TAX

IN THIS ISSUE

SHUTTLEWORTH'S EXIT CHARGE WAS VALID AND DID NOT CONSTITUTE A TAX

VAT CLAUSES IN SALE AGREEMENTS RELATING TO IMMOVABLE PROPERTY

SHUTTLEWORTH'S EXIT CHARGE WAS VALID AND DID NOT CONSTITUTE A TAX

In an about-turn the Constitutional Court handed down judgment in the Shuttleworth matter on 18 June 2015. Not only was it found that Shuttleworth's exit charge constituted a regulatory charge as opposed to a tax, but it was also found that the Exchange Control Regulations were not unconstitutional.

Should one consider the history of the matter, Shuttleworth made application to the South African Reserve Bank (Reserve Bank) to transfer approximately R2,5 billion out of South Africa. This approval was granted subject to an exit charge of 10% being imposed on the capital that was exported. The payment of this exit charge was challenged by Shuttleworth:

- in the High Court it was indicated that the exit charge was not unlawful, even though a number of the Exchange Control Regulations were declared unconstitutional; and
- in the Supreme Court of Appeal it was held that the exit charge was unlawful because it was calculated to raise revenue and that certain procedures prescribed to adopt a money Bill had not been followed.

As a starting point it was indicated that the matter was not moot given the fact that the government would be faced with about R2,9 billions' worth of claims, to the extent that the payment of the exit charge is reversed. A number of other immigrants thus waited with baited breath on the judgment of the Constitutional Court as it was quite likely that a flood of claims would have ensued had Shuttleworth been successful in his argument.

The judgment written by Moseneke DCJ, divided the matter into two categories, being:

- whether the exit charge was validly imposed; and
- the constitutionality of the Exchange Control Regulations.

The question pertaining to the levying of the exit charge was in turn split into three questions, being:

- was the imposition of the exit charge a decision of the Minister of Finance or the Reserve Bank?
- was the exit charge a national tax, levy, duty or surcharge under s75 and s77(1)(b) of the Constitution?
- was the exit charge calculated to raise revenue as envisaged in regulation 10(1)(c) and s9(4) of the Currency and Exchanges Act, No 9 of 1993?

With reference to the question whether the exit charge was a decision of the Minister of Finance or the Reserve Bank, it was indicated that it was ultimately a decision of the Minister of Finance. The Reserve Bank had no discretion or mandate to refuse to impose or vary the exit charge. The Minister of Finance thus gave a general permission that was subject to fixed conditions. The Reserve Bank was only responsible for mechanically applying the policy decision of the Minister of Finance and did not have a discretion when implementing the decision.

The fact that the Minister of Finance made the decision and not the Reserve Bank, still does not put an end to the enquiry. The question is then whether the decision of the Minister of Finance was constitutionally valid.

Should the exit charge have been a charge, levy or tax that was of a kind that could only be imposed after having complied with the procedures of a money Bill, the decision of the Minister of Finance would also have been invalid. A Bill is a money Bill if it imposes national taxes, levies, duties or surcharges. A money Bill must be passed by the National Assembly in a specific manner. The reason for having to adopt this process is that the Executive of government is not entitled to impose a tax burden without due and express consent of elected public representatives. If a law that purports to impose a tax has not followed the due process, it is invalid. In the particular circumstances, however, it was indicated that a law may impose regulatory charges in order to pursue a legitimate government purpose even though it results in money being collected by the government. A money Bill is thus not any Bill that envisages a scenario where revenue is incidentally raised. Moseneke DCJ, indicated that the 'seminal test' is whether the primary or dominant purpose of a statute is to raise revenue or to regulate conduct. It was indicated:

> "If regulation is the primary purpose of the revenue raised under the statute, it would be considered a fee or a charge rather than a tax. The opposite is also true. If the dominant purpose is to raise revenue then the charge would ordinarily be a tax. There are no bright lines between the two. Of course, all regulatory charges raise revenue."

continued

DLA CLIFFE DEKKER HOFMEYR

Turning to the facts, it was indicated that the purpose of the exchange control legislation was to curb or regulate the export of capital from South Africa. The exit charge was thus not directed at raising revenue. In addition, it was indicated that the exit charge was imposed on a discrete portion of the population and did not have general effect.

In addition, it was indicated that the exit charge was not calculated to raise revenue. Given the fact that the primary object of the exit charge was to regulate and discourage the export of capital, it was held that it was not calculated to raise revenue. Any income that may thus have been derived was incidental to the dominant objective of the legislation.

