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TAX AND EXCHANGE CONTROL ALERT

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IMPORTANT JUDGMENT ON THE CONSTITUTIONALITY OF RETROSPECTIVE LEGISLATION

Fabricius J was presented with, among others, the question of whether the enactment of retrospective legislation, particularly fiscal legislation, which ex post facto deems the law at a particular time to be what it was not, offends against the principle of legality and the rule of law which lies at the heart of our constitutional dispensation.

"Our new Constitution is now established, and has an appearance that promises permanency; but in this world nothing can be said to be certain, except death and taxes." — Benjamin Franklin, in a letter to Jean-Baptiste Leroy, 1789.

In this case the court had to consider retrospectivity in the "strong" sense, where the amendment was deemed to be effective from a date earlier than when the relevant amending Act was promulgated.

The famous quote by Benjamin Franklin is important not only because of the inevitability of taxes but also due to the fact that taxes, and the laws which frame them, should maintain a level of certainty. In South African law, this is premised on among others, s1(c) of the Constitution of The Republic of South Africa, 1996 (Constitution) which states that South Africa is founded on the supremacy of the Constitution and the rule of law. Thus, the rule of law proposes that law should not be formulated in wide general terms but should be reasonably clear and precise; otherwise a decision by discretion is imported.

In a recent judgment in the High Court in *Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue and Another* (GNP), unreported case no 87760/2014 of 29 May 2017 (Pienaar Bros), Fabricius J was presented with, among others, the question of whether the enactment of retrospective legislation, particularly fiscal legislation, which ex post facto deems the law at a particular time to be what it was not, offends against the principle of legality and the rule of law which lies at the heart of our constitutional dispensation. The judgment is important as it aims to provide guidance and jurisprudence in an area of South African tax law which has been beset with much debate and consternation.

In the context of retrospectivity of legislation, the court pointed out that South African case law distinguishes between retrospectivity of legislation in the "weak" and "strong" sense. A statutory provision is retrospective in the weak sense if it prospectively effects, or changes the consequences for the future of pre-existing transactions and matters. An enactment is retrospective in the strong sense if the provision is deemed to have been in force from an earlier date than that on which it was in fact enacted. In this case the court had to consider retrospectivity in the latter instance, where the amendment was deemed to be effective from a date earlier than when the relevant amending Act was promulgated.

Facts

Serurubele Trading 15 (Pty) Ltd (Taxpayer) entered into an amalgamation transaction in terms of s44 of the Income Tax Act, No 58 of 1962 (Act) in which it acquired all the assets of Pienaar Brothers (Pty) Ltd (Pienaar Brothers) on 16 March 2007, which acquisition was effective from 1 March 2007. As part settlement of the purchase consideration the Taxpayer issued shares to Pienaar Brothers at the purchase price, less the assumed liabilities (equity consideration), which equity consideration less the par value of the shares was credited to the share premium account of the Taxpayer.

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It was the Taxpayer's submission that, as at 3 May 2007 when the distribution was made, the Distribution did not constitute a "dividend" as defined in the Act and no STC was therefore due and payable by the Taxpayer on the Distribution.

On 3 May 2007, the Board of Directors of the Taxpayer resolved, in terms of s90 of Companies Act, No 61 of 1973 (old Companies Act), read with Article 21A of the Taxpayers Articles of Association, to make a distribution to its shareholders *pro rata* to their shareholding, of an amount of R29,500,000 out of the Taxpayer's share premium account (Distribution).

The applicable law on 3 May 2007 in the context of the definition of a "dividend" in s1 of the Act meant that a "dividend" excluded from its ambit, any amount distributed out of the share premium account (not being profits previously capitalised to the share premium account). It was the Taxpayer's submission that, as at 3 May 2007 when the distribution was made, the Distribution did not constitute a "dividend" as defined in the Act and no STC was therefore due and payable by the Taxpayer on the Distribution, as the Distribution was made out of the share premium account of the Taxpayer, which share premium arose from the issue of ordinary shares at a premium over the par value.

Background and context

Secondary tax on companies (STC) was introduced by s64B and s64C of the Act. It was the tax on net dividends, that is, on a company's distribution of its profits to its shareholders. It was not meant to tax capital distributions. On this basis, para (f) of the definition of a "dividend" in s1 of the Act excluded any distribution that represented "a reduction of a share premium account of a company".

