

THE REQUEST FROM THE AUDITORS

REQUEST PER LETTER FROM SARS

- Confirm that income received in advance was included in income.*
- A calculation in support of the s24C allowances claimed, indicating in terms of which contract the claim is made.*

REQUEST PER EMAIL FROM AUDITOR

Due to the uniqueness of the taxpayer's circumstances, the matter re S24C is regularly highlighted for verification.

The information to be submitted should be like those provided during the appeal/ADR process with a detailed explanation on how the entities contract vs revenue declaration is stated.

The purpose of this document is to answer the above questions which have come from different sources.

INTRODUCTION

The taxpayer sets out the reasons as to why they are entitled to claim the future estimated expenditure allowance in terms of s24C and Interpretation Note 78 (IN78) and vehemently believe that their claim is tax compliant.

IN78 clearly states that the claim can apply to any business type. The circumstances of the taxpayers business model are not unique as it is clearly regular in a software business that offers a licence to use and support the software and receives money in advance in order to provide the necessary services after the year end.

The method of receiving advance income by a software company that builds and maintains software helps create a sustainable business by allowing the company to build the necessary infrastructure.

The fiscus is aware that advance payments being taxable without the matching of deductible expenditure creates an anomaly and has thus created s24c to enable the taxpayer to claim the necessary deductible future estimated expenditure to meet the terms of a contract with clients in order to build the necessary infrastructure to maintain

and support the client. The matching of income with expenditure removes the anomaly.

The taxpayer submits that based on their business model that annual licence fees accrue by submitting an invoice in terms of an annual licence contract which comes into play each time the user logs into the software. The invoice is processed prior to the end of the financial year for the next year in advance and shown in the income of the financial statements as revenue received. It is this that enables the taxpayer to claim the estimated future expenditure in terms of the legislation.

It's a requirement that the taxpayer evaluates the s24C allowance each year to check for changing circumstances and calculates the amount of the claim in terms of the law.
– **IN 78.**

The s24C allowance is clearly not a deduction but a deferral of tax as it is reversed in the following year.

The business model of the taxpayer is based on a **practice that generally prevails** in the software industry where annual licence contracts are signed for the year in advance with a commitment by the taxpayer to provide new releases, for change in government specifications, support and maintenance of the software and provide deemed enhancements for the year in question. In many instances the deemed enhancements are necessitated by change in government specifications.

To be clear the taxpayer collects annual licences fees in advance which is shown in the revenue of the financial statements at 30 June 2021 and is the money to be used that will cover the necessary infrastructure so that its obligations in terms of the contract with clients can be executed.

What we do is contained in Appendix B

PRACTICE GENERALLY PREVAILING

In this explanatory document it is necessary to tie the s24C allowance claimed to IN78.

The law that is in place to be followed in s24C is fairly simple to read, contains language that everyone understands, but in practice in many instances could be difficult to apply and therefore SARS published IN78 which sets out the **practice generally prevailing**.

A **practice generally prevailing** is defined in s5 of the TAA. The TAA does not deal with the current situation that has arisen but specifies that a practice generally prevailing must be communicated by SARS in an interpretation note or a SARS policy which it does in terms of IN78.

In the case of the taxpayers business model it is an accepted practice for a licence fee to be paid in advance to the taxpayer and the taxpayer is obliged to set up the necessary infrastructure for all the obligations required to keep the software operational and up to date in terms of government specifications, to correct errors and undertake all the necessary maintenance.

The taxpayer submits that in an instant like this a normal business relationship exists with the rules in place without a written contract as IN78 indicates, but this can be taken further by having a contract in place which the taxpayer has in place.

Despite the laws and the situation that has transpired the **practice generally prevailing** is known by all parties and has been in place for many years. Please refer to **Annexure A** for s5 of the TAA and some rulings on the practice generally prevailing.

The taxpayer submits they are well within the law of s24c and comply with the facts in IN78. There is one contract in place with the taxpayers customers that amplify the rules intrinsically connecting the rules in the contract to the obligations of the taxpayer.

COURT CASES

There have also been constitutional court (cc) cases where the facts in these have been unusual in terms of s24C. The cc has ruled on why the taxpayer should be claiming or not be claiming the s24C allowance. The facts in these court cases do not compare with the taxpayers business model and should not be taken into account, nevertheless the rulings make the taxpayers claim of the s24C allowance even stronger.

The taxpayer does not believe it is necessary to canvas these rulings at this stage but will do so if the need arises.

SECTION 24C

The facts in the taxpayers situation are pretty straight forward in that advance income is a recurring event each year and the s24C allowance is claimed every year reversing in the following year.-

- A licence fee in advance is shown as Turnover in the financials, included in gross income and is taxed meeting the first requirement of s24C that there is advanced income.
- The taxpayers customer understands they are paying the licence fee in advance which is indicated on their invoice and in terms of a contract and expect new releases where government specifications have changed and where maintenance, corrections and enhancements are required.
- There is one contract between the user and the taxpayer which specifies the obligations and the rights of each party and intrinsically links the obligation of the taxpayer to provide updates where government specifications are changed, corrections are required and enhancements are deemed necessary by the taxpayer.
- The estimate for the future expenditure allowance is **less than** the advanced income as it is apportioned accordingly and is reversed in the following year as is specified in s24C (3).
- The money received in advance is to be utilized in whole or in part to finance the taxpayers obligations under the contract and in this case set up the

obligation for creating an infrastructure in order to carry out all the related services that every customer has signed up for. – IN78.

- The amounts of the future expenditure claimed are all allowable expenditure items and are eventually claimed in the income statement of the following year when they are incurred and should in no way be confused with the future estimate allowance.

EXAMINATION OF THE TAXPAYERS CONTRACT

The annual user licence has been attached for SAR's inspection.

