

Judgment a tax victory for car manufacturers

 By Joon Chong

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A recent Supreme Court of Appeal (SCA) judgment in the case of *Volkswagen South Africa v SARS* has provided much needed clarity that Productive Asset Allowance (PAA) certificate amounts granted to automotive manufacturers are capital in nature as their purpose is to incentivise capital investments.



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The PAA programme was the follow on of the motor vehicle industry development programme (MIDP) intended to develop an internationally competitive and growing automotive industry in South Africa. The purpose of the PAA programme was to continue the growth and competitiveness in the automotive industry by reducing the number of models produced by the industry, as was the global trend observed in other countries. In order to rationalise the models produced in South Africa, manufacturers had to invest extensively in plant upgrades and technology enhancements to be comparable with the world's best.

The PAA certificates were issued to compensate manufacturers for a portion of the capital outlay for the new plant and machinery necessary for the rationalisation. As such, the amounts on the certificates were calculated using a formula based on the investments in the qualifying plant and machinery. The recipient could then claim a rebate of import duty for the amounts on the certificates against the importation of the rationalised range of motor vehicles.

The taxpayer had submitted its tax returns for the 2008, 2009 and 2010 years of assessment on the basis that the PAA certificates received by it of R83,651,677; R76,895,388 and R48,338,557 respectively, were capital in nature.

SARS had assessed the taxpayer on the basis that the amounts in question were revenue in nature. In disallowing the taxpayer's objection, SARS had stated that "there is no indication from the PAA Guidelines that the amount, as received, was for the purpose of establishing an income-earning structure". SARS held the view that although the formula was based on amounts invested in the qualifying plant and machinery, this was done to calculate the allowance and did not mean that the taxpayer had been compensated "for the capital outlay in respect of the plant and machinery". In expressing this view, SARS had gone against its own interpretation note (Interpretation Note 59) which provided that a government grant made towards the cost of specified capital expenditure is capital in nature as the grant is made to assist a person to meet such capital costs.

The Tax Court held that the grants were made for capital expenditure. However, as the PAA certificates would lapse if not used within the specified period as payment for customs duties on the importation of motor vehicles, the PAA certificates were conditional and did not accrue until there were imports. Thus, the certificates only had value when motor vehicles were imported. The purpose of the grants was to assist the taxpayer with revenue expenditure in the form of customs duty payable on imports. Accordingly, the grants were revenue in nature.

The SCA was of the view that the PAA certificates were to assist with the taxpayer's new investments in approved productive assets required as part of the programme to rationalise motor vehicles manufactured in South Africa and to import others. The purpose of the PAA programme is to assist taxpayers in making the required capital expenditure, as was shown in the formula used to calculate the amounts. If the incentives had been paid in cash, there would have been no doubt that they were capital in nature. Allowing a rebate against customs duties of selected imported vehicles did not change the nature of the incentives. The rebate was the programme's method of reimbursing the manufacturers for the investments in the required capital assets. The reduction in payment of customs duty was not linked to the gross income of the taxpayer, but linked to the capital investments.

It is interesting that the PAA programme, with its purpose to promote economic development and employment in the automotive industry, had been misconstrued by SARS and the Tax Court, with SARS holding views which contradicted its interpretation note. The SCA observed that there were "insuperable difficulties" in holding the views held by SARS. Indeed, they are bizarre views, especially in light of the economic climate and its reliance on foreign investment. Fortunately, the PAA certificates have been clarified in this judgment as being capital in nature, albeit only at the SCA level.

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