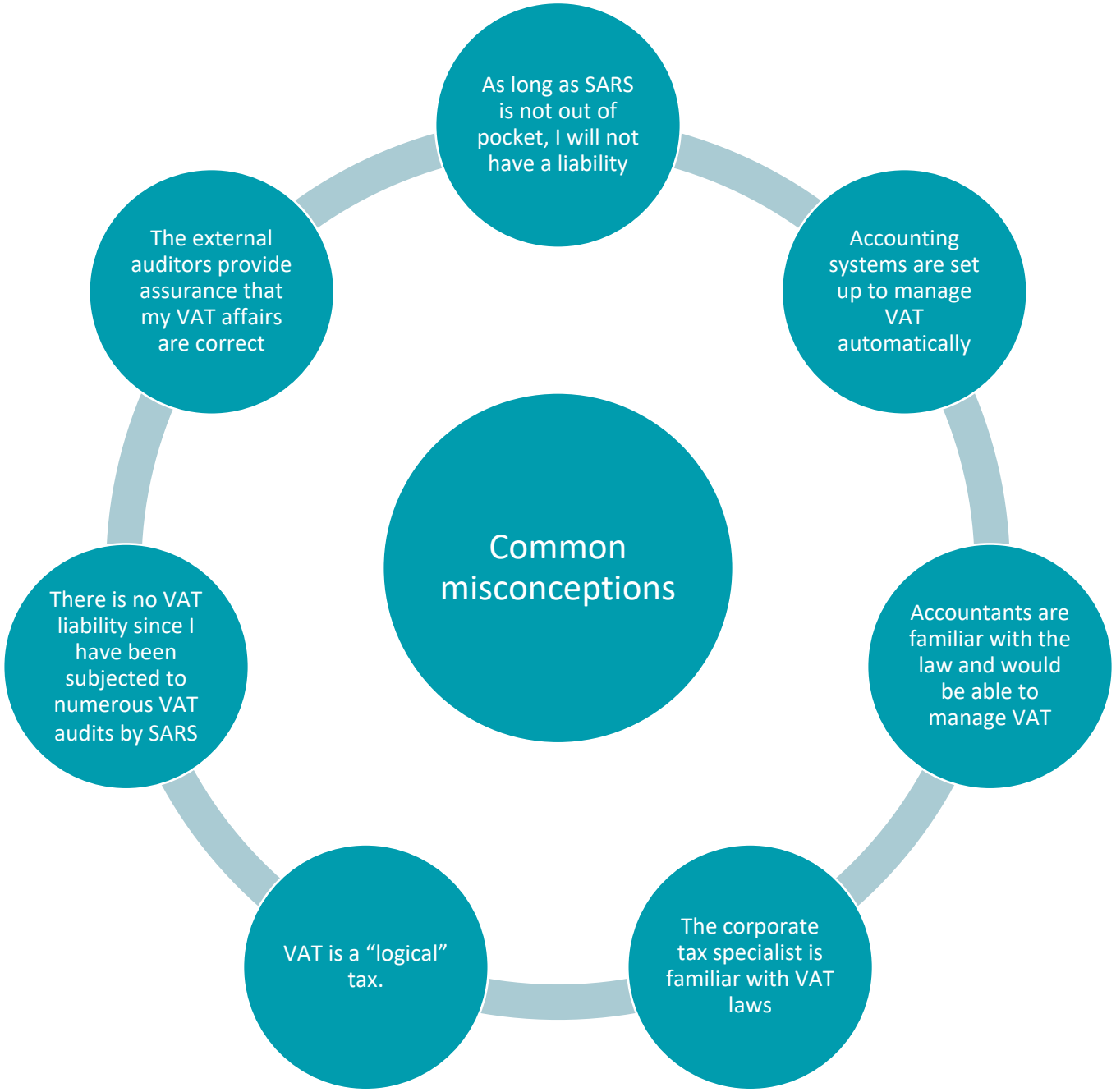

Common misconceptions
As long as SARS is not out of pocket, I will not have a liability
Accounting systems are set up to manage VAT automatically
Accountants are familiar with the law and would be able to manage VAT
The corporate tax specialist is familiar with VAT laws
VAT is a “logical” tax.
There is no VAT liability since I have been subjected to numerous VAT audits by SARS
The external auditors provide assurance that my VAT affairs are correct

What are the main reasons why Taxpayers are exposed to liabilities upon VAT Audit?

Common misconceptions

- As long as SARS is not out of pocket, I will not have a liability
  - Inter-company charges
  - Journals without VAT
  - Zero-rating of supplies

What are the main reasons why Taxpayers are exposed to liabilities upon VAT Audit?

Common misconceptions

- Accounting systems are set up to manage VAT automatically
  - Apportionment of VAT
  - Non-deductible VAT on entertainment, car rentals etc
  - Set up to automatically levy VAT at 0% where the recipient of the service is a non-resident.

What are the main reasons why Taxpayers are exposed to liabilities upon VAT Audit?

Common misconceptions

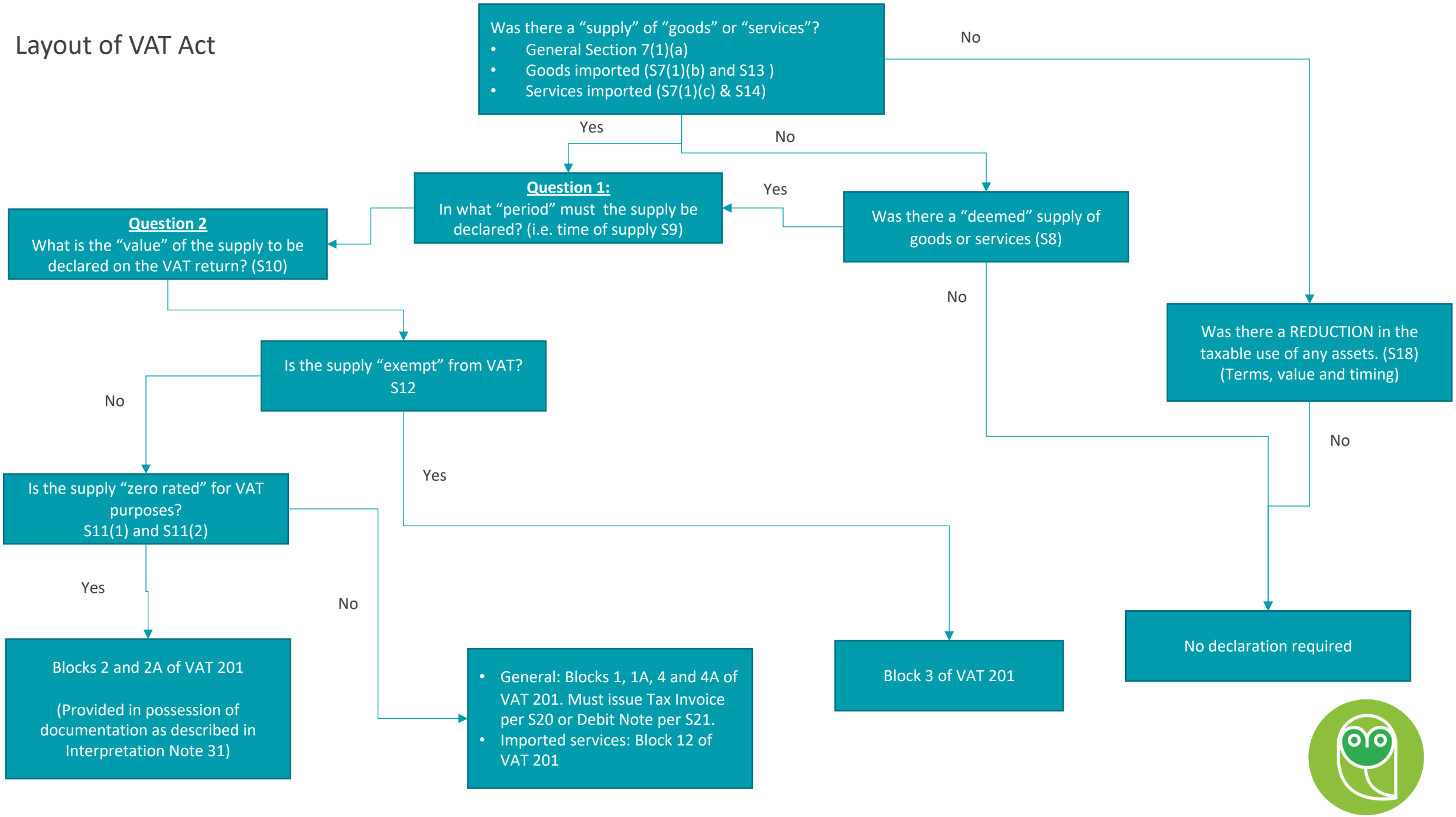
- Accountants are familiar with the law and would be able to manage VAT
  - VAT training in most B.Com degrees is superficial at best
  - Accountants often confuses VAT principles with accounting principles – especially in so far as time of supply and value of supply rules are concerned.
  - It is notable that indirect taxes such as VAT and PAYE does not even fall within IFRIC 23. Not even the IASB thinks that VAT represents a major disclosure risk.

What are the main reasons why Taxpayers are exposed to liabilities upon VAT Audit?

Common misconceptions

- The corporate tax specialist is familiar with VAT laws
  - Neglect VAT when designing merger, acquisition, restructure.
    - Assume S8(25) will automatically apply
    - Fail to take into account Section 18A adjustments
  - Fail to recognise VAT when doing income tax returns
    - Income tax deduction is not available when VAT is “claimable” See section 23C of the Income Tax Act
    - Fail to identify VAT risks when reviewing Income Tax Returns and performing IT14SD
      - E.g. VAT on barter transactions
  - Fail to recognise that the definition of a VAT vendor is wider than that of an Income Taxpayer.
    - Includes “body of persons”
    - Includes branches (if elect to do so)
  - Applies income tax principles to VAT

Layout of VAT Act



What are the main reasons why Taxpayers are exposed to liabilities upon VAT Audit?

Common misconceptions

- VAT is a “logical” tax.
  - VAT on business related entertainment expenditures?
  - VAT on business related passenger car related costs (e.g. car rentals)?
  - VAT incurred as “agent” and VAT incurred as a “principal”?
  - Output VAT on “imported” services – reverse VAT?
  - VAT registration liabilities for non-residents – Electronic services, enterprise?

What are the main reasons why Taxpayers are exposed to liabilities upon VAT Audit?

Common misconceptions

- There is no VAT liability since I have been subjected to numerous VAT audits by SARS
  - Unless SARS issues a formal “binding ruling” there is nothing preventing SARS from taking a different view with regards to the application of the law
  - VAT desk-audits are often superficial focusing on the existence of the rights documentation.
  - A comprehensive VAT audit, especially with the benefit of an IT 14SD and use of data analytics may uncover numerous VAT technical risks.

What are the main reasons why Taxpayers are exposed to liabilities upon VAT Audit?

Common misconceptions

- The external auditors provide assurance that my VAT affairs are correct
  - Auditors are concerned as to whether or not the AFS “fairly” represent the financial position of the company.
  - Whilst auditors focuses on the income tax and deferred tax in the AFS, since they are disclosable items, auditors, as a general rule do not audit VAT separately.
  - VAT is generally included in the audit of purchases, sales, debtors and creditors by audit trainees.
  - Auditors may in some instances perform reasonability tests but seldom focuses on a VAT technical audit.
  - IFRIC 23 does not address VAT

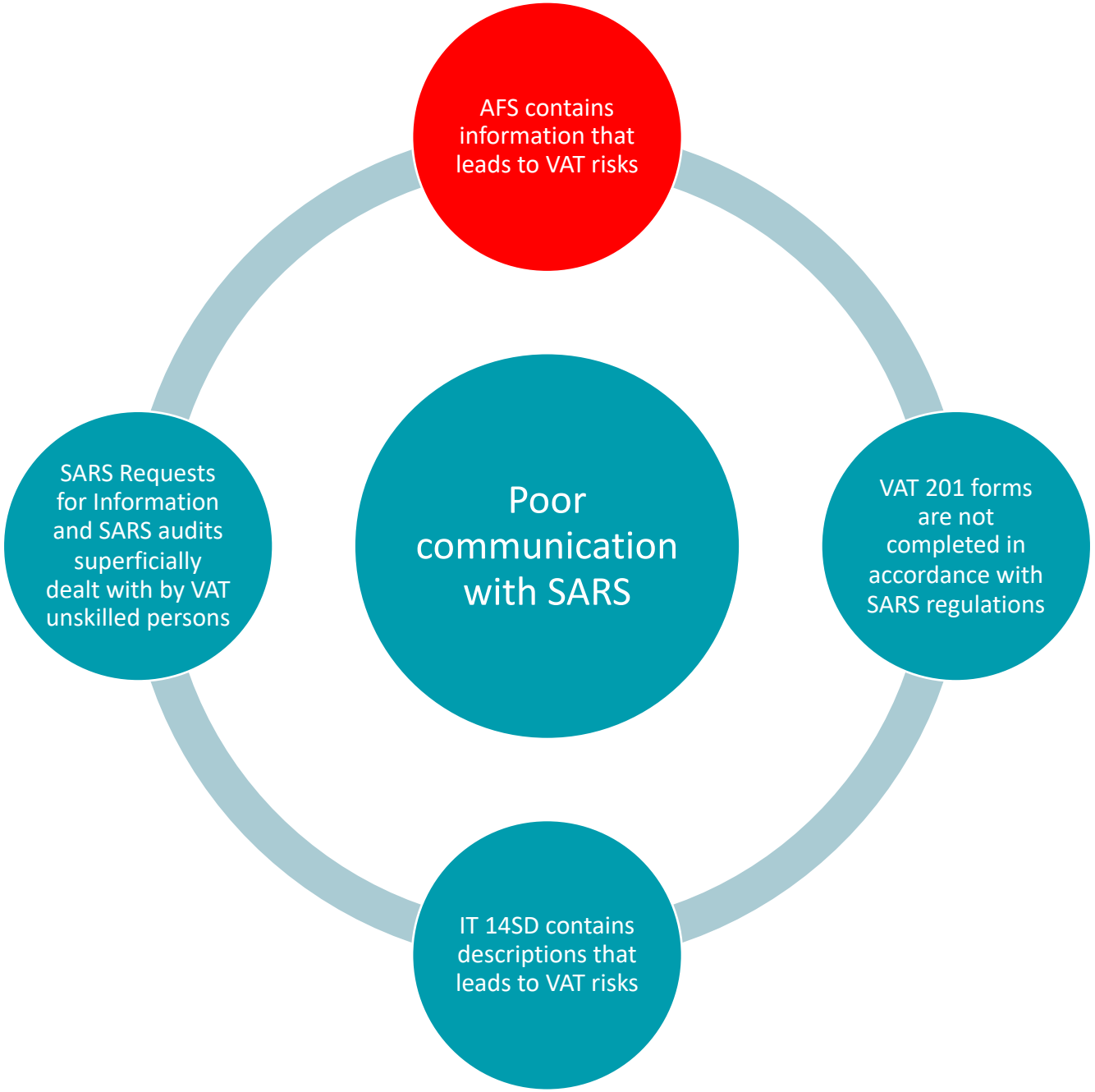
What are the main reasons why Taxpayers are exposed to liabilities upon VAT Audit?

Reason 2

Poor Communication with SARS

The Tax Faculty


AFS contains information that leads to VAT risks
VAT 201 forms are not completed in accordance with SARS regulations
IT 14SD contains descriptions that leads to VAT risks
SARS Requests for Information and SARS audits superficially dealt with by VAT unskilled persons
Poor communication with SARS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AFS preparation and VAT exposures

- The AFS is a “language” that tells the story of the company.
- The AFS is provided to SARS as part of the ITR 14 submission.
- The vendor must assume that SARS will review the AFS when conducting a VAT audit and not only when conducting an Income Tax Audit
- Numerous VAT risks can be identified by a careful review of the AFS.
- Failure to confirm that disclosures in the AFS are supportive to disclosures in the VAT 201 may lead to a VAT audit and VAT risks.

AFS disclosures and VAT exposures

AFS Disclosure	VAT Risks
Long outstanding creditors	Section 22(3) states that if a vendor claimed input tax and failed to pay the creditor within 12 months, output VAT is payable on the unpaid portion.
Long outstanding foreign debtors	Non compliance with IN 30 and IN 31 documentary rules to substantiate zero rating – specifically the proof of payment rules
High interest, dividend or other exempt income	Risk of apportionment of input tax.
Related party transactions and cost recoveries	• Risk of special value or time of supply rules • Recoveries of cost such as salaries may attract VAT unless costs are incurred as agent on behalf of a principal
Recapitalisation, share issues, B-BBEE deals	VAT on legal fees, raising fees, consulting fees may not be claimable

AFS disclosures and VAT exposures

AFS Disclosure	VAT Risks
Barter transactions	Output VAT is payable on the value of the consideration received.
Agents and Principals	The AFS are prepared on the basis of “substance over form”. In some instances, the entity will disclose “commission income” when factually it is a “margin on sale”. SARS queries may arise if there is a disconnect.
Insurance claims	The AFS is likely to disclose significant events that lead to insurance claims. (Fire, floods etc). Section 8(8) liabilities may arise where the vendor is indemnified by a contract of insurance.
Disputes, damages, contingent liabilities, settlements.	The VAT treatment arising from disputes are often not considered when reaching a settlement. Depending on the circumstances, the settlement may or may not attract VAT.

AFS disclosures and VAT exposures

AFS Disclosure	VAT Risks
Retention debtors	VAT on retention debtors is payable when the retention debtors becomes due and payable or when paid.
Donations and Corporate Social Investment initiatives	The VAT implications of these initiatives are extremely complex. A vendor may for example claim VAT on computers and donate the computers to a PBO. The vendor may become involved in a CSI event that is entertainment related. A careful review of the CSI disclosures from a VAT perspective is highly advisable
Marketing initiatives	The VAT treatment of marketing events is complex. In particular conferences, Year-end functions, Awards, sponsorships
Journals, transfer pricing adjustments	Failure to record VAT accurately on journals, transfer pricing adjustments and other year-end adjustments.

AFS disclosures and VAT exposures

AFS Disclosure	VAT Risks
VAT on imported services	Output VAT is payable where services are acquired for consumption is South Africa. **otherwise** than in the course of making taxable supplies.
VAT on fringe benefits	Failure to pay output VAT on e.g. company cars provided to employees


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VAT 201 Preparation – commonly found errors

- The VAT 201 return is the primary submission to SARS of the vendors VAT liability.
- Incorrect disclosure exposes the taxpayer to understatement penalties

Prescription

9. Period of limitations for issuance of assessments.—(1) An assessment may not be made in terms of this Chapter … (*b*) in the case of self-assessment for which a return is required, five years after the date of assessment of an original assessment (i) by way of self-assessment by the taxpayer…

(2) Subsection (1) does not apply to the extent that—

(*a*) in the case of assessment by SARS, the fact that the full amount of tax chargeable was not assessed, was due to—

(i) fraud;

(ii) misrepresentation; or

(iii) non-disclosure of material facts;

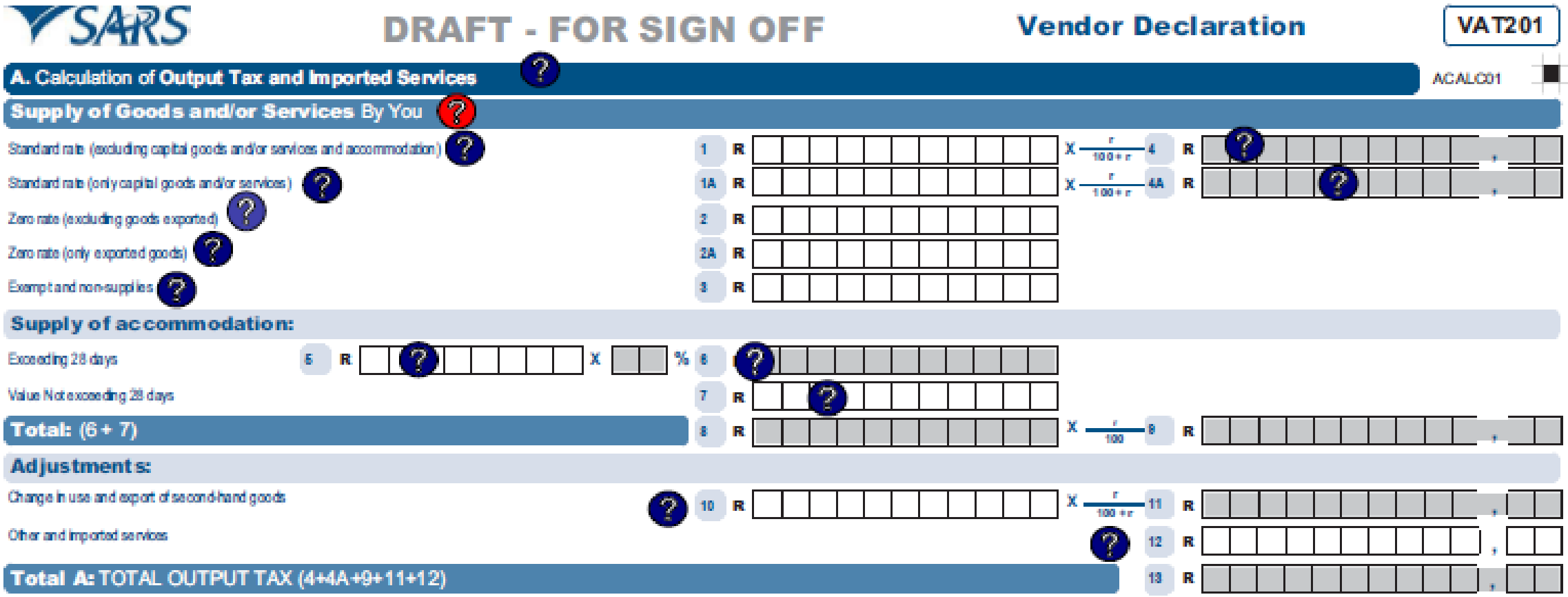
VAT 201 preparation

Incorrect VAT 201 Disclosure	VAT Risks
Non-disclosure or incorrect disclosure of zero rated supplies	Difficulties to complete IT 14SD. Non-disclosure of material facts if SARS disputes the application of the zero rating
Netting input tax and output tax instead of disclosing it properly	Output VAT must be disclosed properly in the month that coincides with the Time of supply rules. Input VAT is a different concept that can be claimed within 5 years from date of receipt of valid tax invoice.
Credit Notes issued reflected as reduction of output VAT, Bad debts reflected as normal input tax, adjustments not separately disclosed.	Non-disclosure of material facts if SARS challenges application. This means that prescription does not apply.

VAT 201 preparation

Incorrect VAT 201 Disclosure	VAT Risks
No split of input tax between capital and non-capital items	Difficulties with IT 14SD
Non-disclosure of exempt supplies and non-supplies – in particular interest and dividends	Incorrect information at SARS for apportionment risks. Prescription may not apply.
Change in use adjustments not separately disclosed	Prescription may not apply.

VAT 201 form preparation



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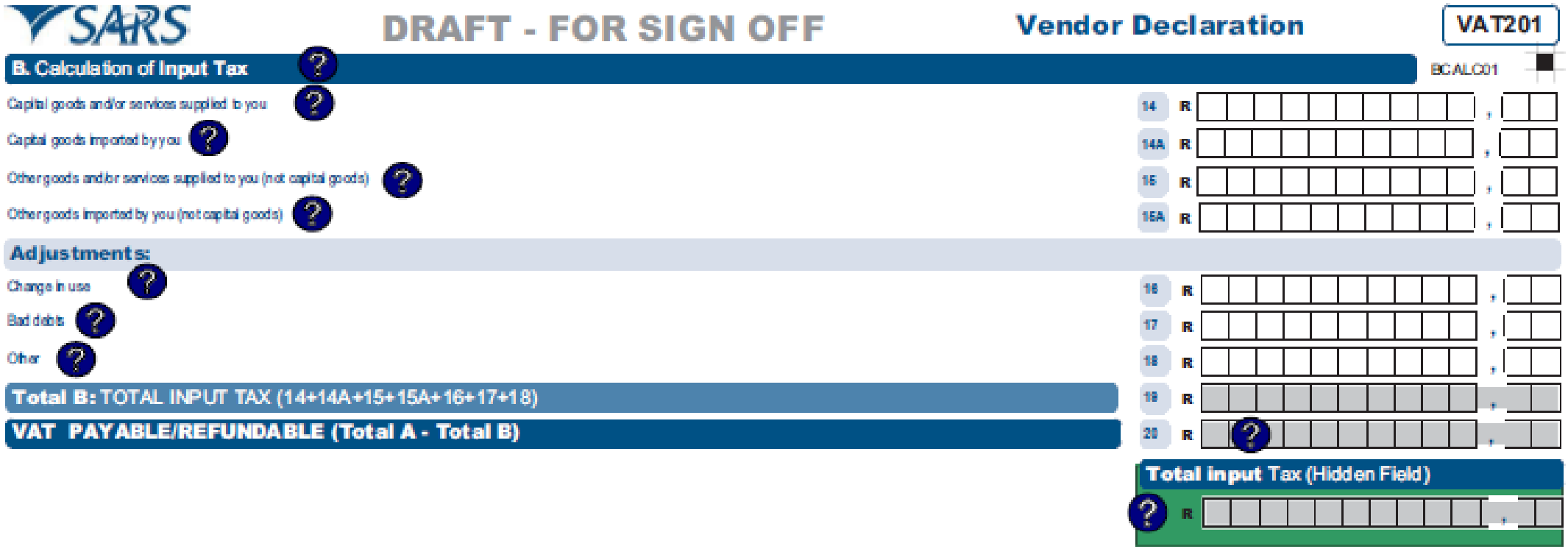
SARS

DRAFT - FOR SIGN OFF

Vendor Declaration

VAT201

B. Calculation of Input Tax

BCALC01

Capital goods and/or services supplied to you	14	R	,
Capital goods imported by you	14A	R	,
Other goods and/or services supplied to you (not capital goods)	15	R	,
Other goods imported by you (not capital goods)	15A	R	,
Adjustments:			
Change in use	16	R	,
Bad debts	17	R	,
Other	18	R	,
Total B: TOTAL INPUT TAX (14+14A+15+15A+16+17+18)	19	R	,
VAT PAYABLE/REFUNDABLE (Total A - Total B)	20	R	,

Total input Tax (Hidden Field)

R ,


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IT 14SD Preparation – commonly found errors

- Turnover reconciliation
  - Turnover per AFS to Value of supplies per VAT 201
- Input tax recon
  - Cost of sales per AFS to input tax per VAT 201
- Recommend that a separate worksheet is prepared
  - The impact of each reconciling item should be tested from a tax technical perspective addressing
    - Time of supply
    - Value of supply
    - Documentary requirements

IT 14SD preparation

Client Name

IT 14SD for period ending

Information per VAT 201

Description	R	R
Output VAT per VAT return - Including Capital goods - Block 13		
Total supplies (excluding zero rated supplies)		-
Total zero rated supplies		
Total exempt and non-supplies		
Total supplies per VAT 201		-

Information per ITR 14

Detail	R
Gross Sales (excluding credit notes) - Foreign Connected	
Gross Sales (excluding credit notes) - Other than foreign connected	
Total Sales per ITR 14	-

Difference between VAT 201 to ITR 14

Detail	R
Difference per the above	-

Reconciliation of VAT 201 to ITR 14

Detail			R
Turnover per AFS			-
Items on which output VAT was paid per the VAT 201 but is not included in Sales per AFS			
Value of capital supplies			
Items included in AFS Sales but not included in output VAT per VAT 201			
		Accuracy level	
Other: Immaterial	Various small timing differences	#DIV/0!	-
Total value of supplies per VAT 201			-

Information per VAT 201

Description	R
Input VAT per VAT returns field 19 - Including Capital goods	
Total purchases on which input VAT was claimed	-

Information per ITR 14

Detail	R
Opening Stock	
Add: Credit notes on sales	
Add: Purchases - Foreign connected (excluding rebates)	
Add: Purchases - Other than Foreign connected (excluding rebates)	
Less: Rebates on purchases	
Less: Closing Stock	
Less: Inventory adjustments (Previous year's stock provision reversed)	
Add: Inventory adjustments (Current year's stock provision/obsolete/slow moving)	
Total Cost of Sales per ITR 14	

Difference between VAT 201 to ITR 14

Detail	R
Difference per the above	-

Reconciliation of VAT 201 to ITR 14

Detail		R
Amounts on which input VAT is claimed per AFS		
Credit notes on sales	Only if disclosed as input VAT on VAT return	-
Purchases - Foreign connected (excluding rebates)		-
Purchases - Other than Foreign connected (excluding rebates)		-
Rebates on purchases	Only if disclosed as input VAT on VAT return	-
Items on which input VAT was claimed per the VAT 201 but is not included in cos per AFS		
VAT included in admin and operational expenses and disclosed below the line in AFS		
10% Upliftment in Customs Value for Imports		
Items included in AFS cost of sales but on which no VAT is claimable		
Less: Purchases of zero rated goods		
Other - mainly due to purchases from non VAT registered vendors, timing differences and zero rated purchases.	***Accuracy level*** #DIV/0!	-
Total value of supplies per VAT 201		-


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SARS Request for information and SARS audits

- Communication with SARS should be considered carefully before submission.
- Identify the person in the organisation that is responsible for all communication with SARS. At the very least, this person must review information before submission
- Be careful of communicating “on an informal basis” with SARS (See Purveyor case)

The Purveyor case

The case deals with VAT but is important to gauge the approach of SARS towards a Taxpayer where the Taxpayer makes voluntary disclosures to SARS otherwise than through the formal VDP process

IN THE HIGH COURT OF SOUTH AFRICA

(GAUTENG DIVISION, PRETORIA)

CASE NO: 61689/2019

DELETE WHICHEVER IS NOT APPLICABLE

(1) REPORTABLE: YES/NO
(2) OF INTEREST TO OTHERS JUDGES: YES/NO
(3) REVISED

....

