TAX UPDATE

For period: 1 April 2018 to 30 June 2018

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1. INTRODUCTION

The purpose of this update is to summarise developments that occurred during the second quarter of 2018, specifically in relation to Income Tax and VAT. Johan Kotze, a Tax Executive at Shepstone & Wylie Attorneys, has compiled this summary.

The aim of this summary is for clients, colleagues and friends alike to be exposed to the latest developments and to consider areas that may be applicable to their circumstances. The reader is invited to contact Johan Kotze to discuss their specific concerns and, for that matter, any other tax concerns.

The first thing readers should take note of is dates income tax returns have to be filed.

There are also very interesting tax cases reported in this update. For instance ITC 1904 has been the first default order against SARS for not complying with the tax court rules.

Interpretation notes, rulings and guides are all important aspects of the developments that took place, as they give taxpayers an insight into SARS' application of specific provisions.

Enjoy reading on!

A fine is a tax for doing wrong. A tax is a fine for doing well.

2. MEDIA RELEASES, REGULATIONS, NOTICES

2.1. Returns to be submitted by a person in terms of section 25 of the Tax Administration Act

Schedule

1. General

(1) Any term or expression in this notice to which a meaning has been assigned in a 'tax Act' as defined in section 1 of the Tax Administration Act, 2011, has the meaning so assigned, unless the context indicates otherwise and the following terms have the following meaning—

'2018 year of assessment' means—

(a) in the case of a company, the financial year of that company ending during the 2018 calendar year; and

(b) in the case of any other person, the year of assessment ending during the period of 12 months ending on 28 February 2018; and

'income tax return' means a return for the assessment of normal tax in respect of the 2018 year of assessment.

(2) Notice is hereby given in terms of section 25 of the Tax Administration Act, read with section 66(1) of the Income Tax Act, that a person specified in terms of paragraph 2 is required to submit an income tax return within the period prescribed in paragraph 4.

2. Persons who must submit an income tax return

The following persons must submit an income tax return:

(a) every company or other juristic person, which is a resident that—

(i) derived gross income of more than R1 000;

(ii) held assets with a cost of more than R1 000 or had liabilities

of more than R1 000 at any time during the 2018 year of assessment;

(iii) derived any capital gain or capital loss of more than R1 000 from the disposal of an asset to which the Eight Schedule of the Income Tax Act applies; or

(iv) had taxable income, an assessed loss or an assessed capital loss;

(b) every trust which is a resident;

(c) every company, trust or other juristic person, which is not a resident—

(i) which carried on a trade through a permanent establishment in the Republic;

(ii) which derived income from a source in the Republic; or

(iii) which derived any capital gain or capital loss from the disposal of an asset to which the Eighth Schedule to the Income Tax Act applies;

(d) every company incorporated, established or formed in the Republic, but which is not a resident as a result of the application of any agreement entered into with the Government of any other country for the avoidance of double taxation;

(e) every natural person who–

(i) is a resident and carried on any trade (other than solely in his or her capacity as an employee); or

(ii) is not a resident and carried on any trade (other than solely in his or her capacity as an employee) in the Republic;

(f) every natural person who—

(i) is a resident and had capital gains or capital losses exceeding R40 000;

(ii) is not a resident and had capital gains or capital losses from the disposal of an asset to which the Eighth Schedule to the Income Tax Act applies;

(iii) is a resident and held any funds in foreign currency or owned any assets outside the Republic, if the total value of those funds and assets exceeded R225 000 at any stage during the 2018 year of assessment;

(iv) is a resident and to whom any income or capital gains from funds in foreign currency or assets outside the Republic could be attributed in terms of the Income Tax Act;

(v) is a resident and held any participation rights, as referred to in section 72A of the Income Tax Act, in a controlled foreign company;

(vi) is issued an income tax return form or who is requested by the Commissioner in writing to furnish a return, irrespective of the amount of income or nature of receipts or accruals of that person; or

(vii) subject to the provisions of paragraph 3, at the end of the year of assessment—

(aa) was under the age of 65 and whose gross income exceeded R75 750;

(bb) was 65 years or older (but under the age of 75) and whose gross income exceeded R117 300; or

(cc) was 75 years or older and whose gross income exceeded R131 150;

(g) subject to the provisions of paragraph 3, every estate of a deceased person that had gross income;

(h) every non-resident whose gross income included interest from a source in the Republic to which the provisions of section 10(1)(h) of

the Income Tax Act do not apply; and

(i) every representative taxpayer of any person referred to in subparagraphs (a) to (h) above.

3. Persons not required to submit an income tax return

(1) A natural person or estate of a deceased person is not required to submit an income tax return in terms of paragraph 2(f)(vii) or (g) if the gross income of that person consisted solely of gross income described in one or more of the following subparagraphs:

(a) remuneration paid or payable from one single source, which does not exceed R350 000 and employees' tax has been deducted or withheld in terms of the deduction tables prescribed by the Commissioner;

(b) interest (other than interest from a tax free investment) from a source in the Republic not exceeding—

(i) R23 800 in the case of a natural person below the age of 65 years;

(ii) R34 500 in the case of a natural person aged 65 years or older; or

(iii) R23 800 in the case of the estate of a deceased person;

(c) dividends and the natural person was a non-resident throughout the 2018 year of assessment; and

(d) amounts received or accrued from a tax free investment.

(2) Subparagraph (1) does not apply to a natural person who was—

(a) paid or granted an allowance or advance as described in section 8(1)(a)(i) of the Income Tax Act other than an amount reimbursed or advanced as described in section 8(1)(a)(ii) or an allowance or advance referred to in section 8(1)(b)(iii) that does not exceed the amount determined by applying the rate per kilometre for the simplified method in the notice fixing the rate per kilometre under

section 8(1)(b)(ii) and (iii) to the actual distance travelled; or

(b) granted a taxable benefit described in paragraph 7 of the Seventh Schedule to the Income Tax Act.

4. Periods within which income tax returns must be furnished

Income tax returns must be submitted within the following periods:

(a) in the case of any company, within 12 months from the date on which its financial year ends; or

(b) in the case of all other persons (which include natural persons, trusts and other juristic persons, such as institutions, boards or bodies)—

(i) on or before 21 September 2018 if the return is submitted manually;

(ii) on or before 31 October 2018 if the return is submitted by using the SARS eFiling platform or electronically through the assistance of a SARS official at an office of SARS;

(iii) on or before 31 January 2019 if the return relates to a provisional taxpayer and is submitted by using the SARS eFiling platform; or

(iv) where accounts are accepted by the Commissioner in terms of section 66(13A) of the Income Tax Act in respect of the whole or portion of a taxpayer's income, which are drawn to a date after 28 February 2018 but on or before 30 September 2018, within 6 months from the date to which such accounts are drawn.

5. Form of income tax returns to be submitted

The forms prescribed by the Commissioner for the submission of income tax returns are obtainable on request via the internet at www.sarsefiling.co.za or from any office of SARS, other than an office which deals solely with matters relating to customs and excise.

6. Manner of submission of income tax returns

Income tax returns must—

(a) in the case of a company, be submitted electronically by using the SARS eFiling platform; and

(b) in the case of all other persons (which include natural persons, trusts and other juristic persons, such as institutions, boards or bodies), be—

(i) submitted electronically by using the SARS eFiling platform, provided the person is registered for eFiling, or electronically through the assistance of a SARS official at an office of SARS;

(ii) forwarded by post to SARS;

(iii) delivered to an office of SARS, other than an office which deals solely with matters relating to customs and excise; or

(iv) delivered to such other places as designated by the Commissioner from time to time.

3. TAX CASES

3.1. Pienaar Brothers (Pty) Ltd v C:SARS

Applicant, being Pienaar Brothers (Pty) Ltd, had entered into an amalgamation transaction in terms of section 44 of the Income Tax Act in which it had acquired all the assets of Pienaar Brothers (Pty) Ltd on 16 March 2007 and which acquisition had effect from 1 March 2007 in terms of the Sale of Business Agreement.

Pienaar Brothers' Board of Directors had thereafter on 3 May 2007 resolved, in terms of section 90 of the Companies Act, to make a distribution to its shareholders *pro rata* to their shareholding, of an amount of R29 500 000 out of the Pienaar Brothers' share premium account ('the Distribution').

The applicable law on 3 May 2007 in the context of the definition of a 'dividend' in

section 1 of the Income Tax Act meant that a 'dividend' excluded from its ambit any amount distributed out of the share premium account (not being profits previously capitalised to the share premium account).

It was Pienaar Brothers' submission that as at 3 May 2007, when the distribution was made, the distribution did not constitute a 'dividend' as defined in the Income Tax Act and no Secondary Tax on Companies ('STC') was therefore due and payable by Pienaar Brothers on the distribution as the distribution was made out of the share premium account of Pienaar Brothers which share premium arose from the issue of ordinary shares at a premium over the par value.

The present dispute pertained to the liability of Pienaar Brothers to STC on the distribution that has been described.

SARS had raised an STC assessment in an amount of R3 687 500, being 12.5% of R29 500 000, on the distribution of Pienaar Brothers made on 3 May 2007 in pursuance of the amalgamation transaction and this was based on an amendment made to the Income Tax Act having retrospective effect and therefore applying to the distribution made on or after 21 February 2007.

At the time that the Pienaar Brothers' directors had resolved to make the distribution, and when the distribution was effected and finalised, it did not amount to a 'dividend' for purposes of the imposition of STC under the Income Tax Act and this was so by virtue of par. (*f*) of the definition of 'dividend' in section 1 of the Act in that the distribution represented a reduction of the Pienaar Brothers' share premium account to which the first proviso of the definition of 'dividend' did not apply.

Had the distribution been a dividend for purposes of the Income Tax Act at the time it was made, the Pienaar Brothers would, by virtue of section 64B(7) of the Income Tax Act have been required to pay STC on the amount of the distribution and to render the associated STC return by no later than 30 June 2007, the distribution having been made on 3 May 2007.

Despite the above, however, Pienaar Brothers contended that it had been assessed for STC on the distribution by virtue of a retrospective amendment of the Act.

In the Budget Speech of 20 February 2007 the then Minister of Finance made reference, in general terms, to an intention to pass retrospective legislation to deal with certain anti-avoidance arrangements relating to STC and he provided no further detail as to what arrangements were to be addressed or in what manner.

On 21 February 2007 the SARS issued a press release in terms of which, *inter alia*, the STC exemption for amalgamation transactions contained in section 44(9) of the Act was stated to be withdrawn with immediate effect.

The particular statement read as follows:

> 'The STC exemption for amalgamation transactions contained in section 44(9) of the Act is withdrawn. This exemption permits a permanent loss of STC, rather than a deferral of tax, which is the intent of the amalgamation provisions.'

It was clear from this statement that the 'exemption from amalgamation transactions' was the target of the intended reform.

On 27 February 2007 SARS and the National Treasury released for public comment a Draft Taxation Laws Amendment Bill and, in keeping with the press release, the Bill proposed the amendment of section 44 of the Act by the deletions of sections 44(9) and (10) thereof and which amendments would be deemed to have come into operation on 21 February 2007 and would apply in respect of any disposal of an equity share, or any deemed declaration of a dividend, by an amalgamated company.

In this case the amalgamation transaction, the distribution and the introduction of the BEE partner was completed in early May 2007.

On 7 June 2007 the Taxation Laws Amendment Bill was published together with an *explanatory memorandum*. This Bill no longer proposed the deletion of sections 44(9) and (10), but instead proposed the insertion of section 44(9A) and the Bill also proposed that the amendment be retrospective to 21 February 2007.

It is convenient at this stage to refer to the *explanatory memorandum* relating to the insertion of section 44(9A):

> 'It has come to Government's attention that certain private stakeholders are

> attempting avoidance [of] transactions that are specifically aimed at exploiting this gap. In these transactions, a pre-existing target company with substantial assets and profits is amalgamated into a newly formed company without assets or profits. The newly formed company then distributes the former target company assets, but this distribution is free from the STC due to the lack of profits within the newly formed acquiring company. From the above anomaly, the proposed amendment inserts section 44(9A) which deems resultant company equity share capital (and share premium) arising from the amalgamation to be profits not of a capital nature available for distribution to shareholders to the extent of any profits distributed by the amalgamated company in terms of subsection (9). The result is that the amalgamated company's profits are effectively rolled over to the resultant company, so that STC remains payable when the resultant company makes subsequent distribution.'

Pienaar Brothers maintained that the aforementioned was the first indication of any amendment that would impact upon the STC position of an entity in the position of Pienaar Brothers.

On 8 August 2007 the Taxation Laws Amendment Act 8 of 2007 was promulgated and section 34(1)(*c*) of the amending Act inserted into section 44 of the Act a new section 44(9A) and the effect of that appeared from the *explanatory memorandum* note quoted above.

Section 34(2) of the amending Act provided that section 44(9A) was deemed to have come into operation on 21 February 2007 and would be applicable 'to any reduction or redemption of the share capital or share premium of the resultant company, including the acquisition by that company of its shares in terms of section 85 of the Companies Act 61 of 1973 upon or after that date.'

