TAX & EXCHANGE CONTROL
ALERT

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IN THIS ISSUE

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Both residential and commercial developments are on the rise in South Africa. Owners (and sometimes tenants) of these estates and developments, are generally obliged to become members of a *"property owners association"*. Members of the association are bound by the rules that govern it, to manage and regulate such developments. Generally, the payment of levies by members are required to upkeep and maintain the estate/development. As such, the number of property associations being formed to manage such estates and developments are vastly increasing.

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FOR MORE INSIGHT INTO OUR EXPERTISE AND SERVICES

Are property associations automatically exempt in terms of Section 10 of the Income Tax Act?

Both residential and commercial developments are on the rise in South Africa. Owners (and sometimes tenants) of these estates and developments, are generally obliged to become members of a "*property owners association*". Members of the association are bound by the rules that govern it, to manage and regulate such developments. Generally, the payment of levies by members are required to upkeep and maintain the estate/development. As such, the number of property associations being formed to manage such estates and developments are vastly increasing.

Section 10(1)(e)(i)(aa) of the Income Tax Act 58 of 1962 (ITA) provides that any levy received by or accrued to a body corporate established in terms of the Sectional Titles Act 95 of 1986 from its members is exempt from income tax. Section 10(1)(e)(i)(bb) states similarly in relation to share block companies.

In the case of body corporates and share block companies, the general view is that the exemptions apply automatically given the wording in sections 10(1)(e)(i)(aa) and (bb). Paragraph 5.1 of SARS' Interpretation Note 64 (Issue 4) (IN64) corroborates this "*automatic exemption*" and states as follows:

> *"A body corporate or share block company is not required to apply for exemption under section 10(1)(e)(i)(aa) or (bb) respectively. These entities are not registered at the TEU for income tax, but are required to register at a branch office and submit annual income tax returns even if they are unlikely to have an income tax liability. The levy income exemption and the basic exemption are applied on assessment."*

Accordingly, to the extent that a property association is not a body corporate established in terms of the Sectional Titles Act 95 of 1986, it can be asserted that this automatic exemption does not apply to such property association. The question then arises as to whether section 10(1)(e) income tax exemption automatically extends to property associations.

Section 10(1)(e)(cc) of the ITA provides that "*associations of persons*" shall be exempt from normal tax as contemplated below:

> *"(e)(i) any levy received by or accrued to—*
>
> *(cc) any other association of persons (other than a company as defined in the Companies Act, any co-operative, close corporation, and trust, but including a non-profit company as defined in that Act) from its members, where the Commissioner is satisfied that, subject to such conditions as he or she may deem necessary, such association of persons—*
>
> *(A) has been formed solely for purposes of managing the collective interests common to all its members, which includes expenditure applicable to the common immovable property of such members and the collection of levies for which such members are liable; and*
>
> *(B) is not permitted to distribute any of its funds to any person other than a similar association of persons:*
>
> *Provided that such body, company or association is or was not knowingly a party to, or does not knowingly permit or has not knowingly permitted, itself to be used as part of any transaction, operation or scheme of which the sole or main purpose is or was the reduction, postponement or avoidance of liability for any tax, duty or levy which, but for such transaction, operation or scheme, would have been or would become payable by any person under this Act or any other law administered by the Commissioner; and*

Are property associations automatically exempt in terms of Section 10 of the Income Tax Act?

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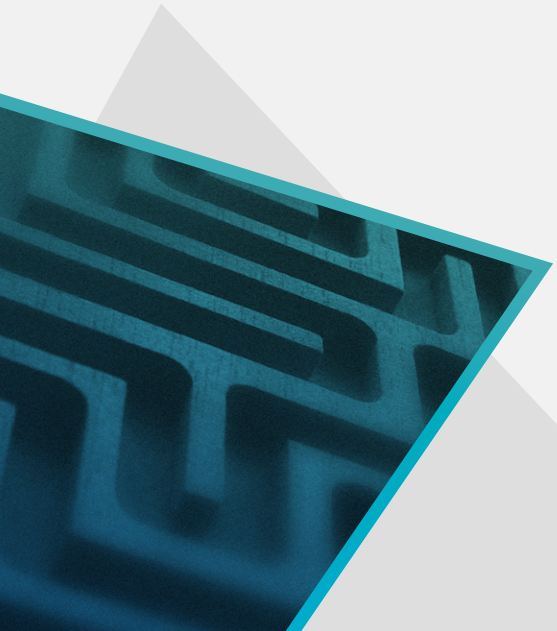

