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TAX ALERT

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IN THIS ISSUE

THIRD PARTY APPOINTMENTS – AN AUSTRALIAN CAT AMONGST THE PIGEONS??

A recent Tax Alert (16 November 2012) considered SARS's ability to make third party appointments under s179 of the Tax Administration Act, No 28 of 2011 (TAA).

This follow-up article looks at the Australian case of *Commissioner of Taxation v Park [2012] FCAFC 122 (decided on 31 August 2012)* that analysed the corresponding provision in the Australian Tax Administration Act, 1953 (Australian TAA). The judgment caused quite a stir down under and could have significance for South African mortgagees.

Division 260 of the Australian TAA deals with 'Special rules about collection and recovery'. Section 260-5 specifically provide that the 'Commissioner may collect amounts from third party'. There is significant overlap and similarity in design and intent between the Australian third party notice provisions and those found in s179 of the local TAA. At the core of both sets of provisions is the Commissioner's ability to give a third party notice to pay to the fiscus money in satisfaction of a taxpayer's debt.

In the *Park* case the Federal Court of Australia had to decide whether the Commissioner's claim to payment of a tax debt front-ranked a registered mortgagee's entitlement to payment of monies lent to the taxpayer. The facts: There were two mortgages registered over the taxpayer's property. The sale price of the land was however insufficient to discharge the debt owed to both mortgagees. Before settlement the Commissioner served upon the purchasers of the land a garnishee notice issued under Australia TAA. It required the purchasers to pay part of the purchase consideration to the Commissioner in discharge of the seller's/taxpayer's tax debt. According to the Commissioner the fiscus was entitled to discharge of the tax debt in priority to the mortgagee's right to have its loan repaid.

In the court *a quo* the Federal Magistrate found against the Commissioner. It was held that the monies due to be tendered by the purchasers to the taxpayer at settlement, insofar as they were attributable to the secured debt, were not monies 'due' to the taxpayer pursuant to the notice under the Australian TAA [paragraph 29 of FCAFC judgment].

The Commissioner took the matter on appeal to the FCAFC.

The FCAFC majority judgment held as follows regarding the operation of the notice: "A notice under s260-5 (which this one was) imposes an obligation on the addressee immediately money becomes owing to the taxpayer. The money must be paid to the Commissioner instead of being paid to the taxpayer. There would, therefore, never be proceeds in the hands of the errant vendor which might be the subject of a charge in favour of the mortgagee" [par 103 of FCAFC judgment].

It was submitted to the FCAFC that, as a matter of construction, s260-5 should not be understood as entitling the Commissioner to step in and take the money promised to be paid to the vendor of a mortgaged property by his or her purchaser, at the expense of the mortgagee. The argument was that that would, in effect, turn the mortgagee into an unsecured creditor. The FCAFC rejected this proposition [par 104].

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Consequently, the majority judgment was that, once the mortgage was released to allow settlement, the Commissioner's notice applied in relation to the purchase consideration receivable by the seller/taxpayer – the Commissioner was therefore entitled to payment in priority to the mortgagee. The Court pointed out that the second mortgagee's position became compromised "...when it released its mortgage over the property" [par 114]. The second mortgagee's release of the mortgage (and allowing the proceeds to be held in a trust account pending resolution of a dispute between the parties), was its undoing.

The facts in the *Park* case were complex and somewhat unique. The wording of s260-5 ("The Commissioner may give a written notice ... if the third party owes or may later owe money to the debtor") is also not identical that of s179 of the TAA ("A senior SARS official may by notice to a person who holds or owes or will hold or owe any money ... for or to a taxpayer, require the person to pay the money to SARS ..."). One should thus be careful to extrapolate the Australian approach locally. The *Park* case does illustrate, however, the potential prejudice a third party notice could bring to the unwary mortgagee.

Taking into account SARS's increased reliance on s179 third party notices as a tax debt collection mechanism, recipients of such notices should be vigilant.

Johan van der Walt

NON-DISCRIMINATION – CAN IT BE APPLIED IN OUR GROUP RELIEF PROVISIONS?

An interesting judgment was reported in the United Kingdom (UK) on the application of the non-discrimination provisions contained in Article 24(5) of the UK-US Double Taxation Convention (DTC), which may also be applicable in a South African context.

Article 24 of the DTC is intended to preclude discrimination against certain classes of persons or entities in respect of the taxation by a Contracting State, but does not preclude every form of discrimination.

In *Revenue and Customs Commissioners v FCE Bank plc [2012] EWCA Civ 1290*, the Court of Appeal (Civil Division) had to consider whether Article 24(5) of the DTC was applicable, which provided that:

"Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected."

