DLA CLIFFE DEKKER HOFMEYR

TAX ALERT

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EXIT CHARGE REVISITED

Following the Supreme Court of Appeal decision in *CSARS v Tradehold Ltd (case no 132/2011 Supreme Court of Appeal, handed down on 8 May 2012)*, much has been written about whether or not SARS will be entitled to levy an exit charge following a person ceasing to be a resident of South Africa, pursuant to the deemed disposal provisions in section 9H of the Income Tax Act, No 58 of 1962 (Act).

In a previous issue of the Tax Alert, we traversed some of the difficulties and anomalies that arose in this judgment. Essentially, a person (whether an individual, a juristic person or a trust) is deemed to have disposed of its assets, subject to certain exceptions, on the day immediately before the day on which it so ceases to be a resident.

On the one hand, certain authors hold the view that the judgment should be seen in light of the unique facts and circumstances of the case that are unlikely to ever present themselves again. On this basis, it is believed that the *Tradehold* decision should not be seen as offering taxpayers a defence against an attempt by SARS to levy an exit tax following the taxpayer ceasing to be a resident of South Africa.

On the other hand, it is believed that, although premised on a set of unique facts, the judgment nonetheless provides authority for an argument that the relevant provisions of a double taxation agreement be applied in preference to, and has the effect of the overriding the exit tax provisions contained in section 9H of the Act. The proponents of this view thus believe that in the context of an applicable double taxation agreement, section 9H of the Act cannot apply and it is only the contracting state of which the former resident of South Africa is now resident that can levy tax on any gains derived as a consequence of any disposals or alienations. The effect, if this view is to be upheld going forward, is that SARS will no longer be entitled to levy an exit tax arising out of a person ceasing to be a resident of South Africa.

To avoid any uncertainty, the National Treasury has in the Draft Taxation Laws Amendment Bill 2012 (DTLAB) (recently released for public comment) proposed that section 9H of the Act be amended. Essentially, the amendment contemplates that a person's year of assessment is deemed to have ended the day before that person becomes a resident of another country. It also provides that in the context of persons other than companies such persons will be deemed to have disposed of all their assets immediately before the end of that year of assessment, at market value. Insofar as companies are concerned, the relevant company will be deemed to have been liquidated and to have distributed all its assets to its shareholders. Such company will also be deemed to have re-incorporated a new foreign company on the following day. Foreign residency will thus only commence in the new year of assessment.

According to the Explanatory Memorandum to the DTLAB, the amendments will more closely align the exit charge provisions in section 9H with international norms.

Although the amendment does not favour taxpayers, it is to be welcomed as bringing about certainty in relation to exit charges, if nothing more. If finally brought into law, the proposed amendment will have retrospective effect to 18 May 2012, that is the date on which the *Tradehold* case was decided by the Supreme Court of Appeal.

Andrew Seaber

SMALL BUSINESS CORPORATIONS AND 'CONSULTING': *XYZ CC V CSARS*

The matter of *XYZ CC v CSARS (case number 12860, 22 June 2012)* was recently decided in the Tax Court.

The case principally revolved around the meaning of the term 'consultant' or 'consulting' with reference to a small business corporation (SBC) rendering a 'personal service' and thus not meeting the requirements for an SBC under section 12E of the Income Tax Act, No 58 of 1962 (Act). SARS accordingly refused to tax the Appellant as an SBC, thus denying it the benefit of special tax rates under section 12E.

The Appellant described its revenue as 'consultancy fees' and it was on this basis that SARS found the Appellant failed to comply with section 12E(4)(a)(iii) of the Act. Section 12E(4)(a)(iii) provides that a company or close corporation (CC) that earns more than 20% of its total receipts and accruals (other than those of a capital nature) from investment income plus personal services, does not comply with the definition of an SBC.

The term 'personal service' is defined under section 12E(4)(d) of the Act as including various professional services, as well as *quasi*-professional activities requiring a particular qualification, and in many cases, a licence, certificate or membership of a professional body. The latter may include 'consulting', 'management and 'broking'. The court had to decide on the meaning of the previously mentioned terms and whether these could be seen to describe any part of the Appellant's activities. Secondly, the court had to determine, if in fact the Appellant provided a 'personal service', whether the income from these, along with investment income, exceeded 20% of the Appellant's total receipts and accruals. The second part to the latter question is whether these 'personal services' had been rendered by a member of the Appellant.

The court, being guided by legal interpretation principles, noted that the literal interpretation of the term 'consulting' or 'consult' was found in the Concise Oxford Dictionary to mean: *a person who provides expert advice professionally.* The Appellant did not hold any professional or *quasi*-professional qualifications, nor could the service it offered be described as advice offered by a professional person. It was on this basis that the court concluded that the Appellant was not providing a 'personal service'. This, coupled with the fact that the income received from any services that could possibly qualify as 'personal services' along with investment income did not exceed more than 5% of the receipts and accruals of the Appellant, meant that the Appellant did comply with the definition of a SBC.