Pienaar Brothers stated that at no stage prior to the conclusion and implementation of this actual amendment was it placed on any guard by any public statement to the effect that it might be exposed to an STC liability in relation to the distribution of any amount from its share premium account, whether with retrospective effect or otherwise.

SARS, in January 2011, had commenced with an audit of Pienaar Brothers' tax affairs for the 2007 year and on 6 December 2011 SARS notified the Applicant in an 'assessment letter' that an adjustment would be made in respect of STC, and, more particularly, that STC in the amount of R3 687 500 was to be levied on Pienaar Brothers.

It was also stated that the applicable dividend cycle for STC purposes was the period ending 3 May 2007 and a formal notice of assessment of STC was issued by SARS on 13 December 2011. This assessment reflected the applicable dividend cycle as commencing on 23 September 2005, ending on 3 May 2007.

Pienaar Brothers, on 20 February 2012, delivered an objection to the assessment which was disallowed by SARS on 16 March 2012.

Pienaar Brothers then brought an application in the High Court whereby it sought an order declaring section 34(2) of the Taxation Laws Amendment Act 8 of 2007 to be inconsistent with the Constitution and invalid and declaring that the provisions of section 44(9A) of the Income Tax Act did not apply to the distribution by Pienaar Brothers on 3 May 2007 to its registered shareholders at that date *pro rata* to their shareholding, of an amount of R29 500 000 out of the Pienaar Brothers' share premium account. In consequence thereof SARS' assessment of Pienaar Brothers on 13 December 2011 to STC in relation to a dividend cycle commencing on 23 September 2005 and ending on 3 May 2007, and to interest calculated from 1 July 2007 to the 'date payable' was invalid and that the STC assessment be declared invalid and set aside.

Pienaar Brothers also requested the court to refer the order sought to the Constitutional Court for confirmation.

Pienaar Brothers also alleged a further cause of action for the unconstitutionality of section 34(2) of the Taxation Laws Amendment Act 8 of 2007 on the basis of its inconsistency with section 25(1) of the Constitution, the so-called 'property clause'.

The crux of Pienaar Brothers' complaint was that it related to the constitutionality of the retrospective amendment referred to above in that such retrospective legislation, which *ex post facto* deemed the law at a particular time to be what it was not, offended against the principle of legality and the rule of law which lay at

the heart of our constitutional dispensation.

It was submitted that the prejudice to the subject of such legislation was only heightened where, as here, it purported to attach adverse consequences to transactions that have been completed and arising from which persons have acquired vested rights before such promulgation.

Pienaar Brothers contended that to the extent that SARS would seek to rely upon the public statements referred to above which preceded the amendment, it would be submitted that these were of no relevance in assessing the legality of retrospective amendment.

In any event, on the present facts, no such public statements involved an amendment of the nature of section 44(9A).

Moreover, even if the retrospective amendment was not unconstitutional *per se*, the Pienaar Brothers contended, in accordance with its second basis, that it did not apply to the distribution, either because that transaction was already completed at the time of the amendment, or because section 44(9) was not capable of being applied in a manner that is fair and practically effective in the context of the Income Tax Act as a whole.

It was submitted that Pienaar Brothers' attack was not on the content of section 44(9A) but on the purported retroactivity of the amendment and the prime relief sought was an order of constitutional invalidity.

The second order, couched as an alternative to the first, was to the effect that the provisions of section 44(9A) of the Income Tax Act did not in fact apply to the distribution when it was made and hence the second order was based on statutory interpretation.

Judge Fabricius held the following:

<u>As to statutory interpretation of retrospective legislation</u>

(i) That in the context of retrospectivity of legislation, it was pointed out that South African case law distinguishes between retrospectivity of legislation in the 'weak' and 'strong' sense. A statutory provision is retrospective in the weak sense if it prospectively effects, or changes the consequences for the

future of pre-existing transactions and matters. An enactment is retrospective in the strong sense if the provision is deemed to have been in force from an earlier date than that on which it was in fact enacted.

(ii) That Pienaar Brothers was of the view that in the present case the court was concerned with retrospectivity in the strong sense, or retroactivity, inasmuch as section 34(2) of the Taxation Laws Amendment Act 8 of 2007 stated that a new section 44(9A) would be deemed to have come into operation on 21 February 2007, even though the Amendment Act was only promulgated on 8 August of that year.

(iii) That the submission was that there was no impediment to the High Court determining the legal issue of interpretation in this case and the relief sought in this context was limited to a declaratory order, and once the ambit of the law had been established, the Tax Court will be asked to address the merit of the assessment in that light and the court would therefore not be impinging unjustifiably on the jurisdiction and powers of the Tax Court. Moreover, on ordinary principles, a court will always retain a discretion whether or not to entertain an application for declaratory relief.

(iv) That it was submitted that Pienaar Brothers' attack was not on the content of section 44(9A) but on the purported retroactivity of the amendment and the prime relief sought was an order of constitutional invalidity. The second order, couched as an alternative to the first, was to the effect that the provisions of section 44(9A) did not in fact apply to the distribution when it was made. The second order was based on statutory interpretation and the question was whether, on a proper interpretation, the introduction of section 44(9A) actually had retroactive effect so as to render the distribution subject to STC as it did not expressly state that it affected completed transactions as it was common cause that all the elements of the amalgamation transaction, including the distribution, were completed before the Taxation Laws Amendment Act 8 of 2007 was passed.

(iv) That the very fact of imposing tax *ex post facto* on a completed transaction was prejudicial and unfair to the taxpayer, who has a well-established right

to know what the law is, and to conform his or her conduct accordingly, and to arrange his or her affairs in a manner that attracts the least tax within the context of existing legislation. In this case, the prejudice extended to the BEE shareholder who could not have known that Pienaar Brothers had an STC liability when it agreed to purchase the shares.

(v) That, however, Pienaar Brothers' complaint that the effect of the amendment was 'prejudicial and unfair' to taxpayers was unfounded and while the court acknowledged that there are degrees of 'unfairness', such conceptual reasoning may also become involved in statutes that are prospective in operation. Prospective legislation may, and often does, affect vested rights as well and such statutes may be tax statutes, they may relate to property, they may relate to withholding tax on dividends, as well as to Customs and Excise statutes, by way of example only and the court agreed that 'no one has a vested right to continuance of the law as it stood in the past and in tax law it is imperative that legislation conform to changing social needs and governmental policy. A taxpayer may plan his financial affairs in reliance on the tax laws remaining the same but he takes the risk that the legislation may be changed.' The court also agreed that 'in the context of tax statutes specifically, rigidity is not to be expected and the *fiscus* must be able to function effectively, taking into account changing demands of society.

(vi) That the *fiscus* must act lawfully, of course, but the court does not hold that general considerations of 'fairness', which is in any event a relative term, can be the overriding consideration in the present instance as it is indeed difficult to argue one particular company resulting from an amalgamation process is being treated so unfairly that a court would be able to say that a retrospective tax statute could not have been intended to be applied to its factual circumstances.

(vii) That, in the light of all the abovementioned considerations, the court held that the amendment in section 44(9A) was clear, its purpose was rational and that it applied to all transactions including completed transactions relating to the provisions of section 44(9A) which did apply to the

distribution by Pienaar Brothers on 3 May 2007 and consequently the court went on to consider the constitutional validity of the relevant amendment.

As to the constitutional validity of retrospective legislation

(ix) That it was correctly submitted that not only must Government act in accordance with laws, but also that the laws must have a certain essential quality, namely, in the present context, that laws should be reasonably clear, accessible and prospective in their operation. Section 1(*c*) of the Constitution, read with section 2, provides that the rule of law is one of the founding values of the Constitution and that any law or conduct, inconsistent with the Constitution is invalid. Given this status, all arms of Government are bound by the fundamental value of the rule of law, so it was correctly submitted.

(x) That the court was also referred to the provisions of section 172(1)(*a*) of the Constitution which obliges courts, in determining constitutional matters, to declare that any law which is inconsistent with the Constitution to be invalid to the extent of its inconsistency.

(xi) That it was clear that not only do certain statutes affect rights or vested rights retrospectively, but that decisions of courts do so in many cases. The court was not aware of any authority, and none had been provided to the court that those results would mean that any such statute or decision was unconstitutional *per se*, irrespective of the reason for the adoption of the statute or the facts of a particular case before a court of law, and irrespective of its wording.

(xii) That it was submitted by Pienaar Brothers that, as in Germany, the rule of law compels a conclusion that strongly retrospective tax statutes should be presumed to be constitutionally invalid. It was however expressly not suggested that our constitutional dispensation would never allow the legislature to expressly introduce retrospective legislative amendments. There could well be exceptional cases where this could be done without attracting constitutional sanction. The touchstone would, however, always be whether the retrospectivity amounts, in the particular circumstances of

the case, to a contravention of the rule of law.

(xiii) That there are obviously degrees of unfairness and not all laws are 'fair' and that the real question would be whether a law is 'unjust', i.e. whether it passes constitutional muster, i.e. was the law, accepting its language is clear, passed for a rational reason? The court did not agree, if that was suggested, that 'unfair impairment' is the appropriate test in our constitutional dispensation.

(xiv) That it was submitted that unless there was adequate warning of the intention to implement the change retrospectively, such that the taxpayer cannot be said to have been entitled to rely on the law continuing to apply, a retroactive amendment could never pass constitutional muster. The court did not agree that a 'precise' warning is required, if any at all. Economic circumstances generally will demand a degree of fluidity. Rigidity does not belong to a modern jurisprudence, and even less in tax legislation.

(xv) That the court was not aware of any authority or legislative provision that provided that a fairly precise warning need to be given before the legislature can pass retrospective legislation, whether in general, or in the case of a tax statute. In the latter instance, economic demands must be considered in the context of the purpose and effect of an intended statute. If the tax statute is rationally connected to a legitimate purpose, no precise warning is required, if one at all.

(xvi) That in regard to comparative law, there are three important conclusions that are relevant for present purposes:

(a) Retroactive tax legislation is a commonly known phenomenon in the relevant European countries;

(b) Only in countries like Poland, Portugal and Hungary, is there a mere prohibition of such retroactive tax legislation;

(c) The constitutional restrictions on retroactive tax legislation vary significantly.

(xvii) That it was submitted that the foreign law comparison makes it clear that

retrospective laws are permissible and indeed common place in countries based on the rule of law. At the same time it was not suggested that Parliament may legislate with retrospective effect as it pleases. The real question is what the standard is by which the constitutional validity of retrospective legislation is judged and the court agreed with that contention and followed that approach.

(xviii) That the aforementioned question must be answered with reference to the standards of review laid down by our courts when the constitutional validity of a statute is challenged and there are two main standards: The first is the 'rationality' test which is the standard that applies to all legislation under the rule of law entrenched in section 1(c) of the Constitution. The second, and more exacting standard, is that of 'reasonableness' or 'proportionality' which applies when legislation limits a fundamental right in the Bill of Rights. Section 36(1) of the Constitution provides that such a limitation is valid only if it is 'reasonable and justifiable in an open and democratic society.'

(xix) That the question then is: which of these standards applies when a retrospective law is enacted. It was submitted that the answer was quite clear: If the law limits a fundamental right, the exacting 'reasonableness' standard applies. If the law permits a 'deprivation of property' under s 25(1) of the Constitution, the intermediate standard of 'sufficient reason' applies. If, however, the law does not infringe upon the Bill of Rights, then the question is merely whether it passes muster under section 1(c) of the Constitution, then the basic 'rationality' standard applies.

(xx) That the rationality test provided a difficulty for the Applicant in that there was an unintended loophole in the Income Tax Act created by section 44(9) of the Act and SARS considered, on the basis of the possible Shoprite/Brait transaction, that a 'flood' of such transactions would occur and that there was a real risk that the national fiscus would suffer extensive and permanent harm. This transaction, which was pending when the decision was made to close the loophole, would have resulted in a loss of approximately R1.5 billion in unpaid STC. It was therefore submitted that it

was eminently rational to close the loophole with retrospective effect.

(xxi) That in regard to Pienaar Brothers' complaint that the manner in which Parliament ultimately closed the loophole differed from the manner in which the Minister had originally foreshadowed in his budget address, the court was not aware of any provision in any of the jurisdictions that it had referred to, or indeed in ours, to the effect that the warnings given must relate to the exact same amendment that was ultimately made. To adopt such an approach would undermine the parliamentary process and the public participation process completely.

(xxii) That the court was therefore not of the opinion that a precise warning must be given in each and every case, nor that a warning, of whatever ambit, needs to be given in all cases. In the court's view, a proper approach would be to judge the legality of retrospective amendments on a case-by-case basis, having regard to the various considerations that had been referred to. The Constitution itself certainly does not prohibit retrospective legislation in civil law.

(xxiii) That the Constitution obviously does not prohibit the passing of legislation in the civil sphere that has retrospective effect, and this ought to be the starting point in any argument. It was also clear that as yet there has not been any test on whether the retrospective operation of a statute was inconsistent with the rule of law. Moreover, it was clear from the Canadian decisions that their parliament has an unfettered discretion in deciding the effective dates of new tax laws provided that the intended retrospective effect must be clear and unequivocal.

