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# TAX & EXCHANGE CONTROL ALERT

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### Legal professional privilege protection available to taxpayers too

In a litigious context, the doctrine of legal professional privilege provides that communications between an attorney and a client are protected from disclosure in litigious proceedings. The protection afforded to a litigant in terms of this doctrine is aimed at encouraging and protecting the full and honest disclosure of information by clients to their legal advisors when seeking legal advice, which is necessary for the proper functioning of the South African adversarial system of litigation.

### A (quin)tessential consideration for the commercial property sector: Section 13quin of the Income Tax Act

Recently, the South African Property Owners Association (SAPOA) released its Office Vacancy Report for the first quarter of 2019. According to one of the key findings of the report, there has been a quarter on quarter decline in SAPOA's assessment of the square meterage of commercial property under development from 559,000 sqm to 404,000 sqm.

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## Legal professional privilege protection available to taxpayers too

In the recently reported High Court case of *Astral Operations Ltd & Others v Minister for Local Government, Western Cape & Another* 2019 (3) SA 189 (WCC), the Court examined the scope of legal professional privilege and the circumstances in which such privilege will be waived.

In a litigious context, the doctrine of legal professional privilege provides that communications between an attorney and a client are protected from disclosure in litigious proceedings. The protection afforded to a litigant in terms of this doctrine is aimed at encouraging and protecting the full and honest disclosure of information by clients to their legal advisors when seeking legal advice, which is necessary for the proper functioning of the South African adversarial system of litigation.

Legal professional privilege also applies to taxpayers who are engaged in litigious proceedings against the South African Revenue Service (SARS). As such, communication between a taxpayer and their attorney that is subject to legal professional privilege is protected from disclosure at the instance of SARS.

In the recently reported High Court case of *Astral Operations Ltd & Others v Minister for Local Government, Western Cape & Another* 2019 (3) SA 189 (WCC), the Court examined the scope of legal professional privilege and the circumstances in which such privilege will be waived.

### Facts

In the course of review proceedings, the Applicants sought to compel the Respondents to comply with a notice, served in terms of Rule 35(12) of the Uniform Rules of Court, for the production of a memorandum drafted by one of the Respondents' junior counsel.

Given the nature of the review proceedings and the identical grounds on which the review was opposed, each of the two Respondents' attorneys engaged the same senior counsel to act on the Respondents' behalf. Each of the attorneys also appointed their own junior counsel. The two Respondents therefore formed a single cohesive legal team to represent the Respondents' aligned interests in the review.

During the preparation for trial stage, one of the Respondents' junior counsel prepared a memorandum, at the instance of the senior counsel, regarding the allegations made by the Applicants in their pleadings. This memorandum was made available to each of the Respondents' attorneys and was subsequently given to three experts (on a confidential basis) who were instructed by the Respondents to prepare reports for purposes of the review application. The Applicants were made aware of the existence of the memorandum by way of a reference to it in a document that formed part of the official court record and therefore insisted that the Respondents disclose it.

The Respondents refused to make the memorandum available on the basis that it was protected by legal professional privilege. The Applicants contended that the exchange of the memorandum between the Respondents' attorneys and the subsequent disclosure thereof to the three experts resulted in a waiver of privilege by the Respondents, alternatively

## Legal professional privilege protection available to taxpayers too...*continued*

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The Court noted that legal professional privilege belongs to the litigant and can therefore only be waived by the litigant and not by the legal advisor or third parties.

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that a waiver of privilege can be imputed by virtue of the disclosure that had been made of the existence of the memorandum in the court documents.

### Judgment

Legal professional privilege exists in respect of legal advice obtained from a legal practitioner and given in confidence to a litigant. However, it is necessary for the litigant to assert legal professional privilege before the communication will be afforded legally privileged status.

The Court in this case recognised that there are two manifestations of legal professional privilege:

1. 'Legal advice privilege', which protects communication between attorneys and their clients where legal advice is sought or given; and
2. 'Litigation privilege', which protects communications between a litigant or his attorney and a third party that comes into existence once litigation is in contemplation or has commenced.

The tension between the public interest that is served by full disclosure of all information as an aid to the vindication of the truth in litigious proceedings and the public policy considerations that inform the existence of legal professional privilege was highlighted by the Court, and it was reiterated that the right to assert legal professional privilege is not absolute.

In order to claim litigation privilege, it must be shown that the relevant document was obtained or brought into existence for the

purpose of a litigant's submission to a legal advisor for legal advice, and that litigation was pending or imminent at that time.