Following from the above principle, it was also indicated that every national revenue of whatever kind does not only need to be raised by original legislation. It was indicated that not every levy constitutes a national tax. Also, it was indicated that the legislation did not assign plenary legislative power to the President. In doing so, the President has not delegated legislative power as his power was (and still is) to regulate by imposing conditions for export of capital. In any event, it was indicated that one is dealing with exceptional circumstances and that one should consider legislative provisions against the background of what they intend to achieve. It was indicated that the Executive bears a responsibility to secure a stable currency within a good and prospering economy:

> "This duty is sufficiently exceptional, and paramount, to warrant a broad power that allows the Executive to respond to the uniquely dynamic field of exchange control. The global financial crisis of 2007 is still fresh in many of our memories, a testament to the need for the ability to respond rapidly, and guard against the potential negative impact of drastic market or economic changes. This is particularly true for vulnerable economies such as ours. It is on this basis that we recognise the importance, indeed the public interest, in permitting the Executive to impose a limited charge on the export of capital."

Turning to the constitutionality of the Exchange Control Regulations, it was indicated that the constitutional attack of Shuttleworth could only be limited to the circumstances and provisions that affect him and not all Exchange Control Regulations. Such an approach would be "academic, hypothetical and speculative". In the context of his specific circumstances, it was indicated that the broad discretionary powers that were conferred by the legislation were not subject to attack given the fact that the exchange control system "requires a flexible, speedy and expert approach to ensure that proper financial governance prevails". One is not able to lay down rules in advance and for this reason, one had to have broader provisions to cater for whatever circumstances could arise.

The Constitutional Court has now decisively indicated that neither the particular circumstances of Shuttleworth nor the general framework of the Exchange Control Regulations, in the context of the levying of the exit charge, could be successfully attacked. Not only was it found that the exit charge did not constitute a tax, but it was also indicated that wide and discretionary powers could be conferred in terms of the legislation given the unforeseen circumstances that can arise in the context of exchange control. Whereas the authorities are probably expressing a sigh of relief, a number of other individuals are probably expressing a sigh of disappointment. Two different sighs, but given in the context of the Exchange Control Regulations having to protect the South African economy in unforeseen and exceptional circumstances. If anything, the only form of scrutiny would now be the way in which the discretion is exercised given the circumstances of the matter as opposed to the framework within which it is exercised.

Emil Brincker

VAT CLAUSES IN SALE AGREEMENTS RELATING TO IMMOVABLE PROPERTY

Parties to sale agreements of immovable property should take great care when drafting the value-added tax (VAT) clauses.

Consider the recent case of *Lezmin 2358 CC v Tomeridian Properties CC and others* [2015] JOL 33210 [GJ].

The facts of the case are complex. Put simply, the seller sold commercial immovable property to the buyer. The sale agreement, which went through a few permutations, stated that:

> "The purchase price is the sum of R25 000 000 (Twenty Five Million Rand) exclusive of VAT which is payable..."

Under the heading 'Transfer and Bond Costs' the agreement provided that the buyer "shall pay all costs of transfer, transfer duty and/or VAT and bond registration costs". However, initially no VAT payment was contemplated because the property was subject to a lease and was sold as a going concern.

Accordingly, the transaction was zero-rated for VAT purposes in terms of s11(1)(e) of the Value-Added Tax Act, No 89 of 1991. (That provision states that if a VAT vendor sells a business to another VAT vendor and certain requirements are met, the transaction attracts VAT at a rate of zero percent).

The agreement provided further that if the South African Revenue Service (SARS) ruled that VAT was payable (as the zero-rating did not apply for some reason), the buyer had to pay the VAT against delivery of a tax invoice.

After the sale, but before transfer, the lease was cancelled. Accordingly, the transaction was no longer zero-rated for VAT purposes. SARS indicated that VAT was payable at the standard rate of 14%.

continued

The parties then settled a dispute between them about the agreement on the basis that the property was to be transferred to the buyer 'forthwith' and that the (reduced) purchase price, 'exclusive of Value-added Tax' had to be paid by way of bank guarantees within a stipulated time period.

The seller conceded that VAT in terms of the contractual relationship between the parties, was payable by the buyer either on delivery of a tax invoice or, in the absence thereof, on the registration of transfer of the property into the buyer's name.

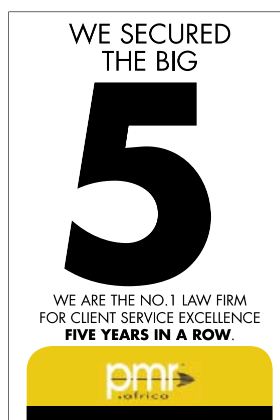
In crisp issue was this: On a proper interpretation of the agreements between the parties, should VAT have been considered as part of the purchase price and therefore not separately and, accordingly, when the seller called for a guarantee, was the buyer obliged to provide a guarantee for the purchase price only or for the purchase price plus VAT?