IN THE MATTER BETWEEN:

PURVEYORS SOUTH AFRICA MINE SERVICES (PTY) LTD Applicant

AND

THE COMMISSIONER FOR THE SOUTH AFRICAN

REVENUE SERVICE Respondent

The Purveyor case: The Facts

Purveyors had imported an aircraft into South Africa during 2015 which it then used to transport goods and personnel to other countries in Africa; Purveyors became liable for the payment of Import VAT to SARS in respect of the importation of the aircraft in 2015. Purveyors failed to pay Import Vat to SARS;

Respondent submitted that the **chronology of events demonstrates** that the relevant application did not constitute a “disclosure”, nor was it made voluntary:

- On 30 January 2017 Purveyors requested an appointment with SARS to discuss its liability to pay VAT in respect of the aircraft. In the e-mail, Purveyors explained to SARS the broad nature of the default it had committed.
- On the 1st of February 2017, SARS responded through an e-mail from Mr Duppie Du Preez ("Mr Du Preez") in which he indicated that the aircraft was subject to penalty implications. He also requested to see documentation in terms of Section 101 of the Customs and Excise Act 91 of 1964
- On 2 February 2017 Mr K Thakudi acknowledged receipt and indicated that he would revert as soon as possible with the requested information

The Purveyor case: The Facts

- On the 29th of March 2017 Mr Du Preez wrote to Purveyors in which he explained the reasons why VAT and penalties were payable. Mr Du Preez further indicated that Purveyors needed to appoint a clearing agent to assist it with an Import Permit in order to regularize its continued default;

- Purveyors responded on the same day (29 March 2017) in which it indicated that it understood from Mr Du Preez's e-mail and from their telephone discussion that VAT output and custom duties were applicable as well as fines and penalties;

- Mr Du Preez responded with an e-mail dated 30th March 2017 in which he sought to clear the misunderstanding. He indicated that there existed no waiver of potential penalties and further that if the tax to the Receiver is late the taxpayer would be liable for penalty and interest.

- On the 16th May 2017 Mr Du Preez wrote a further e-mail to Purveyors indicating that it had to address the matter as he had allowed Purveyors sufficient time to regularize its tax affairs. Purveyors responded and indicated that it was still awaiting a response from its Head Office.

- Subsequent thereto, Purveyors took no further steps until the 4th of April 2018 when it applied for voluntary disclosure relief. This was approximately a year after the last letter from Purveyors to SARS.

The Purveyor case: The Facts

It was applicant's contention that the crux of applicant's case was that as at the date of submission of its VDP application it had not been given notice by the respondent of the commencement of an audit or criminal investigation into the affairs of the applicant, which had not been concluded as contemplated by the provisions of s 226(2) of the TAA, and that the effect thereof was that this application was indeed "voluntary" as contemplated in s 227 (a) of the Act, despite the said prior knowledge on the part of the respondent.

The Purveyor case: The Facts

The further question was whether the VDP application was “voluntary”. The term is not defined but its ordinary meaning is “an act in accordance with the exercise of free will”. If there is an element of compulsion underpinning a particular act, it is no longer done voluntary. In the context of Part B of Chapter 16 of the TAA, a disclosure is not made voluntary where an application has been made after the taxpayer had been warned that it would be liable for penalties and interest owing from its mentioned default. It was submitted that the application was brought in fear of being penalised and with a view to avert the consequences referred to.

Lastly, it was contended on behalf of respondent that there had been no disclosure of information of which SARS had been unaware. This was not the case here. When applicant made the VDP application it was obviously aware that SARS knew of its default. It in fact disclosed nothing new the application was therefor not a valid one. There can be no disclosure to a person if the other already has knowledge thereof: certainly not in the present statutory context.

The Purveyor case: Lessons learned

Some questions….

- Why did the Taxpayer not seek formal tax advice from a reputable tax advisor who would have advised them that there is obviously a "default" when VAT was not paid on importation?
- Why did the Taxpayer approach SARS in such an informal manner when the TAA makes provision for a formal process that protects the Taxpayer's rights?
- Why did the Taxpayer take a year after the informal SARS enquiry before making a formal application in terms of the TAA? Why did SARS not initiate a formal audit once they became aware of the default?

It is important that Taxpayer's obtains reputable tax advice when they suspect that a "default" occurred

SARS is NOT a source for technical advice!

Time is of the essence

If Purveyor simply applied the formal VDP process once they became aware of the default and did not approach SARS for "advice" as if SARS is a "Tax Practitioner" the benefits under the VDP programme would CLEARLY have been available and this matter would never have served in front o the court

Note from the presenter…

The VDP process is your friend!

SARS is not your friend!

SARS is not your tax advisor!

Be careful on what basis you communicate with SARS.

> At some point, at some level, someone must look at the trees and see the forest…I am saying that a step back for a balanced look by a CRA official exercising a good dose of commercial common sense should not have resulted in relentless pursuit of a half-million dollar penalty. Yes, the Act stipulates taxpayers are to be penalized for remitting late, but do not bite the hand that feeds you when the hand tries so diligently to ensure you get every mouthful.
>
> The Honorable Campbell J. Miller
> *Home Depot of Canada Inc. v. R.*, 2009 TCC 281

Counter Tax Lawyers

The Tax Faculty

What are the main reasons why Taxpayers are exposed to liabilities upon VAT Audit?

Reason 3

Lack of appropriate tax risk management controls

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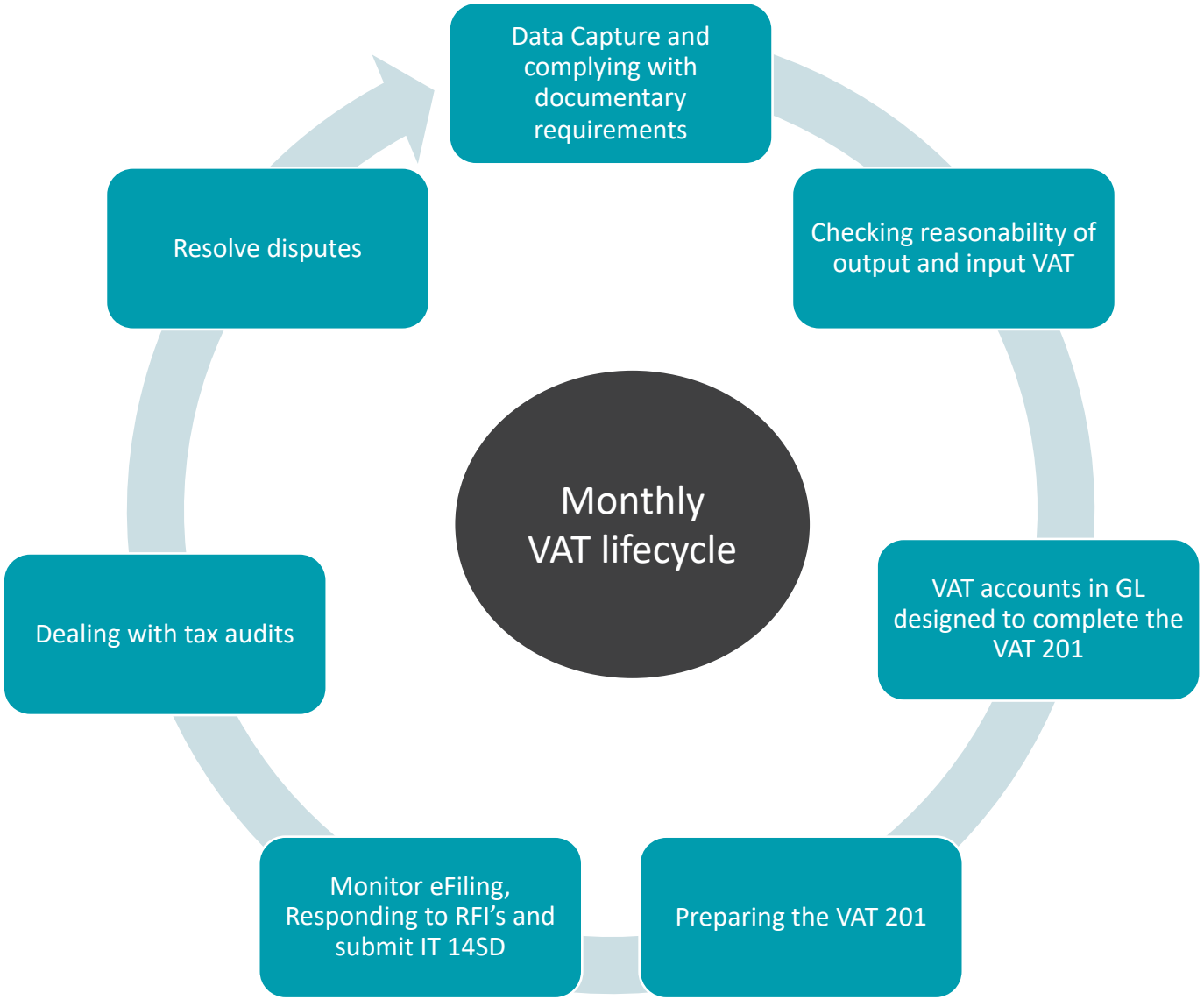
Monthly
VAT lifecycle
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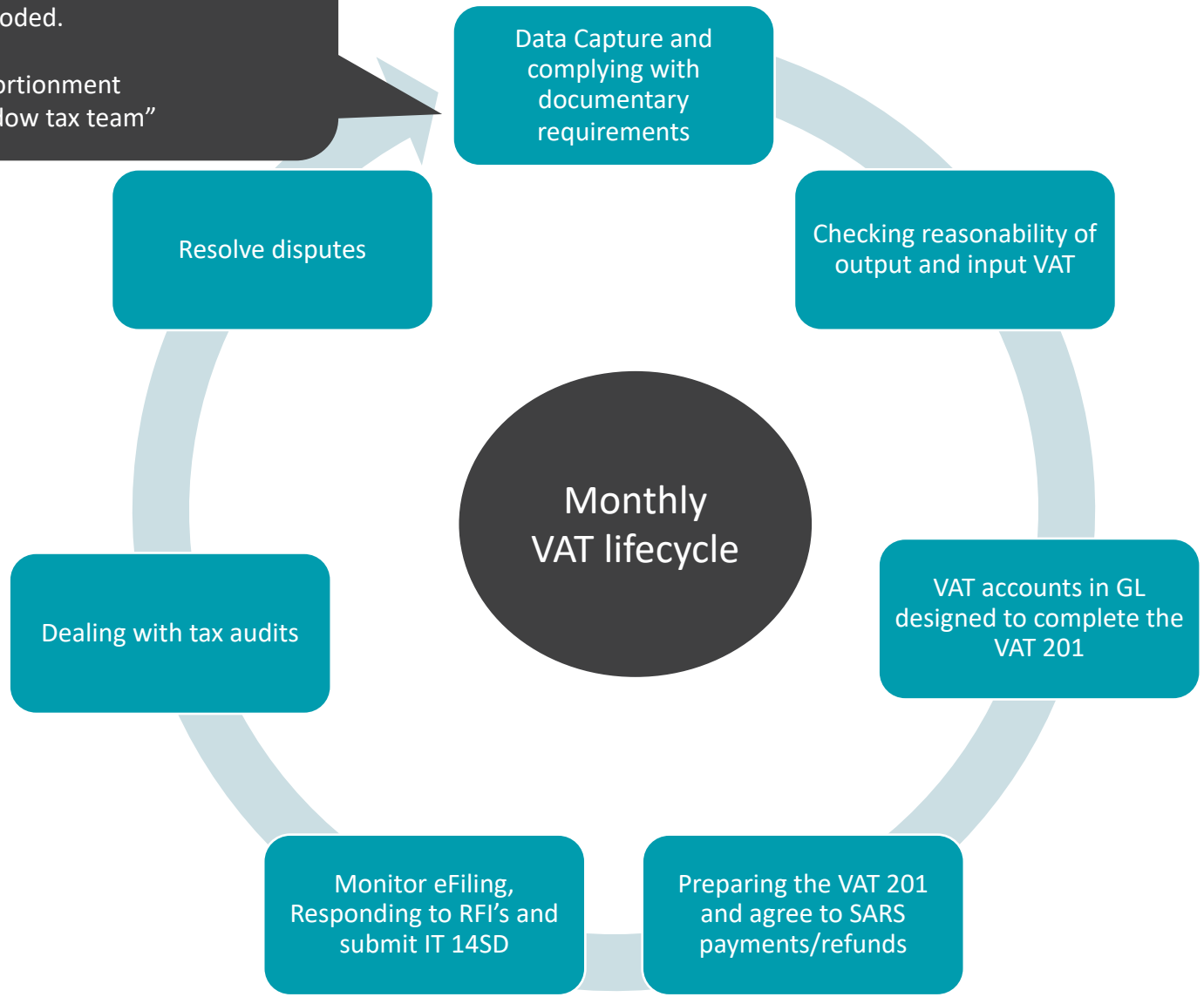

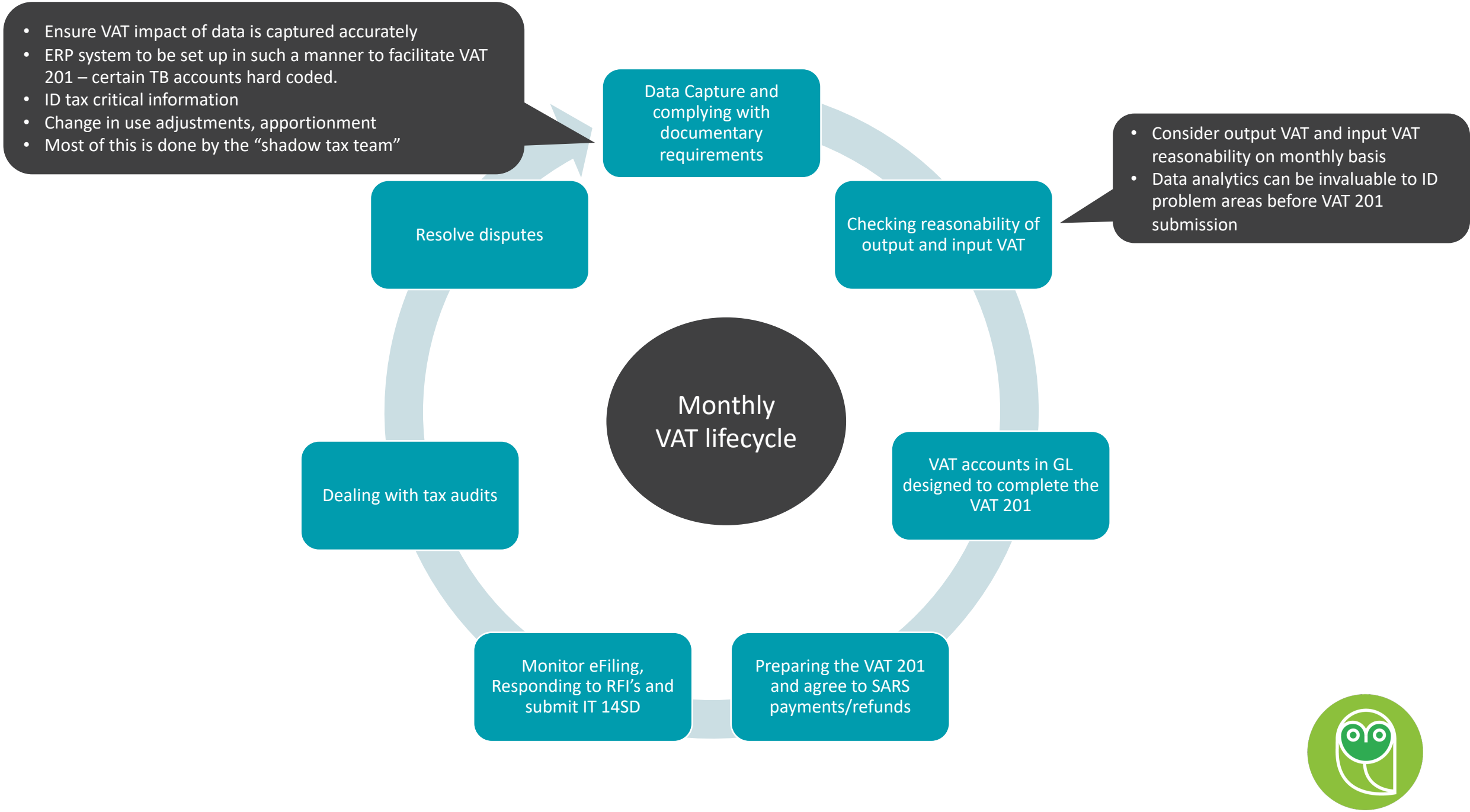
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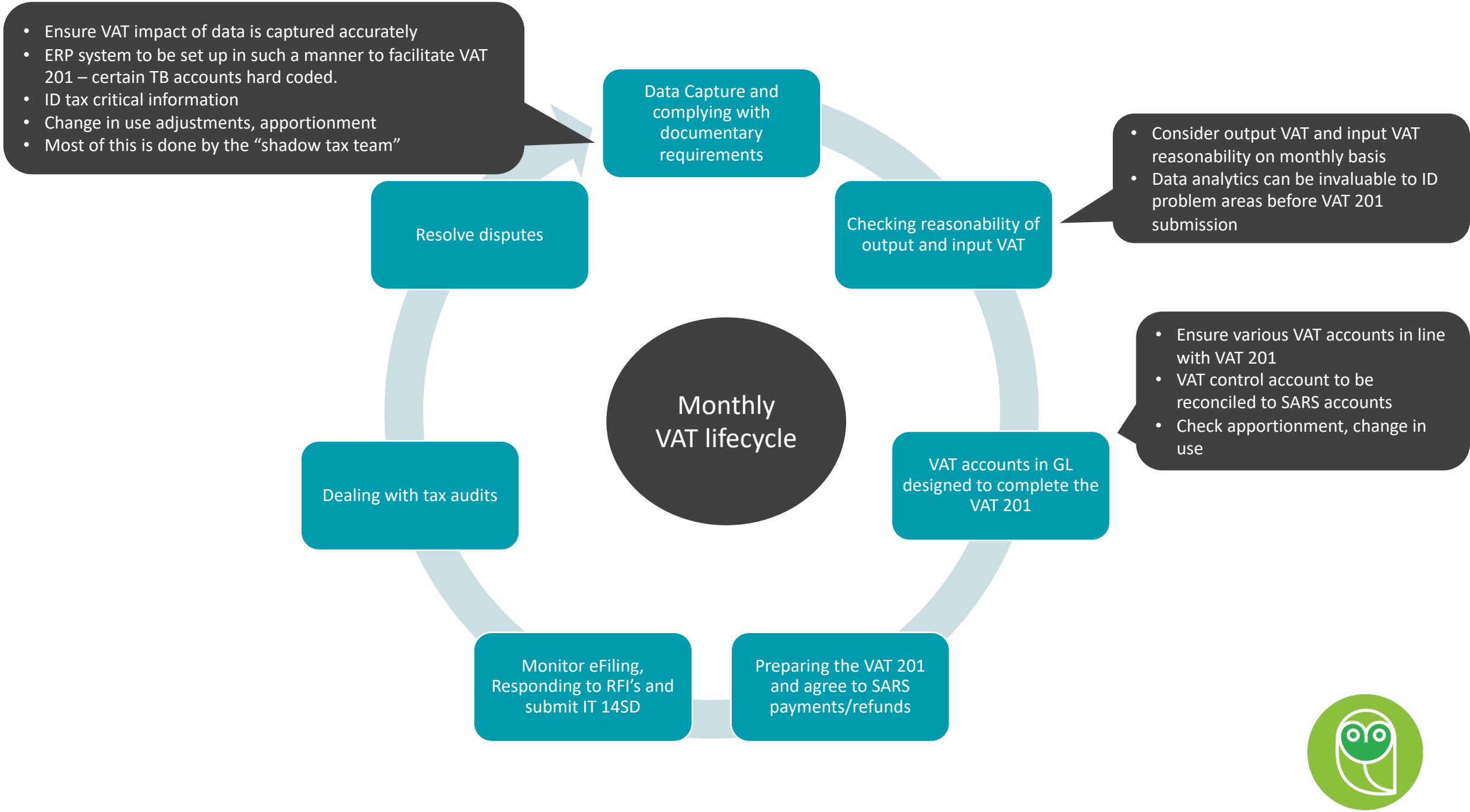
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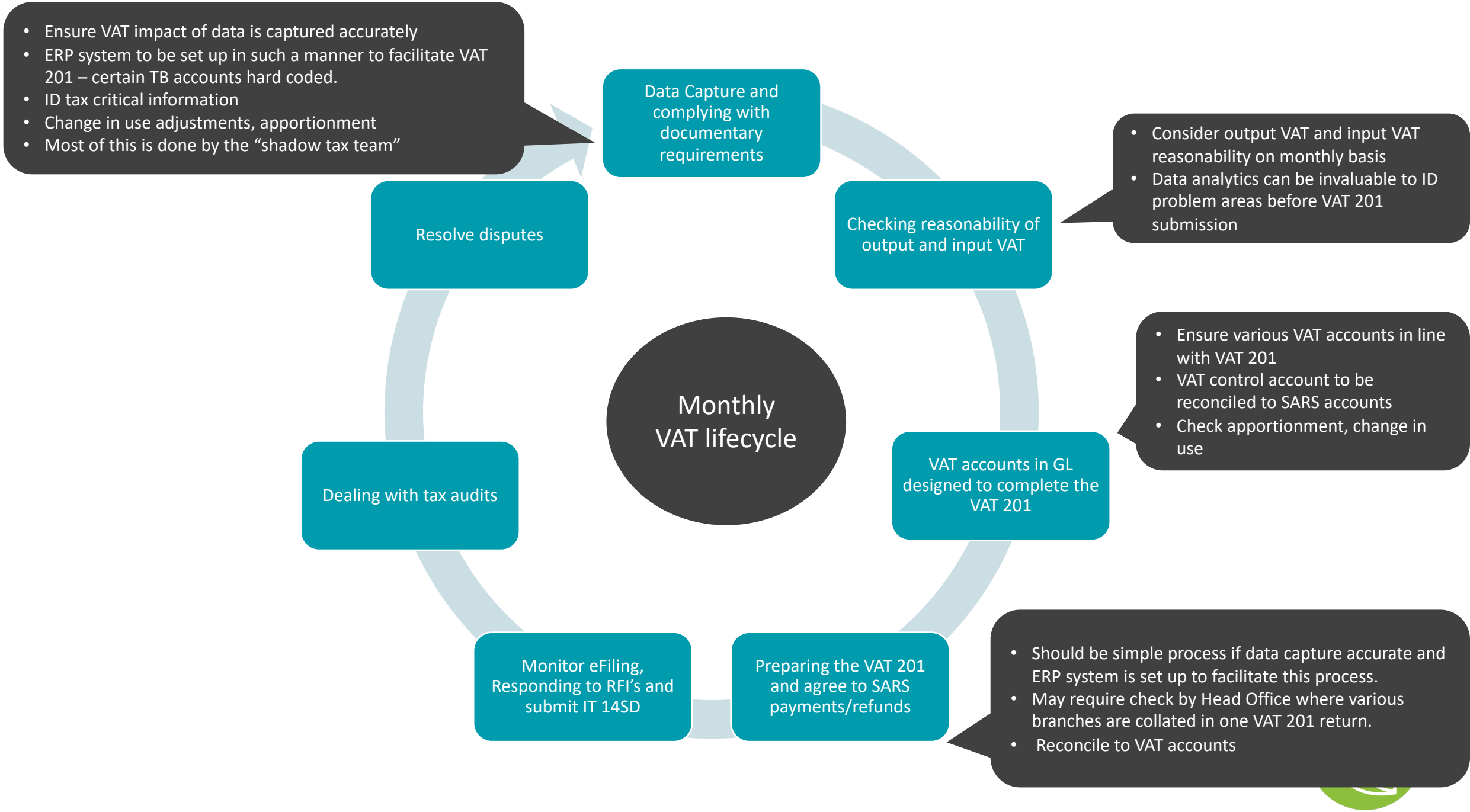
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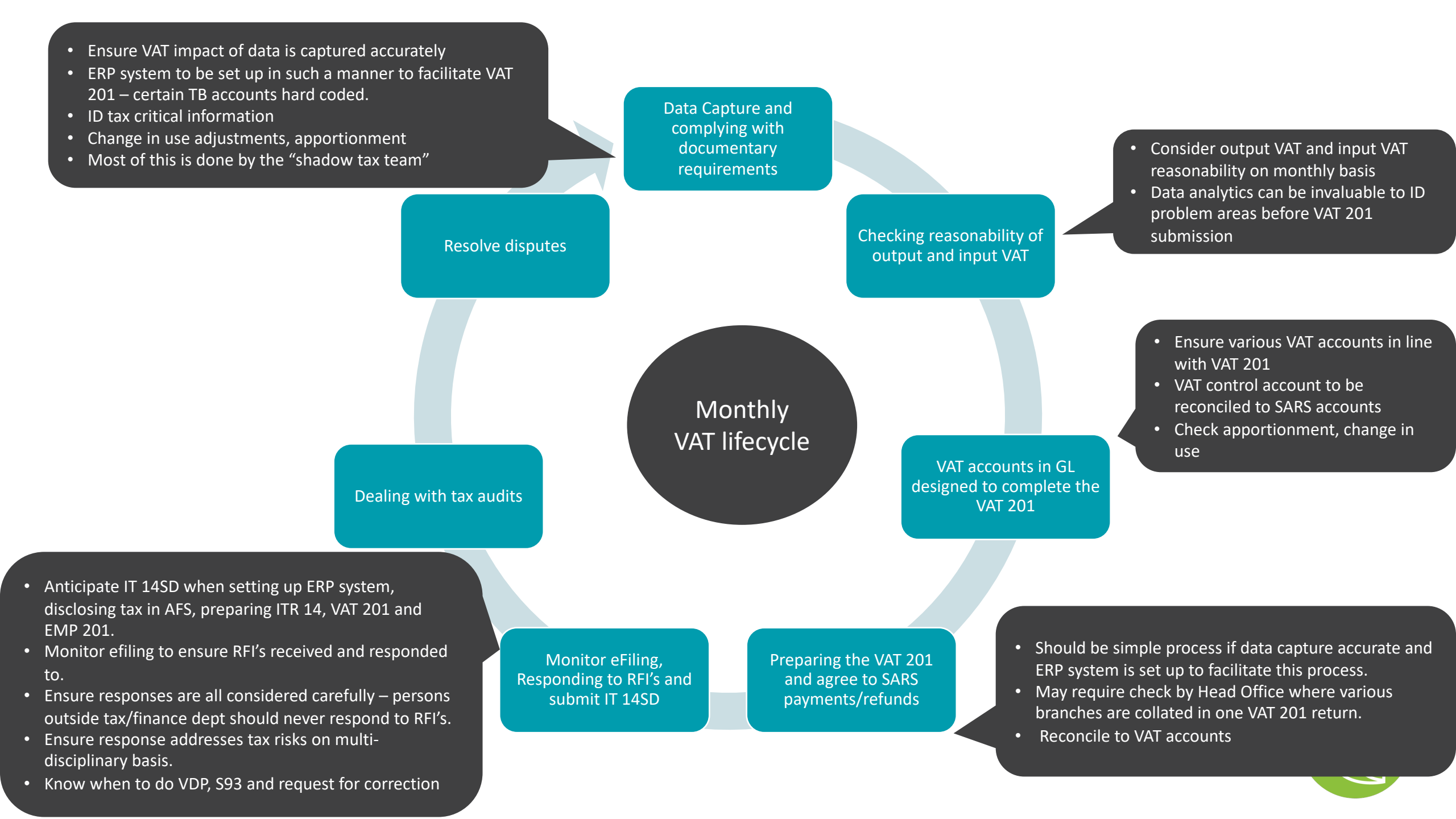
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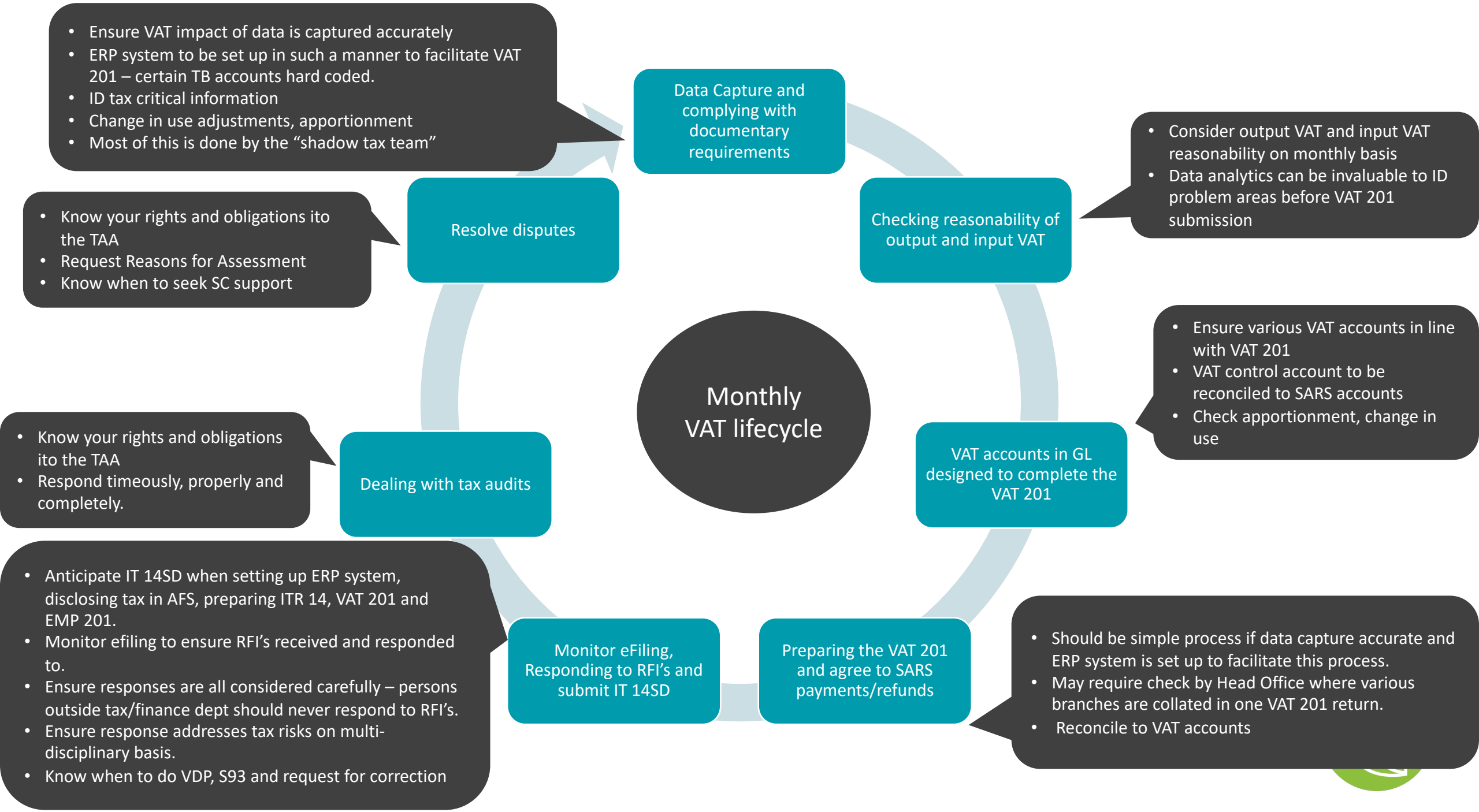
Monitor eFiling, Responding to RFI’s and submit IT 14SD