Section 44 of the Act, which facilitates amalgamations, defines an amalgamation as a transaction by which a company (amalgamated company) disposes of all of its assets to another company (resultant company) and as a result of which, the amalgamated company is terminated. Section 44(9) catered for amalgamations, such as the Pienaar Brothers' amalgamation in the case at hand, where the resultant company (Newco) issued shares to the amalgamated company (Oldco) which the latter then distributed to its shareholders as a dividend *in specie*. Such a dividend would ordinarily have attracted STC. Section 44(9), however, exempted it from STC by deeming the distribution not to be a dividend for purposes of STC.

The purpose of the exemption was to render an amalgamation transaction as STC neutral, by exempting the distribution by the amalgamated company (ie Oldco) of its shares in the resultant company (Newco). Parliament assumed that the distributable income previously held by the amalgamated company (Oldco), would be rolled over into the resultant company (Newco) and thus attract STC, as it would have done in the amalgamated company (Oldco) if and when distributed by way of a dividend declared by the resultant company (Newco).

The assumption, however, overlooked the fact that distributable income in the hands of the amalgamated company (Oldco) may change character and become share premium in the resultant company (Newco) as happened in the Pienaar Brothers' transaction. The parties to such a transaction would then avoid STC altogether.

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As a result of becoming aware of this loophole, the then Minister of Finance, in the 2007 Budget Speech made reference, in general terms, to an intention to pass retrospective legislation to deal with certain anti-avoidance arrangements relating to STC.

The amalgamated company (Oldco) would surrender its distributable income to the resultant company (Newco) in return for Newco shares. Its distribution of the Newco shares to its own shareholders would constitute a dividend, but be exempt from STC by virtue of s44(9) of the Act. The resultant company (Newco) would receive the assets of the amalgamated company (Oldco) but, in its hands, they would represent share premium and not distributable income. Any distribution to shareholders by the resultant company (Newco) from its share premium, would also avoid STC because, it would be a capital distribution and not a "dividend" as defined. The amalgamation accordingly would allow the parties to avoid STC that would otherwise have been payable by the amalgamated company (Oldco) on its distributable income.

Announcement by Minister of Finance in 2007 Budget

As a result of becoming aware of this loophole, the then Minister of Finance, in the 2007 Budget Speech made reference, in general terms, to an intention to pass retrospective legislation to deal with certain anti-avoidance arrangements relating to STC. He provided no further detail as to what arrangements were to be addressed, or in what manner.

On 21 February 2007 the Commissioner for the South African Revenue Service (Commissioner) issued a press release in terms of which, among other things, the STC exemption for amalgamation transactions contained in s44(9) of the Act was stated to be withdrawn with immediate effect. The particular statement read as follows:

> 21 February 2007: The STC exemption for amalgamation transactions contained in Section 44 (9) of the Income Tax Act, 1962, is withdrawn. This exemption permits a permanent loss of STC, rather than a deferral of tax, which is the intent of the amalgamation provisions.

What followed thereafter was the ordinary public consultation process in respect of any revenue bill, which ultimately resulted in the promulgation of the Taxation Laws Amendment Act 8 of 2007 on 8 August 2007 (Amending Act). Section 34(1)(c) of the Amending Act inserted into s44 of the Act, a new s44(9A). The effect was that it deemed the resultant company's equity share capital (and share premium) arising from the amalgamation to be profits not of a capital nature available for distribution to shareholders to the extent of any profits distributed by the amalgamated company in terms of subsec(9). Effectively therefore the amalgamated company's profits would be rolled over to the resultant company, so that STC remained payable when the resultant company makes the subsequent distribution, thereby closing the loophole.

Importantly for our purposes, s34(2) of the Amending Act provided that s44(9A) was deemed to have come into operation on 21 February 2007 and would be applicable "to any reduction or redemption of the share capital or share premium of the resultant company, including the acquisition by that company of its shares in terms of s85 of the Old Companies Act upon or after that date".

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The question was whether, on a proper interpretation, the introduction of s44(9A) actually had a retroactive effect so as to render the distribution subject to STC.