The court ruled that SARS was compelled to tax the Appellant as an SBC in terms of section 12E of the Act. The court applied a literal interpretation of the term 'consulting' and used the *contra fiscum* rule, which provides that a statute must be interpreted in favour of the Appellant, where the tax statute reveals ambiguity.

Danielle le Roux

INFORMATION GATHERING BY SARS – IT'S NOT CARTE BLANCHE

Chapter 5 of the Tax Administration Act, No 28 of 2011 (TA Act) significantly extends the information gathering powers of the South African Revenue Service (SARS).

In SARS's recently published Short Guide to the Tax Administration Act it is stated: "SARS's information gathering powers are supplemented or extended by TA Act. This is essentially to address the problem that too many requests for information by SARS results in protracted debates as to SARS's entitlement to certain information. However, taxpayer's rights are amplified and made more explicit to counterbalance SARS's new information gathering powers."

Despite SARS's extended information gathering powers it's certainly not carte blanche – where appropriate, taxpayers should resist potential abuse of those powers. A recent Canadian judgment is instructive regarding the limitations on the information gathering powers of a revenue authority (in this instance the Canadian Revenue Authority (the CRA)).

The case of *R. v. He 2012 BCCA 318 (judgment by the Court of Appeal for British Columbia on 25 July 2012)* involved a CRA programme called the "Electronic Records Evaluation Pilot Project". This programme, used by the CRA's Audit Division, targeted certain businesses for research purposes such as restaurants, convenience stores and small supermarkets to evaluate their record-keeping compliance. The He family in Vancouver ran a small sushi restaurant. The CRA suspected that it had used sales suppression software (a so-called 'zapper' programme) to suppress $1.6 million in sales revenue over a four year period. Initially the CRA stated that it was not auditing the restaurant. However, inconsistencies found subsequently resulted in a CRA audit and investigation culminating in criminal charges. The question was

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whether the CRA was authorised to seize and examine the He family's records under the circumstances of this case.

At the criminal trial of the three He family members, the judge stated that the CRA's letter requesting the taxpayer's voluntary cooperation in the research project was misleading and deceptive. He pointed out that said letter even reassured that the review "... was not an audit, but rather a limited review of your current record keeping practices to determine if they are adequate for purposes of the Income Tax Act and Excise Tax Act." The judge therefore ruled that the evidence obtained from the restaurant's point of sale system was inadmissible. On appeal this finding was confirmed by the Supreme Court of British Columbia. The CRA then appealed to the BCCA.

In its judgment the BCCA referred to sec 231.1 of the Canadian Income Tax Act, 1985 (ITA). This section empowers the CRA to demand taxpayer information "for any purpose related to the administration or enforcement of" the ITA. The BCCA considered the reasoning of the Supreme Court of Canada in *James Richardson & Sons v. M.N.R., [1984] 1 S.C.R. 614* and other cases laying down the parameters of the CRA's information gathering powers. In the end the BCCA agreed with the judge and the Supreme Court of British Columbia that the examination of the restaurant's books and records was not authorised by sec 231.1 of the ITA.

The Supreme Court of Canada in the *James Richardson* case acknowledged that the CRA's information gathering powers were unquestionably broad. It nevertheless warned that the revenue authority should not be allowed to undertake a 'fishing expedition'. The *James Richardson* case applied the reasoning in *Canadian Bank of Commerce v. Attorney General of Canada, [1962] S.C.R. 729.* The last-mentioned case held that a request for taxpayer information could only be made where such information was relevant to the tax liability of a person or persons and on the basis that the CRA was engaged in a "genuine and serious inquiry into the tax liability of some specific person or persons ... for purposes of the administration or enforcement of the Act...". Any demand for taxpayer information not meeting that yard-stick could not be said to be related to the administration or enforcement of the Act.

The wording in the local TA Act is comparable to that of corresponding provisions in the Canadian ITA. For example, section 45(1) [dealing with 'Inspection'] and section 46(1) [dealing with 'Request for relevant material'] of the TA Act provide that "SARS may, for purposes of the administration of a tax Act in relation to a taxpayer" require certain information to be submitted to it.

The Canadian experience shows that, before a taxpayer complies with any information request, it should clearly understand exactly what information is being requested by the revenue authority, the statutory basis for the request and the purpose for which said information is needed. The He family discovered to their detriment that the road from research to audit to investigation to criminal prosecution gets blurred quite easily – especially when travelled by over-zealous revenue officials.

Although locally the TA Act might have supplemented and extended SARS's information gathering powers, those powers are by no means unfettered. Taxpayers should be aware of their rights and obligations when it comes to SARS demanding information from them.

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