

AN INVESTIGATION OF THE UNDERSTANDING AND APPLICATION OF THE
PRINCIPLES OF THE BRUMMERIA RENAISSANCE CASE

by

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ABSTRACT

A recent ruling by the Supreme Court of Appeal in the case of *Commissioner for the South African Revenue Services v Brummeria Renaissance (Pty) Ltd and others*, held that the right of use of interest-free loans is a taxable benefit and must be included in gross income in the hands of the recipient. This case is the first case of its kind and has caused much confusion and concern among tax professionals.

The purpose of this study is to determine whether audit firms in the Pretoria area are aware of the court case and also to determine whether the principles arising from the case are correctly understood and applied by the audit firms in practice. Should the audit firms not be aware of the Brummeria Renaissance case, or should the principles arising from the case not be clearly understood, the tax clients of the audit firms may be detrimentally influenced as a potential tax risk may not be recognised or, if recognised, may be incorrectly treated for tax purposes.

The research was conducted by first obtaining and studying the court transcript of the Brummeria Renaissance case and identifying the principles arising from this case and the implications thereof. A literature study was conducted in order to determine the views and concerns of tax professionals with regards to the court ruling in this case.

A questionnaire survey was conducted on a sample of small, medium and large audit firms in the Pretoria area. The sample was selected by making use of specifically stratified systematic sampling. The population was stratified into small, medium and large audit firms and five firms were selected from each sub-population.

From the literature study conducted it is clear that the facts of the Brummeria Renaissance case are very specific and the principles arising from the ruling will only be applicable in the future, in cases where one form of goods or services is exchanged for another. An analysis of the results of the questionnaire survey indicates that a lack of knowledge does exist among audit firms in the Pretoria area. Although, the audit firms that are in fact aware of the case appear to understand and correctly apply the principles of the case in practice.

OPSOMMING

'n Onlangse uitspraak deur die Appèlhof in die saak van *Kommissaris vir die Suid Afrikaanse Inkomste Diens vs Brummeria Renaissance (Edms) Bpk en ander*, het bepaal dat die reg van gebruik van rentevrye lenings 'n belasbare voordeel is en dat dit ingesluit moet word in die bruto inkomste van die ontvanger. Hierdie saak is die eerste van sy soort en het baie verwarring en kommer by belastingkundiges veroorsaak.

Die doel van hierdie studie is om te bepaal of oudit firmas in die Pretoria gebied bewus is van die hofsaak en ook om te bepaal of die beginsels wat uit die hofsaak voortspruit reg verstaan is en deur die oudit firmas in die praktyk reg toegepas word. Sou die oudit firmas nie bewus wees van die Brummeria Renaissance saak, of sou die beginsels wat uit die saak voortspruit nie reg verstaan word nie, kan die kliente van die oudit firmas benadeel word as 'n potensiële belasting risiko nie herken is nie, of indien herken is verkeerd hanteer word.

Die navorsing is gedoen deur eerstens die verkryging en bestudering van die hofverslag van die Brummeria Renaissance saak, die identifisering van die beginsels wat uit die saak ontstaan het, sowel as die implikasies daarvan. 'n Literatuurstudie is gedoen om die standpunte en kommer van belastingkundiges met verwysing na die hofuitspraak in hierdie saak te bepaal.

'n Opname metode deur middel van 'n vraelys is gedoen. Die steekproef het klein, medium en groot oudit firmas in die Pretoria gebied ingesluit. Die steekproef is bepaal deur gebruik te maak van 'n spesifiseerde gestratifiseerde sistematiese steekproef metode. Die populasie was gestratifiseerd in klein, medium en groot oudit firmas en vyf firmas is uit elke subpopulasie geselekteer.

Van die literatuurstudie wat gedoen is, is dit duidelik dat die feite van die Brummeria Renaissance saak baie spesifiek is en dat die beginsels wat uit die uitspraak ontstaan het slegs van toepassing sal wees in gevalle waar een vorm van goedere of diens uitgeruil word vir 'n ander. 'n Analise van die resultate van die vraelys dui aan dat daar wel 'n gebrek aan kennis by die oudit firmas in die Pretoria gebied is. Alhoewel, die oudit firmas wat bewus is van die saak, verstaan die beginsel daarvan en pas dit in die praktyk reg toe.

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CHAPTER 1 INTRODUCTION

1.1 BACKGROUND

“Recent court case shakes the foundation of business world” (Troskie, 2007). On 13 September 2007 the Supreme Court of Appeal (SCA) in Bloemfontein, ruled in the case of *Commissioner for South African Revenue Services (SARS) v Brummeria Renaissance (Pty) Ltd and others* (69 SATC 205) (hereafter “the Brummeria case”), that the right of use of interest-free loans is a taxable benefit and must be included in gross income in the hands of the recipient.

In the Brummeria case, the companies, each in the business of developing retirement villages, were given interest-free loans by prospective occupants in order to finance the building of the properties. In exchange, the prospective occupants were granted a right of life-long occupation to the specific property. The Commissioner for SARS argued that the right to use the loans interest free had an ascertainable money value and that this value had accrued to the companies. The SCA ruled that the right to use the money interest free did in fact have an ascertainable money value and included such value in the gross income of the companies (SATC, 2007:209-210 & 214-215). From the reasoning of the court, it can be deduced that the benefit of an interest-free loan will only be taxable in a situation where the interest-free loan is given as consideration for other goods or services (*quid pro quo*) (Williams, 2007:4). The court decision has set a precedent that is binding on all courts in the country (Williams, 2007:3). It should be noted that the court did not consider the appropriateness of the valuation; nature or timing of the benefit, as these issues were not addressed in the original grounds of objection submitted to SARS.

If all interest-free loans are considered to be taxable, the financial implications on the taxpayer will be enormous (Desmond, 2007). The implications of this SCA decision need to be clearly understood, in order to avoid unnecessary tax liabilities.

1.2 PROBLEM STATEMENT

The Brummeria case is the first case of its kind and has caused much confusion and concern among tax professionals and taxpayers alike. The main purpose of this study is to investigate whether audit firms in the Pretoria area are aware of the SCA decision in the Brummeria case and to determine whether the principles and potential tax risks of the Brummeria case are considered and correctly applied, in providing advice to clients. The study will also determine whether the size of the audit firm, has an influence on the audit firm's level of awareness with regards to the Brummeria case.

1.3 RESEARCH OBJECTIVES

- To study the facts of the Brummeria case and to understand the principles and basis of the ruling made, with regards to interest-free loans.
- To investigate the audit firms' awareness of the Brummeria case and to determine whether they consider the impact and tax risks of the case when advising clients.
- To compare the level of awareness of the Brummeria case between small, medium and large audit firms.
- To investigate how the audit firms determine the value, nature (revenue or capital) and timing of the amount to be taxed in the event of a tax risk being identified.

1.4 HYPOTHESES

It is submitted that there is a lack of knowledge among audit firms with regards to the Brummeria case. It is submitted that not all audit firms are considering the implications of the Brummeria case when advising clients, and that not all tax professionals within the audit firms have interpreted the ruling of the SCA in the Brummeria case correctly.

It is further submitted that there will be a more apparent lack of knowledge among small audit firms, in comparison to larger audit firms.

1.5 DELIMITATIONS AND ASSUMPTIONS

1.5.1 Delimitations

The study will not consider the second part of the ruling of the SCA in the Brummeria case, which determined whether SARS was precluded by section 79(1) of the Income Tax Act 58 of 1962 (hereafter “the Income Tax Act”) from issuing further revised assessments.

The study will be limited to the Pretoria area and will not extend to the rest of Gauteng or South Africa.

The study will be limited to a selection of audit firms registered with the Independent Regulatory Board for Auditors (IRBA).

This study will only consider the impact of the Brummeria case ruling with respect to income tax. No other taxes or Acts will be taken into consideration.

During the gathering of the research results by means of questionnaires, it was noted that some of the audit firms delegated the completion of the questionnaire to an article clerk. These clerks may not have sufficient knowledge or experience to provide accurate information.

1.5.2 Assumptions

Firstly, it is assumed that SARS will attempt to tax other taxpayers, in the future, based on the SCA ruling in the Brummeria case. It is further assumed, that the same criteria will be applied by SARS in any future scenarios. Although SARS has indicated that it would issue an interpretation note after the Brummeria case decision, in order to clarify the application of the case in respect of other interest-free loans, no interpretation note has yet been issued by SARS. It is assumed that there will be no changes in legislation with regard to the taxability of interest-free loans.

Secondly, it is assumed that the selected audit firms will be interested in the study and will be willing to participate. Also, it is assumed that the selected audit firms will be open and honest in their participation in the study and openly admit to any lack of knowledge they may have, regarding the facts or interpretation of the Brummeria case.

1.6 IMPORTANCE AND BENEFITS OF THE STUDY

The ruling of the SCA in the Brummeria case is contrary to everything that tax professionals know about the tax implications of interest-free loans and have applied for many years (Williams, 2007:3). It is common practice for shareholders; members; trustees and related entities to provide financial support by granting interest-free loans (Jones, 2007:13). The implications of this court case need to be clearly understood and correctly applied in order for tax professionals to provide a quality service to their clients.

There have been many articles written since September 2007 with differing views with regards to the Brummeria case. Olivier (2008:151) is of the opinion that it is merely a “storm in a teacup”. However, many tax professionals consider it to be a much bigger issue. It has “turned tax law on its head” (Ernst & Young in Olivier, 2007:151). Staffer (2007) speaks of the “watershed SCA decision”, and Williams (2007:2) regards this as one of our “landmark decisions”. Janine Connor, Executive Editor and head of Tax talk (2007) warns against the “MASS misapplication of the principles that emerge from the new SCA judgement”. Tax professionals are therefore unsure of how to interpret this SCA decision.

As far as could be ascertained, this is the first study conducted regarding the understanding and application of the principles of the Brummeria case among tax professionals. The study may raise awareness among tax professionals, which may lead to further investigation and an increased knowledge of the Brummeria case, as well as other court rulings. This study will not only examine the facts of the Brummeria case and how it was decided, but will also identify any lack of knowledge regarding the Brummeria case and also identify any incorrect application of the principles of the Brummeria case (to be referred to as a “knowledge gap”) within audit firms in the Pretoria area. It is submitted that some tax professionals may not be aware of the Brummeria case, or may be

incorrectly applying the principles to all interest-free loans, which the court ruling clearly states is not the case. It is also submitted that, should such a “knowledge gap” be identified within the audit firms in the Pretoria area, such a “knowledge gap” would similarly be found throughout Gauteng and the rest of South Africa.

1.7 DEFINITION OF KEY TERMS

The following key terms are used in the dissertation:

Debenture: is defined in section 1 of the Companies Act No. 61 of 1973 as: “includes debenture stock, debenture bonds and any other securities of a company, whether constituting a charge on the assets of the company or not;”. A debenture is a certificate given to the provider of a loan as confirmation of the amount provided as a loan and also contains the terms and conditions of the loan. Refer also section 2.2, p 9.

Gross income: is defined in section 1 of the Income Tax Act as: “in relation to any year or period of assessment, means—

(i) - in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or

(ii) - in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within or deemed to be within the Republic,

during such year or period of assessment, excluding receipts or accruals of a capital nature, ...”. Refer also section 2.2, p 10.

Large audit firm: for the purposes of this study, is defined as an audit firm with five or more partners or directors. Refer also section 3.3.2, p 30.

Life right: is defined in paragraph 3 of the court transcript of the Brummeria case as “The right of the occupier to occupy the unit and to use the facilities, subject to the rules from the date of occupation to the date of termination, as counter-performance for the loan and

subject to the payment of monthly levies and special levies” (SATC, 2007: 209). Refer also section 2.2, p 9.

Medium audit firm: for the purposes of this study, is defined as an audit firm with three or four partners or directors. Refer also section 3.3.2, p 30.

Quid pro quo: is defined as “Something for something; value received; consideration; compensation” (LexisNexis, 2008). Refer also section 2.2, p 11.

Ratio decidendi: is defined as “Reason for the decision; actual decision and the facts material thereto; principle upon which a case is based; the part of a judgment that is binding as a precedent.” (LexisNexis, 2008). Refer also section 2.6, p 21.

Small audit firm: for the purposes of this study, is defined as an audit firm with one or two partners or directors. Refer also section 3.3.2, p 30.

The following abbreviations are used in this dissertation:

Table 1: Abbreviations used in this document

Abbreviation	Meaning
BEE	Black Economic Empowerment
CA	Chartered Accountant
CIR	Commissioner for Inland Revenue
e.g.	For example
i.e.	In other words
IRBA	Independent Regulatory Board for Auditors
MBA	Masters in Business Administration
PAYE	Pay-as-you-earn
RA	Registered Auditor
SAICA	South African Institute of Chartered Accountants
SARS	South African Revenue Services
SCA	Supreme Court of Appeal
SIR	Secretary of Inland Revenue
USA	United States of America
v.	Versus

1.8 RESEARCH DESIGN

The research design consists of two parts.