Issue

The subject matter of the dispute between the parties was the STC assessment raised by the Commissioner in an amount of R3,687,500 (12.5% of R29,500,000) on the Distribution of the Taxpayer made on 3 May 2007 in pursuance of the amalgamation transaction. This was based on the abovementioned amendment having retrospective effect and therefore applying to the Distribution made on or after 21 February 2007.

The application to the High Court by the Taxpayer in pursuance of disputing the STC assessment required the court to consider two main issues which formed the crux of the Taxpayer's argument:

- That s34(2) of the Amending Act should declared to be inconsistent with the Constitution and invalid (Constitutional Issue);
- Alternatively, that the provisions of s44(9A) of the Act did not apply to the distribution by the Taxpayer on 3 May 2007, to its registered shareholders at that date pro rata to their shareholding, of an amount of R29 500 000 out of the Taxpayer's share premium account (Interpretational Issue).

Interpretational Issue

Fabricius J stated at paragraph 15 that while he would strictly speaking not be required to decide the Constitutional Issue if he were to find that the Amending Act, on a proper construction, did not apply to the transaction retrospectively, he stated that it would be convenient to deal first with the Interpretational Issue.

In respect of the Interpretational Issue, the Taxpayer's submission was not concerned with the underlying content of s44(9A), but rather on the supposed retroactivity of the amendment. The alternative submission was thus to the effect that the provisions of s44(9A) of the Act did not in fact apply to the distribution when it was made, which was based on statutory interpretation. The basis then of the Taxpayer's argument was that the Amending Act had to be interpreted in the same way as any other statutory provision, and that the question was whether, on a proper interpretation, the introduction of s44(9A) actually had a retroactive effect so as to render the distribution subject to STC.

In that context it was submitted on behalf of the Taxpayer that while s34(2) of the Amending Act expressly made s44(9A) retrospective to 21 February 2007, it did not expressly state that it affected completed transactions. In summation, the consequences of the retrospectivity led to unfair and anomalous results, and it could therefore not be accepted that Parliament intended the new provision to apply to completed distributions. No such anomalies or difficulties would arise if the new s44(9A) applied only to transactions and distributions that occurred after its promulgation. In the context of the interpretative challenge, it was accordingly submitted that s34(2) should be interpreted to limit the retroactive application of s44(9A) to transactions or distributions that were not complete before 8 August 2007.

Fabricius J dismissed the arguments put forth by the Taxpayer in this regard on the basis that the amendment was clear, its purpose was rational and that it applied to all transactions including completed transactions. As a result thereof, Fabricius J considered the main application, that the introduction of the relevant amendment was constitutionally invalid.

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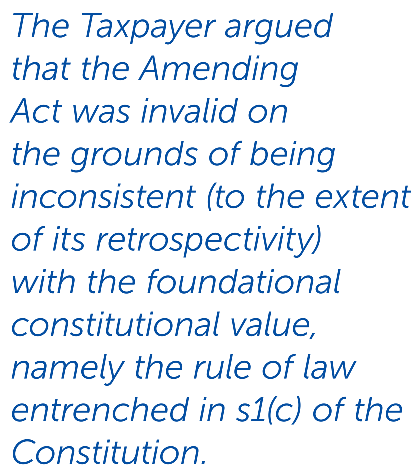
The Taxpayer argued that the Amending Act was invalid on the grounds of being inconsistent (to the extent of its retrospectivity) with the foundational constitutional value, namely the rule of law entrenched in s1(c) of the Constitution.



Constitutional Issue

The Taxpayer argued that where the court found that the legislature intended the Taxpayer to pay STC *ex post facto* on the distribution, then it submitted that the Amending Act was invalid on the grounds of being inconsistent (to the extent of its retrospectivity) with the foundational constitutional value, namely the rule of law entrenched in s1(c) of the Constitution. Importantly, the Taxpayer did not initially put forth the argument that the amendment infringed a right contained in the Bill of Rights of the Constitution wherein the court would have to consider whether the limitation of such right was reasonable and justifiable in an open and democratic society as contemplated in s36(1) of the Constitution. However, as will be discussed below, the Taxpayer did ultimately advance arguments that the right to property as envisaged in s25(1) of the Constitution had been infringed.

