

tax happy hour



Pitfalls and opportunities ITR 14

28 October 2021

PRESENTED BY

Kreston South Africa

- Johan Heydenrych: Director Tax Services
- Marina Pretorius: Associate Director: Tax Services



RCB STATUS

SAIBA is now an
Recognised Controlling
body (RCB)



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qualification and
experience



LICENSE

Perform an
assessment.



BENEFITS

> 12 unique benefits

Read more here

<https://saiba.org.za/licenses/tax-practitioner>

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- 10 **Discounted Tax Practice Software**
- 11 **Discounted Tax Textbook**
- 12 **SARS Webinars**

Support Tools to make your work easier

TAX WORKING GROUP

Krigan Naicker



Siphethuxolo Didiza
BAP(SA)



Barend van der Westhuizen
BAP(SA)



Marius Kotze
BAP (SA)

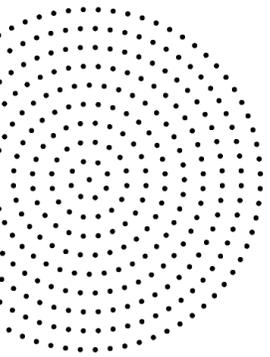


Tania Lee
SAIBA



Ilana de Jager
SAIBA Academy





ABOUT THE PRESENTERS

Johan Heydenrych

Kreston South Africa

Johan is a Chartered Accountant who specialised in taxation since 1991. He holds the following qualifications:

- B. Com (Accounting) (Cum Laude)
- B. Com (Accounting) (Hons) (Cum Laude) (Award: "Best student in Audit 700")
- Certificate in the Theory of Accounting
- M. Com (Taxation) (Cum Laude) (Award: "Best M. Com (Tax) student")
- Chartered Accountant (Specialising in Taxation)
- Member of SAICA
- Registered Tax Practitioner

Johan was a tax partner at KPMG from 1997 to 2020 and is currently a partner in the Kreston SA network specialising in taxation.

He provides a wide range of tax services to various clients across industries. These include but are not limited to the following:

- Advice on Tax Risk Management and Tax Governance.
- Tax compliance services including but not limited to ITR 14 and IT 14SD
- Dealing with tax disputes including representing clients at Alternative Dispute Resolution (ADR) hearings.
- Submission of documentation and revised returns under the Voluntary Disclosure Programme.
- Issuing of tax technical opinions on Income Tax, VAT and PAYE. This include preparing briefs to Senior Counsel and submissions of requests for Binding Opinions from SARS.
- Audit support services that includes Normal Tax and Deferred Tax disclosure and disclosure of uncertain tax positions.
- Assistance with implementation of tax reporting for new accounting standards such as IFRIC 23, IFRS 9, IFRS 15 and IFRS 16.
- Facilitation of tax diagnostic sessions with existing and prospective clients.
- Advice on mergers, acquisitions and reorganizations.
- Tax due diligences
- Advice on tax implications of recapitalization transactions, debt restructures, liquidations and deregistration's



ABOUT THE PRESENTERS

Marina Pretorius

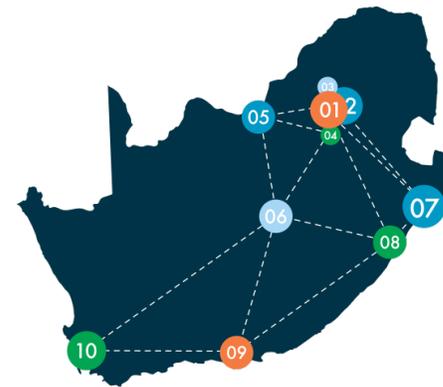
Kreston South Africa



- Marina joined the Kreston Pretoria team on 1 March 2021 after specialising in tax at KPMG for the last 13 years. She is an experienced tax advisor who holds an H. Dip(Tax) Degree. She completed her articles at Deloitte where she also passed the CA(SA) qualifying examination.
- She worked in the UK on large listed clients for 2 years and joined KPMG tax department in 2007.
- As Associate Director and head of KPMG's Global Compliance Managed Services business unit, she is very experienced in tax and accounting reporting requirements for large multi-nationals.
- This includes ITR 14 disclosures required for multi-nationals as well as submissions of CbC Reports, Master Files and Local Files.

Education and Qualifications

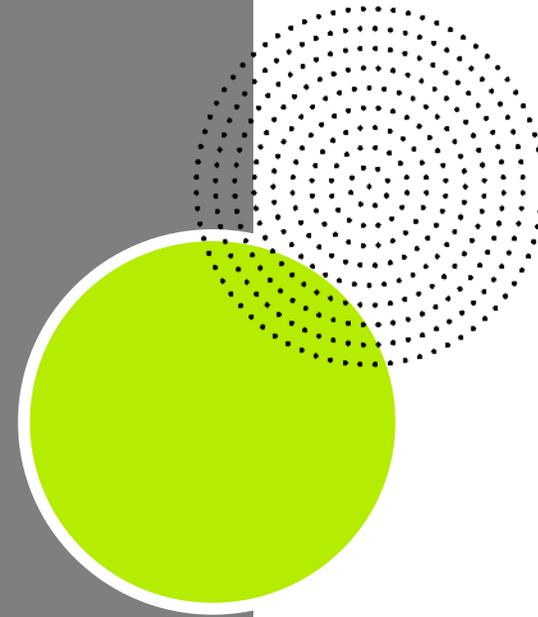
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- H.Dip (Tax)
- Registered Tax Practitioner



**KRESTON SA
HAS MORE
THAN 300 STAFF
IN 10 OFFICES
COUNTRYWIDE
SERVICING ALL
OF THE MAJOR
SECTORS**

TAX HAPPY HOUR INDEX

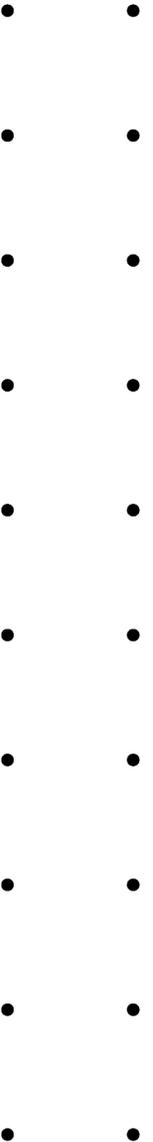
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1.

Introduction

tax happy hour



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.”

SARS vs the Taxpayer

SARS success
rate in SCA over
past 3 years is
80!
SARS is winning
the battle....

**COLD
WAR**

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

The purpose of this presentation is to highlight pitfalls and opportunities in preparing the ITR 14 so that costly disputes with SARS does not arise

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 rules

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
- Contracts
- AFS
- Standard policies and procedures

Protection found in S223 opinions

Preventative approach to tax risk management



The Taxpayer who does not adopt a robust system of defence is exposed to attacks by SARS. SARS is furthermore investing significantly in data analytical capabilities and 3rd party disclosures, making “hiding under the radar” virtually impossible.

2.

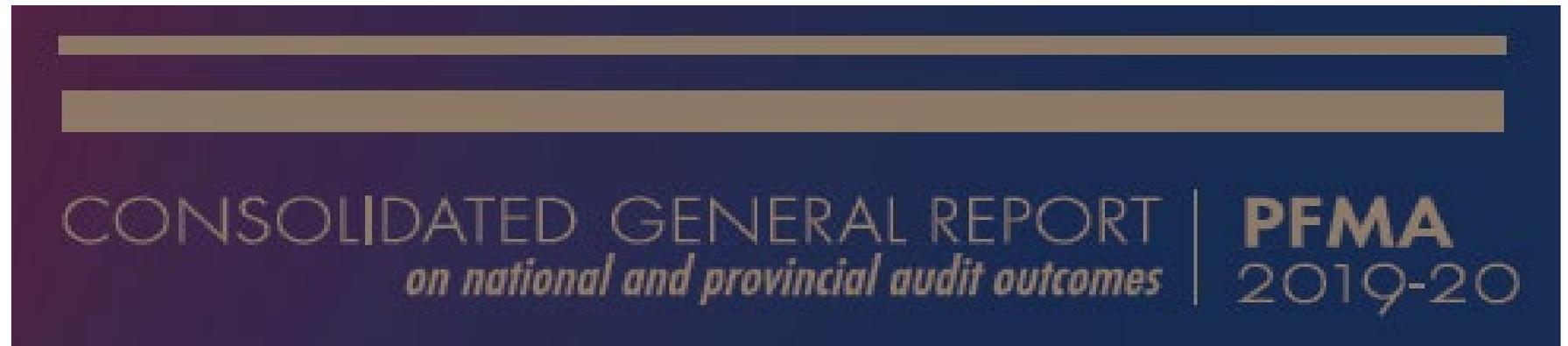
What is Tax Morality

Tax morality – the willingness of individuals to pay their taxes and comply with tax laws.

Samantha du Chenne, freelance writer



Report from the Auditor General



Tsakani Maluleke 31/03/2021

Tsakani Maluleke
Auditor-General

OVERALL AUDIT OUTCOMES

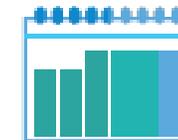
OVERALL IMPROVEMENT IN
AUDIT OUTCOMES

66 Improved
35 Regressed

DEPARTMENTS **30** Improved
10 Regressed

PUBLIC ENTITIES **36** Improved
25 Regressed

Outstanding audits



The audits of **44** auditees had not been finalised by 30 November 2020

Source: <https://www.agsa.co.za/Reporting/PFMAReports/PFMA2019-2020.aspx>



Unauthorised, irregular, and fruitless and wasteful expenditure (UIFW)

The figures for UIFW are inclusive of outstanding audits

Irregular expenditure

R54,34 billion

(2018-19: R66,90 billion)

Unauthorised expenditure

R18,12 billion

(2018-19: R1,65 billion)

Fruitless and wasteful expenditure

R2,39 billion

(2018-19: R2,36 billion)

MATERIAL IRREGULARITIES (MIs)

By 28 February 2021, we had notified accounting officers and authorities of **75** MIs.

R6 851 067 257 estimated financial loss

Nature of material irregularities



Procurement

Non-compliance in procurement processes resulting in overpricing of goods and services procured
27 MIs (14%) – R983 million estimated loss

Non-compliance in procurement processes resulting in appointed supplier not delivering
2 MIs (32%) – R2 221 million estimated loss

Expenditure management



Payment for goods or services not received or of poor quality
24 MIs (21%) – R1 447 million estimated loss

Invoices or claims not paid on time resulting in interest or penalties
11 MIs (2%) – R151 million estimated loss

Revenue management



Revenue not billed
2 MIs (10%) – R666 million estimated loss

Debt not recovered
2 MIs (16%) – R1 096 million estimated loss

Resource management



Inefficiencies – no benefit derived from cost
6 MIs (4%) – R285 million estimated loss

Assets not safeguarded resulting in loss
1 MI (< 1%) – R1,5 million estimated loss

By 28 February 2021, we had notified accounting officers and authorities of auditees selected for our phased-in approach of **75 material irregularities**. They all related to non-compliance with legislation that resulted in a material financial loss. We estimate the financial loss associated with these material irregularities to be R6,9 billion. We included detailed information on 45 of these material irregularities in the audit reports and also discuss them in this report to enable monitoring and oversight. The remainder will be reported in the 2020-21 audit reports.



T Maluleke 31/03/2021

Tsakani Maluleke
Auditor-General

Overall, 69% of the auditees materially did not comply with legislation. This outcome is only slightly better than the 73% of the previous year.

One of the root causes is "Inadequate consequences for poor performance and transgressions"

In the Free State report:

A culture of no consequences has been created through the political and administrative leadership's inability to implement consequence management for the pervasive non-compliance with legislation. Thus, the environment was vulnerable to misappropriation, wastage and the abuse of state funds.

