DLA CLIFFE DEKKER HOFMEYR

TAX ALERT

14 September 2012

IN THIS ISSUE

- **The South African GAAR: who guards the guards?**
- **The AB Mining (Pty) Ltd case**

THE SOUTH AFRICAN GAAR: WHO GUARDS THE GUARDS?

When a revenue authority applies the General Anti-Avoidance Rule (GAAR) in a tax dispute it effectively rolls out the heavy artillery. Presumably, the revenue authority believes that the ordinary taxing provisions (and available specific anti-avoidance provisions) will fall short of what is needed to adequately deal with the taxpayer's tax planning devices (or is it vices?).

Because the GAAR is so powerful a tool, most GAAR regimes contain checks and balances to ensure that it is applied only where really warranted. Certain jurisdictions therefore require the revenue authority to first refer a matter in respect of which it intends applying the GAAR to a so-called 'GAAR panel'. This is the case in both Australia and Canada. In both these jurisdictions, the GAAR panel has no statutory basis – its role is consultative and aimed at achieving consistency in relation to cases where the GAAR is invoked. The recent Aaronson report that proposes a 'narrowly focussed GAAR' for the United Kingdom similarly advocates an advisory GAAR panel as well as the publication (in anonymous form) of its GAAR advice.

Different jurisdictions have different reasons why a GAAR panel is necessary. The Aaronson report proposed such a panel for the UK "to ensure that the centre ground of responsible tax planning is effectively protected". In Australia, the GAAR panel was originally known as the Part IVA panel. In 2000, the Australian Tax Office (ATO) published the mandate of its Part IVA panel. It was to consider the use and development of the general anti-avoidance provisions as a whole (ie not 'driven by individual cases') and to ensure that Part IVA was only applied as a measure of last resort, where clearly appropriate. In 2005, the ATO redefined the role of its GAAR panel: "The primary purpose of the Panel is to assist the Tax Office in its administration of the GAARs in the sense that decisions made on the application of GAARs are objectively based and there is a consistency in approach to various issues that arise from time to time in the application of the GAARs".

Commencement of the Tax Administration Act

The commencement date of the Tax Administration Act No 28 of 2011 has been announced in the Government Gazette of 14 September 2012 by way of presidential proclamation.

The Tax Administration Act will commence on 1 October 2012, except for certain sections relating to the accrual of interest on tax debts.

Effectively, a new regime in respect of tax administration in South Africa will apply from that date and taxpayers should familiarise themselves with the new provisions.

The Australian GAAR panel consists of "business and professional people chosen for their ability to provide expert and informed advice" as well as senior ATO officials. The Canadian panel is constituted of senior officials from the Canadian Revenue Authority, the Department of Justice and the Department of Finance.

Justice Pagone (Judge of the Supreme Court of Victoria, Australia) recently remarked that "Public confidence is also promoted by the pressure of external members on the GAAR Panel ... The presence on the GAAR Panel of reputable external members exposes a critical aspect of tax administration to some measure of direct external review and accountability ... The mere fact of having to explain the proposed application of the anti-avoidance

continued

provisions to an 'outsider' capable of adverse advice or comment is likely to encourage self discipline in the tax official proposing the application of the provision".

The South African GAAR regime is found in Part IIA (s80A - s80L) of the Income Tax Act, No 58 of 1962. Section 80J requires SARS to give prior notice (including reasons) to the taxpayer in circumstances where SARS believes the GAAR may apply in respect of an arrangement. The taxpayer has 60 days within which to convince SARS not to apply the GAAR. Subsequently SARS has 180 days to either request further information, to abandon its GAAR attack or to determine the tax liability in terms of the GAAR. SARS Draft Comprehensive Guide to the GAAR states that s80J "...introduces a statutory safeguard to taxpayers against the arbitrary application of the GAAR".

A search on the SARS website under 'GAAR panel' yields no result. There is also no information available regarding how (and who exactly in) SARS decides which cases are potential GAAR targets and on precisely which basis. The s80J process set out above is all that protects a taxpayer staring down the barrel of a SARS GAAR attack. The GAAR case selection methodology lacks transparency and this could result in the GAAR being applied inconsistently.

Contrast the above to the Australian GAAR model: there is external representation on the GAAR panel (see above) and, to assist the deliberative process of the ATO's GAAR Panel, a taxpayer (and/or representative of the taxpayer's choice) would usually be invited to attend a Panel meeting and address the Panel. On occasions, the promoters or facilitators of the targeted arrangement may also be invited. Prior to the Panel meeting the taxpayer is provided with a 'position paper' so that he can "... be informed of the contentions of fact giving rise to the issue referred to the Panel, and of the substance of the Tax Office's approach to the application of the GAAR". All of this is detailed in a 97 page ATO Practice Statement available on the ATO website.

The GAAR is a powerful weapon in SARS's hands and will be used increasingly. The question is who guards the guards?

Johan van der Walt

THE AB MINING (PTY) LTD CASE

On 5 July 2012, judgment was delivered by Mokgoatlheng J (with him Marius van Blerck and Jacqui Kilani) in the case of *AB Mining (Pty) Ltd v Commissioner for the South African Revenue Service (case no 12906)*.

The essence of the case related to the disposal by the taxpayer of the C Mining Dump. The question was whether the disposal of those rights to the Mining Dump constituted a 'disposal' in terms of paragraph 11 of the Eighth Schedule of the Income Tax Act, No 58 of 1962 (Act). The taxpayer's fundamental contention was that it did not own the C Mining Dump, but had only acquired the rights to exploit certain platinum bearing materials, and those rights were to be exploited in conjunction with the D Company in a 50:50 joint venture.