Taxpayer's submissions on the Constitutional Issue

The court considered various academic writings and case law on the meaning and ambit of the rule of law. In particular, Fabricius J stated that it was quite correctly submitted that not only must Government act in accordance with laws, but also that the laws must have a certain essential quality, namely, in the present context, that laws should be reasonably clear, accessible and prospective in their operation.

Fabricius J thereafter summed up the rule of law argument at paragraph 41 as follows:

> In Veldman v Director of Public Prosecutions: 2007 (3) SA 210 (C), Mokgoro J, writing for the minority said the following at par. [26], with reference to Calder v Bull 3 US 386 (1798) at 388 and 396: "Generally, legislation is not to be interpreted to extinguish existing rights and obligations. This is so unless the statute provides otherwise or its language clearly shows such a meaning. That legislation will affect only future matters and not take away existing rights is basic to notions of fairness and justice which are integral to the Rule of Law, a foundational principle of our Constitution. Also central to the Rule of Law is the principle of legality which requires that law must be certain, clear and stable. Legislative enactments are intended to "give fair warning of their effect and permit individuals to rely on their meaning until expressedly changed".

Within this context, Fabricius J offered the following, also at paragraph 41:

> As it stands, this exposition is generally accepted, but it must be said that context is everything in law, and obviously one needs to examine the particular statute and all the facts that gave rise to it. This principle applies expressly in Criminal Law. See: Section 35 (3) (l) of the Constitution, but our Courts have yet to consider definitely whether outside the Criminal Law context, retrospective legislative amendments can be constitutionally valid. It was therefore submitted in the light of the mentioned constitutional imperative, the Courts must vindicate the Rule of Law by setting aside legislation which contravenes that principle. No longer are the Courts limited to techniques of strict statutory interpretation in the

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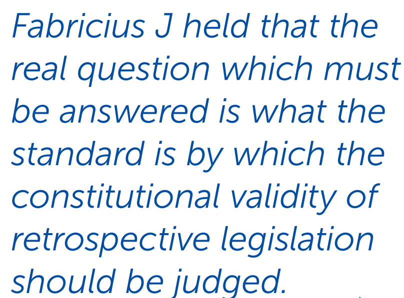

> light of presumptions to express their disapproval of breaches of the Rule of Law. Such legislation is contrary to the Constitution and therefore invalid.

The court noted that the Taxpayer's submission was based on the fact that, as in Germany, the rule of law compels a conclusion that strongly retrospective tax statutes should be presumed to be constitutionally invalid. The Taxpayer, however, did not expressly suggest that South Africa's constitutional dispensation would never allow the legislature to introduce retrospective legislative amendments. There could well be exceptional cases where this could be done without attracting constitutional sanction. The fundamental issue would, however, always be whether the retrospectivity amounts, in the particular circumstances of their case, to a contravention of the rule of law.

It was submitted to the court that knowledge of proposed retrospective amendments to the law is fundamental to the rule of law, and essential for taxpayers to be able to regulate their conduct in accordance with those amendments. Hence, unless there was adequate warning of the intention to implement the change retrospectively, such that the taxpayer cannot be said to have been entitled to rely on the law continuing to apply, a retroactive amendment could never pass constitutional muster.

The Commissioner's counter submissions on the Constitutional Issue

The Commissioner submitted that the Constitution does not in general out-law retrospective legislation, except in the context of criminal law, (ie s35(3)(l) of the Constitution). The question therefore is to what extent the entrenchment of the rule of law inhibited or prohibited retrospective legislation.

The Commissioner submitted that the Taxpayer's contention that the retrospective amendment was invalid, because there had not been adequate notice for its enactment was untenable for the following reasons:

- It was inconsistent with the approach in the foreign jurisdictions to which our courts frequently look for guidance in such matters, such as Canada, the United States, the European Union and the United Kingdom;
- It was inconsistent with the approach the Constitutional Court has laid down in relation to the constitutional scrutiny of legislation; and
- The Taxpayer's challenge would in any event fail, even on its own test.

