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TAX & EXCHANGE CONTROL ALERT

IN THIS **ISSUE**

A CREATURE OF STATUTE: A DECISION ABOUT THE TAX COURT'S POWER TO INCREASE UNDERSTATEMENT PENALTIES

In the recent judgment of *Purlish Holdings (Proprietary) Limited v The Commissioner for the South African Revenue Service* (76/18) [2019] ZASCA 04, the Supreme Court of Appeal (SCA) had to pronounce on the South African Revenue Service's (SARS) entitlement to impose understatement penalties on Purlish Holdings (Proprietary) Limited (Taxpayer) and the quantum thereof.

CUSTOMS & EXCISE HIGHLIGHTS

This week's selected highlights in the Customs & Excise environment since our last instalment.

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A CREATURE OF STATUTE: A DECISION ABOUT THE TAX COURT'S POWER TO INCREASE UNDERSTATEMENT PENALTIES

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In the recent judgment of *Purlish Holdings (Proprietary) Limited v The Commissioner for the South African Revenue Service* (76/18) [2019] ZASCA 04, the Supreme Court of Appeal (SCA) had to pronounce on the South African Revenue Service's (SARS) entitlement to impose understatement penalties on Purlish Holdings (Proprietary) Limited (Taxpayer) and the quantum thereof. To this end, the SCA had special regard to the scope of the powers of the Tax Court to increase an understatement penalty in terms of s129(3) of the Tax Administration Act, No 28 of 2011 (TAA).

Facts

During the 2011 to 2014 years of assessment, the Taxpayer paid provisional tax to SARS, following which it submitted nil tax returns (being tax returns that reflect that a taxpayer had neither received income nor incurred expenditure in the year of assessment), as a result of which a refund became due by SARS. Given the magnitude of the refund claimed by the Taxpayer, SARS initiated an audit into the Taxpayer's corporate income tax (CIT) and value added tax (VAT) affairs.

During the audit process, it was discovered that the Taxpayer had concluded consultancy agreements in terms of which it had earned substantial income. Furthermore, these agreements stipulated that the fees payable to the Taxpayer were inclusive of VAT. Despite this, the Taxpayer submitted nil returns for CIT purposes for the 2011 to 2014 years of assessment, failed to register for VAT and failed to submit VAT returns for the relevant tax periods.

Following the audits, SARS imposed understatement penalties on the Taxpayer at a rate of 100% in respect of both CIT and VAT. Pursuant to an objection by the Taxpayer, the rates of the understatement penalties were reduced to 25% for CIT and 50% for VAT.

The Taxpayer appealed to the Tax Court, which was asked to determine whether SARS was justified in imposing the understatement penalties. However, the Tax Court went further and in terms of its powers in s129(3) of the TAA, increased the understatement penalties to 100% in respect of both CIT and VAT.

Judgment

The SCA was required to give judgment on two aspects of the appeal, specifically:

1. Whether or not SARS had proven that it was entitled to impose understatement penalties in terms of s222 of the TAA; and
2. Whether the Tax Court was entitled to increase the understatement penalties imposed by SARS.

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CONTINUED

The Taxpayer's failure to submit its returns prevented SARS from carrying out its assessment. As such, the SCA held that SARS had discharged its onus to prove that prejudice was suffered.

Regarding SARS's entitlement to impose the understatement penalties, the SCA examined the definition of the term "understatement" as contained in s221 of the TAA. The SCA held that an understatement arises only when the conduct referred to in s221 results in some prejudice to SARS or the fiscus, and that the onus to prove that prejudice rests on SARS in terms of s102(2) of the TAA. The SCA found that prejudice is not only determinable in financial terms, but includes the time and human capital resources employed in conducting the audit into the Taxpayer's tax affairs.

While it was submitted on behalf of the Taxpayer that no prejudice was suffered by SARS as the Taxpayer had paid substantial amounts of provisional tax to SARS, it was confirmed that SARS would be unable to allocate the aforementioned amounts to relevant governmental activities until such time as the Taxpayer submitted a return and SARS was able to assess whether there was an amount owing by or due to the Taxpayer. The Taxpayer's failure to submit its returns prevented SARS from carrying out its assessment. As such, the SCA held that SARS had discharged its onus to prove that prejudice was suffered.

In deciding whether the Tax Court was entitled to increase the understatement penalties imposed by SARS, the SCA considered s129(3) of the TAA and rule 34 of the rules promulgated in terms of s103 of the TAA (Tax Court Rules).

