Grant Thornton

An instinct for growth™

E-TAXLINE JUNE 2014

e-taxline

Introduction

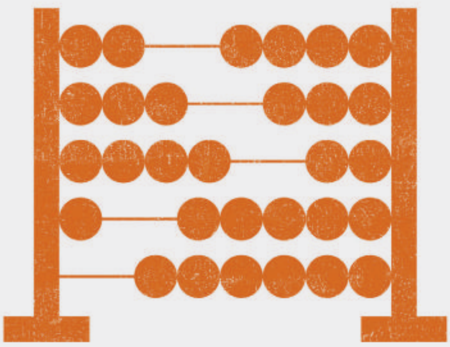
The golden goose's burden

Over the past few years, we have regularly raised concerns about the future of South Africa's golden goose, the taxpayer. However, as this year's tax season kicks off, our fears remain unabated, especially when we consider facts such as these recently highlighted by Economist Mike Sch ssler:

- According to the World Bank, South Africa has the seventh highest tax revenue to GDP ratio when social security taxes such as unemployment insurance and compulsory pensions are left out.
- 27% of our GDP is paid to government, compared to the world average of 14% of GDP.
- The latest General Household Survey shows that 45% of households have at least one person receiving a government grant.

Is there a solution?

The recent formation of the Davis committee, tasked to review the tax system, has ignited the hope of new proposals that will not only expand the tax base but also stimulate economic growth. However, economic pressure and potentially reduced tax collections due to the protracted platinum mining strike and threatening strike in the metal and engineering sector could well serve up a "solution" in the form of a hike in the golden goose's tax liability yet again. And considering the newly created subcommittees of the Davis committee, dealing with mining, VAT and estate duty, will the coffers be filled through an increase in the VAT rate? But how much more can the golden goose be squeezed? Or will a further disincentive be introduced for the mining sector in the form of higher taxes?



Despite these matters hanging in the balance, tax planning and efficiency remains at the top of our agenda. This month, Tax Partner at Grant Thornton Johannesburg, Louis van Manen looks at the effect of Understatement Penalties {link} on taxpayers 20 months after its introduction and highlights the key pitfalls taxpayers face.

Could we have reached the end of highlighting personal calls on our cell phone bills each month? Bruce Russell, Tax Consultant Grant Thornton Cape, considers how SARS' Interpretation Note No. 77 {link} will reduce the compliance burden for employer-provided telecommunication equipment and services.

And finally, in our VAT feature by Carin Grobbelaar, Senior Tax Consultant from Grant Thornton Cape, they provide an alert to all business using Loyalty Programmes {link} as incentive schemes to encourage spending and build loyalty. SARS has issued a Discussion Paper that will potentially affect all the role players in these transactions, from suppliers to loyalty scheme members who redeem their points for purchases and it will be important to monitor developments in this area closely.

Understatement Penalties in hindsight

By Louis van Manen, Tax Partner, Grant Thornton Johannesburg

Some 20 months after the introduction of Understatement Penalties, it is worth taking stock of where taxpayers find themselves following their introduction, and highlighting some of the challenges they are experiencing.

Many taxpayers have become all too familiar with this Understatement Penalty Percentage Table (fig. 1 below) contained in section 223 of the Tax Administration Act No 28 of 2011 ("the TAA"), which was mercifully amended earlier this year by the reduction of some of the penalty percentages:

The understatement penalties - not to be confused with underestimation penalties imposed for underestimating provisional tax – are levied as result of a taxpayer's understatement. An understatement is defined to mean any prejudice to SARS or the fiscus due to a default, omission, incorrect statement, or the failure to pay the correct amount of tax.

Burden of proof

Section 222(2) of the TAA requires the penalties to be calculated by applying the highest applicable understatement penalty to the relevant shortfall.

Although the burden of proof, which it determines the applicable understatement penalty, is legislatively placed on SARS, we find that taxpayers are typically compelled to justify why SARS should not levy the more onerous percentages listed in the table.