(xxiv) That in the present instance, unfairness is in the court's view certainly not the decisive question. Many laws may be 'unfair' in many particular instances, but they are not unjust if they have been lawfully and constitutionally passed by Parliament. Laws are in general aimed at the broader public and are in the main not concerned whether or not a particular statute unfairly affects a particular individual simply on the basis that it may not unfairly affect the majority of the populace.

(xxv) That in Australia the enquiry therefore is whether the statute was couched with ‘sufficient clarity’ that it was to have retrospective effect and if no doubt arises, the statute must be given effect on its own terms. In the present case the Pienaar Brothers, in any event, never argued that its particular circumstances were so grossly unfair and oppressively affected that the amendment could not be regarded as rational as a result, nor was the amendment aimed solely at itself. The court agreed that Australian jurisprudence supported the Pienaar Brothers’ case in this matter.

(xxvi) That Pienaar Brothers did not provide any authority for their contention that ‘knowledge’ or ‘adequate warning’ was constitutionally required for tax legislation to pass constitutional muster. In any event, if it were to be found that such ‘knowledge’ or ‘adequate warning’ was essential, it was submitted that the process that was followed was sufficient and ought to have put any taxpayer who was contemplating amalgamation transactions with a view to derive STC exemption from such, would have been placed on full guard that legislation was going to be amended to remove the particular exemption. Despite this warning, Pienaar Brothers went ahead with the amalgamation transaction.

(xxvii) That there was no authority for the proposition that retrospective tax legislation would survive constitutional scrutiny only if there were ‘good reasons’ for it. It is not for a court to say what a good ‘reason’ is. Foreign law also does not support such an approach. The only question is whether a legitimate legislative purpose is indicated. In the present case the Government’s purpose was to remove the tax exemption in amalgamated transactions and to do so retrospectively was also justified, because there was loss of STC revenue rising from amalgamations which was previously intended to be deferred and not permanently lost.

(xxviii) That there was no basis for holding that under the present Constitution Parliament can only pass retrospective legislation if ‘exceptional circumstances’ exist and a court was not obliged to adopt a ‘rigorous approach’ which would require ‘a very high level of correlation’ between the changes to the law of which the taxpayer has been notified and the actual

legislative amendment that follows.

(xxix) That, accordingly, the constitutional attack on the impugned provision must fail and there was nothing in our Constitution which prohibited Parliament from passing retroactive or retrospective legislation. There was also nothing in other jurisdictions of similar constitutional structure that prohibited such passing. Also, and more significantly, there was nothing internal in the rule of law which rendered retrospective legislation *per se* unconstitutional.

As to Pienaar Brothers' property challenge: section 25(1) of the Constitution

(xxx) That section 25(1) is intended to deal with situations where the law takes away or interferes with the use and enjoyment of assets. The fact that a law creates a civil liability does not in itself deprive the taxpayer of property unlawfully as, if it were otherwise, every tax, levy, fee, fine and administrative charge would constitute deprivations for purposes of section 25(1).

(xxxi) That it could not be argued that all taxes involve a 'deprivation' of property, in the context of section 25(1). A State cannot exist without taxes. Society receives benefits from them. Taxes are not penalties. Neither can they be, without any qualification, be regarded as unjust deprivation of property use. If it is Pienaar Brothers' view that only retroactive taxation gives rise to such deprivation, then again, no unjust deprivation occurred here. The State used a well-accepted mechanism to close a loophole in a statute. It did not solely target Pienaar Brothers. Its purpose was rational and it gave ample warning of its intention. The retroactive amendment does also not amount to illegitimate deprivation. Sufficient reason was established and the process was fair in the present context, not that 'fairness' was a requirement.

(xxxii) That, accordingly, the amendment adopted by Parliament was not arbitrary and therefore not in breach of section 25(1) of the Constitution. Further, and in any event, the amendment was reasonable and justifiable in terms of section 36(1) of the Constitution and the property challenge could therefore not be upheld.

Application dismissed with no order as to costs.

3.2. *ITC 1901*

The taxpayer, at all material times, had conducted the business of a manufacturer, importer and distributor of new and used motor vehicles.

It was common cause that at the end of each of the respective years of assessment in dispute the taxpayer had held in its possession various vehicles in each of its vehicle categories, save for trucks and busses, which only applied in the 2008 year of assessment.

Each of these vehicles constituted 'trading stock held and not disposed of' as envisaged in section 22(1) of the Income Tax Act, which required of a taxpayer who carried on a trade (other than farming) to include in the determination of his taxable income an amount in respect of the value of any trading stock held and not disposed of by him at the end of such year of assessment.

The taxpayer had determined the amount to be so included under section 22(1)(*a*) of the Act on a vehicle-by-vehicle basis, i.e. an amount was determined for each individual vehicle held and not disposed of.

The taxpayer in its aforementioned calculation adopted the following approach:

(a) It ascertained the cost price of each such vehicle as set out at the end of the year in question, in accordance with the requirements of the statement of generally accepted accounting practice referred to as International Accounting Standard Two (Inventories) (IAS2);

(b) In this regard IAS2 was identical to AC108, being the equivalent standard of generally accepted accounting practice pertaining to the valuation of inventories as adopted by the South African Accounting Practices Board prior to the years of assessment in question.

(c) The taxpayer's determination of the cost price of its trading stock in respect of the years of assessment in question was not in dispute and SARS had accepted that this had been determined in accordance with the generally

accepted accounting practice as reflected in IAS2 and envisaged in section 22(3)(*b*) of the Act as it read at the time.

(d) The taxpayer then ascertained the 'net realisable value' (NRV) of each such vehicle on the basis envisaged in IAS2. IAS2 (par. 6) defines NRV as 'the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.'

The taxpayer determined the estimated selling price of the vehicles in the ordinary course of business as the average price realised from sales of the same model in the previous month (described by the taxpayer as the 'wholesale selling price' of the vehicle).

SARS had accepted that the wholesale selling price so determined was in accordance with the 'estimated selling price in the ordinary course of business' for purposes of IAS2.

(e) The taxpayer then compared the NRV so determined for each vehicle with the cost price thereof and where in respect of a particular vehicle the determined NRV was lower than the cost price, it included in its taxable income for purposes of section 22(1)(*a*) of the Act an amount equal to the NRV of that vehicle, but where, on the other hand, the determined NRV of the vehicle was higher than the cost price, it included in its taxable income for purposes of section 22(1)(*a*) the cost price of the vehicle.

SARS, in the course of his audit, had determined the amount which he contended had to be included in respect of trading stock in relation to each of the vehicle categories and each of the years of assessment and, in doing so, he accepted as correct the taxpayer's figures pertaining to the cost price, wholesale selling price and the various other costs taken into account by the taxpayer in determining the NRV.

SARS, however, declined to take into account any of the other costs which the taxpayer had taken into account in determining the NRV of the vehicles.

The parties were agreed that in doing so SARS recognised that an amount lower than the cost price of a vehicle should be included under section 22(1)(*a*) of the Act

in instances where the wholesale selling price of the vehicle, less the SARS included costs (if any) was lower than the cost price and the number of vehicles which SARS considered to qualify for the lower inclusion on this basis was accordingly lower than the number which the taxpayer had identified.

In the circumstances there was no dispute between the parties that the NRV of the taxpayer's trading stock held and not disposed of at the end of each year of assessment had been correctly calculated for accounting purposes in accordance with IAS2.

SARS had raised additional income tax assessments in respect of the taxpayer for the 2008, 2009 and 2010 years of assessment in which he had included in the taxpayer's income the amounts of R72 020 161, R24 778 855 and R5 294 643 in respect of those years of assessment on the ground that the taxpayer had not correctly represented the value of trading stock held and not disposed of by it at the end of the respective years of assessment for purposes of section 22(1)(*a*) of the Act.

SARS justified the inclusion of the aforementioned amounts in the taxpayer's taxable income on the basis that their exclusion by the taxpayer was not warranted by section 22(1)(*a*) of the Act.

The taxpayer disputed the SARS' entitlement to include the said amounts in its taxable income and it accordingly objected to the aforementioned assessments, and which objection was disallowed and the taxpayer then appealed to the Tax Court against the disallowance of the objection as it was entitled to do in terms of section 3(4)(*b*) of the Income Tax Act.

The crisp legal dispute between the parties was whether the NRV of the taxpayer's trading stock, calculated in accordance with IAS2 and taking account of the individual categories of costs referred to in the judgment, may and should, where it is lower than the cost price of such trading stock as determined in accordance with section 22(3) of the Act, be accepted as representing the value of trading stock held and not disposed of at the end of the respective years of assessment for purposes of section 22(1)(*a*) of the Act.

SARS acknowledged that the concept of NRV was provided for and recognised in

the IAS2 for accounting purposes but he contended that the concept of NRV found no direct application for the purposes of section 22(1) of the Act.

SARS contended that the amounts to be deducted from the cost price as envisaged in section 22(1) of the Act were confined to such amounts 'as the Commissioner may think just and reasonable as representing the amount by which the value of such trading stock . . . has been diminished by reason of damage, deterioration, change of fashion, decrease in the market value or for any other reason satisfactory to the Commissioner.'

He contended further that the costs identified by the taxpayer did not fall to be taken into account in respect of the value of the trading stock held by the taxpayer at the end of each year of assessment as envisaged in section 22(1)(*a*) of the Act.

The taxpayer, on the other hand, contended that the amounts in dispute as referred to in the opinion expressed by Mr S, did not fall to be taken into account in ascertaining the 'cost price' of inventory, but did fall to be taken into account in ascertaining the diminution in the value thereof for purposes of section 22(1) of the Act.

Judge Eksteen held the following:

(i) That the interpretation and application of the provisions of section 22 of the Act lay at the heart of the dispute between the parties. Section 22 determines the value to be attributed to trading stock when it is taken into account in determining taxable income. The value to be attributed to closing stock is dealt with in section 22(1) of the Act. Broadly, it is the cost price, less any allowance that the Commissioner may consider to be just and reasonable as representing any further diminution in its value. Section 22(2) determines the value to be attributed to opening stock and the manner in which the cost price is to be determined for purposes of those sections is specified in section 22(3) of the Act.

(ii) That although much was made by SARS of the significance of section 22(3)(*b*) of the Act, section 22(3)(*b*) was not of any assistance in determining the true construction to be placed on section 22(1)(*a*).

(iii) That the 'cost price' of trading stock held and not disposed of at the end of the year of assessment served as the point of departure for the determination of the amount which shall be taken into account in respect of the value of such trading stock. Section 22(3) defined the term 'cost price'. It is the cost incurred by the taxpayer in acquiring such trading stock plus any 'further costs' incurred by him up to and including the date of the end of the year of assessment in getting the stock into its then existing condition and location.

(iv) That the 'further costs' which were to be added to the cost of acquisition of the trading stock in the determination of the 'cost price' were limited in two respects:

- Firstly, they were limited to costs incurred in bringing it to its then existing condition and location; and
- secondly, they were limited by the provisions of section 22(3)(*b*) of the Act.

Section 22(3)(*b*) defined the 'further costs' referred to in section 22(3)(*a*)(i), limited as aforesaid, as costs which are, in terms of any generally accepted accounting practice approved by SARS, included in the valuation of the trading stock. The definition of 'further costs' contained in section 22(3)(*b*), was limited in its application to the calculation of the 'cost price' as defined in section 22(3)(*a*).

(v) That the parties had agreed that the cost price of the trading stock had been correctly calculated and, in the circumstances, no more needed to be said of the provisions of section 22(3) of the Act.

(vi) That the court then turned to section 22(1)(*a*) of the Act and stated that in seeking to ascertain the true construction of section 22(1), the general principles applicable to the interpretation of statutes found application and the current position was authoritatively summarised in *Natal Joint Municipal Pension Fund* v *Endumeni Municipality* 2012 (4) SA 593 (SCA) at par. [18].

(vii) That Marais JA in *Richards Bay Iron & Titanium (Pty) Ltd and Another* v

CIR 58 SATC 55 had carefully considered and discussed the purpose of section 22 and the background to its preparation and inclusion in the Income Tax Act and had referred to and approved the statement by Stephen J in the Australian case *Federal Commissioner of Taxation* v *St Hubert's Island Pty Ltd (in Liquidation)* (1978) 78 Australasian Tax Reports 452 that 'only by taking account of stock-in-trade in the conventional way can a correct reflex of the trader's income for the accounting period be obtained' and that Stephen J had in mind conventional accounting principles.

(viii) That section 22(1)(*a*) sought to determine the amount which was to be taken into account in respect of the value of trading stock held and not disposed of by the taxpayer at the end of the year of assessment. It stipulates that the cost price (as defined in section 22(3)) shall be the amount taken into account in respect of the value of the closing stock, unless the value of the stock has been further diminished by reason of one of the factors listed in the section, or for any other reason satisfactory to SARS. The value which must have been diminished by reason of any of the listed factors is the pre-existing value and that pre-existing value is the cost price (as defined) to the taxpayer of the relevant trading stock.