Section 129(3) states that, in the case of an appeal against an understatement penalty imposed by SARS under a tax Act, the Tax Court must decide the matter on the basis that the burden of proof is upon SARS and may reduce, confirm or increase the understatement penalty imposed.

Rule 34 of the Tax Court Rules states that the issues in an appeal to the Tax Court will be those contained in the statement of grounds of assessment and opposing the appeal, read with the statement of grounds of appeal and, if any, the reply to the grounds of appeal.

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As SARS had not raised the matter of an increase in the reduced penalties in its statement of grounds of assessment, the SCA found that it was not competent for the Tax Court to have increased the reduced penalties.

As SARS had not raised the matter of an increase in the reduced penalties in its statement of grounds of assessment, the SCA found that it was not competent for the Tax Court to have increased the reduced penalties. Ultimately, it was found that the powers conferred on the Tax Court by the TAA are limited by what is stated in the Tax Court Rules. Section 129(3) of the TAA had to be read in conjunction with rule 34 of the Tax Court Rules.

Comment

The judgment will be welcomed by taxpayers involved in disputes with SARS regarding understatement penalties, in particular, as it reaffirms that the Tax Court cannot of its own volition, increase an understatement penalty.

An understatement penalty may only be increased by the Tax Court where SARS has submitted in its statement of grounds of assessment and opposing the appeal, in terms of Rule 31 of the Tax Court Rules, that the understatement penalty should be increased. This is consistent with s102 and s134 of the TAA, which expressly state that when it comes to the imposition of understatement penalties, SARS bears the burden proof regarding the understatement penalty to be imposed.

The judgment further illustrates that the Tax Court is a creature of statute and that it may only do such things allowed in terms of its empowering legislation, being the TAA and the Tax Court Rules.

Louise Kotze and Louis Botha

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CUSTOMS & EXCISE HIGHLIGHTS

Please note that this is not intended to be a comprehensive study or list of the amendments, changes and the like in the Customs and Excise environment, but merely selected highlights which may be of interest.

In the event that specific advice is required, kindly contact our Customs and Excise specialist, Director, Petr Erasmus.

This week's selected highlights in the Customs & Excise environment since our last instalment:

New case law / authority – Levi Strauss SA (Pty) Ltd vs The Commissioner for the South African Revenue Authority, Case number 20923 / 2015 in the High Court of South Africa, Gauteng Division, Pretoria (as yet unreported) (certain sections quoted from the judgment):

Levi Strauss instituted an appeal against the following determinations made by SARS:

- That certain commissions are not buying agent commissions and are therefore dutiable;
- That royalties paid by Levi Strauss based on sales in South Africa are dutiable; and
- That goods imported by Levi Strauss do not qualify for preferential duty rates in terms of the SADC Trade Protocol as (although the products are manufactured and consigned from an SADC country) the trade relationship (ie. the flow of funds) are with non-SADC member states.

The High Court found against SARS as follows:

- Buying commission:

  "While the 33 services for which the provision is made ... to the [Buying Agent Agreement] entered into by Levi SA are more detailed and explicit as to each and every stage of the buying process, the above Explanatory Note both indicates that section 65 is not to be so narrowly construed as argued for by SARS counsel and that those 33 services could indeed fall within the services contemplated by this note".

- Royalties:

  "Third, while there is merit in having regard to international authorities ..., I must first seek guidance from the South African court and especially our higher courts. In Delta supra the court held that the EST charges/royalties were not payable 'as a condition of sale' because there was nothing in the agreement of sale for export which made such EST charges/ royalties payable as a condition of sale.

  ...

  Fifth, ... the royalties become due and payable upon sale and this bears no relation to the issue of importation ... In either event, it has been made clear ... that the royalty by Levi SA is paid as a result of a sale and not as a result of export to the Republic. This subsection does not therefore pertain to the facts in this case".

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CUSTOMS & EXCISE HIGHLIGHTS

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- Origin:

  "Clearly, the Protocol sought to focus on movement of goods from one entity to another. The emphasis is not on trade and transfer of funds and the financial benefits resulting therefrom.

  ...

  Insofar as the SARS argument is to the effect that the economic benefits accrued to Levi APD in Singapore and Levi GTC in Hong Kong and not to the contract-manufacturers in the SADC region, there is nothing to support this contention".

It is currently uncertain whether the matter will proceed to the Supreme Court of Appeal, but it appears to be likely.