Findings – test under South African law

It was submitted that the foreign law comparison makes it clear that retrospective laws are permissible and indeed commonplace in countries based on the rule of law. At the same time it was not suggested that Parliament may legislate with retrospective effect as it pleases. Fabricius J held that the real question which must be answered is what the standard is by which the constitutional validity of retrospective legislation should be judged.

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A mere prospective amendment would have encouraged taxpayers to exploit the loophole in the last few months before the loophole was closed and hence the measure which the legislature chose to close such loophole was properly related to the public good it sought to realise.

In this regard he held that such a question should be answered with reference to the standards of review laid down by our courts when the constitutional validity of a statute is challenged which included two main standards:

- The first is the "rationality" test. This is the standard that applies to all legislation under the rule of law entrenched in s1(c) of the Constitution.
- The second, and more exacting standard, was that of "reasonableness" or "proportionality", which applies when legislation limits a fundamental right in the Bill of Rights. Section 36(1) of the Constitution provides that such a limitation is valid only if it is "reasonable and justifiable in an open and democratic society".

Findings on the rule of law – rationality test

It was submitted on behalf of the Commissioner that the difficulty for the Taxpayer was that once the rationality standard applies, its case would inevitably fail, with which the court agreed. In essence a mere prospective amendment would have encouraged taxpayers to exploit the loophole in the last few months before the loophole was closed and hence the measure which the legislature chose to close such loophole was properly related to the public good it sought to realise. It was thus fundamental that the Legislature protected the fiscus by closing the loophole in the manner that it did.

At paragraph 97, Fabricius J held further that the South African Constitution does not recognise the constraint that knowledge of the proposed retrospective amendment to the law is fundamental to the rule of law. In this regard, Fabricius J held specifically that he was not aware of any authority or legislative provision that provides that a fairly precise warning needed to be given before the legislature could pass retrospective legislation, whether in general, or in the case of a tax statute. In the latter instance, economic demands must be considered in the context of the purpose and effect of an intended statute. If the tax statute is rationally connected to a legitimate purpose, no precise warning is required, if one at all.

Furthermore, it was important that Parliament did not retrospectively amend the Act as it pleased, but rather went through the rigorous and thorough public consultation process where it carefully considered various representations from a variety of stakeholders. Fabricius J thus held at paragraph 97:

> Similarly, Applicant [Taxpayer] did not provide any authority for their contention that "knowledge" or "adequate warning" is constitutionally required for tax legislation to pass constitutional muster. In any event, if it were to be found that such "knowledge" or "adequate warning" was essential, it was submitted that the process that was followed, and I have given all relevant details, was sufficient and ought to have put any taxpayer who was contemplating amalgamation transactions with a view to derive STC exemption from such, would have been placed on full guard that legislation was going to be amended to remove the particular exemption.

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The application by the Taxpayer to declare the retrospective application of the amendment to the legislation as constitutionally invalid based on the rule of law was thus dismissed.

Fabricius J held further at paragraph 85 in respect of the Taxpayer complaint that the manner in which parliament closed the loophole differed from the manner in which the Minister had originally foreshadowed in the 2017 Budget:

> I am not aware of any provision in any of the jurisdictions that I have referred to, or indeed in ours, to the effect that the warnings given must relate to the exact same amendment that is ultimately made. To adopt such an approach would undermine the parliamentary process and the public participation process completely. It would also mean that parliament would be bound by an announcement made by the executive. Taxpayer had already suggested that I do not need to find how precise a warning in this context must be, inasmuch as in the present proceedings, no warning at all had been given. I do not agree with this contention, the facts show otherwise, and it loses sight of the fact that there may be cases where no warning needs to be given at all. I am therefore not of the opinion that a precise warning must be given in each and every case, nor that a warning, of whatever ambit, needs to be given in all cases. In my view, a proper approach would be to judge the legality of retrospective amendments on a case-by-case basis, having regard to the various considerations that I have referred to. The Constitution itself certainly does not prohibit retrospective legislation in civil law.