Firstly, in order to determine whether the audit firms are sufficiently knowledgeable with regards to the Brummeria case and to ensure that the audit firms are correctly applying the principles of the case, it is necessary to understand the facts, reasoning and ruling of the Brummeria case. In order to do this, the court transcript of the Brummeria case (69 SATC 205) will be obtained and studied. Other literature written on the topic of the Brummeria case or interest-free loans in general, will also be consulted and the differing views considered (Refer also chapter 2, p 9).

Secondly, a survey will be conducted by sending a questionnaire to a sample of audit firms in the Pretoria area. A key person will be identified at each audit firm and the questionnaire will be sent to this person for completion. The key person at each audit firm will either be the tax partner, tax manager or a senior staff member in the tax department of the firm. If a firm has neither a designated tax partner, tax manager nor a senior staff member in the tax department, a senior staff member of the audit firm will be identified to participate in the study.

The population will be identified by searching IRBA's website for audit firms registered within the Pretoria area. The sample will be selected by making use of specifically stratified systematic sampling. The population will be categorised (stratified) into small, medium and large audit firms and an equal number of audit firms will be selected from each category.

1.9 CHAPTER OVERVIEW

The dissertation consists out of five chapters:

Chapter 1

The problem, which lead to the study of the knowledge and application of the principles of the Brummeria case by audit firms in the Pretoria area, is discussed. The research objectives and limitations of the study are set out and the importance of the study is considered. The research design and methodology of the study is set out.

Chapter 2

A literature study is conducted to analyse the facts, arguments, reasoning and ruling of the Brummeria case. Various authors are consulted to determine what the general opinion is with respect to the Brummeria case. A comparison is also made between the treatment of interest-free loans in South Africa and in other countries.

Chapter 3

The research is planned, designed and conducted.

Chapter 4

Analysis of the data.

Chapter 5

Conclusion and recommendations.

1.10 CONCLUSION

The problem statement has been made and the research objectives and methodology set out, the literature review may now be conducted.

CHAPTER 2 LITERATURE REVIEW

2.1 INTRODUCTION

In order to study the knowledge among audit firms with regards to the Brummeria case, it is necessary to understand the facts of the case, as well as the arguments and reasoning of the court. The facts, arguments and reasoning of the court are discussed in detail in this chapter. The implications of the case are potentially far-reaching and tax professionals have various opinions with regards to the implications of this case, which are discussed in detail in this chapter. The SCA did not issue judgement with regards to the valuation, nature and timing of the benefit, these three elements are discussed in this chapter. Citations of the Brummeria case since the SCA decision as well as the treatment of interest-free loans in other countries are also discussed in this chapter.

2.2 THE FACTS OF THE BRUMMERIA CASE

The Brummeria case involved three companies, which have each been involved in the development of retirement villages since 1988. The companies entered into written agreements with potential future occupants of the units within retirement villages (SATC, 2007:206). The company received interest-free loans from such potential occupants, that it used solely to finance the construction of a particular unit in a particular retirement village. This was testified to by Mr Pauw, who was called as a witness by the companies, he also testified that no part of the loan monies received were invested in income-earning investments. A debenture was issued to the individuals to acknowledge the loan. A debenture is a written document provided to the lender of funds, this documents sets out the terms and conditions of the loan, confirms the amount of the loan and states the repayment terms. The title deed of the property on which the development was to be done, was endorsed and a covering bond was registered as further security in favour of the individual. In return, the individual was granted a right of lifelong occupation (a life right) to the particular unit, while ownership remained with the company. A life right was defined in the loan agreements as “The right of the occupier to occupy the unit and to use the

facilities, subject to the rules from the date of occupation to the date of termination, as counter-performance for the loan and subject to the payment of monthly levies and special levies” (SATC, 2007:209). The loan agreement stated in its terms, that the interest-free loan was considered to be the consideration for the life right given. The company was obliged to repay the loan, without interest, either on the cancellation of the agreement or on the death of the individual, which would be financed by the granting of a new loan by another occupant. The intention of the companies was to eventually sell the units at a profit (SATC, 2007:209). According to Ernst & Young (2007), this is a standard method of financing in the industry.

SARS issued income tax assessments on each of the companies, then issued revised assessments and then again issued further revised assessments on each of the three companies as follows: Brummeria Renaissance 1996 to 2000; Palms Renaissance 1994 to 2000 and Randpoort Renaissance 1995 to 2000. The further revised assessments included in the gross income of the companies, an amount considered to be the value of the right of the company to make use of the loans interest free. The value was determined by applying the weighted prime lending rate to the average value of the loan for each of the years of assessment in question (SATC, 2007:206). It is these further assessments to which the companies objected and which lead to the court case. The portion of the “gross income” definition that this judgement seeks to clarify is the portion that reads: “the total amount, in cash or otherwise, received by or accrued to or in favour of a person” (SATC, 2007:210). In the past the courts have interpreted this phrase to mean anything which is not money but which can be turned into money or which has an ascertainable value in money, must be included in gross income (Petersen, 2007:12).

The companies appealed against the further revised assessments to the Gauteng Tax Court (ITC 1791 (67 SATC 230)). Goldblatt J ruled in favour of the companies, stating that the companies received no monies on loan which were used to produce any income and that the benefit included in their gross income “clearly had no monetary value”. The tax court granted SARS the right to appeal. SARS appealed against the decision of the Gauteng Tax Court and the case was referred to the SCA (SATC, 2007:207).

The grounds of assessment delivered by the Commissioner in terms of rule 10 of the tax rules, as stated in the court transcript are as follows:

“11. In the case of a developer conducting a housing scheme for retired persons, the capital of the developer is the property units. The property units are employed in its business by either:

11.1 selling the units under sectional title to the purchasers; or

11.2 granting the use (occupation) of the units to the occupiers by way of selling life rights to the occupiers.

12. The *quid pro quo* which the developer received in return is respectively:

12.1 the selling price obtained from the purchasers, in respect of the disposal of the units under sectional title; or

12.2 the benefit of the rights to interest-free loans obtained from the occupiers, in respect of the disposal of the life rights to occupy the units.

13. The benefit received in exchange for the provision of occupation rights has an ascertainable money value and accordingly falls within the definition of “gross income” in the Income Tax Act.

14. As income tax is calculated on an annual basis, an annual value is placed on the benefit referred to above. The value of the benefit is determined by applying the weighted prime overdraft rate of banks to the average loan capital over the period for which the developer had the use of the loan capital during that specific year of assessment.

15. The money value of the benefit of the interest-free loans accrues to the developers, and as such falls within “gross income” as defined in section 1 of the Income Tax Act.” (SATC, 2007: 210).

The companies raised several grounds of appeal in terms of rule 11 of the tax rules. One specific ground of appeal, which is relevant to be considered in this study is stated in paragraph 6(a) of the court transcript as follows:

“(a) All of the companies contended that the interest-free loans did not result in any “amounts” being “received by” them, as contemplated in the definition of “gross income” in section 1 of the Income Tax Act, and accordingly that the amounts included in their gross income, calculated on the basis ... were wrongly so included;”. (SATC, 2007:210).

It should be noted that the valuation of the benefit was not challenged by the counsel for the companies. Heydenrych (2007) considers this to be extremely relevant, as the economic benefit to the developers was not equal to the value on which the developers were taxed. The accuracy of the annual basis used was also not considered by the court (Heydenrych, 2007). Counsel for the companies, sought to argue that the benefit which SARS wanted to include in gross income was of a capital nature. They were however, unable to do so as the nature of the benefit was not included in the original grounds of objection submitted (SATC, 2007:211). In terms of rule 12 of the tax rules, only issues included in the original grounds of objection may be considered by the court on appeal (SATC, 2007: 211). The counsel for the companies failed to argue key issues, due to the fact that the paper work regarding the objection was incomplete (Connor, 2007).

It must be emphasised that it is not the whole loan amount that is sought to be taxed, but rather the amount of interest that would have accrued to the lender had the loan borne interest (Petersen, 2007:12). This application is correct, as in previous court cases, namely *CIR v Genn Co (Pty) Ltd* (20 SATC 113) and *CIR v Felix Schuh (SA) (Pty) Ltd* (56 SATC 57), it was held that the receipt of loan capital is not a receipt for the purposes of the gross income definition. The commissioner is seeking to tax the right to retain and use the loan capital, interest free, for the relevant periods (SATC, 2007:211).

2.3 THE ARGUMENTS PRESENTED TO THE COURT

Arguments were presented to the court by the counsel for SARS, as well as counsel for the companies. A discussion of the arguments made is given below.

2.3.1 The Commissioner for SARS

Counsel for the Commissioner argued that the value received by the companies in return for the life rights to occupy the units (the *quid pro quo*), had an ascertainable money value and accordingly fell within the definition of “gross income” in section 1 of the Income Tax Act (SATC, 2007: 206). This was based on the interpretation of the terms contained in the gross income definition in previous court decisions. The phrase “accrued to” was

interpreted by Watermeyer J in *Lategan v Commissioner for Inland Revenue (CIR)* (2 SATC 16) as meaning “entitled to” and in *CIR v Cactus Investments (Pty) Ltd* (59 SATC 1) as “a right to claim”. The term “amount” was interpreted in *CIR v People’s Stores (Walvis Bay) (Pty) Ltd* (52 SATC 9) to mean “every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value”. Olivier (2007:152) refers to the case of *CIR v Butcher Bros (Pty) Ltd* (13 SATC 21), from which it arose that the burden of proof to prove that an amount exists, rests with SARS. Should the taxpayer disagree with the determination of the value, the onus of proof rests with the taxpayer to prove an alternative value.

SARS argued that the units represented the capital of the developer. The units can be applied in the carrying on of the business of the developer by either selling the units at a profit, or by selling a life-right to the occupants. The proceeds from the carrying on of the business would therefore be the selling price of the units, or the benefit of the interest-free loan respectively (Loubser, 2007:20).

2.3.2 The Companies

Counsel for the companies argued that the interest-free loans did not satisfy the requirements of “amounts” and “received by” included in the definition of gross income in section 1 of the Income Tax Act. Counsel for the companies also argued that the rights could not be turned into money and therefore did not have a monetary value, for this purpose they relied on the decision in *Stander v CIR* (SATC, 2007:206). In the case of *Stander* (59 SATC 212) the taxpayer received an overseas trip as a prize and the Commissioner sought to include the value of the prize in his taxable income. Friedman JP held that the taxpayer had not received any property on which a monetary value could be placed, and he was not able to turn it into money after accepting the award. Therefore the amount was not included in his taxable income (SATC, 2007: 213).

2.4 THE REASONING OF THE COURT

Cloete JA was the judge of appeal presiding over the Brummeria case. Cloete JA quoted Hefer JA in *Cactus Investments* (59 SATC 1) and *People's stores* (52 SATC 9) respectively, as saying that the definition of gross income includes not only income actually received, but also non-capital rights which accrued during the relevant year of assessment. All that is required in order for an amount to be accrued, is for the person to become entitled to the right in question (SATC, 2007:212).

Cloete JA, while relying on the judgements of *CIR v Delfos* (6 SATC 92), *Cactus Investments* (59 SATC 1) and *People's stores* (52 SATC 9), stated that whether a receipt or accrual in a form other than money has a money value is the primary question and whether or not such a receipt or accrual can be turned into money, is merely one of the ways to determine this. It does not follow that if a receipt or accrual cannot be turned into money, it does not have a monetary value (SATC, 2007:214). Cloete JA referred to the ruling of Conradie J in *ITC 701* (17 SATC 108) where the judge rejected the argument that only benefits which can be turned into money, have a monetary value. (SATC, 2007:213) The test to be applied is objective, not subjective (SATC, 2007:214). An objective test would consider what the taxpayer would have paid for the benefit if it was not received free of consideration (Loubser, 2007:20). Olivier (2007:153) points out that the court did not provide any guidance on such an objective test and concludes that it will be very difficult for taxpayers to prove to SARS, that a receipt or accrual does not constitute an amount. The application of an objective test in this respect is clarified by Petersen (2007:12), saying that it does not matter whether the taxpayer is capable of turning the benefit into money – all that matters is whether, in general, such a benefit has value that can be determined in monetary terms. Ernst & Young (2007) are sceptical about the apparent unrestrictive interpretation of the term “amount” and question the sudden new interpretation of a term, which has been contained in the gross income definition for some period of time.

Cloete JA is of the opinion that the decisions taken in the *Stander* case (59 SATC212) reflect the law incorrectly. If that were the law, the right to live in a house rent-free, or to drive a motor vehicle (as set out in the Seventh Schedule to the Income Tax Act) without paying for it could be rendered tax free by limiting the right to exercise such benefit to the

recipient, which is not the case (SATC, 2007:214). Ernst & Young (2007) are however of the opinion that the right to live in a house rent-free or to drive a motor car without paying for it has always been taxable, even though it appears that no one was aware of it. Ernst & Young (2007) do however acknowledge the provisions contained in the Seventh schedule to the Income Tax Act relating to fringe benefit tax.

Cloete JA stated that the granting of an interest-free loan constitutes a continuing donation to the borrower which confers a benefit upon such borrower, as was held in the case of *CIR v Berold* (24 SATC 729). Cloete JA also stated that in the modern commercial world, a right to retain and use loan capital for a period of time, interest free, is a valuable right (SATC, 2007: 207).

