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TAX ALERT

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IN THIS ISSUE

JUDICIAL REVIEW AND RAISING ASSESSMENTS

On 31 January 2013, judgment was handed down in the North Gauteng High Court in the case of *MTN International (Mauritius) Limited v Commissioner for the South African Revenue Service* (as yet unreported, case no 23203/11).

The facts were briefly as follows. The taxpayer was a Mauritian company, registered as a taxpayer with the South African Revenue Service (SARS), and a subsidiary of a South African holding company. The taxpayer acquired various interests, notably in Nigeria and the Middle East, through loans obtained from its South African holding company. The taxpayer had claimed deductions in respect of interest expenditure incurred on the loans in the 2006 year of assessment. The taxpayer had previously claimed such deduction in respect of its Nigerian interests and SARS had always allowed such deductions.

The original assessment in respect of the taxpayer's 2006 year of assessment was raised on 1 April 2008. A refund had been due to the taxpayer and a refund audit was conducted by SARS. Various issues arose, most notably whether the taxpayer was entitled to the interest deductions that it had claimed and transfer pricing issues. Meetings were held between the taxpayer and SARS and correspondence was exchanged in the years following the raising of the original assessment. An audit inquiry was sent to the taxpayer in 2010, to which the taxpayer replied.

A letter of findings was issued to the taxpayer on 24 February 2011 and the taxpayer replied on 25 March 2011. On 31 March 2011, SARS issued an additional assessment to the taxpayer in respect of the 2006 year of assessment (form IT 40). It should be noted that this was just before SARS's power to raise an additional assessment was to prescribe in terms of s79 of the Income Tax Act, No 58 of 1962 (Act).

Even though the assessment was raised on 31 March 2011, SARS indicated the due date of the assessment as 30 March 2011. SARS also indicated the 'second date' as being 31 March 2011.

A notice of assessment (form IT 34) was subsequently issued with due date 1 May 2011 and second date 31 May 2011.

The taxpayer brought an application in terms of section 6 of the Promotion of Administrative Justice Act, No 3 of 2000 (PAJA) for an order setting aside the assessment(s) and to refund monies withheld or having been set off by SARS.

If the taxpayer were to be successful, the 2006 year of assessment will have prescribed and SARS would have been precluded from raising a further assessment.

The taxpayer complained that:

- There was a procedural defect in the raising of the 2006 additional assessment.
- SARS did not properly consider the taxpayer's submissions in its reply to SARS's letter of findings.
- SARS manipulated the commencement date for prescription in respect of the additional assessment by backdating the due date on the assessment by one day.
- SARS was inconsistent in its practice by not indicating the second date as being 30 days after the due date.

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- The decision to raise the assessment was not rationally connected to the reasons contained in SARS's letter of findings.
- SARS's conduct was defective and invalid.
- SARS's conduct was inconsistent with the Constitution and the rule of law.
- The taxpayer had a legitimate expectation that SARS would allow the interest deductions as it had always allowed the deductions in respect of the Nigerian interests.
- The letter of findings was based on an error of law and lacked appreciation for the transfer pricing provisions in the Act.
- SARS failed to follow its common practice after concluding audits to reply to the taxpayer's submissions.
- The taxpayer had a legitimate expectation that SARS would so reply before issuing the assessment.
- SARS ignored the taxpayer's request to not set off the amounts in the disputed assessment against refunds owed to the taxpayer.
- SARS had ulterior motives in raising the additional assessment.

The taxpayer argued that by predating the due date it was deprived of the full period allowed for objecting or requesting reasons.

SARS admitted that it was wrong in manipulating the dates, but argued that the issues raised by the taxpayer required the court to go into the merits of the matter, and thus the facts, which power lies exclusively with the Tax Court.

The court agreed with SARS that the issues raised required going into the facts of the matter, which could not be considered in the present forum.

The court also said that the question had to be asked whether the taxpayer's rights had actually been affected, especially given the fact that it requested reasons in respect of the assessment and that it therefore had longer time to object. The court agreed that the taxpayer's Constitutional rights could potentially have been affected by the wrongful manipulation of the dates, but in this particular instance both the IT40 and the IT34 forms were raised before the 2006 year of assessment had prescribed.

There was some confusion as to whether one assessment had been raised, being the IT40, or two assessments, being the IT40 and the IT34. In the court's view only one assessment had been raised, and that was the IT40 processed on 31 March 2011.

It had to also be determined whether the manipulation of the dates was in bad faith and therefore invalidated the additional assessment. The court said that it could not in the present proceedings make such a determination as it required going into the facts and testing whether SARS's explanation for manipulating the dates was far-fetched and untenable.