(ix) That in the event that such a diminution has occurred in consequence of any of the factors listed, or any other reason satisfactory to SARS, SARS is then empowered to permit the taxpayer to reduce the value of trading stock held by him at the close of the year of assessment to below the cost price (as defined in section 22(3)) by deducting an amount thought by SARS to be just and reasonable 'as representing the amount by which the value of such trading stock . . . has been diminished.'

(ix) That the first enquiry was whether a diminution in the value of such trading stock, when viewed against the cost price, had occurred. In the event that a diminution in the value had occurred, SARS was required to determine whether the reason for the diminution justified a reduction in the amount to be taken into account and, in the event that it did, SARS was required to exercise a discretion as to the amount which he considered to be just and

reasonable as representing the amount by which the value of such trading stock had been diminished.

(x) That the essential dispute between the parties in this matter related to whether a diminution in value of the trading stock, when viewed against the cost price, had in fact occurred and, if so, whether SARS ought to have recognised such a diminution in value for purposes of section 22(1) of the Act.

(xi) That whilst section 22 of the Act sets out a clear guideline for the manner of calculation of the cost price, the Act does not prescribe any method by which to estimate whether a diminution in value has occurred. The taxpayer contended that the assessment of the NRV as envisaged in par. 28 of IAS2 constituted an appropriate method of ascertaining the actual value of the trading stock in the hands of the taxpayer.

(xii) That the specific factors enumerated in section 22(1)(*a*) correlated with the specific factors mentioned in IAS2 and all of the factors as specifically listed impacted upon the amount which the taxpayer could reasonably realise for the asset in the ordinary course of trade.

(xiii) That the legislature, however, clearly envisaged that there may be other reasons, over and above the factors listed, which may give rise to a diminution in value. Paragraph 28 of IAS2 suggested two additional reasons which could give rise to a diminution in the value of the trading stock in the hands of the taxpayer.

(xiv) That the admitted evidence reflected the provisions of par. 30 of IAS2. It recognised, for accounting purposes, that the estimates of NRV took into consideration fluctuations of price or costs directly relating to events occurring after the end of the period of assessment to the extent that such events confirm conditions existing at the end of the period. Although these considerations relate to future events they are taken into account to reflect the true value of trading stock as at the end of the year of assessment.

(xv) That, as alluded to earlier, there was no dispute between the parties that the calculation of the value of trading stock made by the taxpayer was in

accordance with IAS2. There was therefore no dispute that each of the categories of costs taken into account by the taxpayer related to costs to be incurred to make the sale.

(xvi) That the NRV as set out in IAS2 was an appropriate method by which to determine the actual value of trading stock in the hands of the taxpayer at the end of the year of assessment. The NRV, determined in this manner, must be compared to the cost price, computed in accordance with section 22(3) of the Act, in order to determine whether a diminution in value had in fact occurred.

(xvii) That this was consistent with the purpose of section 22 of the Act, although the taxpayer may have converted more profits into acquiring trading stock than the trading stock could now be expected to realise, what had to be added back to taxable income was no more than the reasonably anticipated taxable income that may arise from the disposal of the trading stock in the future and this approach provided an equitable balance which avoided hardship by insuring that the taxpayer need not pay tax in the current year of assessment on more than what the stock could be expected to realise for him.

(xviii) That in all the circumstances, whereas section 22(1) was silent as to the manner of valuation of trading stock at the conclusion of a year of assessment, in order to determine whether a diminution in value had occurred, the adoption of the NRV as a method of the assessment of value provided a sensible, businesslike result which accorded with the purpose of section 22(1) in the context of the Act and with the weight of authority.

Appeal succeeded and the additional assessments were set aside.

3.3. ITC 1902 (ZIm)

The taxpayer was a fast foods enterprise, being of a small to medium size and commenced operations in February 2009 with a single flagship branch, and later diversified into the food court industry in May 2010 with two branches being

opened in Harare in 2011 and in 2012, and 2013 a further three branches were opened in Harare.

Zimbabwe Revenue Authority (ZRA), had, on 20 May 2013, commenced a tax compliance investigation on the taxpayer and it was represented by two chief investigations officers at the initial interview held on 29 May 2013 at the taxpayer's head office in Hatfield, Harare. The taxpayer was represented by its group chief executive officer, a finance manager and public officer and an assistant accountant.

The initial interview provided ZRA with a general overview of the operations of the taxpayer and the nine areas covered were preliminary and general information, identification, bank details, rent and properties, PAYE, consultancy and agents, imports and exports, Income Tax, VAT and accounting systems.

Subsequently the investigators conducted a physical walkthrough of the taxpayer's accounting systems at the taxpayer's head office and as a result of the conduct of a member of the taxpayer's staff the investigators seized two servers, the public officer's laptop and a computer from the marketing department at head office and another computer from one of the Harare branches of the taxpayer.

Although the taxpayer's public officer apologised for the conduct of his accountant and pleaded with the investigators to return his servers, the investigators then demanded declarations of all sales and requested submission of monthly schedules of all suppliers.

The taxpayer's public officer, in consequence of the aforementioned events, and in a spirit of co-operation and mitigation of any possible punishment, wrote a letter to ZRA voluntarily disclosing areas of non-compliance with tax legislation 'as part of our efforts to co-operate with the ongoing tax compliance investigation by your office.' He indicated that the taxpayer had not made full disclosure of both its sales and VAT, and promised that he was in the process of compiling comparative schedules of the declared and actual sales.

ZRA's chief investigator requested the taxpayer to furnish certain schedules and in regard to the declaration of output tax and purchases she urged the taxpayer to provide schedules of the discrepancies indicating on a monthly basis per branch

the declared and understated sales and a schedule of purchases with an aggregate value exceeding $250 per year.

The chief investigator warned the taxpayer that failure to submit all the requested information by 17 March 2014 would force ZRA to issue estimated assessments based on the information at her disposal.

The taxpayer, by 17 March 2014, had appointed a tax consultant to assist it with the compilation and submission of the requested schedules, but it had failed to submit the requested information and, in consequence thereof, on 19 March 2014 ZRA estimated the VAT liability of the taxpayer and dispatched schedules to it giving it two days within which to comment.

Further unsuccessful meetings between the taxpayer and ZRA ensued where the parties discussed the figures collated from the documents and computers seized by the taxpayer, but the taxpayer's new declarations understated the 2013 sales by margins in excess of 100% and the taxpayer's group chief executive officer had conceded the under-declaration of sales and blamed poor controls, theft and stiff competition for its conduct.

The outcome was that ZRA rejected the taxpayer's 2013 final position as it did not accord with the forensic decoded data and, instead, ZRA applied a factor of 171% to raise the self-assessed sales of five of the months and extended deadlines for the submission of the 2010, 2011 and 2012 voluntary disclosures to between 1 and 11 April 2014.

Further high-powered meetings took place between the parties but to no avail and on 4 April 2014 ZRA issued amended assessments for 2013 and issued amended assessments for the period 2010 to 2012 on 14 April 2014 based on sales figures derived from documents recovered from two Harare branches and head office and the computer and forensic downloads.

The taxpayer's chartered accountant on 2 May 2014 wrote a letter of objection to ZRA seeking the reversal of each of the VAT assessments issued on 4 and 14 April 2014 covering the period from 1 January 2010 to 31 December 2013.

The taxpayer raised three grounds of objection:

(a) That ZRA had arbitrarily increased output tax by using estimated sales that were not derived from factual records and information and without showing how the figure had been computed;

(b) That the taxpayer had not been given adequate time to submit full claims for input tax and revise the initial sales figures indicated in the original VAT 7 returns;

(c) That the penalty imposed of 100% was excessive in that it ignored the verbal representations made to the investigators in the various meetings that were held and was not commensurate with the moral blameworthiness of the taxpayer.

ZRA then disallowed all the three grounds of objection and the taxpayer filed the notice of appeal in the present matter in the Fiscal Appeal Court on 13 June 2014 which ZRA in turn contested on 24 July 2014.

The evidence before the court revealed that the taxpayer's chief executive officer had blamed others and not himself for the woes of his company and, in particular, he blamed his finance team for poor workmanship and for submitting inaccurate self-assessments, which excluded zero rated sales. He also blamed ZRA's investigation team for coercing the public officer to sign the 'inaccurate' forensic decoded data. He contended that ZRA had the duty to compare the forensic data with the sales on the fiscalised machines and the Pastel data bank even though he was aware that the machines were adversely affected by power outages and breakdowns.

ZRA's chief investigating officer testified on its behalf and it was she who conducted the coordinated search and seizure at the taxpayer's head office and two other branches in Harare. She had based the estimated assessments on the information derived from the supporting incomplete sales documents and inaccurate voluntary disclosures made by the taxpayer, the downloads from the seized computers made in the presence of the public officer and the forensic decoded data acknowledged by the public officer as belonging to the taxpayer. She testified that she had eventually raised estimated assessments because the taxpayer had failed to supply the requested information and to cooperate on the

core aspects of the investigation.

The court found that the taxpayer's group chief executive officer was an incredible and contradictory witness who had prevaricated on whether the taxpayer had owed or was owed output value-added tax.

It was also of the view that it was disingenuous of both the taxpayer's chartered accountant and the group chief executive officer to accuse their own finance team of incompetence, especially when the amended self-assessments prepared by the chartered accountant mimicked the initial assessments in respect of taxable sales and input VAT claimed.

The court, on the other hand, found ZRA's chief investigating officer to be a credible witness and her version was confirmed by the correspondence that she had exchanged with the taxpayer's public officer. Moreover, she had clearly provided the basis for her estimated assessments. She was an investigator and not an auditor and it was not her duty to compile the taxpayer's books of account and her duty was to request the information needed to establish the correctness of the initial self-assessments.

Further, she had set out in great detail the content and format of the requested information which should have been easy for the taxpayer to supply and it could not be established that her team had coerced the taxpayer into logging into the seized computers and certifying the content derived from these computers.

The following four issues were referred for determination in this appeal at the pre-trial hearing:

(a) Whether or not the taxpayer was indebted to ZRA at all and, if so, in what amount?

(b) Whether or not ZRA had arbitrarily increased the total output tax without showing the basis of how the amount was calculated?

(c) Whether or not ZRA gave the taxpayer an opportunity to submit full claims for input tax for the period January 2010 to December 2013?

(d) What would be the appropriate penalty for the undeclared VAT for the period in question?

The court also considered the following further issues:

(a) Whether the present appeal was circumscribed by the grounds of objection raised by the taxpayer on 2 May 2014;

(b) Whether ZRA had violated the taxpayer's constitutional protection stipulated in section 68 of the Constitution, which provided that every person has a right to administrative conduct that is lawful, prompt, efficient, reasonable, proportionate, impartial and both substantively and procedurally fair. An Act of Parliament must give effect to these rights and the law contemplated by section 68(3)(*a*) exists in the Administrative Justice Act [Chapter 10:28] which in section 4(1) confers review jurisdiction on the High Court and other courts that are entitled by some other law to do so and the further issue considered by the court was whether it had the power to exercise the jurisdiction of the High Court.

Judge Kudya held the following:

<u>As to the limitations on the grounds of objection</u>

(i) That the power of the Fiscal Appeal Court to determine VAT appeals was stipulated in section 33 of the Value-Added Tax Act and section 33(3)(*a*) provided that at the hearing by the Fiscal Appeal Court of any appeal to that court the taxpayer shall be limited to the grounds of objection stated in the notice of objection, unless ZRA agrees to the amendment of such grounds or the taxpayer, on good cause shown prior to or at such hearing, is given leave by the court to amend such grounds of objection within a reasonable period and on such terms as to any postponement of such hearing and costs which may result from such postponement as the court may order.

(ii) That the appeal in the instant case was circumscribed by the grounds of objection raised by the taxpayer on 2 May 2014 and the court's decision was limited to the decision that ZRA was empowered to make on 12 June 2014 when he disallowed the objections raised by the taxpayer.

(iii) That ZRA had submitted that the taxpayer was precluded from relying on information which became available subsequent to the decision appealed

against and they had relied on the provisions of section 33(3) of the Act.

(iv) That in the formal courts such as the High Court and the Supreme Court, and to a limited extent in the Special Courts such as the Fiscal Appeal Court, the notice of objection constitutes the central pleading that circumscribes the new facts but, unlike the appeals in the formal courts which are appeals in the narrow sense, appeals to the Special Courts are rehearings and the architectural design and scope of the legislative provisions that create Special Courts permit the leading of evidence and the submission of facts and arguments which were not placed before ZRA.

(iv) That the taxpayer had to plead the issues it sought to raise for the first time on appeal in its grounds of objection, failing which it would have had to seek the consent of ZRA or leave of the court. *In casu* the taxpayer did not pursue any of these options in respect of the new arguments raised in oral argument and hence it clearly fell afoul of the principles set out in the authorities cited and the provisions of section 33(3)(*a*) of the Value-Added Tax Act.