Cloete JA argued that there is no risk of double taxation occurring. This is due to the fact that if the amounts lent were to be invested so as to produce interest income, there would be two separate and distinct receipts and accruals. Each separate receipt would be included in the companies' gross income (SATC, 2007:215-216).

Jones (2007:14) explains that the rationale behind the SCA ruling is that the potential occupants of the units would in any other case have paid levies, which would have been taxable in the hands of the developer. This particular structure was set up to avoid a taxable amount arising in the hands of the developer. The SCA decision sets legal precedence to close an anti-avoidance loophole specific to the property development industry. Loubser (2007:20), while agreeing that the SCA decision is technically accurate, raises concerns that the interpretation of the terms within the gross income definition was based on the interpretation from case law, which considered scenarios very different to the *Brummeria* case.

After careful consideration of the arguments presented and the reasoning as discussed above, the court made its controversial ruling on the *Brummeria* case.

2.5 THE FINDING OF THE COURT

In considering whether the right to use the loans interest free constituted “amounts” which “accrued” to the companies, the court held that: -

- the word “amount” and the phrase “accrued to” was taken in *Cactus Investments* (59 SATC 1) to include not only income actually received, but also rights of a non-capital nature which accrued and were capable of being valued in money. The court concluded that all that was needed for an amount to be accrued, was that a person had to become entitled to the right in question.
- the right to use the borrowed money interest free had a monetary value and therefore the amount of such value must be included in the gross income of the companies. It should be noted that the basis on which SARS valued the specific right was not challenged on appeal.
- while relying on the judgements in *People’s Stores (Walvis Bay)* (52 SATC 9) and what was restated in *Cactus Investments* (59 SATC 1), all that was necessary was for the right to be capable of being valued in money.
- it was not necessary for a receipt or accrual to be turned into money for it to have monetary value. The test to be applied is objective, not subjective.
- it was incorrect to conclude, that unless a benefit falls within paragraph (i) of the definition of gross income in section 1 of the Income Tax Act and the Seventh Schedule to the Income Tax Act, it is not taxable.
- that a benefit did in fact exist in the companies being able to use the loans interest free, what the companies did or did not do with the money borrowed was irrelevant.
- if a right has a monetary value, the fact that it cannot be alienated did not negate such value and the contrary view in the case of *Stander* was wrong. (SATC, 2007:207-208).

The SCA decision cannot be appealed, and can be applied retrospectively for at least three years to all taxpayers (Staffer, 2007).

The majority of authors are in agreement with the finding of the court and recognise that the judgement will only be applicable in a limited number of situations, that meet very

specific criteria (Erasmus, 2007; Desmond, 2007; Olivier, 2008:156; Olaogun & Neluvhani, 2008:8; Williams, 2007:4 & Jones, 2007:14). There are, however, some who are extremely concerned by the possible implications of the judgement, should it be applied to all interest-free loans (Ernst & Young, 2007; Loubser, 2007:20; Petersen, 2007:12 & Troskie, 2007). The various opinions of the authors are discussed in the following section.

2.6 THE IMPLICATIONS OF THE COURT DECISION

While the full impact of the judgement remains to be seen (Ernst & Young, 2007:3), there are many differing views and concerns regarding the SCA decision in the Brummeria case. An established principle of the commercial world has been given the death sentence, undoing a long standing principle in commerce that such loans have no adverse tax consequences (Troskie, 2007). Connor (2007) warns that there will be mass misapplication of the principles arising from the SCA decision in the Brummeria case, while Erasmus (2007) is concerned that this judgement is going to cause a flurry of revised assessments by SARS. Olaogun & Neluvhalani, (2008:8) consider this decision to represent a divergence from the generally accepted interpretations of earlier judgements. Similarly, Loubser (2007:20) also disagrees with the ruling of the SCA and considers it to be completely separated from the commercial reality of the transaction. Loubser (2007:20) suggests that a more satisfactory and reasonable result would be achieved if the benefit of the interest-free loan was not taxed, but that the developer be taxed fully on the profits when the units are sold in the future, regardless of how long the units were held.

Troskie (2007) and Clegg (in Staffer, 2007) raise concerns that the ruling in of the Brummeria case may have far reaching implications and that this case could impact everyone. Interest-free loans are used in many different transactions, for example: transactions between shareholders and companies; loan transactions with trusts; loan transactions between companies and employee share trusts; loans to family trusts; Black Economic Empowerment (BEE) transactions, companies that commonly use interest-free loans for business purposes and even parents who make loans to children. According to the principles laid down in the Brummeria case, Ernst & Young (2007) consider all inter-company interest-free loans; family loans to trusts and rent-free accommodation from

family trusts to have become taxable. Ernst & Young (2007) argue that benefits such as these have always given rise to a taxable benefit – although taxpayers and tax consultants alike were never aware of it. Clegg (in Staffer, 2007) does not see any obvious technical reason why it should not apply to all forms of interest-free loans, be it private or commercial.

Jones (2007:14) compares the potential imputing of income on shareholder and similar loans to imputing interest on money kept by a taxpayer in a safe as opposed to in a bank where it would earn interest. It would be considered to be poor tax policy if such irrational assessments were raised. Petersen (2007:12) emphasises that it will have harsh consequences for many taxpayers if all interest-free loans become taxable.

Jones (2007:14) argues that the judgement cannot be applied to funds lent by a shareholder to a company. Most small businesses are funded by means of such loans. The main reason for advancing these funds on loan capital, rather than as fixed capital, is to facilitate the withdrawal of such funds once the business starts generating profits and cash flow. Jones (2007:13) believes that from a business perspective, these are sound reasons for providing the loan interest free, and relies on this as a line of defence against these kinds of loans. Desmond (2007) agrees that if this ruling were to be applied to all interest-free loans, the implications would be enormous. Desmond (2007) however, does not believe that the principles of this case could be successfully applied to all interest-free loans, as the facts of the Brummeria case were unusual and specific.

Olivier (2008:152) contends that although the court ruling and the media reports have “sent shock waves throughout the tax community”, the media reports are incorrect and not all interest-free loans fall within the gross income definition. Olivier’s (2008:152) opinion is based on the fact that the giving of the interest-free loan in the Brummeria case was clearly in exchange for the purchase of a life right to the property, the interest-free loan was therefore the proceeds from the sale of the life right. Surtees and Wellsted (2008:11) compare the transaction to a barter transaction, the life-right to the property was given in exchange for the interest-free loan. Jones (2007:14) agrees that this judgement may not be as shocking as originally thought, the details of this case are very specific and the ruling will only apply to similar situations, specifically to developers of retirement housing schemes. The case of a shareholder advancing funds to a company is not a similar

situation and should not result in a taxable benefit arising. Desmond (2007) reiterates that the facts of each case should be considered carefully, as only certain interest-free loans are affected by this ruling. Erasmus (2007) agrees that the facts of this case are very unique and cannot be compared to normal interest-free loans between related companies. These facts cannot be compared to normal interest-free loans, as the companies, in carrying on their business, granted the use of the developed property without receiving a taxable consideration because their consideration was the interest-free loan. The judgement will only apply to interest-free loans where company A renders a service to company B and in return company B grants the right of an interest-free loan. Then the interest-free loan is a *quid pro quo* for the services rendered. In the case of the usual interest-free loan where there is no *quid pro quo*, it can be argued that this benefit is of a capital nature (Erasmus, 2007).

Petersen (2007:12) agrees that this judgement is in line with tax law and Erasmus (2007) also agrees that the ruling in the Brummeria case is not unreasonable. Olaogun and Neluvhalani (2008:8) are in agreement with the thinking that SARS will only be able to attack an interest-free loan if there is a *quid pro quo* attached to it. Similarly Des Kruger, the head of tax for Mallinicks, does not appear to be too anxious about the implications of the Brummeria case. Interest-free loans are used mostly where it is not commercially viable to charge interest, not as part of a tax avoidance scheme (Staffer, 2007).

Williams (2007:4) submits that the presence or absence of a *quid pro quo* is not the decisive factor, but rather whether the payment is capital or revenue in nature. Olivier (2008:154) emphasises that the facts of each case must be considered individually. In some cases the granting of the interest-free loan may be of a capital nature and will therefore not fall within the definition of gross income. The loan would, in such a case, also not have any capital gains implications, as paragraph 11(2)(d) of the Eighth Schedule to the Income Tax Act provides that the borrowing of money or the obtaining of credit, does not qualify as a disposal for capital gains tax purposes.

The Brummeria case does not lay down a blanket rule that an interest-free loan is always a taxable benefit in the hands of the borrower. A distinction should be made between interest-free loans where the benefit is a form of remuneration for goods or services supplied by the borrower to the lender and interest-free loans where there is no such

supply (Williams, 2007:4). Surtees and Wellsted (2008:11), while holding the view that interest-free loans are only taxable in a situation where the loan is given as consideration for other good or services, warn that due to the unclear wording of the judgement and SARS' silence on the issue, no guarantee can be given with regards to the application of the SCA judgement by SARS. SARS may challenge any interest-free loans granted, should they adopt a broad interpretation of the judgement.

Unlike Cloete JA (SATC, 2007:215-216), Williams (2007:4) is concerned that there is a risk of double taxation occurring. The recipient of an interest-free loan receives a benefit by not having to pay the interest on the loan, his taxable income is therefore higher than it would have been if the interest had been paid. Based on this, the tax he will pay for the year will be more, plus the additional amount of tax on the benefit included in the gross income. Williams (2007:4) argues that this surely cannot have been the intention of the court. The biggest concern of Ernst & Young (2007) is that this SCA decision may have possible catastrophic effects by causing asymmetry in the taxing of the benefit of the interest-free loans, as there will not (according to the current general deduction formula in section 11(a) of the Income Tax Act) be a notional deduction for interest expense in the hands of the lender of the funds. Nico Alberts of SARS says that SARS has not evaluated the judgement in this regard, but if the impact is unintentional or severe SARS will consider having the practice or law amended (Staffer, 2007). A further complication may be the application to institutions that under Muslim Sharia law, do not charge interest on some loans. The recipients would nevertheless be taxed. This could open the ruling to constitutional challenge, as it penalises taxpayers by religion (Staffer, 2007).

Heydenrych (2007) suggests that it is the occupant and not the developer that is receiving a tax benefit. This is illustrated by means of an example as follows: the occupant provides an interest bearing loan to the developer. The occupant also pays rent for the unit equal to the interest charged on the loan. The developer would be taxed on the rental income received, and would deduct the interest paid on the loan, a net effect of zero. The occupant would be taxed on the interest income received from the loan, but would not be able to deduct the rent paid, as it is a private expense.

SARS general manager for interpretation and rulings Nico Alberts says SARS will probably consider reissuing assessments on a case-by-case basis (Staffer, 2007). The relationship

between the lender and the entity will have to be considered on a case-by-case basis and then it will have to be determined whether the value transferred is tantamount to a continuous donation (Staffer, 2007). It is similarly reported by Loubser (2007:20), that SARS made a statement that it is not SARS' intention to tax the benefit of all interest-free loans and that the specific facts of each case will be considered. SARS has indicated that an interpretation note would be issued to clarify the intended application of the principles set out in the Brummeria case (Desmond, 2007). At the date of this dissertation, as far as can be ascertained, no such document has yet been issued by SARS.

Whether or not the judgement is considered to be correct, its *ratio decidendi* is binding on all courts in the Republic (Williams, 2007:3). The *ratio decidendi* is the actual decision and the facts material thereto (LexisNexis, 2008). The full impact of the judgement is unknown, it will definitely be cause for concern in the property industry where developers will probably increase the price of life-right units in order to cover the additional amount of tax they may now liable to pay (Williams, 2007:3).

Troskie (2007) believes that if the ruling of the court is correctly applied, the decision will have the effect of bringing in millions of Rand in taxes for SARS, as interest-free loans are used in a variety of transactions in the business world. The success will depend on the ability of SARS to investigate and follow up on interest-free loans (Troskie, 2007).

Loubser (2007:20) considers the court ruling to be unreasonable and is of the opinion that the only way to achieve a more reasonable and fair practice is for a taxpayer, with unlimited cash resources, to take a similar case to the SCA. In the event of a similar case being brought before the courts, it may be beneficial to contest the valuation, timing and possible capital nature of the benefit. These were not taken into consideration in the Brummeria case and may have had an impact on the ruling of the court. Ernst & Young (2007) intend on taking the matter up with SARS at as high a level as possible.

Although many tax professionals have differing views on the extent of the taxability of interest-free loans, it is clear from the above discussion that an interest-free loan will only be taxable in situations where a *quid pro quo* exists.