There should be urgency in dealing with the material irregularities to prevent further wastage, recover money and effect consequences for wrongdoing – all role players should thus work together to ensure the swift resolution of these matters.

If consequences for accountability failures are required, these must be effected swiftly, bravely and consistently.

The average law abiding citizen in South Africa is rightfully asking:

"How can Government expect me to comply with legislation, when Government itself, on own admission, without any adverse consequences, continuously and materially does not comply with legislation?"

Compliance out of a sense of “tax morality” vs Compliance out of “fear for consequences”



Source: <https://www.sars.gov.za/media-release/racehorse-administrator-sentenced-to-10-years-for-vat-fraud-and-theft/>

Pretoria, Thursday 1 October 2020 – *The South African Revenue Service (SARS) welcomes the sentencing of a businesswoman to an effective 10 years imprisonment for submitting fraudulent claims for Value-Added Tax (VAT).*

“SARS is deeply committed to uproot criminality especially as it relates to tax related matters. I am glad that the courts are taking these crimes seriously and handing down these severe sentences. Taxpayers need to understand that they will not get away with defrauding SARS which is in effect a crime against the poor and vulnerable in our society who depend on state assistance.

“My sincere thanks must go to our investigators who put their skills to work in order to expose such blatant and criminal abuse of VAT. If it were not for their dedication and persistence we would not be able to prosecute these criminals who lack any sense of morality or integrity.”

He said individual taxpayers who need to file income tax returns as part of Filing Season need to take note that SARS will not tolerate any attempt to defraud the people of South Africa.

Furthermore, SARS will continue to provide clarity and certainty to taxpayers in order to meet their obligations by making it easy for them to comply. Equally, it will make it hard and costly to those who are determined to engage in criminal malfeasance.

2016

Budget Speech

Check against delivery

South Africa has built one of the most effective tax authorities in the developing world.

The Revenue Service has made huge strides over the past decade in enforcing the law while providing assistance to small businesses and individuals.

Public compliance with tax obligations is high.

Pravin Gordhan

Minister of Finance

I am deeply mindful that we have a corresponding obligation, as government, to improve the impact of every rand spent, and to eliminate waste and corruption.

24 February 2016



- South Africans have the obligation to pay taxes.
- Government has the obligation to spend such public monies wisely



The art of taxation consists in so plucking the goose as to obtain the largest number of feathers with the least amount of hissing.

Louis XIV's Finance Minister,
Jean-Baptiste Colbert

It seems that, in South Africa, people generally comply with tax laws out of fear for the consequences of non-compliance and not out of a moral sense of "it's the right thing to do..."

The vast majority of South African citizens abides with the tax laws.

But, perhaps Government should expect less "hissing" from taxpayers if the monies collected are spent wisely and the recommendations of *inter alia* the AGSA are taken seriously.



3.

Commonly Found Misconceptions

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Commonly found misconceptions

Erroneous statement	Reason
<p>I can rely on the tax computation prepared by the client for AFS purposes and audited by the external auditor.</p>	<ul style="list-style-type: none">• The objective of the audit is to ensure that the AFS are “reasonably” stated.• The audit is completed with “materiality” in mind.• The auditor is concerned with the net effect between current and deferred tax.• The audit is often completed immediately after year-end and incomplete information is available.• ITR 14 requires complete and accurate disclosure of current tax only. Materiality is not relevant.• The auditor relies on the work done by the Tax Practitioner in preparing an audit opinion (especially with regards to prior year tax computations) – The Tax Practitioner cannot rely on the auditor – since this is outside the scope of the audit.



Commonly found misconceptions

Erroneous statement	Reason
Make full disclosure and SARS can decide whether to accept or not.	<ul style="list-style-type: none">• The ITR 14 is effectively a “self-assessment system”• The Tax Practitioner must have the ability to identify any tax position and evaluate whether or not it will be defensible if queried by SARS.• The rationale behind understatement penalties is that the taxpayer and tax practitioner will make concerted effort and take due care when completing the ITR 14.



Commonly found misconceptions

Erroneous statement	Reason
Tax compliance is simply an administrative function to be completed by inexperienced staff	<p>The person completing the tax return must have the following specialist skills:</p> <ul style="list-style-type: none">• Strong accounting skills – the gap between IFRS and Tax Accounting is increasingly becoming larger. E.g. Straight lining of leases, Share Based Payments, Business Combinations etc.• Strong broad-based tax skills – Each Tax Return effectively requires a mini “Tax Due Diligence” to be prepared in order to identify tax critical items.• Solid understanding of Dividend Tax, Interest WTH Tax, PAYE and VAT principles. The interaction between various taxes is extremely relevant. IT14SD’s are becoming the rule instead of the exception. E.g. Transactions between connected parties may hold VAT and PAYE implications. Loans to shareholders and group companies may give rise to Dividend Tax concerns.



Commonly found misconceptions

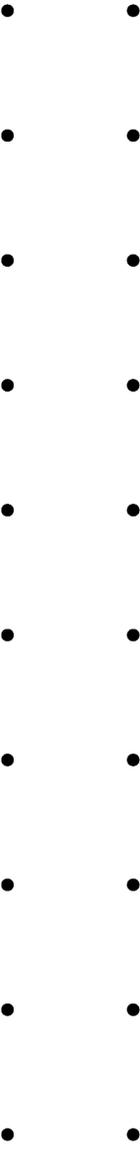
Erroneous statement	Reason
<p>The Tax Practitioner will not be held liable if the Tax Return is incomplete or inaccurate.</p>	<ul style="list-style-type: none">• Where SARS levies a penalty on the grounds that “<i>Reasonable care not taken in completing return</i>” then the client may potentially hold the Tax Practitioner Liable for interest and penalties – subject to engagement letter limitations. This may lead to reputational damage to the individual, his/her employer and SAIBA.• Section 241 (2) of TAA: “A senior SARS official may lodge a complaint with a ‘recognised controlling body’ if a registered tax practitioner has, in the opinion of the official <i>without exercising due diligence</i> prepared or assisted in the preparation, approval or submission of any return, affidavit or other document relating to matters affecting the application of a tax Act;

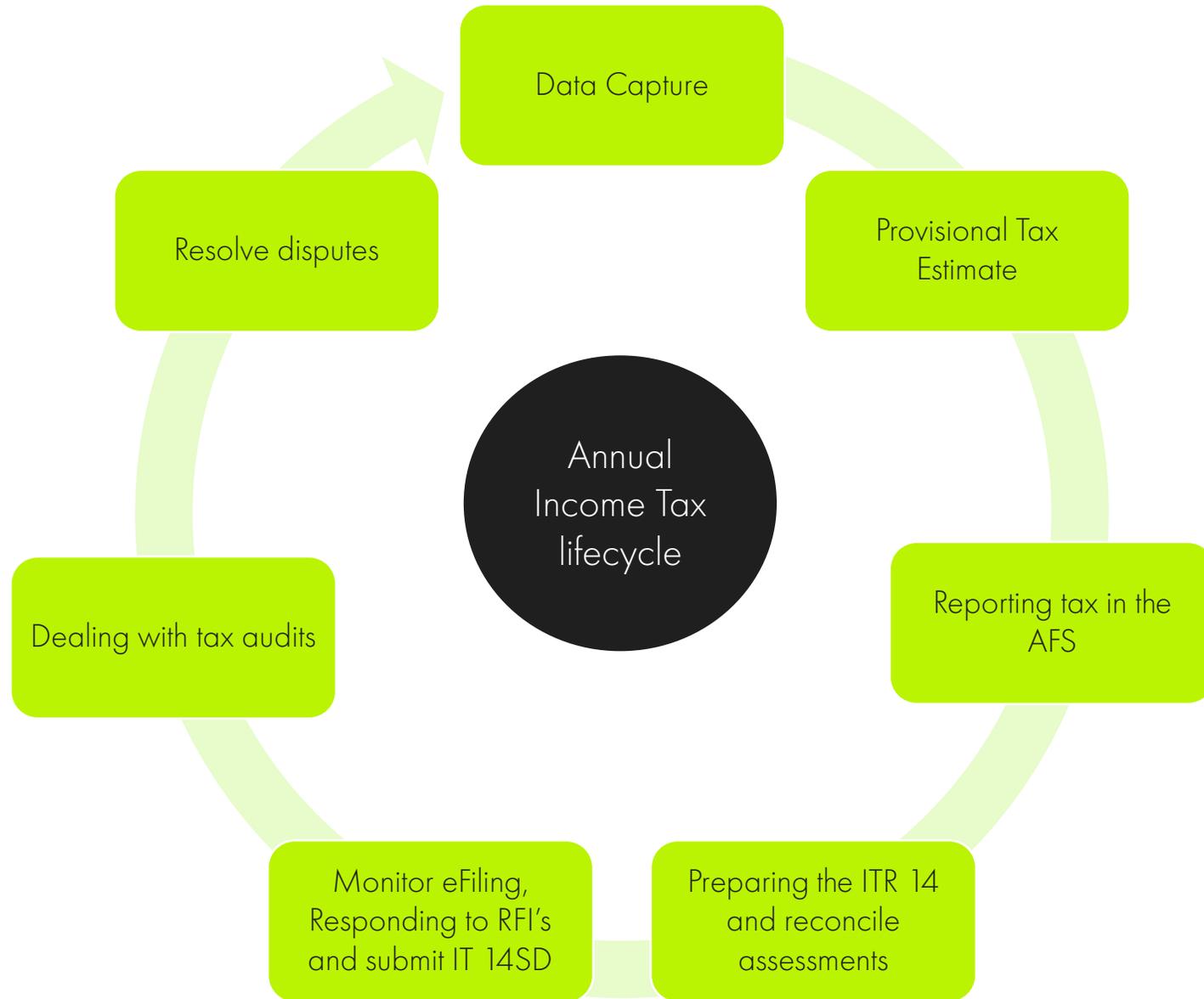


4.

The Income Tax Lifecycle

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Annual Income Tax lifecycle

Data Capture

- Ensure tax impact of data is captured accurately
- ERP system to be set up in such a manner to facilitate ITR 14 preparation
- ID tax critical information
- ID IFRS adjustments
- Most of this is done by the "shadow tax team"

Resolve disputes

- Know your rights and obligations to the TAA
- Request Reasons for Assessment
- Know when to seek SC support

Provisional Tax Estimate

- Estimations to be robust
- Procedures to be ensure compliance with S19(3)
- Mitigate risk of understatement penalties

Reporting tax in the AFS

- Normal tax and deferred tax
 - SOCI & OCI
 - SOFP and Equity
- Proof of deferred tax
- PY adjustments
- New IFRS e.g. IFRS 9, IFRS 15 and IFRS 16
- Consider IFRIC 23
- Contingent Liabilities
- Assets and Liabilities

Dealing with tax audits

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

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

- Anticipate IT 14SD when setting up ERP system, disclosing tax in AFS, preparing ITR 14, VAT 201 and EMP 201.
- Monitor eFiling to ensure RFI's received and responded to.
- 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

Preparing the ITR 14 and reconcile assessments

- Recon to AFS (also proof of deferred tax)
- Identify tax uncertain positions
- Mitigate risk of understatement penalties – S223 opinions
- Complete and accurate information forms foundation of ITR 14
- Ensure ancillary information complete e.g. transfer pricing, IT 10B, S18A certificates, Learnership allowances, CbC, Master File, Local File
- External review where appropriate.

5.

Phased Approach to the ITR14 Preparation

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Phased approach to ITR 14 preparation

Phase	Description
1: Understanding client's business and industry.	<ul style="list-style-type: none"> • Anticipate Tax adjustments. • Anticipate accounting approach followed in AFS • Identify areas where Tax Rulings were issued. • Advise client to consult Tax Practitioner BEFORE major transactions are concluded – Tax Rulings vs Tax Opinions.



