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TAX & EXCHANGE CONTROL **ALERT**

IN THIS ISSUE >

Circumstances in which the utilisation of an assessed tax loss can be disallowed

An assessed loss is incurred by a taxpayer (such as a company) when the deductions claimed by that company exceed its income for the relevant year of assessment (YOA). In terms of section 20 of the Income Tax Act 58 of 1962 (Act), in order to determine its taxable income from trade, a taxpayer is permitted to set off *inter alia* any assessed loss (or balance of an assessed loss) brought forward from the previous YOA.

Advance tax rulings: Public Notice sets section 72 VAT ruling costs

Advance tax rulings (ATRs) present an opportunity for taxpayers to gain certainty about how the South African Revenue Services (SARS) will treat a transaction or decision by a business. Armed with an ATR, a taxpayer can move forward confident that the often-complex variable of the tax cost of the business decision or transaction is known.

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Circumstances in which the utilisation of an assessed tax loss can be disallowed

Taxpayers, when considering whether they are entitled to carry forward an assessed loss (and whether they have satisfied the "*trade*" and "*income from trade*" requirements), should have regard to established principles which emanate from case law over the years.

An assessed loss is incurred by a taxpayer (such as a company) when the deductions claimed by that company exceed its income for the relevant year of assessment (YOA). In terms of section 20 of the Income Tax Act 58 of 1962 (Act), in order to determine its taxable income from trade, a taxpayer is permitted to set off *inter alia* any assessed loss (or balance of an assessed loss) brought forward from the previous YOA.

In terms of section 20(1)(a) of the Act, before a company can carry forward its assessed loss from the immediately preceding YOA (the "*balance of assessed loss*"), it must have carried on a trade during the current year of assessment. If it fails to do so, it will forfeit the right to carry forward its balance of assessed loss under section 20(1)(a).

In addition to the trade requirement, a further question arises, namely whether a company that has traded during the current YOA but has derived no income from trade during that period is denied the opportunity to carry forward its assessed loss from the preceding YOA i.e. the taxpayer has genuinely attempted to trade, but has been unsuccessful in its endeavours. This is referred to as the "*income from trade*" requirement.

Taxpayers, when considering whether they are entitled to carry forward an assessed loss (and whether they have satisfied the "*trade*" and "*income from trade*" requirements), should have regard to established principles which emanate from case law over the years such as:

- a company which seeks to set off an assessed loss from a previous YOA cannot merely "*keep itself alive*" in the YOA which it seeks to carry forward the assessed loss. Compliance with minimum regulatory obligations and the maintenance of a bank account will not constitute the carrying on of a trade even if the taxpayer intended to resume trading in the future;
- the holding of meetings, appointment of directors and/or arranging for financial statements to be prepared, will on its own unlikely constitute the carrying on of a "*trade*". Passive behaviour absent of any active endeavour to carry on a trade will not be sufficient to argue that a trade is being conducted;

Circumstances in which the utilisation of an assessed tax loss can be disallowed*...continued*

Whilst it may be beneficial for taxpayers to try to utilise an assessed loss within a group of companies, taxpayers should be aware that if there is not robust commercial justification for the utilisation of the assessed loss where one of the factors contained in section 103(2) are present, then there is a real risk that SARS will invoke the provisions of the section.

- if a taxpayer does not have any assets with which it can engage in a trade then it will be difficult to argue that it is actively carrying on a trade. For example, in circumstances where a taxpayer has no premises from which to trade, no equipment, no stock and no staff, it is likely that a court will deem this indicative of a company which is not trading. Accordingly, the absence of productive assets has been found to be an indicator of the absence of trading activity;
- in respect of the income from trade requirement, courts have found that even an unsuccessful endeavour to trade can constitute trading even if no expenditure is outlaid (in certain circumstances) and no income is derived. The crux of the argument is that a company should be able to strike a balance even if its income so derived is nil provided that there was some attempt to trade; and
- the discontinuation of a taxpayer's main business operations may not in itself be deemed to be the cessation of trading if the taxpayer undertook other activities such as the continued employment of staff to realise assets and collect trade receivables. However, where a taxpayer's only activities comprised of the collection of trade receivables and it had no stock, employees, or fixed assets of any significance, it is likely that the taxpayer will not meet the "*trade*" requirement.

Accordingly, taxpayers should be certain that they will satisfy the trade and income from trade requirements before relying on the provisions of section 20(1)(a) to carry forward an assessed loss from the previous YOA. An incorrect determination could result in the South African Revenue Service (SARS) disallowing the carry forward of the assessed loss resulting in significant adverse consequences for the taxpayer's business.

In addition to the requirements above, taxpayers should also be aware that SARS can still invoke section 103(2) of the Act to disallow the utilisation of an assessed loss notwithstanding compliance with the trade and income from trade requirements where SARS is of the view that:

- an agreement affecting any company has been concluded; or
- a change of shareholding has occurred;
- the agreement or change of shareholding directly or indirectly results in the receipt or accrual of income or proceeds by that company; and
- such agreement or change of shareholding was mainly or solely entered into for the purpose of utilising any assessed loss incurred by that company in order to avoid, postpone or reduce liability for tax for any person.

Therefore, whilst it may be beneficial for taxpayers to try to utilise an assessed loss within a group of companies, taxpayers should be aware that if there is not robust commercial justification for the utilisation of the assessed loss where one of the above factors are present, then there is a real risk that SARS will invoke the provisions of section 103(2).

Similarly, robust commercial justification would also be applicable in the context of an acquisition of a company with an assessed loss. In this instance, SARS may disallow the utilisation of the assessed loss where it is of the view that the company was acquired for solely or mainly for the purpose of using the assessed loss to avoid tax.