The court held that the buyer was only obliged to provide a guarantee for the purchase price portion, and not the VAT portion.

What the case highlights is that, while it is not always possible for the parties to legislate for all the 'unknown unknowns' (in the words of the US Secretary of Defense, Donald Rumsfeld), the parties should at least provide for the following in the sale agreement:

- Parties should determine beforehand whether the buyer and seller are both registered VAT vendors. Often the buyer is not a vendor at the time of the sale. In that case, the parties should state by when the buyer must be registered for VAT and what happens if the buyer is not registered for VAT timeously (that is, whether the sale will be cancelled or whether the proceeds of the sale will increase on the basis that the buyer must pay VAT at the standard rate).
- The parties should determine whether the immovable property is truly a going concern and, accordingly, whether the transaction can be zero-rated for VAT purposes. The parties should also determine whether some or all of the assets necessary for carrying on the enterprise are disposed of to the purchaser. Commercial immovable property cannot be transferred as part of going concern without further ado. For zero-rating to apply, an enterprise must be carried on in relation to the property. For example, the property must be let, or the seller must carry on its business on the property (say, by way of a manufacturing plant).
- The agreement should state precisely what the purchase price is and whether it includes or excludes VAT. (If the agreement says nothing about that, then the price is deemed to include VAT).
- If the transaction is structured as a going-concern, zero-rated transaction then the parties should include the prescribed statements in the sale agreement, notably, that the business is sold as a going concern, that the price includes VAT at 0% and that the business will be an income-earning activity on transfer.
- The agreement should state what happens if SARS decides not to zero-rate the transaction. Ideally, the agreement should state that the buyer must pay VAT at the standard rate (14%) in addition to the price. The agreement should also state at what time the VAT would then be payable.
- It should be noted that, when immovable property forms part of the supply of a going concern, then the time of supply for VAT purposes is the earlier of (i) the date that an invoice is issued or (ii) the date that any payment of the consideration is made. Usually, when immovable property is included in a going concern, the invoice will be issued and the payment will be made on registration of transfer of the property in the name of the buyer. But the parties should make it clear when the VAT will be due. That is, on the date of the issue of the invoice or the date of payment of the price.
- The agreement should also state that, if the invoice will be issued and the price will be paid on transfer, the buyer must provide a guarantee for both the purchase price and the amount of VAT.

Ben Strauss



CONTACT US

For more information about our Tax practice and services, please contact:

Emil Brincker
National Practice Head
Director
T +27 (0)11 562 1063
E emil.brincker@dlacdh.com

Andrew Lewis
Director
T + 27 (0)11 562 1500
E andrew.lewis@dlacdh.com

Tessmerica Moodley
Senior Associate
T +27 (0)21 481 6397
E tessmerica.moodley@dlacdh.com

Ben Strauss
Director
T +27 (0)21 405 6063
E ben.strauss@dlacdh.com

Mareli Treurnicht
Senior Associate
T + 27 (0)11 562 1103
E mareli.treurnicht@dlacdh.com

Ruaan van Eeden
Director
T +27 (0)11 562 1086
E ruaan.vaneeden@dlacdh.com

Gigi Nyanin
Associate
T + 27 (0)11 562 1120
E gigi.nyanin@dlacdh.com

Lisa Brunton
Senior Associate
T + 27 (0)21 481 6390
E lisa.brunton@dlacdh.com

Nicole Paulsen
Associate
T + 27 (0)11 562 1386
E nicole.paulsen@dlacdh.com

Heinrich Louw
Senior Associate
T +27 (0)11 562 1187
E heinrich.louw@dlacdh.com

This information is published for general information purposes and is not intended to constitute legal advice. Specialist legal advice should always be sought in relation to any particular situation. Cliffe Dekker Hofmeyr will accept no responsibility for any actions taken or not taken on the basis of this publication.

BBBEE STATUS: LEVEL TWO CONTRIBUTOR

JOHANNESBURG
1 Protea Place Sandton Johannesburg 2196, Private Bag X40 Benmore 2010 South Africa
Dx 154 Randburg and Dx 42 Johannesburg
T +27 (0)11 562 1000 **F** +27 (0)11 562 1111 **E** jhb@dlacdh.com

CAPE TOWN
11 Buitengracht Street Cape Town 8001, PO Box 695 Cape Town 8000 South Africa
Dx 5 Cape Town
T +27 (0)21 481 6300 **F** +27 (0)21 481 6388 **E** ctn@dlacdh.com

cliffedekkerhofmeyr.com

Cliffe Dekker Hofmeyr is a member of DLA Piper Group, an alliance of legal practices.

©2015 0539/JUNE

DLA CLIFFE DEKKER HOFMEYR