Figure 1. Understatement Penalty Percentage Table

1	2	3	4	5	6
Item	**Behaviour**	**Standard case**	**If obstructive, or if it is a 'repeat case'**	**Voluntary disclosure after notification of audit or investigation**	**Voluntary disclosure before notification of audit or investigation**
(i)	'Substantial understatement'	10%	20%	5%	0%
(ii)	Reasonable care not taken in completing return	25%	50%	15%	0%
(iii)	No reasonable grounds for 'tax position' taken	50%	75%	25%	0%
(iv)	Gross negligence	100%	125%	50%	5%
(v)	Intentional tax evasion	150%	200%	75%	10%

Assessed losses and penalties

Taxpayers who find themselves in assessed loss positions have regularly been taken aback by SARS levying the penalties where timing errors have occurred. While an uncorrected error made by a taxpayer still in an assessed loss position will result in an understatement in a future year of assessment, by definition, an understatement cannot occur in the year of assessment. SARS, however, levy penalties on shortfalls resulting from the difference between the balance of an assessed loss corrected for an error and an assessed loss affected by an error. But it fails to consider whether SARS or the fiscus was prejudiced as a result or not.

Bona fide errors

SARS may not levy the penalties if an understatement results from a 'bona fide inadvertent error'. The term is unfortunately not defined and taxpayers are accordingly at the mercy of what SARS perceives this concept to mean. To date, we are yet to see SARS acknowledge that once the corporate veil is pierced a taxpayer is but human and prone to making mistakes, even where reasonable care is taken.

Retrospective application

While it's one thing to be aware of these penalties and to plan one's tax matters accordingly, it's quite another to be subjected to them on matters arising before their introduction. Currently, the penalties are levied retrospectively to understatements that occurred before the introduction of the penalty legislation. Our view is that it is unconstitutional and administratively unjust to apply legislation retrospectively, but this assessment is not shared by SARS.

Voluntary disclosure

As illustrated in the table, a taxpayer can avail itself of the Voluntary Disclosure Program (VDP) to disclose errors to SARS, preferably before notification of an audit or investigation, thereby reducing the penalty percentages significantly. However, disclosure under the VDP nevertheless requires awareness of errors and as humans, we unfortunately and inadvertently make errors without being aware of them.

We hope that in time, taxpayers and SARS can see eye-to-eye on these challenges. In the meantime, taxpayers are cautioned to take extra care in managing their tax matters, past and present.

Will SARS' Interpretation Note No. 77 reduce the compliance burden for employer-provided telecommunication equipment and services?

By Bruce Russell, Tax Consultant, Grant Thornton Cape

Employers provide their employees with telecommunication devices and services to enable them to work more efficiently. While the intention may be that these will be used solely for business purposes, there is often an element of private use of the devices, airtime and data.

If an employer provides an employee with a device and it is either, owned by the employer, or provided by means of a contract the employer has with a service provider, a fringe benefit arises for the private use of the device and telecommunication services. However, where devices and telecommunication services are mainly used for business purposes, no value is assigned to these fringe benefits. South African courts have interpreted the word "mainly" to be a quantitative measure of more than 50%. Therefore, if the employee's business use of the device and/or related telecommunication services is more than 50% of the total use, the employee is relieved from any income tax liability.

Administrative burden relieved

Employers that provide such devices and telecommunication services ("employer-provided platforms") are faced with difficulties and administrative burdens to collate the necessary information and documentation to substantiate the fringe benefit tax each month. However, SARS released Interpretation Note No. 77 on 4 March 2014 and it provides taxpayers guidance to better understand and possibly reduce this burden.

SARS interprets that no one solution exists in providing the necessary proof of business use. Relevant aspects must be ascertained and measured on a case-by-case basis, taking into account the device's capabilities and functionality and the various ways in which an employee uses the device.

SARS recognises that a detailed analysis of business use of airtime and data may not be necessary for all employer-provided platforms. SARS will consider the relevant facts and circumstances to evaluate how close the use of the employer-provided platform is to the employee's job specifications and responsibilities.