(ii) any receipts and accruals other than levies derived by a body corporate, share block company or association contemplated in subparagraph (i), to the extent that the aggregate of those receipts and accruals does not exceed R50 000;" [Our underlining]

Most property associations would fall within these provisions to the extent that they are established to manage the collective interests of their members, which members pay levies for purposes of expenditure applicable to common immovable property. It should be noted that Section 10(1)(e)(i)(cc) of the ITA is worded differently in the sense that it provides that the *"Commissioner must be satisfied"* that certain requirements have been met for the relevant exemption to apply. It is not entirely clear whether these words require an upfront application to SARS or whether an alternative approval mechanism is envisaged.

This is particularly the case when one compares the wording in section 10(1)(e)(i)(cc) to the wording used in section 30 of the ITA which explicitly refers to an *"approval process"* in the case of public benefit organisations.

Nevertheless, SARS' is of the view that *"associations of persons"* contemplated in section 10(1)(e)(i)(cc) of the ITA must first apply to SARS to obtain approval in relation to being exempt from normal income tax under that section. Paragraph 5.2 of IN64 thus states as follows:

"An association of persons must lodge an application with the Commissioner at the TEU to qualify for exemption from income tax under section 10(1)(e)(i)(cc)... It will be determined on application whether the [relevant] requirements have been met. Additional conditions may be prescribed to ensure that the above requirements are met."

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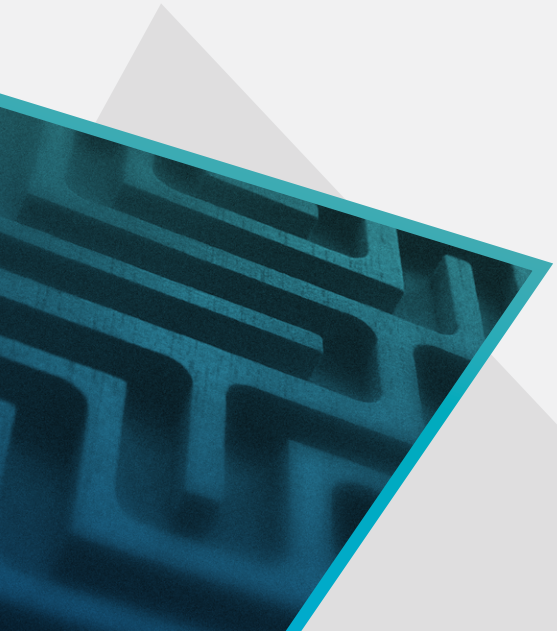
Accordingly, a property association is not automatically exempt from income tax on its levies received (as is the case with a body corporate). While there is some debate, SARS' view is that these associations must first apply to SARS to obtain approval for the exemption under the relevant section of the ITA.

In order to apply to SARS for income tax exemption in terms of section 10(1)(e)(i)(cc), the property association will be required to complete and submit an EI1 *"Application for Exemption from Income Tax application"* form to SARS, together with supporting documents including the founding documents of the property association (i.e. its memorandum of incorporation or its constitution). IN64 states that the following should be included in the founding document:

- the sole object of the association of persons must be to manage the collective interests common to all its members, which includes expenditure applicable to the common immovable property and the collection of levies for which such members are liable;
- the association of persons is not permitted to distribute its funds to any person other than to a similar association of persons;
- any amendments to the founding document of the association of persons must be submitted to the Commissioner;
- on dissolution of the association of persons, its remaining assets must be distributed to a similar association of persons that is also exempt from income tax under section 10(1)(e).

It is critical that property associations are compliant with section 10(1)(e)(i)(cc) of the ITA should they want to apply for the exemption. Furthermore, property associations that have not applied for tax exemption would be well advised to seek advice to consider their circumstances and regularise their tax affairs (if necessary).

JEROME BRINK AND
SAMANTHA KELLY



Revoked! Beware both tax judgments, and courts that do not heed authority

A revenue authority must be given "teeth" to execute its mandate. One of these "teeth" is found in sections 172 to 174 of the Tax Administration Act 28 of 2011 (TAA).

Essentially, in terms of these provisions, if a taxpayer owes SARS a tax debt, SARS may file a certified statement with a competent court. Once endorsed, this statement is then treated as a civil judgment against the taxpayer. Notably, even if the taxpayer has objected to the debt or has taken it on appeal, SARS may still, in certain circumstances, proceed to file the statement. This is supported by section 164(1), better known as the "*pay now, argue later*" rule (another "*tooth*" of the taxman).

