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TAX ALERT

THE DE BEERS VAT CASE

In September 2011 an article appeared in the Tax Alert on *ITC 1853 (2011) 73 SATC*. This case dealt with the services of the English merchant bank in advising De Beers on a scheme of arrangement under s311 the old Companies Act. The court's conclusion was that these services from the English merchant bank did not constitute 'imported services' because the services had been used and consumed by the taxpayer for the making of taxable supplies and in the course or furtherance of its enterprise of mining and selling diamonds.

This matter was taken by SARS on appeal to the Supreme Court of Appeal (SCA). Judgment was handed down on 1 June 2012. There were two judgments written for the court – a lengthy judgment written jointly by Navsa and van Heerden JJA, and a separate concurring judgment written by Southwood AJA (Leach JA and Maclaren AJA concurring with that separate judgment). The judgment of Navsa and van Heerden sets out the background in the matter very clearly – that this English merchant bank had been retained to advise the independent committee of directors as to whether the consortium's offer to buy out the diamond business was fair and reasonable to independent unit holders. There were, of course, a complex set of relationships between the Oppenheimer family, Anglo American plc and De Beers. The critical issue before the court was whether the English merchant bank's services were utilised or consumed by De Beers for the purpose of making taxable supplies in the course or furtherance of its enterprise of buying and selling diamonds.

De Beers' contention was that the provision of these services were a necessary concomitant of their mining and their commercial enterprise as a public company. The requirements of the independent committee of directors and the formalities involved in s311 were statutory obligations that are incurred by a company that conducts its operations as a public company having raised money from the public. They argued that these supplies can rightly be said to have been wholly utilised or consumed in the making of supplies in the course of the commercial enterprise. As such they did not fall within the definition of imported services.

The Commissioner was arguing for a restrictive approach to this question of what is an enterprise, and seeing it as "the nuts and bolts of the operational diamond business and excluding statutory duties imposed on the company in the interest of shareholders" (Navsa and van Heerden JJA at paragraph 23). These two judges said that in the case of a public company, there is a clear distinction between the enterprise with its attendant overhead expenses and the special duties imposed on a company in respect of its shareholders. The duty imposed on a public company that is the target of a takeover is too far removed from the advancement of the VAT enterprise to justify characterising the services acquired in the discharge of that duty as services acquired for the purposes of making taxable supplies (at paragraph 27). The two judges said that the submissions on behalf of the Commissioner were undoubtedly correct. The Canadian and Australian cases referred to were particular to the facts of those cases and the task of the court was to interpret and apply the VAT legislation to the facts put before them.

De Beers pointed out that the advice from the English merchant bank was, to a large extent, related to De Beers' holding of shares in Anglo American. It did not have a discreet non-enterprise activity of holding Anglo American shares for investment, which was separate from its diamond business. The court was unconvinced by this argument and did not see the investment as constituting an enterprise in the meaning of the Act. Given this finding there was quite substantial argument on the question of where the supplies by the English merchant bank were consumed – whether in London or in Johannesburg. The court's view that De Beers was a South African company with its head office in Johannesburg – that was where the independent committee of directors had met and resolved to acquire the services of the English merchant bank (and other local service providers). That was the place where the board met to receive and approve the recommendation of the sub committee and the s311 scheme of arrangement was approved and implemented in South Africa. The court's overwhelming conclusion was that the services had been consumed in South Africa.

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The cross-appeal in the case related to import credits in respect of the legal services rendered to the company as part of the s311 scheme of arrangement. The court had found that the purchase consideration that a unit holder received was partly a share buy-back in terms of which he received new shares in another company, and then the cancellation leg that gave the unit holder an amount in cash. The matter had accordingly been referred back to SARS to determine an appropriate ratio to which a percentage of the services would constitute a deductible input credit. In the SCA, the judges' view was that the legal services of formulating and executing the s311 scheme of arrangement, obtaining the tax rulings in terms of s60 of the Income Tax Act, No 113 of 1993, and the exchange control requirements for the distribution of the unbundled Anglo shares, was subject to the same reasoning as those applying to the English merchant bank's services. The intention of these services was to ensure that the scheme conceived by Mr Oppenheimer was carried out. As such, this was not part of De Beers' diamond mining enterprise.