2.7 THE VALUATION, NATURE AND TIMING OF THE TAXABLE BENEFIT

Olivier (2008:153-154) considers the court to have made two errors in valuing the benefit. Firstly, the court should not have assumed that if interest was charged it would have been charged at prime rate, as under normal circumstances the interest rate of a loan is determined based on an individual's financial circumstances and credit history. Secondly, instead of calculating the deemed interest at a prime related rate, the court should have placed a value on the right of occupation that the company was forfeiting. Desmond (2007) similarly considers the use of a weighted prime interest rate to be excessive. There are a number of cases where the topic of valuation has been considered, for example *CIR v Butcher Bros (Pty) Ltd* (13 SATC 21), which could have been helpful in this regard. In the *Butcher Bros* case the judge held that a benefit must have an ascertainable monetary value before it can be taxed (SATC, 1944:25). Heydenrych (2007) suggests that the present value of the future income streams should have been discounted to arrive at a value. Heydenrych (2007) notes that no deduction was made available to the developer, to offset against the deemed income. Heydenrych (2007) considers the provision of the life right to be a part disposal of the property and the developer should therefore have been allowed to deduct a proportionate amount of the development costs. Staffer (2007) agrees that the difference between the interest charged and the value received would be suspicious. Troskie (2007) considers the situation where interest is charged on a loan, but at a very low rate. As SARS used the prime rate in the *Brummeria* case, it is suggested that the difference between the prime rate and the low interest rate will give rise to a taxable benefit. Troskie (2007) then raises a concern regarding cases where bank customers obtain financing at an interest rate lower than prime, will this also give rise to a taxable benefit?

As far as the timing of the accrual is concerned, Olivier (2008:154) submits that the time of accrual is the year in which the interest-free loan is granted. SARS does not have the choice whether to tax an amount either in the year of receipt or accrual, but must tax the amount in the year that comes first (*SIR v Silverglen* (30 SATC 199)). Oliver (2008:154) argues further, that the fact that the benefit of the loan could be enjoyed over a number of years will merely influence the value of the right (time value of money) and not the time of accrual.

Olivier (2008:154), unlike the court in the Brummeria case, considered the nature of the receipt and concluded that it was unquestionably received as part of a scheme of profit making and was therefore of a revenue nature. Erasmus (2007) is also of the opinion that the companies would have had difficulty in arguing that the amount was of a capital nature, because of the fact that the benefit was received in return for a service rendered in carrying on a trade. Olivier (2008:154) is careful to note that it does not follow that all interest-free loans will be of a revenue nature. This would be dependant on the facts of each case, a loan may also be of a capital nature and therefore be excluded from the gross income definition. Both Olivier (2008:154) and Erasmus (2007) consider the usual related company interest-free loan situation, to not have a *quid pro quo* and therefore be of a capital nature. Surtees and Wellsted (2007:11) agree and explain further that most family trusts have received interest-free loans, not as a consideration, but in receipt of a loan granted on favourable terms by the founder. Such an interest-free loan would give rise to a right, but a right of a capital nature, this would exclude the benefit from the gross income definition. In order to determine whether an interest-free loan is of a capital or revenue nature, Strydom (2008) suggests using the well known example of the tree and the fruit (CIR v Visser (8 SATC 271)). The tree is that which produces the income, the fruit. If the tree (the income-producing machine) is disposed of, the proceeds are of a capital nature. If the fruit of the tree is disposed of, the proceeds will be of a revenue nature. Taking this into consideration in the Brummeria case, the tree was their business of constructing units in retirement villages, the fruit of their operations was derived by allowing occupants the right of lifelong occupation of those units, the consideration was however (in their minds) non-taxable.

2.8 CITATIONS OF THE BRUMMERIA RENAISSANCE CASE

The first case has been ruled on based on the judgement in the Brummeria case. The Cape Tax Court in case number 12244, relied on the statement made by Cloete JA in the Brummeria case which stated that it did not follow that if a receipt or accrual could not be turned into money, it did not have a monetary value. The court also relied on another statement made by Cloete JA in the Brummeria case saying that if a right has a monetary value, the fact that it cannot be alienated does not negate its value. The court placed a

monetary value on free points given to employees of a holiday time share exchange company and assessed the company for additional pay-as-you-earn (PAYE) (Morphet, 2008:1).

2.9 THE TREATMENT OF INTEREST-FREE LOANS IN OTHER COUNTRIES

In the United States of America (USA), regulations exist which treat the provision of an interest-free loan as economically equivalent to a loan bearing interest at an ascribed rate. The forgone interest is treated as a transfer from the lender to the borrower. In the case of the borrower being an employee, the amount of deemed interest is subject to employment taxes. The deemed interest is treated as a dividend where the borrower is a shareholder (Duncan, Everett & Lassar, 2006:28-29). Forgone interest is defined in section 7872(e)(2) of the USA tax legislation as “the interest that would be payable if interest accrued on the loan at the applicable federal rate for a given annual period, over any interest payable on the loan properly allocable to such period” (Forst, Hodges, Manigault, Kautter & Eichel, 2005:312). Similarly, in Canada interest-free loans are deemed to be taxable, but they are also regarded as an expense and are therefore tax deductible (Staffer, 2007). In the USA deemed interest must even be calculated and taxed on interest-free personal loans (e.g. a loan from a father to a son). The amount included in taxable income is however limited to the interest income earned by the borrower on the funds (McGill, 2006:36).

The creator of a private charitable foundation in the USA obtained a loan from a commercial bank and lent the funds so borrowed to the foundation, in order for the foundation to pay its operating costs. The creator was not allowed to charge interest on the loan made by him to the foundation, in terms of the regulations applicable to foundations. The creator therefore, made an interest-free loan to the foundation. The creator was taxed on the ascribed interest income in terms of the prevailing tax legislation, as the amount was a gift loan as defined by the USA tax legislation. A gift loan is defined in section 7872(f)(3) of the USA tax legislation as “below-market loans in which the concession of interest is the nature of the gift” (Forst *et al*, 2005:312). Although special Temporary Treasury regulations exist in respect of gift loans to charitable organisations, this exemption is limited to loans with a value less than \$250 000. This exemption did not apply

to the creator of the foundation as the loan made by him exceeded \$250 000. However, as the loan to the foundation was classified as “property held for investment” the taxpayer could deduct the interest paid on the bank loan, but only to the extent that it gave rise to interest income (Anon., 2005:149).

A New Jersey tax court ruled that interest could be imputed on an interest-free loan made by a person holding an ownership interest (whether a controlling interest or not) in a limited liability company, as this resulted in an incorrect assessment of the person’s tax for the year. According to New Jersey regulations interest should be charged on loans made by one related party to another. There is as yet, no reported New Jersey court decision which has determined when an interest-free loan results in the distortion of the lenders taxable income. Federal court decisions indicate that an interest-free loan is an appropriate basis to ascribe interest income to the lender (Anon., 2004:19).

2.10 CONCLUSION

Based on the literature study conducted in this chapter, there appears to be much misconception among tax professionals as to the implications of the SCA ruling in the Brummeria case. It is however quite clear that the facts of the Brummeria case are very specific and that this ruling can only be applied, in the future, in the presence of a *quid pro quo*, a situation where one form of goods or services is exchanged for another. In the USA and Canada, legislation is in place that deems interest to be levied on interest-free loans and therefore results in a taxable benefit, there is however an equal deemed deduction for the lender of the funds. The ruling in the Brummeria case raises a potential problem in that no notional deduction was allowed to the lender in this case.

The valuation method applied by SARS appears to be inappropriate. This matter was however not included in the original notice of objection submitted to SARS and was accordingly not ruled on by the court. The timing of the accrual was also not included in the original objection and accordingly not ruled on by the court. Olivier is of the opinion that that timing of the accrual is the time at which the loan is granted and that calculating an annual amount of the benefit is incorrect. The nature of the benefit should also be

considered. The nature of the benefit will depend on the specific circumstances of each case, use should be made of the tree and fruit analogy in *CIR v Visser* (8 SATC 271).

The facts of the *Brummeria* case and its potential implications are now clearly understood, the research design and methodology may now be carried out.

CHAPTER 3 RESEARCH DESIGN AND METHODOLOGY

3.1 INTRODUCTION

The research aims to determine the extent of knowledge with regards to the Brummeria case and the resultant application of the principles of the Brummeria case by audit firms in the Pretoria area. The research will be conducted by performing a literature study as well as a questionnaire survey. A questionnaire will be drawn up, based on the facts and ruling of the Brummeria case and distributed to a selection of small, medium and large audit firms in the Pretoria area for completion. A description of the research design and reasons for the chosen methodology are set out in the paragraphs to follow.

3.2 DESCRIPTION OF OVERALL RESEARCH DESIGN

Firstly, a literature study is conducted in order to obtain an understanding of the facts, reasoning and ruling of the Brummeria case. Other literature sources are consulted in order to obtain an understanding of the interpretation and application of the principles of the Brummeria case by tax professionals (refer chapter 2, p 9).

The audit firms are questioned with regards to their knowledge and application of the principles of the Brummeria case in order to conclude on the research objectives as set out in section 1.3, p 2. A survey is therefore the most appropriate means to obtain the information required.

The research is conducted using an empirical research method. Empirical research is research in which new data is collected or existing data is re-analysed (Kotzé, 2008:2). The survey will collect and analyse new data from audit firms in the Pretoria area.

The research is qualitative in nature. A qualitative study aims to answer questions about the complex nature of phenomena with the purpose of explaining, predicting and

controlling phenomena, unlike quantitative research which focuses on the relationships between measurable variables (Leedy & Ormond, 2005:94). The research aims to identify whether small, medium and large audit firms in the Pretoria area have a lack of knowledge with regards to the Brummeria case and whether the principles of the case are being correctly applied when consulting with clients.

The research makes use of primary data. Primary data is newly collected data, specifically for use in the research project being undertaken (Saunders, Lewis & Thornhill, 2007:607). Data is collected by making use of questionnaires; this data is collected solely for the purposes of this research and is therefore primary data.

The research is a combination of basic and applied research. Basic research is research aimed at the academic community with little consideration of its practical importance (Saunders *et al*, 2007:7). Whereas applied research is more specifically aimed at people in the business sector and is presented in terms that they can readily understand (Saunders *et al*, 2007:7). This study is relevant to academics as it may provide grounds for further research, if a “knowledge gap” is identified in the Pretoria area there may be a similar “knowledge gap” in the rest of Gauteng and throughout South Africa. The research is of practical importance to the audit firms as it may timeously identify any lack of knowledge or misinterpretation of the facts of the Brummeria case, which can be corrected in order to provide more accurate and reliable tax advice to clients in the future.

The research is exploratory in nature. An exploratory study serves to gain an understanding of the nature, context, potential impact and possible causes of, as well as the possible factors contributing to a certain problem (Babbie & Mouton in Kotzé, 2008:3). The research aims to determine whether audit firms are aware of the Brummeria case and whether the audit firms understand and correctly apply the principles of this case. The results of the research may also provide the basis for future research as to the extent of the lack of knowledge with regards to the Brummeria case throughout South Africa and within other industries.

The research is a cross-sectional study. A cross-sectional study is one which is carried out at a fixed point in time (Saunders *et al*, 2007:148). The audit firms are all questioned at

one point in time, no subsequent data is collected to analyse a change in their knowledge and application of the principles of the Brummeria case.

The research is conducted on a non-experimental basis. Non-experimental research is also known as an *ex post facto* design. An *ex post facto* design is one in which it is not feasible to control the variables of an event. In an *ex post facto* design existing events or conditions are identified and investigated (Leedy & Ormond, 2005:232). The research aims to determine the current level of knowledge of the principles of the Brummeria case in audit firms and how the principles are currently being applied. No attempt is made to obtain different results by introducing other variables.

3.3 RESEARCH METHODOLOGY

3.3.1 Target population

The population from which the sample is selected consists of audit firms registered with IRBA and operating within the Pretoria area. The population is limited to the Pretoria area as this is the first study of this kind with regards to the Brummeria case and it must first be determined whether there is in fact a lack of knowledge or misinterpretation of the principles of the Brummeria case. In the event that a lack of knowledge and an incorrect application of the principles is identified in the Pretoria area, further research may be conducted in other areas or in other industries.

The results of the survey will provide useful information to the audit firms concerned by alerting them timeously to any “knowledge gap” and allowing them to gain the necessary expertise in order to provide a better service to tax clients in the future.

3.3.2 Units of analysis

A sample of audit firms is selected from the target population (refer section 3.3.1, p 29) for the purposes of the survey. The population is categorised into small, medium and large audit firms and an equal number of audit firms is selected from each category.

For the purposes of this study a small, medium or large audit firm is categorised as follows:

- A small audit firm is one which has only with one or two partners or directors;
- A medium audit firm is one which has three or four partners or directors;
- A large audit firm is one which has five or more partners or directors.

Written consent is obtained from each of the participants prior to commencing with the study. Only audit firms which consent to participating in the study, are included in the study.

3.3.3 Sources from which data is collected

In order to satisfy the first research objective, it is necessary to understand the facts, reasoning and ruling of the Brummeria case. In order to do this, the court transcript of the Brummeria case (69 SATC 205) is obtained and studied. Other literature written about the topic of the Brummeria case or interest-free loans in general, is also consulted and the differing views considered (Refer also chapter 2, p 9).

A questionnaire is used to collect the information from the audit firms. A key person at each audit firm is identified and the questionnaire is sent to this person for completion. The key person at each audit firm is either the tax partner, tax manager or a senior staff member in the tax department of the firm. If a firm has neither a designated tax partner, tax manager nor a senior staff member in the tax department, a senior staff member of the audit firm is identified to participate in the study. Participants from which no response is received, are followed up telephonically and the questionnaire is completed by the researcher telephonically with the participant.