The Interpretation Note identifies the following examples of facts and circumstances that can be evaluated in ascertaining this connection:

- The nature of the employee's work;
- The employee's duties;
- The qualifying criteria before being granted use of the employer-provided platform; and
- The conditions or terms under which the employer-provided platform may be used.

In some instances, it is clear that the nature of the employee's work and his or her duties mean that the employer-provided platform is used mainly for business purposes. By way of example, it is evident that tablets used by sales representatives (who are required to work eight hours a day in a five day working week) to capture customer's orders, are used mainly for business purposes.

However, can the same be said for mobile phones provided by the employer to the same sales representatives? In this case the documented terms and conditions for use of the mobile phone may specify that the phone can only be used for business calls and further specifies disciplinary action for failing to comply. In evaluating the collective of a sale representative's nature of work, his or her duties and the terms and conditions for use of the mobile phone, it could be substantiated that the mobile phone is used mainly for business purposes.

Unfortunately, the burden of prove that employer-provided platforms are used mainly for business purposes rests with the employer and employee and therefore due consideration should be given to individual circumstances.

Thankfully, Interpretation Note No. 77 provides the some guidance, which can reduce the compliance burden for employers and employees. Examples of facts and circumstances are provided to evaluate whether employer-provided platforms are mainly used for business purposes. The Interpretation Note also recognises that when these facts and circumstances clearly show that employer-provided platforms are mainly used for business purposes, employers and employees can be relieved from the monthly burden of collecting itemised bills and other documentation to substantiate that no tax has been withheld for these fringe benefits.

VAT Treatment of Loyalty Programmes

By Carin Grobbelaar and Janine Swanepoel, Grant Thornton Cape

Loyalty programmes are gaining more popularity as companies aim to make their products and services more attractive than their competitors' offers. These programmes are widely used as incentive schemes to encourage spending and build loyalty by rewarding customers with discounts, vouchers and other benefits.

There are currently no sections in the VAT Act that specifically address the treatment of loyalty programme transactions and thus these transactions are subject to the normal VAT rules. However, in April this year, SARS issued the Discussion Paper on the VAT treatment of loyalty programmes.

The objective of the Discussion Paper is to promote discussion between SARS and stakeholders primarily to identify areas in the VAT Act that are interpreted differently by different stakeholders and to identify sections of the VAT Act that may require amendments. Due to the vast number of different loyalty programmes, it is SARS' aim to adopt a policy, which will result in the consistent application of the VAT principles for all types of loyalty programmes.

The Discussion Paper defines and describes the,

- characteristics of loyalty programmes;
- nature and characteristics of a loyalty points;
- loyalty programme structures;
- transactions that form part of the programmes; and
- parties to these transactions.

Loyalty programmes can generally be divided into two main types of programmes, namely the 'exclusive programme' (the so-called in-house loyalty programme) and the more complex 'multiple party programme'. Both these types of loyalty programmes have a number of transactions, all of which have VAT implications.

The Discussion Paper explains the recommended VAT treatment of the various transactions within a loyalty programme and outlines proposed amendments to the VAT Act. Some of the changes proposed include for example, that in specific circumstances when loyalty points are redeemed the transaction should be treated similar to that of a voucher.

While these proposals are still in the discussion phase, it is clear that all role players in the value chain will be affected by the proposed changes. Members making purchases using loyalty points, loyalty partners supplying goods and services and Loyalty Programme Operators, may all be subject to new VAT implications and possibly greater VAT liabilities.

Role players will hence be not only be compelled to review the structures of their loyalty programmes but also to assess the commercial viability of these schemes. In the meantime, it is important to remember that the normal VAT principles must be applied to each separate transaction that forms part in these loyalty programmes.