Amendments to Rules to the Customs and Excise Act, No 91 of 1964 (Act) (certain sections quoted from the SARS website):

New Rules are proposed under s110 of the Act, which oblige the licensee of a customs and excise manufacturing warehouse for the manufacture of tobacco products to determine the quantities of all tobacco products manufactured in the warehouse by means of a functional product counter on each tobacco manufacturing machine. The draft Rules explain the physical requirements of the product counter system of which further details will be communicated by SARS to the licensee in writing at least 20 days before the installation date. The licensee would need to further adhere to strict reporting requirements, but may request approval from SARS for an alternative methodology if the prescribed product counter system cannot be used.

Due date for comments: 8 March 2019 to C&E_legislativecomments@sars.gov.za.

Amendments to Schedules to the Act (certain sections quoted from the SARS website):

- Schedule 1 Part 1:

  The substitution of tariff subheadings 1701.12, 1701.13, 1701.14, 1701.91, and 1701.99 to increase the rate of customs duty on sugar from 369.57c/kg to 401.79c/kg in terms of the existing variable tariff formula;

- Schedule 2:

  The insertion of safeguard item 260.03/7318.15.39/01.08 to implement safeguard duty of 48.01% on other screws fully threaded with hexagon heads (with effect from 3 August 2019 up to and including 2 August 2020); and

  The insertion of safeguard item 260.03/7318.15.39/01.08 to implement safeguard duty of 45.61% on other screws fully threaded with hexagon heads (with effect from 3 August 2020 up to and including 2 August 2021).

SARS issued the following circular wherein external stakeholders were advised as follows (certain sections quoted from the circular):

On 1 February 2019, a reminder to all Customs Clients who are deferment account holders to kindly adhere to the 13th deferment payment requirements, which become due by each financial year end. The statement period for the thirteenth payment of this financial year (2018/2019) will close on 28 March 2019 at midnight (00:00) and payment must be made by 15h00 on 29 March 2019.

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CUSTOMS & EXCISE HIGHLIGHTS

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In the event that specific advice is required, kindly contact our Customs and Excise specialist, Director, Petr Erasmus.

The rewrite of the Act (certain sections taken from the SARS website):

As a consequence of the rewrite of the Act, which will be replaced with the new Customs Duty Act, 2014 (CDA), and the Customs Control Act, 2014 (CCA), SARS has published the below documents for consideration and comments relating to customs:

- Correlation table

  This document is comprehensive and contains a bird's eye view of the tariff structure as contained in the changes to the wording and structure and wherein the new Customs Tariff can be found. The correlation is from the Act to the new Customs Tariff and the other way round.

- The General Notes to the Customs Tariff

  The General Notes are circulated without the rest of Schedule 1 as it will make the documents bulky and difficult to email. Schedule 1 contains a few changes that are elaborated on in the correlation table but in essence it contains the current tariff code structure of the existing Schedule 1 Part 1 of the Act.

- Schedule 2 to the Customs Tariff

  Schedule 2 remained unchanged with the exception of the Notes which were previously repeated in each Part of Schedule 2. The changes are contained in the correlation table.

- Schedule 3 to the Customs Tariff

  Schedule 3 significantly changed and contains both the provisions of Schedule 3 and 4. The Schedule is also aligned with the procedures as contained in the CDA and CCA. All the changes are elaborated upon in the correlation table.

- Schedule 4 to the Customs Tariff

  Schedule 4 contains the refund and drawback provisions previously contained in Schedule 5 to the Act. The Schedule now also makes provision for some refunds contained in Chapters 25 and 26 of the CCA that did not form part of the 1964 version of Schedule 5. All the changes and movement of items are elaborated upon in the correlation table.

- Schedule 5 to the Customs Tariff

  Schedule 5 contains the provisions for the ordinary levy that were previously contained in Part 8 of Schedule 1 of the Act.

Comments may be submitted to Lenez Keyser at lkeyser@sars.gov.za. Enquiries may be submitted to Laetitia Culbert at lculbert@sars.gov.za. Due date for comments is 9 March 2019.

As a consequence of the rewrite of the Act, which will be replaced with the new Excise Duty Act, 1964, and the Customs Control Act, 2014, SARS has published the below documents for consideration and comments relating to excise:

- Correlation Table

  This document is comprehensive and contains corresponding references and provisions for inclusions from the Schedule to the Act and the new draft Customs Tariff.

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CUSTOMS & EXCISE HIGHLIGHTS

CONTINUED

In the event that specific advice is required, kindly contact our Customs and Excise specialist, Director, Petr Erasmus.