3.3.4 Selection of data sources and participants

The audit firms included in the sample are selected by means of a probability sampling method. Saunders *et al* (2007:207) explains that with probability sampling the chance of each case being selected is equal for all cases, this allows the results of the survey

conducted on the sample to be extrapolated to the whole population. It is expected that any “knowledge gap” that is identified in the sample, will be similar throughout the population.

The probability sampling technique that is used is specifically stratified systematic sampling. Firstly, the number of audit firms within the population is determined, the population is divided (stratified) into three sub-populations based on its classification as a small, medium or large audit firm (refer also section 1.7, p 5 & 6). The desired sample size is determined as set out in section 3.3.5, p 31. An equal interval is calculated by dividing the size of each sub-population by the sample size. In order to select the sample from each sub-population, the researcher starts with the first audit firm on the list, the interval is added to select the next firm to include in the sample, this procedure is followed until the desired sample size is reached.

3.3.5 Number of participants

As the main purpose of this survey is to determine whether a “knowledge gap” does in fact exist, a small sample from each sub-population is selected. If a “knowledge gap” is in fact identified, further research may be undertaken at a later stage, on larger samples, in order to conclude on the extent of such a “knowledge gap”.

For the purposes of this study five audit firms from each sub-population are selected.

3.3.6 Data collection

Data is collected from the court transcript as well as other literature written on the topic of the Brummeria case and interest-free loans in general. Data is also collected by means of questionnaires completed by the audit firms included in the sample.

3.3.6.1 The Brummeria case

The published court transcript of the Brummeria case is obtained by the researcher from the LexisNexis Butterworths CD publication (69 SATC 205). The report is read by the

researcher and the arguments, reasoning and ruling by Cloete JA (69 SATC 205 at 212-215) is studied in order to fully understand the principles of the case. The literature study conducted is contained in chapter 2, p 9.

The court transcript is readily available as it is part of a published tax library. No problems or obstacles are experienced in obtaining this documentation. The collection of this data is a speedy process, as no interaction from any third party is needed in order to obtain the data.

A search on the internet using the Google search engine and a search of the University of Pretoria's electronic library journal database is performed, to identify other literature written on the topic of the Brummeria case or interest-free loans in general. The words "Brummeria Renaissance", "interest-free" and "loan" are used as keywords for this search. The findings and reasoning of the various authors are considered, together with the analysis of the Brummeria case.

3.3.6.2 The audit firms

A search for registered auditors (RA's) by area is performed on IRBA's website to obtain a list of all the audit firms in the Pretoria area. Each company's profile is viewed on the IRBA website to determine the number of directors or partners each firm has, this is used to stratify the population into small, medium and large audit firms. During the search conducted on the IRBA website it is noted that some firms are registered as in Pretoria while other firms are registered according to suburb names and therefore are not included in the results when a search is performed for "Pretoria". The population obtained when a search for "Pretoria" is conducted is considered to be representative of the total population in the Pretoria area and contains a sufficient spread of small, medium and large audit firms. The search results of "Pretoria" are therefore deemed to be sufficient for the purposes of this study.

3.3.6.3 The questionnaire

A standardised structured questionnaire (see Appendix B, p 68) is drawn up based on the principles of the Brummeria case and the application of these principles in practice. These questionnaires are used to gather primary data regarding the degree of knowledge and application of the principles of the Brummeria case by the audit firms. The questionnaire is sent by the researcher via e-mail to the identified key person (refer also section 3.3.3, p 30) in each audit firm.

The questionnaire is drawn up as follows:

The first section of the questionnaire aims to obtain information regarding the specific audit firm. It aims to determine whether the firm in fact advises clients with respect to tax issues and the level of qualification of the tax professional/s within the firm.

The second section of the questionnaire aims to obtain information regarding the firm's knowledge of the Brummeria case. The questionnaire first determines whether the firm (the representative tax professional) is aware of the Brummeria case and further aims to determine whether the principles of the case have been interpreted correctly and whether the principles are being correctly applied.

Use is made of structured questions in a yes / no format, additional motivation is required on certain questions. The structured questions guide the participant initially, the participant must then motivate why a certain statement is agreed or disagreed with. There are a total of fourteen questions and the questionnaire takes approximately fifteen minutes to complete.

A pilot test of the questionnaire is performed prior to it being used for data collection purposes. The pilot sample consists of eleven work colleagues of the researcher. The main purpose of the pilot test is to refine the questionnaire to ensure it is user-friendly and easily understandable for use in the data collection phase, the accuracy of the answers provided is not important as the information is not used in the study. Colleagues of the researcher are asked to volunteer to attend a questionnaire session. Each volunteer is asked to complete the questionnaire based on their specific knowledge and application of

the principles of the Brummeria case. Colleagues of the researcher are used in the pilot study, as they work in the audit field on a daily basis and therefore find themselves in a similar position as the audit firms contained in the population. The volunteers are at various levels of qualification and experience and are therefore able to provide constructive feedback on the ease of use of the questionnaires. The volunteers completed the questionnaire in an average time of twelve and a half minutes.

The data collection process may be hampered by a lack of response by participants. Non-response may result in the sample no longer being representative of the population. A schedule is maintained indicating all consent forms and questionnaires that are distributed and those which are received back. Follow-up e-mails and phone calls are made to obtain as many of the consent forms and questionnaires back as possible. The time period over which this data is collected, is dependant on the speed of response by the audit firms.

3.3.7 Data analysis

The data analysis phase commences as soon as all completed questionnaires are received, for this purpose the schedule referred to in section 3.3.6, p 34 is inspected and any outstanding questionnaires followed up on. On receipt of the completed questionnaires from the audit firms, the completed questionnaires are inspected to determine whether there is any outstanding or unclear information. All questionnaires received are completed in full, no information is outstanding or unclear.

The responses provided in the completed questionnaires are summarised in an excel spreadsheet. The responses are set out on a firm by firm basis and are categorised into small, medium or large audit firms. In order to maintain the confidentiality of the results, the questionnaires will be numbered S1–5; M1–5 and L1–5 and entered in the spreadsheet on this basis. The results are analysed to determine whether there is an indication of a “knowledge gap” among audit firms in the Pretoria area. The results achieved for each sub-population are compared in order to determine whether there appears to be any correlation between the size of the audit firm and any identified “knowledge gap”.

The researcher considers whether the results of the sample are representative of the population and in so doing, may suggest future research on this topic to determine whether this is a phenomenon that is unique to the Pretoria area or whether a similar situation may exist in the rest of Gauteng and South Africa. The researcher may also suggest further research to determine the extent of such a “knowledge gap” by conducting research on larger samples.

3.4 THE QUALITY AND RIGOUR OF THE RESEARCH DESIGN

The advantages of identifying the possible risk that the Brummeria case may hold for clients of the audit firms, as well as a need for an increased awareness and knowledge of emerging tax issues will be stressed to the participants. The results of the survey will be made available to the participants, this information will assist them in identifying any “knowledge gap” that exists within their firm. As the population is obtained from a listing from IRBA, all the participants in the study are Chartered Accountants (CA’s) and RA’s. Due to the ethical and other requirements imposed on CA’s by SAICA and IRBA, CA’s and RA’s are assumed to be people of integrity and to have high ethical values. It is believed that they provide full disclosure of the required information and will also provided reliable, accurate information. A risk exists that participants will try to give what is thought to be the correct answer, this risk is considered to be minimal as the findings of the research are directly applicable and practically useful to each participant.

A risk exists that the questionnaire will be completed by a staff member of the audit firm, who is not sufficiently qualified or experienced to provide accurate information. The person completing the questionnaire will be requested to state what position is held in the audit firm. A decision can be made as to the credibility of the answers provided by determining the seniority and experience of the staff member who completes the questionnaire. If necessary the questionnaire may resubmitted to a more senior member of staff. During the data collection it is noted that the completion of the questionnaire is in some cases delegated to article clerks, this occurs especially in the smaller firms. It is assumed that similar delegation of work occurs in the audit firm when performing work for clients,

therefore these participants are dealing with client's tax matters. The level of knowledge of these participants is therefore relevant to the study.

The most important aspect of a probability sample is a high response rate. In cases where certain respondents do not respond, the sample may no longer be representative of the population as certain sample units are left out, the results of the survey may therefore be biased (Saunders *et al*, 2007:213). Any questionnaires that are outstanding after the specified due date (12 December 2008) are followed up telephonically to obtain as many questionnaires back as possible

No risk exists that the researcher may be perceived not to be independent, as the audit firms and participants are not personally known to the researcher.

3.5 RESEARCH ETHICS

The term ethics refers to the manner in which the researcher behaves during the design, collection, processing and analysis stages of a research project with regards to the rights of the participants of the study, or any other person who may be affected by the research project or its results (Saunders *et al*, 2007:178). In order to ensure that the researcher behaves ethically in the carrying out of the research, certain safety measures are put in place to protect both the researcher as well as the participants. Ethics should be considered at all times throughout the research project.

Before any data is collected, with respect to the research, the research proposal is submitted to the University of Pretoria's Research Ethics Committee for approval (refer Appendix A, p. 66). Once approval is received from the said committee, the IRBA website is used to obtain the list of audit firms within the Pretoria area and a sample is selected (refer section 3.3.4, p 30). Once the possible participants are identified, consent for the study to be conducted is obtained from the audit firms before any client specific data is collected (refer Appendix C, p. 73). Participants that do not consent to the study are eliminated from the sample.

Upon requesting consent from the participants, a short information letter is provided together with the consent form, in order for the participants to make an informed decision as to whether or not to participate in the study. The information regarding the participants obtained during the study is kept confidential at all times. Should the results of the study indicate that an audit firm has clients with a possible tax risk, no reporting to SARS or to any other person will occur. The participants are also not named in the study, so as to maintain anonymity. The participation in the study by the audit firms is voluntary, participants are not coerced into participating in the study and may withdraw from the study at any time. The participants are at no time deceived or coerced into providing the information necessary for the study, in cases where consent is not obtained. No compensation, whether financial or otherwise, is given to the participants for participation in the study. Every effort is made by the researcher to cause as little inconvenience as possible to participants during the data collection process, participants are only contacted during work hours.

The researcher behaves ethically at all times during the study and maintains objectivity throughout the study. Data is collected and recorded completely and the subjective selection of data recording is avoided. Care is taken by the researcher not to over exaggerate the benefits and application of the results of the research.

3.6 CONCLUSION

In this chapter the research design and methodology is explained, this is applied in conducting the research. The analysis of the results of the research is contained in the following chapter.

CHAPTER 4 DATA ANALYSIS

4.1 INTRODUCTION

The previous chapter discussed the research design and methodology. In this chapter the data obtained from the sample is analysed. The objective of the research was to investigate the level of knowledge with regards to the Brummeria case among audit firms in the Pretoria area and to determine whether the principles of the Brummeria case are being correctly applied by the audit firms.

4.2 ANALYSIS AND PRESENTATION OF THE DATA

Fifteen questionnaires were sent to participants, five small audit firms; five medium audit firms and five large audit firms, of which eleven completed questionnaires were received back (73%). The four audit firms that did not respond gave reasons as follows:

- does not have the time to complete (1)
- does not consent to participate in the study (2)
- is a forensic auditor and does not handle tax matters (1)

The analysis of the data is done in three sections, divided similarly to the questionnaire, namely:

- general information about the audit firm
- knowledge of the Brummeria case
- application of the principles of the Brummeria case.

The analysis of the data is stated in number of respondents (nr) and percentage (%).

4.3 FINDINGS

4.3.1 The firm

Two questions were posed to the respondents regarding the tax services provided by the audit firm and the qualifications of the tax professional within the audit firm.

4.3.1.1 Advice provided by the audit firm to clients

Table 2 below refers to question 1 of the questionnaire (Appendix B, p 70).

Table 2: Advice provided by the audit firm to clients

	Respondents	
	Nr	%
Yes	11	100
No	0	0
	11	100

From the above table it can be seen that all 11 (100%) of the audit firms do in fact advise clients with respect to tax issues.

4.3.1.2 Tax specialist within the audit firm

Table 3 and 4 below refer to question 2 of the questionnaire (Appendix B, p 70).

Table 3: Presence of a tax specialist within the audit firm

	Respondents	
	Nr	%
No	3	27,3
Yes	8	72,7
	11	100

Based on the results as stated in table 3 above, it is evident that most of the audit firms, namely 8 (72.7%) have a designated tax specialist within the firm. 3 (27.3%) audit firms do not have a tax specialist within the firm.

A further question was posed to the three audit firms that do not have a tax specialist within the firm, as to what procedures are followed by the firm should a high level tax issue arise. The audit firms stated the procedures as follows:

- External consultation (1)
- Consult partner at head office (1)
- Senior partner of firm handles high level tax issues (1).