Further important findings by Fabricius J on the arguments put forth are set out below:

- There is no authority for the proposition that retrospective tax legislation would survive constitutional scrutiny only if there were "good reasons" for it. It is not for a Court to say what a good "reason" is [paragraph 99].
- The language of the present amendment was clear, as it referred to "all" transactions. It was immaterial whether a transaction was completed or not if it fell within the period of the retrospective operation of that legislation. All the foreign judgments, to which reference had been made, were concerned with completed transactions… [He further added] that modern jurisprudence should never be dogmatic, especially not in the field of fiscal legislation, as economic considerations seem to be presently in a constant state of fluidity, and not only in South Africa [paragraph 100].
- Furthermore there was no basis for holding that under the present Constitution, Parliament can only pass retrospective legislation if "exceptional circumstances" exist. A Court is also not obliged to adopt a "rigorous approach, which would require "a very high level of correlation" between the changes to the law of which the taxpayer has been notified and the actual legislative amendment that follows, as the Taxpayer contended for [paragraph 101].

The application by the Taxpayer to declare the retrospective application of the amendment to the legislation as constitutionally invalid based on the rule of law was thus dismissed.

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Importantly, the court did not state outright that all legislation would pass the requirements of rationality and uphold the rule of law, but rather that each specific instance should be decided on its facts and specific circumstances.

Further submission – deprivation of property

In a Supplementary Affidavit, the Taxpayer sought to establish a further cause of action based on s25(1) of the Constitution. This challenge was founded on the fundamental right to property on the basis that the retroactive removal of the exemption from STC in para (f) of the definition of "dividend", without adequate notice, would have amounted to a deprivation of property that was both procedurally and substantively arbitrary and thus inconsistent with s25(1) of the Constitution. In dismissing the Taxpayer's contention in this regard, Fabricius J held the following at paragraph 107:

> It was therefore submitted that the Taxpayer had to establish that the impugned provisions give rise to a substantial interference with property rights that go beyond the normal restrictions on property use or enjoyment in a democratic society. In my view it cannot be argued that all taxes involve a "deprivation" of property, in the context of section 25(1). A State cannot exist without taxes. Society receives benefits from them. Taxes are not penalties. Neither can they be, without any qualification, be regarded as unjust deprivation of property use. If it is Taxpayer's view that only retroactive taxation gives rise to such deprivation, then again, no unjust deprivation occurred here. The State used a well-accepted mechanism to close a loop hole in a statute. It did not solely target the Taxpayer. Its purpose was rational. It gave ample warning of its intention. The retroactive amendment does in my view also not amount to illegitimate deprivation. Sufficient reason was established and the process was fair in the present context, not that "fairness" is a requirement.

Summary

The *Pienaar Bros* case is therefore a fundamental judgment on whether retrospective legislation passes Constitutional muster. Importantly, the court did not state outright that all legislation would pass the requirements of rationality and uphold the rule of law, but rather that each specific instance should be decided on its facts and specific circumstances. Nevertheless, the court also importantly pointed out that the Constitution, in itself, does not prohibit the retrospective amendment of legislation.

Furthermore the court dismissed the alternative submission by the Taxpayer that the retroactive effect of the legislation without adequate notice would have amounted to a deprivation of property that was both procedurally and substantively arbitrary and thus inconsistent with s25 (1) of the Constitution.

It will be interesting to monitor developments on this matter and to see whether the Taxpayer ultimately appeals to the Constitutional Court.

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THE VAT IMPLICATIONS OF THE SALE OF BOOK DEBTS WRITTEN OFF

According to the Explanatory Memorandum to the Taxation Laws Amendment Bill, 1997, the purpose of proviso (iv) to s22(1) was to prohibit a deduction of the difference between the face value and the consideration for accounts receivable upon transfer.

Proviso (iv)(aa) to s22(1) of the VAT Act, does not preclude a vendor from claiming a deduction in terms of s22(1) on irrecoverable debts which are subsequently sold to a debt collector on a non-recourse basis, and no adjustment in relation to deductions previously made is required when the debts are sold.

When a vendor, which is registered for value added tax (VAT) on the invoice basis, has made a taxable supply on credit, the vendor is generally required to account for the VAT on the value of the supply when a tax invoice for the supply is issued. If the vendor is unable to recover the debt, then s22(1) of the Value Added Tax Act, No 89 of 1991 (VAT Act) provides relief to the vendor by allowing for a deduction of the VAT previously accounted for, when the debt is written off as irrecoverable.

