

# TAX & EXCHANGE CONTROL ALERT

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It is beyond doubt that South Africa enjoys sunshine more than most places on earth. The South African Department of Energy (DoE) states on its website that the majority of regions in South Africa average more than 2,500 hours of sunshine per year, and average solar-radiation levels range between 4.5 and 6.5kWh/m<sup>2</sup> in one day.

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# WHAT COSTS CAN TAXPAYERS DEDUCT IN PURSUANCE OF INSTALLING SOLAR ENERGY SYSTEMS?

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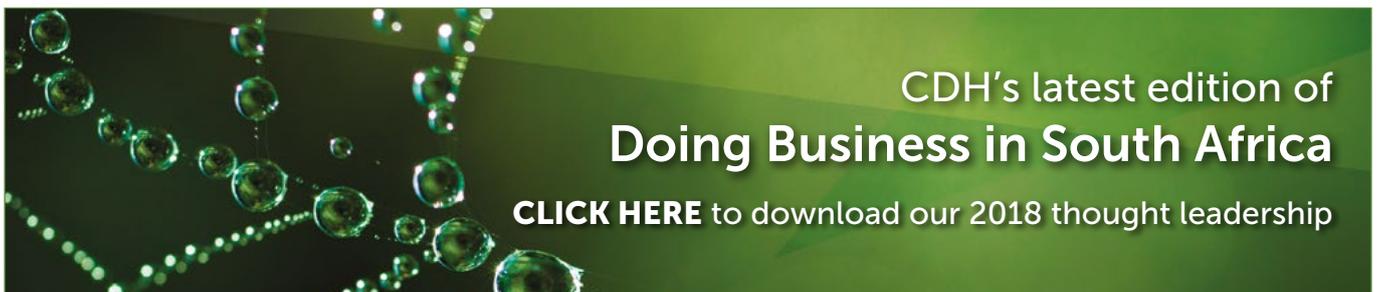
The DoE further states that the annual 24-hour global solar radiation average is about 220 W/m<sup>2</sup> for South Africa, compared with about 150 W/m<sup>2</sup> for parts of the United States of America, and about 100 W/m<sup>2</sup> for Europe and the United Kingdom. Given these statistics, South Africa is undoubtedly "resource rich" when it comes to the ability to exploit sunshine for energy purposes.

With this background, various tax "incentives" pertaining to renewable energy (including especially solar energy) have been introduced over the years. One of the key "incentives" provided for is set out in s12B(h) of the Income Tax Act, No 58 of 1962 (Act) which allows a taxpayer (ie a person subject to tax in terms of the Act) to claim a deduction on the costs incurred in respect of plant, machinery, implements and articles owned by it, that are first brought into use by that taxpayer in the course of its trade in the generation of electricity from various

renewable energy resources (including specifically photovoltaic solar energy). Three of the critical requirements which need to be met in order to qualify for the s12B(h) deduction include:

1. that the plant, machinery, implement, utensil or article is owned by the relevant taxpayer claiming the deduction (or purchased by it under an instalment credit agreement);
2. that such plant and machinery is brought into use for the first time by that taxpayer; and
3. that such plant and machinery is utilised by the taxpayer in the course of its trade in the generation of electricity from specific renewable energy resources.

In respect of photovoltaic solar energy of more than one megawatt, a taxpayer is allowed a deduction of the costs to the taxpayer of the asset producing the electricity on a 50/30/20 basis. In other



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words, one is allowed a 50% deduction of costs in the first year of use, 30% in the second year and the balance in the third year of use. Where the photovoltaic solar energy system produces less than one megawatt of power, then the taxpayer is allowed a 100% deduction in the first year of use.

One of the critical questions, however, pertains to what can be technically included as "costs" pursuant to the s12B(h) deduction. Section 12B(3) of the Act provides some guidance as follows:

For the purposes of this section the cost to a taxpayer of any asset acquired by that taxpayer shall be deemed to be the lesser of the actual cost to the taxpayer or the cost which a person would, if he or she had acquired the asset under a cash transaction concluded at arm's length on the date on which the transaction for the acquisition of the asset was in fact concluded, have incurred in respect of the direct cost of acquisition of the asset, including the direct cost of the installation or erection thereof.