(v) That, accordingly, the taxpayer had moved new legal grounds of objection in its oral submission and which were not in the letter of objection in violation of section 33(3)(*a*) of the Value-Added Tax Act and it did not show good cause or seek ZRA's consent or leave of the court to amend its grounds of objection and hence such legal arguments were improperly placed before the court but the court still considered them on the 'off-chance' that it might be wrong in declining to address them.

<u>As to whether Special Court capable of review jurisdiction</u>

(vi) That the taxpayer had submitted that ZRA had violated its constitutional protection provided for in section 68 of the 2013 Constitution which stated that every person had a right to administrative conduct that was lawful, reasonable and impartial, but it was clear that the taxpayer had moved this point in the wrong court as section 68(3)(*a*) directed that an Act of Parliament must give effect to these rights and must provide for the review of administrative conduct by a court or where appropriate by an

independent and impartial tribunal.

(vii) That the Fiscal Appeal Court is not a superior court of inherent jurisdiction. It is a creature of statute and operates within the confines of its founding legislation and decided cases and both the Fiscal Appeals Court Act *[Chapter 23:05]* and the Value-Added Tax Act *[Chapter 23:12]* do not confer review jurisdiction on the court.

(ix) That it was clear that the law contemplated by section 68(3)(*a*) of the Constitution existed in the Administrative Justice Act *[Chapter 10:28],* which in section 4(1) confers review jurisdiction on the High Court and other courts that are entitled by some other law to do so. The mere fact that the judge hearing this case happens to be a High Court judge who was appointed in terms of section 3 of the Fiscal Appeal Court Act to be a President of this court, does not confer on him the power to exercise the jurisdiction of the High Court in this court.

(x) That, therefore, the taxpayer had misconstrued the provisions of section 68 of the Constitution and section 3 of the Administrative Justice Act and consequently the submission failed.

<u>As to whether ZRA's estimated assessments were justified</u>

(xi) That the essence of the taxpayer's objection and appeal in this matter was that the decision of ZRA to issue estimated assessments was wrong and both parties agreed that in terms of section 15 of the Fiscal Appeal Court Act [Chapter 23:05] and section 37 of the Value-Added Tax Act [Chapter 23:12] the burden of proof to discharge this issue on a balance of probabilities rested on the taxpayer.

(xii) That the provisions of section 57(4) of the Value-Added Tax Act required that a registered operator such as the taxpayer would keep and retain books of account that were in compliance with the demands set out in the Act and these were to be preserved and retained in their original form or in the form authorised by ZRA for a period of six years from the date of the last entry. However, the evidence led by the taxpayer failed to establish the existence of these books of account, records and documents that its

chartered accountant purportedly used.

(xiii) That the taxpayer had failed to establish that it had demanded ZRA's authority given to the investigators to inspect, audit and examine information or documents of the taxpayer in contemplation of section 58(*a*), (*b*) and (*h*) of the Act and the provisions of section 59 as read with section 60(4) which authorise such officers as investigators to request any information they may require from the registered operator and only to produce ZRA's authority on demand. Moreover, proof of such authority was thereafter not tendered.

(xiv) That, generally, in terms of section 61 of the Act, ZRA is authorised to seize documents including computer printouts for further examination, investigation, trial or enquiry. The section does not authorize seizure of computers or other information retrieval systems but was, however, incorrect to suggest that the information derived from seized computers had no probative value as such information is admissible in terms of section 61(2) and its weight assessed in terms of section 68B(3) of the Act.

(xv) That the taxpayer's strategy in this appeal was to attack the documentation used by ZRA to estimate the principal liability due and the conduct of ZRA in discharging their mandate but the taxpayer found itself in the invidious position of having to attack its own documents and in the absence of the personnel who drew up the management accounts and the forensic data it was always an impossible task for the taxpayer to impugn these documents.

(xvi) That it was common cause that the taxpayer had failed to provide the schedules for zero rated goods that it sold and it was most likely that some zero rated goods were sold from the supermarkets, which only commenced operations in December 2012. Moreover, the taxpayer was solely to blame for failing to supply ZRA with the requested schedules and the taxpayer failed to prove on a balance of probabilities that it sold raw agricultural products including meat for its own account.

(xvii) That the taxpayer failed to establish the extent of its liability for output tax to

ZRA and the figure provided by its chartered accountant could not be correct.

(xix) That on the figures provided by the parties the court was unable to make a finding on the actual amount of output VAT due from the taxpayer and, in the result, the taxpayer had failed to show on a balance of probabilities that the estimated figures were wrong and the court accordingly confirmed them.

(xx) That ZRA had properly used documentation and computer generated data derived from the taxpayer to estimate the output VAT due from it and the taxpayer had failed to discharge the *onus* on it to show that the information in these documents was incorrect. Moreover, it was not in dispute that these documents emanated from the taxpayer and the public officer had confirmed the source of the documents by appending his signature and by stamping them and the suggestion that he had acted under duress was not established.

(xxi) That the court was satisfied that ZRA had used the best documentation available at the time to estimate the output value added tax liability of the taxpayer for the period in question and the taxpayer had failed to show that the estimates were computed in an arbitrary manner.

(xxii) That it was incorrect to suggest that the taxpayer was not afforded an opportunity to submit input claims and, in any event, the taxpayer was, in terms of section 15(2)(*a*) of the Act required to claim input tax at the latest within 12 months of the invoiced date.

(xxiii) That, in the result, the court was satisfied that the taxpayer had failed to cooperate fully with ZRA and, accordingly, ZRA was entitled in terms of section 33(4) of the Value-Added Tax Act to make estimated assessments of the taxpayer's output VAT that was payable and due.

<u>As to an appropriate penalty for the undeclared VAT</u>

(xxiv) That ZRA had imposed a 100% penalty on the principal VAT liability which the taxpayer contended was disproportionate to its moral blameworthiness

and verbal representations made in the various meetings held between the parties and the court reiterated that in all appeals before the Fiscal Appeal Court it exercised its own discretion and was not fettered in any way by what ZRA had done.

(xxv) That the court's approach in determining the appropriate penalty in the circumstances borrowed heavily from the criminal law and it preferred the approach first enunciated in *S* v *Zinn* 1969 (2) SA 537 (A) at 540G [also reported at [1969] 3 All SA 57 (A) at 61] which considered the triad of the personal circumstances of the taxpayer, the infringement and the interests of society.

(xxvi) That in assessing the appropriate penalty the court was guided by the submissions advanced by both counsel and it agreed with the taxpayer that it contributed in its own small way to the general economic wellbeing of the country and in an economy characterised by high formal unemployment, it had provided employment to about one thousand bread winners and its business activities provided downstream linkages with other industries which benefit the country's ailing economy.

(xxvii) That the taxpayer's principal liability of US$4 860 153.61 was an estimate and that estimate was probably higher than the actual liability and, therefore, in these circumstances it would be unfair to impose a penalty of 100%. Moreover, an excessive penalty would most likely lead to the liquidation of the taxpayer with the inevitable attendant economic damage to employees, suppliers and the general fortunes of the country.

(xxviii) That, therefore, in the absence of a deliberate intention to evade the payment of VAT and taking into account the extent of the principal VAT liability, it seemed that a penalty of 10% of the estimated liability was most appropriate and such a penalty was accordingly imposed.

Appeal dismissed but with a reduced penalty of 10%, each party to bear its own costs.

3.4. C:SARS v Reunert Ltd

Reunert had held 40% of the shares in Nokia Siemens Networks South Africa (Pty) Ltd (NSN-SA) and the remaining 60% of the shares were held by companies in the Nokia Siemens Networks Group (NSN Group).

NSN-SA was a South African company through which the Siemens Group – which consisted of NSN-SA and NSN Group – sold its telecommunications products throughout Africa and their shareholders' agreement obliged the Siemens Group to channel all its Southern African business through NSN-SA, which it did. Siemens Group in fact channelled all its African business through NSN-SA which was consequently 'extremely profitable' and paid 'extremely good' dividends to its shareholders, including Reunert.

The NSN Group thereafter changed its business model and it decided to stop conducting its African business through NSN-SA. Reunert was concerned that this would diminish NSN-SA's profitability and particularly the dividend stream it received from NSN-SA. It thus suggested to NSN Group that they buy out Reunert's share in NSN-SA. NSN Group was however keen to maintain Reunert as a partner in NSN-SA because of its close relationships with their biggest South African customers and NSN Group therefore persuaded Reunert to stay by offering to top-up the dividends it received from NSN-SA if they fell below historical levels. These were the circumstances that led to the adoption of the disputed clauses in the Sales Promoter Agreement (SPA) and the background to which the court had to have regard in their proper interpretation.

The parties gave effect to this arrangement by two agreements in November 2007. The first was a new Shareholders' Agreement in terms of which Reunert agreed to stay on as a 40% shareholder in NSN-SA and the second was the SPA between Reunert and the NSN entities (NSN) in terms of which NSN appointed Reunert as their sales promoter and in terms of which NSN undertook to pay Reunert commission and to top-up the dividends it received from NSN-SA as and when necessary if they fell below historical levels.

On this understanding, which was given effect to in the SPA, NSN appointed Reunert as its sales promoter in Southern Africa.

In terms of clause 4.3 of the SPA NSN undertook to pay Reunert commission twice a year from 1 January 2008. For the period January to June, commission was payable on 31 July and, for the period from July to December, it was payable on 31 January the following year. Clause 4.1 provided for the commission to be calculated as a percentage of NSN's turnover in Southern Africa. The calculation was based on a sliding scale percentage of sales revenue and, importantly, it was made 'subject to' clause 4.9, which in effect said that Reunert's actual commission as calculated would be reduced by the 'grossed-up' value: that is, the pre-tax value of any dividend that Reunert had received from NSN-SA.

If the grossed-up value of the dividend exceeded the gross commission, no commission was payable, and the excess of the grossed-up dividend was carried forward to the calculation of the commission payable on the next payment date. If the grossed-up value of the dividend fell short of the gross commission, NSN was obliged to pay the shortfall only.

Clause 4.1 provided for the commission to be calculated on the basis of a percentage of NSN Group's sales revenue in Southern Africa and this formula was devised to maintain the dividend stream that Reunert had historically received from NSN-SA, expressed as a percentage of NSN's Southern African turnover.

Clause 4.10 enabled the sales revenue for each period to be converted from Euros into Rands based on the average exchange rate for each month for the purpose of calculating the commission.

SARS had appealed against a Tax Court order upholding Reunert's appeal against its additional assessments for the years 2008 and 2009 amounting to R26 856 859 and R53 143 142 respectively.

SARS had included these in Reunert's gross income on the ground that they were part of the gross commission that had accrued to Reunert under the SPA and Reunert disputed that it had acquired an unconditional right to the gross commission and thus had incurred a tax liability for the tax years in question.

The appeal in this matter turned on the correct interpretation of clauses 4.1 and 4.9 and, read together, they provided for Reunert's commission to be calculated in two steps. The first was to calculate the gross commission in terms of clause 4.1. The

second was to calculate the net commission in terms of clause 4.9 by deducting the 'grossed-up' value of any dividend that Reunert received from NSA-SA at any time up to the date of the calculation.

Reunert submitted that it had no unconditional right to the gross commission because this was always subject to deduction of the grossed-up value of any further dividends received until the final date of payment and only then did Reunert acquire an unconditional right to the net commission and it followed that only the net commission, determined after the deduction of the further dividends, accrued to Reunert for tax purposes.

Reunert submitted further that its evidence demonstrated that NSA-SA supplemented the dividends it paid to it when they fell below the levels preceding the agreement, which accorded with the purpose of clause 4 and the manner in which they implemented the agreement.

SARS contended, on the other hand, that the gross commission accrued to Reunert in terms of clause 4.1 because it was possible to calculate the amount from month to month in accordance with clause 4.10, the right to receive it having vested when the sale of products were made. It was thus immaterial whether or not Reunert received the dividends. The dividends Reunert in fact received from NSN-SA in terms of clause 4.9 thus constituted payments of the gross commission by NSN-SA to it in terms of clause 4.1 and accrued to it for tax purposes.

SARS also relied on the notes in Reunert's 2009 and 2010 annual financial statements, which state that 'NSN may pay a dividend to Reunert as a method of settlement of commission income.' These notes, contended SARS, accorded with its interpretation of clause 4.9, namely that the clause concerned the method by which Reunert was paid its commission earnings and had no bearing on the date of its accrual.

The Tax Court had upheld Reunert's interpretation of the relevant clauses and SARS had maintained that it had erred in doing so.

Judge Cachalia held the following:

(i) That a proper interpretation of the relevant provisions of clause 4 of the

agreement required a consideration of their language, the context within which they appear, their purpose and the background giving rise to them. In addition, as the clause was apparently aimed at achieving a legitimate commercial purpose, an interpretation that sensibly advances this purpose rather than one inimical to it should be chosen.

(ii) That the relevant clauses in the SPA had the following commercial implications:

- First, Reunert was entitled to commission only if the grossed-up value of the dividends it received from NSN-SA fell short of the gross commission calculated in terms of clause 4.1. If the grossed-up value of the dividends matched or exceeded the gross commission, Reunert would not receive a commission.
- Secondly, if the grossed-up value of the dividends fell short of the gross commission calculated in terms of this clause, Reunert was entitled only to so much as would compensate it for the shortfall.
- Thirdly, Reunert's commission was calculated twice a year, on 31 July (the interim payment), and on 31 January the following year (the final payment). Until the calculation was done, it was impossible to ascertain whether Reunert would be entitled to any commission at all, and, if so, what the amount would be.