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2: Information gathering.	<ul style="list-style-type: none"> • Requesting and collecting required information timeously and in an appropriate format expedites the ITR 14 process. • It is strongly advised that a comprehensive well laid out tax pack be developed that contains detailed information of all tax critical items. These include but are not limited to the following: Detailed TB with explanations, Detailed tax asset register, legal fees, consulting fees, section 24C, Section 6quat etc.



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3: Critical and objective analysis of information.	<ul style="list-style-type: none"> • Analysing and interpretation of information. • Draft preparation of Tax computation. • Prepare draft tax computation and compare to that used in AFS. (Normal and Deferred Tax) • Identification of tax critical items, tax uncertain positions and tax aggressive positions. • If applicable, prepare register of Tax Uncertain Positions for IFRIC 23. • DO NOT file return if the above has not been satisfactorily addressed!!



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4: Tax computation and supporting Working Papers	<ul style="list-style-type: none"> • Preparing supporting working papers • Completion of draft ITR 14. • Anticipate SARS audit and the request for an IT 14SD.



Phased approach to ITR 14 preparation

Phase	Description
5: Tax opinions and tax rulings	<ul style="list-style-type: none">• Consider section 223 opinions for any Tax Positions Taken.• “More likely than not” obtained before ITR 14 is “due”.• SARS may not levy understatement penalties.• Note: Ensure person who issued the opinion is suitably qualified and that the assumptions aligns with the reality. Often, the opinion is subject to inaccurate assumptions. Critically review opinion – do not simply accept opinion!



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6: Formal communication	<ul style="list-style-type: none"> • Issue formal report to taxpayer client. • If Tax Practitioner is part of the external auditing firm, communicate to external auditor. • Obtain formal sign-off from taxpayer who understands tax positions.



Phased approach to ITR 14 preparation

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7: eFiling	<ul style="list-style-type: none"> • Submissions of ITR 14 and comparing with ITA 34 assessments. • Ongoing monitor of statement of account and emails for queries, disputes. • Ongoing check of Tax Clearance position.

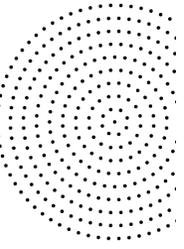


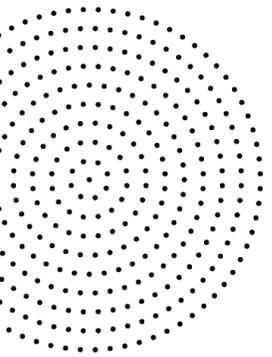
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8: Tax Disputes and Tax Audit	If applicable – manage tax disputes including requests for refunds under section 190 of the Tax Administration Act.



End-to-end process – ITR 14 process





- If the taxpayer follows the above process, it is highly unlikely that SARS will raise a query on a topic that has not been anticipated by the Taxpayer.
- If the above process has been followed, it will be impossible for SARS to raise a 25% understatement penalty being "Reasonable care not taken in preparing the return".

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. (Defined as larger of 5% of tax properly chargeable or R1 m)

If the ITR 14 process is followed, SARS will have extreme difficulty to prove that "reasonable care was not taken in preparing the ITR 14"

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

The Tax Administration Act S222(1)

Understatement penalty.—

- In the event of an 'understatement' by a taxpayer,
- the taxpayer must pay, in addition to the 'tax' payable for the relevant tax period,
- the understatement penalty determined under [subsection \(2\)](#)
- unless the 'understatement' results from a *bona fide* inadvertent error.

The Tax Administration Act S223(3)

- (3) SARS must remit a 'penalty' imposed for a '**substantial understatement**' if SARS is satisfied that the taxpayer—
- (a) made full disclosure of the arrangement, as defined in section 34, that gave rise to the prejudice to SARS or the fiscus by no later than the date that the relevant return was due; and
 - (b) was in possession of an opinion by an **independent** registered tax practitioner that—
 - (i) was issued by **no later than the date that the relevant return was due**;
 - (ii) was based upon **full disclosure of the specific facts** and circumstances of the arrangement and, in the case of any opinion regarding the applicability of the substance over form doctrine or the anti-avoidance provisions of a tax Act, this requirement cannot be met unless the taxpayer is able to demonstrate that all of the steps in or parts of the arrangement were fully disclosed to the tax practitioner, whether or not the taxpayer was a direct party to the steps or parts in question; and
 - (iii) confirmed that the taxpayer's position is **more likely than not** to be upheld if the matter **proceeds to court**.
- '**substantial understatement**' means a case where the prejudice to SARS or the fiscus exceeds **the greater of five per cent** of the amount of 'tax' properly chargeable or refundable under a tax Act for the relevant tax period, or **R1 000 000**;

6.

Interpreting Annual Financial Statements

tax happy hour 



Interpreting AFS

- Before commencing with the tax return completion process, it is important to critically review the AFS with the view to identify potential risk areas and adjustments.
- AFS is a “language” – Understanding the “language” will assist in ID tax challenges/opportunities
- In addition to Integrated Report:
 - Speak to client
 - Review Website
 - Search for SENS announcements
 - Download Brochures

Interpreting AFS

Step 1:

Understand the industry:

- Each industry has its own tax challenges
- Most industries have tax specific legislation
- Most industries have tax rulings, interpretation notes, tax opinions relevant to the industry

Examples

- Retail
- Banking
- Short term and long-term insurance
- Mining
- Manufacturing
- Automotive industry
- Telecommunication

Interpreting AFS

Step 2:

Understand that AFS contains both financial and non-financial information:

- Report of the directors
- Report of the chairman
- Integrated report contains extensive non-financial information

Interpreting AFS

Step 3:

Identify any major events that may give rise to tax challenges:
(Examples)

- Proposed merger/acquisition/Unbundling/reorganisations
- Introduction of new shareholders
- Fraud
- Competition Commission investigations
- Significant investment in capital
- Raising of finance
- New acquisitions or disposals
- Disputes with 3rd parties (Commercial, Competition Commission, Customers, Shareholders, SARS, Foreign Entities)
- Change in accounting policies
- Restatement of prior years – fundamental errors

**The Balance Sheet and notes
thereto provide insight into:**

Potential apportionment issues (Loans incurred to acquire share investments)

Potential unproductive interest (Interest bearing loans incurred to fund interest free loans)

Potential Transfer pricing – Thin capitalization and interest free loans

Potential IFRS adjustments – e.g., Straight lining of leases, derivatives, fair valuations, Share Based payments (IFRS 6), Rehabilitation Provisions debited to Balance Sheet

Potential 24I(10A) adjustments on exchange items with connected parties reflected as non-current assets/liabilities

Potential PAYE and dividend tax issues (e.g., interest free loans made to shareholders and companies owned by shareholders)

Potential adjustments for leasehold improvements

Terms and conditions of loans and shares may lead to adjustments in terms of S8EA, S8E, S8F, S8FA.

The Income Statement and notes thereto provide insight into:

Non-deductible and non-taxable items e.g., dividends, penalties etc.

Adjustments reflected via OCI and Equity that may have a tax impact.

Potential apportionment issues – e.g., holding company that received interest, management fees and dividends from group companies.

Can provide insight as to whether or not the company is trading and assessed losses from prior years can be carried forward.

Interest paid to entities not subject to tax in RSA may give rise to Section 23M limitations

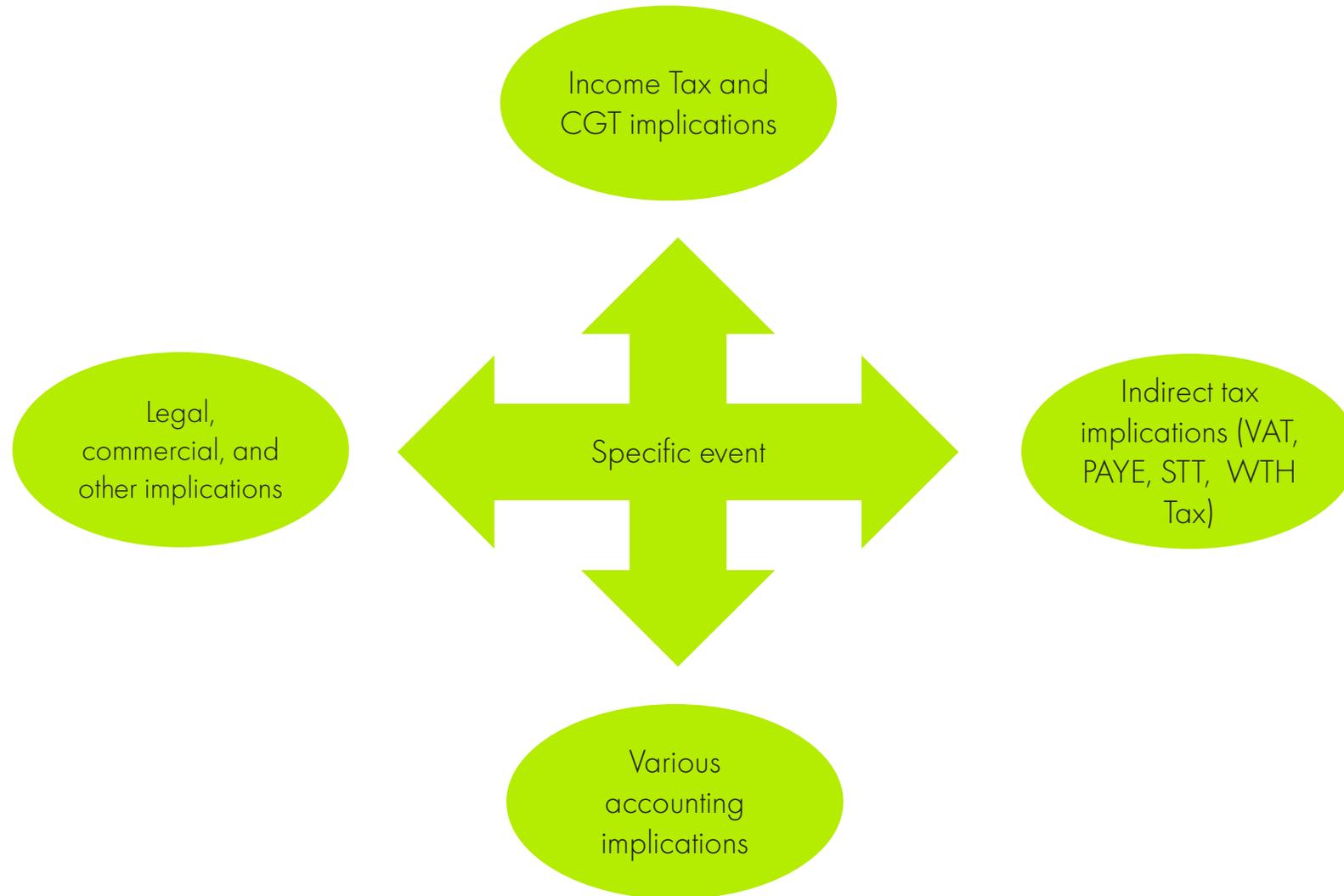
Notes and narrative provides insight

Normal tax and Deferred Tax notes

- Analysing the normal tax, tax rate recon and Deferred tax notes can provide insights into potential adjustments that are required.
- Prior year over/understatements should be compared to actual assessments.

Non- Income Tax

- The AFS may indicate non-income tax risks e.g., VAT, STT, Dividend Tax, PAYE, Royalty WTH Tax and non-RSA taxes.
- E.g., Supplies to connected parties may give rise to VAT risks
- Royalty payments to non-residents may give rise to WTH Tax and Transfer pricing risks

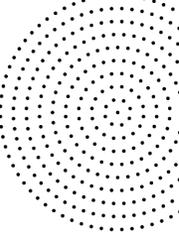


7.

