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Our Ref.: PHG/bobrof

16 December 2023

FOR ATTENTION: MR. D. BOSHOFF AND MS. H ANDREW
- ILLICIT ECONOMY UNIT

SA Revenue Service
Riverwalk Office Park
Block A, First Floor
41 Matroosberg Street
Ashlea Gardens, Menlo Park
Pretoria

Dear Sir/ Madam

Re: Ms. LB Bobroff (Reference No. 1250/088/14/1) "The Taxpayer"
Section 107(1) Notice of Appeal Against Additional Disallowed Notice of Objection to 2013-2017 Additional Tax Assessments

We refer to your letter dated 28 November 2023 in which you have entirely disallowed the taxpayer's Notice of Objection dated 22 August 2022.

In terms of section 107(1) of the Tax Administration Act we hereby Appeal against the decision to disallow the Notice of Objection on the following grounds:

A. POINTS RAISED IN NOTICE OF OBJECTION DATED 22 AUGUST 2022.

1. **Foreign interest income earned on Bank Leumi-R46,731.34(2013; R58,559.72(2014); R41,672.56(2015) and 105,882.55(2016):** We refer to points 88.3-88.4 and 89 of the SARS Letter of Assessment dated 8 July 2022, in which the following is stated:

   *"**88.3** The taxpayer makes the submission that there was no attempt to deliberately omit her Israeli income from her income tax returns but did so on the advice of her tax practitioner. The taxpayer has not been able to determine, through her Israeli legal representatives, whether Bank Leumi deducted 25% withholding tax from her interest income upon remittance to her Australian accounts.*

   ***88.4** The taxpayer suggests **Article 23(1)(b) of the Double Taxation Agreement between South Africa and Israel** to be applicable and that a notional 25% tax credit be allowed on the assumption that the taxpayer cannot prove a 25% withholding tax by Bank Leumi.*

   ***89.** After considering the taxpayer's representations, SARS has concluded that the interest received by the taxpayer on her foreign account from Bank Leumi, Israel be included in her taxable income in the 2013 to 2016 years of assessment."*

We have since established that Bank Leumi did not deduct 25% withholding tax and we agree with your conclusion that the foreign interest in the amount of R46,731.34 should be included as taxable income in her 2013 Income Tax Return.
However, we are still of the opinion that the provisions of paragraph 1.(b) of Article 23 of the Double Taxation Agreement between South Africa and Israel are applicable. The subparagraph states:

"If Israeli tax on dividends or interest has been wholly or partly relieved for a period of time under provisions of Israeli tax law which are certified by the competent authority of Israel to be for the encouragement of the Israeli economy, the amount to be allowed as a credit against the South African tax on such income shall be an amount of tax which would have been imposed by Israel if no such relief or reduction had been granted…"

Lior Pick,Adv. (C.P.A. (Isr.)) states in his essay: Tax Exemption for Foreign Resident Deposits" that:

"As of January 1, 2003, foreign residents will be liable to tax in Israel provided that they have income derived and/or accrued in Israel. Paragraph 4A of the Ordinance contains rules of origin list, according to which the income of interest is accrued in Israel if the payer is located in Israel. In other words, the interest income in the hands of non-resident from a corporation located for the fiscal purposes in Israel will be taxed in Israel.
On the other hand, since the State of Israel, similarly to other states, is willing to attract foreign investments to Israel, for years interest income of foreign residents accrued from bank deposits was exempted from income tax. According to Income Tax Order (Tax Exemption of Foreign Residents' Deposit) of 1981, which has replaced the Order of 1961, the interest income which are paid by the state or by the authorized dealer (based on the definition in the Israeli Law of Foreign Currency Regulation) are exempted from income tax, provided that it is a deposit of a non-resident, who is not running a business or vocation in Israel.
Pursuant to Income Tax Order (Tax Exemption of Foreign Residents' Deposit) of 2002, the order from 1981 was revoked, and the new order stated instead that interest which is paid to the foreign resident on the basis of a deposit in foreign currency at General Accountant or by banking corporation will be exempted from taxation, provided all of the following conditions:

1. *The deposit is not registered (and its registration is not required) in the books of a Permanent Establishment in Israel and the interest income is not a business income;*
2. *Israeli residents are not partners in the deposit;*
3. *Foreign resident has declared of his foreign residency;*
4. *The deposit is not used as loan or as a guarantee for a loan from a banking corporation to a relative of foreign resident or to a body of people…"*

We believe that the purpose for the exemption from 25% withholding tax on interest income from foreign currency accounts in Israel, is to attract foreign currency into Israel and thus stimulate the Israeli economy. In other words, the exemption is in place for the encouragement of the Israeli economy.
SARS should therefore allow a notional credit for the 25% withholding tax which would have been imposed if it was not for the provisions of Income Tax Order (Tax Exemption of Foreign Residents') of 2002, as provided for in paragraph 1.(b) of Article 23 of the Double Taxation Agreement.