- Know your rights and obligations ito the TAA
- Respond timeously, properly and completely.

Dealing with tax audits

Resolve disputes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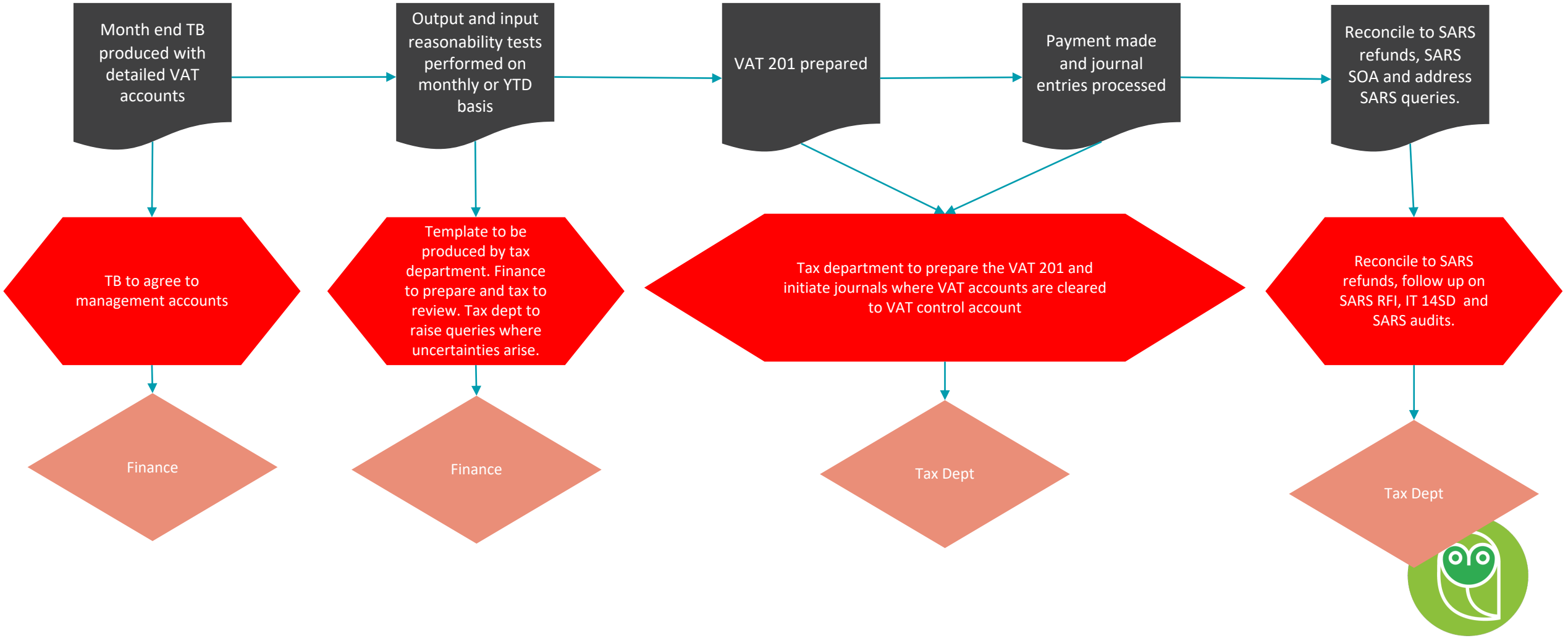
• Know your rights and obligations ito the TAA
• Respond timeously, properly and completely.
• Know your rights and obligations ito the TAA
• Request Reasons for Assessment
• Know when to seek SC support

End-to-end process – VAT 201 preparation



Understatement penalty

1	2	3	4	5	6
Item	*Behaviour*	*Standard case*	*If obstructive, or if it is a 'repeat case'*	*Voluntary disclosure after notification of audit or criminal investigation*	*Voluntary disclosure before notification of audit or criminal investigation*
(i)	'Substantial understatement'	10%	20%	5%	0%
(ii)	Reasonable care not taken in completing return	25%	50%	15%	0%
(iii)	No reasonable grounds for 'tax position' taken	50%	75%	25%	0%
(iv)	'Impermissible avoidance arrangement'	75%	100%	35%	0%
(v)	Gross negligence	100%	125%	50%	5%
(vi)	Intentional tax evasion	150%	200%	75%	10%

Where S223 opinions are obtained from independent tax practitioner, protection is obtained against this penalty.

If the VAT 201 process is followed, SARS will have extreme difficulty to prove that "reasonable care was not taken in preparing the VAT 201"

The process is designed to identify uncertain tax positions and where appropriate obtain external tax advice.

Please refer to separate processes under purchases, sales etc. The VAT 201 process, in conjunction with the other processes conducted by the shadow tax team should provide protection against behaviours (ii) and (iii) above.

The Tax Faculty

What are the main reasons why Taxpayers are exposed to liabilities upon VAT Audit?

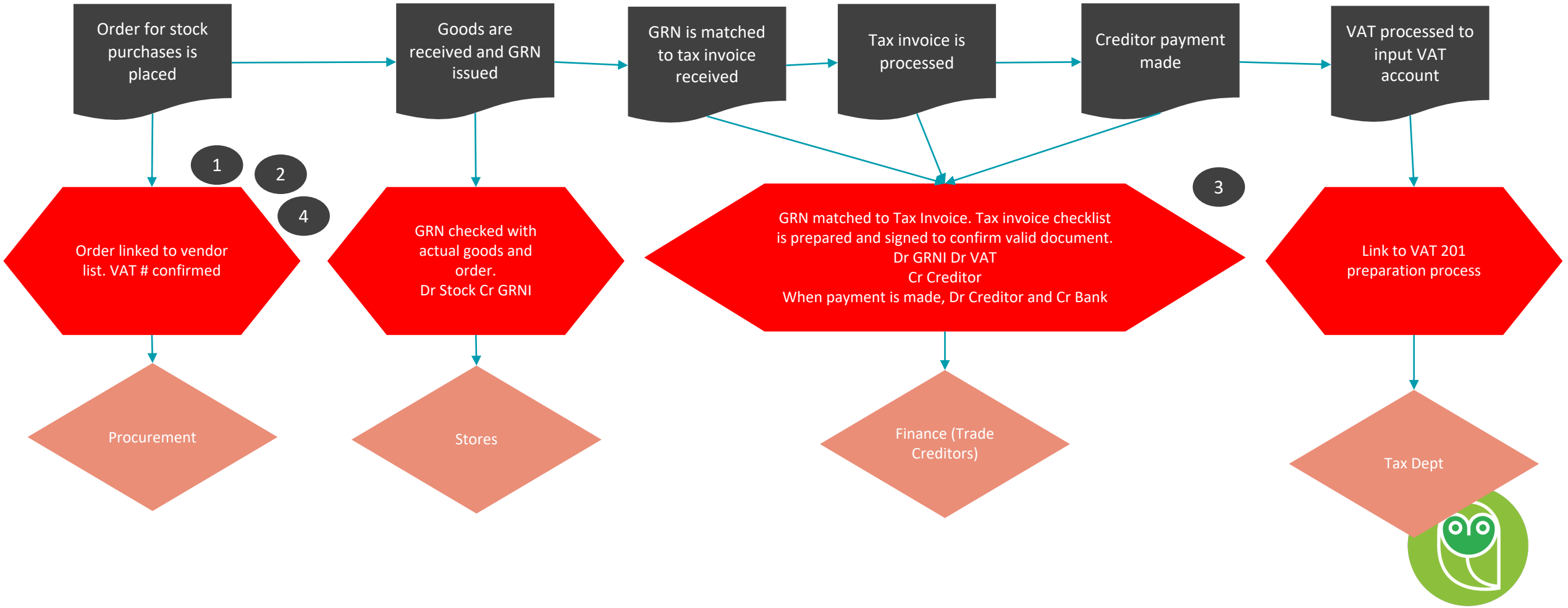
Reason 4

Lack of appropriate VAT controls for “shadow” tax teams

The Tax Faculty

End-to-end process – stock purchases

Major risk: VAT and fraud

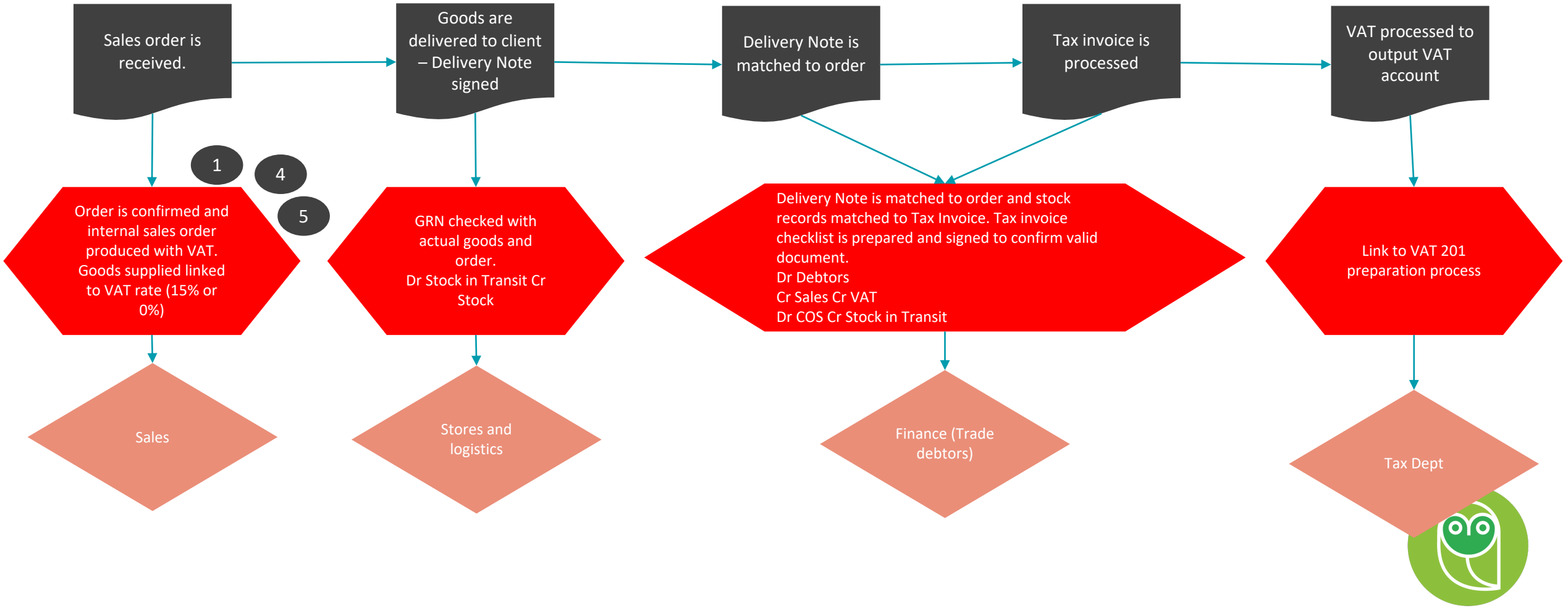


Purchases and creditors

#	Activity	Risk	Tax Risk	Control	Auto/ Manual
1	Purchases	Claim VAT on purchases from non-registered VAT vendors	Input VAT overclaimed Income Tax deduction understated Penalties and interest	• Maintain list of vendors with VAT numbers • Verify VAT numbers to SARS website • Automatically link all purchases to VAT vendor listing ensuring valid vendor	Manual Automated Automated
2	Direct purchases	VAT is claimed on direct purchases (non-trading stock) designated for non-taxable purposes (e.g. canteen and residential)	Input VAT overclaimed Income Tax deduction understated Penalties and interest	• Hard code certain accounts to prohibit input VAT claim.	Automated
3	Creditor payments	Output VAT liability arises where VAT was claimed but creditor not paid within 12 months (S22(3))	Underpayment of output VAT	• IT department to provide extraction list to tax department of all invoices received on which VAT was claimed but not paid in 12 months. • Tax dept to consider list and make VAT adjustment where appropriate. • Procedure to be included in monthly VAT 201 return preparation checklist.	Combined
4	Purchases	Input VAT not supported by valid tax invoice	Input VAT overclaimed Income Tax deduction understated Penalties and interest	• Tax dept to develop a manual “tax invoice checklist stamp” which is stamped on each tax invoice received listing requirements of invoices >R5 000, <R5 000 and < R50.	Manual

End-to-end process – sales

Major risk: VAT (particularly VAT and 90 days rules on 0%) and IFRS adjustments to sales

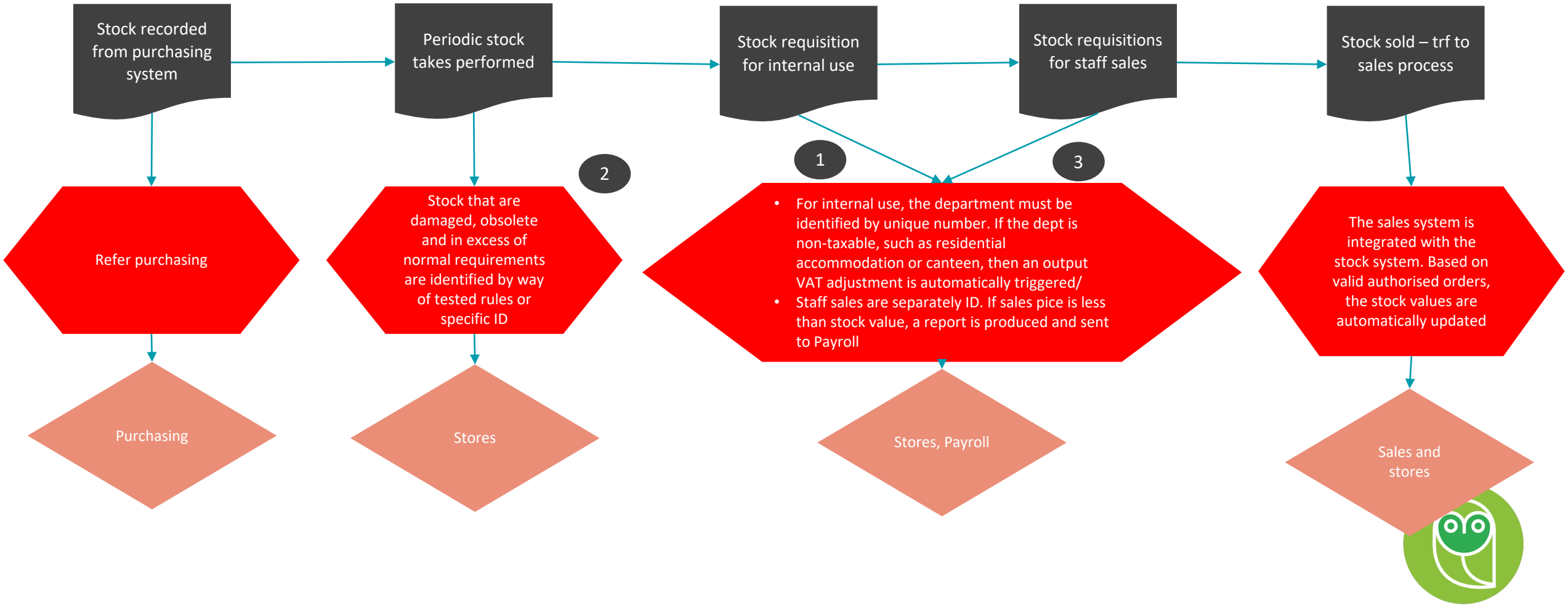


Sales and debtors

#	Activity	Risk	Tax Risk	Control	Auto/ Manual
1	Export of goods	Incorrect application of zero rate VAT on exports	Liable for 15% VAT Interest and penalties Overpayment of income tax	• Automated exception list for all zero rated supplies where payment was not received in 90 days. • Invest in technology solution to ensure documentary requirements obtained per IN 30.	Combined
2	Bad debts	Inability to ID the VAT component of debtor balances	Input VAT on bad debt either under or overstated Income Tax under or overstated	• Automate the application rules for part payments, journals, debt collection costs etc.	Automated
3	Debtor payments	Overpayments from customers not managed properly from a tax perspective.	Potential underpayment of output VAT (S8(27)) where excess consideration is not refunded in 4 months Incorrect income tax treatment taking into account Consumer Protection Act and prescription rules	• Monthly exception report for debtors in credit and unallocated credits for consideration by tax department. • The review of this list is incorporated in the checklist of the tax department before sign-off of the monthly VAT returns and annual income tax returns	Manual
4	Adjustments to consideration	Credit Notes on sales not treated in accordance with VAT Act. (E.g. credit notes not issued where customers takes rebates)	Input VAT claimed without supporting documentation.	• Adjustment to sales price can only be effected through valid credit notes that are issued to the client.	Combined
5	Sales of zero rated goods	Zero rated of goods supplied for agricultural purposes applied without being in possession of required notice of registration as a farmer from the recipient.	Zero rate of VAT incorrectly applied Overpayment of income tax Interest and penalties	• ERP system to be designed so that zero rate in terms of Section 11(1)(g) can ONLY be applied if the customer is loaded as a “farmer” and a “Yes/No” question indicates that the supplier is in possession of a valid registration certificate.	Combined

End-to-end process – stock

Major risk: Stock valuation and VAT on application of stock for non-taxable use

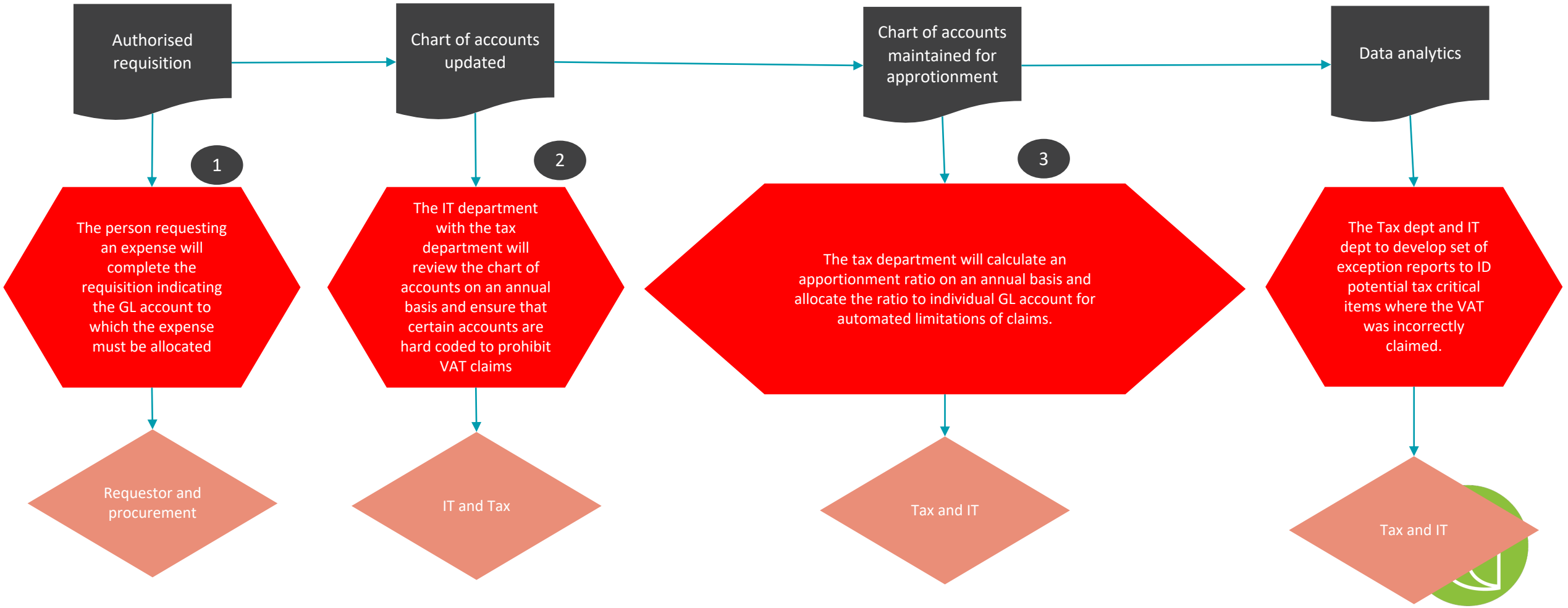


Stock

#	Activity	Risk	Tax Risk	Control	Auto/ Manual
1	Stock drawn for internal use	Change in use adjustment when stock is applied for non-taxable purposes e.g. residential accommodation or canteen	Output VAT understated Penalties and interest Income Tax deduction understated	• Automated adjustment of output VAT where stock is drawn for non-taxable use	Automated
2	Stock valuation	Stock is not valued for tax purposes in terms of Section 22 of the ITA	Under statement of Gross Income and underpayment of income tax.	• Design tax stock obsolescence policy that will withstand SARS scrutiny. • Integrate with stock management system	Combined
3	Staff sales	Stock sold to staff at less than cost is not appropriately treated for PAYE and VAT purposes.	Understatement of output VAT (VAT on fringe benefits) Underpayment of PAYE Interest and penalties	• System to ID stock drawn for staff sales and compares sales price to cost. • Prepares exception report where proceeds is less than cost for consideration by the payroll department. • Payroll integrated with VAT system to ensure VAT at 15% is calculated where fringe benefit under code 3801 arises for asset acquired at less than cost	Combined