Contact us

Cape Town
Anton Kriel
Tax Principal
T +27 (0)21 417-8731
E anton.kriel@za.gt.com

Mike Betts
Partner
T +27 (0)21 417-8822
E mike.betts@za.gt.com

George
Stef Lategan
Partner
T +27 (0)44 874-2320
E stef.lategan@za.gt.com

Durban
Ahmed Timol
Partner
T +27 (0)31 576-5500
E ahmed.timol@za.gt.com

Hawa Bibi Hoosen
Senior Tax Consultant
T +27 (0)31 576-5514
E hawabibi.hoosen@za.gt.com

Johannesburg
Eugene du Plessis
Partner & Head of Tax
T +27 (0)11 384-8116
E eugene.duplessis@za.gt.com

AJ Jansen van Nieuwenhuizen
Partner
T +27 (0)11 322-4559
E aj@za.gt.com

Don Howell
Partner
T +27 (0)11 384-8038
E done.howell@za.gt.com

Louis van Manen
Partner
T +27 (0)11 384-8085
E louis.vanmanen@za.gt.com

Port Elizabeth
David Honeyball
Partner
T +27 (0)41 374-3222
E david.honeyball@za.gt.com

Pretoria
Nick Kyriacou
Partner
T +27 (0)12 346-1430
E nick.kyriacou@za.gt.com

UNIVERSUM TOP 100 IDEAL EMPLOYER 2014 Student Survey

MPF Awards For Management Excellence 2014 — Winner Best managed international firm, Grant Thornton

IMPUMELELO
SOUTH AFRICA'S TOP EMPOWERED COMPANIES 2014

Awarded to Grant Thornton in recognition of their commitment to transformation. In celebration of 20 years of democracy (1994 – 2014)

Bloemfontein
Terry Ramabulana
Director
Suite 6 The Park,
14 Reid Street,
Westdene,
Bloemfontein, 9300
T +27 (0)51 430-5368
E terry.ramabulana@za.gt.com

Cape Town
Ian Scott
Managing Partner
6th Floor, 119 Hertzog Boulevard,
Foreshore
Cape Town, 8001
P O Box 2275
Cape Town, 8000
T +27 (0)21 417-8800
E cape@za.gt.com

Durban
Deepak Nagar
National Chairman & Managing Partner
2nd Floor, 4 Pencarrow Crescent
Pencarrow Park
La Lucia Ridge Office Estate, 4019
P O Box 950
Umhlanga Rocks, 4320
T +27 (0)31 576-5500
E mail@gtdbn.co.za

George
Charles Minie
Managing Partner
124 Cradock Street
George, 6529
Private Bag X6544
George, 6530
T +27 (0)44 874-2320
E info.george@za.gt.com

Johannesburg
Andrew Hannington
CEO
137 Daisy Street,
Sandown, 2196
Private Bag X28
Benmore, 2010
T +27 (0)11 322-4500
E info@za.gt.com

42 Wierda Road West
Wierda Valley, 2196
Private Bag X10046
Sandton, 2146
T +27 (0)11 384-8000
E info@za.gt.com

Nelspruit
Billy de Jager
Director
No 2 Cherato Place
36 Murray Street
Nelspruit, 1201
T +27 (0)13 752-8084
E info@za.gt.com

Polokwane
Yugen Pillay
Director
Suite 3, Parklane Building
76 Hans Van Rensburg Street
Polokwane, 0699
T +27 (0)15 297-3541
E yugen.pillay@za.gt.com

Port Elizabeth
David Honeyball
Partner
125 Cape Road, Mount Croix
Port Elizabeth, 6001
P O Box 63814
Greenacres, 6057
T +27 (0)41 374-3222
E pe@za.gt.com

Pretoria
Johan Blignaut
Managing Partner
Building A, Summit Place
Garsfontein Road
Menlyn, 0181
P O Box 1470
Pretoria, 0001
T +27 (0)12 346-1430
E infopta@za.gt.com

Rustenburg
Seth Radebe
Director
234-2 Beyers Naude Drive,
Rustenburg, 0300
T +27 (0)14 592-1028
E seth.radebe@za.gt.com

National marketing
Pamela Grayman
Partner and Head of National Marketing
and Business Development
137 Daisy Street
Sandown, 2196
Private Bag X28
Benmore, 2010
T +27 (0)860-GTLINE
E info@za.gt.com

Grant Thornton
An instinct for growth™

www.gt.co.za