(iii) That, on this basis, Reunert contended successfully before the Tax Court that it was liable to pay income tax only on the net commissions calculated in terms of clause 4.9 and not on the gross commission calculated in terms of clause 4.1, as SARS had insisted it was. The reason was that Reunert never became unconditionally entitled to the gross commission calculated in terms of clause 4.1 because this calculation was always subject to reduction in terms of clause 4.9. It was not possible to determine, until the last day, whether Reunert would be entitled to any commission at all and, if so, how much. Reunert thus never became unconditionally entitled to the gross commission calculated in terms of clause 4.1 because its claim was contingent upon the further dividends it might receive at any time until the

last day and only then did it become possible to determine the net commission in terms of clause 4.9. This was the only commission to which Reunert became unconditionally entitled. In other words, it was the only commission that accrued to Reunert for tax purposes.

(iv) That SARS had contended in the Tax Court, as it did before the Supreme Court of Appeal, that Reunert became unconditionally entitled to commission in terms of clause 4.1 for the tax years in question and this was because it was possible for Reunert to ascertain in terms of clause 4.10 the commission due to it, monthly. However, there was no merit in this submission. Clause 4.10 enabled the sales revenue for each period to be converted from Euros into Rands based on the average exchange rate for each month for the purpose of calculating the commission: it has no bearing on Reunert's entitlement to receive commission, as the Tax Court correctly found.

(iv) That, however, the more fundamental problem with SARS' contention that clause 4.1 vested Reunert with an unconditional right to gross commission based on a sliding scale percentage of sales revenue was that this calculation was expressly made 'subject to clause 4.9.' The words 'subject to' are usually used in statutes as subordinating language to denote that the first clause (clause 4.1) is subordinate to the second (clause 4.9). In other words: Reunert's entitlement to receive a commission in clause 4.1 was subordinated by clause 4.9, which provided for a further reduction if Reunert received a dividend from NSN-SA at any time before the final payment date.

(v) That SARS contended, however, that clause 4.9 did not have this effect. Read contextually, so the argument went, it was a material term of the SPA, which dealt with the amount of commission payable and the method by which Reunert was paid its commission earnings; it did not concern the determination of the amount to which Reunert had become entitled.

(vi) That SARS' reading of these clauses was at odds with their language. Clause 4.1 states expressly that the 'amount determined' to be paid to

Reunert as commission was ‘subject to’ clause 4.9. Clause 4.9 was thus as integral to the calculation of Reunert’s commission as was clause 4.1. This was because it emphatically stated that if Reunert received a dividend from NSN-SA, the commission payable to it ‘shall be calculated’ and ‘shall be determined’ by deducting the grossed-up value of the dividend. Furthermore, clause 4.9 states in terms that the NSN-SA was entitled to ‘adjust the commission payable by it to Reunert as a result of the provisions of this clause.’ This could only mean that Reunert was entitled to receive whatever the adjusted amount was determined to be due to it, not the commission determined under clause 4.1.

(vii) That it followed that Reunert’s claim to commission could only be determined by subjecting the calculation in 4.1 to any possible reduction by the grossed-up value, that is, the pre-tax value, of any dividend that Reunert received from NSN-SA in terms of clause 4.9 until the payment date. Hence, the SARS’ contention that Reunert became entitled to commission in terms of clause 4.1 must fail as it flew in the face of the express language of the clause. It was also at odds with Rawlinson’s evidence regarding the background and purpose of the SPA, which was devised to protect the dividend stream that Reunert received historically from NSN-SA. This was done, he stated, by ensuring that there was a top-up mechanism should Reunert’s dividend stream fall below a prescribed level and this purpose found expression in clause 4.9 of the SPA.

(ix) That, in addition, Reunert’s interpretation yielded a sensible commercial result. It served its purpose of topping-up the dividends that Reunert received from NSA-SA, whenever they fell below historical levels. On the other hand, SARS’ contention that NSN-SA’s dividend payments to Reunert also constituted commission payments had no apparent commercial rationale. It carried the unavoidable implication that a dividend paid by a company to its shareholder, was at the same time being treated as a payment of a debt owed to the shareholder and, as Reunert correctly submitted, it could only be the one or the other, but never both.

(x) That what remained was to determine the dispute regarding the manner in

which the SPA was implemented. Reunert contended that its unchallenged evidence demonstrated conclusively that the parties had implemented the SPA in a manner consistent with its interpretation of clause 4 thereof. SARS, on the other hand, pointed to the notes in Reunert's 2008 and 2009 annual financial statements which treat the dividend as payment of a commission due to it as provided for in clause 4.9. It contends that the manner in which the payments were dealt with in the statements supported its interpretation of the clause, which was that the dividend declared was used as a method of paying the commission that had already accrued to Reunert for the sale of products.

(xi) That Reunert had called four witnesses and, in a nutshell, the effect of their evidence was that Reunert never became entitled to or received any gross commission. The only commission to which it became entitled and in fact received was the amount determined after the deduction of dividends. Their evidence, supported by telling documentary proof, showed that Reunert never invoiced NSN-SA for gross commission – the only commission for which NSN-SA was invoiced, and made payment, was the net commission as envisaged in clause 4.9.

(xii) That SARS had another difficulty. Not only did the parties implement the agreement as testified by their witnesses, but SARS itself issued a receipt for a payment of R20 million from NSN-SA in February 2009. The payment was for income tax on the dividend paid to Reunert in the tax year in question. In other words, the SARS acknowledged the payment to Reunert as a dividend and not commission and, as before, it could only be one or the other, not both.

(xiii) That it was therefore clear that the parties to the SPA – including SARS – did not treat the gross commission calculation in terms of clause 4.1 as a debt NSN-SA owed Reunert, or deal with dividends paid to Reunert as the payment of such a debt. It was also clear that their evidence that the commission did not accrue monthly as and when sales were made but accrued only at the end of the six month period after the gross commission was reduced by the dividends paid out. They were emphatic that the

dividend declared was not used as a method of paying the commission that had already accrued to Reunert.

(xiv) That, on this last aspect that the dividend declared was a method of settlement of commission income, the notes to the annual financial statements were admittedly inconsistent with the evidence. Rawlinson, a witness, testified that this was an error but there was no explanation for how the error had occurred. It also weighed against Reunert that it did not call the person or persons who were responsible for preparing the statements for the relevant period to explain the error.

(xv) That, given the weight of the undisputed evidence regarding the manner in which the parties implemented the SPA, which was at odds with how it was described in the notes to the annual financial statements, the court considered that Reunert had discharged the *onus* of proving that SARS' decision to disallow its objection to the assessments was wrong. The court came to this conclusion despite what the notes in the annual financial statements said because, in addition to the evidence of how the parties had implemented the agreement, the background facts leading to its conclusion and a proper interpretation of clauses 4.1 read with 4.9, which included a consideration of their purpose, permitted no other finding.

Appeal dismissed with costs, including the costs of two counsel.

3.5. C:SARS v Digicall Solutions (Pty) Ltd

Digicall Solutions (Pty) Ltd (Digicall) had been incorporated on 24 February 2000 under the name B Clear and Simple Telecommunications South Africa (Pty) Ltd (BCS) and at that time B Digital Limited (Australia) (B Digital) owned 100% of the issued shares in BCS.

Digicall had established a call centre facility in Cape Town and it had utilised the Cape Town call centre, providing services as a cellular service provider to MTN and Vodacom.

Digicall had accumulated an assessed loss of approximately R86 million by the

end of its 2003 year of assessment, 30 June 2003. During 2003 the shares in Digicall were sold twice,

- first by B Digital to Selldirect Marketing (Pty) Ltd (SDM) on 5 March 2003 (i.e. during the 2003 year of assessment) and
- then from SDM to Glasfit (Pty) Ltd (Glasfit) on 1 October 2003 (i.e. during the 2004 year of assessment) through its nominee Nutbridge Investments (Pty) Ltd (Nutbridge).

It was thus common cause that the change in shareholding requirement in section 103(2) of the Income Tax Act had been met.

In relying on section 103(2) SARS was, however, limited to the first change in shareholding, i.e. from B Digital to SDM on 5 March 2003, in terms of a judgment handed down by Rogers J on 8 December 2014. SARS had applied to amend its grounds of assessment to rely also on the second change in shareholding, i.e. from SDM to Nutbridge on 1 October 2003 but the application was refused on the basis that it was the first change in shareholding that formed the foundation for SARS' satisfaction of the three requirements to invoke section 103(2).

At paragraph [24] of the judgment, reported as *ITC 1876* 77 SATC 175 Rogers J found that the first requirement could never be viewed in abstract, because the matters contemplated in the second and third requirements were matters which related back to the change in shareholding which was the subject of the first requirement. The fact that SARS in his letter, as part of its background and elsewhere, referred to the fact there had been a second change in shareholding was not relevant unless he was linking the fulfilling of the second and third requirements to that second change in shareholding.

On Rogers J's analysis of the letter of the assessment it was perfectly clear that SARS did not seek to link the second and third requirements to the second change in shareholding but to the first.

This case was an appeal in terms of section 133 of the Tax Administration against the judgment of Allie J in the Cape Town Tax Court (see *ITC 1888* (2016) 79 SATC 23) handed down on 7 September 2016 in which the Tax Court upheld Digicall's

appeal.

In issuing the additional assessments SARS had relied on section 103(2) of the Income Tax Act which, at the relevant time, had provided, *inter alia*, that the following three requirements must all be met before section 103(2) can be applied:

(a) a change in the shareholding of a company

(b) which must, as a direct or indirect result, lead to income being received by or accrued to that company and

(c) the purpose of the change was solely or mainly to utilise any assessed loss, in order to avoid or reduce a tax liability.

The Tax Court, in upholding Digicall's appeal, had found that the second and third requirements of section 103(2) had not been met.

The Tax Court found that the evidence had established that the transaction of 25 November 2003, in which Nutbridge had acquired Digicall's shares from SDM, had strong commercial substance as opposed to being an attempt to solely or mainly utilise the assessed loss acquired.

It found that the income generated by Glasfit was derived from a later, intervening event and that such income was not contemplated at the time when SDM acquired the shares in March 2003 and hence a causal link was not established between SDM's acquisition of the shares and the income that was later generated by Glasfit and, accordingly, Digicall had discharged its *onus* of proving that the sole or main purpose of the share acquisition of November 2003 was not to utilise Digicall's assessed loss.

SARS had contended that section 103(2) should be interpreted in a way that advanced its remedy, namely to suppress 'trafficking' in shares of companies with assessed losses and that it would defeat the purpose of section 103(2) if parties were allowed to artificially put distance between themselves and the acquisition of shares which, so it was contended, was done by Glasfit (through the vehicle of Nutbridge) in collaboration with SDM.

SARS contended that when SDM had acquired the shares, it and Glasfit had already contemplated on-selling of the shares to Glasfit after artificially restoring

Digicall (a shell with a substantial assessed loss) to a going concern, and that therefore the two changes in shareholding should be considered as part of one stratagem.

Digicall contended, however, that there was nothing inherently sinister or mischievous about the set-off of income in any given tax year against an assessed loss carried forward from a previous year in accordance with section 20(1) of the Income Tax Act.

Digicall contended that the 'trafficking' contemplated by section 103(2) must be determined with reference to the sole or main purpose of the 'traffickee' (i.e. Glasfit through the vehicle of Nutbridge) rather than that of the 'trafficker' (i.e. SDM) and Digicall was always beyond the reach of section 103(2) because no income was set off by it against its assessed loss pursuant to the first change in shareholding during its 2003 year of assessment and the first change in shareholding was too remote from the accrual of the income under scrutiny, and that therefore the two requirements had not been met.

SARS, in its grounds of appeal, contended that the Tax Court had erred in its approach to the facts by, *inter alia*, ignoring the evidence of Digicall's witnesses in cross-examination, analysing the evidence piecemeal instead of holistically and in context and failing to have sufficient regard to the probabilities.

The common cause facts were that Digicall had established a call centre facility in Cape Town, providing services as a cellular service provider to MTN and Vodacom. With effect from December 2001 Digicall terminated its service provider contracts and disposed of its subscriber bases to MTN and Vodacom. After December 2001 disputes arose between Digicall and MTN, and Digicall and SAS Security which provided security at the premises over amounts owing to it.

Digicall, despite terminating the service provider contracts and disposing of its subscriber bases, continued to own the Cape Town call centre which had movable assets as well as the aforementioned two claims but was no longer operational, and it was bound to a lease agreement in respect of its premises.

At the beginning of 2002 Ian Lloyd, then a director and employee of Digicall, offered an investment company, Global Capital, the opportunity to acquire

Digicall's shares and to provide services to Cell C. Global Capital took up the offer and for this purpose acquired a shelf company, Basfour 2544 (Pty) Ltd, later changing its name to SDM. Global Capital and Lloyd were SDM's major shareholders and other shareholders were Messrs Nestadt, Bloch and Benatar of Global Capital.