End-to-end process – operating expenses

Major risk: Non-income tax deductible expenses and non-VAT claimable expenses

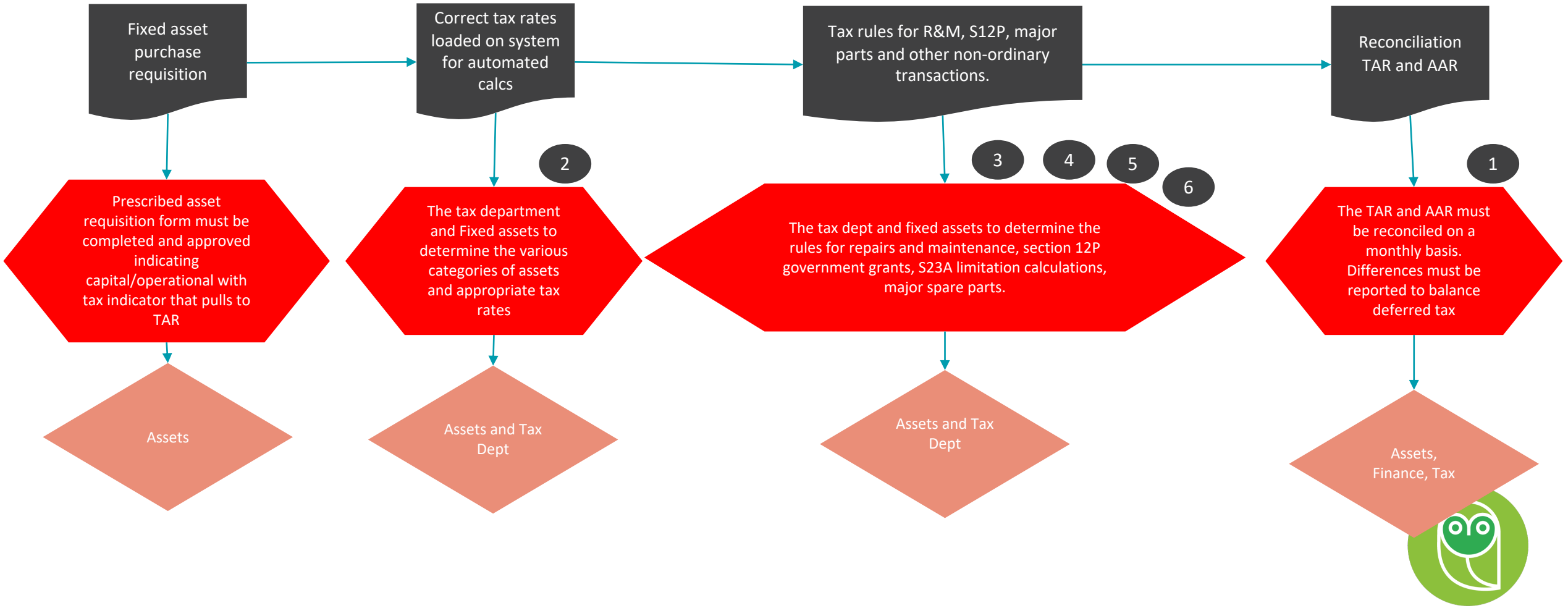


Operating expenses

#	Activity	Risk	Tax Risk	Control	Auto/ Manual
1	Ad hoc Operating expenses	Certain expenses are claimed for income tax purposes despite not meeting the requirements of S11(a), S11(d), S11(c) etc.	Underpayment of income tax Interest and penalties VAT potentially also incorrectly treated.	Tax critical income statement items to be identified and the Trial Balance split between “deductible” and “non-deductible” expenses. Examples include: • Overseas travel • Legal Fees • Repairs and Maintenance • Consulting Fees • Legal Fees • Minor assets written off. These expenses to be analysed in full and a detailed analysis be provided to the tax department. Tax department to provide annual training to shadow tax team regarding tax implications of these costs.	Manual
2	Ad hoc Operating expenses	VAT is claimed on certain expenses despite being denied in terms of VAT Act.	Overclaim of input VAT Interest and penalties Overpayment of income tax	• VAT critical expense items to be identified by tax department. Examples include entertainment, subsistence of non-employees, casual car hire, canteen, staff refreshments. • System is hard coded to automatically prohibit claim of input VAT. • Use of data analytics to identify items not correctly addressed.	Combined
3	Ad hoc Operating expenses	VAT is claimed incorrectly on costs incurred with dual purpose. (i.e. apportionment rules applied incorrectly)	Overclaim or underclaim of input VAT. Overpayment or underpayment of Income Tax.	• Tax dept to calculate apportionment ratio each year per VAT 404 guide or ruling. Tax dept to propose retrospective and prospective adjustments including adjustments where ratio has changed by more than 10 percentage points over time. • IT department in collaboration with tax dept to allocate apportionment ratios to individual TB accounts and automate system to ensure that VAT is automatically claimed in accordance with ratio. • Report issued on amounts claimed to facilitate IT 14SD.	Combined

End-to-end process – fixed asset acquisitions

Major risk: VAT claimed on e.g. canteen/motor cars and capital allowances



Fixed assets

#	Activity	Risk	Tax Risk	Control	Auto/ Manual
1	Integrity of TAR	Tax asset register Is not reconciled to accounting asset register	Incorrect deferred tax and/or normal tax.	• Follow principle of "capture-once accurately" • Any additions, disposals etc are based on unique identifiers that are similar for accounting registers and tax asset register. • If a transaction is recorded for accounting, it will automatically deal with the tax consequences.	Automated
2	Capital allowances	Incorrect capital allowance rates used	Normal tax over or underpaid Interest and penalties	• Tax department to allocate correct capital allowance rates. • This will include 12C, 11(e), 11(g) etc. • Once loaded, the system will automate the calculation.	Combined
3	Capital allowances	Section 12P limitations not correctly applied	Normal tax over or underpaid Interest and penalties	• Tax dept to provide guidance to IT and fixed asset dept • Automate section 12P limitation where grants received on fixed assets (e.g. Automotive Incentive Scheme) • The automation to be done on a line by line basis	Combined
4	Capital allowances	Major parts incorrectly treated for income tax purposes. (Major parts qualify as trading stock for tax purposes and not as fixed assets.)	Normal tax over or underpaid Interest and penalties	• Tax dept to collaborate with fixed asset department on annual basis to identify major parts and to determine accounting and tax treatment. • Major parts to be allocated unique identifier to ensure that no capital allowances claimed. • Major parts to be allocated a "location" identifier to identify if part is in store or has been used as repair. • Tax treatment to be automated if possible	Combined
5	Expenditures	Tax deductible operating expenses are capitalised for accounting purposes to fixed assets.	Underclaim of section 11(a) or 24J deductions but overclaim of section 11(e) or 12C allowances.	• Expenses such as interest and salaries capitalised for accounting purposes should be identified and excluded from asset values where appropriate. • Unique identifier to these costs to be allocated.	Combined
6	Leases	Section 23A limitation not applied on rentals (specific risk with intergroup rentals)	Overclaim of section 11(e), 11(o), 12C allowances resulting in underpayment of income tax, interest and penalties	• Tax department sign-off to be obtained when determining the intergroup rental charges for affected assets. Tax dept to review ITR 14 before submission.	Manual

The Tax Faculty

Value – added tax

Overview of recent case law

THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable

Case no: 1010/2019

In the matter between:

CONSOL GLASS (PTY) LTD **APPELLANT**

and

THE COMMISSIONER FOR THE
SOUTH AFRICAN REVENUE SERVICE **RESPONDENT**

Neutral citation: *Consol Glass (Pty) Ltd v The Commissioner for the South African Revenue Service* (1010/2019) [2020] ZASCA 175 (18 December 2020)

Background

- The Appellant, Consol Glass (Pty) Ltd ('Consol'), manufactures and sells glass containers.
- It is a vendor, registered as such under the Value-Added Tax Act 89 of 1991 ('the VAT Act').
- During April 2007, Consol, then a shell company, acquired the businesses of Consol Limited and two of its subsidiaries.
- These businesses were acquired as going concerns. Upon making these acquisitions, Consol commenced trading, continuing the glass making businesses previously conducted by the three companies.
- These acquisitions formed part of a leveraged buy-out. In simple terms, a leveraged buy-out is the acquisition by one company of another (or its assets and liabilities) using a significant amount of debt to fund the cost of acquisition.
- In 2012, Consol restructured its debt. In doing so, it procured services, some from local vendors and others from suppliers resident outside of South Africa. Services of this latter kind are defined in the VAT Act as imported services.
- In July 2015, the Respondent, the Commissioner, raised additional assessments in respect of Consol's value-added tax ('VAT') liability for five tax periods in 2012.
- The additional assessments disallowed input tax deductions that Consol had claimed in relation to the services provided by local vendors.
- The Commissioner imposed output VAT on the imported services procured by Consol.

Finding

- It follows according to the logic of Consol's argument, that if the Eurobond debt was not issued in 2007 with the purpose of making taxable supplies, then neither was the raising of local debt in 2012.
- The purpose remained the same: to maintain the funding for the reorganisation of the Consol group of companies.
- Once that was so, the procurement of local and imported services in 2012 was not used by Consol in the course of making taxable supplies. The purpose of using these services was to replace Eurobond debt with local debt and thereby continue to finance the reorganisation that had taken place in 2007.

Note from the presenter…

This is a typical “Uncertain Tax Position”.

S223 opinion will provide protection against 10% understatement penalty

The VAT on costs incurred to raise finance, restructure finance may be significant.

Do not forget about VAT on imported services

This case does not mean that one can never claim VAT on costs incurred to raise finance. One has to consider the purpose of the finance.

My personal view is that VAT can be claimed on the costs to raise finance used to buy a business that will make taxable supplies (Not shares!!)

However, if existing loans are refinanced, then, as a general rule, I do not believe that VAT can be claimed

The Tax Faculty

Note from the presenter…

<u>What about requesting an Advance Tax Ruling?</u>

My view is that you only request an advance tax ruling if you intend to abide by the Ruling. If you intend to defend your tax position, then obtain a thorough tax opinion issued in terms of section 223. Consider consulting with SC at an early stage in order to anticipate the dispute with SARS and increases chances of success in court.

THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable

Case no: 330/2019

In the matter between:

DIAGEO SOUTH AFRICA (PTY) LTD **APPELLANT**

and

COMMISSIONER FOR THE SOUTH AFRICA REVENUE SERVICE **RESPONDENT**

The facts

This appeal concerns the proper interpretation and application of s 8(15) of the Value Added Tax Act 89 of 1991 (the Act), in the context of a single supply of advertising and promotional goods and services (the A&P services) by the appellant, Diageo South Africa (Pty) Ltd (Diageo), a South African VAT vendor, to various non-resident entities (the brand owners).

Diageo made supplies of the A&P services to the brand owners and levied a fee for the supplies during its VAT periods ending June 2009, 2010 and 2011.

Pursuant to s 11(2)*(l)* of the Act, Diageo charged VAT on the said fee at zero percent.

However, the respondent, the Commissioner for the South African Revenue Service (the Commissioner), invoked s (8)(15) of the Act and maintained that Diageo had made deemed separate supplies of zero rated A&P services and standard rated goods in the form of promotional giveaways and samples that were not exported but consumed in the Republic of South Africa (the Republic).

The facts

Section 8(15) provides as follows:

'For the purposes of this Act, where a single supply of goods or services or of goods and services would, if separate considerations had been payable, have been charged with tax in part at the rate applicable under section 7(1)(a) and in part at the rate applicable under section 11, each part of the supply concerned shall be deemed to be separate supply.'

The Commissioner assessed Diageo for additional output VAT on the goods component of the supply of the A&P services rendered by Diageo to the brand owners during the aforementioned periods. Diageo's output VAT was accordingly adjusted by the inclusion of the further amounts of R3 444 764 (June 2009), R4 631 620 (June 2010) and R5 932 209 (June 2011).

The facts

- Diageo challenged the additional assessment in the Tax Court, Cape Town (Savage J), contending that it made a supply only of zero-rated A&P services to the brand owners and that it did not make separate or dissociable supplies of both services and goods.
- The Tax Court disagreed and held that the supply of promotional goods, as a portion of the single A&P service was, by virtue of s 8(15), a cognisable supply of goods capable of notional separation from the total A&P services supplied to the brand owners.
- This local supply of promotional goods, not exported but consumed in the Republic, was accordingly deemed to be a separate supply, and VAT at the standard rate in terms of s 7(1)*(a)* of the Act, was justifiably levied on these goods, with the result that the additional assessments were confirmed.
- Diageo was therefore liable for the VAT output tax adjustment under s 8(15) in respect of the A&P services costs incurred by Diageo constituting goods not exported but consumed in the Republic.
- This appeal, with the leave of the Tax Court, is against that finding.

The facts

(i) Diageo, which is engaged in the business of the importation, manufacturing and distribution of alcoholic beverages, entered into an agreement with foreign brand owners for the advertising and promotion of their alcoholic products in South Africa.

The brand owners granted Diageo the exclusive rights in respect of the brands distributed by Diageo to use the brand owners' trademarks, intellectual property, equipment, packages and labels in South Africa;

(ii) The brand owners invested in advertising and promotions to build and maintain brand recognition and perception, with the aim of generating sales and sustainable long term cash flow, by way of enhanced brand equity. The brand owners however did not perform or undertake these activities themselves in respect of their brands.

They relied instead on Diageo which rendered these services to the brand owners in return for a fee, which was calculated with reference to the costs and expenditure incurred on advertising and promoting the brand owners' brands;

The facts

(iii) The advertising and marketing activities consisted of a range of activities such as advertising from various channels, brand building promotions, events, sponsorships and market research. Services which were rendered by Diageoincluded advertising media cost and digital, website design and build, social networks and sponsorship of, amongst others, sports events. In addition, Diageo made use of promotional merchandise and packaging; alcoholic products for sampling; and branded giveaways items such as glasses, optics, towels, beer mats, lanyards, keyrings, T-shirts, aprons, caps and the like. These were given away free of charge to third parties for use or consumption within the Republic for purposes of promoting the product.

(iv) The handing out of the physical goods by Diageo in the course of rendering the A&P services to the brand owners was not an end in itself but simply another means to enhance brand equity and sales. Two categories of goods were used. Firstly, products of the brand owners namely, alcoholic beverages were taken out of the trading stock and used for product sampling or tasting. Secondly, point of sales items such as branded glasses and T-shirts were given to third parties, for no consideration. Similarly, aprons and caps were supplied to employees at no cost to them;

The facts

(vi) The fee charged by Diageo to the brand owners represented the cost incurred by Diageo in rendering the A&P services, which comprised the supply of both goods and services, to the brand owners.

However, the tax invoices rendered by Diageo to the brand owners reflected a total fee for services rendered. It did not differentiate between goods and services. The fee was charged on the basis that it constituted a zero-rated supply of the A&P services in terms of s 11(2)*(l)* of the Act

The finding

[18] Having regard to the facts of this case, I find that the provision of the A&P services by the appellant, Diageo, to the foreign based brand owners comprised a single supply of goods and services, which, if they had been supplied separately, would have attracted a different rate of tax and for which a single consideration was payable. The jurisdictional requirements of s 8(15) were therefore satisfied with the result that the deeming provision had the effect of notionally separating the supply of services from the supply of goods, when in fact they were not separate supplies.

Furthermore, there can be no justification for importing into s 8(15) a requirement derived from foreign authorities, as the appellant would have it, that the deeming provision may apply only to a single supply of economically divisible, independent and hence dissociable supplies of goods and services.

[20] As I have shown above the meaning of s 8(15) of the Act is clear. Its purpose is to ensure that in a case like the present the appellant and other similarly positioned VAT vendors fulfil their obligation to pay VAT at the standard rate on the goods that they have supplied.

[21] In the light of all what I have stated above, I find that the appellant is accordingly liable for the VAT output tax adjustments under s 8(15) of the Act in respect of advertising and promotional costs incurred by the appellant constituting goods, not exported but consumed in the Republic.

Note from the presenter…

One should always remember that at the foundation of VAT, lies the

SUPPLY of

GOODS and

SERVICES

In this case, the court effectively found that the vendor partially received consideration for the supply of goods and not only for the supply of services.

This is an example where an Advance Tax Ruling would probably have been the best route to avoid this very costly dispute with SARS. In that case, Diego could have amended the prices charged.

The Taxpayer probably did not even recognise that there is a tax risk since the recipients of the services is a non resident, and factually no goods are delivered to the recipients

The Tax Faculty

Note from the presenter…

Top Tips:

- It is irrelevant to whom the supply of goods are made when considering the zero rating of supplies.
- Zero rating of supplies of goods depends on whether the goods are exported or not. It is irrelevant who pays for the goods.
- Know when to request an Advance Tax Ruling and when to obtain a tax opinion

REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA
HELD AT CAPE TOWN, WESTERN CAPE

CASE NO: VAT 1857

In the matter between:

ABC (PTY) LTD Appellant

and

THE COMMISSIONER FOR THE
SOUTH AFRICAN REVENUE SERVICE Respondent

Date of hearing: 3 December 2019
Date of judgment: 25 February 2020

Calculation on notional input VAT on second hand property

[2] The appellant is a property developer and a registered value-added tax vendor.

[3] During the two tax periods in question the appellant claimed a deduction of input tax pertaining to five immovable properties which it had purchased from sellers who were not registered VAT vendors.

[4] As the sellers were non-vendors the appellant had been required to pay transfer duty, and not input tax, on the five properties.

[5] The appellant calculated its notional input tax based on the consideration of money paid for the immovable properties and included the transfer duty paid in its calculation of the consideration paid.

[6] The respondent disallowed the inclusion of the transfer duty amounts paid in the calculation of the consideration to which the tax fraction was applied, thereby reducing the appellant's notional input tax amount.

[11] The appellant calculated its input tax on the "consideration" in money given by the vendor as provided for in the definition of "input tax" set out above by including the transfer duty paid. The crisp question before the court is whether the words "any consideration in money given by the vendor" includes the payment of transfer duty.

The finding

[12] The definition of “consideration” set out above includes “any payment made … in respect of, … the supply of any goods …”

[13] The word “any” is to be given a wide meaning unless the context reuires differently (*CIR v NST Ferrochrome (Pty) Ltd* 59 SATC 407 at 413). The said word is *prima facie* unlimited (*CIR v Ocean Manufacturing Ltd* 1990 (3) SA 610 (A) at 618 G-I.

[14] The amount must be paid “in respect of, in response to, or for the inducement of, the supply”. The same wording is used in the definition of the term “consideration” in the New Zealand VAT legislation.

[15] The transfer duty paid was in respect of the supply of second hand goods, being the properties purchased. This interpretation is in accordance with the purpose of allowing a vendor a notional input tax credit in relation to the purchase of second hand goods. This does not result in a portion of the Transfer Duty being recovered, it rather has the effect less VAT being paid or a greater refund being received as is provided for by the VAT Act through the concept of a notional input tax.

The finding

[20] The broad definition of consideration in section 1 of the VAT Act which includes any payment made in respect of the properties is unambiguous and the clear language used includes transfer duty paid. The words in parenthesis in the definition are not relevant to this enquiry with the word “tax” referred to therein being defined as tax chargeable in terms of the VAT Act.

[23] The above interpretation is thus compatible with the stated purpose of the provision allowing for a notional input tax.

Note from the presenter…

"Logic" is on the side of the taxpayer – the mere fact that the tax fraction 15/115 is used and not 15% implies that Transfer Duties should have been included.

The Taxpayer had the resolve to take a tax position that is contrary to SARS views and challenge this in court.
It is uncertain of SARS will appeal this decision.

	Taxpayer	SARS
Purchase Price to supplier	1 000 000	1 000 000
Transfer duty to SARS	100 000	100 000
Total price paid	1 100 000	1 100 000
Notional input VAT 15/115	143 478	130 435

VAT 404 Guide
In the case of the supply of second-hand goods being "fixed property" which is not subject to VAT, the input tax is limited to the transfer duty payable if the property was acquired on or before 9 January 2012

In the case of second-hand goods being "fixed property" acquired after 9 January 2012, the limitation of the input tax deduction to transfer duty payable does not apply. However, the input tax may only be deducted if the fixed property is transferred to the recipient vendor by registration in the deeds registry (where applicable) and to the extent that payment towards the purchase price for the property has been made to the seller.

Note from the presenter…

Risk that SARS will appeal the decision? The law is sufficiently convoluted that it can be interpreted either way.

Section 16(3)(1(ii) allows a input tax deduction for the following:

*… in respect of supplies of second-hand goods to which paragraph (b) of the definition of "input tax" in section 1 applies to the extent that payment of any **consideration** which has the effect of reducing or discharging any obligation (whether an existing obligation or an obligation which will arise in the future) **relating to the purchase price** for those supplies has been made during that tax period;*

Battle may have ben won but the war may be far from over

***"consideration"**, **in relation to the supply of goods or services** to any person, includes any payment made or to be made … , whether in money or otherwise, or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods or services, whether by that person or by any other person, but does not include any payment made by any person as a donation to any association not for gain*

The Tax Faculty

REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA
(HELD AT CAPE TOWN)

CASE NO: VAT 1904

ABC BANK LIMITED	Appellant
and	
THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE	Respondent

Date of hearing: 21 August 2020
Date of judgment: 26 November 2020

Case deals with claim of section 16(3)(c) deductions

[1] The appellant is ABC Bank Limited ("ABC"), a registered bank which conducts business with regard to both transactional banking (including savings accounts and credit card facilities) and unsecured lending. ABC appeals against the additional VAT assessment raised by the respondent ("SARS") against its November 2017 VAT return in which ABC claimed an input tax deduction in terms of section 16(3)(*c*) of the Value-Added Tax Act 89 of 1991 ("the VAT Act").

[2] The input tax deduction claimed relates to ABC's unsecured lending business. The standard form loan agreements with the bank's customers contained a contractual division that ABC would, on their retrenchment or death, settle their outstanding loans up to a specified amount. During the VAT period from November 2014 to November 2015 ABC made payments in this regard totalling R582 383 753,66. The tax fraction of this amount, being R71 520 811,85, was claimed as a deduction.

Case deals with claim of section 16(3)(c) deductions

[5] In its statement of grounds of assessment and for opposing the appeal SARS contends that the loan cover payments do not qualify for an input tax deduction in terms of section 16(3)(*c*) of the VAT Act because the supply of the loan cover did not constitute a "taxable supply" in that:

(1) the loan cover was provided for no "consideration" and accordingly the supply of the loan cover had no "value", and

(2) the loan cover constituted, alternatively was in respect of, an exempt supply.

SECTION 16(3)(*c*)

[9] Section 16 (3)(*c*) permits the deduction of an amount equal to the tax fraction of any payment made by the vendor to indemnify another person in terms of any contract of insurance provided that the supply of that contract of insurance is a taxable supply.

Case deals with claim of section 16(3)(c) deductions

[14] The following facts are not in dispute:

(1) ABC paid out loan cover in the amount of R582 383 753,66 during the tax periods in question and the tax fraction of the total payments made is R71 520 811,85.

(2) The standard written loan agreement between ABC and its clients includes an undertaking in clause 13 that for loans of 6 months or more, if the customer dies or is retrenched, the amount owing to ABC would be covered to a maximum of R264 000,00, save that if the customer was retrenched within 3 months from taking the loan only half of the amount owing will be covered.

(3) The agreement stated that ABC did not charge any fees for the loan cover.

(4) The agreement recorded the costs of credit as being the initiation fee charged upfront, the monthly services fee, included in the instalment, and interest. Both the initiation fee and monthly service fee included 14% VAT.

Case deals with claim of section 16(3)(c) deductions

[19] This while the written loan contract expressly states that ABC does not charge any fees for the loan cover it does set out the statutory service fees charged. These service fees are defined in section 1 of the National Credit Act 34 of 2005 ("the NCA") as being a fee that may be charged periodically by a credit provider in connection with the routine administration cost of maintaining a credit agreement.

[20] Regulation 44(3) to the NCA provides that:

"the service fee covers the cost of administering a credit agreement which is the operational cost of the credit provider such as rent, labour, communication, banking, processing of repayments and any other costs related to the administration of a credit agreement."

[21] Thus whilst ABC makes no separate and distinct charge for the loan cover the cost of such cover to ABC is at least in part recovered through service fees which provide for its operational costs. These fees constitute consideration for the cover provided.

Finding

[35] The loan cover promotes and is made in the course and furtherance of an enterprise that includes the making of taxable supplies. These fees are a key component on the income side of ABC's business model. It would be uncommercial and inconsistent with X's evidence in this regard to accept that the loan cover exclusively advances an exempt supply.

[36] The clients contracted to get a loan and not for other separate distinct services. The taxable fees recover costs to the bank and not services to the client. The NCA includes these with interest as being "costs of credit". All three are the consideration paid for credit.

[37] As the supply of loan cover advances the entire business of advancing credit and this includes a taxable supply, the loan cover advances a taxable supply for consideration.

[38] The requirements of section 16(3)(*c*) are thus satisfied and ABC qualifies for the deduction provided for therein.

Note from the presenter…

- This is one of those "too good to be true findings…."
- There is no charge for the "contract of insurance", yet the taxpayer is entitled to a significant input tax deduction.
- SARS is appealing the case and it will be interesting to see the outcome in the SCA.

- The foundation of the VAT system is that there must be a link between output VAT and input VAT.
- In this case, there is no output tax since there is no separate charge for the contract of insurance. Yet there is an input tax deduction for payments made under the contract of insurance.
- Since there is no apparent equilibrium, and if the matter is not won by SARS in the SCA, the legislator will have no choice than address the potential deficiency.

Battle may have been won but the war is far from over

The Tax Faculty

Note from the presenter…

- Special Court Cases does not provide any precedent.
- Extreme caution is advised for any taxpayer who intends using this case in support of claiming input tax deductions before clarity is provided by the SCA.
- Personally, I do not believe that SARS have exhausted all the ammunition in its arsenal to counter the arguments raised by the taxpayer:
  - Risk that SARS may recharacterize a portion of the interest received from interest to "consideration for insurance" and challenging that output VAT is payable thereon.
  - The special court has not explored the term "insurance" or "contract of insurance" in any depth. Is there truly an "indemnity payment" made or is the Bank simply abandoning its right to claim payment of a debt upon the happening of some uncertain future events?

Battle may have been won but the war is far from over

The Tax Faculty

The Tax Faculty

Dealing with SARS PAYE Audit

PAYE – Getting it wrong….

Section 234(2) of the TAA

(2) Any person who wilfully or negligently fails to—

(d) submit a return or document to SARS or issue a document to a person as required under a tax Act

(h) comply with a directive or instruction issued by SARS to the person under a tax Act

(k) in the event where that person becomes liable to make a payment for withholding any tax, deduct or withhold or pay to SARS the amount of tax, as and when required under a tax Act,

is guilty of an offence and is liable, upon conviction, to a fine or to imprisonment for a period not exceeding two years

PAYE – Getting it wrong….

Par 30(1) of the 4th Schedule to the Income Tax Act

Any person who—

(a) wilfully uses or applies any amount deducted or withheld by him or her by way of employees' tax for purposes other than the payment of such amount to the Commissioner; or

(b) not being an employer and without being duly authorised by any person who is an employer, wilfully issues or causes to be issued any document purporting to be an employees' tax certificate,

is guilty of an offence and is liable, upon conviction, to a fine or to imprisonment for a period not exceeding two years.

PAYE – Getting it wrong….

Par 30(1A) of the 4th Schedule to the Income Tax Act

Any person who—

(a) wilfully or negligently fails to deliver to any employee or former employee any employees' tax certificate as required by paragraph 13;

(b) being a registered employer under paragraph 15 (1), wilfully or negligently fails to notify the Commissioner of having ceased to be an employer as required by paragraph 15 (3); or

(c) wilfully or negligently fails to submit to the Commissioner any estimate of his or her taxable income as required under paragraph 19,

is guilty of an offence and is liable, upon conviction, to a fine or to imprisonment for a period not exceeding two years.

PAYE – Getting it wrong….

Par 5(1) and 5(5) of the 4th Schedule to the Income Tax Act

5. (1) Subject to the provisions of subparagraph (6), if an employer is personally liable for the payment of employees' tax under Chapter 10 the Tax Administration Act, the employer shall pay that amount to the Commissioner not later than the date on which payment should have been made if the employees' tax had in fact been deducted or withheld in terms of paragraph 2.

(5) Any amount which an employer is required to pay in terms of sub-paragraph (1) and which the employer does not recover from the employee shall, insofar as the employer only is concerned, for the purposes of be deemed to be a penalty due and payable by that employer.

