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TAX ALERT

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IN THIS ISSUE

CLAIMING INPUT TAX ON PROFESSIONAL MEMBERSHIP FEES

The issue of professional membership fees and the deductibility of input tax by employers that settle these fees on an employees' behalf, has always been a contentious issue.

SAICA recently informed its members that a VAT ruling pertaining to the deductibility of input tax on its membership fees will not be renewed and that there would be no amendment to the Value-Added Tax Act, No 89 of 1991 (VAT Act) to address the incongruity. The ruling will be withdrawn with effect from 1 January 2013.

The failure by SARS to renew the VAT Ruling, coupled with no corresponding amendment to the VAT Act does not necessarily mean that input tax may not be deducted in relation to professional fees. It does however now solely becomes an interpretation issue, which inevitably will result in more disputes with SARS.

The deductibility of input tax on professional membership fees goes beyond SAICA and would affect any other payment made by an employer to a professional body on behalf of the employee, for example, payments made by legal firms to the various Law Societies.

As a basic principle, an input tax deduction is granted to a vendor where goods or services have been acquired wholly for the purpose of consumption, use or supply in the course of making taxable supplies. Where a vendor has acquired goods or services partly in the course of making taxable supplies, it would be limited to claiming input tax only to the extent that such goods or services were acquired.

There appears to be an anomaly under the VAT Act, where a sole practitioner can enjoy the benefit of claiming an input tax deduction as opposed to an incorporated entity, which, as the employer, pays the professional membership fees on behalf of its employees. As a result of this anomaly and its potential impact from a VAT perspective, SAICA obtained a ruling from SARS under s72 of the VAT Act seeking an interim measure on the recoverability of VAT on professional membership fees by other business forms while SARS considered SAICA's request that the VAT Act be amended to clarify the position.

In practice, SARS generally allows for input tax to be claimed by an employer to the extent that its employee is reimbursed for the expenditure incurred in relation to professional membership fees, provided a valid tax invoice in the name of employer has been issued and such obligation is contained in the employment contract of the employee. This practice is in line with a similar approach followed by the New Zealand tax authorities relating to professional membership fees. However, the withdrawal of the SAICA ruling exposes an apparent differentiation between sole practitioners who practice for their own account and other business forms that pay the professional membership fees on behalf of their employees.

It is understandable that, from a sole practitioner's point of view, the payment of the relevant professional membership fees can be argued to be services acquired directly in the course and furtherance of his enterprise. In the case of an employer, which is an incorporated entity, the question may be asked as to which party (ie the employer or employee) is the real or actual recipient of the supply. Furthermore, is there any difference between

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business related expenditure reimbursed by an employer such as travel and mobile phone and the reimbursement of professional fees which, by its very nature, is ultimately for the benefit of the employer and directly related to the employer's enterprise? The test may boil down to whether or not a taxable fringe benefit arises for the employee, it being argued that in the absence of a fringe benefit, there is no private or domestic element to the expense.

Employers paying professional membership fees on behalf of employees are required to review their current VAT policies for compliance in light of recent events. As stated above, the withdrawal of the SAICA ruling does not mean that there will be an automatic denial of input tax by SARS, however, it may create an environment for renewed disputes on this topic.

Ruaan van Eeden and Carmen Moss-Holdstock

VESTING OF DIVIDEND RIGHTS IN EXEMPT BODY

In a binding private ruling issued on 25 October 2012 (BPR 125), SARS was asked to rule primarily on the application of paragraph 80(1) read with paragraph 63 of the Eighth Schedule to the Income Tax Act, No 58 of 1962 (Act).

Briefly, the facts were as follows:

A resident discretionary trust (Trust) holds 100% of the equity shares in a resident private company (Company). One of the beneficiaries of the trust is recognised as a traditional community under s2 of the Traditional Leadership and Governance Framework Act, No 41 of 2003 and is exempt from normal tax under s10(1)(t)(vii) of the Act. It was proposed that the trustees of the trust will, in the exercise of their discretion, distribute dividend rights in respect of the shares held in the Company to the traditional community.