On 15 March 2002 SDM (under its then registered name of Basfour 2544), B Digital and Digicall concluded an agreement ('the asset sale agreement') with an effective date of 1 March 2002. In terms of that agreement SDM acquired the Cape Town call centre at a purchase price of R1 million, took over the lease and secured an option to purchase Digicall's shares. B Digital did not wish to dispose of the shares at that stage because of Digicall's pending claims against MTN and SAS Security.

SDM proceeded to provide services to Cell C from the Cape Town call centre, but only utilised 30 of its 120 seat capacity for this purpose. A decision was then taken to sell the Cape Town call centre because Cell C was able to accommodate SDM's business in its own call centre.

The litigation between Digicall and MTN was resolved on 10 September 2002 and certain amounts became payable to it by MTN. On 19 September 2002 SDM exercised its option to purchase the shares. The written agreement giving effect thereto was ultimately only concluded on 5 March 2003 ('the share sale agreement'). SDM purchased the shares for R1.00. It was a condition of the share sale agreement that B Digital (and not Digicall) would receive any amounts recovered as a result of the litigation with MTN and SAS Security.

During the latter part of 2002 SDM had, however, already started looking for a buyer for Digicall in accordance with the earlier decision to sell. It was at this point that Glasfit expressed interest. What transpired between SDM and Glasfit *via* the relevant role-players during the latter part of 2002 until conclusion of the share sale agreement between B Digital and SDM on 5 March 2003, and thereafter, was the focus of the evidence before the Tax Court, given that it formed the crux of the parties' dispute.

On 7 May 2003, SDM resold to Digicall its 'business and assets' for R1 million with

effect from 6 March 2003 (the 'sale of business agreement'). In reality what was resold was the infrastructure of the Cape Town call centre which was essentially comprised of movables.

The Cell C service provider contracts remained with SDM. It would appear that the lease also remained with SDM. Payment of the sum of R1 million was effected by crediting SDM's loan account in Digicall which at that stage still held the name of BCS. The effect of this transaction was thus that SDM owned 100% of the shares in Digicall and Digicall in turn owned 'the business' of the Cape Town call centre. It was common cause that, on conclusion of the share sale agreement on 5 March 2003, Digicall was a shell.

On 3 October 2003 SDM offered to sell 100% of the shares in Digicall to Glasfit for the sum of R3.68 million. The offer was accepted subject to satisfactory due diligence and certain other conditions. The formal agreement was concluded on 25 November 2003 with effect from 1 October 2003, with SDM disposing of its shares in Digicall to Glasfit (the shares were ultimately transferred directly to Nutbridge as Glasfit's nominee). At the same time Glasfit and SDM concluded an agreement in which SDM was to rent 30 seats at the Cape Town call centre from Digicall at R7 000 per seat per month for a period of 18 months terminating on 31 March 2005, with the lease remaining valid and enforceable until at least that date (the lease was assigned to Nutbridge by SDM). Again, Digicall's claims against MTN and SAS Security were excluded in favour of B Digital.

After conclusion of the agreement on 25 November 2003 the Glasfit group moved its central electronic branch (CEB) into Digicall, conducted the business which PG Glass outsourced to it in Digicall and, following the establishment of its consolidated call centre (CCC) in Bryanston, Johannesburg, in the first part of 2004, operated the CCC in Digicall.

Under the control of Nutbridge Digicall's name was changed to Digicall Solutions. It received income, or income accrued to it, and it utilised Digicall's assessed losses during the 2004 to 2008 years of assessment.

Following the additional assessment issued by SARS during November 2010 Digicall filed an objection in which it contended, *inter alia*, that SARS had relied on

the first change in shareholding during 2003, whilst the income from which the assessed losses were deducted was earned after the second change in shareholding in 2003.

Judge Cloete held the following:

(i) That in relying on section 103(2) SARS was limited to the first change in shareholding, i.e. from B Digital to SDM on 5 March 2003, in terms of a judgment handed down by Rogers J in *ITC 1876* 77 SATC 175. SARS had applied to amend its grounds of assessment to rely also on the second change in shareholding, i.e. from SDM to Nutbridge on 1 October 2003 but the application was refused on the basis that it was the first change in shareholding that formed the foundation for the appellant's satisfaction of the three requirements to invoke section 103(2).

(ii) That section 103 of the Income Tax Act (as it was at the relevant time) was clearly directed at tax avoidance schemes, and should be interpreted in a way that advances the remedy provided by the section while suppressing the mischief against which it is directed.

(iii) That where the taxpayer was a company, whose shares can readily change hands, new proprietors will attach themselves to the company and inject new income into it in order to exploit the assessed loss. It was this 'trafficking' in the shares of companies with assessed losses which gave rise to the enactment of section 103(2). (See *Conshu (Pty) Ltd* v *CIR* 57 SATC 1 at 8).

(iv) That, any income, whether diverted or internally generated, may fall within the ambit of the second requirement of section 103(2) as long as it was received by or accrued to the taxpayer 'as a direct or indirect result of the taxpayer's change in shareholding: and there is no limitation of the meaning of an 'indirect result', and the chain of causation may therefore be long and involved, so long as it is not broken'. (See *ITC 1123* 31 SATC 48 and *ITC 1388* 46 SATC 126).

(iv) That a taxpayer's *ipse dixit* as to its intent and purpose is not decisive, and direct evidence of intent and purpose must be weighed and tested against

the probabilities and the inferences normally to be drawn from the established facts. (See *ITC 1185* 35 SATC 122).

(v) That, having regard to these established legal principles, applied to the evidence and in light of the probabilities, the court was satisfied that it was proven that while the first change in shareholding may have been the *sine qua non* of the receipt or accrual of the income under scrutiny to the taxpayer, it was not the *causa causans*, i.e. the effective cause thereof. It was instead the second change in shareholding that was the effective cause. Moreover, Glasfit did not acquire the taxpayer's shares for the sole or main purpose of utilising the assessed loss.

(vi) That in the particular circumstances of this matter neither the second nor third requirements of section 103(2) were met, and that the taxpayer successfully discharged the *onus* resting upon it in this regard.

(vii) That it followed that the appeal must fail.

Appeal dismissed with costs, including the costs of two counsel.

3.6. ITC 1903

SARS had raised an STC assessment on the taxpayer on the basis of a 'deemed dividend', deemed to have been declared on 28 February 2011 in respect of a 'dividend cycle' ending on 28 February 2011, the latter date being the last day of the taxpayer's income tax year of assessment which ended on 28 February 2011.

The sole issue in this appeal was whether the SARS was precluded from raising an original assessment ('the STC assessment') on the taxpayer for Secondary Tax on Companies ('STC') when he purported to do so.

The purported STC assessment bore the date 11 March 2015 and indicated a 'Dividend declared date' of 28 February 2011 and a 'Dividend Cycle' from 1 March 1997 to 28 February 2011.

The issue for determination between the parties was whether SARS was precluded by prescription of the time period within which it could validly issue an STC

assessment from issuing the purported STC assessment on 11 March 2015.

SARS' representative, Mr Y, stated in an email dated 11 November 2014, sent to the taxpayer's accountant that: 'The date used was the assessment date for the 2011 return, namely, 19/12/2011. This return will thus prescribe on 19/12/2014.'

On 18 December 2015 SARS' Tax Court Specialist, one Mr Z, said the following in a letter to the taxpayer: 'It is common cause between the parties that the period within which the Commissioner 'had' to issue an assessment in respect of the dividend cycle in dispute expired on 19 December 2014.'

According to the taxpayer, these two SARS officials were correct in what they stated in the correspondence already referred to. However, the stance adopted by these SARS officials was departed from three days later in a letter dated 21 December 2015 and it was also departed from in SARS' Rule 31 statement of the grounds of assessment and opposing the appeal.

There was a fundamental difference between the parties as to which statutes governed the question of prescription in the circumstances of this matter. The taxpayer had relied on section 269(5) of the Tax Administration Act read with the further proviso to section 79(1) of the Income Tax Act, while the Commissioner relied exclusively on the provisions of the Tax Administration Act, i.e. section 99. The further proviso to section 79(1) of the Income Tax Act applied prior to its repeal by the Tax Administration Act with effect from 1 October 2012.

It is significant to mention that the Tax Administration Act came into force on 1 October 2012, i.e. after 28 February 2011 and after 19 December 2011, but prior to the raising of the purported STC assessment on 11 March 2015.

By the time that the Tax Administration Act came into force on 1 October 2012, STC had already been replaced by the dividends tax and it explains why the taxpayer's rights and entitlements in relation to STC assessments were preserved in terms of section 269(5) of the Tax Administration Act.

The Tax Administration Act contained 'transitional provisions' in sections 258 to 270 thereof and section 269(5) provided that 'a right or entitlement enjoyed by, or obligation imposed on, a person under the repealed or amended provisions of a tax

Act, that had not been exercised or complied with before the commencement date of this Act, is a valid right or entitlement of, or obligation imposed on, that person in terms of any comparable provision of this Act, as from the date that the right, entitlement or obligation first arose, subject to the provisions of this Act.'

One of the provisions that was repealed by the Tax Administration Act was section 79(1) of the Income Tax Act, including the provisos thereto and the furthest proviso thereto which provided, *inter alia*, at the relevant time that SARS shall not, after the expiration of three years from the date of the said assessment, make any assessment in respect of any amount of secondary tax on companies payable by the company in respect of any dividend declared during that year, unless SARS is satisfied that the fact that an assessment in respect of the said amount was not previously made was due to fraud or misrepresentation or non-disclosure of material facts.

The taxpayer contended that SARS could not issue an STC assessment in respect of a dividend (deemed to be) declared during its 2011 year of assessment after the expiration of three years from 19 December 2011. SARS had made an assessment upon the taxpayer for normal tax purposes, in respect of its year of assessment which ended 28 February 2011, on 19 December 2011.

The issues before the court were those contained in the Commissioner's Rule 31 statement of the grounds of assessment and opposing the appeal and these documents had set out both the material facts and the legal grounds on which the parties placed reliance and it was the correctness of this pleaded stance that called for adjudication by the court along with that of the taxpayer, being the taxpayer.

Judge Dlodlo held the following:

(i) That it was significant to mention that the Tax Administration Act (TA Act) came into force on 1 October 2012, i.e. after 28 February 2011 and after 19 December 2011, but prior to the raising of the purported STC assessment on 11 March 2015. On 1 April 2012, the STC which was governed by sections 64B and 64C in Part VII of Chapter 2 of the Income Tax Act had been replaced by the dividends tax that was governed by sections 64D to 64N in Part VIII of Chapter 2 of the Income Tax Act and which was enacted

with effect from 1 April 2012. It was therefore clear that by the time that the TA Act came into force on 1 October 2012, STC had already been replaced by the dividends tax and one must accept that this explained why section 99 of the TA Act did not deal specifically with STC, whereas the further proviso to section 79(1) of the Income Tax Act did and it explained further why taxpayers' rights and entitlements in relation to STC assessments were preserved in terms of section 269(5) of the TA Act.

(ii) That one of the provisions that was repealed by the TA Act was section 79(1) of the Act, including the provisos thereto, which, prior to its repeal, was in force on 28 February 2011 (the date on which SARS maintained that dividends were deemed to have been declared by the taxpayer for STC purposes) and on 19 December 2011, the date of the assessment for normal tax raised by SARS on the taxpayer in respect of its year of assessment ended 28 February 2011.

(iii) That the words 'any dividend declared during that year' in the further proviso to section 79(1) included 'an amount deemed to be a dividend declared by a company to a shareholder' as contemplated in section 64C(2), the provision relied on by SARS when purporting to raise the STC assessment. SARS had made an assessment upon the taxpayer for normal tax purposes, in respect of its year of assessment which ended 28 February 2011, on 19 December 2011.

(iv) That it followed that on 19 December 2011, prior to the coming into force of the TA Act and prior to the repeal of section 79(1) of the Act, the taxpayer had acquired a right or entitlement, as contemplated in section 269(5) of the TA Act, that SARS would not be able to – in the words of the further proviso to section 79(1) – 'make any assessment in respect of any amount of secondary tax on companies payable by the company in respect of any dividend declared during that year' after the expiration of three years from 19 December 2011.

(iv) That, indeed, given the existence of this right or entitlement under the further proviso to the repealed section 79(1) of the Income Tax Act (as

contemplated in section 269(5) of the TA Act) it was 'a valid right or entitlement in terms of' section 99 of the TA Act. The latter section was the 'comparable provision' of the TA Act and this was the case as from the date that the right or entitlement first arose in terms of section 269(5) of the TA Act. In other words, the content of the further proviso to the repealed section 79(1) must be 'read into' section 99 of the TA Act in the circumstances of this matter.

(v) That it was of importance to mention that section 99 of the TA Act governed the 'period of limitations for issuance of assessments' and it must thus follow that, by virtue of section 269(5) of the TA Act, the taxpayer was, and is, entitled to rely on the content of the further proviso to section 79(1) of the Act which expressly dealt with STC.