General Deduction Formula

tax happy hour 





General Deduction Formula (S11 (a))

Carrying on a trade

Expenditure and losses

Actually incurred

During the year of assessment

In the production of income

Not of a capital nature

General deduction formula:

Not of a capital nature

- Expense to acquire/create an income producing asset or expense to work the asset
- Each item considered on merits of own case

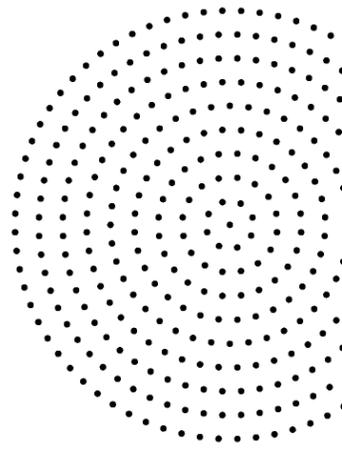
Some guidelines

- Enduring benefit?
- Add to "income earning structure"
- Once off expense from which future benefits will flow

Section 23B(3)

(3) No deduction shall be allowed under section 11 (a) in respect of any expenditure or loss of a type for which a deduction or allowance may be granted under any other provision of this Act, notwithstanding that—

- (a) such other provision may impose any limitation on the amount of such deduction or allowance; or
- (b) that deduction or allowance in terms of that other provision may be granted in a different year of assessment.



8.

Penalty, Fines & Corrupt Activities

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Section 23(o)

Section 23. Deductions not allowed in determination of taxable income.

No deductions shall in any case be made in respect of the following matters, namely— (o) any expenditure incurred—

- (i) where the payment of that expenditure or the agreement or offer to make that payment constitutes an activity contemplated in Chapter 2 of the Prevention and Combating of Corrupt Activities Act, 2004 (Act No.12 of 2004); or
- (ii) which constitutes a fine charged or penalty imposed as a result of an unlawful activity carried out in the Republic or in any other country if that activity would be unlawful had it been carried out in the Republic;

Interpretation Note 56

IN 56: Position of the recipient

- Despite section 23(o) denying a deduction to the payer, illegal contracts can in principle have fiscal consequences for the recipient.
- The only question as between the taxpayer and the *fiscus* is whether amounts received by or accruing to a taxpayer fall under the literal meaning of "gross income".

Conclusion IN 56

- Section 23(o) has put it beyond doubt that corrupt payments such as bribes, fines and penalties for unlawful activities are not deductible for income tax purposes.
- However, the deductibility of bona fide commercial penalties remains unaffected by the provision. Such commercial penalties are subject to the normal tests for deductibility under the general deduction formula.

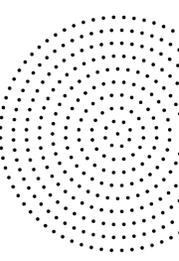
9.

Capital Allowances Introductory Comments

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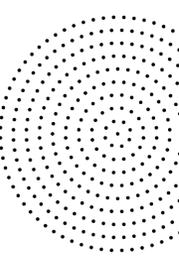


Summary: Capital allowances



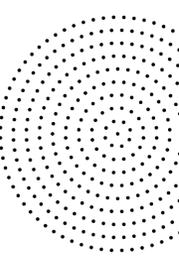
Section	Description	Summary of provisions
Section 11 (d)	Repairs	Cost to repair assets used by taxpayer in course of conducting a trade may be claimed when incurred.
Section 11 (e)	Wear and Tear Allowance	Allowance on assets not of permanent nature over useful life of the asset. Not available on section 12C assets. Interpretation Note 47 lists certain acceptable useful lives. Note that allowance under 11 (e) is based on value of asset and not cost.
Section 11 (f)	Lease Premium Allowance	Lease premium payable by lessee to lessor may be claimed over period of lease or 25 years (whichever is shorter). Deduction is only available if premium is included in income of lessor.
Section 11 (g)	Leasehold Improvements	Cost of leasehold improvements or amount of contractual obligation to effect leasehold improvements (whichever is lower) can be claimed over the period of the lease or 25 years (whichever is shorter) provided that the value of the leasehold improvements is included in the income of the lessor.

Summary: Capital allowances



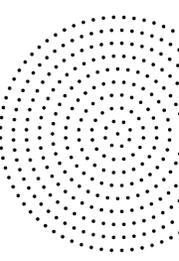
Sect 11(o)	Depreciable asset allowance	<p>Applies to alienation, loss or destruction (destroyed) of an asset</p> <ul style="list-style-type: none">• No allowance on land and buildings• Applies to machinery, plant etc that qualified for an 11(e), 12C, 12B, 12E, 14 or 14bis allowance AND the expected useful life (for tax purposes) did NOT exceed 10 years as determined on date of original acquisition.• At election of taxpayer• The allowance is the amount by which the cost of the assets exceeds the sum of allowances claimed and the proceeds on disposal.• Careful consideration when assets are taken out of production (i.e. mothballed).• Not available when sold to connected party
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Summary: Capital allowances



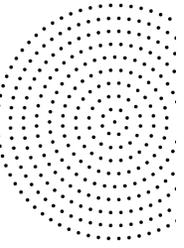
Section 11A	Pre-trade expenditure	<p>Expenditure and Losses incurred prior to commencement of trade may be claimed in full at commencement of trade provided that:</p> <ul style="list-style-type: none"> - The expenditure would generally have been allowable if it was incurred after trade commenced and; - The deduction is ringfenced to the income generated from that trade. Unutilised amounts are carried forward to the next year. <p>SARS practice (incorrect) not to increase or create an assessed loss)</p>
Section 11D	Research and development	<p>The section is complex but the following could be available:</p> <ul style="list-style-type: none"> - 150% allowance on revenue type R&D expenditure - A 50/30/20 allowance may be available on capital equipment and building used for R&D purposes. <p>Prior approval from Department of Science and Technology</p>
Section 12B	Farming and Renewable Energy allowance	<p>50/30/20 allowance available for</p> <ul style="list-style-type: none"> - certain farming equipment and - machinery, plant and equipment used for production of bio-fuel or bio-ethanol. - machinery, plant and equipment used for generation of electricity from wind, sunlight, gravitational water and biomass.

Summary: Capital allowances



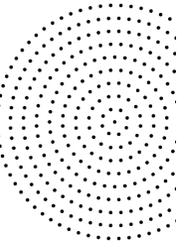
Section 12C	Manufacturing allowance	<p>Capital allowance on machinery, plant and equipment used in process of manufacture or similar process:</p> <p>40/20/20/20 for new and unused 20/20/20/20/20 for used.</p> <p>Allowance is not apportioned for part of the year</p> <p>From 1/1/2016 applies also to supplier tooling</p>
Section 12D	Oil pipelines, electricity transmission lines, telephone lines and railway lines	<p>Allowance available on new or unused assets and supporting structures.</p> <p>5% on electricity transmission lines, telephone lines and railway lines 10% on oil pipelines</p>
Section 12DA	Rolling stock	<ul style="list-style-type: none"> • Applies to any rolling stock brought into use from 1 January 2008 • Used directly by taxpayer wholly or mainly for the transportation of persons, goods or things • Allowance of 20% per annum
Section 12F	Airport and Port Assets	5% allowance available on certain specified assets.

Summary: Capital allowances

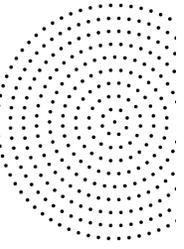


Section 12I	Additional investment and training allowance iro industrial policy projects	<p>ADDITIONAL investment allowances of 55% or 35% of cost of manufacturing assets. Limits are applicable for additional allowances e.g. maximum of R900m for project with preferred status or R550m for other projects. Maximum of R550m for brownfield project with preferred status or R350m for other brownfield projects apply.</p> <p>Additional training allowances up to R36k per employee is also available.</p>
Section 13(1)	Manufacturing building allowance	<p>5% allowance available on the cost of the building used in manufacturing process or process similar to manufacturing.</p> <p>This section is complicated and careful planning is required. Warehouses do not qualify but a building where more than 50% is used for manufacturing would qualify.</p> <p>Even where the investor does not own the land, he should still be able to claim the allowance as it is available on the "cost of a building" used for manufacturing purposes.</p> <p>Interaction between 11 (e) and 13(1) complicated.</p>

Summary: Capital allowances



Sect 13quin	Allowance	<p>5% allowance available to the "owner" of the building where construction, erection or installation commenced on or after 1 April 2007 and it was contracted for on or after that date.</p> <p>Interaction between 11 (e) and 13quin complicated.</p>
37B	Environmental expenditure	<p>New and unused environmental treatment and recycling assets an allowance of 40%/20%/20%/20%</p> <ul style="list-style-type: none"> • New and unused environmental waste disposal assets an allowance of 5% per year. • No apportionment required • To qualify the plant or equipment should be required by any law of the Republic for purposes of complying with measures that protect the environment



Other SARS Guidance



Interpretation Note 74: Deductions and recoupments of expenditure incurred on repairs



Binding General Ruling 7: Wear and tear or depreciable allowance



Interpretation Note 60: Loss on disposal of depreciable assets



Practice Note 42: Process of manufacture, process similar to manufacture and process not regarded as process of manufacture



Interpretation Note 47: Wear and tear or depreciable allowance

10.

Section 11 (e)

tax happy hour

Section 11(e) Wear and Tear Allowance

Allowance on assets not of permanent nature over useful life of the asset.

Apportioned

Not available on section 12C assets.

Interpretation Note
47

Value of asset vs cost.

Often confused with assets of permanent nature.

<R7 000 Rule
(Not applied to lessor of assets)

Shade netting, fences, roads, security, signage.



**IN THE TAX COURT OF SOUTH AFRICA
GAUTENG DIVISION, PRETORIA**

Case deals with Understatement penalties charged by SARS when a Section 11 (e) catch-up claim was made

**CASE NO: 24674
DATE: 25 November 2020**

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

25 November 2020
Date


SIGNATURE

Before the Honourable Justice P.M. Mabuse
Ms Anna Teichert, Commercial Member
Ms Natasha Singh, Accountant Member

In the matter between:

CBA (PTY) LTD

APPELLANT

and

**COMMISSIONER FOR THE
SOUTH AFRICAN REVENUE SERVICE**

RESPONDENT

Understatement Percentage Penalty 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%

ORDINARY NEGLIGENCE

Negligence would include the failure to take reasonable care in completing returns or the lack of reasonable grounds for the assumption of a particular tax position.

(Guide to understatement Penalties (Issue 2))

Note: Impermissible avoidance arrangements falls short of "gross negligence" but will arguably also be "negligence".

Transnet Limited t/a Portnet v Owners of the N B Stella Tingas and Another 2003(2) SA 473 SCA

- "It follows I think that to qualify as gross negligent the conduct in question, ... must involve a departure from the standard of the reasonable person to such an extent that it may properly be categorised as extreme.
- It must demonstrate where this is found to be conscious risk-taking, a complete obtuseness of mind or where there is no conscious risk taking a total failure to take care. If something less were required the distinction between ordinary and gross negligence would lose its validity."

The facts

[1] This is an appeal by CBA (Pty) Ltd (“the taxpayer”), against the decision of the Commissioner for the South African Revenue Service (SARS) to impose under statement penalties (“usp”) at the rate of 15% on the grounds of “no reasonable grounds for tax position taken”. For purposes of convenience, the taxpayer will be referred to as the appellant.

[5] The taxpayer submitted to SARS an Income Tax Return for audit in 2017. This tax return was submitted in respect of the 2016 tax year. SARS completed the tax type for the said tax period 2016 and, based on the audit findings, made the following adjustment:

Summary and Explanation for the Proposed Adjustment

Tax Period:	2016
Provisions of Income Tax Act (ITA):	Section 11(e)
Brief Description of the Adjustment:	Wear and Tear
Adjustment Amount:	R17,564,368.00
Tax Amount:	R4,918,023.00

Appears to be a typo... rate should be 50%

The facts

[6] In the 2016 year of assessment tax return, the taxpayer had claimed “wear and tear” allowance of R54,305,235.00. Included in this allowance was an amount of R17,564,367.99 described by the taxpayer as “wear and tear catch-up” which was due to an error in the 2015 year’s calculation of the “wear and tear’ allowance. According to SARS the foregoing description was according to emails sent to Ms Edith Mantloane by Ms LM on 16 April 2017. The taxpayer agreed with the proposed adjustment in its letter dated 30 June 2017 which was the taxpayer’s response to SARS’s Letter of the Audit Findings.