Essentially, paragraph 80(1) of the Eighth Schedule to the Act provides that where a capital gain is determined in respect of the vesting by a trust of an asset in a trust beneficiary (other than the Government, a provincial administration, organisation, person or club contemplated in paragraph 62(a) to (e)) who is a resident, that gain:

- must be disregarded for the purpose of calculating the aggregate capital gain or aggregate capital loss of the trust; and
- must be taken into account for the purpose of calculating the aggregate capital gain or aggregate capital loss of the beneficiary to whom that asset was so disposed of.

It will be noted that paragraph 80 is peremptory in that it provides that any capital gain *must* be disregarded by the trust and *must* be taken into account by the resident beneficiary to whom that asset was disposed. Paragraph 80(1) thus recognises the conduit principle and determines that the gain which arises flows through the trust and is taken into account in the hands of the beneficiary.

Any capital gain arising on the vesting of an asset by a trust in the Government, a provincial administration, organisation, person or club contemplated in paragraph 62(a) to (e) cannot be attributed to such bodies under paragraph 80(1) since they are specifically excluded from its ambit. As a consequence, capital gains arising from a vesting in such bodies remain in the trust.

The traditional community, although constituting a body exempt from tax under s10(1)(t)(vii) of the Act, does not fall within the ambit of the bodies contemplated in paragraph 62(a) to (e). As a result, any capital gain arising from the distribution of the dividend rights must be taken into account in determining the aggregate capital gain or loss of the traditional community and must be disregarded by the Trust.

However, the enquiry does not end there. Paragraph 63 of the Eighth Schedule provides that a person must disregard any capital gain or loss in respect of the disposal of an asset where any amount constituting gross income of whatever nature would be exempt from tax in terms of s10 were it to be received by or to accrue to that person. It is not entirely clear whether paragraph 63 applies only to disposals by the exempt body or whether, for instance, it also applies to a disposal by the trustees of a trust by way of the vesting of an asset in an exempt body.

Applying the provisions of paragraph 80(1) read with paragraph 63 Schedule, SARS confirmed in BPR 125 that the vesting of the dividend rights by the Trust in the traditional community will not be subject to capital gains tax in the hands of the Trust, in terms of paragraph 80(1) of the Eighth Schedule. Furthermore, in terms of paragraph 63 of the Eighth Schedule, any capital gains arising from the vesting of the dividend rights will not give rise to any capital gains tax liability in the hands of the traditional community, given that its receipts and accruals are exempt from normal tax under s10(1)(t)(vii). In other words, it is implicit in the ruling that paragraph 63 also applies to capital gains arising pursuant to the attribution thereof in accordance with paragraph 80(1) of the Eighth Schedule to the Act and is not limited to disposals by the exempt body.

SARS also confirmed that, as the traditional community will be regarded as the 'beneficial owner' of any dividends declared by the Company, the Company will not be required to withhold dividends tax from any dividends paid to the Trust, provided that the Trust has by the date determined by the Company, or by the date of payment of the dividend, submitted a declaration to the Company that the dividend amount is exempt from dividends tax under s64F(g) as well as a written undertaking to inform the Company should the traditional community cease to be the beneficial owner of the dividend.

BPR125 serves as a useful illustration of the interplay between paragraph 80(1) and paragraph 63 of the Eighth Schedule to the Act. Although paragraph 80(1) is peremptory and provides that any capital must be taken into account by the beneficiary, in

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circumstances where the beneficiary is exempt from tax in terms of s10 of the Act, no capital gains tax will be payable by either the trust or the beneficiary.

It should be appreciated that the statutory conduit principle as contained in paragraph 80(1) gives way to the special attribution rules contained in paragraphs 68 (attribution of capital gain to spouse), 69 (attribution of capital gain to parent of minor child), 71 (attribution of capital gain subject to conditional vesting) and 72 (attribution of capital gain vesting in a person who is not a resident) of the Eighth Schedule which, if applicable, will override paragraph 80(1).