The Tax Faculty

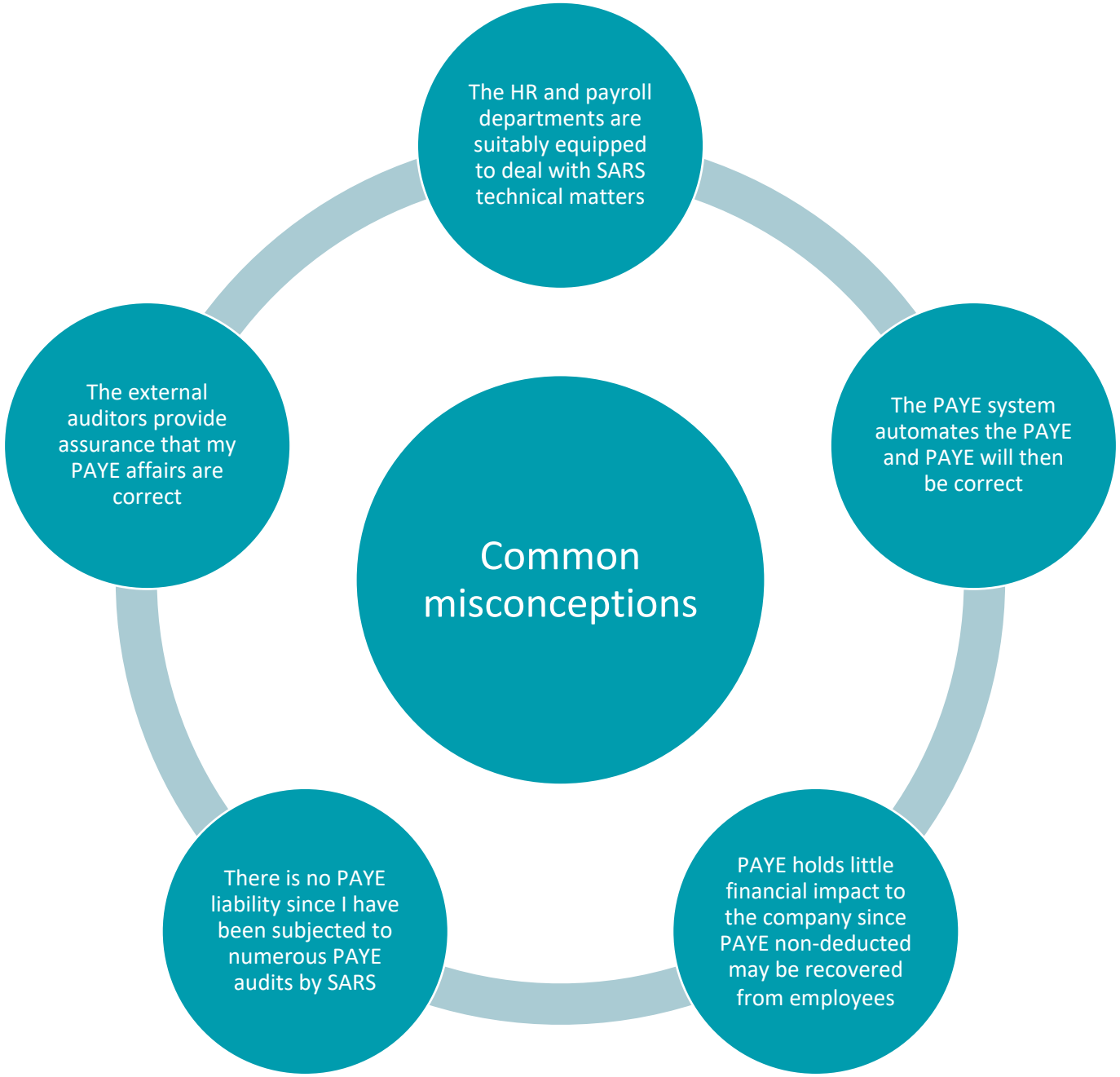
What are the main reasons why Taxpayers are exposed to liabilities upon PAYE Audit?

What are the main reasons why Taxpayers are exposed to liabilities upon PAYE Audit?

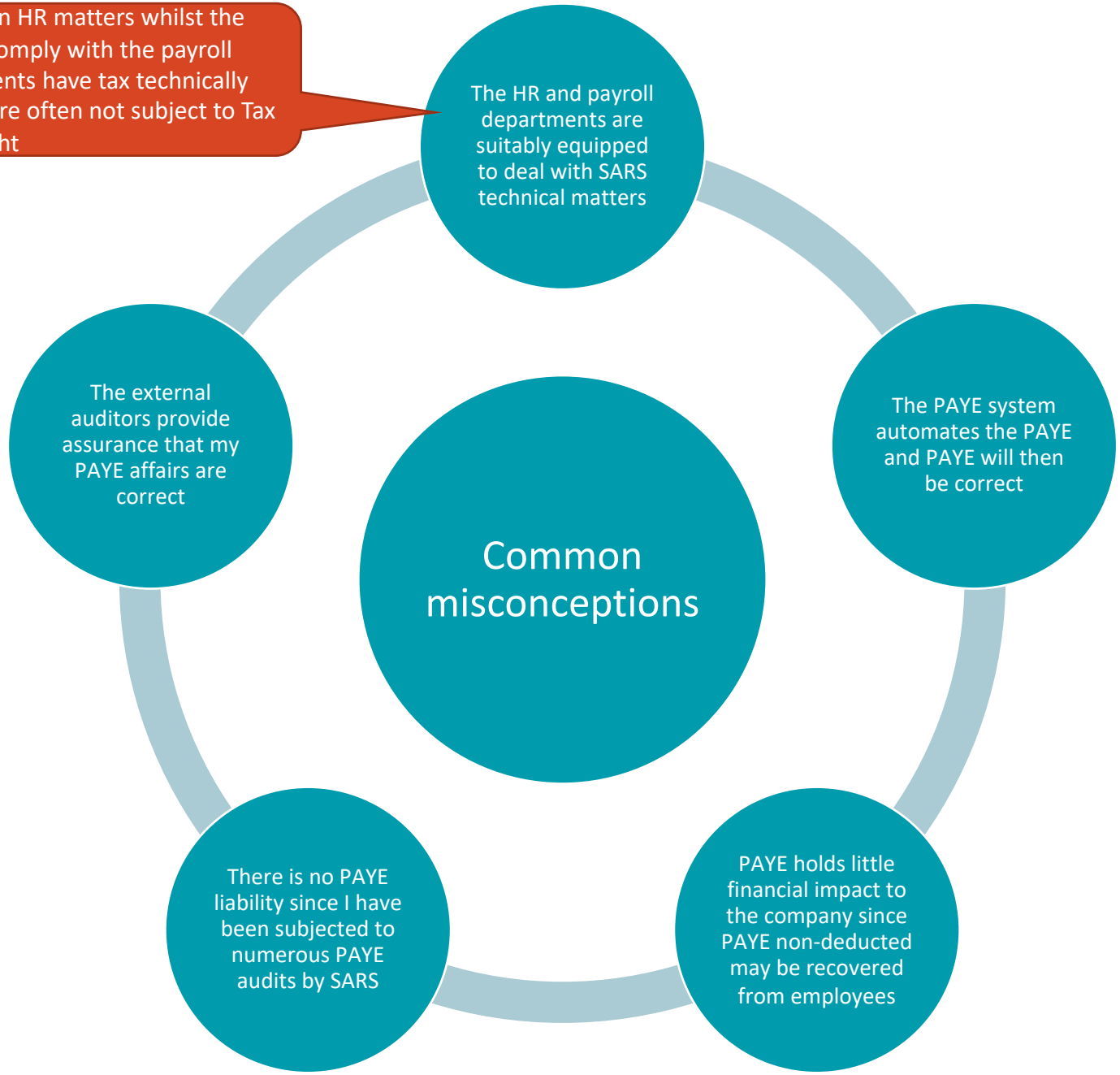
Reason 1

Misconceptions about PAYE

The Tax Faculty


Common misconceptions
The HR and payroll departments are suitably equipped to deal with SARS technical matters
The PAYE system automates the PAYE and PAYE will then be correct
PAYE holds little financial impact to the company since PAYE non-deducted may be recovered from employees
There is no PAYE liability since I have been subjected to numerous PAYE audits by SARS
The external auditors provide assurance that my PAYE affairs are correct

Most HR departments are skilled in HR matters whilst the Payroll department is skilled to comply with the payroll administration. Very few departments have tax technically skilled employees. HR departments are often not subject to Tax Dept oversight



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PAYE systems are generally robust, but, as with any system is dependant on accurate information being uploaded and accurate classifications being done by the users.

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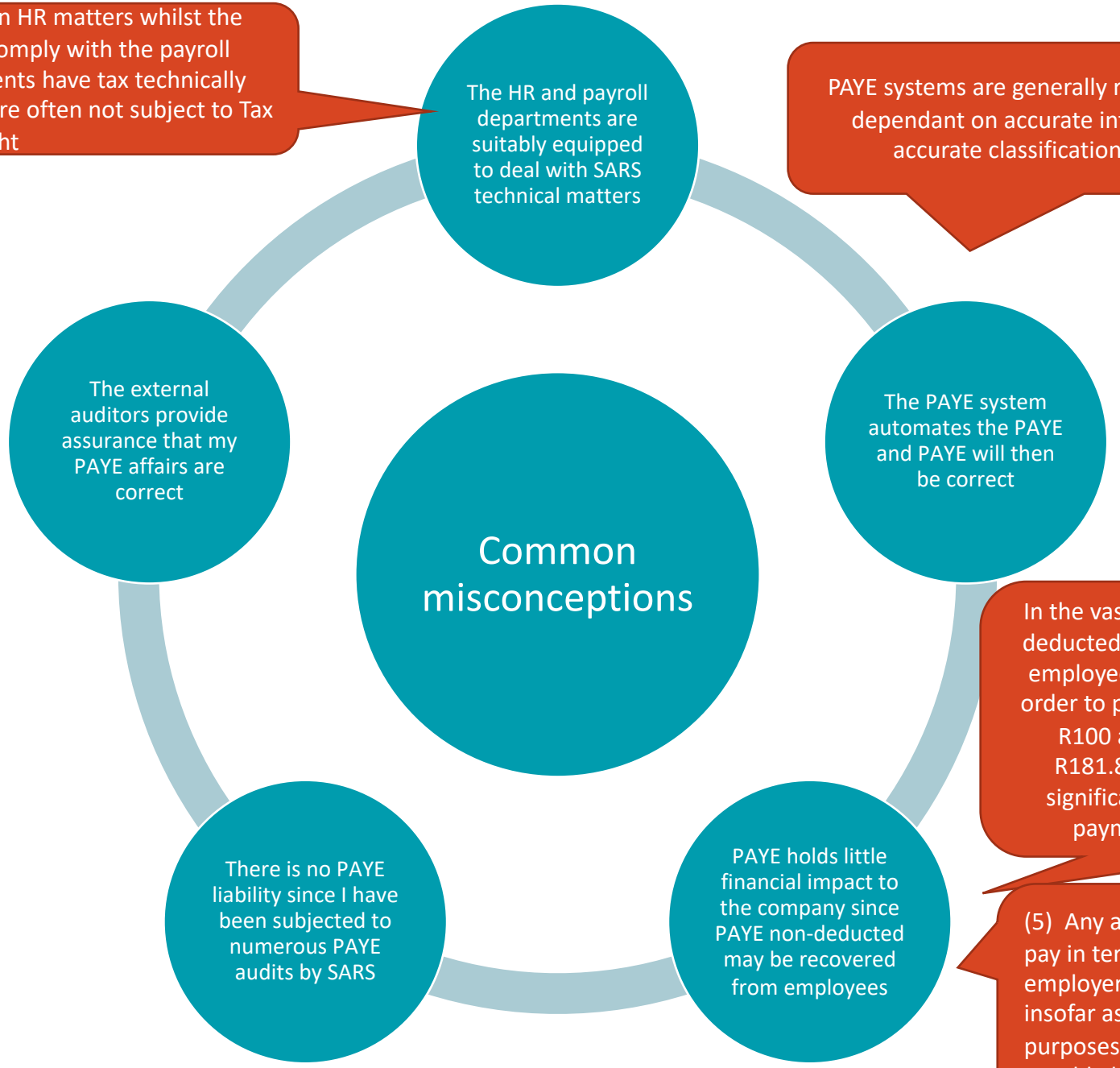

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PAYE systems are generally robust, but, as with any system is dependant on accurate information being uploaded and accurate classifications being done by the users.

In the vast majority of cases, PAYE erroneously not deducted cannot practically be recovered from the employees. The tax must then be "grossed up". In order to provide a person with 45% marginal rate a R100 after tax benefit, the pre-tax benefit is R181.82. The PAYE impact is therefore often significant. Understatement penalties and late payment penalties can also be significant

(5) Any amount which an employer is required to pay in terms of sub-paragraph (1) and which the employer does not recover from the employee shall, insofar as the employer only is concerned, for the purposes of be deemed to be a penalty due and payable by that employer.

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The external auditors provide assurance that my PAYE affairs are correct

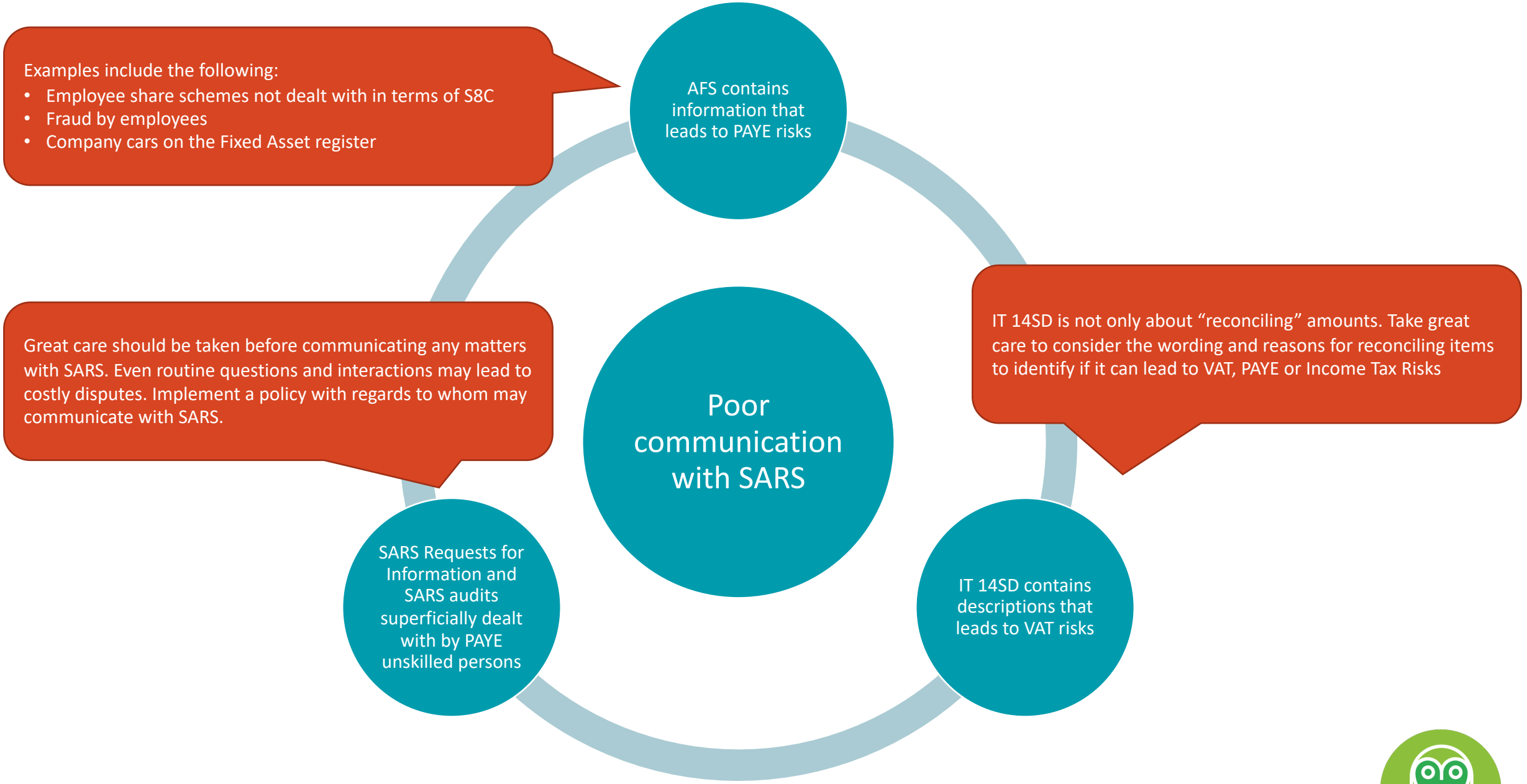
Auditors are concerned with the reasonability of the AFS seen in its entirety. They do not provide assurance that there are no PAYE liabilities.

What are the main reasons why Taxpayers are exposed to liabilities upon PAYE Audit?

Reason 2

Poor Communication with SARS

The Tax Faculty


Examples include the following:
• Employee share schemes not dealt with in terms of S8C
• Fraud by employees
• Company cars on the Fixed Asset register
AFS contains information that leads to PAYE risks
IT 14SD is not only about “reconciling” amounts. Take great care to consider the wording and reasons for reconciling items to identify if it can lead to VAT, PAYE or Income Tax Risks
IT 14SD contains descriptions that leads to VAT risks
SARS Requests for Information and SARS audits superficially dealt with by PAYE unskilled persons
Great care should be taken before communicating any matters with SARS. Even routine questions and interactions may lead to costly disputes. Implement a policy with regards to whom may communicate with SARS.
Poor communication with SARS

Client Name

IT 14SD for period ending

Information per ITR 14

Description	R		R
Directors/members remuneration			
Employee expenes: Pension and Provident Fund Contributions			
Employee expenses: Medical Scheme contributions			
Salaries and wages (excluding medical, provident and pension contributions)			
Employee expenses: Group Life insurance			
Other Employment costs: Describe		-	-
Various			
Total Per ITR14 and AFS			-

Information per EMP 201 and payroll records

Detail	R
Total PAYE paid per EMP 201	
Amount on which PAYE liability was calculated	

Difference between Payroll and ITR 14

Detail	R
Amount by which AFS amount exceeds/(is lower than) amount per payroll report	-

Reconciliation of EMP 201 to ITR 14

Detail			R
Payroll expenses per AFS and ITR 14			-
Deduct items that are included in AFS expenses but that do not appear on Payroll report			-
Add items appearing on payroll report but are not disclosed as salaries and wages in ITR 14			
Other: Immaterial	Various small timing differences	*Accuracy level* #DIV/0!	-
Total amount on which PAYE was calculated per the payroll reports			-

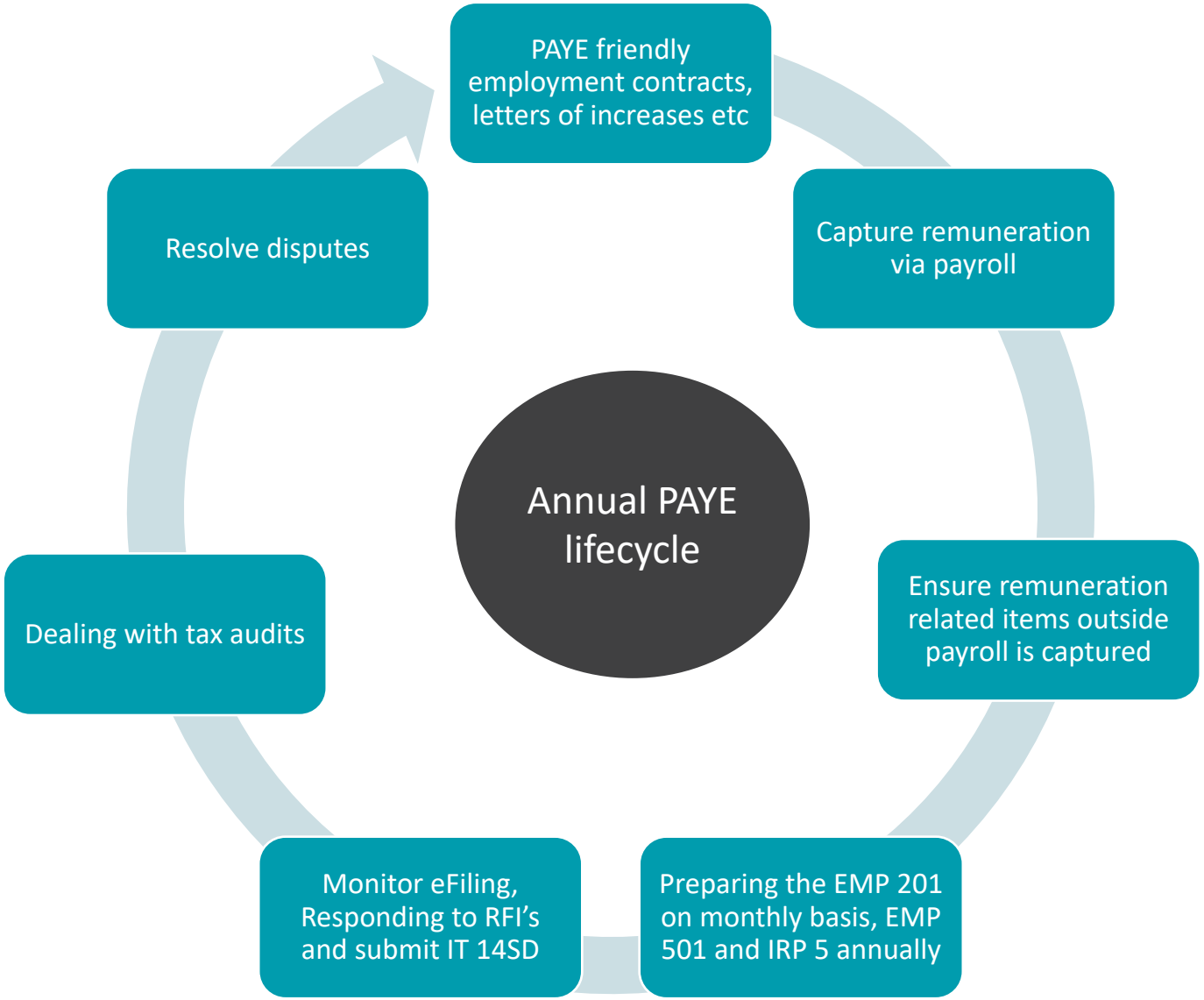
Highly recommended to upload supporting documentation on efiling with the IT 14SD and provide clear and accurate descriptions of any reconciling items.

What are the main reasons why Taxpayers are exposed to liabilities upon PAYE Audit?

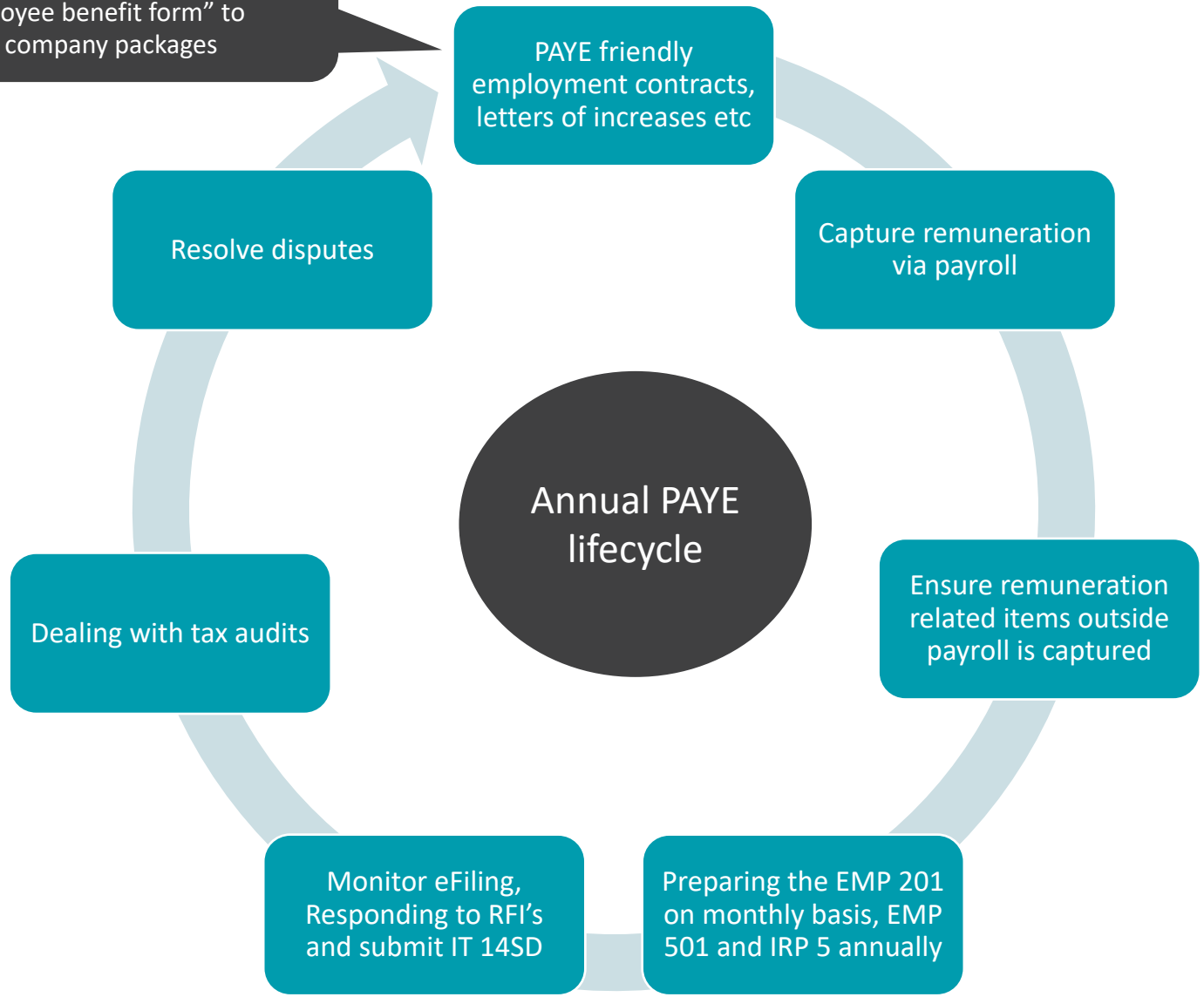
Reason 3

Lack of appropriate tax risk management controls

The Tax Faculty


Annual PAYE lifecycle
PAYE friendly employment contracts, letters of increases etc
Capture remuneration via payroll
Ensure remuneration related items outside payroll is captured
Preparing the EMP 201 on monthly basis, EMP 501 and IRP 5 annually
Monitor eFiling, Responding to RFI's and submit IT 14SD
Dealing with tax audits
Resolve disputes

- Employment contracts should be drawn up in such a manner to create clarity on PAYE.
- Consider implementing an “employee benefit form” to provide certainty on total cost to company packages