In coming to its finding, the Court was required to ascertain whether the memorandum was subject to legal professional privilege, and, if answered in the affirmative, whether or not the Respondents had waived that privilege.

The Court noted that legal professional privilege belongs to the litigant and can therefore only be waived by the litigant and not by the legal advisor or third parties. Furthermore, once the confidentiality of the information that forms the subject of the communication has been breached, the basis for claiming legal professional privilege falls away.

It was concluded that the memorandum was covered by legal professional privilege as:

- The content of the memorandum was pertinent to a single topic, being counsel's advice in respect of the steps to be taken to further the Respondents' case in response to the allegations contained in the Applicants' papers; and
- The Respondents' conduct showed that they had formed a composite legal team to represent the aligned interests of both Respondents and as such, the distribution of the memorandum amongst the instructing attorneys did not exclude the document from being legally privileged.



## Legal professional privilege protection available to taxpayers too...continued

While the matter has yet to be decisively determined by the South African Tax Court, international tax case law has made it clear that tax advice solicited from accountants or tax practitioners – who do not qualify as legal advisors – will not be subject to legal professional privilege and will have to be disclosed should SARS require such disclosure.

While the Court did not consider it material whether the privilege ascribed to the memorandum was legal advice privilege or litigation privilege, it was noted that the use of the memorandum by the attorneys to instruct the three experts would subject it to litigation privilege.

In determining whether the Respondents had expressly or impliedly waived their privilege, or if a waiver of privilege was to be imputed, the Court found that the references to the memorandum in the documents contained in the official court record did not disclose the substance or content of the memorandum to the extent that an intention to abandon the confidentiality of the document may be inferred. It was also held that a mere reference to a document does not constitute a reliance on that document in the review proceedings.

In the result, the Court found that legal professional privilege had not been waived and dismissed the application.

### Comment

Similar to the Uniform Rules of Court that find application in the High Court, the Tax Court Rules, issued in terms of s103 of the Tax Administration Act, No 28 of 2011 (TAA), apply to litigation proceedings between SARS and taxpayers in the Tax Court.

Rule 36 of the Tax Court Rules makes provision for either SARS or a taxpayer to request the disclosure of pertinent documentation during litigation

proceedings and to provide such documentation if necessary. However, Rule 36(4) allows either party to object to the exchange of such documents if the documents are, for example, covered by legal professional privilege.

The communication between a taxpayer and its legal advisor will be covered by legal professional privilege where the communication pertains to legal advice that has been sought and given in a professional capacity, and where the communication between the taxpayer and the legal advisor has been made in confidence. It is also a requirement that legal professional privilege be claimed by the taxpayer in respect of the communication. Where the legal advice is sought for criminal or fraudulent purposes, such as tax evasion, legal professional privilege will not apply.

While the matter has yet to be decisively determined by the South African Tax Court, international tax case law has made it clear that tax advice solicited from accountants or tax practitioners – who do not qualify as legal advisors – will not be subject to legal professional privilege and will have to be disclosed should SARS require such disclosure.

Given the likelihood that SARS will request a multitude of documents from a taxpayer before and during litigation proceedings, it is imperative that taxpayers are aware of the types of documents that are protected by legal professional privilege and that these documents are not provided to SARS

## Legal professional privilege protection available to taxpayers too...continued

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If a privileged document is to be circulated, it is essential that it is not circulated to more persons than necessary, that the confidential nature of the document is emphasized and that the limited purpose for which the advice is being disclosed is duly specified.

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at any time. This includes not only the final document that constitutes the legal communication between the attorney and the taxpayer, but all of those documents called into existence for purposes of inclusion in the final document. The disclosure of these documents, even before the commencement of legal proceedings in the case of documents subject to legal advice privilege, will destroy the confidentiality of the document on which the legal professional privilege is based and the taxpayer will lose the protection afforded to it in terms of the doctrine of legal professional privilege.

It is important for taxpayers to safeguard the confidentiality of their communication with their legal advisors. Confidentiality is a broader concept than legal professional privilege, however, its existence is vital to the assertion of privilege. There are various ways in which the information contained in a document can lose its confidentiality and thereby its status as a legally privileged document. As a general rule, information that enters the public domain will no longer be confidential. However, the mere circulation of information that constitutes communication with a legal advisor will not necessarily negate the confidentiality thereof. It is only when the communication is circulated too widely – to persons who are not integral to the matter at hand – that the confidentiality of the communication may be lost.