2. **Understatement penalty in the amount of R4,075.00 imposed in terms of section 222 read with section 223 of the Tax Administration Act:** In point 111.3 of Part K of the Letter of Assessment, SARS states:

   "Despite submitting her income tax returns for the 2014 to 2016 years of assessment, the taxpayer failed to declare her foreign interest received. Although the taxpayer may have been advised that she was not required to declare this interest, she still had an obligation to disclose the receipt of this income in her tax returns, albeit that she considered it not taxable.".

   Point 90.5 of the letter states:

   "The taxpayer's income tax returns for the 2014 to 2016 years of assessment were submitted to SARS on 13 August 2018. The e-mail of Mr. Kaplan that the taxpayer referred to was allegedly dated 22 August 2018,

after the income tax returns had been submitted. A copy of this e-mail has not been attached to the taxpayer's representations. It is therefore not clear in what context this e-mail was addressed by Mr. Kaplan to the taxpayer's husband."

We herewith attach a copy of the e-mail dated 22 August 2018 from Darren Bobroff, the taxpayer's husband, to Shayne Kaplan of Andrew Fischer and Associates, in which he asks whether the foreign interest has been included in the income tax returns. We also attach Mr. Kaplan's response of the same date in which he states that, since Lisa lived in South Africa and not Israel, the interest received from her Israeli banking account will not be part of her South Africa tax return.
Andrew Fischer, a highly experienced accountant, expressed his opinion through his senior assistant, Shayne Kaplan who made it clear that such interest was not declarable in the taxpayer's income tax return.
Neither the taxpayer nor her husband is acquainted with South African and international tax laws and they must rely on professional guidance provided by qualified tax practitioners. Accordingly, the taxpayer did not willfully contravene the provisions of the Income Tax Act.
For the above reasons we stated in the reply to the letter findings that the most appropriate behaviour should be: "reasonable care not taken in completing return."

B. RESPONSE TO REASONS PROVIDED BY SARS FOR DISALLOWANCE OF NOTICE OF OBJECTION IN LETTER DATED 28 NOVEMBER 2023.

1. Basis for disallowance of Objection (per SARS Letter):

*36. The taxpayer submits that SARS should allow a notional income tax credit of 25% of the foreign interest earned by the taxpayer in terms of **paragraph 1(b)** of **Article 23** of the DTA which provides as follows:*
"if Israeli tax on dividends or interest has been wholly or partly relieved for a period of time under provisions of Israeli tax law which are certified by the competent authority of Israel to be for the encouragement of the Israeli economy, the amount to be allowed as a tax credit against the South African tax on such income shall be an amount of tax which would have been imposed by Israel if no such relief or reduction had been granted…"
*37. The taxpayer also attached an article titled "Tax Exemption for Foreign Resident Deposits" in support of the submissions made. According to this article, pursuant to the **Income Tax Order (Tax Exemption for Foreign Residents' Deposit) of 2002** interest which is paid to a foreign resident on the basis of a deposit in foreign currency by a banking corporation will be exempted from taxation provided inter alia if the foreign resident has declared its foreign residency.*
38. The further document provided by the taxpayer in support of its submissions is an information sheet of Bank Mercantile of Israel (and not Bank Leumi where the deposit was held). This information sheet advises clients that in the case of non-residents of Israel that interest received is exempt from income tax withholding with a declaration (that the client is a non-resident of Israel).
*39. **Article 11** of the DTA provides that interest arising in a Contracting State and paid to a resident of the other contracting state may be taxed in that other Contracting State, i.e., South Africa), but the tax so charged shall not exceed 25% of the gross amount of the interest. Therefore, the income tax levied in South Africa on the foreign income assessed is limited to an effective tax rate of 25%.*
40. The taxpayer has confirmed in its objection letter that Bank Leumi did not deduct 25% withholding tax on the interest earned by the taxpayer.
*41.The taxpayer has provided no evidence that the interest has" been wholly or partly relieved for a period of time under provisions of Israeli tax law which are certified by the competent authority of Israel to be for the encouragement of the Israeli economy" as provided for in **paragraph 1(b) of Article 23** of the DTA.*
*42.**Section 6 quat** of the IT Act provides for a rebate in respect of foreign taxes on income where the taxable income of any resident from any source outside the Republic.**Section6quat (1A)** provides that the rebate shall be an amount equal to the sum of any taxes on income proved to be payable to any sphere of government of any country other than the Republic, without any right of recovery by any person.*
*43. **Section 6 quat** of the Income Tax Act does not provide for a notional tax credit as submitted by the taxpayer, but rather allows a rebate on taxes on income proved to be payable to any sphere of government of any country other than the Republic on any income received by or accrued to such resident from any source outside the Republic.*
44.The taxpayer has admitted in its objection letter that no withholding tax was deducted by Bank Leumi, therefore no taxes have been proved to be payable to any sphere of government of Israel.