We indicate some definitions and some terms and conditions in the contract that link the income received in advance intrinsically to the taxpayers obligations. There are a number of definitions in the agreement that are extremely important as they provide the necessary proof that the taxpayer has to build an infrastructure to meet their specified obligations.

“Accfin Infrastructure” means the infrastructure that the Company sets up at its cost to provide the necessary platform and technical support for use of the product, to provide new releases to meet with all the necessary Government System Specifications, to correct errors and make enhancements deemed necessary by the Company;

“New software Release” means the software loaded into the cloud for use by the User or on the Users server each time there is a change to meet changes to government specification and for the correction of errors as well as necessary enhancements;

“Government Systems Specifications” means all government specifications that require changes to the Sky Product;

“Initial Licence Fee” means the charge made to the User for the initial supply and licence of the Sky Product and Documentation as set out on the first page of this documentation and runs to the next end of June or as agreed with the User;

“Annual Licence Fee” means the annual charge to cover the continued use of the Sky Product and Documentation and becomes due 30 days prior to the end of the Annual licence Period;

“Annual Licence Period” means the period for which the annual licence fee entitles the Sky Product to be used

PREAMBLE TO THE AGREEMENT

This agreement sets out the basis upon which the Company licences the User to use the Sky Product and the Documentation and includes the clauses required by POPIA. Such use of the software is subject to the User's compliance with these terms and conditions and the Agreement as a whole. This agreement replaces all other agreements between the Company and the User and comes into effect the first time the User loads any of the Sky Products

The above paragraph sets up the terms of the agreement.

CLAUSE 10 THE COMPANIES OBLIGATIONS

The definitions are used in the companies obligations which intrinsically link advanced income to the companies obligations..

The company undertakes to set up the necessary adequate infrastructure in terms of employees, equipment, software and any other related costs in order to support the User and to provide the User with new releases as determined by changes in Government System Specifications, errors that are fixed and enhancements determined by the Company.

It is a condition that the company sets up a secure backup infrastructure for all Accfin Cloud users and ensures that all data is backed up to a number of cloud systems and locally on to Accfin Servers and remote drives.

The Company endeavours to keep the Sky Product up to date with all government legislative changes and Government System changes and processes that are indicated in Government System Specifications.

CALCULATION OF THE S24C CLAIM

The fees in advance and the expenditure claim are set out in the schedules attached. Various supporting documents will be included as attachments.

Lists of fees in advance

Ryyyyyyyy. This amount is included in the income statement as revenue and is revenue in advance - some of the lists have been attached.

Expenditure claimed

Rxxxxxxx. This amount is the future expenditure claimed – schedule attached. This amount will be reversed in the following year and the actual expenditure when incurred will be claimed in the income statement.

The amount added back in respect of the previous years allowance amounts to Rxxxxxx.

Sample invoices

Some sample invoices have been attached for your perusal.

CONCLUSION

The taxpayer submits that based on the above explanation that they are entitled to the future expenditure allowance in terms of the law, in terms of the practice generally prevailing and in terms of the contract with customers.

All the conditions are in place that establishes the validity of the s24C allowance.

It's imperative that SARS takes note;-

The taxpayer wishes to advise SARS that the compliance in regard to this matter is clear cut. The taxpayer does not wish to go through this every year as it is extremely costly for a smaller business and therefore undertakes to include a schedule in its future financials setting out how the claim is calculated.

APPENDIX A

TAX ADMINISTRATION ACT

5. Practice generally prevailing

(1) A practice generally prevailing is a practice set out in an official publication regarding the application or interpretation of a tax Act.

(2) Despite any provision to the contrary contained in a tax Act, a practice generally prevailing set out in an official publication, other than a binding general ruling, ceases to be a practice generally prevailing if—

(a) the provision of the tax Act that is the subject of the official publication is repealed or amended to an extent material to the practice, from the date the repeal or amendment becomes effective;

(b) a court overturns or modifies an interpretation of the tax Act which is the subject of the official publication to an extent material to the practice from the date of judgment, unless—

(i) the decision is under appeal;

(ii) the decision is fact-specific and the general interpretation upon which the official publication was based is unaffected; or

() the reference to the interpretation upon which the official publication was based was *obiter dicta*; or

(c) the official publication is withdrawn or modified by the Commissioner, from the date of the official publication of the withdrawal or modification.

(3) A binding general ruling ceases to be a practice generally prevailing in the circumstances described in section 85 or 86.

2054. Additional assessments; practice prevailing

April 2012 – Issue 151

The judgment of the Tax Court (Western Cape), in Cases No 12760, 12828 and 12756 (decided on 14 September 2011 not yet reported) is relevant for a number of reasons. One of the issues considered by the Court was whether SARS was precluded from issuing additional assessments pursuant to proviso (iii) to section 79(1) of the Income Tax Act, No 58 of 1962 (the Act). This section provides that SARS is not entitled to raise an assessment if the amount which should have been assessed to tax was (in accordance with the practice generally prevailing at the date of the assessment), not assessed to tax.

In CIR v SA Mutual Unit Trust Management Co Ltd [1990] (52 SATC 205), it was indicated that a practice generally prevailing is one that is applied generally in the different offices of SARS in the assessment of taxpayers. It is not sufficient merely to show that the practice was applied in one or two offices. The concept of "practice" has been interpreted to be "a habitual way or mode of acting". It is therefore not sufficient to show that a certain attitude had been adopted by assessors concerned only in some instances. Ultimately, a practice generally prevailing is one known to the Commissioner and authorised by him for application, and duly applied by the various assessment offices throughout the country. It was also indicated that a taxpayer must show that the failure originally to assess in a particular manner was attributable to the practice generally prevailing.