Table 4: Qualification of the tax specialist within the audit firm

	Respondents	
	Nr	%
Masters degree – tax	3	37,5
CA (SA)	2	25,0
CA (SA) & MBA	1	12,5
Some tax courses	1	12,5
Unknown	1	12,5
	8	100

From table 4 above, it is evident that the minority of audit firms (3 (37.5%)) that have a designated tax specialist within the firm, have a tax specialist with a qualification which is tax specific. 3 (37.5%) audit firms have a tax specialist with a Masters degree in tax and 1 (12.5%) audit firm has a tax specialist who has undertaken some *ad hoc* tax courses with a university. 2 (25%) audit firms have a tax specialist with a CA(SA) qualification and 1 (12.5%) has a tax specialist with a CA(SA) qualification as well as a Masters degree in business administration (MBA). The qualification of the tax specialist in 1 (12.5%) audit firm was not known to the respondent.

4.3.2 Knowledge of the Brummeria case

Seven questions were posed to the respondents in order to determine their specific knowledge with regards to the Brummeria case. The questions relate to the audit firms'

awareness of the Brummeria case and the method by which such awareness was obtained, the reaction of the audit firms to the SCA ruling, as well as the controversy surrounding the decision and the specific circumstances in which the ruling will be applicable in the future.

4.3.2.1 Awareness of court ruling in the Brummeria case

Table 5 below refers to question 3 of the questionnaire (Appendix B, p 70).

Table 5: Awareness of court ruling in the Brummeria case

	Respondents							
	Small audit firms		Medium audit firms		Large audit firms		Total	
	Nr	%	Nr	%	Nr	%	Nr	%
Yes	2	50,0	2	50,0	2	66,7	6	54,5
No	2	50,0	2	50,0	1	33,3	5	45,5
	4	100,0	4	100,0	3	100,0	11	100,0

The data as analysed in the table indicates that 6 (54.5%) of the respondents are aware of the Brummeria case, whereas 5 (45.5%) respondents are not. 2 (50%) of the 4 respondents representing small audit firms are aware of the Brummeria case as compared to 2 (50%) of the 4 respondents representing medium audit firms and 2 (66.7%) of the 3 respondents representing large audit firms that are aware of the Brummeria case.

The remaining questions contained in the questionnaire are specific to the Brummeria case, therefore the remaining questions were only answered by the six respondents that were in fact aware to the Brummeria case.

Table 6 below refers to question 4 of the questionnaire (Appendix B, p 70).

Table 6: Method of awareness of Brummeria case

	Respondents	
	Nr	%
Media (TV, radio, newspapers, SAICA newsletters)	4	66,6
Seminar / course	1	16,7
Own research	1	16,7
	6	100

From the above table it can be seen that the majority of respondents, namely 4 (66.6%) became aware of the Brummeria case through the media, media being the television, radio, newspapers and industry publications. 1 (16.7%) respondent became aware of the Brummeria case whilst attending a SAICA seminar or course and 1 (16.7%) respondent learnt about the Brummeria case through own research.

4.3.2.2 Reaction within the audit firm

Table 7 below refers to question 5 of the questionnaire (Appendix B, p 70).

Table 7: Reaction within the audit firm

	Respondents	
	Nr	%
Technically analysed, discussed within firm	1	16,7
Staff informed, staff to notify affected clients	1	16,7
Determine whether the firm has affected clients	3	50,0
Cannot remember	1	16,7
	6	100

Based on the table above it is evident that the SCA ruling in the Brummeria case caused various reactions among audit firms. 1 (16.7%) of the respondents cannot remember what reaction, if any, the SCA ruling caused within the audit firm. The remaining audit firms (5) had similar reactions. 1 (16.7%) audit firm technically analysed the case and discussed the case and action to be taken by the firm in future dealing with clients. 1 (16.7%) audit firm merely informed its staff of the SCA decision and staff was instructed to notify any affected clients. 3 (50%) audit firms determined whether any of the clients of the firm would be effected by the SCA decision.

4.3.2.3 Concurrence with ruling of court

Table 8 below refers to question 6 of the questionnaire (Appendix B, p 70).

Table 8: Concurrence with ruling of court

	Respondents	
	Nr	%
Yes, interest-free loans are used instead of drawing a salary	1	16,7
Yes, applies only where is given as consideration for goods or services	2	33,3
Do not have detailed knowledge of the case	1	16,7
Not in a position to answer / in terms of company policy may not answer	2	33,3
	6	100

The table above indicates that there are differing opinions as to the concurrence with the ruling of the SCA in the Brummeria case. 1 (16.7%) respondent indicated that due to the fact that detailed knowledge of the case was lacking, the question could not be answered. 2 (33.3%) respondents indicated that either the respondent is not in a position to answer the question or due to company policy may not answer this kind of question.

2 (33.3%) respondents agree with the ruling of the court, indicating that their concurrence is based on the fact that the ruling will only apply in the future where an interest-free loan is given as consideration for good or services as was the case in the Brummeria case. 1 (16.7%) respondent agrees with the ruling of the case on the basis that individuals often have interest-free loans (owing to the company) instead of drawing a salary so as to avoid paying PAYE.

4.3.2.4 Contentious nature of the ruling

Table 9 below refers to question 7 of the questionnaire (Appendix B, p 71).

Table 9: Contentious nature of ruling

	Respondents	
	Nr	%
Ruling was misinterpreted, applies only where specific circumstances exist	3	50,0
An amount was not actually received	1	16,7
There was an offset of amounts	1	16,7
Not in a position to answer / in terms of company policy may not answer	1	16,7
	6	100

With reference to the table above, it is noted that half, namely 3 (50%), of the respondents consider the ruling to have been largely misunderstood and are of the opinion that the ruling is not as controversial as was originally thought, as the circumstances of the case are very specific and the ruling can only be applied in the future to cases with similar circumstances. 1 (16.7%) respondent also considers the ruling to be nothing to be concerned about as there was an offset of amounts.

1 (16.7%) respondent considers the ruling to be as controversial as initially thought, as no amount was actually received and therefore there should not have been an amount taxed. 1 (16.7%) respondent indicated that either the respondent is not in a position to answer the question or due to company policy may not answer this kind of question.

4.3.2.5 Application of the ruling

Table 10 below refers to question 8 of the questionnaire (Appendix B, p 71).

Table 10: Application of ruling

	Respondents	
	Nr	%
Where the interest-free loan is compensation for goods or services / similar facts to Brummeria case	4	66,6
Where the definition of gross income or section 80 can be applied	1	16,7
Cannot remember details of the case	1	16,7
	6	100

Table 10 indicates that when asked about the circumstances in which the ruling of the Brummeria case could be applied in the future, the majority of respondents, namely 4 (66.6%), are of the opinion that the ruling would be applicable in future, to cases where an interest-free loan is given as compensation for goods or services or where the case has similar facts and circumstances to the Brummeria case.

1 (16.7%) respondent is of the opinion that the ruling may be applied to any situation where the definition of gross income in section 1 of the Income Tax Act or the requirements of section 80 (tax avoidance arrangements) of the Income Tax Act could be successfully applied.

1 (16.6%) respondent does not recall the details of the case and could therefore not provide a response to the question.

4.3.2.6 The meaning of *quid pro quo*

Table 11 below refers to question 9 of the questionnaire (Appendix B, p 71).

Table 11: The meaning of *quid pro quo*

	Respondents	
	Nr	%
Something for something	2	33,3
Do not know	2	33,3
Other incorrect answer	2	33,3
	6	100,0

This question was included in the questionnaire in order to determine the extent of technical knowledge among the audit firms. *Quid pro quo* is a legal term meaning “something for something” (LexisNexis, 2008) (refer also section 1.7, p 6) and formed the basis of the ruling in the Brummeria case.

2 (33.3%) respondents correctly stated the meaning of *quid pro quo* as something for something. 2 (33.3%) respondents did not know the meaning of the term and 2 (33.3%) respondents provided other incorrect answers.

4.3.3 Application of the principles of the Brummeria case

The questionnaire included five questions specifically addressing the principles of the Brummeria case and the application thereof by the audit firms. The last question included in the questionnaire relates to the valuation, timing and nature of the taxable benefit.

4.3.3.1 Queries received from clients

Table 12 below refers to question 10 of the questionnaire (Appendix B, p 71).

Table 12: Queries received from clients

	Respondents	
	Nr	%
No	4	66,7
Yes, evaluated the applicability based on the specific circumstances and the specific application of the ruling explained to clients	2	33,3
	6	100

Based on the table above, it is evident that only 2 (33.3%) of the audit firms have received queries from clients specifically relating to the Brummeria case. The respondents state that when queries were received the applicability of the Brummeria case was evaluated based on the specific circumstances of the situation and the specific application of the ruling was explained to the client. 4 (66.7%) audit firms did not receive any queries from clients with regards to the Brummeria case.

4.3.3.2 Consideration of the Brummeria case when advising clients

Table 13 below refers to question 11 of the questionnaire (Appendix B, p 71).

Table 13: Consideration of the Brummeria case when advising clients

	Respondents	
	Nr	%
Yes, all case law needs to be considered when advising clients	1	16,7
Yes, some clients do make use of interest-free loans	1	16,7
Yes, the case is considered in general terms	1	16,7
Yes, make clients aware of the circumstances of the case and the risks	1	16,7
No, the case is not considered relevant	1	16,7
Depends on what client wants	1	16,7
	6	100

From the above table it is evident that 4 (66.7%) of the respondents consider it necessary to consider the Brummeria case when advising clients. 1 (16.7%) respondent states that all case law needs to be considered when advising clients. 1 (16.7%) respondent considers it necessary to consider the Brummeria case as some clients do make use of interest-free loans. 1 (16.7%) respondent states that the case is always considered in general terms and 1 (16.7%) respondent considers it necessary to make clients aware of the circumstances of the case and the related risks.

1 (16.7%) respondent is of the opinion that the case is not relevant and therefore does not need to be considered and 1 (16.7%) respondent indicates that whether or not the case is considered would depend on the client's request.

4.3.3.3 Clients exposed to a tax risk

Table 14 below refers to question 12 of the questionnaire (Appendix B, p 71).

Table 14: Clients exposed to a tax risk

	Respondents	
	Nr	%
No	5	83,3
Not in a position to answer / in terms of company policy may not answer	1	16,7
	6	100

The above table indicates the 5 (83.3%) respondents are of the opinion that they do not have clients that are exposed to a tax risk as a result of the Brummeria case. 1 (16.7%) respondent indicates that either the respondent is not in a position to answer the question or due to company policy may not answer this kind of question.

4.3.3.4 The risk of double taxation

Table 15 below refers to question 13 of the questionnaire (Appendix B, p 71).

Table 15: The risk of double taxation

	Respondents	
	Nr	%
Yes, the deductibility of expenses was not considered	1	16,7
Yes, the supplier is taxed on deemed interest and the recipient is taxed on what is received	1	16,7
Yes, no motivation given	1	16,7
No, there was an offset of benefits	1	16,7
No, the ruling closes a loop hole in the law	1	16,7
No, any double tax that occurs can be queried with SARS	1	16,7
	6	100

Based on the above table, 3 (50%) of the respondents consider a risk of double taxation to exist whereas 3 (50%) respondents consider no such risk to exist. Of the 3 respondents that consider a risk of double taxation to exist, 1 (16.7%) respondent is of the opinion that the double tax risk arises from the fact that the deductibility of expenses was not considered, 1 (16.7%) respondent considers the risk to arise from that fact that the supplier is taxed on deemed interest and the recipient is taxed on what is received. The third respondent provided no motivation as to the risk of double taxation.

1 (16.7%) respondent considers there to be no risk of double taxation occurring as there was an offset of benefits, where another respondent (16.7%) considers the SCA ruling to have closed a loophole in the law. 1 (16.7%) respondent is of the opinion that should double taxation occur the matter can be queried with SARS.

4.3.3.5 The valuation, nature and timing of a taxable benefit

Tables 16, 17 and 18 below refer to question 14 of the questionnaire (Appendix B, p 72).

The SCA did not deliver an opinion with regards to the valuation, nature and timing of the taxable benefit that arose in the Brummeria case, due to the fact that these issues were not included in the original grounds of objections and therefore could not be considered by the court on appeal (refer also section 2.2, p 12). Due to this the audit firms were asked to give an opinion as to how the valuation, nature and timing of a taxable benefit should be determined.

Table 16: Valuation of a taxable benefit

	Respondents	
	Nr	%
Present value of interest-free loan	1	16,7
Prime rate	1	16,7
Market value	1	16,7
Cost	1	16,7
Do not know	2	33,3
	6	100

With reference to the table above, it can be seen that there are many opinions as to the method to be applied in determining the value of an identified taxable benefit. 1 (16.7%) respondent suggests using the present value of the interest-free loan, while another respondent (16.7%) suggests using the prime interest rate to discount the benefit. 1 (16.7%) respondent suggests using the market value of the loan, but does not indicate how this market value should be determined and another respondent (16.7%) suggests using the cost or original value of the loan. 2 (33.3%) respondents do not know how to determine the value.

Table 17: Timing of accrual of a taxable benefit

	Respondents	
	Nr	%
At the time that the loan is granted	1	16,7
On accrual of the benefit received in exchange	2	33,3
Do not know	3	50,0
	6	100

Based on the above table, it is evident that 3 (50%) respondents do not know when the time of accrual of the taxable benefit should be. 1 (16.7%) respondent is of the opinion that the time of accrual of the taxable benefit should be the time at which the loan is granted whereas 2 (33.3%) respondents consider the time of accrual to be the time at which the benefit received in exchange for the loan is received.