On the issues regarding legitimate expectation, the court noted that, in principle, it could perhaps endorse the doctrine of legitimate expectation, but declined to do so, citing again that the Tax Court would be the appropriate forum to decide the matter.

The court did not go into detail regarding the taxpayer's other complaints and the application was dismissed.

This case again illustrates that the High Courts are reluctant to hear tax matters on the papers where in the Tax Court all the factual issues can be canvassed. However, it raises questions as to the effectiveness of review applications under PAJA where one is dealing with administrative action by SARS and its officials. Here the taxpayer tried to make a case that its submissions were not properly considered by SARS and that an assessment, being a very important document, had been improperly issued, and could negatively affect its rights. On SARS's own admission the document was wrongly issued.

It is a pity that the court took the strict approach that where there might be disputed facts (which there were not in this particular case, SARS having acknowledged that the manipulation of the dates was wrong) a matter should be heard by the Tax Court and is not suitable for review under PAJA. This jurisdictional tension essentially nullifies the otherwise powerful remedy in the hands of a taxpayer to have administrative action by SARS subjected to judicial scrutiny in the High Court. This leaves the taxpayer with having to use the rather time-consuming objection and appeal procedures where administrative action by SARS at the initial phases of the assessment process had been irregular.

The case also illustrates SARS's habit of setting off amounts under disputed assessments against the credit balances of taxpayers and refusing to refund moneys otherwise payable to the taxpayer, despite requests to do so.

What is most striking about the case is the irregular form that the assessment process takes and the confusion as to what constitutes a letter of findings, an assessment and a notice of assessment and how this links up with SARS's IT infrastructure which produces the forms (with their dates) that are eventually received by the taxpayer. The facts of this case also leave taxpayers with uncertainty as to the various points in the assessment process at which they are entitled to make submissions and to have those submissions properly considered, and the remedies available should those submissions not be properly considered.

Heinrich Louw

WITHHOLDING TAX ON INTEREST PAID TO FOREIGN PERSONS

Currently, South Africa's income tax system provides for a blanket tax exemption on all interest payable to foreign residents.

The exemption however does not apply where the foreign residents conduct business through a permanent establishment in South Africa or where the foreign residents are physically based in South Africa for more than 183 days during the relevant year of assessment. Accordingly, debt instruments issued to foreign residents who do not fall within the aforementioned categories, will be exempt from normal tax in South Africa.

In order to align the South African tax system with international global practice government announced in 2010 that it intended to introduce a withholding tax on interest paid to foreign residents at a rate of 10%. The proposed tax was to be effective from 1 January 2013 and the effect was that any interest that accrues, is received, becomes payable or is deemed to have accrued to a foreign resident on or after 1 January 2013, will be subject to withholding tax at the proposed rate.

However, on 11 December 2012, National Treasury issued a press release in which it stated that with effect from 1 July 2013, the South African government will introduce a withholding tax on interest at a rate of 15% [s37J of the Income Tax Act 58 of 1962 (the Act)]. In the press release, National Treasury specifically stated that the withholding tax will apply to all interest paid by South African residents to foreign residents, except of course where the foreign residents are subject to normal tax as outlined above.

In light of the important changes made to the withholding tax arena, it is important to consider the following administrative consequences:

- The liability to withhold tax on interest will remain with the person making payment of the interest for the benefit of the foreign resident. However, ultimately the liability for the payment of the withholding tax will rest with the beneficial owner, being the foreign resident (s37JA read with s37L of the Act).
- The trigger date for the withholding of taxes will be the date that the interest is paid or becomes due and payable and not the date that the amount has accrued to the foreign resident (s37JA of the Act).
- Payment of withholding tax to the South African Revenue Service (SARS) must be made at the close of the month following the month in which the interest was paid (s37M of the Act).
- A claim for a refund, in the case of an overpayment to SARS, must be made solely to SARS within three years after the payment of interest (s37N of the Act).

Furthermore, under the new withholding tax regime and in terms of s37K of the Act, there are certain exemptions which will apply to interest paid or accrued to foreign residents from the following sources:

- Bonds issued by any sphere of government.
- Listed debt instruments, for example, bonds listed on the Johannesburg Stock Exchange.
- Any debt owed by a domestic bank or the South African Reserve Bank, Development Bank of Southern Africa and the Industrial Development Corporation.
- Domestic dealer and brokerage accounts and domestic investment schemes in respect of bills of exchange, letters of credit or a similar instrument.

It is important to note that the withholding tax exemption does not apply to back-to-back loan agreements designed to avoid the 15% withholding tax.

In light of all the above, it can be concluded that the rationale behind the introduction of the proposed withholding tax on interest is to narrow the cross-border interest exemption in order to align it with international global tax practice.

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