Since this certified statement is effectively a civil judgment, what remedy would a taxpayer have if, for example, SARS files a statement but the debt reflected in the statement did not consider amounts already paid to SARS to reduce the debt? This happened in the case of *Barnard Labuschagne Incorporated v SARS & Another* [2022] ZACC 8 which we discuss in this article.

BACKGROUND

In this judgment, delivered by a unanimous bench of the Constitutional Court (ConCourt), the applicant, Barnard Labuschagne Incorporated (BLI), owed SARS outstanding tax money. Accordingly, BLI made several payments to SARS. Nevertheless, on 15 December 2017 SARS filed a certified statement in terms of section 172(1) of TAA with the Registrar of the High Court in Cape Town, recording that BLI owed SARS R804,747.

The ConCourt refers to the certified statement as a "*tax judgment*" and we accordingly follow this nomenclature throughout this article.

BLI then brought an application in the High Court to rescind the tax judgment (i.e. to revoke it). BLI based its application on the fact that the judgment was wrong since SARS failed to reduce the initial amount owed considering BLI's payments.

SARS' main opposition was that a tax judgment is not capable of rescission. BLI responded by contending that if a tax judgment is not susceptible of rescission, then sections 172 and 174 of the TAA are constitutionally invalid. To avoid prolixity and to retain focus on the matter of rescission, the constitutional challenge is not discussed in this article.

The High Court agreed with SARS and held that the tax judgment against BLI was not susceptible of rescission. Thereafter, the High Court and the Supreme Court of Appeal refused to grant BLI leave to appeal; which resulted in BLI turning to the ConCourt.

CONSTITUTIONAL COURT'S FINDINGS

As a point of departure, the ConCourt considered the historical development of certain tax statutes as precursors to the current form of the TAA. Once the ConCourt was satisfied that the TAA was contextualised, it turned to notable cases that dealt with rescission of tax judgments.

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The ConCourt considered, amongst others, the following cases:

1 *Kruger v Commissioner for Inland Revenue* 1966 (1) SA 457 (C) (Kruger I). In this case the High Court in Cape Town heard an appeal against a decision of a Magistrates' Court which refused to rescind a tax judgment. The High Court held that a tax judgment was susceptible of rescission in terms of section 36(a) of the Magistrates' Courts Act.

2. The same parties in Kruger I later litigated in the Appellate Division (as it was then) in *Kruger v Sekretaris van Binnelandse Inkomste* 1973 (1) SA 394 (A) (Kruger II). In this case the taxpayer sued the revenue authorities for recovery of money he paid "*under duress*" pursuant to the tax judgment in Kruger I. In its judgment, the Appellate Division emphasised its view that tax judgments were rescindable. The court cited, as examples, certain grounds which may give rise to a rescission application (including incorrect computation of tax, the date from which interest runs, and the lawfulness of the levying of tax).

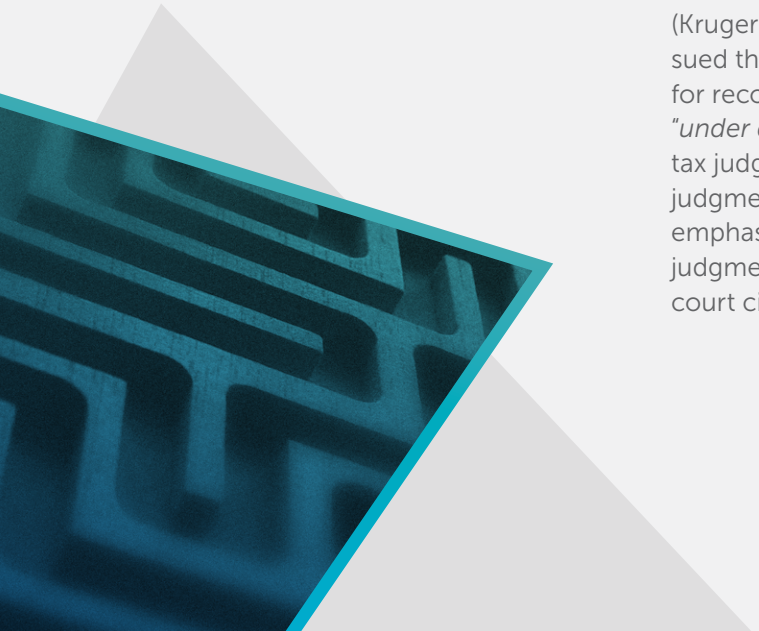
3 A few years later, the Constitutional Court in *Metcash Trading Ltd v CSARS* [2000] ZACC 21 (Metcash) unanimously confirmed, in line with the decisions in the Kruger judgments, that –

3.1 A tax judgment was, in principle, capable of rescission; and

3.2 despite the "*conclusive evidence*" provisions of the Income Tax Act (now contained in the TAA), that the correctness of any assessment on which such certified statement is based, cannot be questioned, there are numerous defences available in rescission proceedings against tax judgments.

