TAX

INVALID ASSESSMENTS ARE SUBJECT TO OBJECTION AND APPEAL

Judgment was delivered by the Supreme Court of Appeal (SCA) in the case of *Medox Limited v Commissioner for the South African Revenue Service* on 27 May 2015.

While under provisional liquidation, Medox Limited (Taxpayer) incurred an assessed loss during its 1996 year of assessment. The Taxpayer failed to submit a return for the 1997 year of assessment. In its returns for the 1998 and subsequent tax years, it neglected to carry forward the assessed loss from 1996.

The Taxpayer only realised in 2009 that the assessed loss had not been accounted for and set off against its income in the subsequent years of assessment. However, the Taxpayer did not object to the assessments issued by the Commissioner for the South African Revenue Service (Commissioner) in respect of the 1998 and subsequent years of assessment. Rather, the Taxpayer took the view that the issuing of these assessments without taking into account the assessed loss from 1996 was *ultra vires*, and the assessments were therefore void. On this basis, the Taxpayer approached the High Court in Pretoria for relief, but the High Court dismissed the matter. The Taxpayer then appealed to the SCA.

The SCA reasoned that, in order for the Taxpayer to succeed, the Taxpayer had to show that it had an existing, future, or contingent right to have the assessments set aside. However, as was submitted by the Commissioner, the Taxpayer never objected to the assessments and they had thus become final and binding in terms of s81(5) of the Income Tax Act, No 58 of 1962 (Act) – now s100 of the Tax Administration Act, No 28 of 2011 (TAA).

The Commissioner also argued that three years had lapsed since the date of all the relevant assessments, and any right to object had effectively prescribed in terms of s81(2) of the Act – now s104(5)(b) of the TAA.

It was submitted on behalf of the Taxpayer that the provisions relating to the finality of assessments only applied to valid assessments, being assessments that were correctly issued in terms of the Act. However, the SCA noted that if this argument is followed through, it would mean that any assessment in terms of which an amount is incorrectly included, or a deduction incorrectly refused, would be invalid, and accordingly not subject to s81 to s83 of the Act, rendering the objection and appeal process irrelevant. This would mean that taxpayers could bypass the Tax Court and directly approach the High Court.

The SCA specifically noted that the Taxpayer did not base its case on the assessments having been issued as a result of *iustus error* or fraud. It seems therefore that taxpayers could potentially approach a High Court to set aside assessments in such circumstances.

The court accordingly refused to read s81 as applying only to valid and correct assessments, as such an interpretation would conflict with the intention of the legislature, which presumably was for the objection and appeal procedure to apply to all assessments, whether they are valid and correct, or not.

The Taxpayer essentially contended that it was the Commissioner's duty to set off the loss from 1996 against income from the subsequent years. However, the SCA held that it was the Taxpayer's duty to render a return carrying forward any such assessed losses from previous years, and the burden of proof in respect of any set-off of assessed losses lies with the Taxpayer. In this matter, the Taxpayer did not render a return for the 1997 year of assessment, and did not claim the assessed loss in any of the subsequent years.

The appeal was therefore dismissed.

An additional matter that warrants mention is the SCA's manifest dissatisfaction with the State attorney, who acted for the Commissioner. It appears that the State attorney failed to file timeously its heads of argument and accompanying practice note, which initially lead the court to believe that the appeal would not be opposed. The SCA noted that:

"*…due to a litany of administrative deficiencies, no steps were taken to forward the heads of argument to this court nor was any practice note prepared for filing. The administrative deficiencies leading to this sorry state of affairs can only be described as grossly negligent, demonstrating a flagrant disregard for the rules of this court. It is clear that, had this court not brought the failure to file the heads of argument and practice note to the attention of the State attorney, nothing would have been done and the appeal would have been heard without the Commissioner being represented…this court has been seriously inconvenienced by the supine attitude adopted by the State attorney…*"

As a sanction, the court disallowed the Commissioner's costs by not making any cost order.

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TRANSFER PRICING ADJUSTMENTS AND WITHHOLDING TAX ON INTEREST

The South African Revenue Service (SARS) released Binding Private Ruling 192 (Ruling) on 28 May 2015, which dealt with withholding tax on interest and cross-border interest-free loans.

The applicant was a non-resident and did not have a permanent establishment in South Africa. The co-applicant was a resident South African company, and a connected person in relation to the applicant.

The applicant and co-applicant intended to enter into a loan agreement in terms of which the foreign applicant would advance money to the local co-applicant. The loan would be interest-free, unsecured, and payable on demand.

It appears that the main concern of the parties was that transfer pricing adjustments might be made in terms of s31 of the Income Tax Act, No 58 of 1962 (Act), most probably because the terms of the loan would not be considered arm's length.

The issue that SARS had to consider was whether, if transfer pricing adjustments were to be made in order to counter the effect of the interest-free nature of the loan, withholding tax on interest would have to be accounted for by the co-applicant in terms of s50B of the Act.

SARS ruled that no withholding tax on interest would have to be accounted for in the event that transfer pricing adjustments were made. SARS did not provide any reasons for its decision, but one assumes that the operation of s31(2) would not necessarily deem there to have been any interest.

Section 31(2) provides that "…the taxable income or tax payable by any person…must be calculated as if the transaction…had been entered into on the terms and conditions that would have existed had those persons been independent persons dealing at arm's length…"

If one considers that s31(2) of the Act obliges certain taxpayers to calculate their 'tax payable' as if their transaction had been on arm's length terms, as opposed to the actual terms, then it seems unclear why SARS ruled that the parties would not have to account for withholding tax on interest to the extent that the arm's length position would have been that the loan would bear interest.

If the arm's length position was that the loan would bear interest, then the 'tax payable' by the parties would surely have included a liability for withholding tax on interest.

SARS did not rule on the applicability of the secondary adjustment provisions contained in s31(3) of the Act, in terms of which the relevant amount of interest could be deemed to be a dividend *in specie* declared to the applicant.

In other words, even though the withholding tax on interest would not apply in the case of a transfer pricing adjustment, dividends tax could potentially apply.

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