It often happens that the vendor then sells these book debts that have been written off to specialised debt collectors in an attempt to recover at least a portion of the losses suffered as a result of the non-payment by the debtors. The question that often arises is whether there are any consequences for the vendor regarding the sale of such book debts.

The book debts are generally sold to a debt collector on a non-recourse basis for amounts which are substantially less than the amounts owing. Proviso (iv)(aa) to s22(1) of the VAT Act, prohibits the claiming of a deduction for VAT on the transfer of accounts receivable at face value on a non-recourse basis. According to the *Explanatory Memorandum to the Taxation Laws Amendment Bill*, 1997 (Explanatory Memorandum), the purpose of proviso (iv) to s22(1) was to prohibit a deduction of the difference between the face value and the consideration for accounts receivable upon transfer thereof. This is because such discount is not considered to be an irrecoverable debt as contemplated by s22(1), but a financing cost.

The Explanatory Memorandum stipulates further that the 'face value' of a debt transferred is, for the purpose of s22(1), the net value of the account receivable at time of transfer, after adjustments have been made for debit and credit notes and after bad debts are already written off by the vendor. Therefore, if the special meaning to the term 'face value', as attributed by the Explanatory Memorandum is applied, then the accounts receivable, which have been written off as irrecoverable by the vendor, are transferred for a consideration greater than their face value, and not at a discount. Therefore, there is in any event no amount that could qualify as a deduction in these circumstances.

Accordingly, proviso (iv)(aa) to s22(1) of the VAT Act, does not preclude a vendor from claiming a deduction in terms of s22(1) on irrecoverable debts which are subsequently sold to a debt collector on a non-recourse basis, and no adjustment in relation to deductions previously made is required when the debts are sold.

A further aspect to consider is whether the vendor 'recovers' an amount, as contemplated by s22(2) of the VAT Act, when the book debts are sold.

Section 22(2) provides that where an amount, which was previously written off as irrecoverable in terms of s22(1) and any amount is subsequently recovered, the vendor is required to account for VAT on the amount recovered.

The debtors are never absolved from their obligation to make payment to the supplying vendor, and the total amount owing remains payable. The vendor disposes of its rights and interest in and to the debt owing by the debtors to the debt collector.

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THE VAT IMPLICATIONS OF THE SALE OF BOOK DEBTS WRITTEN OFF

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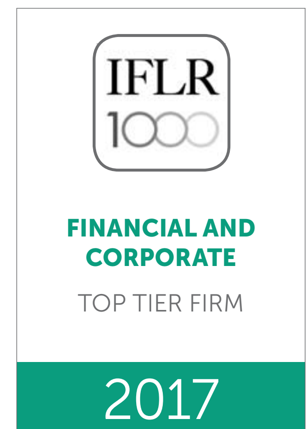
When the vendor sells the book debts to the debt collector, the sale proceeds are consideration for an exempt supply, being the transfer of ownership of a debt security, and do not comprise amounts 'recovered' in relation to the book debts.

Section 12(a) of the VAT Act exempts from VAT the supply of 'financial services'. The term 'financial services' includes the transfer of ownership of a debt security. A 'debt security' is in turn defined to include an interest in, or right to be paid money that is owing by any person. The book debts therefore comprise 'debt securities' and the sale by a vendor of such book debts is then exempt from VAT.

Consequently, when the vendor sells the book debts to the debt collector, the sale proceeds are consideration for an exempt supply, being the transfer of ownership of a debt security, and do not comprise amounts 'recovered' in relation to the book debts. The debt collector further does not make any payment to the vendor on behalf of the debtors when the book debts are acquired. The vendor merely transfers its right to recover the amounts owing by the debtors to the debt collector, who then becomes entitled to recover the amounts from the debtors concerned.

Accordingly, when a vendor disposes of book debts that have previously been written off as irrecoverable on a non-recourse basis to a debt collector, the sale is exempt from VAT, and the vendor is not required to make any adjustment in respect of the VAT previously deducted when the debts were written off as irrecoverable. The vendor is also not required to account for VAT on the sale proceeds.