The costs, which can thus be deducted in terms of s12B(h), is the lesser of the actual cost to the taxpayer, or the costs incurred in respect of the acquisition of the relevant assets under a hypothetical "arm's length" scenario. In a recent ruling issued by SARS on 11 October 2018, namely Binding Private Ruling 311 (Ruling), SARS

was tasked with determining, amongst other things, the extent of the costs to be deducted pursuant to the installation of a specific solar energy system. While the taxpayer in the Ruling wished to deduct the usual costs incurred in respect of plant and machinery (and related equipment) required to erect the solar installation, the taxpayer also wished to deduct (as part of the cost of the installation of the solar system) the following related expenditure:

- installation planning costs;
- panels delivery costs;
- installation costs; and
- installation safety officer costs.

In this regard, SARS ruled, among other things, that the taxpayer would be entitled to claim deductions in respect of the direct costs of the installation and erection of each of the plants, consisting of the installation planning costs, panel delivery costs and the cost of the installation safety officer to be appointed, under s12B(3).

While taxpayers should be careful of blindly relying on binding private rulings issued by SARS as they are very fact and circumstances specific and are only binding between SARS and the specific taxpayer applicant, this particular Ruling is welcomed as it provides further clarification as to what costs can be included when claiming a s12B(h) renewable energy deduction.

*Jerome Brink*

# THE TAX OMBUD'S REPORT IS IN AND THE RESULTS ARE FEW. IS THE OFFICE OF THE TAX OMBUD DOING ITS JOB?

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*Prior to the establishment of the OTO no alternative forms of independent redress were available.*



Since its establishment in October 2013, in terms of s15 of the Tax Administration Act, No 28 of 2011 (TAA), the Office of the Tax Ombud (OTO) has been expected to enhance South Africa's tax administration system. The OTO has released its annual report for 2017/2018 (Report) in terms of s19 of the TAA and the Public Finance Management Act, No 1 of 1999. Though the taxpayer may hope for a report of increased and meaningful progress made by the Tax Ombud, the results emanating from the Report appear to convey many challenges, weak platitudes and limited confidence in the impact of the OTO.

#### What is the Tax Ombud supposed to do?

Following the lead of international best practices, the South African OTO is modelled on the Tax Ombud systems of Canada, the United States of America and the United Kingdom and is required to promote its mandate as set out in s16 of the TAA. The OTO must review and address taxpayer complaints, be they service-related, procedural or administrative. The Tax Ombud may also, in terms of its TAA mandate, be requested by the Finance Minister to review any systemic and emerging issues related to the South African tax system. As the current Tax Ombud, retired Judge President of the Gauteng High Court, Judge Bernard Ngoepe, mentioned in his foreword to the Report, "many people in [South Africa] do not know their rights... so, in establishing an office like this, it is critical to educate them about their rights as taxpayers". According to the Strategic

Overview in the Report, the OTO's conduct must always be aligned with the core values of Accountability, Independence, Efficiency, Fairness and Confidentiality.

Prior to the establishment of the OTO, in circumstances where taxpayers had exhausted all of their options in the South African Revenue Service's (SARS) usual complaints channels, no alternative forms of independent redress were available. As the Tax Ombud states in the foreword to the OTO report, "the first [milestone] was the very act of establishing this institution. Remember, there was no Tax Ombud before then and yet people felt they had many legitimate questions about SARS and that an independent office was needed to assist them in regard to their complaints". He continues to confirm that "a taxpayer must have the comfort of knowing that if SARS does not treat them well, there is somewhere else they can go to complain".



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Gerhard Badenhorst ranked by CHAMBERS GLOBAL 2014 - 2018 in Band 1: Tax: Indirect Tax.

Emil Brincker ranked by CHAMBERS GLOBAL 2003 - 2018 in Band 1: Tax.

Mark Linington ranked by CHAMBERS GLOBAL 2017- 2018 in Band 1: Tax: Consultants.