45. The income tax levied on the foreign interest in the assessments issued for 2014 to 2016 years of assessment does not exceed 25% of the foreign interest earned accrued to the taxpayer.
46. This ground of objection is disallowed.

C. FURTHER INFORMATION IN SUPPORT OF ARGUMENTS RAISED IN NOTICE OF OBJECTION, DISPUTING GROUNDS RAISED BY SARS IN DISALLOWANCE OF NOTICE OF OBJECTION.

1. We herewith attach an extract from: "The Explanatory Notes for the 169 amendment to the Israeli Income Tax Ordinance regarding the exemption granted for foreign residents which is in Hebrew. The English translation of an excerpt states as follows:
   "This bill proposes several amendments to the Income Tax Ordinance (hereinafter- the Ordinance), aimed at assisting the Israeli economy, similar to other markets around the world, in crisis. The assistance, in accordance with the proposal, is provided by way of providing incentives to bring funds from abroad to Israel – providing tax incentives to nonresidents to invest in Israel (through tax exemption on interest paid on traded bonds and capital gains from the sale of securities of Israeli companies) and reducing the tax on dividends received by an Israeli resident company from a foreign resident company".
2. We further quote ad verbatim Paragraph 3.3- **Tax Sparing** - from the book: **International Tax- A South African Perspective** by Lynette Olivier (a former Professor of Taxation at the University of Johannesburg, tax consultant with Price Waterhouse-Coopers and former CEO of SARS Service Monitoring Office) and Michael Honiball (Head of Werksmans Tax Practice and formerly a tax director at KPMG (Pty) Ltd.
   "Tax sparing, sometimes referred to as a tax sparing credit, is the allowance of a credit under a tax treaty by a residence-based Contracting State for hypothetical or notional foreign taxes paid to the other Contracting State.
   Tax sparing is linked to the granting of tax incentives to foreign investors, particularly in regard to the promotion of economic development in the source state. Where the state of residence of the foreign investor applies the credit method of preventing international double taxation, the benefit of any foreign investment incentive granted by the state of source will be reduced to the extent that a credit is only granted for tax actually paid in the State of source. Similarly, where the residence State applies the exemption method but subjects the application of that method to a certain level of taxation in the state of source (like the designate country exemption which was contained in s 9D), the granting of the foreign investment tax incentive will have the effect of denying the investor the application of the exemption method (para 72 of the OECD Commentary on arts 23A and 23B).Generally however, tax sparing provisions are irrelevant when the resident state grants a tax exemption, as opposed to a tax credit (Rohatgi 2002 213).
   The extent of the tax sparing credit depends on the relevant tax treaty and could apply either to certain kinds of income, like dividends and interest or to all income arising in the source state. Tax sparing relief 'is designed to respect the source country's taxing right and prevents the incentive effect of the measure in question being negated by residence taxation of the same income (IBFD International Tax Glossary 2001 353)
   The OECD Report *Tax Sparing*: *a Reconsideration* 1998 45 contains the following example of the negative effect of the application of the credit method in the absence of a tax sparing provision:

   Example 13.3
   The tax sparing provision in the tax treaty between country X and country Y would require country X to grant a credit for the taxes that would have been paid by S on the distributed income in the absence of the incentive legislation in country Y per the example above. The tax due on the dividends in country X amounts to 20 (40% out of 50). However, A is now granted a credit of 15 (30 per cent out of 50), constituting the tax that would have been paid in country Y had S not benefitted from the incentive legislation. Because of the tax sparing provision in the treaty, A will pay only 5 in income tax in Country X on the dividends.

   As stated above, and as confirmed in para 74 of the OECD Commentary on arts 23A and 23B, tax sparing provisions may take on different forms, including the following:
   - The State of residence allows as a deduction or credit the amount of tax which the State of source could have imposed in accordance with its general legislation;

- The State of residence allows as a deduction the amount of tax as limited by the tax treaty for a specific type of income, for example the limitation of rates provided for dividends and interest in arts 10 and 11;
- The State of residence allows a deduction against its own tax of a specified amount fixed at a higher rate; or
- The State of residence exempts the income which has benefitted from tax incentives in the source state.

