+27 83 417 5904
pieter@pvdz.co.za
www.pvdz.co.za

Relevance of accounting standards to South African taxpayers

While income tax legislation and accounting standards generally operate independently of each other, the legislature in South Africa has gradually increased the reliance placed on accounting standards in tax laws. This article considers the relevance of the accounting treatment of transactions for South African taxpayers and highlights why it is important that taxpayers, or their advisors, should have an understanding of both tax law and accounting standards.

Income tax legislation and accounting standards generally operate independently. Despite the fact that both ultimately aim to determine a measure of profitability, each has its own definitions and methodology to achieve a specific purpose.

There have always been clear overlaps. This is evident from the fact that, practically, the South African company tax return uses accounting profit or loss as a basis to calculate taxable income.

In recent years, the National Treasury have increasingly placed reliance on accounting treatment to determine the tax treatment of certain transactions. This article considers the relevance of the accounting treatment of transactions for South African taxpayers.

Accounting standards incorporated into the tax laws

The South African legislature has gradually increased the number instances where the tax treatment of certain items must be determined with reference to its accounting treatment. This practice may be open for some debate. While it eases the administrative burden on taxpayers and simplifies certain matters where a taxpayer is only required to apply one set of rules, it does, to some extent, delegate legislative powers to external international accounting setting bodies.

Examples of these instances in the Income Tax Act include:

- Alignment of the IFRS 9 and tax treatment of gains or losses in respect of certain financial instruments of covered persons, aimed at financial institutions (section 24JB)
- Classification of companies as controlled companies in relation to REITs based on whether they are consolidated in terms of IFRS 10 (section 25BB),
- Classification of a foreign company as a controlled foreign company (CFC) based on whether it is consolidated in terms of IFRS 10 and the inclusion of its results into taxable income based on the financial results included in the consolidated financial statements (section 9D), and
- Reliance on accounting classification of related party items as current or non-current to determine whether exchange differences should be deferred or not (section 24I).

The impact of accounting standards incorporated into tax legislation has arguably affected a much greater number of taxpayers since 1 January 2019 when the doubtful debt allowance (in section 11*(j)*) was linked to the impairment allowances recognised in terms of IFRS 9. Taxpayers require a detailed knowledge and understanding of accounting matters such as the permutations that may arise under the expected credit loss (ECL) model in IFRS 9 and accounting policy choices available (for example, the election to apply practical expedients or not) since these have a direct impact on their taxable income.

Broader accounting treatment

Although not stated explicitly in the tax legislation, consistency between the accounting and tax treatment has always played a role in a taxpayer's ability to discharge the burden of proof in claiming an exception, non-liability, deduction, abatement, or set-off. This is evident from the SCA judgment in *GB Mining and Exploration SA (Pty) Ltd v C: SARS*:

> "Balance sheets and accounts perform a vital and formal role in corroborating the information in the return. The Commissioner must be able to rely upon the veracity and accuracy of this evidence which forms the basis for the assessment. The Commissioner is entirely dependent upon the taxpayer to furnish this evidence. In the event of incorrect information being included in the balance sheets or accounts, evidence would have to be furnished to explain the precise nature and extent of the incorrect information and how it was included."

Unless the treatment of a transaction in terms of accounting standards is clearly different from its tax treatment or it can be demonstrated that the information in the financial statements is wrong, taxpayers would be hard pressed to argue that a transaction's accounting treatment is not relevant for tax purposes.