Therefore, if a privileged document is to be circulated, it is essential that it is not circulated to more persons than necessary, that the confidential nature of

the document is emphasized and that the limited purpose for which the advice is being disclosed is duly specified.

As has been stated above, legal professional privilege is the right of the taxpayer and can be waived – either expressly or by implication – only by the taxpayer and not by its legal advisor or a third party. In the Tax Court case of *A Company and Others v Commissioner for South African Revenue Service 76 SATC 321*, the Tax Court noted the following in respect of the waiver of legal professional privilege:

1. If a document is covered by legal professional privilege, disclosure of a part of the document may constitute implied or imputed waiver of the privilege attached to the whole document;
2. The mere reference to advice sought or given in a separate document that has been disclosed does not constitute a waiver of privilege as long as the content of the advice is not disclosed or cannot be inferred from that reference; and
3. Where a document is not privileged, but refers to legal advice sought or given and also discloses the content or scope thereof, legal professional privilege will not be lost if that reference is redacted.

While legal professional privilege is aimed at protecting the confidential communication between a taxpayer and its legal advisor, there is an anomaly provided for in the TAA in terms of which

## Legal professional privilege protection available to taxpayers too...continued

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If a taxpayer seeks an opinion in order to ensure that its tax affairs are structured in accordance with the law and that opinion subsequently enables the taxpayer to qualify for the remittance of an understatement penalty in terms of s223(3), it is likely that the opinion will be covered by legal professional privilege.

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a taxpayer would seek tax advice for purposes of its disclosure to SARS in order to safeguard itself against the imposition of understatement penalties that may be imposed by SARS in terms of s223 of the TAA.

Section 223(3) provides that SARS must remit an understatement penalty imposed on a taxpayer in respect of a "substantial understatement" if SARS is satisfied that:

- (a) Full disclosure of the arrangement has been made by the taxpayer by no later than the date that the relevant return was due; and
- (b) The taxpayer was in possession of an opinion by an independent registered tax practitioner that:
  - (i) was issued by no later than the date that the relevant return was due;
  - (ii) was based on full disclosure of the facts and circumstances of the arrangement; and
  - (iii) confirmed that the taxpayer's position is more likely than not to be upheld if the matter proceeds to court.

This section makes reference to an opinion received from a tax practitioner, which includes the advice sought and received from a legal advisor that specialises in tax law. Whether or not an opinion of this nature is covered by legal professional privilege is dependant on the intention with which the taxpayer sought the opinion.

If a taxpayer seeks an opinion in terms of s223(3) purely for purposes of safeguarding itself against any understatement penalty that may be imposed by SARS in the future, it is unlikely that legal professional privilege will apply to the document as the taxpayer at all times intended to disclose the document to SARS and never intended for it to be privileged.

However, if a taxpayer seeks an opinion in order to ensure that its tax affairs are structured in accordance with the law and that opinion subsequently enables the taxpayer to qualify for the remittance of an understatement penalty in terms of s223(3), it is likely that the opinion will be covered by legal professional privilege. In such a case, there may be a financial advantage (being the remittance of an understatement penalty) in the voluntary waiver by the taxpayer of the legal professional privilege that covers the opinion.

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*Emil Brincker and Louise Kotze*

## A (quin)tessential consideration for the commercial property sector: Section 13quin of the Income Tax Act

Where a person decides to purchase or acquire commercial immovable property, a factor which should be taken into account when assessing the costs of the purchase, is the tax deductions or allowances that may be available.

Recently, the South African Property Owners Association (SAPOA) released its Office Vacancy Report for the first quarter of 2019. According to one of the key findings of the report, there has been a quarter on quarter decline in SAPOA's assessment of the square meterage of commercial property under development from 559,000 sqm to 404,000 sqm. Among the factors SAPOA identifies are a decline in speculative development, which could be attributed to a perception of high levels of economic risk, resulting in lower demand for office space in South Africa.

Where a person decides to purchase or acquire commercial immovable property, a factor which should be taken into account when assessing the costs of the purchase, is the tax deductions or allowances that may be available. In this regard, a potential purchaser of commercial property should take note of s13quin of the Income Tax Act, No 58 of 1962 along with Interpretation Note 107 (IN107), which was issued by the South African Revenue Service (SARS) during December 2018.

In terms of s13quin, provided certain requirements are met, a person may claim an allowance on part of the costs of new and unused commercial buildings or improvements to such buildings. IN107 provides some insight into SARS's interpretation of this provision and explains how the allowance available under this section operates.