The Court had to consider whether or not Article 24(5) was applicable in the circumstances where FCE and FMCL were companies resident in the UK. They were both owned and controlled by FMC, a company resident in the USA. FMCL made trading losses during the relevant accounting period and claimed to surrender a portion of them to FCE in terms of the UK group relief provisions (similar provisions do not exist in South Africa). The Revenue and Customs Commissioners (HMRC) refused the claim on the basis that, under the applicable legislation, the status of the parent company, FMC, as a non-UK resident company, prevented it and the two subsidiaries from constituting a 'group' as defined in the UK tax legislation.

FCE admitted that it did not fall within the domestic group relief provisions, but claimed that those domestic group relief provisions were contrary to the non-discrimination provision in Article 24(5), and was thus entitled to the group relief.

Appealing from the First-tier Tribunal and the Upper Tribunal (which both agreed with FCE), the HMRC argued that the discrimination was not solely due to the foreign ownership or control of FCE and referred extensively to *Boake Allen Limited and others v HMRC [2007] 1 WLR 1386*. In the *Boake Allen* case is was held that legislation which allows a parent company and a subsidiary to pay dividends free of the advance corporation tax (ACT) between resident companies, but not resident and a non-resident companies, did not amount to discrimination (ie the reason for the discrimination by the subsidiaries was not because the parent was a foreign company but because they were not companies liable for corporation tax).

In response, the taxpayer (FCE) submitted that:

- In a case in which group relief is claimed it is simply necessary for there to be two companies, the surrendering company and the claimant company. Both such companies of course have to be liable to corporation tax and in the present case the surrendering company, FMCL, and the claimant company, FCE, were so liable. The liability or otherwise of the parent company, FMC, to corporation tax was of no relevance: FMC's only relevance was the fact that it was the owner of the two subsidiaries, which showed that it and they together formed a corporate group;

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- The reason for the discrimination suffered by the subsidiaries in Boake Allen was not because their parents were foreign companies but because they were not companies liable to corporation tax or, therefore, to which the ACT liability could be passed on by the subsidiaries; and
- The true, and only, reason for the discriminatory treatment of FMCL and FCE is because their corporate parent was resident in the US rather than the UK.

The Court held that the *Boake Allen* case is a valuable decision in that it shows the need to focus on the ground for the discrimination when considering whether Article 24 is applicable. In addition, it was observed that if the case involved the surrender of losses from FMC (USA resident) to FCE (UK resident), it appears unlikely that the discriminatory refusal of group relief would be subject to Article 24(5).

Accordingly, it was held that the purpose and effect of Article 24(5) is to outlaw the admittedly discriminatory tax treatment to which (but for the convention) FCE would be subject as the directly held subsidiary of a US resident company as compared with the more favourable tax treatment to which it would be entitled if it were the directly held subsidiary of a UK resident company. Thus, the only reason for the difference in treatment in the present case was the fact of FMC's US residence and thus contained discrimination as contemplated in Article 24(5).

South African Context

In a South African context, it may be possible to raise similar arguments in respect of the intra-group provisions contained in s45 of the Income Tax Act No. 58 of 1962 (Act).

For instance, s45 of the Act provides tax roll-over relief for assets disposed of between companies that form part of the same 'group of companies' as at the end of the day of the transaction. However, for purposes of s45 of the Act, the "group of companies" definition excludes a foreign group of companies (see the narrower definition of 'group of companies' in s41 of the Act). As a result, two South African companies that are wholly owned subsidiaries of a foreign company, will not necessarily form part of the same 'group of companies' contemplated in s41 of the Act. Notably, there is a view that the two South African subsidiaries should still form part of the same 'group of companies', only the foreign parent company being excluded from the group. There may be merit in this view taking into consideration the comments in the Explanatory Memorandum on the Revenue Laws Amendment Bill, 2007, which said that "[a] group of companies eligible for intra-group relief must all operate on the same tax plane… Therefore, fully or partially exempt companies will now fall outside the intra-group relief (including foreign companies falling wholly or partially outside the South African tax net and enforcement)."

While these conflicting views on the interpretation of the 'group of companies' definition contained in s41 of the Act remain, there is a risk that s45 of the Act currently precludes the transfer of assets between two South African subsidiaries that are wholly owned by a foreign parent company (which is similar to the circumstances described in the *FCE Bank* case). Depending on the wording of the applicable treaty (if any), there may therefore be an argument, based in the *FCE Bank* case, that the only reason for the difference in the treatment in this scenario, compared to a scenario where the subsidiaries are directly held by a South African resident controlling company, is the fact that the parent company is a non-resident. If that is the case, one may be in contravention of the non-discrimination provisions contained Article 24 of the applicable treaty.

Importantly, Article 24(5) of the treaty will only be applicable where the reason for the discrimination (difference in tax treatment) is that the enterprise is wholly or partly owned or controlled by a non-resident. It will be interesting to see whether this argument will be raised by any South African taxpayers in the future and whether the principle it may be applied to other provisions of the Act (or other types of taxes such as securities transfer tax).

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