Andrew Seaber

WHAT'S IN A NAME: 'PRIMARY RESIDENCE' EXAMINED

The term 'primary residence' is defined in paragraph 44 of the Eighth Schedule to the Income Tax Act, No 58 of 1961 (ITA) (read with paragraph 1).

The reason this definition has captured the minds of many is due to the exclusion on the gain or loss made on disposal of one's primary residence, provided the gain does not exceed R2 million or the proceeds from the sale of the property do not exceed R2 million. To qualify as a primary residence, and receive the benefit of the exemption, a residence must be one in which a natural person or a special trust holds an interest. But, in addition, the natural person or a beneficiary of the special trust or spouse of the person or beneficiary must:

- ordinarily reside or have resided in the residence as his or her main residence; and
- use or have used the residence mainly for domestic purposes.

In order for property to qualify as a primary residence, the residence must meet both of the latter requirements or face disqualification as a primary residence. The definition also makes it clear that a company, ordinary trust or close corporation owning a residence, will not qualify for the primary residence exclusion.

The SARS Guide to the Disposal of a Residence from a Company or Trust, 1 October 2010 to 31 December 2012 (Guide), provides that the term 'mainly for domestic purposes' implies a purely quantitative standard of more than 50% of the residence being used for domestic purposes. This may be measured on a floor-area or time basis. This interpretation was given by Botha JA in *SBI v Lourens Erasmus (Eiendoms) Bpk 1966 (4) SA 444 (A), 28 SATC 233 at 245* (see page 15 of the Guide).

Aside from the above definition in the ITA and the two requirements that need to be met, the 'primary residence' definition has not been interpreted by South African courts. In order to provide some clarity in this regard, we look to the recent Australian case of *Commissioner of State Revenue v Burdinat [2012] WASC 359*.

The case discussed comes on appeal from the State Administrative Tribunal of Western Australia and relates to principal place of residence (PPR) land tax exemption under s21 of the Australian Land Tax Assessment Act, 2002 (LTAA), being similar to the South African primary residence rebate.

The facts are briefly that a retired couple, who have lived in their Bicton home for 25 years, took an extended holiday from early June to early September 2011, to a warmer part of the country, where they lived in a caravan on their own Broome Vacation Village site. While they were away they let their house in Bicton, fully furnished, mainly for security reasons. Shortly after their return, they were issued with a land tax assessment, which effectively provided that the Vacation Village site and not their Bicton residence, was granted the PPR land tax exemption. The question the Supreme Court of Western Australia was required to answer, was whether the Bicton property was the Burdinats' primary residence. The reason for this question was that according to the LTAA, private property is exempted from land tax, if at midnight on 30 June in the preceding year, the property was owned by husband and wife, where at least one of them used it as a primary residence. Thus, given that the couple were away over the crucial date of 30 June, the tax assessment was issued.

This case is helpful in that, the court examined a multitude of analogous cases in determining the meaning of primary residence, specifically in the light of absences from the residence in question. Various judgments provided that where a place has been determined to be the primary residence, the taxpayer is not 'less resident' because he leaves from time to time for business and pleasure. In other words, where the place of abode has been established, physical presence or absence from it does not change its status. It would require a change of intention by the taxpayer to change the status. The duration of residency alone does not determine permanence.

On a broad view of the facts, the Court dismissed the appeal by the Commissioner against the review decision in favour of the Burdinats, finding that their primary residence was the house in Bicton. Despite the taxpayers having been away from their residence on that crucial date namely, 30 June, the Court was not persuaded that the grounds for appeal had been made out by the Commissioner.

Thus, for South African taxpayers it is encouraging to note from the Australian example, that the primary residence definition must be applied specifically to each case, taking all circumstances into account. It is also positive that where a primary residence has been established, absences from the residence for business or recreation will not result in the residence losing its status and exemption as primary residence.

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