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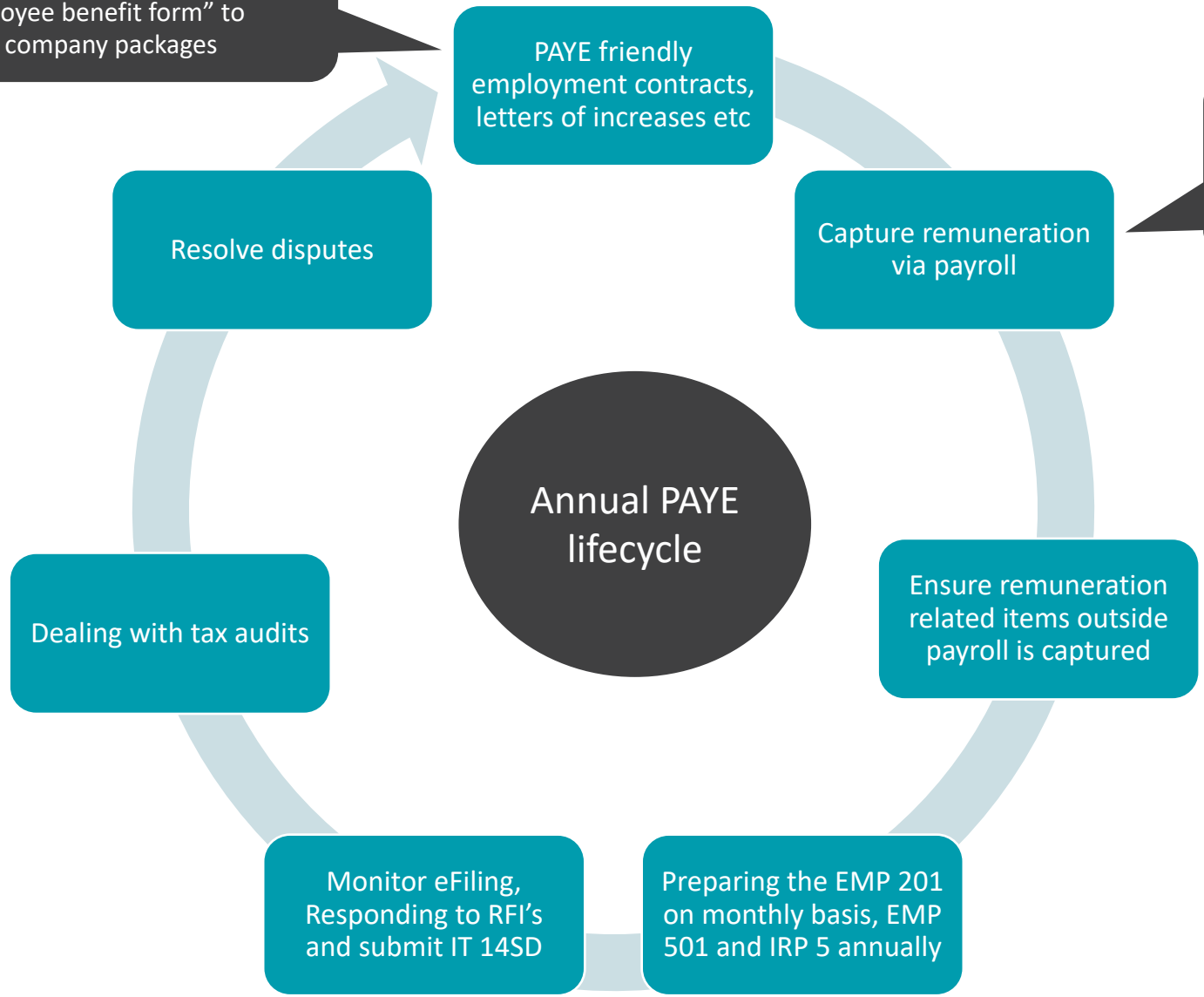
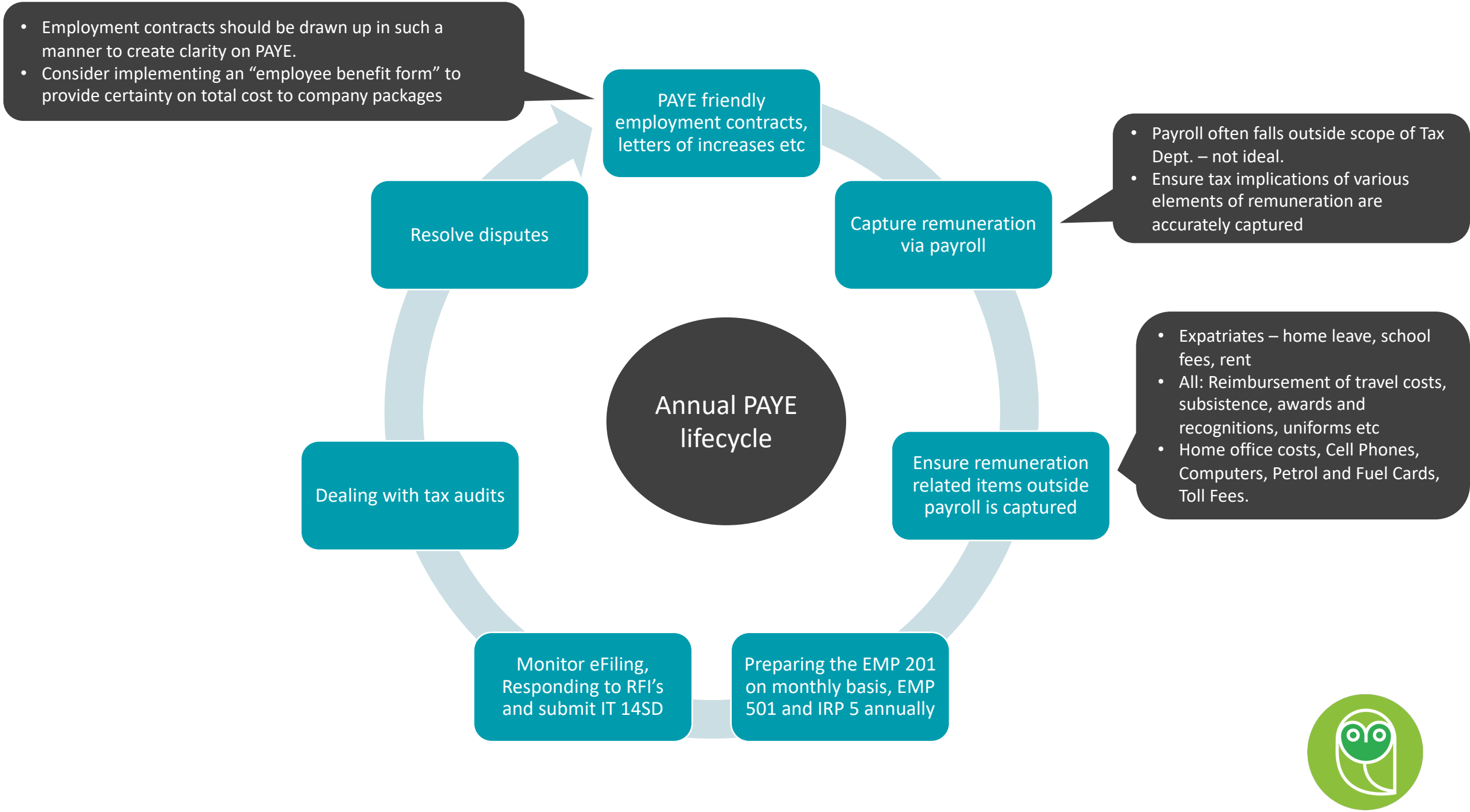


- Payroll often falls outside scope of Tax Dept. – not ideal.
- Ensure tax implications of various elements of remuneration are accurately captured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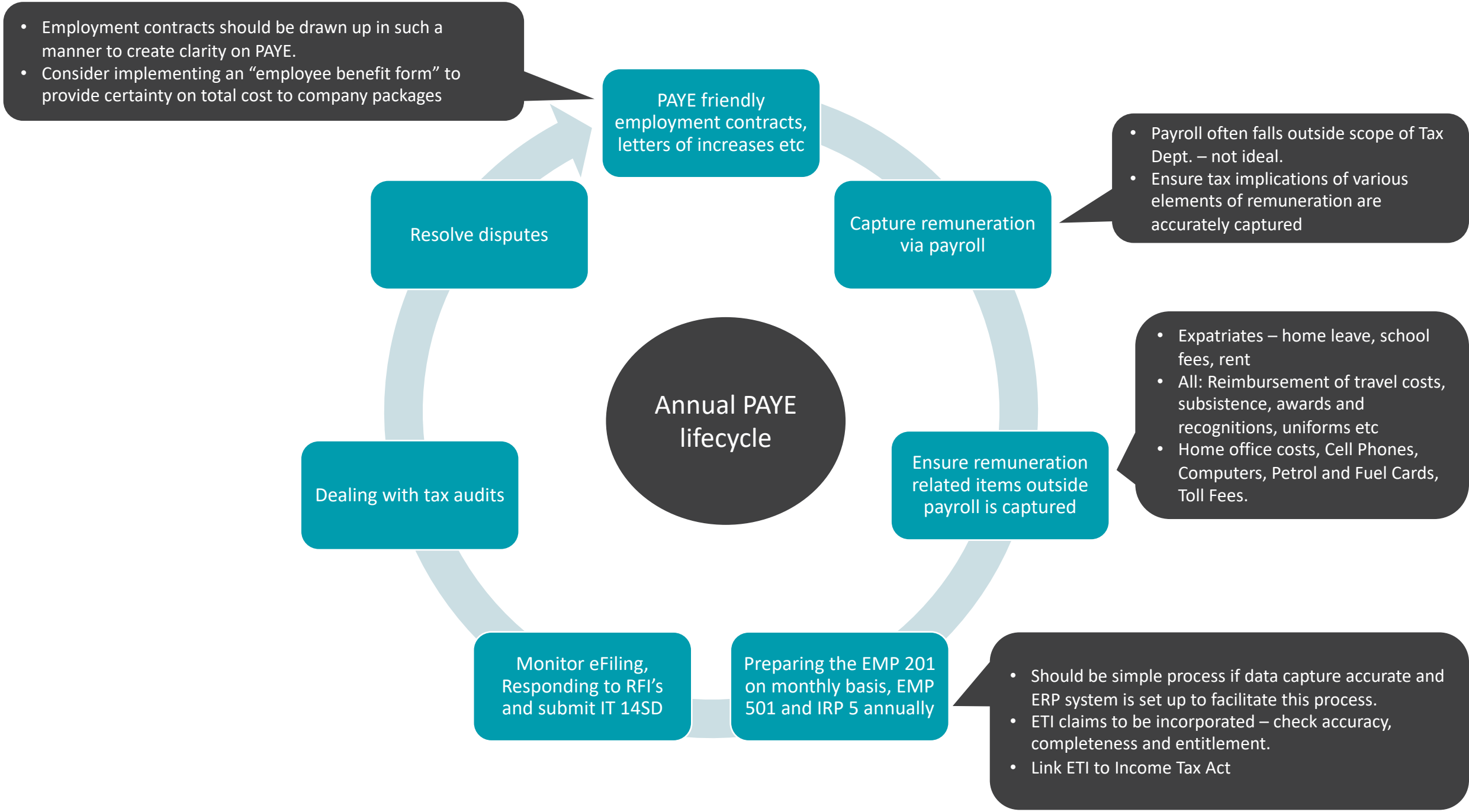
• Expatriates – home leave, school fees, rent
• All: Reimbursement of travel costs, subsistence, awards and recognitions, uniforms etc
• Home office costs, Cell Phones, Computers, Petrol and Fuel Cards, Toll Fees.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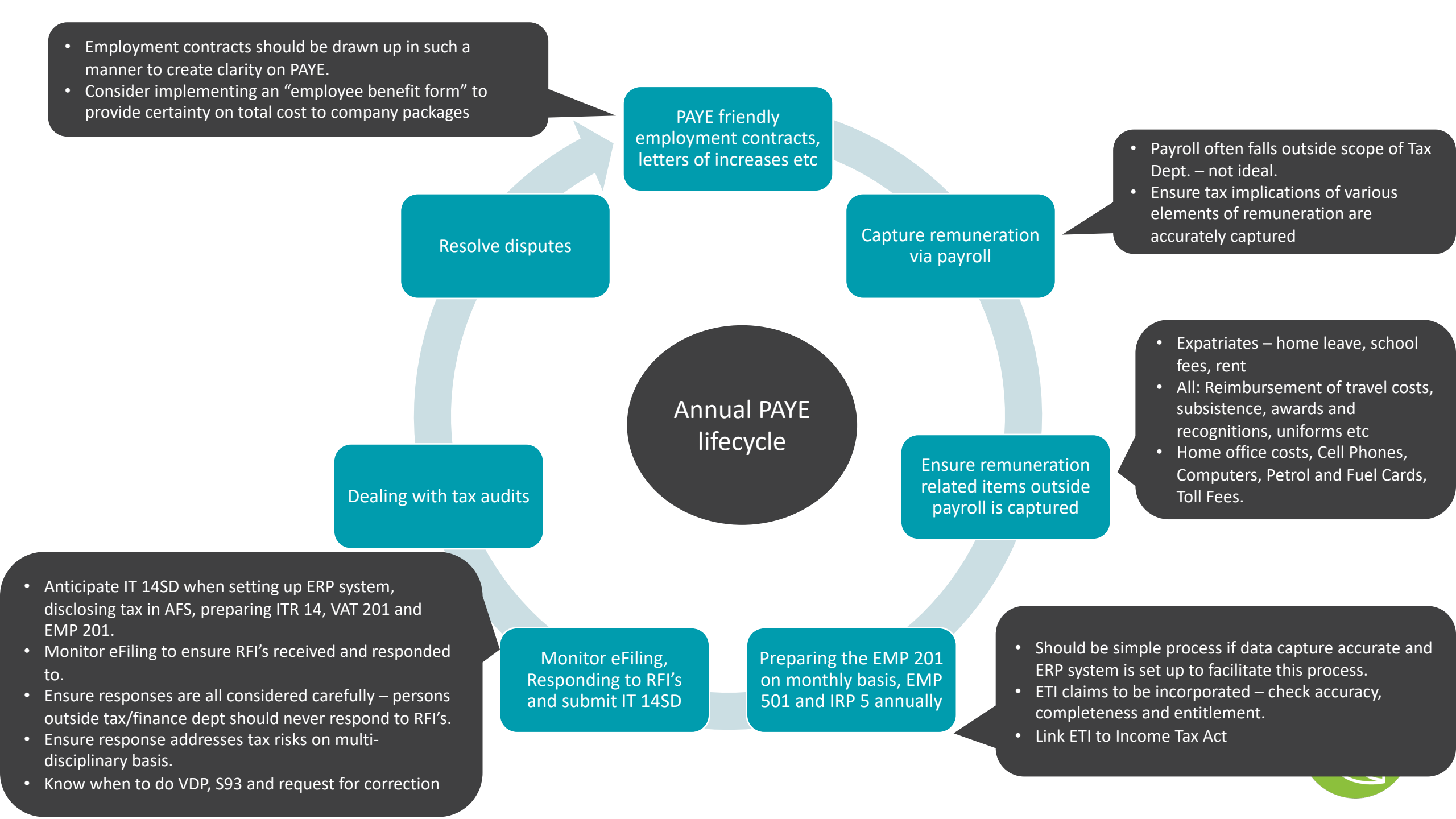
• Expatriates – home leave, school fees, rent
• All: Reimbursement of travel costs, subsistence, awards and recognitions, uniforms etc
• Home office costs, Cell Phones, Computers, Petrol and Fuel Cards, Toll Fees.
• Should be simple process if data capture accurate and ERP system is set up to facilitate this process.
• ETI claims to be incorporated – check accuracy, completeness and entitlement.
• Link ETI to Income Tax Act


Annual PAYE lifecycle
PAYE friendly employment contracts, letters of increases etc
Capture remuneration via payroll
Ensure remuneration related items outside payroll is captured
Preparing the EMP 201 on monthly basis, EMP 501 and IRP 5 annually
Monitor eFiling, Responding to RFI's and submit IT 14SD
Dealing with tax audits
Resolve disputes
• Employment contracts should be drawn up in such a manner to create clarity on PAYE.
• Consider implementing an "employee benefit form" to provide certainty on total cost to company packages
• Payroll often falls outside scope of Tax Dept. – not ideal.
• Ensure tax implications of various elements of remuneration are accurately captured
• Expatriates – home leave, school fees, rent
• All: Reimbursement of travel costs, subsistence, awards and recognitions, uniforms etc
• Home office costs, Cell Phones, Computers, Petrol and Fuel Cards, Toll Fees.
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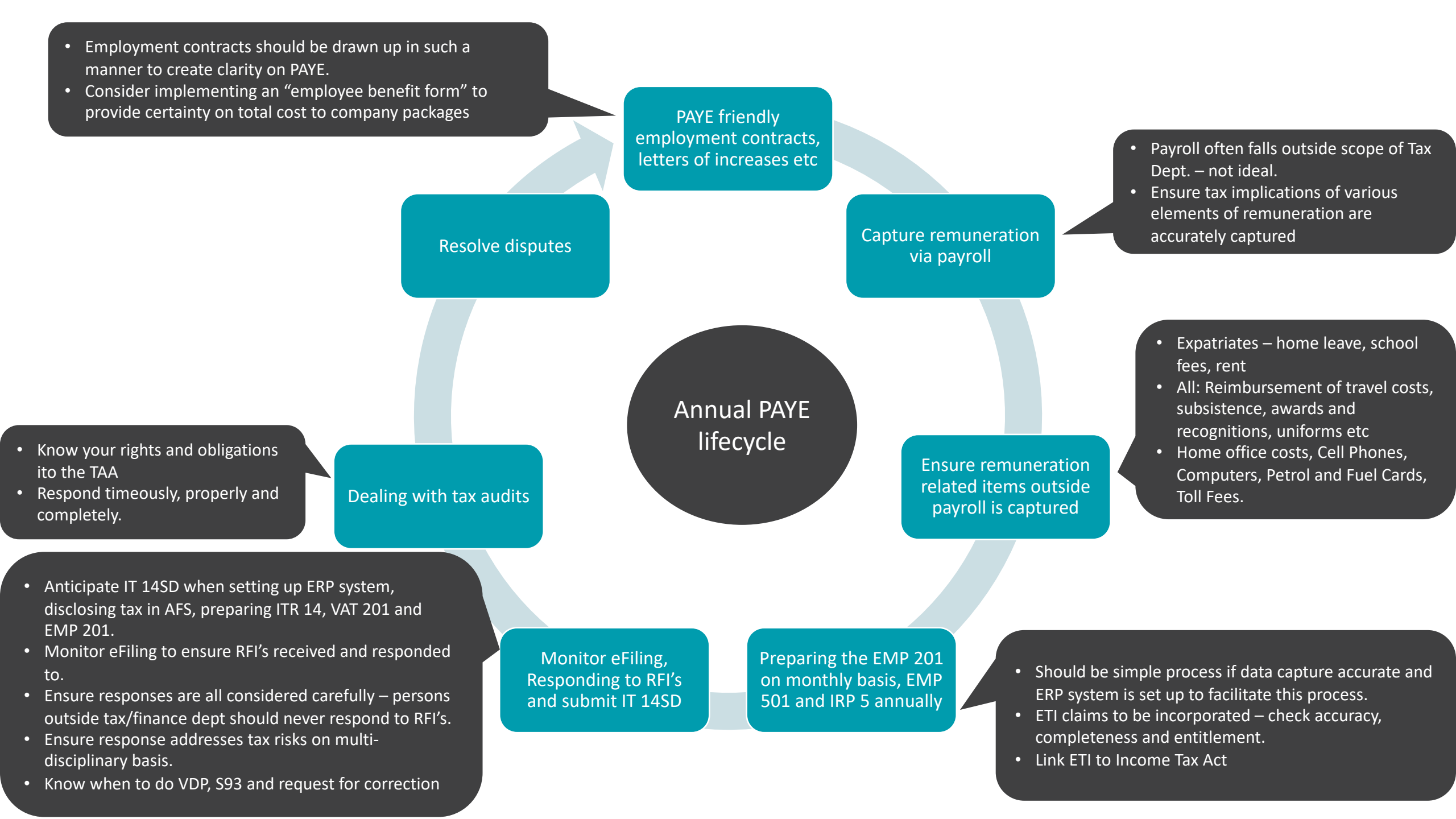
• Ensure responses are all considered carefully – persons outside tax/finance dept should never respond to RFI's.
• Ensure response addresses tax risks on multi-disciplinary basis.
• Know when to do VDP, S93 and request for correction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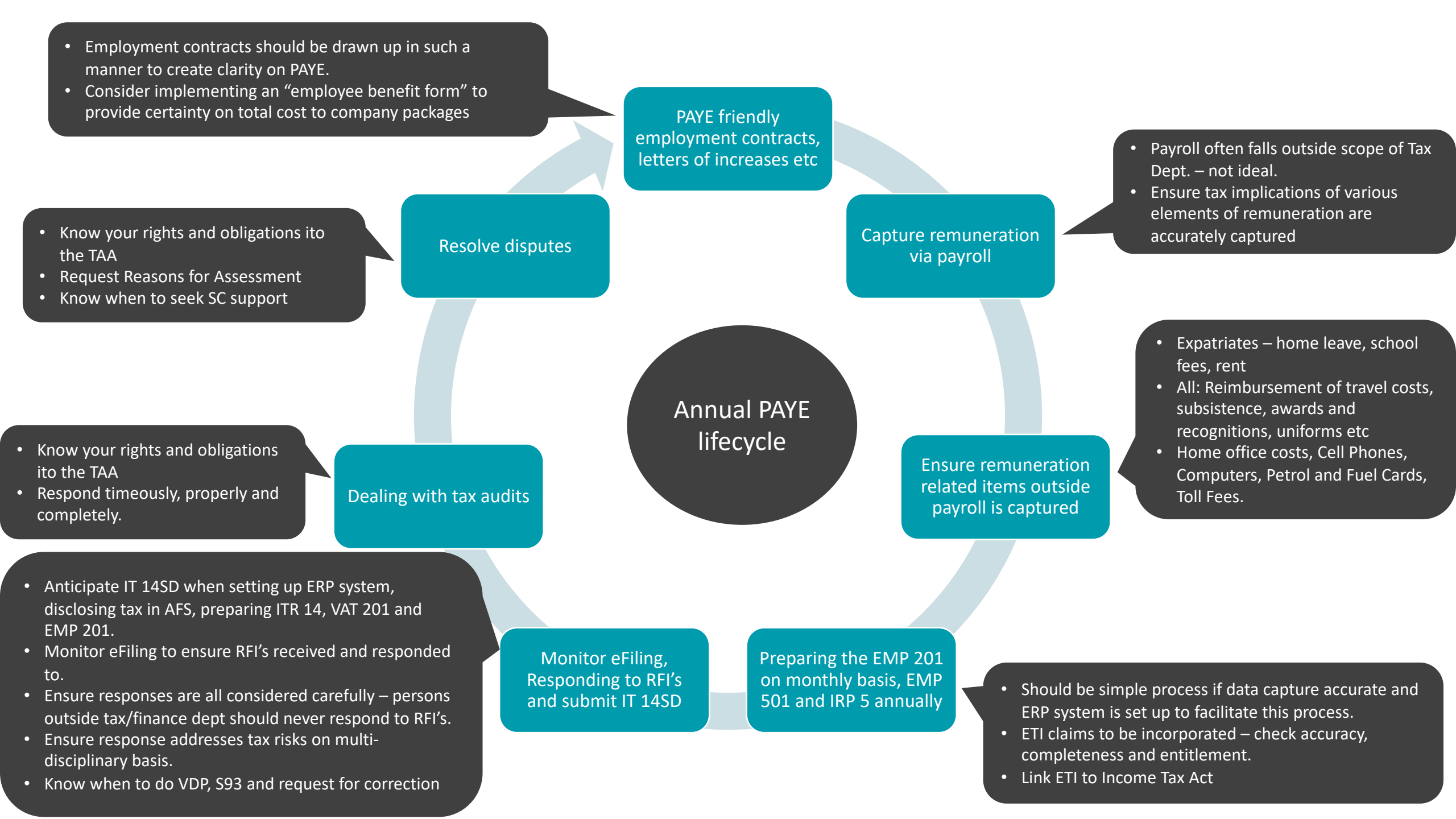
• Ensure response addresses tax risks on multi-disciplinary basis.
• Know when to do VDP, S93 and request for correction
• Know your rights and obligations ito the TAA
• Respond timeously, properly and completely.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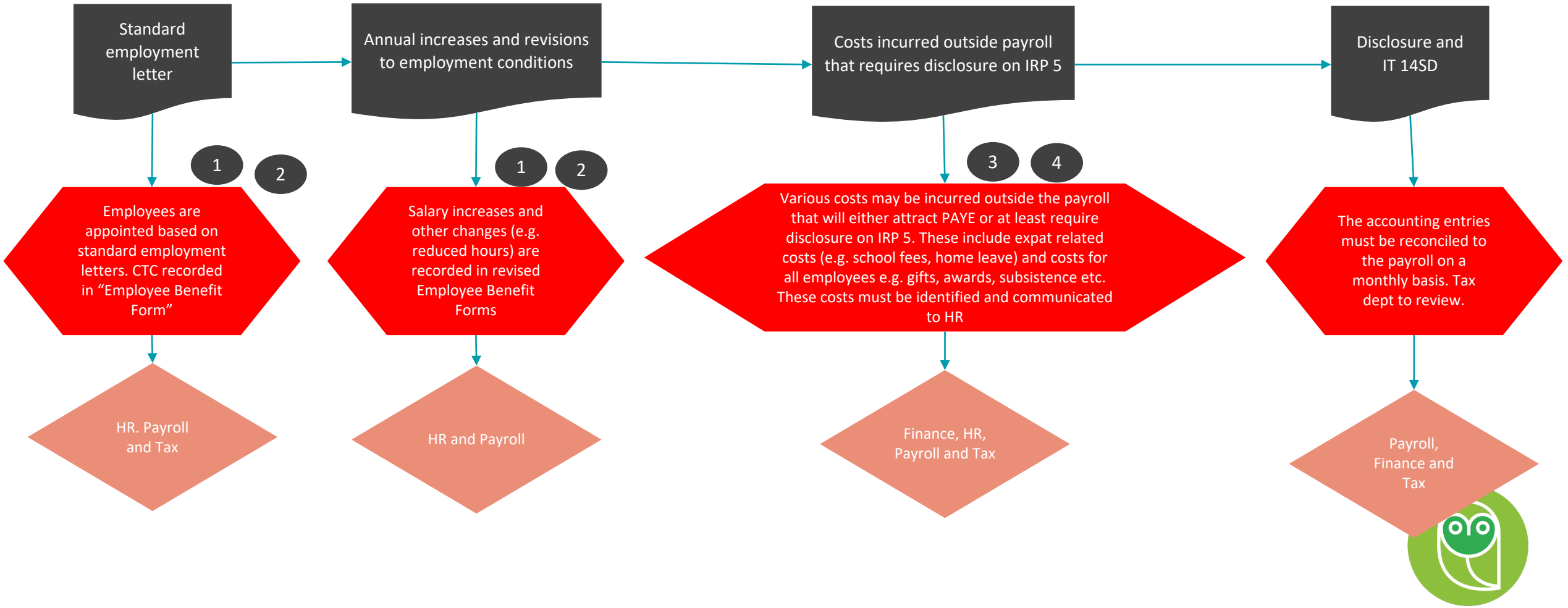
• Ensure response addresses tax risks on multi-disciplinary basis.
• Know when to do VDP, S93 and request for correction
• Know your rights and obligations ito the TAA
• Respond timeously, properly and completely.
• Know your rights and obligations ito the TAA
• Request Reasons for Assessment
• Know when to seek SC support

End-to-end process – Salaries and wages

Major risk: Items outside payroll



Salaries and wages

#	Activity	Risk	Tax Risk	Control	Auto/ Manual
1	Employment and increases	Employment letters and letters of increases contains ambiguous language giving rise to PAYE and VAT risks	Underpayment or overpayment of PAYE Interest and penalties	• Tax department to review and sign off on the standard remuneration letters and letters of increase format • Implement a “employee benefit form” to govern the true relationship between the parties.	Manual
2	Remuneration restructures	Out of the ordinary adjustments to remuneration packages are implemented incorrectly – e.g. salary sacrifices during lockdown period, retrenchments or relocations.	Underpayment of PAYE Interest and penalties	• Tax dept to review and formally sign off all structural amendments to standard employment packages.	Manual
3	Operating expenses related to employees	Remuneration related expenses are paid outside the payroll and are not properly recorded on the IRP 5.	Underpayment of PAYE Interest and penalties. Potential understatement of VAT on fringe benefits.	• Strict rule to be applied that reimbursive claims will ONLY be paid via payroll and payslips • Payroll department to collaborate with tax dept regarding all expenses outside the payroll that attracts PAYE and/or should be disclosed on the IRP 5 • Data analytics to be used to detect items that failed to be disclosed on IRP 5	Combined
4	Awards, gifts	Awards, prizes, gifts etc are treated incorrectly from a VAT and payroll perspective	Underpayment of PAYE Overclaim of input VAT or underpayment of output VAT Interest and penalties	• Policies for rewards and recognition to be reviewed and signed off by tax department. Gross-up formula of tax to be approved and signed off by tax department. • All rewards and incentives to be processed via payroll.	Manual
5	Reconcile to GL	The payroll is not reconciled to GL complicating IT14SD disclosure.	Inability to prepare IT14SD SARS disputes, estimated assessments, interest and penalties	• A monthly payroll report is produced and reconciled to the GL. • This reconciliation is also performed on an annual basis and checked by external auditors.	Combined

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Commonly found errors

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Lack of understanding of “Total Cost to Company” and “Salary Sacrifice” principles.

