TO CREDIT IS TO PAY

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Although common in practice, and especially between group companies, not much judicial thought has previously been given to the tax effect of crediting an inter-company loan account.

A judgement handed down by the Tax Court in September 2016 gives us some food for thought in this regard.

The facts are as follows:

> The taxpayer became a wholly-owned subsidiary of KL (Pty) Ltd ('KL') in 2008. During 2009 the taxpayer made land owned by it available to KL so that KL could develop residential property units.

> By agreement between KL and the taxpayer, and during the development process, KL had funded the taxpayer's cash flow requirements on loan account via inter-company shareholder loans.

> In April 2009, KL issued a tax invoice to the taxpayer in respect of a taxable supply of R82 095 000, inclusive of VAT at the rate of 14%, in respect of the development of the residential component of the development. The taxpayer, following receipt of the invoice, claimed an input tax deduction in respect of the VAT in the amount of R10 081 842,10 and received payment of this amount from SARS. After the taxpayer had paid the input tax it received from SARS to KL, by way of a cash payment, KL paid the output tax to SARS in the same amount.

> The remaining liability due to KL in terms of the invoice was credited to the loan account of KL in the books of the taxpayer, in accordance with the funding arrangement between the two companies. The invoice amount was instead converted to a long-term debt in the taxpayer's financial statements, and was reflected as a non-current asset in KL's financials. There was an understanding that the long-term debt liability would be paid as and when the development properties were sold, through increasing and decreasing the loan accounts between the two companies. Both KL and the taxpayer considered that the liability under the invoice had been paid after KL's loan account had been credited.

> SARS, in its audit of the taxpayer in 2013, determined that the consideration in respect of the service rendered had not been "paid" in a period of twelve months after the expiry of the tax period in which the input tax had been claimed as was required by the provisions of section 22(3) of the VAT Act. Section 22(3) effectively provided that where a vendor had claimed an input tax deduction on the basis of a tax invoice, payment of the relevant consideration must occur within twelve months thereafter. Failing this, the transaction was effectively reversed, which effectively results in the input tax previously deducted having to be refunded.

> The taxpayer contended that due to its funding arrangement with KL, the crediting of KL's loan account constituted payment of the invoice given that it was funded by KL via agreed inter-company loan accounts.

> SARS contended that, given the definition of an 'invoice' in the Act, the effect of the tax invoice issued was that the taxpayer was obliged to pay the amount invoiced to KL and hence recording the amount in the loan account of KL in the books of the taxpayer did not constitute 'payment' of the full consideration and remained a debt on the books.

The issue in the appeal turned on whether the crediting of a loan account constituted payment of full 'consideration' for the VAT component of the invoice raised by KL as a related company or not.

The court referred to SCA authority as authority for the fact that a commercial meaning should be given to statutory concepts, as applied in business transactions, taking into account the wider context of the transaction.

The commercial transaction in the current matter arose within the context of an agreed funding arrangement between the taxpayer and KL as group companies.

The court considered, inter alia, the fact that:

> Both KL and the taxpayer did not expect that KL would be paid in cash for the relevant supply and that the parties contemplated that the invoice would be settled by crediting the loan account of KL in the books of the taxpayer as its wholly-owned subsidiary.

> Crediting the loan account did not extinguish the taxpayer's liability to KL as what it did was to move the liability from a current one to a long-term liability in the books of the taxpayer.

The dispute turned on whether, in adjusting the liability to a long-term one, the taxpayer had complied with section 22(3)(b) of the Act in that it 'paid the full consideration in respect of such supply'. The enquiry turned on the overriding purpose of the loan account liability incurred, which was to discharge the invoice debt. The issue then became whether the conversion of the liability from one arising from an invoice into a loan liability, constituted payment of consideration for purposes of section 22(3).

The court held that, in relation to the supply of goods and services to any person, 'consideration' included 'any payment made or to be made' whether 'in money or otherwise, or any act or forbearance'.

To the extent that payment amounted to the discharge of an obligation to another, there was no reason why an obligation under an invoice may not be discharged through the creation of another liability, such as one under a loan. The court relied on other SCA authority for this.

As contended by SARS, the court was not persuaded that for payment to occur, there needed to be an enrichment of one party or impoverishment of the other. The court, however, accepted that there may exist distinct instances of gain and loss in the discharge of one liability and the creation of a different liability on the facts of any matter.

The court considered, inter alia, the fact that:

> The crediting of KL's loan account by the taxpayer in the context of the funding arrangement between the two companies amounted to payment of 'consideration' in relation to the supply of goods and services invoiced; and

> It was not required of KL to make a cash payment to the taxpayer in order to enable the taxpayer to settle the invoice with KL in cash.

The VAT Act was amended, with effect from 10 January 2012, by the addition of section 22(3A) into the Act. This section had no bearing on the current matter as it arose after the tax period in issue in this matter, but it is noteworthy that the effect of this insertion into the Act was that section 22(3) no longer applies where the supplier and recipient in question are both members of the same group of companies.

Even though the VAT Act has been amended, this judgement has value in other areas where a fiscal Act (such as the Income Tax Act) might in certain circumstances require a payment and not simply the incurral of a liability, before a deduction is claimed.

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Varshani Ebrahim joined Werksmans Attorneys as a Candidate Attorney in the Insolvency Litigation team in 2015. Varshani thereafter rotated to the Tax Team in her second year of articles and settled in Tax as an Associate. During her time at the firm, she has been involved in Litigation and Commercial matters across different areas of law, with particular emphasis on Tax Law.

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