The separate concurring judgment of Southwood AJA dealt with a tight analysis of the provisions of the VAT Act, No 89 of 1991 (VAT Act). The majority judges said that if one looked to the definition of 'enterprise' and proviso (v) that any activity to the extent it involves the making of exempt supplies is not deemed to be the carrying on of an enterprise. To be entitled to deduct 'input tax' against his VAT payable, the vendor must be carrying on an enterprise and must have paid VAT on goods and services which he acquired wholly for the purpose of consumption, use or supply in the course of supplying the goods or services which are chargeable to tax under s7(1)(a) of the VAT Act. Section 17 provides for the apportionment method where the deductible input tax is acquired partly for consumption, use or supply in the course of making taxable supplies. Then, having regard to the definition of 'imported services' the question is whether the services are not utilised or consumed in the Republic or if they are utilised or consumed in the Republic they are utilised or consumed for the purpose of making taxable supplies, then the services would not be imported services.

Accordingly, the question was the nature of the enterprise because the purpose of acquiring the services and whether they were consumed or utilised in making taxable supplies could only be determined in relation to the enterprise (at paragraph 51). In the circumstances of the case, the majority held that De Beers was not a dealer in shares and that the holding of shares and the receipt of dividends did not fall within the definition of 'enterprise'. De Beers' enterprise for the purposes of the VAT Act consisted of mining, marketing and selling diamonds. Having arrived at this conclusion, it was clear that the English merchant bank's services were not acquired to enable De Beers to enhance its VAT enterprise of mining, marketing and selling diamonds. The services of the English merchant bank did not contribute in any way to the making of De Beers taxable supplies (at paragraph 53).

This was not a good outing to Bloemfontein for the taxpayer. While the judgment of Davis J was narrow in its finding and related very much to the facts, it would be of little value as a precedent. The finding of Navsa and van Heerden JJA in paragraph 27 is the finding that SARS will have left Bloemfontein very satisfied with, the enterprise of a holding company having been judicially ruled on.

Alastair Morphet

"RELEVANCE" IS IN THE EYE OF THE BEHOLDER (OR IS IT SARS?)*

Section 74A of the Income Tax Act, No 58 of 1962 (the ITA) is probably the most applied section when the South African Revenue Service (SARS) requires a taxpayer or third party to provide it with information. [Section 57A is the corresponding section in the VAT Act, No 89 of 1991.]

Section 74A reads: "The Commissioner or any officer may, for the purposes of the administration of this Act in relation to any taxpayer, require such taxpayer or any other person to furnish such information (whether orally or in writing) documents or things as the Commissioner or such officer may require".

Section 74(1) of the ITA contains wide-ranging definitions for 'information', 'documents' and 'things'.

The phrase 'for the purposes of the administration of this Act in relation to any taxpayer' is also defined in s74(1). It means the 'obtaining of full information' in relation to, for example, ascertaining the correctness of any return or information in SARS' possession, the determination of the liability of any person for any tax, the collecting of any such liability, and ascertaining whether an offence under the ITA has been committed.

Despite the wide ambit of the above-mentioned concepts, disputes regarding the legality of SARS' information gathering efforts and its entitlement to sensitive taxpayer-related information occur regularly.

The arguments normally raised are, firstly, the person in respect of whom SARS is requesting information should actually be a 'taxpayer' (that is, someone already on the SARS register); and secondly, unless SARS can specifically identify the taxpayer 'in relation to' whom it is requesting the information, SARS would not be entitled to such information under s74A.