[8] The Commissioner contends that tax is an annual event and therefore expenses and/or allowance must be claimed in the year during which such expenses or assets are first incurred. The amount of the allowance must be determined on the basis of the period of use listed for the purpose of section 11(e) allowance issued by the Commissioner, or a shorter period of use approved by the Commissioner from the date the asset was brought into use. Therefore, the appellant may not in law, claim in the 2016 year of tax assessment, the “catch-up wear and tear” expenses that it was supposed to have claimed or that it incurred in the 2015 tax year of assessment. It was for that reason that the amount of “catch-up wear and tear’ allowance of R17,564,368.00 was not allowed.

Taxpayer claimed “catch-up” claim

SARS argues that tax is annual event

The facts

[11] Relying on the law, SARS demonstrated how the understatement penalty was imposed. That was done as follows:

Description:	Tax amount
“Catch-up wear and tear”:	R4,418 ,023.04
Applicable behaviour:	No reasonable grounds for tax position taken
Applicable conduct:	Standard
Usp percentage:	50%
USP Amount:	R2,459,011.00

[10] Then the taxpayer indicated that it was objecting against the penalties levied in terms of section 223 of the TAA. The taxpayer states that, because of the adjustment, the taxpayer had an original assessed loss of R37,635,914.00. After the adjustment, the assessed loss to be carried forward was R20,071,546.00. The taxpayer then contends that there had been no loss to the *fiscus* that resulted from the identified error.

USP is payable even though it only affects assessed losses and is timing in nature only

The facts

The appellant agrees with SARS's findings with regards to the over-claiming of the allowances. It contends that the over-claim of wear-and-tear resulted an error in the preparation of the financial and the registers.

Was this the right approach?
Would the outcome have been different if SARS was challenged on this point?

NB – This case does not deal with the question whether or not catch-up claims are available. It deals with whether or SARS could levy USP

The appellants argument

[17] The taxpayer objected to the understatement penalty imposed of R2,459,011.00 on the grounds that there is no understatement by the taxpayer in respect of the 2016 year of assessment under this ground of assessment. Under this ground of objection, the taxpayer contended that reading section 222 and section 221 together the understatement cannot be levied unless there is prejudice to SARS or *fiscus*. Harm would be caused to SARS if SARS consented to the erroneous refund and subsequently made payment of that refund to the taxpayer, in other words, to the appellant. In other words, if SARS would be out of pocket in the amount of incorrect sum. There is therefore no loss of the *fiscus*.

The Taxpayer argued that there was no "prejudice" to SARS due to the assessed loss

[18] SARS disallowed the objection and furnished written reasons for the disallowance. SARS pointed out that following the finalisation of an audit, when the catch up wear-and-tear allowance of R17,564,368.00 was disallowed (and the appellant agreed that this wear-and-tear should not have been claimed in the 2016 year of assessment), an understatement penalty of R2,459,011.52 was imposed. The understatement penalty was imposed because it was found that there was no bona fide inadvertent error; that there was an understatement and prejudice to SARS and *fiscus*. The applicable behaviour was determined to be "no reasonable grounds for the tax position taken" and the conduct was determined to be "standard". A penalty was determined at 50% of the tax of R17,564,368.00.

The Law: Section 11 (e)

11. General deductions allowed in determination of taxable income.—For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived—

(e) save as provided in [paragraph 12 \(2\)](#) of the [First Schedule](#), such sum *as the Commissioner may think just and reasonable* as representing the amount by which the value of any machinery, plant, implements, utensils and articles (other than machinery, plant, implements, utensils and articles in respect of which a deduction may be granted under [section 12B](#), [12C](#), [12DA](#), [12E \(1\)](#), [12U](#) or [37B](#)) owned by the taxpayer or acquired by the taxpayer as purchaser in terms of an agreement contemplated in paragraph (a) of the definition of “instalment credit agreement” in [section 1](#) of the Value-Added Tax Act and used by the taxpayer for the purpose of his or her trade has been diminished by reason of wear and tear or depreciation during the year of assessment

The Law: Section 11(e)

4.1.5 Use requirement

The allowance is deductible only to the extent that the qualifying asset is *used* by a taxpayer for purposes of his or her trade. The asset will be written off over its useful life.

(a) Qualifying assets for which write-off periods have been listed in the Annexure

The **Annexure** contains a schedule of write-off periods that are acceptable to the Commissioner for assets that are written off on the straight-line method. These write-off periods are acceptable for assets that are used for purposes of trade, including a trade of leasing, and apply to any asset brought into use on or after 24 March 2020. The assets listed in the **Annexure** are of general application and not intended for specific industries.

IN 47 determines the "USEFUL LIFE" of the asset. If a catch-up claim is required in order to be in line with the useful life as determined by SARS, has there been truly non-compliance with SARS practice?

Annexure– Schedule of write-off periods acceptable to SARS

Asset	Proposed write-off period (in years)
-------	--------------------------------------

The Law: Section 11 (e)

- The question is then whether or not whether there was any “understatement” for purposes of the understatement penalty regime. The term “understatement” is defined in section 221 as follows:
- *‘understatement’ means any prejudice to SARS or the fiscus as a result of—*
 - (a) *failure to submit a return required under a tax Act or by the Commissioner;*
 - (b) *an omission from a return;*
 - (c) *an incorrect statement in a return;*
 - (d) *if no return is required, the failure to pay the correct amount of ‘tax’;*
 - (e) *an ‘impermissible avoidance arrangement’.*
- The taxpayer clearly does not have the authority to determine the period over which a section 11 (e) allowance may be claimed. This is the sole responsibility of SARS.
- The ITR 14 therefore merely represent a request by the taxpayer for SARS to exercise their discretion in a particular manner. Nothing precludes SARS under a specific set of circumstances to allow a catch-up claim for section 11 (e) claims.

Some personal notes....



The court case does not deal with 11 (e) catch-up claims

The Taxpayer should not have conceded that it was not entitled to a catch-up claim. Given strong substantiation that an asset must be written off over its useful life, SARS may have been convinced to exercise their discretion favourably.

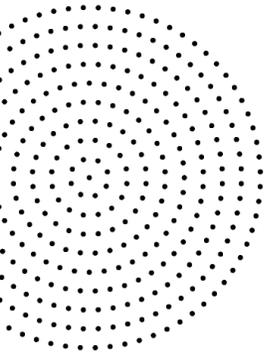
I suspect that the Taxpayer conceded on the disallowance of the catch-up claim since it was in a tax loss situation and the difference is temporary only. I still maintain that there was no prejudice to SARS. The fact that the taxpayer claimed allowances over the expected life of the asset but claims less in the beginning years and more in the latter years is to the advantage of SARS and not to the prejudice of SARS

Some personal notes....



Be careful to concede too easily on the subject matter in dispute – even if it will only create a temporary adjustment

Be careful to make full disclosure in the ITR 14 for any discretionary allowances. This includes section 11 (e) and Section 22 stock obsolescence. If the amounts are large, obtain a Binding Private Ruling. If relatively small, disclose separately under “other” with full description.



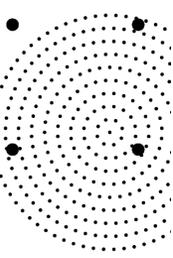
Some personal notes....

SARS is not the Taxpayer's friend.... This is an unfortunate reality created by SARS and not by the Taxpayer. One must anticipate a confrontational relationship with SARS. The 50% penalty charged by SARS for an issue where the allowance is subject to SARS discretion, the taxpayer was in an assessed loss, and the amounts will in any event qualify for deductions in future years, seems overly punitive and unfair.



“ 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.

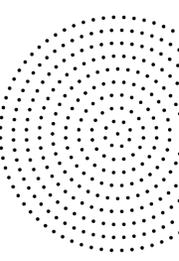
The Honorable Campbell J. Miller
Home Depot of Canada Inc. v. R., 2009 TCC 281



11.

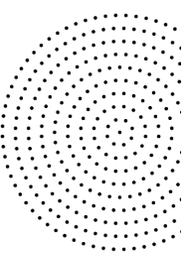
Repairs and Maintenance (S 11 (d))

tax happy hour



Specific accounting rules governing repairs and maintenance

- Repairs and maintenance are expenses a business incurs to restore an asset to its previous operating condition or to keep an asset in its current operating condition.
- An entity shall capitalise the cost of repairs and maintenance when they
 - extend the life of an asset,
 - increase the functionality or
 - improves the outcome of the asset

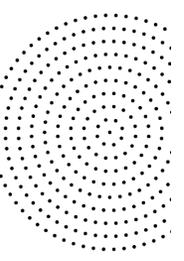


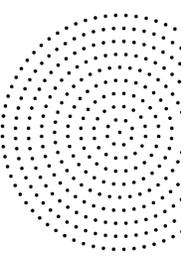
11. **General deductions allowed in determination of taxable income.**—For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived—

- expenditure
- actually incurred
- during the year of assessment
- on repairs of
 - property
 - occupied for the purpose of trade or
 - in respect of which income is receivable,
- and sums expended for the repair of
 - machinery, implements, utensils and other articles
 - employed by the taxpayer for the purposes of his trade;

The first category mentioned above refers to repairs effected to immovable property and the second category to repairs pertaining to movable property.

Was there deterioration of the
property because of use?

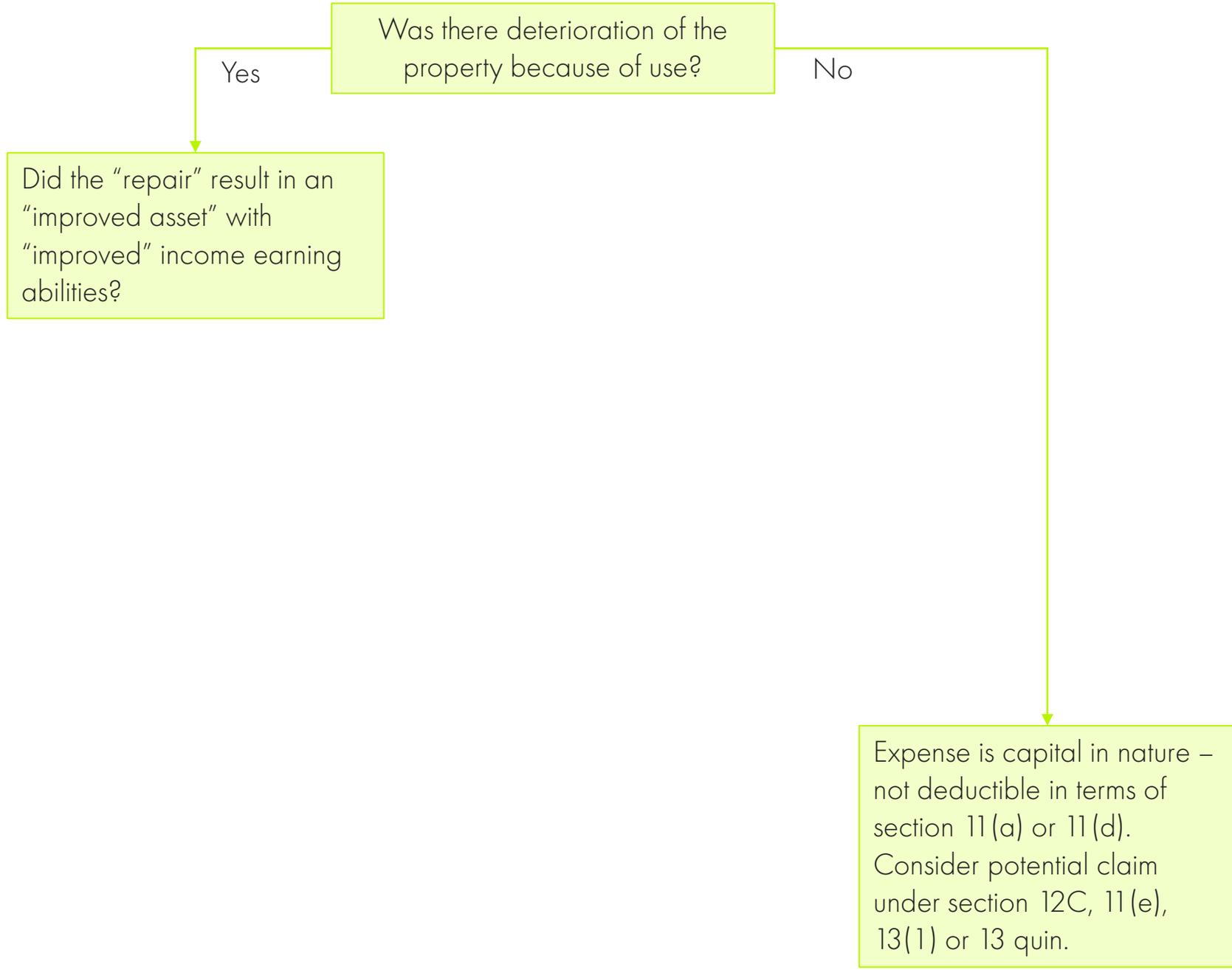
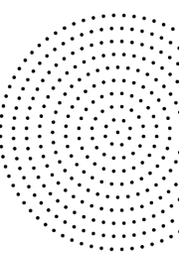