Ludwig Smith ranked by CHAMBERS GLOBAL 2017 - 2018 in Band 3: Tax.

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## The Tax Ombud's Report

The Tax Ombud's annual report covers the performance of all aspects of the Tax Ombud's role. It includes a number of statistics pertaining to issues brought to the attention of the Tax Ombud during the period and provides insights from the Tax Ombud himself by way of a foreword, as well as an overview of the OTO's activities as provided by the OTO's Chief Executive Officer (CEO), Advocate Hanyana Eric Mkhawane.

The Report highlights both the achievements and the challenges of the OTO and provides strategic and situational analyses and recommendations. This year's report begins with a summary indicating that, of 17,920 contacts (i.e. taxpayer engagements in the form of queries, comments or complaints) received by the OTO, 3,652 of these were complaints and less than half of these complaints were finalised. Most of the complaints received pertained to refunds owing to the taxpayer, followed closely by dispute resolution complaints. Only 20% of complaints related to ancillary issues such as assessments, debt management and verification.

Nevertheless, as per the Tax Ombud's foreword to the Report, it is encouraging to note that taxpayers, either individually or represented by professional bodies, have been making increased use of the OTO. According to statistics included in the Report's overview by the CEO, the number of contacts has demonstrably improved from only 670 in April 2014 to over 17,000 in the 2017/2018 reporting period. 95.37% of taxpayer contact with the OTO is made via email, with fax, walk-ins and post very rarely utilised. Most of the complainants in the reporting period were from Gauteng (65.65%), with the Western Cape in second place with 14.15% of the complainants.

The OTO appears from the situational analysis in the Report to have been largely preoccupied with taxpayers having incorrectly approached the offices prior to exhausting SARS' internal resolution mechanisms, with almost half of the complaints rejected due to premature lodging by taxpayers or issues falling outside of the OTO's mandate.

Despite taxpayers' incorrect approach, however, almost half of the accepted complaints have, according to the Report, been carried into the new reporting period due to what the OTO report has referred to as "delays by SARS in considering the recommendations of the Tax Ombud".

## Who's Who Legal

Emil Brincker has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory & Controversy for 2018.

Mark Linington has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2018.

Ludwig Smith has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2018.

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## Challenges of the Tax Ombud

Whilst the Tax Ombud's foreword praised the OTO for resolving "literally thousands of taxpayer complaints", given that the OTO has been in operation for five years, the seemingly ineffectual progress of the OTO is perhaps brought into question when considering that only 1,945 complaints were accepted for consideration, and 786 had to be carried forward to the following year. Whilst this delay is attributed to SARS, the OTO's obstacles extend further.

The Tax Ombud himself recognises that the OTO has fallen short of its responsibilities, in that he states in his foreword "I think there were times when we and our people could have performed better". He puts forward the unfamiliarity of the OTO as a main challenge in this respect, indicating that "while we were new, we were supposed to be a national office, and people knew nothing about us. So, the challenge was to tell people about our existence and...educate them about our mandate".

The OTO report also sets out the detrimental effect of not having a "provincial footprint". The single Pretoria office that the OTO has in the country is not sufficiently accessible by taxpayers throughout the country and the Report states that the OTO aims to have a presence in various provinces in due course.

Though complaints resolution is the "heartbeat of the OTO", "teething problems" are blamed by the CEO of the OTO for the short supply of resolved complaints, with a "return to manual processes" and lacking efficiency and responsiveness identified in the service manager system.

## Has the Office of the Tax Ombud achieved anything?

Per the CEO's overview in the Report, a small but critical improvement has been made by beginning to provide the taxpayer with written reasons where a complaint is rejected due to being outside of the OTO's mandate.

In terms of raising awareness as to the existence of the OTO as a "free, fair and impartial complaint resolution avenue" as described in the CEO's overview, the CEO confirms the positive impact of the efforts that the OTO has made in "making use of many opportunities to alert taxpayers to the existence and purposes of the OTO" and in "reaching out to industry bodies such as the South African Institute of Professional Accountants (SAIPA), the South African Institute of Chartered Accountants (SAICA) and the South African Institute of Tax Professionals", as these endeavours have increased the visibility of the OTO and the understanding that the taxpayer has of the OTO's mandate and role.