* *The saying 'beauty is in the eye of the beholder' first appeared in the 3rd century BC in Greek. The earliest citation of the phrase is found in Molly Bawn (published in 1878) by Margaret Wolfe Hungerford who wrote under the pseudonym "The Duchess".*

The Tax Administration Bill (TAB) that will soon become law substantially expands SARS' information gathering powers. Apparently SARS got fed-up with all the tussles regarding the scope of its information gathering powers. The Memorandum accompanying the TAB (at p185, paragraph 2.2.5) states: "SARS' information gathering powers are substantially supplemented or extended by the TAB. This is essentially to address the problem that too many requests for information by SARS result in protracted debates as to SARS's entitlement to certain information".

Section 1 of the TAB defines 'administration of a tax Act' by simply referring to s3(2). That section, to a large degree, describes the concept in similar terms to s74(1) of the ITA.

The crucial difference is, however, that 'administration of a tax Act' as defined in s3(2) also empowers SARS to "obtain full information in relation to ... a taxable event." Section 1 of the TAB defines 'taxable event' as 'an occurrence' which affects or *may affect* the liability of a person to tax.

Furthermore, s3(2)(c) allows SARS to obtain full information to 'establish the identity of a person for purposes of determining liability for tax'.

The extent to which SARS' information gathering powers have really been expanded is also evident from Chapter 5 of the TAB.

In terms of s46(1) SARS may for purposes of the 'administration of a tax Act' (see above) "in relation to a taxpayer, whether identified by name *or otherwise objectively identifiable*, require the taxpayer or *another person* to, within a reasonable period, submit *relevant material* (whether orally or in writing) that SARS requires".

The following is noteworthy:

- SARS does not need to specifically identity the taxpayer in respect of whom it seeks information, as long as such taxpayer is 'otherwise objectively identifiable';
- SARS' information request could either be addressed to the taxpayer or to 'another person', for example a bank, insurance company, credit bureau.
- 'Relevant material' is defined in s1 of the TAB as "any information, document or thing that is *forseeably relevant* for tax risk assessment, assessing tax, collecting tax, showing non-compliance with an obligation under a tax Act or showing that a tax offence was committed";
- 'Information', 'document' and 'thing' are all defined in s1 of the TAB in very wide terms (stretching even further than under the equivalent ITA definitions).

The ambit of 'relevant material' that could be required by SARS under s46(1) is extremely wide seeing that it also includes any information/ document/thing that could be 'forseeably relevant' to SARS for a variety of purposes, for example tax risk assessment, assessing tax, collecting tax, showing non-compliance with a tax Act.

In many instances it would be virtually impossible for a third party from whom information is sought, to determine whether such material might, or might not be, 'forseeably relevant' in relation to something as opaque as tax risk assessment (to be undertaken by SARS).

Section 46(2) further broadens SARS' information-gathering powers by empowering a senior SARS official (defined term) to 'require relevant material in terms of ss(1) in respect of *taxpayers in an objectively identifiable class of taxpayers*."

A senior SARS official could conceivably require a bank to provide SARS with a spreadsheet listing all clients with fixed deposits of more than R10 million, alternatively all clients that have mortgage loans in respect of residential homes valued at more than R20 million.

All that s46(6) requires is that the "relevant material required by SARS ... must be referred to in the request with reasonable specificity."

The TAB, without doubt, substantially expands the information-gathering powers SARS will have in future.

What does SARS intend doing with all the information?

In its Strategic Plan 2012/13 – 2016/17 (at p 25) SARS talks of 'becoming data and information rich' and then states: "*By increasing and integrating data from multiple sources*, SARS will increasingly be able to gain a complete economic understanding of the taxpayer and trader across all tax types and all areas of economic activity. By moving from a transactional to an economic view of the taxpayer and trader, SARS will be able to detect inaccuracies in declarations as well as to identify those who have attempted to stay outside the tax net, but at the same time provide a more appropriate service".

Under the TAB both taxpayers and third parties should expect increasing information requests from SARS.

The real difficulty will be to evaluate the 'relevancy' of the information requested by SARS taking into account how broadly the TAB couches a concept like 'administration of a tax Act'.

Phrases like 'may affect', 'forseeably relevant' and 'reasonable specificity' could mean different things to different people – it depends on which side of the fence you are.

Maybe the debates that so irritated SARS in the past have only started ...

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