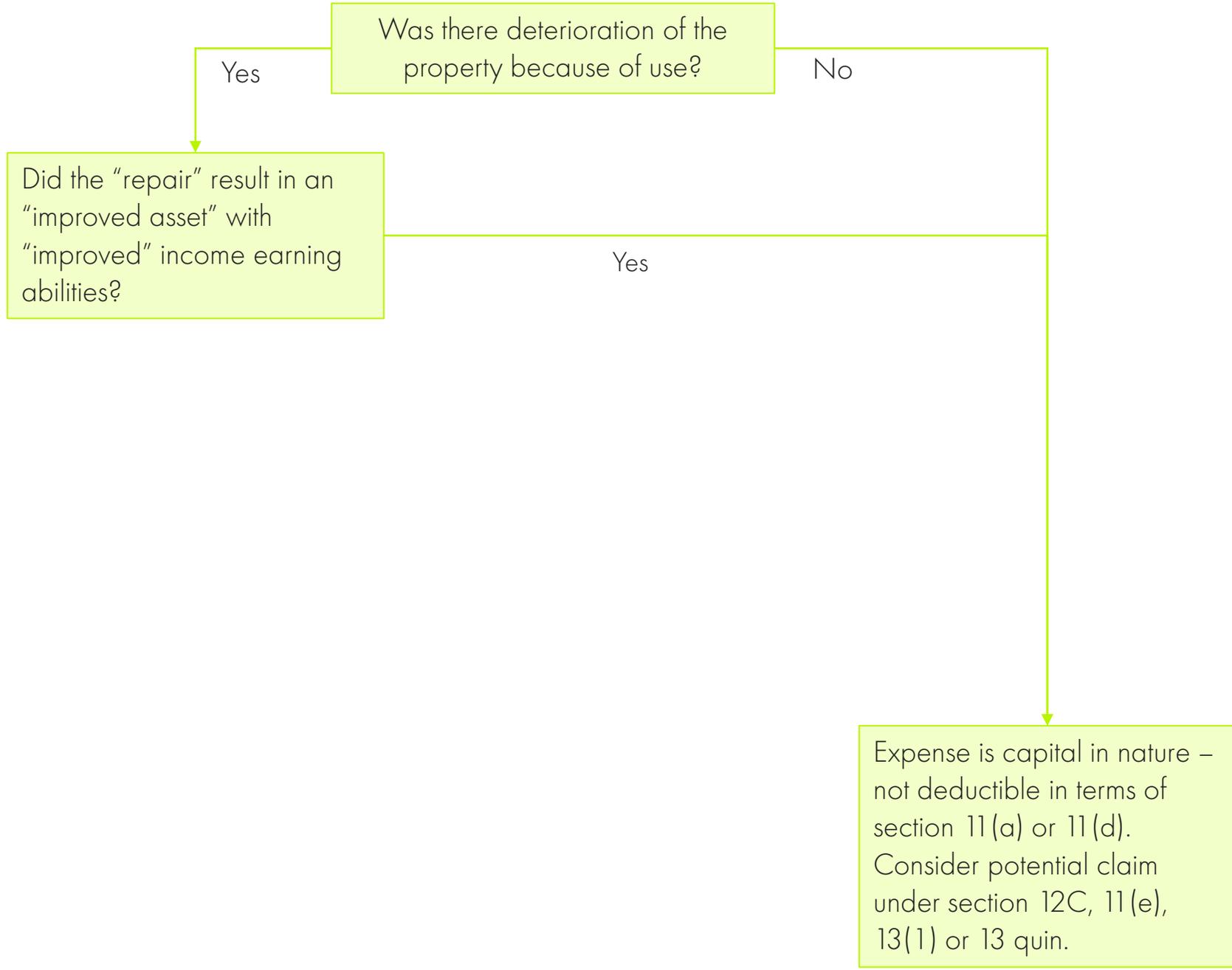
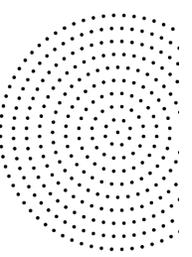


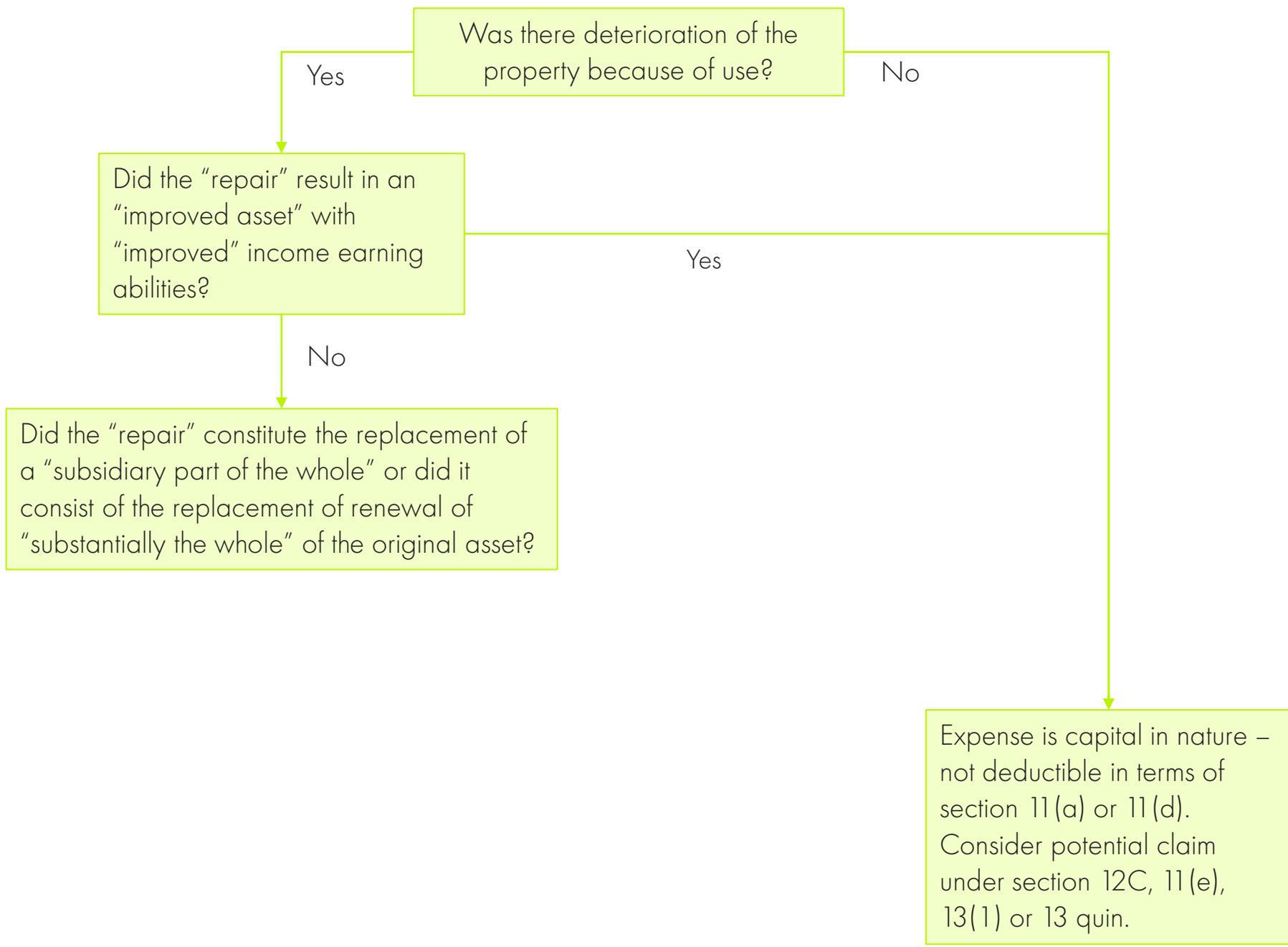
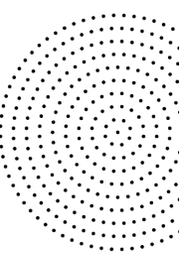
Was there deterioration of the property because of use?