Table 18: Nature of a taxable benefit

	Respondents	
	Nr	%
Follows the nature of the supply i.e. whether a capital asset or stock is sold	2	33,3
Definitely revenue	1	16,7
Definitely capital	1	16,7
Do not know	2	33,3
	6	100

The above table indicates that 2 (33.3%) respondents consider the nature of the benefit to follow the nature of the supply, i.e. whether a capital asset or stock is disposed of. 1 (16.7%) respondent is of the opinion that the benefit is definitely revenue in nature and 1 (16.7%) respondent is of the opinion that the benefit is definitely of a capital nature. 2 (33.3%) respondents do not know how to determine the nature of the taxable benefit.

4.4 CONCLUSION

The data obtained from the questionnaires has been analysed. The findings and conclusions are contained in chapter 5.

CHAPTER 5 CONCLUSION AND RECOMMENDATIONS

5.1 INTRODUCTION

The SCA ruling in the Brummeria case caused various reactions among tax professionals. The researcher hypothesised that there is a lack of knowledge among audit firms with regards to the Brummeria case and that small audit firms are more likely to experience a lack of knowledge in comparison to larger audit firms. Chapter 4 analysed and set out the results obtained from the questionnaires distributed to a sample of audit firms in the Pretoria area. Based on the data analysis and the information obtained during the literature review, conclusions are drawn with regards to the knowledge and application of the principles arising from the Brummeria case among audit firms in the Pretoria area.

The conclusions are drawn in accordance with the research objectives set out in chapter 1 (p 1), namely:

- the facts and principles of the Brummeria case,
- the audit firms' awareness and correct application of the principles of the Brummeria case,
- a comparison of the awareness and application of the principles of the Brummeria case between small, medium and large audit firms,
- the methods used to determine the value, nature and timing of a taxable benefit.

5.2 CONCLUSION

5.2.1 The facts and principles of the Brummeria case

The Brummeria case involved three companies, each involved in the development of retirement villages. The companies entered into contracts with prospective occupants of the retirement village units, whereby the company obtained an interest-free loan from the

prospective occupant, which the company used to finance the construction of a particular unit within the retirement village. In exchange for the provision of the loan, the prospective occupant was given a right of life-long occupation of the particular unit (refer section 2.2, p 9).

SARS issued revised assessments on each of the companies, which included an amount considered to be the value of the right of the company to make use of the money interest-free. SARS determined the value of the benefit by applying a weighted-average prime rate to the average value of the loan for each year. The inclusion of this amount in the revised assessments was objected to by the companies. The matter was referred to the Gauteng Tax Court which ruled in favour of the companies. SARS appealed to the SCA (refer section 2.2, p 10).

During the hearing of the case by the SCA, the valuation; nature and timing of the taxable benefit was not argued and ruled upon as these matters were not included in the original grounds of appeal submitted. The SCA ruled that The benefit was deemed to be taxable as the words “amount” and “accrued to” in the gross income definition in section 1 of the Income Tax Act, includes not only income actually received but also rights of a non-capital nature which have accrued to the taxpayer and are capable of being valued in money. The SCA determined that the right to use the borrowed money interest free had a monetary value and therefore should be included in the gross income of the companies (refer section 2.5, p 16).

It is important to note that it is not the whole loan amount that is sought to be taxed, but merely the amount of the benefit enjoyed by the loan recipient by not having to pay interest on the loan (refer section 2.2, p 12). The SCA decision cannot be appealed and can be applied retrospectively for at least three years for all taxpayers (refer section 2.5, p 16).

The facts of the *Brummeria* case are quite specific. The principles arising from the SCA ruling in this case may only be applied in future in the existence of a *quid pro quo*, a situation where one form of goods or services is exchanged for another. The ruling is therefore not applicable to all interest-free loans, nor is it necessarily limited only to loans (refer section 2.10, p 25).

5.2.2 Knowledge and application of the principles of the Brummeria case by audit firms

5.2.2.1 The audit firm

All the audit firms participating in the research do in fact advise clients with regards to tax matters (refer table 2 p 39). Most of these audit firms, namely 8 (72.7%) have a designated tax professional within the firm, who primarily deals with or oversees the tax matters of the clients of the firm (refer table 3 p 39). Only 3 of the 8 audit firms (37.5%) have a designated tax professional who has a masters degree in tax (refer table 4 p 40), based on this it appears that audit firms are entrusting potentially high level tax issues to persons without a tax specific degree. This may lead to misinterpretations of legislation, rulings and potential tax risks and result in the incorrect treatment of tax issues and incorrect advice being given to clients. The three audit firms that do not have a tax specialist within the firm refer high level tax issues to external consultants, partners at the head office branch or the senior partner of the firm.

5.2.2.2 Awareness of court ruling in the Brummeria case

6 (54.5%) of the 11 respondents are aware of the Brummeria case (refer table 5 p 41). The majority of these respondents became aware of the Brummeria case through television, radio, newspapers and industry publications. Only 1 (16.7%) respondent became aware of the Brummeria case through own research (refer table 6 p 42). From this it appears that most of the respondents became aware of the Brummeria case coincidentally rather than through a proactive effort, this has a potential risk that the tax professional within the audit firm will not be aware of all the most recent tax changes and applicable court rulings. This may also lead to tax risks not being identified timeously and incorrect advice and treatment of clients' tax affairs.

The converse is also true. The research indicates that almost 50% of audit firms that are providing tax advice to clients, are unaware of a recent development in the tax industry which has a potentially large influence on the treatment and advice given to clients in respect of tax matters (refer table 5, p 41).

5.2.2.3 Reaction within the audit firm

Tax professionals have differing views and concerns with regards to the ruling of the SCA in the Brummeria case. Concerns are raised that a long standing business principle, that interest-free loans have no adverse tax consequences has been undone and that it is completely separated from commercial reality. Tax professionals are also concerned that the principles of the case will be incorrectly applied by SARS and will result in a number of incorrect revised assessments being issued. Tax professionals realise that the future application of the ruling in the Brummeria case may have harsh consequences, should all interest-free loans be taxed (refer section 2.6, p 17).

Other tax professionals correctly consider the ruling of the SCA to be reasonable, as it is not applicable to all interest-free loans. Their concerns are with regards to the nature, timing and valuation of the benefit which appears to be exorbitant and was not ruled on by the SCA. The facts of each case must be considered individually to ascertain whether the principles arising from the Brummeria case are applicable (refer section 2.6, p 17)

The audit firms in the sample also had various reactions to the SCA ruling. 1 (16.7%) respondent does not recall what reaction the ruling of the SCA caused within the audit firm (refer table 7, p 42). As the respondent could not recall what reaction the SCA decision caused within the firm, it is evident that there was not a very pronounced reaction by the firm. The remaining 5 (83.3%) audit firms appear to have reacted appropriately to the SCA ruling. The audit firms analysed the facts of the case, informed the staff of the application and implications of the case and determined whether any of the clients of the firm were at risk of a taxable benefit arising due to the existence of circumstances similar to the Brummeria case (refer table 7, p 42).

5.2.2.4 Concurrence with and contentious nature of the court ruling

As discussed above in section 5.2.2.3 tax professionals have differing views and concerns with regards to the SCA ruling in the Brummeria case. Some of the tax professionals consulted during the literature review are of the opinion that the SCA ruling is accurate and is only applicable in specific circumstances, while others consider the ruling to be absurd

as they consider the ruling to be applicable to all interest-free loans (refer section 2.6, p 17).

When asked about their concurrence with the court ruling, only 3 (50%) of the respondents were able to answer the question. All 3 respondents agree with the ruling of the court, although for different reasons. 2 (33.3%) of the 3 respondents that did not provide an answer indicated that this was due to company policy (refer table 8, p 43). The response rate for this question is not sufficient to draw a certain conclusion as to the concurrence of audit firms with the ruling of the court for the population as a whole.

With regards to the contentious nature of the ruling, 3 (50%) respondents consider the ruling to be largely misunderstood and not to be as controversial as was portrayed in the media. The circumstances of the case are quite specific and can only be applied in future to cases with similar circumstances (refer table 9, p 44). Based on this it appears that at least half of the audit firms in the population do not consider the SCA ruling to be as controversial as was originally thought.

5.2.2.5 Application of the ruling

The principles arising from the court ruling in the *Brummeria* case, its *ratio decidendi*, can only be applied in future to cases with similar circumstances, where a *quid pro quo* exists. The ruling is not applicable to all interest-free loans and is not necessarily limited to loans (refer section 2.10, p 25).

The majority of the respondents, namely 4 (66.6%), correctly consider the ruling to be applicable in the future to cases where an interest-free loan is given as compensation for goods or services, or where the facts and circumstances are similar to that of the *Brummeria* case (refer table 10, p 44). From the above it appears that the majority of audit firms are aware of the correct application of the ruling of the SCA in the *Brummeria* case.

5.2.2.6 The meaning of *quid pro quo*

Quid pro quo is a legal term meaning “something for something” (refer section 1.7, p 6). This is a technical term which was included in the questionnaire in order to establish the level of technical knowledge among the audit firms.

Only 2 (33.3%) respondents answered correctly (refer table 11, p 45). It appears that the tax professionals within the audit firms do not, in general terms, have a high level of technical knowledge. This could result in misinterpretation of the law and rulings and cause incorrect advice or treatment of client’s affairs.

5.2.2.7 Application of the principles of the Brummeria case by audit firms

4 (66.7%) of the 6 audit firms indicated that they have not received queries from clients with regards to the Brummeria case (refer table 12, p 46). The 2 (33.3%) audit firms that have in fact received queries from clients, reacted by evaluating the applicability of the case based on the specific circumstances of each case and the specific application of the case was explained to the clients (refer table 12, p 46).

4 (66.7%) audit firms consider it necessary to take into account the possible implications of the Brummeria case when advising clients with regards to tax matters (refer table 13, p 46). The audit firms gave various reasons for this, ranging from the need to consider all case law when advising clients, to the fact that many firms make use of interest-free loans between companies. 1 (16.7%) audit firm considered it necessary to make clients aware of the circumstances of the case and the potential risks arising there from. 5 (83.3%) of the audit firms are of the opinion that they do not have clients which are exposed to a tax risk as a results of the Brummeria case (refer table 14, p 47).

From the above, it appears that although not many audit firms have received queries from clients and do not consider any of their current clients to be exposed to a tax risk as a result of the Brummeria case. The audit firms are aware of the case and its potential risks and do take these potential risks into account when advising clients.

5.2.2.8 The risk of double taxation

While providing the reasoning behind the court ruling, judge Cloete stated that there is not a risk of double taxation occurring, as should the money be invested instead of being lent, there will be two separate and distinct receipts and accruals (refer section 2.4, p 15). Williams disagrees and is of the opinion that there is in fact a risk of double taxation occurring, as there is an inequality in taxing the recipient and the lender (refer section 2.6, p 20). The recipient, had the loan been an interest-bearing loan, would deduct interest paid in the calculation of taxable income for the year, as there is not a tax deductible interest amount the tax paid by the recipient for the year is higher. The lender is then also taxed on a deemed amount due to the benefit of receiving an interest-free loan. SARS is therefore receiving a combined higher amount of tax from both taxpayers, than would have been the case had the loan been interest-bearing. A representative of SARS stated that SARS has not considered the ruling in this regard, but if the impact is severe or harsh SARS will consider having the practice or law amended (refer section 2.6, p 20).

3 (50%) respondents consider a risk of double tax to exist and 3 (50%) do not consider a risk to exist (refer table 15, p 48). One of the reasons provided as an indication that a double tax risk may exist, is that the deductibility of expenses or notional expenses was not considered. Some of the reasons provided in support of a double tax risk not occurring are that the ruling has now closed a loophole in the law and that in the case of double taxation occurring, an objection can be made to SARS in this regard.

Based on the above a definite conclusion cannot be drawn as to the risk of double taxation occurring. It is however evident that SARS may be approached for relief should the impact be severe.

5.2.3 Comparison between small, medium and large audit firms

It was the intention of the researcher to draw a comparison between small, medium and large audit firms in order to determine whether the lack of knowledge with regards to the Brummeria case is more apparent in smaller, rather than larger audit firms. A sample of 5

each was selected from small, medium and large audit firms in the Pretoria area (refer section 3.3.5, p 31).

From the 5 small audit firms selected, only 4 responded to the questionnaire. 2 (50%) audit firms are aware of the Brummeria case and 2 (50%) audit firms are not. From the 5 medium audit firms selected also only 4 responded to the questionnaire. 2 (50%) audit firms are aware of the Brummeria case and 2 (50%) are not. From the 5 large audit firms selected, only 3 responded to the questionnaire. 2 (66.7%) audit firms are aware of the Brummeria case and 1 (33.3%) is not (refer table 5, p 41).

From the above there is no apparent difference between small, medium and large audit firms with regards to the knowledge of the Brummeria case.