Failure to accurately record the true make-up of Total Cost to Company

EMPLOYER

EMPLOYEE BENEFIT FORM

Name	EMPLOYEE NAME	
Employee Number	EMPLOYEE NUMBER	
Validity of remuneration package: 12 months ended	28 February 2022	Annual TCOE
Total monthly guaranteed cost of employment to company	R73 034.00	R876 408.00
Do you elect that a 13th Cheque be paid in December?	Yes	
If you elect that bonus is paid in December - Must the PAYE be deducted monthly or in December?	December	
Bonus payment if 13th cheque is elected	R49 403.40	Annual Travel
Monthly travel allowance selected as part of TCOE	R7 000.00	R84 000.00
What percentage of the travel allowance should be subject to PAYE?	80%	
Maximum monthly reimbursement of business expenses: Cell Phone	350	
Medical Aid Contributions and information		
Total monthly employee contribution to medical aid	R1 000.00	
Medical Aid Number of dependants (INCLUDING SELF)	3	Annual Credit
Medical Aid Credit per month	888	10 656
Retirement Fund Contributions		Amount ZAR
Percentage of TCOE Employer contribution to Pension Fund	0.0%	R0.00
Percentage of TCOE Employee contribution to Pension Fund	15.0%	R10 955.10
Voluntary monthly employee contributions to Pension Fund in ZAR	R1 000.00	R1 000.00
Employer contribution to Group Life	0.274%	R200.11
Employer contribution to Income Disability	1.430%	R1 044.39
Employer contribution to Dreaded Disease	0.280%	R204.50
Employer contribution to fund administration	0.150%	R109.55

Section A: Make-up of Total Cost of Employment

Description	Cash/Non Cash	Monthly Remuneration	Annual Remuneration	Income Tax and PAYE implications
Basic Salary	Cash	60 358.50	724 302.05	Subject to PAYE in full.
13th Cheque	Cash	0.00	49 403.40	Subject to PAYE in full. With the approval of the employee, the PAYE may be deducted on a monthly basis. If formal approval not received, PAYE deducted in month of payment.
Travel Allowance	Cash	7 000.00	84 000.00	80% of this amount is subject to PAYE but 100% of the amount will appear on the IRP 5. A claim must be made in the personal income tax return based on a detailed logbook of business km. You may use actual expenditures or deemed expenditures to calculate a rate per km for tax deduction. NB: Any reimbursement of business km will not be subject to PAYE but will be added to this amount on the IRP 5.
Company contribution to pension fund	Non-Cash	0.00	0.00	This amount is taxable in full. However, it is taken into account in determining the retirement fund deduction. (See below)
Company contribution to GLA, Income Protector, Dread Disease and Management fee	Non-Cash	1 558.55	18 702.55	Monthly contributions are fully taxable, but benefits received from Group Life are not taxable.
Total Guaranteed Cost of employment after 13th Cheque ("TCOE")		68 917.05	876 408.00	This is the amount on which all benefits are calculated. This includes but is not limited to Retirement Funding, Overtime, Unpaid Leave. maternity benefits and retrenchment pay.
Reimbursement of business expenses: Cell phone costs - maximum reimbursement amount	Cash	350.00	4 200.00	The reimbursement of business related expenses is not taxable. The employee must submit to the employer a detailed cell phone account substantiating the business related expenses.
Employer contribution to Skills Development Levy (SDL)	Non-Cash	555.62	7 161.47	Not taxable. Calculated as 1% of "remuneration" that is used for calculating PAYE.
Employer contribution to UIF	Non-Cash	148.72	1 784.64	Not taxable. Amount is 1% of TCOE with a maximum of R148.72 per month.
Total non-guaranteed Cost of employment		69 971.39	889 554.11	

Section B: Estimation of PAYE

Description	Monthly Remuneration	Annual Remuneration	Income Tax and PAYE implications
Gross income for PAYE purposes (excluding travel allowance)	61 917.05	743 004.60	TCOE as calculated above.
Travel allowance percentage taxable	5 600.00	67 200.00	80% of the travel allowance is normally subject to PAYE but the employee may elect that 100% of this allowance is subject to PAYE. 100% of the allowance will appear on the IRP 5 and the employee may claim a tax deduction based on the actual business km (per detailed logbook) and a rate per km (either deemed or actual). Reimbursement of business km will not be subjcet to PAYE but will be disclosed on the IRP 5 as a travel allowance against which a tax deduction must be claimed.
Tax on 13th cheque	0.00	49 403.40	Subject to PAYE in full. With the approval of the employee, the PAYE may be deducted on a monthly basis. If formal approval not received, PAYE deducted in month of payment.
Less: Tax deduction for contribution to Retirement Fund	-11 955.10	-143 461.20	The employee contribution as well as the employer contribution are added together and qualifies for a tax deduction. This tax deduction may not be larger than the smaller of R350k per annum or 27.5% of Taxable Income
Taxable income for PAYE	55 561.95	716 146.80	
Tax thereon for 2021_2022 tax year after primary rebate	14 028.91	187 614.25	
Medical aid credit	-888.00	-10 656.00	The MONTHLY tax credit is determined as R332 for the member and 1st dependant, and R224 per dependant thereafter. (Credit may not exceed the collective amount contributed by the employer and the employee)
Estimated PAYE	13 140.91	176 958.25	

Section C: Cash-Flow Estimation

Description	Monthly Remuneration	Annual Remuneration
Basic Salary	60 358.50	724 302.05
13th Cheque	0.00	49 403.40
Travel allowance	7 000.00	84 000.00
Reimbursement of business expenses: Cell phone costs - maximum reimbursement amount	350.00	4 200.00
Employee contribution to pension fund	-11 955.10	-143 461.20
Employee contribution to medical aid	-1 000.00	-12 000.00
Employee contribution to UIF	-148.72	-1 784.64
Estimated PAYE	-13 140.91	-176 958.25
Estimated Cash Flow	**41 463.77**	**527 701.36**
	In addition, a 13th cheque will be received in December.	

Confirmation:

EMPLOYER SIGNATURE: _____

EMPLOYEE SIGNATURE: _____

I confirm that I am required to use a motor vehicle regularly for business purposes and that the total monthly allowance is not excessive in relation to my TCOE and in relation to the total cost of ownership of the vehicle.

Date: _____

The Tax Faculty

Home study expenses

Section 23(b) of the Income Tax Act

Home study

23. Deductions not allowed in determination of taxable income.— *No deductions shall in any case be made in respect of the following matters, namely—*

(b) domestic or private expenses, including the rent of or cost of repairs of or expenses in connection with any premises not occupied for the purposes of trade or of any dwelling-house or domestic premises except in respect of such part as may be occupied for the purposes of trade: Provided that—

(a) such part shall not be deemed to have been occupied for the purposes of trade, unless such part is specifically equipped for purposes of the taxpayer's trade and regularly and exclusively used for such purposes; and

(b) no deduction shall in any event be granted where the taxpayer's trade constitutes any employment or office unless—

(i) his income from such employment or office is derived mainly from commission or other variable payments which are based on the taxpayer's work performance and his duties are mainly performed otherwise than in an office which is provided to him by his employer; or

(ii) his duties are mainly performed in such part;

More than 50%

The Tax Faculty

Impact of Home study on Primary Residence Exclusion (Extract from SARS CGT Guide)

11.2.4 Restriction on use of the R2 million proceeds threshold for exclusion [para 45(4)]

Under para 45(1)(*b*) a natural person or special trust must disregard the capital gain or loss on disposal of a primary residence if the proceeds on disposal are R2 million or less. However, this exclusion does not apply if the natural person or special trust

- was not ordinarily resident in the residence throughout the period commencing on or after the valuation date during which that person or special trust held that interest, or
- used the residence or a part of it for the purposes of carrying on a trade for any portion of the period commencing on or after the valuation date during which the person or special trust held the interest.

These disqualifying criteria are required to ensure that the portion of a capital gain or loss that does not relate to the use of a residence as a primary residence is brought to account as a capital gain or loss. A taxpayer who has such a tainted primary residence will similarly not qualify for the exclusion of R2 million on the 'tainted' portion of any capital gain or loss.

Impact of Home study on Primary Residence Exclusion (Extract from SARS CGT Guide)

Facts:

Antoinné acquired her primary residence in 1996. From 1 October 2001 until she sold it on 31 January 2020, she used 10% of the house as a home study and consulting room for her legal practice. The proceeds on disposal of the residence amounted to R2 million and its base cost was R500 000.

Result:

The proceeds threshold under para 45(1)(*b*) of R2 million for the exclusion of a capital gain on disposal of a primary residence does not apply because Antoinné used a portion of the house for the purposes of trade during the period on or after the valuation date. She will therefore have to determine a capital gain or loss. Of the overall gain of R1,5 million [R2 million (proceeds) less R500 000 (base cost)], R150 000 (10%) comprises a capital gain which must be accounted for in determining her aggregate capital gain or loss for the 2020 year of assessment. The balance of the overall gain of R1 350 000 (R1,5 million − R150 000) must be disregarded because it is less than the primary residence exclusion of R2 million.

Proceeds on disposal	R2 000 000
Base cost	R500 000
Trade use	10%
Capital Gain	R1 500 000
Business use	R150 000
Primarey residence use	R1 350 000

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Section 23(m) of the Income Tax Act

Allowed deductions

23. Deductions not allowed in determination of taxable income.— *No deduction shall in any case be made in respect of the following matters, namely—*

(m) subject to paragraph (k), any expenditure, loss or allowance, contemplated in section 11, which relates to any employment of, or office held by, any person (other than an agent or representative whose remuneration is normally derived mainly in the form of commissions based on his or her sales or the turnover attributable to him or her) in respect of which he or she derives any remuneration, as defined in paragraph 1 of the Fourth Schedule, other than—

(i) any contributions to a pension fund, provident fund or retirement annuity fund as may be deducted from the income of that person in terms of section 11F;

(ii) any allowance or expense which may be deducted from the income of that person in terms of section 11 (c), (e), (i) or (j);

Refunded income

(iiA) any deduction which is allowable under section 11 (nA) or (nB); and

(iii) . . . . . .

(iv) any deduction which is allowable under section 11 (a) or (d) in respect of any rent of, cost of repairs of or expenses in connection with any dwelling house or domestic premises, to the extent that the deduction is not prohibited under paragraph (b);

Home study allowed

Summary

The salaried employee is generally prohibited from claiming any home office expenditures unless his duties are mainly performed in such part.

The salaried employee is entitled to a section 11(e) allowance (e.g. on computers, printers and cell phones) but this is generally queried/denied by SARS.

The employer can reimburse the employee for these expenditures in one of 3 ways:

Fixed allowance that employee does not need to substantiate	**Advances for business expenditures**. Unexpended payments must be refunded to the employer.	**Reimbursement of actual business expenses** based on verifiable invoices etc

Interpretation Note 14 (Issue 4)

3. The nature of allowances, advances and reimbursements

3.1 Definition of the terms "allowance", "advance" and "reimbursement" for the purposes of section 8(1)

The distinction between an allowance, an advance and a reimbursement for purposes of sections 8(1)(*a*), (*b*) and (*c*) is set out in **3.1.1 – 3.1.3**.

3.1.1 Allowance

An allowance is an amount of money granted by an employer to an employee to incur business-related expenditure on behalf of the employer, without an obligation on the employee to prove or account for the business-related expenditure to the employer. The amount of the allowance is based on the *anticipated* business-related expenditure.

Tax inefficient
Administratively efficient

3.1.2 Advance

An advance is an amount of money granted by an employer to an employee to incur business-related expenses on behalf of the employer, with an obligation on the employee to prove or account for the business-related expenditure to the employer. The amount of the advance is based on the *anticipated* business-related expenditure. The employer recovers the difference from the employee if the actual expenses incurred are less than the advance granted and *vice versa*.

Tax efficient
Administratively inefficient

3.1.3 Reimbursement

A reimbursement of business-related expenditure occurs when an employee has incurred and paid for business-related expenses on behalf of an employer without having had the benefit of an allowance or an advance, and is subsequently reimbursed for the exact expenditure by the employer after having proved and accounted for the expenditure to the employer.

Tax efficient
Administratively inefficient

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Interpretation Note 14 (Issue 4)

5.1 Inclusion in taxable income – allowances and advances

Section 8(1)(*a*)(i) –

- deals with **all** allowances and advances paid by a "principal" to a "recipient" (for example, travel, subsistence, public office, cell phone and housing allowances); and
- provides that all such allowances and advances must be included in the recipient's taxable income to the extent that they are not expended[2] –
  - for travelling on business;[3] or
  - for accommodation, meals and incidental costs while such office holder or employee is obliged to spend at least one night away from his or her usual place of residence as a result of business or official purposes;[4] or
  - by reason of the duties attendant upon public office.

Section 8(1)(*a*)(ii) provides that in limited circumstances a reimbursement or advance must not be included in taxable income as otherwise required by section 8(1)(*a*)(i) (see **5.2**).

NET amount is included in gross income for travel and subsistence

Interpretation Note 14 (Issue 4)

5.2 Exclusion from taxable income – reimbursements and advances

Section 8(1)(*a*)(ii) excludes reimbursements or advances from taxable income if the –

- reimbursement or advance was or must be expended by the recipient on instruction of the principal in the furtherance of the principal's trade;
- recipient must produce proof to the principal that the amounts were wholly and actually expended for this purpose;
- recipient must account to the principal for the expenditure; and
- expenditure was or will be incurred to acquire any asset and ownership in that asset vests in the principal.

"Travel reimbursements" by an employer to an employee for the actual business kilometres travelled at an employer-agreed rate per kilometre are "exceptions" to this rule. Accordingly, the provisions of section 8(1)(*a*)(i) (see **5.1**) and section 8(1)(*b*) (see **5.4**) must still be applied to travel reimbursements when determining the amount, if any, which must be included in the recipient's taxable income. The inclusion in taxable income will be nil if the amount of the allowable deduction (see **5.4** for further detail) is equal to the amount of the reimbursement, but if the amount of the allowable deduction is less than the amount of the reimbursement, then a net inclusion in taxable income will be required (see **Example 12**).

Not taxable if these requirements are met

Reimbursement or advance: Evidentiary issues

- Cellphone costs (Contract in name of employee):
  - Obtain detailed billing and apportion the total cost based on ratio of business calls vs private calls. A reimbursement of expenditure by an employer up to this maximum should be acceptable.
  - If the employee already has unlimited voice, SARS may argue that the employee did not incur any "marginal/additional" cost for business purposes and the intention of the cell phone remained primarily private. If the employee historically used the cell phone for both private and personal purposes, a reimbursement by the employer based on calls made should be tax free.
- Wi-fi costs (Contract in name of employee)
  - Additional data purchased for exclusive business use should be acceptable as a basis for reimbursement
  - If the employee already has unlimited wi-fi, SARS may argue that the employee did not incur any "marginal/additional" cost for business purposes and the intention of the wi-fi remained primarily private. If the employee historically used the wi-fi for both private and personal purposes, a reimbursement by the employer based on data usage should be tax free.

Use of assets

Minimal/incidental private use

- Exemptions (Par 6(4) of 7th Schedule)
  - No value shall be placed under this paragraph on the private or domestic use of an asset by an employee, if such use is **incidental** to the use of the asset for the purposes of the employer's business
  - the asset consists of **telephone or computer equipment** which the employee uses **mainly** for the purposes of the employer's business; or
  - the asset consists of books, literature, recordings or works of art.

>50% must be for business purposes

Free or cheap services (Par 10 of 7th Schedule)

(2) No value shall be placed under this paragraph on—

(*b*A) any communication service provided to an employee if the service is used mainly for the purposes of the employer's business;

>50% must be for business purposes

If employer provides wi-fi service. This does not apply if the employee is liable as principal for communication services.
VAT can be claimed by employer.

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Other commonly found errors

Travel allowances

Scenario	Must PAYE be deducted?	Code
A fixed travelling allowance is paid	Yes	3701
Fuel and expenses paid by the employer (e.g. petrol, garage and maintenance cards).	Yes	3701
Reimbursed at **not** more than the prescribed rate per kilometer and **no other compensation paid (** travel allowance)	No	3703
Reimbursed at a rate exceeding the prescribed rate per kilometre (irrespective of kilometres travelled) and no other compensation was paid. Two codes will be applicable – Portion on or below the prescribed rate Portion above the prescribed rate	 No Yes	 3702 3722
Reimbursed at a rate exceeding the prescribed rate per kilometre (irrespective of kilometres travelled) and other compensation was paid (travel allowance). Three codes will be applicable – Portion on or below the prescribed rate Portion above the prescribed rate Travel Allowance	 No Yes Yes	 3702 3722 3701

The allowance is paid to employees not required to travel for business

The allowance is excessive when compared to cost of acquiring and maintaining the vehicle

Garage cards are often not recorded on IRP 5.
EToll is not subject to tax
VAT incorrectly dealt with

Reimbursements per km is often incorrectly calculated

Pool cars – exemption in Par7(10) of 7th Schedule

(10) For the purposes of this paragraph the private use by an employee of a motor vehicle shall be deemed to have no value, if—

(*a*) (i) the vehicle is available to and is in fact used by employees of the employer in general;

(ii) the private use of the vehicle by the employee concerned is infrequent or is merely incidental to its business use; and

(iii) the vehicle is not normally kept at or near the residence of the employee concerned when not in use outside of business hours; or

(*b*) the nature of the employee's duties are such that he or she is regularly required to use the vehicle for the performance of those duties outside his or her normal hours of work, and he or she is not permitted to use that vehicle for private purposes other than—

(i) travelling between his or her place of residence and his or her place of work; or

(ii) private use which is infrequent or is merely incidental to its business use.

Highly advisable to prepare a document entitled "conditions applicable to use of company car" for any employee allocated use of a pool vehicle. This agreement should be aligned with Par 7(10) of the 7th Schedule

Awards, gifts, free services

- Awards and gifts must generally be subject to PAYE.
- Need to gross up the value of any award/gift if you wish to provide it tax free
- Invariably, there will be a VAT implication.

Meal vouchers, cash awards, gifts at year-end functions, overseas trips, local trips

Employment of family members

- Many SMME's often employ family members on the payroll.
  - Spouses, children, brothers, sisters
- SARS often scrutinises the nature of these employment contracts to establish whether or not they are paid to the spouse for services rendered by the director/owner

Ensure that a valid employment contract with specific job descriptions exist whenever any family member/connected person is employed.
The onus to prove that the payment is a bona fide salary rests with the taxpayer.

Canteens and free meals

MEALS, REFRESHMENTS AND MEAL AND REFRESHMENT VOUCHERS

8. (1) Where an employee has been provided with any meal, refreshment or voucher as contemplated in paragraph 2 (*c*), the cash equivalent of the taxable benefit shall be so much of the value of such meal, refreshment or voucher (as determined under subparagraph (2) of this paragraph) as exceeds any consideration given by the employee in respect of such meal, refreshment or voucher.

(2) The value to be placed on such meal, refreshment or voucher shall be the cost to the employer of such meal, refreshment or voucher.

(3) No value shall be placed under this paragraph on—

(*a*) any meal or refreshment supplied by an employer to his employee in any canteen, cafeteria or dining room operated by or on behalf of the employer and patronised wholly or mainly by his employees or on the business premises of the employer;

(*b*) any meal or refreshment supplied by an employer to an employee during business hours or extended working hours or on a special occasion; or

(*c*) any meal or refreshment enjoyed by an employee in the course of providing a meal or refreshment to any person whom the employee is required to entertain on behalf of the employer.

A monetary canteen allowance will be taxable in full

Bursaries

(*q*) any *bona fide* scholarship or bursary, other than any scholarship or bursary contemplated in paragraph (*q*A), granted to enable or assist any person to study at a recognized educational or research institution: Provided that if any such scholarship or bursary has been so granted by an employer or an associated institution (as respectively defined in paragraph 1 of the Seventh Schedule) to an employee (as defined in the said paragraph) or to a relative of such employee, the exemption under this paragraph shall not apply—

(i) in the case of a scholarship or bursary granted to so enable or assist any such employee, unless the employee agrees to reimburse the employer for any scholarship or bursary granted to that employee if that employee fails to complete his or her studies for reasons other than death, ill-health or injury;

(ii) in the case of a scholarship or bursary granted to enable or assist any such relative of an employee so to study—

(*aa*) if the remuneration proxy derived by the employee in relation to a year of assessment exceeded R600 000;

(*bb*) to so much of any scholarship or bursary contemplated in this subparagraph as in the case of any such relative, during the year of assessment, exceeds—

(A) R20 000 in respect of—

(AA) grade R to grade twelve as contemplated in the definition of "school" in section 1 of the South African Schools Act, 1996 (Act No. 84 of 1996); or

(BB) a qualification to which an NQF level from 1 up to and including 4 has been allocated in accordance with Chapter 2 of the National Qualifications Framework Act, 2008 (Act No. 67 of 2008); and

(B) R60 000 in respect of a qualification to which an NQF level from 5 up to and including 10 has been allocated in accordance with Chapter 2 of the National Qualifications Framework Act, 2008 (Act No. 67 of 2008); and

(*cc*) if any remuneration to which the employee was entitled or might in the future have become entitled was in any manner whatsoever reduced or forfeited as a result of the grant of such scholarship or bursary;

Low interest loans (Par 11 of 7th Sch)

The cash equivalent of the value of the taxable benefit derived in consequence of the debt owed by an employee in the circumstances contemplated in paragraph 2 (*f*) shall be

the amount of interest that would have been payable on the amount owing in respect of the debt in respect of the year of assessment if the employee had been obliged to pay interest on such amount during such year at the official rate of interest,

less the amount of interest (if any) actually incurred by the employee in respect of the debt in respect of such year.

Exemptions

(4) No value shall be placed under this paragraph on the taxable benefit derived in consequence of—

(*a*) a debt owed by any employee to his or her employer if such debt or the aggregate of such debts does not exceed the sum of R3 000 at any relevant time; or

(*b*) the debt owed to any employer by an employee incurred for the purpose of enabling that employee to further his or her own studies;

(*c*) a debt owed to his or her employer in consequence of a loan by that employer to that employee as does not exceed the amount of R450k if—

(i) the debt was assumed for the purposes of acquiring immovable property by the employee;

(ii) the market value of the immovable property acquired does not exceed R450 000 in relation to the year of assessment during which the property is acquired;

(iii) the remuneration proxy of the employee does not exceed R250 000 in relation to the year of assessment during which the loan is granted; and

(iv) the employee is not a connected person in relation to the employer.

Tax return preparation services

THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable

Case No: 1156/2018

In the matter between:

BMW SOUTH AFRICA (PTY) LTD	**APPELLANT**
and	
THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE	**RESPONDENT**

The Tax Faculty

Background

- As part of the Group's international business policy employees are required to work for short or medium term periods in locations where the Group has a presence, other than in their home countries.
- Such employees retain their connection with their home countries and continue to submit tax returns there. Additional costs are incurred by the expatriate employees as a result of the Group requiring them to work in foreign countries.
- The employment relationship between the expatriate employees and the Group operates on an agreed 'tax equalisation' basis, which is standard in the Group.
- In simple terms, this means that the Group, wherever it has a presence, will ensure that the net income of their employees, in countries where they are placed, is no less than in their home countries.
- So, for example, if the marginal tax rate is higher in another jurisdiction, the Group will ensure that the impact is nullified by structuring remuneration in such a way that the employee is not worse off in terms of net remuneration.

Background

- BMWSA, in order to facilitate tax compliance by their expatriate employees in South Africa, engaged the services of the firms to complete their registration as taxpayers.
- It also required them to assist expatriate employees with their tax returns as well as to deal with queries and objections to assessments in respect of the domestic tax regime.
- It is common cause that the reason for engaging their services is that the tax regime, insofar as it applies to expatriate employees, is fairly complex.

The Finding

- That there might have been some peripheral advantage to BMWSA in that the tax returns of the expatriate employers and the results of the other services rendered to them could be utilised in checking the accuracy of their own calculation and otherwise utilising the data is irrelevant.
- The statement by Davis *et al* referred to in para 20 above on which BMWSA relied, is too strongly worded. There will be instances in which benefits or advantages contemplated within s 1(i) read with the Seventh Schedule have some residual or marginal advantage for an employer.
- The primary question however, is whether an advantage or benefit was granted by an employer to an employee and whether it was for the latter's private or domestic purposes.
- In the present case, as stated above, the compelling conclusion is that the services were correctly valued and utilised for the employees' private or domestic purposes as contemplated by s 1 of the Act read with para 2*(e)* of the Seventh Schedule.

The Tax Faculty

Section 8C

Section 8C

8C. Taxation of directors and employees on vesting of equity instruments.—

(1) (*a*) Notwithstanding sections 9C and 23 (*m*), a taxpayer must include in or deduct from his or her income for a year of assessment any gain or loss determined in terms of subsection (2) in respect of the vesting during that year of any equity instrument, if that equity instrument was acquired by that taxpayer—

(i) by virtue of his or her employment or office of director of any company or from any person by arrangement with the taxpayer's employer

Section 8C

(2) (*a*) The gain to be included in the income of a taxpayer—

(ii) in any other case, is the amount by which the market value of the equity instrument determined at the time that it vests in that taxpayer exceeds the sum of any consideration in respect of that equity instrument.

Section 8C

Many companies issues shares to employees without even knowing that it is an 8C instrument

(3) An equity instrument acquired by a taxpayer is deemed for the purposes of this section to **vest** in that taxpayer—

(*a*) in the case of the acquisition of an unrestricted equity instrument, at the time of that acquisition; or

(*b*) in the case of the acquisition of a restricted equity instrument, at the earliest of—

(i) when all the restrictions, which result in that equity instrument being a restricted equity instrument, cease to have effect;

(ii) immediately before that taxpayer disposes of that restricted equity instrument, other than a disposal contemplated in subsection (4) or (5) (*a*), (*b*) or (*c*);

The Tax Faculty

Section 8C

"equity instrument" means a share or a member's interest in a company, and includes—

(*a*) an option to acquire such a share, part of a share or member's interest;

(*b*) any financial instrument that is convertible to a share or member's interest; and

(*c*) any contractual right or obligation the value of which is determined directly or indirectly with reference to a share or member's interest;

Section 8C

"restricted equity instrument" in relation to a taxpayer means an equity instrument—

(*a*) which is subject to any restriction (other than a restriction imposed by legislation) that prevents the taxpayer from freely disposing of that equity instrument at market value;

(*b*) which is subject to any restriction that could result in the taxpayer—

(i) forfeiting ownership or the right to acquire ownership of that equity instrument otherwise than at market value; or

(ii) being penalised financially in any other manner for not complying with the terms of the agreement for the acquisition of that equity instrument;

(*c*) if any person has retained the right to impose a restriction contemplated in paragraph (*a*) or (*b*) on the disposal of that equity instrument;

(*d*) which is an option contemplated in paragraph (*a*) of the definition of "equity instrument" and where the equity instrument which can be acquired in terms of that option will be a restricted equity instrument;

(*e*) which is a financial instrument contemplated in paragraph (*b*) of the definition of "equity instrument" and where the equity instrument to which that financial instrument can be converted will be a restricted equity instrument;

(*f*) if the employer, associated institution in relation to the employer or other person by arrangement with the employer has at the time of acquisition by the taxpayer of the equity instrument undertaken to—

(i) cancel the transaction under which that taxpayer acquired the equity instrument; or

(ii) repurchase that equity instrument from that taxpayer at a price exceeding its market value on the date of repurchase,

if there is a decline in the value of the equity instrument after that acquisition; or

(*g*) which is not deliverable to the taxpayer until the happening of an event, whether fixed or contingent;

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The Tax Faculty

Integrated Case Study

Request for information (RFI)

SARS sends a standard VAT questionnaire to the taxpayer containing some 48 questions including details of zero-rated exports, importation of services, motor cars acquired and details of entertainment related expenditure incurred. The information is requested for 5 years and an answer must be provided within 21 working days from the date of the RFI.