Gerhard Badenhorst



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CUSTOMS AND EXCISE HIGHLIGHTS

Please note that this is not intended to be a comprehensive study or list of the amendments, changes and the like in the Customs and Excise environment, but merely selected highlights which may be of interest.

In the event that specific advice is required, kindly contact our Customs and Excise specialist, Director, Petr Erasmus.

This week's selected highlights in the Customs and Excise environment since our last instalment:

1. The Draft Deferment Rules in terms of the Customs Duty Act, No 30 of 2014 (Customs Duty Act) has been published for comment, which comments are due on 31 July 2017. Comments may be sent to C&E_legislativecomments@sars.gov.za. Major changes to the existing structure appear to be the following:

   1.1 Currently a separate deferment account is required for each Customs branch office, but in terms of the new legislation a single guarantee may be implemented throughout the RSA;

   1.2 An applicant must have a record of compliance with the Customs Duty Act, the Customs Control Act, No 31 of 2014 (Customs Control Act), Customs & Excise Act, No 91 of 1964 (Act) and other tax levying Acts during a period of 5 years preceding the application;

   1.3 General payment dates will be confined to the 7th, 14th or 21st of each month;

   1.4 The deferment benefit will remain valid for a maximum period of three years;

   1.5 All deferments granted under the Act expire on the effective date of the Customs Duty Act. However, these deferment holders are allowed to apply for deferment benefits and for the customs authority to consider and decide these applications before the effective date so that deferment benefits can be utilised without a break during the transition; and

   1.6 Only certain procedures will be allowed to be cleared under deferment. These exclude the warehousing procedure, the inward/home use processing procedures, etc. Footnote number 1 provides as follows:

   > Deferment of duty benefits will therefore not be available for persons clearing goods for home use after the goods have first been cleared for a customs procedure, such as warehousing. Also excluded are persons liable for duties on imported goods cleared for inward or home use processing. Secondly, the rule also aims to exclude from the permitted categories of applicants certain subcategories that do clear goods for home use under Chapter 8 upon importation, viz. casual importers, non-local importers and registered agents of non-local casual importers.

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CUSTOMS AND EXCISE HIGHLIGHTS

CONTINUED

In accordance with the Policy, the two persons referred to will have to write an open book test where the required pass rate will be 60%.

2. The Customs Sufficient Knowledge Policy (Policy) has been made available by SARS. It becomes effective on the date that the Customs Control Act is proclaimed in the Government Gazette. In accordance with the Policy, two persons must have sufficient customs knowledge for the following types of licensees and/or registrants:

    2.1 Air cargo depot;

    2.2 Container depot;

    2.3 Courier carrier;

    2.4 Courier air cargo depot;

    2.5 Courier Customs broker;

    2.6 General Customs brokers;

    2.7 Home use processing premises including Special Economic Zones (SEZ);

    2.8 Inbound or Outbound Tax Free Shop(s);

    2.9 Inward processing premises, including SEZ;

    2.10 Local or non-local carrier transports goods / travellers into or out of South Africa for reward by sea, air, rail or road;

    2.11 Private storage warehouse, including SEZ;

    2.12 Public storage warehouse, including SEZ;

    2.13 Registered agent for all non-local registered or licensed clients;

    2.14 Terminal(s):

        2.14.1 Sea cargo terminal for general, special, bulk, combination or multi-purpose;

        2.14.2 Container terminal;

        2.14.3 Travellers terminal: Sea, air or rail;

        2.14.4 Air cargo terminal;

        2.14.5 Rail cargo terminal; or

        2.14.6 Container terminal.

    2.15 Transhipment depot for sea and air cargo;

    2.16 Special shops for diplomats;

    2.17 State warehouses operated by a licensee on his/her premises; and

    2.18 Stores supplier for foreign-going vessels, aircrafts or cross-border trains.

3. In accordance with the Policy, the two persons referred to will have to write an open book test where the required pass rate will be 60%.

4. Draft rule amendment to substitute item 200.08 of the Schedule to the Rules by the addition of Saldanha Bay and Richards Bay as places where container depots may be established. Due date for public comments is 20 June 2017 and comments may be sent to C&E_legislativecomments@sars.gov.za.

5. Please advise if additional information is required.

Petr Erasmus

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