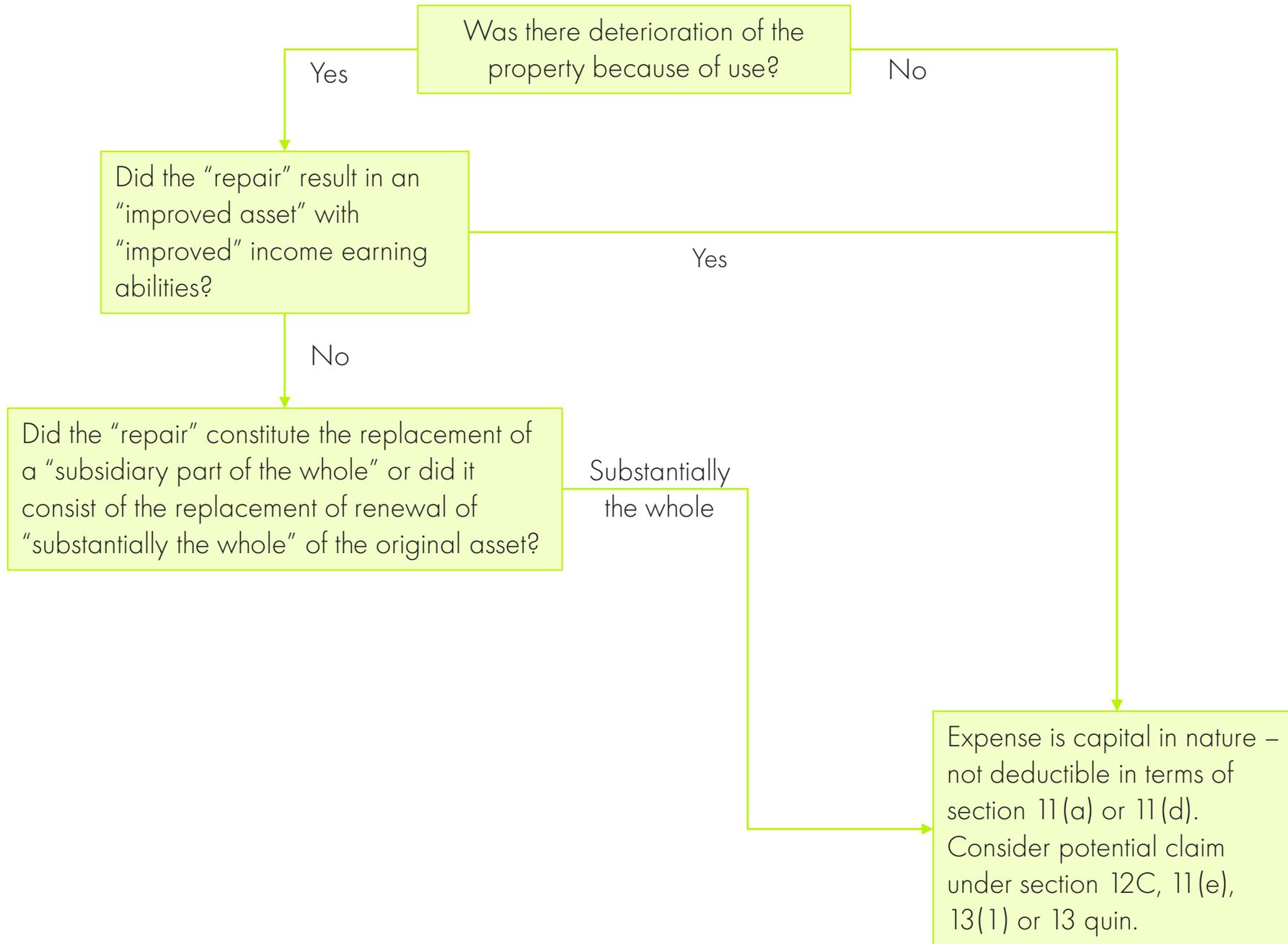
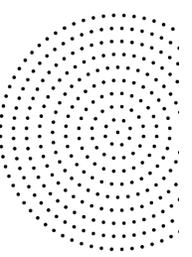
No

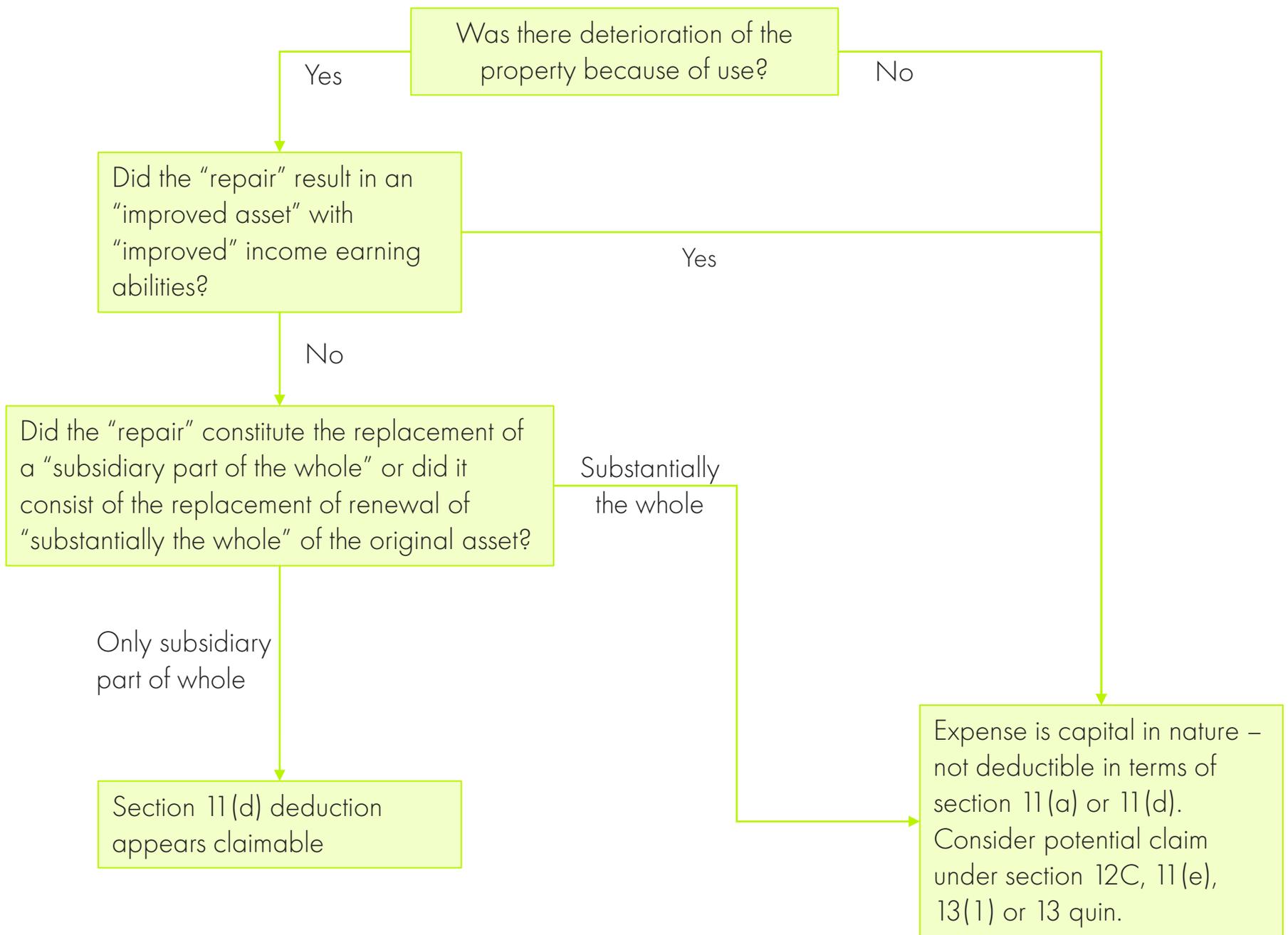
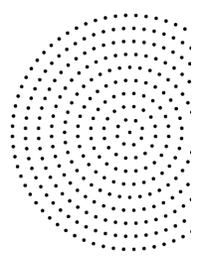
Expense is capital in nature – not deductible in terms of section 11(a) or 11(d).
Consider potential claim under section 12C, 11(e), 13(1) or 13 quin.











12.

Leasehold improvements Section 11(g) and par (h) of Gross Income Definition

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Section 11(g)

11. **General deductions allowed in determination of taxable income.—**
For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived—

(g) an allowance in respect of any expenditure actually incurred by the taxpayer, in pursuance of an obligation to effect improvements on land or to buildings, incurred under an agreement whereby the right of use or occupation of the land or buildings is granted by any other person, where the land or buildings are used or occupied for the production of income or income is derived therefrom: Provided that—

(vi) the provisions of this paragraph shall not apply in relation to any such expenditure incurred if the value of such improvements or the amount to be expended on such improvements, as contemplated in paragraph (h) of the definition of "gross income" in section 1, does not for the purposes of this Act constitute income of the person to whom the right to have such improvements effected has accrued;

Par (h) of Gross Income Definition

(h) in the case of any person to whom, in terms of any agreement relating to the grant to any other person of the right of use or occupation of land or buildings, or by virtue of the cession of any rights under any such agreement, there has accrued in any such year or period the right to have improvements effected on the land or to the buildings by any other person—

- (i) the amount stipulated in the agreement as the value of the improvements or as the amount to be expended on the improvements; or
- (ii) if no amount is so stipulated, an amount representing the fair and reasonable value of the improvements

Test for accession

1

The nature and purpose of the attached thing: This test entails that there has to be a rationale or reason for the thing to be attached to the immovable. This is largely a matter of recognising the obvious destination of certain things. E.g., chimney-pots, guttering, plumbing components, electrical fittings and the like made for a building, or to be permanently affixed to a building, lose their independent identity as the purpose for which they are affixed is to become a permanent part of the immovable.

2

The manner and degree of its attachment: This test entails that there has to be an enquiry as to the extent that the thing has become a part of the immovable. The fundamental issue is that of permanence and finality of the attachment. E.g., something which cannot be removed without damage to itself, or the immovable is more likely to be regarded as having become immovable by accession.

3

The intention with which the attachment was made: In this test the court has to determine the intention of the owner of the thing at the time when the attachment was made to the immovable. E.g., whether the intention was that the attachment should be permanent or temporary.

Commonly found errors

For accounting purposes, items are loosely classified as “leasehold improvements” when for tax purposes, the cost may be claimable in terms of sections 11(a), 11(e), 11(d), 12C or may even be a notional amount (e.g. notional interest)



The fact that the lessee is “entitled” to effect leasehold improvements does not mean that the lessee is “obligated” to effect leasehold improvements



At the end of the lease period – a capital loss arise – but consider potential connected party rules?

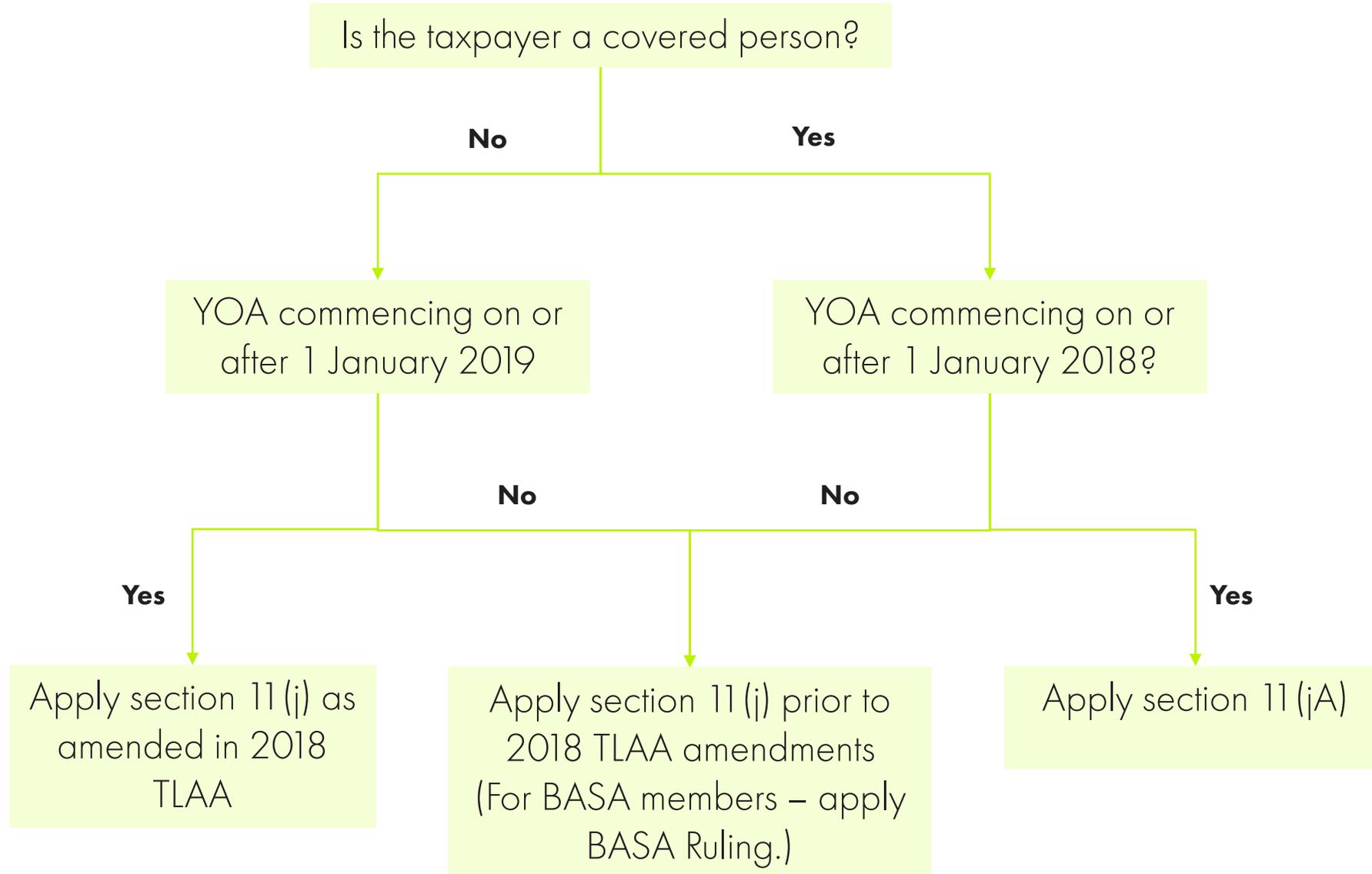
13.