The ConCourt also considered the cases relied upon by SARS in its defence. Whilst the ConCourt found that generally these cases did not deal with the rescindibility of tax judgments, SARS relied upon an unreported 2015 case, *SARS v Van Wyk* (Case No A145/2014), where the High Court held that a Magistrate's Court was not entitled to hear a rescission application in respect of a tax judgment. The High Court reached a similar decision again in the 2021 judgment of *Hamid v SARS* (Case No 3280/2017) (in terms of the Customs and Excise Act 91 of 1964).

The ConCourt criticised the fact that these recent High Court decisions did not apply the decisions in Kruger II and Metcash, which bound it in terms of the rules of precedent. Essentially, a court is required, by the rules of precedent, to follow a binding statement in an earlier judgment of the (higher) court unless satisfied that the earlier statement was clearly wrong.



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Turning to the High Court bench that heard BLI's initial application, the ConCourt found that the High Court was bound by, amongst others, Kruger II and Metcash. Furthermore, the High Court's view that a tax judgment was not final is irrelevant – this was apparent from the various cases. The ConCourt held that even though the TAA empowers SARS to amend or withdraw a tax judgment, this does not materially change its legal character. The ConCourt noted that the court with which the tax judgment is filed, on the other hand, has no power to treat it as an interim order, and thus availability of rescission is befitting.

The ConCourt found it unacceptable that the High Court did not discuss the relevant cases – despite the parties bringing them to the court's attention. The ConCourt further declared that, *"observance of the rules of precedent is not a display of politeness to courts of higher authority; it is a component of the rule of law, which is a founding value of the Constitution"*.

The appeal was upheld with BLI's application for rescission referred back to the High Court to be heard before a different judge to determine the merits of the application.

CONCLUSION

This case is important for two principal reasons:

- The Constitutional Court has again confirmed – this time in light of the TAA – that a tax judgment (ie a section 172 certified statement) can be rescinded by a competent court of law; and
- Our courts must give effect to precedent. They are not entitled to disregard superior court judgments unless the previous statement was clearly wrong.

It is ironic that SARS has chosen to oppose this case, since on its own version in the SARS Dispute Resolution Guide (paragraph 11.5.7) published at the time that the TAA was created, SARS states: *"If the rules do not provide for a procedure in the tax court, then the most appropriate rule under the Rules of the High Court made in accordance with the Rules Board for Courts of Law Act and to the extent consistent with the [TAA] and the rules, may be utilised by a party or the tax court."* This would allow a taxpayer to apply for rescission of a tax judgment in any event.

We welcome the ConCourt's considered and detailed judgment. It provides certainty to taxpayers; knowing that in cases where the judgment can be defended outside the *"conclusive evidence"* provisions, a taxpayer may bring an application for rescission of a tax judgment.

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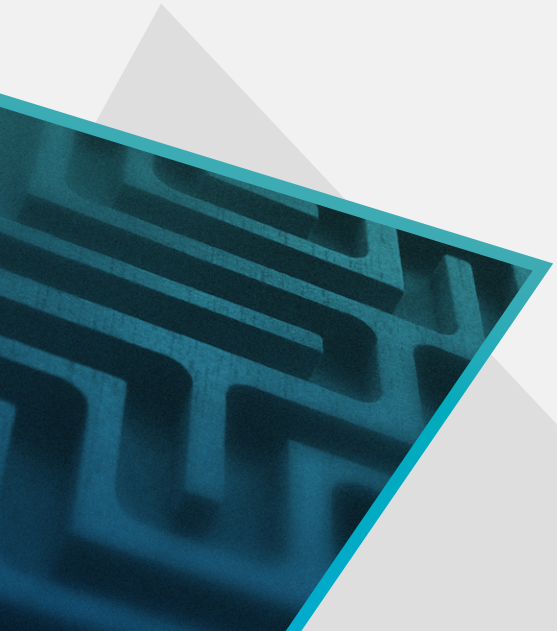

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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