5.2.4 Valuation, nature and timing of a taxable benefit

The SCA did not make a ruling with regards to the valuation, nature or timing of the accrual of the taxable benefit, due to the fact that these issues were not included in the original grounds of objection and therefore could not be considered by the court on appeal in terms of rule 12 of the tax rules (refer section 2.2, p 12).

5.2.4.1 The valuation of the benefit

Olivier considers the court to have valued the benefit incorrectly. The court assumed that should interest have been charged, it would have been charged at prime rate and the court should not have valued the deemed interest but rather the right of occupation. Heydenrych suggests that a present value of the future income streams should have been used as a basis for determining the value of the taxable benefit and that a deduction of a proportional amount of the development costs should have been considered for the developer, as the providing of a life right to a unit is a part disposal of the property (refer section 2.7, p 22).

As the valuation method applied was not ruled on by the court, there is no prescribed method to be used. The audit firms in the sample were asked to suggest a method to be used in determining the valuation of a taxable benefit. 2 (33.3%) audit firms did not know

what method should be used to determine the value of a taxable benefit. The other audit firms provided the following suggestions (refer table 16, p 49):

- calculate the present value of the interest-free loan
- use prime rate to determine the interest that should have been paid
- use the market value of the loan (the respondent did not indicate how the market value should be determined)
- use the cost price or original value of the loan.

5.2.4.2 The nature of the benefit

Olivier states that not all interest-free loans will result in a taxable benefit that is of a revenue nature, a loan may also be of a capital nature and therefore be excluded from the gross income definition in section 1 of the Income Tax Act. The facts of each case should be carefully considered. Erasmus agrees and states that companies will have difficulty in arguing that an amount is of a capital nature, if the benefit is received in exchange for the rendering of a service in carrying on a trade. The usual related company loan does not have a *quid pro quo* and will therefore be of a capital nature, similarly most family trusts have received interest-free loans not as consideration for something, but as a loan granted on favourable terms by the founder. In order to determine the capital or revenue nature of a benefit Strydom suggests using the analogy of a tree and its fruit as was established in the case of CIR v Visser (refer section 2.7, p 23).

Only 2 (33.3%) of the 6 audit firms correctly considered the nature (revenue or capital) of the benefit to follow the nature of the supply, i.e. whether a capital asset or stock is disposed of (refer table 18, p 50). This may lead to the incorrect taxing of deemed benefits by the audit firms.

5.2.4.3 The timing of the accrual of the benefit

In terms of the ruling made in the case of SIR v Silverglen (30 SATC 199), SARS does not have a choice as to when to tax an amount, but is forced to tax an amount at the time of the earlier of receipt or accrual of a taxable amount. Oliver is of the opinion that the time of

accrual of the taxable benefit in the Brummeria case, is the year in which the interest-free loan is granted (refer section 2.7, p 22). In the Brummeria case the benefit was annualised and taxed on an annual basis (refer section 2.2, p 10).

Most of the audit firms, namely 3 (50%) did not know what the correct timing of the taxing of the benefit should be. 1 (16.7%) audit firm considered the time of accrual to be the time at which the loan is granted, while 2 (33.3%) audit firms considered the time of accrual to occur when the actual benefit is received in exchange for the loan (refer table 17, p 50). As half the audit firms in the sample did not know when the amount should be taxed, this could also lead to the incorrect declaration of potential tax benefits by the audit firms, this may in turn lead to interest and penalties being levied on the clients' taxes.

5.3 RECOMMENDATIONS

During the course of the research it was identified that a lack of knowledge among audit firms does in fact exist. The researcher recommends future research in order to determine:

- whether there is a similar lack of knowledge among audit firms throughout Gauteng and the rest of South Africa.
- whether there is a similar lack of knowledge among companies other than audit firms.
- the extent of such a lack of knowledge.
- whether there is a more apparent lack of knowledge among smaller rather than larger audit firms should the research be conducted a larger sample.

5.4 CONCLUSION

The facts of the Brummeria case are very specific and the principles arising from the ruling will only be able to be applied, in the future, in cases where a *quid pro quo* exists, in other words where a form of goods or services is exchanged for another.

A lack of knowledge does in fact exist among audit firms in the Pretoria area. A meaningful comparison could however not be drawn between small, medium and large audit firms. The audit firms that are aware of the Brummeria case, while not having a high technical knowledge, appear to understand the principles and specific application of the principles of the Brummeria case and how to correctly apply these in practice.

The valuation, nature and timing of the taxable benefit was not ruled on by the SCA. There are various opinions among tax professionals as to the application of these three principles. There is no prescribed method to be used, which may result in the incorrect treatment of taxable benefits.

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APPENDIX A
- Approval of draft research proposal by University -



DATE 3 NOVEMBER 2008

**FACULTY OF ECONOMIC AND
MANAGEMENT SCIENCES
DEPARTMENT OF TAXATION**

Dear Ms Abraham
Ref.: **98003102**

Your draft research proposal has been approved in principle by the research committee of the Department of Taxation. You may now continue with your research together with you allocated supervisor.

The supervisor allocated to you is:

- Name: **Mr Gert Meiring**
- E-mail: [REDACTED]
- Tel: [REDACTED]

NB Please take note of the following instructions:

The draft proposal was evaluated for EBW801 purposes and the mark that you received for that is no indication that the document is finalized and acceptable.

1. You must **finalize your draft research proposal together with your supervisor before you start** your research. Please contact your study leader for further arrangements in this regard.
2. You must complete the **ethical clearance form**, get it **signed by your supervisor** and return the document to Hettie Terblanche (hettie.terblanche@up.ac.za) **before you start doing your research**. Your research will not be accepted if the University does not have a signed ethical clearance form signed and dated at the start of your research.
3. The target date for the submission of your ring-bound copy of your essay is **30 April 2009**. You are welcome to submit your final ring bound copy any time before this date, however if your date of submission is after 30 December 2008, you will have to register for BEL 897 in 2009 as well. Please ensure that you have registered for BEL 897 for 2008. On that date your final ring-bound copy together with the report from your supervisor and a MS Word copy of your essay must be submitted at the Department of Taxation.
4. Attached are also other important documents that you must read and apply in your research. These documents will assist both you and your supervisor in the research process. NB You please sign the attach declaration for plagiarism and the signed document must be included in the ring-bound copy of your essay.
5. Please note that all submissions will be reviewed for plagiarism by means of the Turnitin software. It is your responsibility to ensure that you comply with the policy on plagiarism. Refer to www.ais.up.ac.za/plagarism/students.htm

Good luck and enjoy your research.

Kind regards

Theuns Steyn
Programme Leader
MCom (Taxation)

APPENDIX B
- Questionnaire sent to audit firms -



THE BRUMMERIA RENAISSANCE CASE AND INTEREST-FREE LOANS QUESTIONNAIRE

AUDIT FIRM

e-mail address

28 November 2008

Dear Contact person,

This questionnaire is part of a research project to investigate the level of knowledge among audit firms in respect of the Brummeria Renaissance case and the accuracy of the application of the principles arising from the Brummeria Renaissance case in practice. Please answer the questions as completely and honestly as possible. **Your responses will be treated in the strictest confidence.** No information will be reported to SARS or to any other third party.

The questionnaire should take you about 15 minutes to complete. Please answer the questions in the spaces provided. If you wish to add further comments, please feel free to do so.

The findings from your questionnaire and others will be used as the main data set for my dissertation for my Masters degree in Taxation at the University of Pretoria.

Please return the completed questionnaire to me, Clare Abraham, by e-mail [REDACTED] on or before 12 December 2008. If you have any queries or would like further information, please feel free to contact me on [REDACTED].

Thanking you for your assistance in this regard.

Miss Clare Abraham

S	M	L
---	---	---

Firm name: _____

For official use

Participant name: _____

Participant position: _____

THE FIRM

1. Does the firm advise clients in respect of tax issues?

YES	NO
-----	----

2. Is there a tax specialist in the firm?

YES	NO
-----	----

Qualification: _____

If not, what procedure is followed when high level tax issues arise?

THE BRUMMERIA RENAISSANCE CASE

3. Are you aware of the court ruling with respect to interest-free loans in the Brummeria Renaissance case?

YES	NO
-----	----

IF NO, questionnaire ends here.

IF YES, please continue with questions 4 to 14

4. How did you become aware of the Brummeria Renaissance case?

5. When the ruling of the Supreme Court of Appeal was made in the Brummeria Renaissance, how did the firm react to the ruling?

6. Do you agree with the ruling of the court?

YES	NO
-----	----

Please motivate

7. Do you consider the ruling to be as controversial as has been portrayed in the media?

YES	NO
-----	----

Please motivate

8. Under what circumstances do you consider the ruling to be applicable?

9. What do you understand by the term *quid pro quo*

APPLICATION OF THE PRINCIPLES ARISING FROM THE BRUMMERIA RENAISSANCE CASE

10. Have you received queries from clients regarding the Brummeria case?

YES	NO
-----	----

What action has been taken by your firm in this regard?

11. Do you consider the ruling in the Brummeria Renaissance case when advising clients?

YES	NO
-----	----

Please motivate

12. Does this firm have clients that are exposed to a potential tax risk as a result of the Brummeria case?

YES	NO
-----	----

What action has been taken by the firm in this regard?

13. Do you think this ruling will result in double tax?

YES	NO
-----	----

Please motivate

14. The valuation, timing and nature (capital or revenue) of the interest-free loan was not ruled on by the court.

What method would you use to determine the valuation, timing and nature of an identified benefit?

VALUATION -

TIMING -

NATURE -

APPENDIX C
- Informed consent form sent to audit firms -



Informed consent for participation in an academic research study

Dept. of Taxation

An investigation of the understanding and application of the principles of the Brummeria Renaissance case

Research conducted by:

Miss C. R. Abraham

Cell: [REDACTED]

Dear Respondent

You are invited to participate in an academic research study conducted by Clare Abraham, a Masters student from the Department of Taxation at the University of Pretoria.

The purpose of the study is to investigate whether audit firms in the Pretoria area are aware of the Supreme Court of Appeal decision in the Brummeria case and to determine whether the principles and potential tax risks of the Brummeria case are considered and correctly applied, in providing advice to their clients. The study will also determine whether the size of the audit firm, has an influence on the level of awareness of the Brummeria case.

Please note the following:

- This study involves a questionnaire survey. The answers you give will be treated as strictly confidential.
- Your participation in this study is very important to me. You may, however, choose not to participate and you may also stop participating at any time without any negative consequences.
- Please answer the questions in the attached questionnaire as completely and honestly as possible. This should not take more than 15 minutes of your time
- The results of the study will be used for academic purposes only and may be published in an academic journal. I will provide you with a summary of our findings on request.
- Please contact my supervisor, Gert Meiring ([REDACTED]) if you have any questions or comments regarding the study.

Please sign the form to indicate that:

- You have read and understand the information provided above.
- You give your consent to participate in the study on a voluntary basis.

Respondent's signature

Date

APPENDIX D
- Plagiarism declaration -



FACULTY OF ECONOMIC AND MANAGEMENT SCIENCES

Declaration Regarding Plagiarism

The Faculty of Economic and Management Sciences emphasises integrity and ethical behaviour with regard to the preparation of all written assignments.

Although the lecturer will provide you with information regarding reference techniques, as well as ways to avoid plagiarism, you also have a responsibility to fulfil in this regard. Should you at any time feel unsure about the requirements, you must consult the lecturer concerned before submitting an assignment.

You are guilty of plagiarism when you extract information from a book, article, web page or any other information source without acknowledging the source and pretend that it is your own work. This does not only apply to cases where you quote the source directly, but also when you present someone else's work in a somewhat amended (paraphrased) format or when you use someone else's arguments or ideas without the necessary acknowledgement. You are also guilty of plagiarism if you copy and paste information directly from an electronic source (e.g., a web site, e-mail message, electronic journal article, or CD-ROM) without paraphrasing it or placing it in quotation marks, even if you acknowledge the source.

You are not allowed to submit another student's previous work as your own. You are furthermore not allowed to let anyone copy or use your work with the intention of presenting it as his/her own.

Students who are guilty of plagiarism will forfeit all credits for the work concerned. In addition, the matter will be referred to the Committee for Discipline (Students) for a ruling. Plagiarism is considered a serious violation of the University's regulations and may lead to your suspension from the University. The University's policy regarding plagiarism is available on the Internet at <http://www.library.up.ac.za/plagiarism/index.htm>.

For the period that you are a student in the Faculty of Economic and Management Sciences, the following declaration must accompany all written work that is submitted for evaluation. No written work will be accepted unless the declaration has been completed and is included in the particular assignment.

I (full names & surname):	Clare Rhian Abraham
Student number:	98003102

Declare the following:

1. I understand what plagiarism entails and am aware of the University's policy in this regard.
2. I declare that this assignment is my own, original work. Where someone else's work was used (whether from a printed source, the Internet or any other source) due acknowledgement was given and reference was made according to departmental requirements.
3. I did not copy and paste any information directly from an electronic source (e.g., a web page, electronic journal article or CD ROM) into this document.
4. I did not make use of another student's previous work and submitted it as my own.
5. I did not allow and will not allow anyone to copy my work with the intention of presenting it as his/her own work.

Clare Rhian Abraham

15 April 2009

Signature

Date