Doubtful Debt Allowances

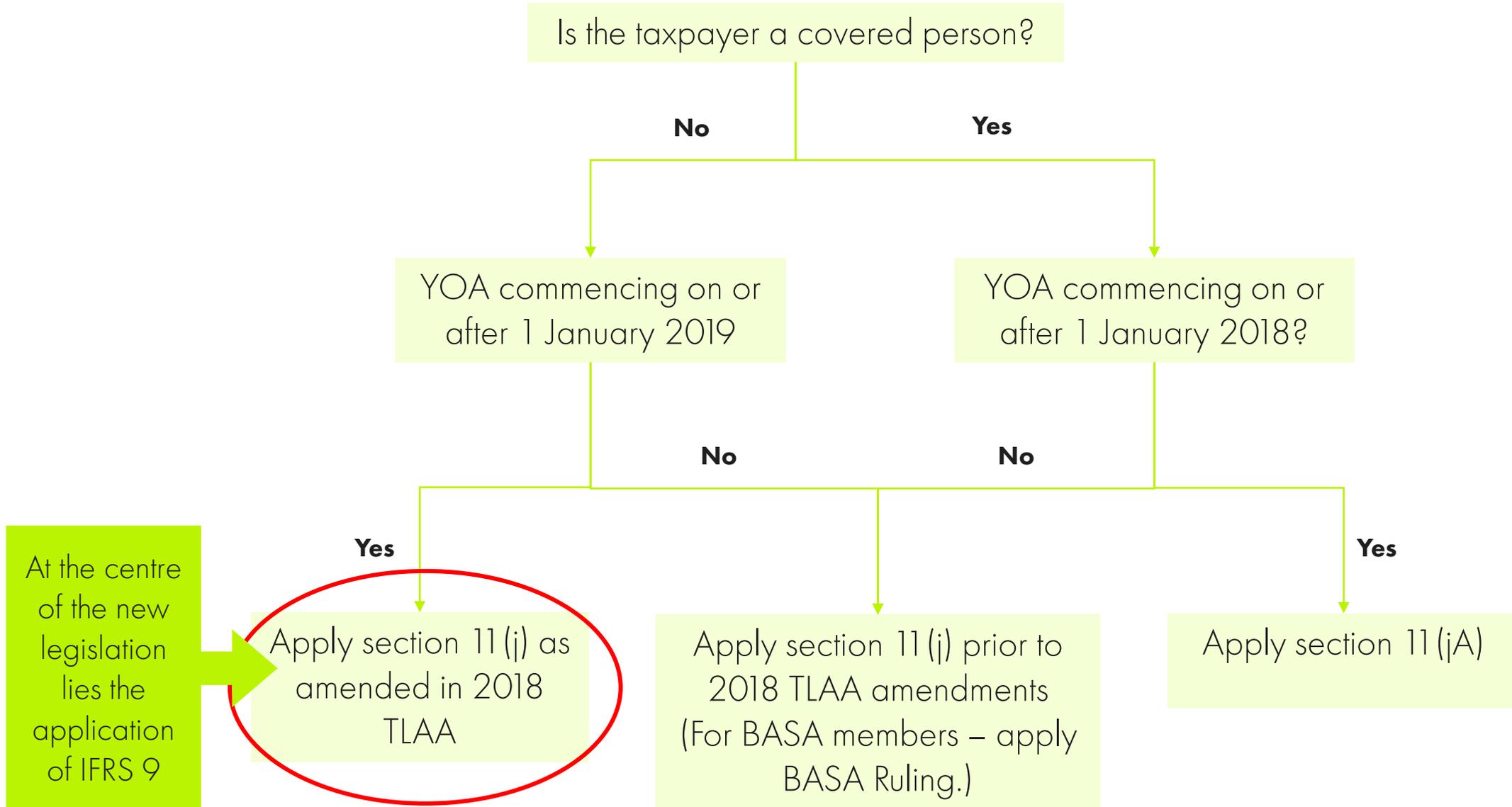
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Doubtful debts: Applying appropriate section



Doubtful debts: Applying appropriate section



What is IFRS 9?

IFRS 9 is effective for annual periods beginning on or after 1 January 2018 with early application permitted.

- IFRS 9 specifies how an entity should classify and measure financial assets, financial liabilities, and some contracts to buy or sell non-financial items.
- IFRS 9 requires an entity to recognise a financial asset or a financial liability in its statement of financial position when it becomes party to the contractual provisions of the instrument.
- **At initial recognition**, an entity **measures a financial asset or a financial liability at its fair value** plus or minus, in the case of a financial asset or a financial liability not at fair value through profit or loss, **transaction costs that** are directly attributable to the acquisition or issue of the financial asset or the financial liability.



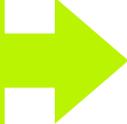
Be careful for tax purposes to disengage transaction costs. This may include raising fees, legal fees etc



Be careful for tax purposes to establish if the financial asset/liability was fair valued or not.

What does IFRS 9 say about impairment?

e.g. History indicates that 3% of debt is bad within 12 months – provide now even though no default



Impairment of financial assets is recognised in stages:

Stage 1

- As soon as a financial instrument is originated or purchased, 12-month expected credit losses are recognised in profit or loss and a loss allowance is established.
- This serves as a proxy for the initial expectations of credit losses.
- For financial assets, interest revenue is calculated on the gross carrying amount (ie without deduction for expected credit losses).

What does IFRS 9 say about impairment?

Impairment of financial assets is recognised in stages:

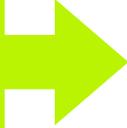
Stage 1

- As soon as a financial instrument is originated or purchased, 12-month expected credit losses are recognised in profit or loss and a loss allowance is established.
- This serves as a proxy for the initial expectations of credit losses.
- For financial assets, interest revenue is calculated on the gross carrying amount (ie without deduction for expected credit losses).

Stage 2

- If the credit risk increases significantly and is not considered low, **full lifetime expected credit losses** are recognised in profit or loss.
- The calculation of interest revenue is the same as for Stage 1.

Generally
"under-
performing
debt" – not yet
in "default", but
pays late every
month.



What does IFRS 9 say about impairment?

Impairment of financial assets is recognised in stages:

Stage 1

- As soon as a financial instrument is originated or purchased, 12-month expected credit losses are recognised in profit or loss and a loss allowance is established.
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- For financial assets, interest revenue is calculated on the gross carrying amount (ie without deduction for expected credit losses).

Stage 2

- If the credit risk increases significantly and is not considered low, full lifetime expected credit losses are recognised in profit or loss.
- The calculation of interest revenue is the same as for Stage 1.

Stage 3

- If the credit risk of a financial asset increases to the point that it is considered credit-impaired,
- interest revenue is calculated based on the amortised cost (ie the gross carrying amount less the loss allowance).
- Financial assets in this stage will generally be assessed individually. **Lifetime expected credit losses are recognised** on these financial assets.

Disconnect
accounting
and tax – for
tax gross
interest accrues
and can make
an adjustment

Section 11 (j) – 2018 Taxation Laws Amendment Act

- an allowance
- in respect of any debt due to the taxpayer,
- if that debt would have been allowed as a deduction under any other provision of this Part had that debt become bad,
- of an amount equal to—

Section 11 (j) – 2018 Taxation Laws Amendment Act

(i) if IFRS 9 is applied to that debt by that person for financial reporting purposes, the sum of—

(aa) 40 per cent of the aggregate of—

(A) the loss allowance relating to impairment that is measured at an amount equal to the **lifetime expected credit loss**, as contemplated in IFRS 9, in respect of debt; and

(B) the amounts of debts disclosed as bad debt written off for financial reporting purposes that have not been allowed as a deduction under section 11 (i) for the current or any previous year of assessment and the debt is included in the income of the taxpayer in the current or any previous year of assessment; and



Stages 2
and 3

(bb) 25 per cent of the loss allowance relating to impairment, as contemplated in IFRS 9, in respect of debt other than debt taken into account under item (aa); or



Stage 1

Section 11 (j) – 2018 Taxation Laws Amendment Act

- (ii) if IFRS 9 is not applied to that debt by that person for financial reporting purposes, the sum of—
- (aa) 40 per cent of so much of any debt, other than a debt contemplated in [subparagraph \(i\)](#), due to the taxpayer, if that debt is 120 days or more in arrears, after taking into account the value of any security in respect of that debt; an
 - (bb) 25 per cent of so much of any debt, other than a debt contemplated in [subparagraph \(i\)](#) or [item \(aa\)](#), due to the taxpayer, if that debt is 60 days or more in arrears, after taking into account the value of any security in respect of that debt



Debtors aging is normally determined from date that invoice is produced – What if debt is only payable 30 days after presentation?



Basis is different – it is calculated on outstanding debt without taking into account the actual provision made by the taxpayer

Section 11 (j) – 2018 Taxation Laws Amendment Act

Provided further that the Commissioner may, **on application by a taxpayer, issue a directive** that the percentage contemplated in subparagraph (i)(aa) or (ii)(aa) may be increased, **to a percentage not exceeding 85** per cent after taking into account—

- (A) the history of a debt owed to that taxpayer, including the number of repayments not met, and the duration of the debt;
- (B) steps taken to enforce repayment of the debt;
- (C) the likelihood of the debt being recovered;
- (D) any security available in respect of that debt;
- (E) the criteria applied by the taxpayer in classifying debt as bad; and
- (F) such other considerations as the Commissioner may deem relevant;



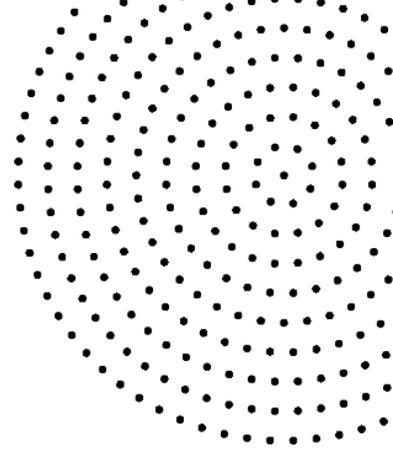
- Mechanism to create equal playing field where taxpayer is conducting a trade similar to covered persons.
- Mechanism where reality is that 40% and 25% is not economically realistic and creates hardships
- Questions regarding publication of “directives” and consistent treatment of taxpayers

VAT and Irrecoverable debts

22. **Irrecoverable debts.**—(1) Subject to [subsection \(6\)](#), where a vendor—

- (a) has made a taxable supply for consideration in money; and
- (b) has furnished a return in respect of the tax period for which the output tax on the supply was payable and has properly accounted for the output tax on that supply as required under this Act; and
- (c) has written off so much of the said consideration as has become irrecoverable,

the vendor may make a deduction in terms of section 16 (3) of that portion of the amount of tax charged in relation to that supply as bears to the full amount of such tax the same ratio as the amount of consideration so written off as irrecoverable bears to the total consideration for the supply, the deduction so made being deemed for the purposes of the said section to be input tax...



THANK YOU

For joining us.
Stay In touch.
www.saiba.org.za

SEE YOU AGAIN

24 Nov 2021
Wednesday
16:00

tax happy hour