- The General Notes to the Excise Tariff
- Schedule 1 – Excise and Ad Valorem Duty
- Schedule 2 – Environmental Levy
- Schedule 3 – Fuel and Road Accident Levy
- Schedule 4 – Health Promotion Levy
- Schedule 5 – Ordinary Levy
- Schedule 6 – Rebates and Refunds of Excise Duties, Fuel Levy, Road Accident Fund Levy, Environmental Levy and Health Promotion Levy
- Schedule 7 – Rebate on Import Duties
- Schedule 8 – Drawback and Refunds of Excise Duties on Imported Goods

Comments may be submitted to Lenez Keyser at lkeyser@sars.gov.za. Enquiries may be submitted to Laetitia Culbert at lculbert@sars.gov.za. Due date for comments is 29 March 2019.

The International Trade Administration Commission has (certain sections quoted from the notices):

On 1 February 2019 published guidelines pertaining to a temporary rebate provision which provides for rebate of the full anti-dumping duty on bone-in cuts of the species *gallus domesticus,* frozen, classifiable in tariff subheading 0207.14.9 and imported from or originating in the United States of America in terms of the Act.

Interested parties are notified that all applications submitted for permits in terms of this rebate provision will be dealt with according to the guidelines as described in the notice and must be submitted in the format as set out in the application forms in the notice, where applicable.

On 22 February 2019 published a notice confirming its receipt of the following applications concerning the creation of rebate provisions on:

- Optical fibres, not individually sheathed, classifiable in tariff subheading 9001.10, for use in the manufacture of optical fibre cables classifiable in tariff subheading 8544.70, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market;
- Petroleum jelly, in immediate packings of a content exceeding 5kg, classifiable in tariff subheading 2712.10.20, for the manufacture of optical fibre cables, classifiable in tariff subheading 8544.70, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market;
- Other, monofilament of which any cross-sectional dimension exceeds 1 mm, rods, sticks and profile shapes, whether or not surface-worked but not otherwise worked, of other plastics, classifiable in tariff subheading 3916.90.90, for the manufacture of optical fibre cables, classifiable in tariff subheading 8544.70, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market;

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CUSTOMS & EXCISE HIGHLIGHTS

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- Wire of non-alloy steel, clad with aluminium, classifiable in tariff heading 72.17, for use in the further processing of optical fibre cable classifiable in tariff subheading 8544.70, by reinforcing the optical fibre cable with one or more layer of stranded wire, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market; and
- Optical fibre cable, classifiable in tariff subheading 8544.70, for further processing by reinforcing the fibre optical cable with one or more layer of wire, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market.

Enquiries: ITAC Ref: 12/2018. Ms A. Varachia and Ms K. Mzinjana Tel: (012) 394-3732/3664 or Email: avarachia@itac.org.za or kmzinjana@itac.org.za. Representations should be submitted to ITAC within four weeks of the date of the notice.

On 1 March 2019 issued a notice of an initiation of the investigation for remedial action in the form of a safeguard against the increased imports of threaded fasteners of iron or steel: bolt ends & screw studs, screw studding and other hexagon nuts (excluding those of stainless steel and those identifiable for aircraft) imported under tariff subheadings 7318.15.41, 7318.15.42, and 7318.16.30.

Interested parties are invited to submit comments on the initiation of the investigation or any information regarding this matter. Queries may be directed to the investigating officers, Ms Thuli Nkomo at (012) 394-1190, e-mail tnkomo@itac.org.za and Ms Mercy Mutheiwana at (012) 394-3907, email mmukwevho@itac.org.za or at fax number (012) 394-0518.

The Department of Agriculture, Forestry and Fisheries published the following notices (certain sections quoted from the notices):

- On 1 March 2019 an invitation to submit applications for a DAFF quota import permit in terms of rebate item 460.03/0207.14.9/01.07 for rebate of full anti-dumping duty on bone-in cuts of the species *gallus deomesticus*, frozen, classifiable in tariff heading 0217.14.9 imported from or originating in the United States of America.

The quota will be issued on a quarterly basis in equal amounts per quarter.

A fee of R1094 will be payable for permits and replacement permits issued from 1 April 2019.

- On 1 March 2019, an amendment regarding the standards and requirements regarding control of the export of the following products (which shall come into operation seven days after publication of the notice):
  - Peaches and nectarines;
  - Plums and prunes;
  - Pears;
  - Apples; and
  - Apricots.

Petr Erasmus

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BBBEE STATUS: LEVEL TWO CONTRIBUTOR
Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 2 BBBEE verification under the new BBBEE Codes of Good Practice. 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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