The client approaches you for assistance in responding to this RFI.

Phased approach when dealing with SARS RFI

Phase 1: Logistics and planning

Step 1: What is the scope of the RFI?
Is it limited to VAT or does it include other taxes? Confirm that it is an RFI and not a formal notification of an audit. Do you have the appropriate skills to deal with the full scope of the RFI?

Step 2: Is the timeline realistic and is the information available?
Should one request extension for the submission of the responses? Factors such as changes in ERP systems, business acquisitions etc may impact the availability of information.

Step 3: In what format must the information be provided to SARS?
Generally a narrative in a report combined with supporting schedules in pdf or excel.

Step 4: Does the taxpayer have sufficient resources to obtain the information.
Can it be obtained manually? Should ERP extraction and data analytics be used?

Step 5: Obtain Power of Attorney from client if necessary.

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Phased approach when dealing with SARS RFI

Phase 2: Communication with SARS

Step 1: Depending of the outcome of Phase 1, contact SARS and request extension where appropriate.

Step 2: If the scope of the RFI is too wide for electronic submission, consider communicating this fact to SARS. Potential amendment of scope of RFI is possible.

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Phased approach when dealing with SARS RFI

Phase 3: Information gathering

Step 1: High level discussion on each question.

Meet with client and discuss each question in detail. Even though the scope of the RFI may be VAT focused, evaluate the scope of each question as to whether or not it may lead to a non-VAT risk. E.g. A question regarding transactions with connected party transactions may lead to transfer pricing risks and/or denial of income tax deductions for unproductive expenditure.

Example: Does the company provide subsidized meals in the form of a canteen to employees? If so, what is the VAT treatment. Client responds that employees receives a canteen allowance and not subsidized meals. No VAT risk – but potential PAYE risk

Step 2: Obtain information from client and review carefully.

Identify potential contraventions of the law on a multi-disciplinary basis. This may include risks and opportunities.

Step 3: Discuss potential risks and opportunities with the client as well as the appropriate treatment thereof.

Distinguish between, clear contraventions of the law and Tax Uncertain positions

The Tax Faculty

Phased approach when dealing with SARS RFI

Phase 4: Prepare response to SARS

Step 1: Perform proper planning around the lay-out of the response and the flow of information. An “information dump” may lead to future questions and/or assessments.

Step 2: Prepare the response and clarify any uncertainties in supporting information.
Take specific care where large volumes of data is provided to SARS based on narratives provided by junior data capture staff.

Step 3: Consider how disclosure will be made of law contraventions. Full disclosure in responding to an RFI is compulsory.

The Tax Faculty

Phased approach when dealing with SARS RFI

Phase 5: Obtain client approval regarding the proposed response to SARS

Step 1: Ensure that the client is fully aware of all tax uncertain positions, contraventions of the law as well as potential consequences.

Step 2: Obtain and retain sign off for your records.

The Tax Faculty

Phased approach when dealing with SARS RFI

Phase 6: Submit response to SARS

Step 1: Make sure that the submission is made in an appropriate format and that the SARS RFI is included in the submission pack.

Step 2: Obtain confirmation of receipt from SARS.

The Tax Faculty

Phased approach when dealing with SARS RFI

Phase 7: Await further responses from SARS

Step 1: SARS may

- issue further requests for information or
- may issue an assessment or
- May notify the taxpayer of the commencement of an audit

Step 2: For further requests for information, follow the previous process again.
For an assessment – consider the merits and object where necessary
For notification of an audit, await further instructions from SARS.

The Tax Faculty

Request for information: Finding

Contravention: In the course of answering the standard VAT questionnaire, you discover that VAT was incorrectly claimed on the lease costs of passenger cars leased by the company.

Quantification: The VAT incorrectly claimed is approximately R15 000 per month over a 5 year period, i.e. R900 000 in total.

Action: What actions are you required to take?

Transgression of the law

Step 1: Ask probing lateral questions

- Why does the company lease so many passenger cars?
  - *You establish that the cars are provided as company cars to senior local and expatriate employees.*
- Does the company calculate a fringe benefit value in terms of the 7th Schedule to the Income Tax Act?
  - *You establish that no fringe benefit is calculated with the result that PAYE was underpaid for 5 years.*
- Was output VAT paid on the deemed supply of company car as a fringe benefit?
  - *You establish that the output VAT was not paid.*
- What was the income tax treatment of the lease payments?
  - *You establish that the VAT exclusive amount was claimed as an income tax deduction with the result that income tax was overpaid.*

Transgression of the law

Step 2: Consider appropriate corrective actions

In this instance, there is a clear transgression of the law:

- Input VAT was overstated due to incorrect claim of VAT on a “motor car” as defined.
- Output VAT was understated since output VAT was not paid on the deemed supply of a fringe benefit. (Determined value x 0.3% x tax fraction p.m.)
- PAYE was underpaid due to non-disclosure of fringe benefit tax.

In addition, Income tax was overpaid due to underclaim of lease expenses.

Consider following:

- Is the taxpayer allowed to make use of the Voluntary Disclosure Programme (VDP) to avoid understatement and late payment penalties?
  - VAT?
  - PAYE?

  If not, what should the approach be?
- Can the taxpayer make use of S93(1)(d) of the TAA to claim a reduced income tax assessment?

The Tax Faculty

Transgression of the law

Step 2: (Continued)

VDP Process

In situations of this nature, it is the view of SARS that the VDP process may not be followed despite the fact that an "audit" has not yet commenced.

Section 227(a) of the TAA states that one of the requirements of a valid voluntary disclosure is that the disclosure must be "voluntary". SARS holds the view that where the default has been identified in consequence of a response to an RFI, that the process is "induced" by the RFI and as such does not meet the requirements of section 227(a) of the TAA.

- This will definitely apply to the VAT obligations since RFI's scope is VAT related.
- It is arguable whether or not a VDP can be done for the PAYE obligation since the RFI is directed at VAT and it is a routine generalized VAT questionnaire.

Note – this view is contradictory to the following statement on the SARS website under the heading: What steps should I take if I am selected for verification? "*At all times, the taxpayer can approach the Voluntary Disclosure Unit to make a voluntary disclosure. Refer to the Voluntary Disclosure programme for more guidance on that process.*"

Transgression of the law

Step 2: (Continued)
VDP Process

226. Qualification of person subject to audit or investigation for voluntary disclosure.—

(1) A person may apply, whether in a personal, representative, withholding or other capacity, for voluntary disclosure relief.

*(2) If the person seeking relief **has been given notice of the commencement of an audit or criminal investigation** into the affairs of the person, which has not been concluded and **is related to the disclosed 'default',** the disclosure of the 'default' is **regarded as not being voluntary** for purposes of section 227, unless a senior SARS official is of the view, having regard to the circumstances and ambit of the audit or investigation, that—*

(a) . . . . . .

(b) the 'default' in respect of which the person has sought relief would not otherwise have been detected during the audit or investigation; and

(c) the application would be in the interest of good management of the tax system and the best use of SARS' resources.

Transgression of the law

Step 2: (Continued)

S93 of TAA

Section 93 of the TAA can be used to request a reduced income tax assessment but this is limited to 3 years after date of assessment. SARS often disputes whether or not the error is “readily apparent”.

Transgression of the law

Step 3: Consider worst case scenario

Evaluate behaviour ito S223 understatement penalty percentage table

1	2	3	4	5	6
Item	*Behaviour*	*Standard case*	*If obstructive, or if it is a 'repeat case'*	*Voluntary disclosure after notification of audit or criminal investigation*	*Voluntary disclosure before notification of audit or criminal investigation*
(i)	'Substantial understatement'	10%	20%	5%	0%
(ii)	Reasonable care not taken in completing return	25%	50%	15%	0%
(iii)	No reasonable grounds for 'tax position' taken	50%	75%	25%	0%
(iv)	'Impermissible avoidance arrangement'	75%	100%	35%	0%
(v)	Gross negligence	100%	125%	50%	5%
(vi)	Intentional tax evasion	150%	200%	75%	10%

Monthly VAT and even PAYE is less than R1m – this cannot apply.

Look at returns holistically – probably difficult for SARS to argue

SARS will probably apply this with regards to VAT

SARS will probably apply either gross negligence or intentional tax evasion with regards to PAYE

Transgression of the law

Step 3: Consider worst case scenario (Continued)

(2) Any person who wilfully or negligently fails to—

(d) submit a return or document to SARS or issue a document to a person as required under a tax Act

(h) comply with a directive or instruction issued by SARS to the person under a tax Act

(k) in the event where that person becomes liable to make a payment for withholding any tax, deduct or withhold or pay to SARS the amount of tax, as and when required under a tax Act,

is guilty of an offence and is liable, upon conviction, to a fine or to imprisonment for a period not exceeding two years

Conclusion: On the face of it, there has potentially been either intentional tax evasion of negligence in so far as the company's PAYE obligations are concerned.

Transgression of the law

Step 4: Communicate the findings with the Taxpayer

Understand reasons for non-compliance with VAT and PAYE

- Advise client to obtain senior counsel advice.
- Advise client to make full disclosure to SARS.

Transgression of the law

Step 4: Communicate the findings with the Taxpayer (Continued)

What is the situation if the client instructs you to make full disclosure of fact that input VAT was incorrectly claimed but not to disclose fact that PAYE and output VAT was underpaid on fringe benefit?

Transgression of the law

Step 4: Communicate the findings with the Taxpayer (Continued)

What is situation if client instructs you to make full disclosure of fact that input VAT was incorrectly claimed but not to disclose fact that PAYE and output VAT was underpaid on fringe benefit?

234. Criminal offences relating to non-compliance with tax Acts.—*(2) Any person who wilfully or negligently fails to—*

(g) issues an erroneous, incomplete or false document required to be issued under a tax Act to SARS or to another person;

(h) refuses or neglects to—

(i) furnish, produce or make available any information, document or thing, excluding information requested under section 46 (8);

(ii) reply to or answer truly and fully any questions put to the person by a SARS official;

is guilty of an offence and, upon conviction, is subject to a fine or to imprisonment for a period not exceeding two years.

Your responsibility as Tax Practitioner

- If a Chartered Accountant (SA) – consider NOCLAR
- If audit client – consider Reportable Irregularity to IRBA
- If not a Chartered Accountant (SA) – consider rules of governing body

If the client does not want to make full disclosure to SARS, obtain legal advice, but at the minimum, withdraw from client and refuse to make any submissions to SARS.

Given the SARS website statement under “verification process”: *At all times, the taxpayer can approach the Voluntary Disclosure Unit to make a voluntary disclosure.*

From a strategic perspective, one may consider using the VDP for the PAYE liability where the penalty may be reduced to 10% under intentional evasion. Full disclosure of all relevant facts should be made including the fact that a routine VAT questionnaire was received.

The Tax Faculty

Communication with SARS – Some guidance

The Tax Faculty

Introductory comments:

Responding to a

- SARS Request for Information or
- SARS letter of audit findings

Introductory comments

The objective when responding to a SARS letter of audit findings or a request for information is different from a situation where one needs to issue an opinion.

When communicating with SARS, please consider the following:

- Respond comprehensively and truthfully to the questions and/or findings of SARS.
- Avoid providing information outside the scope of the questions/findings.
- Acknowledge situations where there was indeed a contravention of the law. Use the opportunity to provide reasons for this in order to minimise the risk of understatement penalties.
- Ensure that the document is self-standing.
- Confirm the contents of any potential communication with SARS with the client before sending it to SARS.
- Take note of the fact that your submissions will be regarded as evidence for or against the Taxpayer should this matter go to ADR or a court of law. As such, take extreme care in the responses to ensure that you represent the client appropriately.
- If you believe that the topic is sufficiently contentious so that it will escalate to a court of law, advise the client that Senior Counsel should be consulted before making submissions. Since Senior Counsel will need to represent the Taxpayer in a court of law, it would be advisable to obtain such guidance as early as possible.

Layout

Assume that the SARS official knows nothing of the client's business and/or industry. Extra care should be taken to explain the background to the client's business and to provide context to transactions concluded.

The layout of the document must be:

- Logical
- Have appropriate headings
- At the minimum cover the following:
  - Background information to the Taxpayer. What industry, what business etc.
  - The facts as specifically confirmed by the client.
  - Details of SARS query/request for information.
  - The law
    - The required sections
    - Appropriate case law
    - Appropriate guidance by SARS
  - Application of the law to the facts

Language

It is critically important to use clear and concise language when communicating with SARS. SARS will interpret ambiguous statements to favour SARS and not the taxpayer.

- Avoid using long sentences.
- Avoid long paragraphs
  - Make use of bullets or sub numbering
- Ensure that the headings and sub paragraphs are suitably numbered.
- Use “professional” language.
  - Avoid words such as “think”, “like”.
  - Avoid complex terms.
  - Preferably use “everyday language” but avoid “slang”.
- The language must be free of ambiguity.
- If you make use of abbreviations, then it should
  - Be defined the 1st time that it is used
  - Be consistently used thereafter

  E.g. The Annual Financial Statements (“AFS”), or Big Fish (Pty) Ltd (“Big Fish”) or the Income Tax Act No 58 of 1962 (“The Income Tax Act”)

The facts

- Reproduce the SARS questions in point form.
- Contextualise these questions with accurate facts in a logical and understandable way.
- When responding to SARS audit findings, evaluate whether the potential dispute is a question of law or a question of fact.
- Avoid assumptions. Only communicate verifiable facts.
- If the facts are dependant on the verbal submissions of a taxpayer (e.g. the “intention” of a taxpayer, then explore of there are any surrounding evidence that will support the *ipse dixit* of the taxpayer.

Responses and the law

Responses to audit findings/requests for information

- Be specific to the question in your response.
- If the SARS finding is ambiguous, first obtain clarity before responding.

The law

The law will generally have sub-headings e.g.:

- The Income Tax Act
- Relevant Case Law
- SARS Guides and Binding Rulings
- There is no prescribed format how to respond to SARS, but the general “rule of thumb” is to put yourself in the position of the SARS official when reading through your response and assuming that that SARS would use any opportunity to deny a tax deduction or include an amount in gross income.

The Tax Faculty

Lodging an objection

Introductory comments

The objective when submitting an objection to an assessment is different from a situation where one needs to issue an opinion or when one responds to a RFI.

When preparing the objection, please consider the following:

- The objection is prepared from the perspective of the taxpayer. ***It does not represent your personal opinion***. The wording in the objection must reflect this. (NOTE: Even if you disagree with the position of the taxpayer, you can still prepare the objection with grounds and reasons that supports the taxpayer's viewpoint.) It is strongly advisable to inform the taxpayer whether you believe that his chances for success is weak, moderate or strong. You should also advise him/her of the process going forward should SARS deny the objection.
- Respond comprehensively and truthfully to the **specific issue** under dispute.
- Do not address anything outside the scope of the additional assessment.
- Ensure that the document is self-standing. It forms the foundation of the dispute resolution process. The taxpayer is prohibited to add any further grounds of objection if this matter were to proceed to court.

Introductory comments

- Assume that this matter will proceed to court of law and prepare it in such a manner that you will be satisfied that it can be scrutinised in a court of law and become public knowledge.
- Confirm the contents of the objection with the client before sending it to SARS.
- NB – address every single item on the assessment separately. E.g:
  - The additional income
  - Understatement penalty
  - The Section 89quat(2) interest.
- If the candidate fails to object separately to this, then one will be precluded to do so at a later stage.
- If you believe that the topic is sufficiently contentious so that it will escalate to a court of law, advise the client that Senior Counsel should be consulted before making submissions. Since Senior Counsel will need to represent the Taxpayer in a court of law, it would be advisable to obtain such guidance as early as possible.

Layout

Assume that the SARS committee that will consider the merits of the objection knows nothing of the client's business and/or industry. This assumption becomes increasingly important as the case may proceed through the dispute resolution process. Extra care should be taken to explain the background to the client's business and to provide context to transactions concluded.

- The layout of the document must be:
- Logical
- Have appropriate headings
- At the minimum cover the following:
  - Background information to the Taxpayer. What industry, what business etc.
  - The facts as specifically confirmed by the client.
  - Details of the specific item under dispute.
  - The law
    - The required sections
    - Appropriate case law
    - Appropriate guidance by SARS
  - Application of the law to the facts

Language

In the context of an “objection” the language is critically important.

- The manner in which the argument is submitted must be convincing, eloquent and professional.
- Great care must be taken with the language so that it presents the argument of the taxpayer in a convincing, elegant and eloquent manner.
- This is important as it will positively influence the SARS committee as to the bona fides of the taxpayer and that the taxpayer has reasonable grounds supporting any tax positions taken.
- It is critically important to use clear and concise language when preparing the objection. SARS will interpret ambiguous statements to favour SARS and not the taxpayer.
- A court of law will furthermore highlight ambiguous language and since the onus to prove that an amount is not taxable rests on the taxpayer, will interpret ambiguous language to the detriment of the taxpayer.

Language

The following should be considered:

- Avoid using long sentences.
- Avoid long paragraphs
  - Make use of bullets or sub numbering
- Ensure that the headings and sub paragraphs are suitably numbered.
- Use “professional” language.
  - Avoid words such as “think”, “like”.
  - Avoid complex terms.
  - Preferably use “everyday language” but avoid “slang”.
- The language must be free of ambiguity.
- If you make use of abbreviations, then it should
  - Be defined the 1st time that it is used
  - Be consistently used thereafter
- E.g. The Annual Financial Statements (“AFS”), or Bad Karma Luxury Lodge (Pty) Ltd (“Bad Karma”) or the Income Tax Act No 58 of 1962 (“The Income Tax Act”)

The facts

- Reproduce the “reasons of assessment” by SARS in point form.
- Contextualise these questions with accurate facts in a logical and understandable way.
- When preparing an objection, evaluate whether the dispute is a question of law or a question of fact.
- Avoid assumptions. Only communicate verifiable facts.
- If the facts are dependant on the verbal submissions of a taxpayer (e.g. the “intention” of a taxpayer, then explore of there are any surrounding evidence that will support the *ipse dixit* of the taxpayer.

The law

The law will generally have sub-headings e.g.:

- The Income Tax Act
- Relevant Case Law
- SARS Guides and Binding Rulings

There is no prescribed format how to submit the objection to SARS, but the general “rule of thumb” is to put yourself in the position of the SARS official or the judge of a tax court when reading through your response and assuming that that SARS would use any opportunity to deny a tax deduction or include an amount in gross income.

The Tax Faculty

Request for reasons: Template letter

Request for reasons: The law

Government Notice 550 as published in Government Gazette 37819

Definitions

"day" means a "business day" as defined in section 1 of the Act;

6. Reasons for assessment

(1) A taxpayer who is aggrieved by an assessment may, prior to lodging an objection, request SARS to provide the reasons for the assessment required to enable the taxpayer to formulate an objection in the form and manner referred to in rule 7.

(2) The request must-
   (a) be made in the prescribed form and manner;
   (b) specify an address at which the taxpayer will accept delivery of the reasons; and
   (c) be delivered to SARS within 30 days from the date of assessment.

(3) The period within which the reasons must be requested by the taxpayer may be extended by SARS for a period not exceeding 45 days if a SARS official is satisfied that reasonable grounds exist for the delay in complying with that period.

(4) Where a SARS official is satisfied that the reasons required to enable the taxpayer to formulate an objection have been provided, SARS must, within 30 days after delivery of the request, notify the taxpayer accordingly which notice must refer to the documents wherein the reasons were provided.

(5) Where in the opinion of a SARS official the reasons required to enable the taxpayer to formulate an objection have not been provided, SARS must provide the reasons within 45 days after delivery of the request for reasons.

(6) The period for providing the reasons may be extended by SARS if a SARS official is satisfied that more time is required by SARS to provide reasons due to exceptional circumstances, the complexity of the matter or the principle or the amount involved.

(7) An extension may not exceed 45 days and SARS must deliver a notice of the extension to the taxpayer before expiry of the 45 day period referred to in subrule (5).

Request for reasons: The law

Government Notice 550 as published in Government Gazette 37819

7. Objection against assessment

(1) A taxpayer who may object to an assessment under section 104 of the Act, must deliver a notice of objection within 30 days after-

(a) delivery of a notice under rule 6(4) or the reasons requested under rule 6; or

(b) where the taxpayer has not requested reasons, the date of assessment.

Extracts from SARS website

How should I request reasons?

There are two options:

- Electronic Request for Reasons for assessments: SARS has an electronic Request for Reasons process via eFiling and the SARS branches for Personal Income Tax (PIT), Company Income Tax (CIT), Value-Added Tax (VAT) and Pay-As-You-Earn (PAYE).
- Manual Request for Reasons for assessments or decision taken: A manual process for Request for Reasons or decision taken exists for all other taxes or decisions taken. The taxpayer must submit a letter detailing the request and adhere to the requirements mentioned above. The request must be submitted via post, submitted at a SARS branch or email it to SARS.

Request for reasons: Template letter

The South African Revenue Services

Taxpayer Name and Tax Reference Number

We refer to the notice of assessment issued to [**taxpayer name and tax reference**] dated [**date must be within 30 business days of date of assessment**] of which a copy is attached as Annexure A for your convenience. Please find attached as Annexure B a duly completed Power of Attorney from the taxpayer authorising us to act on its behalf in lodging an objection against this assessment.

We submit that the grounds provided in the assessment do not sufficiently enable us to understand the basis of the assessment and to formulate an objection against the said assessment. In terms of Rule 6 of Government Notice 550 as published in Government Gazette 37819, the taxpayer is entitled to, "*prior to lodging an objection, request SARS to provide the reasons for the assessment required to enable the taxpayer to formulate an objection in the form and manner referred to in rule 7.*"
We kindly request SARS to provide said reasons for the assessment within 45 days of the date of delivery of this letter.

Upon receipt of the required reasons for assessment we record our intention to deliver a notice of objection within 30 business days after the date of delivery of the reasons requested under rule 6. (Refer Rule 7 of Government Notice 550).

Please do not hesitate to contact the undersigned should you require any additional information.

Kind regards

Name of Tax Practitioner
Tax Practitioner Ref Number

The Tax Faculty

Lodging an objection: Rules and Template letters

Lodging an objection: The law

Government Notice 550 as published in Government Gazette 37819

7. Objection against assessment

(1) A taxpayer who may object to an assessment under section 104 of the Act, must deliver a notice of objection within 30 days after-
  (a) delivery of a notice under rule 6(4) or the reasons requested under rule 6; or
  (b) where the taxpayer has not requested reasons, the date of assessment.

(2) A taxpayer who lodges an objection to an assessment must-
  (a) complete the prescribed form in full;
  (b) specify the grounds of the objection in detail including-
    (i) the part or specific amount of the disputed assessment objected to;
    (ii) which of the grounds of assessment are disputed; and
    (iii) the documents required to substantiate the grounds of objection that the taxpayer has not previously delivered to SARS for purposes of the disputed assessment.

Lodging an objection: The law

Extract from the guide on the rules promulgated in terms of Section 103 of the Tax Administration Act issued by SARS

6.5. When will an objection be valid?

Under section 107(1) SARS must consider a valid objection in the manner and within the period prescribed under the TA Act and the rules. The requirements for a valid objection under rule 7(2) are as follows:

The objection must be made in the prescribed form (ADR1 / NOO) with the information requested in the form completed

The taxpayer must specify in detail the grounds upon which the objection is made, including—

- the part or specific amount of the disputed assessment objected to;
- which of the grounds of assessment are disputed;
- the documents required to substantiate the grounds of objection that the taxpayer has not previously delivered to SARS for purposes of the disputed assessment

Contrary to the old rules, a power of attorney is not required from a person who signs an objection on behalf of the taxpayer.

The Tax Faculty

Lodging an objection: Template letter

The South African Revenue Services
By eFiling

Taxpayer Name and Tax Reference Number
We refer to the notice of assessment issued to [**taxpayer name and tax reference**] dated [**date must be within 30 business days of date of assessment or from the date that SARS provided reasons for the assessment i.t.o. Rule 6 of Public Note 550**] of which a copy is attached as Annexure A for your convenience.

We also refer to the Notice of Objection (NOO1) form duly completed on eFiling. The purpose of this letter is to provide the reasons and grounds for the objection and should be regarded as an integral part of the N001 form submitted on efiling.

Background facts

An additional assessment was issued by SARS on [**date**]. This additional assessment was issued subsequent to a formal audit conducted by SARS and is issued in terms of the letter of audit findings dated [**insert date]**. **[If SARS provided reasons for the assessment in terms of Rule 6 of Public Note 550, please refer to these reasons].**

The subject matter of the dispute is as follows:
[Provide the background to the dispute. E.g. the company is engaged in the construction industry and SARS disputes a S24C claim, or the company received income subject to the Consumer Protection Act that SARS regarded as taxable.]
[If there is a dispute in facts, use this opportunity to highlight the difference in facts as described in the SARS letter of audit findings or the SARS reason for assessment.]
[Top Tip: Be specific to the matter under dispute. Do not deviate to matters that are not being assessed by SARS. Make sure all information is True, Helpful and Relevant]

Lodging an objection: Template letter

Summary of items under dispute

[Summarise the specific items in the additional assessment that is being disputed. E.g. specifically state if the taxpayer accepts the revised normal tax assessment but only disputes the levy of understatement penalty.]

On behalf of the Taxpayer, with respect to the [XXX] year of assessment, we formally object against the following:

- The inclusion of an amount of Rx in the taxable income in terms of section [x] of the Income Tax Act.
- The inclusion of an amount of Rx as a Capital Gain in terms of par [x] of the 8th Schedule to the Act.
- The levy of an understatement penalty of Rx in terms of section 222 of the Tax Administration Act.
- The levy of interest on the underpayment of provisional tax of Rx in terms of section 89quat of the Income Tax Act.
- The levy of an underestimation penalty of Rx in terms of par 20 of the 4th Schedule to the Income Tax Act.

The law

[Provide the sections in the Act that applies to the matter under dispute. Also add any additional information that supports the legal contentions made by the taxpayer, e.g. case law, Advance Tax Rulings, Foreign Case law etc.]

Application of the law

[**Apply the law to the Taxpayers specific situation. Highlight areas in law or in facts where the taxpayer disputes any SARS contentions.**]

Lodging an objection: Template letter

Summary

In summary, we kindly request that SARS allows the following objections:

[Repeat the specific items on the tax assessment being objected to and summarise in a sentence the grounds on which the objections are based.]

[Top Tip: Once the objection letter is completed, reconsider if the grounds of objection are complete. One is precluded from adding further grounds of objections on appeal. Also ensure that the language used is clear and not subject to misinterpretation.]

Please do not hesitate to contact the undersigned should you require any additional information.

Kind regards

Name of Tax Practitioner
Tax Practitioner Ref Number

DISCLAIMER:

Nothing in this presentation should be construed as constituting tax advice or a tax opinion. An expert should be consulted for advice based on the facts and circumstances of each transaction/ case. Even though great care has been taken to ensure the accuracy of the answer, neither SAIT nor The Tax Faculty accept any responsibility for consequences of decisions taken based on this query and answer. It remains your own responsibility to consult the relevant primary resources when taking a decision.

The Tax Faculty