South Africa has stated its OECD non-member country position that it reserves the right to add tax sparing provisions in relation to the tax incentives that are provided for under its national laws. This is in contrast to the position of the US, which has a policy of not including tax sparing provisions in its tax treaties (Rohatgi 2002 213) …"

South African Double Taxation Agreements with the following countries include tax sparing clauses: Algeria (art 23(2), Botswana (art 22(2), Egypt (art 22) (2)), Greece (art 23(2), Pakistan (art 22(2)), Seychelles (art 23(21)), Thailand (art 22(3)), Tunisia (art 22(2)) and Uganda (art 23(2)).
Therefore, it is not unusual that there is a Tax Sparing clause in Article 23(1(b) of the Double Taxation Agreement between Israel and South Africa.

D. RESPONSE TO PARAGRAPHS 42 AND 43 OF SARS LETTER

Your letter states the following:

42. Section 6 Quat *of the IT Act provides for a rebate in respect of foreign taxes on income where the taxable income of any resident during a year of assessment includes any income received by or accrued to such resident from any source outside the Republic.* ***Section 6quat(1A)*** *provides that the rebate shall be an amount equal to the sum of any taxes in income proved to be payable to any sphere of government of any country other than the Republic, without any right of recovery by any person.*
43. Section 6 quat *of the Income Tax Act does not provide for a notional tax credit as submitted by the taxpayer, but rather allows a rebate on taxes on income proved to be payable any sphere of government of any country other than the Republic payable on any income received by or accrued to such resident from any source outside the Republic.*

RESPONSE

It is recognized by the OECD that the provisions of Double Taxation Agreements override domestic tax legislation.
Recognized international tax commentator, Klaus Vogel (Professor Emeritus at the University of Munich), states the following in his article: **The Domestic Law Perspective- 1.1 Tax Treaties Being Leges Speciales.**
"*Being restricted to cross-border taxation of residents of two contracting States, tax treaties are equivalent to special legislation (leges speciales) compared to the contracting states' general tax law (lex generalis). Thus, according to the old rule "Lex speciales derogate legi generali" ("special legislation overrides general legislation"), treaties override the domestic tax law that is effective at the time of their implementation …"*

E. ISSUE IN DISPUTE: UNDERSTATEMENT PENALTY

In your letter you have state that:

61. The taxpayer has not made any submissions with regard to SARS' finding that the conduct of the taxpayer displayed during the audit was of "obstructive behaviour".
We reiterate our contention that the taxpayer relied on the opinion provided by Mr. Shayne Kaplan of Fischer and Associates because she is not tax savvy. Once she had relocated to Australia, she also engaged the services of Mr. Andre Kruger, (a reputable tax practitioner) of Messrs Fluxmans Attorneys, but when it became evident that Mr. Kruger was not attending to the audit queries, she approached our firm. Her attorney Mr. Marius Du Toit and father Dr. Berman, have been continuously contacting our office to check that we are timeously attending to issues raised in the tax audit

There was no willful attempt to be obstructive.

F. REQUEST

Having considered our points raised above, we hereby request the following in this dispute:

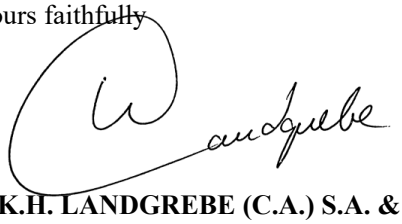
1. That the recognized practice of Tax Sparing as contained in Article 23(1)(b) of the Double Taxation Agreement between Israel and South Africa, be recognized and that the 25% notional tax credit applied to the extent of South African taxes owing on interest received from Bank Leumi. We believe that the Explanatory Notes for the 169 amendment to the Income Tax Ordinance regarding exemption granted for foreign residents, are proof that the exemption from the 25% withholding tax, introduced by Israel, was done so to incentivize foreign investment in Israel and thus benefit the Israeli economy. Therefore, the notional 25% credit should be allowed in respect of and to the extent of taxes owing in South Africa on the interest income received from Bank Leumi.
2. That the provisions of the Double Taxation Agreement between Israel and South Africa, override the provisions of section 6quat of the Income Tax Act, therefore allowing for application of Tax Sparing credits as stated in Article 23(1)(b) of the DTA.
3. Since the taxpayer is not tax savvy, she relied heavily on tax opinions provided by South African tax practitioners. Neither was there an attempt to evade tax nor to be obstructive.
4. Should SARS concede to this Appeal we request that the Additional Tax Penalties also be remitted.

G. ATTACHMENTS

1. SARS letter dated 28 November 2023.
2. Certificates from Bank Leumi proving that the interest income was exempt from withholding tax.
3. Article 23 of the Double Taxation Agreement between Israel and South Africa.
4. The Explanatory Notes for the 169 amendment to the Income Tax Ordinance regarding the exemption granted for foreign resident states.
5. Article by Klaus Vogel in regard to the fact that provisions of double taxation agreements override domestic tax legislation.

Should you have any queries please do not hesitate to contact Mr. Wolf Landgrebe of this office.

Yours faithfully



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