Keshen Govindsamy

Advance tax rulings: Public Notice sets section 72 VAT ruling costs

Recently the Commissioner of SARS signed Public Notice 299 under section 81 of the TAA setting the fees to be charged for ATRs.

Advance tax rulings (ATRs) present an opportunity for taxpayers to gain certainty about how the South African Revenue Services (SARS) will treat a transaction or decision by a business. Armed with an ATR, a taxpayer can move forward confident that the often-complex variable of the tax cost of the business decision or transaction is known.

ATRs are generally governed by the procedural provisions set out in Chapter 7 of the Tax Administration Act 28 of 2011 (TAA). The Value Added Tax Act 89 of 1991 (VAT Act) provides for an ATR system specific to value added tax. It provides for two categories of rulings:

- Section 41B VAT Rulings and VAT Class Rulings (VAT Rulings), which mirror the Binding Private Rulings (BPR) and Binding Class Rulings (BCR) available regarding the other tax Acts administered by the Commissioner; and
- Section 72 which allows VAT Vendors or classes of VAT Vendors to approach SARS for a ruling to alleviate the difficulties, anomalies or incongruities which would be caused by the application of the provisions in the VAT Act to their business model.

Recently the Commissioner of SARS signed Public Notice 299 under section 81 of the TAA setting the fees to be charged for ATRs (PN 299). This Public Notice has not altered the cost scale charged by SARS but has rather provided clarity on the costs for determinations under section 72 of the VAT Act.

Section 41B

Section 41B allows a taxpayer or representative of a class of taxpayers to approach SARS for a determination of the application of the provisions of the VAT Act to such taxpayer or class. It further provides that the provisions of Chapter 7 of the TAA apply to rulings under section 41B. Meaning the procedure for applying for a VAT Ruling, and the bases for rejection of an application, are the same as for a BPR and BCR.

However, under section 41B(1)(a), certain provisions of Chapter 7 of the TAA do not apply to VAT Rulings. Notably, in the application process for a VAT Ruling a proposed ruling does not have to be submitted, nor does a statement that the ruling does not fall within section 80 of the TAA. Section 81(1)(b) of the TAA, which provides for the payment of cost recovery fees for VAT Rulings, also does not apply to VAT Rulings.

Section 72

Where satisfied that as a consequence of the way in which a VAT vendor conducts their income earning activity the application of the provisions of the VAT Act has or may result in difficulties, anomalies or incongruities, section 72 empowers the Commissioner of SARS to make a ruling to overcome such difficulties, anomalies or incongruities. The ruling is to alleviate the concerns by determining:

- how the provisions of the VAT Act will apply to that particular VAT vendor or class of VAT vendors, or
- the calculation or payment of VAT by that VAT vendor, class of VAT Vendors, or persons transacting with the VAT Vendor or class.

Advance tax rulings: Public Notice sets section 72 VAT ruling costs

...continued

With the promulgation of PN 299, VAT Vendors who find themselves facing difficulties, anomalies or incongruities are now able to more easily understand a critical requirement for making an application under section 72 – the expected cost.

Section 72(2) makes the procedural provisions regarding ATRs in the TAA applicable to VAT rulings. Specifically, it provides sections 75, 81, 83, 84, 85, 86, 87, 89 and 90 of the TAA are applicable (with the necessary changes) to section 72 rulings.

Notable provisions of Chapter 7 of the TAA which are not applicable to section 72 rulings include:

- section 76: which sets out the policy purpose underlying ATRs;
- section 79: setting out the requirements for an application for an ATR;
- section 80: on the prescribed grounds upon which SARS may reject an application for an ATR; and
- section 82: dealing with the binding effect of ATRs.

The details about how a VAT Vendor applies for a section 72 determination are contained in the VAT404 Guide for Vendors, published by SARS.

Public Notice 299

PN 299 was promulgated on 1 April 2021 and as stated above, states the fees to be paid in respect of ATRs, including applications under section 72 of the VAT Act. PN 299 replaces Public Notice 102 of 8 February 2013 which previously set the applicable fees for ATRs.

The application fees provided for under section 81(1)(a) of the TAA for BPRs and BCRs, under the recently promulgated PN 299, remain differentiated between small, medium and micro enterprises (SMMEs), and any other taxpayer. The application fee for SMMEs to obtain a BCR or BPR is R2,500, while other taxpayers must pay a fee of R14,000.

The cost recovery fees under section 81(1)(b) of the TAA similarly remain differentiated between urgent applications and non-urgent applications, Non-urgent applications will carry a cost of R650 per hour and urgent applications will carry a cost of R1,000 per hour.

The most notable aspect covered by PN 299 is the introduction of provisions dealing with the costs for applications for a ruling under section 72 of the VAT Act. For such applications the application fee is capped at R2,500, regardless of the type of taxpayer. Following the track of VAT Rulings, no cost recovery fees are payable for a section 72 ruling.

Comment

As noted in our recent alerts dealing with ATRs published as part of our special budget day alert and alert on 28 January 2021, SARS has embarked on a process to improve the ATR system. Ensuring that taxpayers can easily determine the costs of an ATR is key to the good functioning of the system.

With the promulgation of PN 299, VAT Vendors who find themselves facing difficulties, anomalies or incongruities are now able to more easily understand a critical requirement for making an application under section 72 – the expected cost.

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Overseen by Louis Botha

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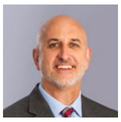

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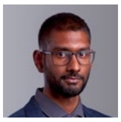

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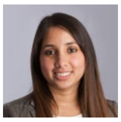

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