It needs to be explained that the judgment also dealt with other issues such as management fees and the travel allowances, in addition to a participation in the L Consortium. While that burdened the judgment as it constitutes a lengthy piece of material to work through, the essence of the case relates to the C Mining Dump.

The taxpayer's former Chief Executive Officer (CEO) testified that the appellant acquired the mineral rights to the C Mining Dump for an amount of R2,4 million, plus certain E Mining (Pty) Limited shares, as well as a contribution of R75,000 towards the C area's farmers arbitration costs. He then approached the CEO of the D Company and offered to sell it the Mining Dump for an amount of R3,5 million. He thought he was selling 50% of the Mining Dump to the D Company. Instead of this arrangement, the taxpayer then set up a joint venture with D Company to exploit the mining rights on a 50:50 basis.

Then the company's auditors accounted for the transaction as a sale of 50% of the C Mining Dump to D Company for the amount of R1.3 million. When the CEO saw this he thought it was incorrect. He was unhappy that the auditors had treated the amount of R1,3 million of the R3,5 million paid by D Company as a consideration for the acquisition of a 50% share in the C Mining Dump and therefore susceptible to Capital Gains Tax because of the assumed disposal of the C Mining Dump to D Company, while the remaining 50% ownership of this C Mining Dump was shown as an asset in the taxpayer's balance sheet. His argument was that there was no disposal of any rights to D Company because the appellant retained ownership of the rights concerned.

SARS contentions with regard to the disposal of the C Mining Dump was a disposal of the 50% ownership of the chrome tailing rights to D Company for a consideration of R3,5 million. SARS contention was that this constituted the transfer of an asset, the sale of an asset or the alienation of an asset in terms of paragraph 11(1) of the Eighth Schedule. The taxpayer then argued that the D Company's upfront cost for the joint venture was the contribution of R3,5 million and this is what had caused the problem in the accounts. SARS did not accept this explanation and said that it relied on what was reflected in the annual financial statements.

The law on this question of whether the partner disposes of property to a joint venture or partnership is clearly dealt with in the text books (see R.C. Williams' *Concise Corporate and Partnership Law 2nd* ed, Butterworths 1997 at page 26, the learned author cites Prof Beinart writing in the 1961 *Acta Juridica* at page 143). The partners' respective contributions to the capital may or may not fall into the fund of partnership property that is jointly owned by the partners. The question is whether the partners intended to grant ownership of their capital contribution to the partnership, in which case that partner has disposed of his property to the partnership, and paragraph 11 of the Eighth Schedule will apply. This must be distinguished from

continued

where the partners merely grant the use of the capital which they contribute, in which case the contribution remains an asset of the partner's respective personal estate, and all the partnership acquires is the right to use the asset. In any partnership or joint venture agreement, this issue needs to be spelt out carefully, because the tax treatment will follow this issue.

In the Court reaching its conclusions, the taxpayer was going to deliver the C Mining Dump tailings to the D Company's concentrate plant, and it was to be paid for those tailings delivered, 50% of the consideration paid by the off taker, less 50% of the operating costs. In this way the operating costs and the capital costs were to be shared on a 50:50 basis with D Company. The agreement then recorded a start up contribution of R7 million as an aggregate initial contribution by the parties to facilitate the implementation of the L Consortium project. The appellant's portion of the R3,5 million was described as a contribution by way of time, expenditure and services rendered in establishing the L Consortium project and the tailings project. The Court found that the CEO of the taxpayer was not a credible witness. Moreover, the Court found that the documentary evidence was overwhelming (to which the appellant's sole director, and Public Officer Mr Y, as well as the appellant's external auditors were all parties, extending from 2002 to as late as 2 February 2009) indicating that a sale of rights did indeed take place (the first contention by the taxpayer to the contrary was only made on 12 June 2009 together with the vagueness of the eventual agreement of 3 June 2003 as to the nature of the R3,5 million in question). This indicated that a sale of rights had indeed taken place, and the Court's finding was that a sale of 50% of the C Mining Dump mineral rights for R3,5 million did in fact take place in 2003, either as an outright sale or as a portion of the appellant's contribution to the joint venture (this is contained in paragraph 177 of the Court's judgment). The injection by one party of 100% of an asset for a cash consideration in a joint venture where it only has a 50% participation is a disposal of 50% of that asset for such consideration (at paragraph 178). While the agreement had been vague about the treatment of the R3,5 million paid by D Company as its start-up contribution, the Court's finding was that the taxpayer had not discharged the onus in s82 of the Act required to show that this amount is not liable to tax.

One of the most significant findings in this judgment is not explicit: the Court effectively treated the appellant's disposal of its C Mining Dump or rights to the platinum bearing materials in the dump, as mining, as it dealt with this issue under the mining capital expenditure of the L Consortium. The findings in this regard are contained in the judgment at paragraphs 232 and 233. The Court said that whatever amount was in fact legally so incurred should be treated as a deduction of mining capital expenditure in terms of s36 of the Act, split between the appellant's 62% and the other South African company's 38% in accordance with their respective interests in the participation share in the L Consortium.

Alastair Morphet

DLA CLIFFE DEKKER HOFMEYR

CONTACT US

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

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

Alastair Morphet
Director
T +27 (0)11 562 1391
E alastair.morphet@dlacdh.com

Andrew Seaber
Senior Associate
T +27 (0)11 562 1768
E andrew.seaber@dlacdh.com

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

Heinrich Louw
Associate
T +27 (0)11 562 1085
E heinrich.louw@dlacdh.com

Johan van der Walt
Director
T +27 (0)11 562 1177
E johan.vanderwalt@dlacdh.com

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

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

Carmen Moss-Holdstock
Associate
T + 27 (0)11 562 1614
E carmen.moss-holdstock@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 THREE 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

www.cliffedekkerhofmeyr.com

©2012

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