Ordinarily, only taxpayers for whom commercial buildings constitute revenue assets (i.e. taxpayers that in the normal course of business acquire and trade in commercial buildings) would be allowed to deduct attendant purchase, construction and improvement costs.

### Basic requirements to claim s13quin allowance

The basic requirements to claim an allowance under s13quin are the following:

1. The contract for construction, purchase or improvement must have been concluded after 1 April 2007;
2. Costs relate to a new and unused commercial building or improvement;
3. The building or improvement is owned by the taxpayer; and
4. The building is wholly or mainly being used for trade in the year of assessment.

### Commercial Building

The s13quin allowance is restricted to commercial buildings and improvements thereto. IN107 defines buildings as substantial structures of a relatively permanent nature consisting of walls, a roof and necessary appurtenances. It further states that the allowance is not available for all the immovable assets that would be covered by the broader concept of commercial property.

## A (quin)tesential consideration for the commercial property sector: Section 13quin of the Income Tax Act...*continued*

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The s13quin allowance is limited to 5% of the lower of the actual cost to the taxpayer, or the cost that would have been incurred by the taxpayer in an arm's length transaction.

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In discussing the meaning of "commercial building" within the context of s13quin, IN107 refers to the decision in *ITC 1007* (1962) 25 SATC 251 (N), where it was held that a hotel swimming pool and surrounds that were detached from the hotel itself did not constitute a building within the meaning of s13quin. One should note that in the same decision, the court stated that a swimming pool that was part of the building may have fallen within the parameters of the section. This would be the case if, for example, such swimming pool was built into the rooftop of the hotel and therefore physically part of the permanent structure.

### *New and Unused*

For s13quin to apply, the buildings or improvements must be both new and unused. IN107 states that "new" must be taken to mean recently constructed and "unused" means that the building was not previously used by any person for any purpose. IN107 further states that whether a building is "new and unused" depends on the facts of the case and must be determined at the point where the taxpayer becomes the owner of the building or improvement. According to IN107, where the building is purchased, the s13quin allowance is still available to the purchaser, provided that it is new and unused from the perspective of the purchaser.

Even where a building is no longer new or unused, any new and unused improvements to its physical structure will qualify for a s13quin allowance. According to IN107, an improvement has been held to be an extension, addition, improvement that is physically attached to, connected or structurally integrated with the building.

### *Value of the allowance*

The s13quin allowance is limited to 5% of the lower of the actual cost to the taxpayer, or the cost that would have been incurred by the taxpayer in an arm's length transaction. The allowance is also limited by any deductions or allowances available regarding the same expenditure.

Importantly, where only part of a new and unused building is acquired by the taxpayer without the taxpayer having erected or constructed that part, the acquisition cost for the purposes of s13quin is deemed to be 55% of the acquisition price of the part of the building acquired. In the case of an improvement being acquired, the acquisition cost for the purposes of s13quin is deemed to be 30% of the acquisition price. IN107 explains that the purpose of the 55% limitations is to ensure that the allowance is not calculated on the cost of the land, which would be included in the acquisition price of the building purchased.



## A (quin)tesential consideration for the commercial property sector: Section 13quin of the Income Tax Act...continued

A valuable feature of the s13quin allowance is that it is potentially available for past years of assessment where the taxpayer's income for the trade conducted out of the building was exempt, provided the building or improvement has not been disposed of subsequently.

### Wholly or mainly used for trade

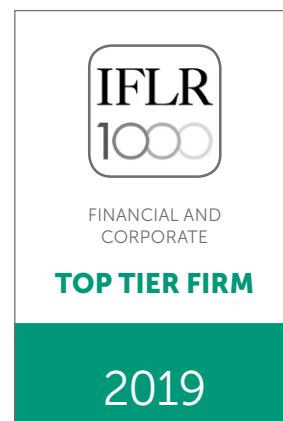
A valuable feature of the s13quin allowance is that it is potentially available for past years of assessment where the taxpayer's income for the trade conducted out of the building was exempt, provided the building or improvement has not been disposed of subsequently.

### Comment

Section 13quin, in the present high risk and unpredictable economic environment, provides some welcome tax relief for those persons who are in the business of building and creating new commercial infrastructure in South Africa. The section is helpful for taxpayers who build or buy new and unused commercial buildings in circumstances where they would ordinarily not be allowed a deduction.

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