# THE TAX OMBUD'S REPORT IS IN AND THE RESULTS ARE FEW. IS THE OFFICE OF THE TAX OMBUD DOING ITS JOB?

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One of what the CEO of the OTO refers to as the Tax Ombud's "ground-breaking achievements" is the review conducted in respect of hundreds of complaints from taxpayers regarding the undue delay of payment of refunds. The OTO was able to prepare a consolidated report by July 2017, which identified "12 different obstacles that SARS had put in place that were causing delays in the payment of verified refunds, some running into the millions of Rands and affecting all types of taxpayers and tax categories." Whilst the Report on the systemic issue did "generate huge interest among taxpayers and the media", there is nothing in the OTO's report that indicates that the investigation yielded tangible results. Though the OTO has deemed the investigation a "major milestone", SARS has to date failed to revert with any action plan that would address the issues around refunds.

#### **Could SARS bully the Tax Ombud?**

In his foreword to the Report, the Tax Ombud's sentiments regarding the relationship between SARS and the OTO may not invoke much comfort as to the independence of the Tax Ombud. He states that the relationship between SARS and the OTO is one of mutual respect and continuing collaboration, however, he prefaced this by mentioning that "SARS has some very drastic powers – perhaps with some justification, it must be said – but those drastic powers need to be exercised properly and within the limits of the law." Though taxpayers have been encouraged to approach the Tax Ombud mainly to have their complaints pertaining to SARS resolved, the Tax Ombud must also promote an ethical and efficient tax system

and advocate for taxpayers' rights by acting as part of the checks and balances on the revenue authority.

The independence of the OTO was noted as a prevailing challenge throughout the Report. Not only was the limited financial independence of the OTO highlighted in both the Tax Ombud's foreword and the CEO's overview, the situational analysis of the OTO detailed the manner in which the OTO places ongoing reliance on SARS for financial management, IT and procurement services and pinpointed these intricacies as a risk of "perceived and alleged corruption in the public sector" which could conceivably "adversely affect taxpayer confidence".

In addition to this, as noted in the Tax Ombud's foreword, the employment practices of the OTO were not independent either as it "could not even recruit its own staff directly; [staff] first had to be employed by SARS and then seconded to this office in consultation with the Commissioner of SARS. This was odd, given that the Tax Ombud was supposed to exercise some kind of oversight over SARS."

#### **All bark but no bite?**

The Report makes it clear that, after the January 2017 revision of the OTO's mandate, the Tax Ombud was authorised to tackle a larger scope and thereby attempt to make a greater impact. The CEO of the OTO provides details in the Report of what he terms the "fairer treatment of taxpayers" that resulted from allowing the OTO, upon approval by the Minister of Finance, to initiate systemic investigations.

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*Though the OTO put the spotlight on the issue, taxpayers are still hindered in obtaining their refunds.*



Though the OTO prides itself on its investigations such as that into the delay in refunds from SARS, it is evident that SARS does not take action in this respect. There is no measurable response to the investigation into this systemic issue more than a year after the findings were released. Though the OTO put the spotlight on the issue, taxpayers are still hindered in obtaining their refunds.

A similar lack of action by SARS is evident in the CEO of the OTO's overview where he details the initiative that the Tax Ombud took in 2015 to create the Taxpayer Bill of Rights. Whilst this document has certainly been considered by SARS, the OTO has failed to achieve meaningful buy-in in this instance and merely states in the CEO's overview in the Report that the Tax Ombud "eagerly awaits news of progress".

The Tax Ombud has noted in the foreword to the Report that achieving independence is "crucial and fundamental", and that poor, unimpactful service "simply demoralises the public". He further states that the public must "feel that their complaints are being addressed expeditiously". Though the Tax Ombud has proven its value to the industry and taxpayers alike by resolving complaints, securing large refunds and launching much-anticipated investigations, its greatest challenge continues to be in proving that the OTO is equipped and has the capacity to go toe-to-toe with SARS.

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