(vi) That in view of the fact that the 'prescription period' or, in the words of section 99 of the TA Act, the 'period of limitations for the issuance of assessments', commenced from the date of the taxpayer's 2011 normal tax (i.e. income tax) assessment being 19 December 2011, it became important to appreciate what an assessment was.

(vii) That there has been no suggestion of any fraud, misrepresentation or non-disclosure in the present matter and still SARS purported to raise the STC assessment on 11 March 2015, i.e. after the expiration of the three-year period from 19 December 2011, the date of the taxpayer's 2011 assessment for normal tax. The problem was that SARS only changed the basis on which it purportedly assessed the taxpayer on 11 March 2015 in its letter dated 21 December 2015, which can be contrasted with the basis stated in its letter dated three days earlier, on 18 December 2015.

(ix) That, in regard to what exactly was an assessment, it was trite that an assessment was not the piece of paper that notifies a taxpayer of a tax determination. The latter is a 'notice of assessment'. An 'assessment' is the determination or decision itself, notified in a notice of assessment.

(x) That it was noteworthy that the word 'assessment' was defined in section 1 of the TA Act as a 'determination' and there was no reason why this court

could not take judicial cognisance of the fact that the date of the purported STC assessment was 11 March 2015 and that this was more than three years after the date of the taxpayer's 2011 assessment for normal tax, i.e. 19 December 2011 and the latter date was common cause between the parties.

(xi) That the taxpayer's original normal tax assessment for the year of assessment which ended on 28 February 2011 dated 19 December 2011, was clearly 'relevant to the issues in appeal' when regard is had to the contents of the taxpayer's Rule 32 statement but this was not included in the *dossier* by SARS. The taxpayer has had this included in the Trial Bundle. Such assessment should be treated as it would have been treated if it had been in the *dossier* precisely because it was required to have been included in the *dossier* and the court can and must take notice of the contents of the *dossier*.

(xii) That, in the alternative, a legitimate expectation on the part of the taxpayer developed that the period of limitations for the issuance of an STC assessment in respect of the taxpayer's dividend cycle ending 28 February 2011, ended on 19 December 2014. The taxpayer must have had a legitimate expectation that an STC assessment would not and could not be issued after 19 December 2014. Ordinarily, there can be no legitimate expectation that is contrary to the provisions of the applicable legislation but what needs to be pointed out, though, was that the content of the legitimate expectation was fully in conformity with sections 99 and 269(5) of the TA Act read with the repealed further proviso to section 79(1) of the Income Tax Act.

(xiii) That, in summary, in terms of section 79(1) of the Income Tax Act prior to its repeal by the TA Act, the taxpayer had the right and an entitlement not to be subjected to an STC assessment in respect of a dividend cycle ending on 28 February 2011 after 19 December 2014. The STC assessment was in fact issued on 11 March 2015, by which time the period of limitations for the issuance of the STC assessment had expired. Therefore it must follow that the STC assessment was not validly issued by SARS and the period

within which SARS could validly have done this had 'prescribed' on 19 December 2014.

(xiv) That, on the question of costs, they were to be awarded in favour of the taxpayer in terms of section 130(1)(*a*) of the TA Act on the ground that there were failures and omissions on the part of SARS and it was unnecessary to repeat same.

Appeal allowed and the purported STC assessment was set aside.

3.7. *ITC 1904*

The taxpayer had made application for default judgment in terms of Rule 56 of the Tax Court Rules (the rules) promulgated under section 103 of the Tax Administration Act and SARS had made application for condonation for late filing of its answering affidavit in opposition to the default judgment application.

SARS had also raised a point *in limine*, namely that the Tax Court sitting in Cape Town had lacked jurisdiction to hear the taxpayer's application.

SARS had assessed the taxpayer on 2 November 2015 in respect of the 2005 to 2010 years of assessment and on 3 November 2015 in respect of the 2011 and 2012 years of assessment and the taxpayer's appeal had involved its 2005 to 2012 years of assessment.

The parties had been engaged in earlier litigation in relation to the taxpayer's 2002 to 2004 years of assessment and the Supreme Court of Appeal judgment in *C: SARS* v *South African Custodial Services (Pty) Ltd* 74 SATC 61 had set out the factual *matrix* at paras [4] to [21] thereof.

The taxpayer, on 31 January 2017, had filed its notice of appeal against the aforementioned assessments in terms of section 107(1) of the Tax Administration Act as read with Rule 10 of the rules.

In terms of Rule 31 SARS was required to deliver their statement of the grounds of assessment and opposing the appeal ('Rule 31 statement') within 45 days

thereafter and the 45 day period expired on 5 April 2017.

However, SARS did not deliver their Rule 31 statement timeously and there was no agreement in place for late delivery by that date, nor had SARS requested an extension in terms of Rule 4(2).

After various exchanges between SARS and the taxpayer's tax consultant, SARS' representative requested an extension for delivery of the Rule 31 statement and on 11 April 2017 the taxpayer's tax consultant advised SARS' representative that the taxpayer had reluctantly agreed to an extension until 13 June 2017, i.e. a further 45 days calculated from the initial deadline of 5 April 2017.

The taxpayer, on 26 May 2017, had made a 'without prejudice' settlement proposal to SARS but nowhere in that proposal was there any indication by the taxpayer that SARS was, as a result of the settlement offer, relieved of its obligation to deliver its Rule 31 statement by the agreed extended deadline of 13 June 2017.

On 31 May 2017 SARS' representative advised the taxpayer that the Rule 31 statement would not be forthcoming by 13 June 2017 and in response the taxpayer agreed that a final extension for delivery of the Rule 31 statement by 14 July 2017 would be granted on the basis that SARS would be able to consider the settlement proposal while it prepared the Rule 31 statement. Moreover, SARS did not dispute that the final deadline was 14 July 2017.

SARS did not comply with the final deadline and, accordingly, on 17 July 2017 the taxpayer delivered its notice in terms of Rule 56(1) and in that notice it was pointed out that, despite the extensions granted and having had a total of 113 days to deliver the Rule 31 statement, SARS had still not done so. SARS was formally notified that the taxpayer would apply to the Tax Court for a final order in terms of section 129(2) of the Tax Administration Act in the event of it failing to remedy its non-compliance within 15 days, i.e. by 7 August 2017.

However, yet again, SARS did not comply and on 8 August 2017 the taxpayer delivered its application for default judgment. SARS eventually delivered its Rule 31 statement on 9 September 2017, one month after delivery of the application for default judgment.

It was clear from the application for default judgment that what the taxpayer sought, as its main relief, was a final order in terms of section 129(2)(*b*) of the Tax Administration Act, upholding its appeal in terms of its notice of appeal dated 31 January 2017. It was only in the alternative that the taxpayer sought an order directing SARS to deliver its Rule 31 statement within five days thereof in the event that the court found good cause for SARS' default.

SARS, although timeously filing their notice of intention to oppose, had failed to deliver their answering affidavit timeously, which SARS was required to do by 12 September 2017.

SARS' explanation for this failure was that they believed that should it remedy the non-compliance before 13 September 2017, then other subsequent actions, including the filing of the answering affidavit, fell away. Its Rule 31 statement had been delivered on 9 September 2017, while the answering affidavit was due on 12 September 2017.

SARS had, at no stage, sought condonation for late filing of the Rule 31 statement itself, and simply serving that statement on the taxpayer and filing it in the court file did not automatically remedy its non-compliance, contrary to what SARS may have believed.

On 13 September 2017 the taxpayer requested the Registrar to allocate a date for hearing of the default judgment application and the parties were provided with the notice of set down on 20 September 2017.

SARS only brought their application for condonation for late filing of its answering affidavit on 29 September 2017, i.e. five days before the hearing on 9 October 2017.

SARS had complained that the taxpayer had requested the Registrar to set down the application for default judgment despite receipt of the Rule 31 statement. It complained that its subsequent requests to the taxpayer's representatives to withdraw the default judgment application were refused. In its view there was no prejudice to the taxpayer because it had been in possession of the Rule 31 statement since 9 September 2017 and it was on this basis that it sought condonation for the late filing of the answering affidavit.

The taxpayer had submitted that its prejudice arising from SARS' repeated failure to comply with the rules was manifest. It explained that it had over the past ten years tried to regularise its tax affairs, and during this period it had locked horns with SARS in court on four occasions. Consequently, over these years it had difficulty in performing income tax calculations, filing income tax returns and attending to provisional tax but it had nevertheless never defaulted on payment of sums due to SARS.

Judge Cloete held the following:

(i) That on the court's calculation, the Rule 31 statement was delivered 107 days after the initial deadline expired on 5 April 2017. However, SARS had failed to secure yet another extension for its delivery later than 7 August 2017, nor indeed had it even requested one. It has also, at no stage, sought condonation for late filing of the Rule 31 statement itself. Simply serving that statement on the taxpayer and filing it in the court file did not automatically remedy its non-compliance, contrary to what SARS may have believed.

(ii) That the Constitutional Court has held that the standard for considering an application for condonation is the interests of justice. Whether it is in the interests of justice to grant condonation depends on the facts and circumstances of each case. Factors that are relevant to this enquiry include but are not limited to the nature of the relief sought, the extent and cause of the delay, the effect of the delay on the administration of justice and other litigants, the reasonableness of the explanation for the delay, the importance of the issue to be raised in the intended appeal and the prospects of success. An taxpayer for condonation must give a full explanation for the delay. In addition, the explanation must cover the entire period of delay. And, what is more, the explanation must be reasonable. (see *Van Wyk* v *Unitas Hospital* 2008 (2) SA 472 (CC); 2008 (4) BCLR 442 (CC) at paras [20] and [22].)

(iii) That the explanation provided by SARS for its delay of five months beyond the time limit of 45 days stipulated in Rule 31 was grossly inadequate. It

was not a full explanation and it did not cover the entire period of the delay. Moreover, it was not reasonable.

(iv) That the court had already highlighted the material deficiencies in the SARS representative's explanation for the delay over the period 17 July 2017 to 7 August 2017 and will not repeat them. What was clear, however, was that the Rule 31 statement was still not finalised by 7 August 2017, and it must have been nowhere near completion even when SARS filed its notice of intention to oppose the default judgment application on 22 August 2017, given that the statement was only eventually served and filed on 9 September 2017.

(iv) That, however, SARS had a further, more fundamental, difficulty and that was that there was no application before the court for condonation for late filing of its Rule 31 statement. The only application was for condonation for late filing of the answering affidavit. Even were it to be granted, it would not cure that fundamental difficulty.

(v) That the fact of the matter was that the Rule 31 statement was not properly before the court. It was delivered months out of time and at the very least more than a month after the deadline of 7 August 2017 stipulated in the taxpayer's Rule 56(1) notice.

(vi) That it may be that the SARS representative was a recent appointee in the SARS litigation division when the taxpayer's appeal was allocated to him on 27 February 2017. There was no suggestion however that he lacked the necessary skills and experience. Indeed, this is unlikely given that SARS appointed him in the first place. He had been employed in the SARS litigation division for over four months by the date when the first agreed extended deadline of 13 June 2017 expired. In these circumstances it can surely be fairly accepted that by then he would have had the opportunity to familiarise himself with the rules. Indeed, even by 10 April 2017 he must have been aware of the 45 day time limit contained in Rule 31, given that he knew he would require an agreed extension and the same applied to the further extension requested and to which the taxpayer agreed.

(vii) That this was not a typical case of an attorney representing a number of clients in a number of different types of matters. The SARS representative was employed by SARS itself and although he has taken responsibility for their belief that simply delivering the Rule 31 statement, albeit grossly out of time, would automatically remedy SARS' non-compliance, SARS was otherwise silent.

(ix) That the court accepted that the amount involved of some R44 million was substantial but insofar as the delay was concerned, SARS' conduct fell into the category of 'inexcusable' and it has paid little, if any, regard to the proper administration of justice and the effect of its delay, both on the taxpayer in this matter and the *fiscus*.

(x) That, in regard to the prospects of success, the taxpayer's appeal involved its 2005 to 2012 years of assessment. The parties were engaged in earlier litigation in relation to the taxpayer's 2002 to 2004 years of assessment and the Supreme Court of Appeal judgment in *C: SARS* v *South African Custodial Services (Pty) Ltd* 74 SATC 61 sets out the factual *matrix* at paras [4] to [21] thereof.

(xi) That SARS had assessed the taxpayer on 2 November 2015 in respect of the tax periods 2005 to 2010 and on 3 November 2015 in respect of the tax periods 2011 and 2012. The taxpayer had requested reasons for those assessments in a letter dated 1 December 2015 and SARS had replied thereto by letter dated 15 December 2015. (see judgment of Henney J dated 3 June 2016 ('Henney judgment') under Tax Court case number 0004/2016 between the parties.)

(xii) That, accepting that this court was not determining the merits of the disputed assessments, the *onus* rested upon SARS to persuade the court that it had good prospects of success in the context of whether it had shown good cause for condonation. SARS had failed to deal at all with the findings, by which it was bound, in the SCA and *Henney* judgments. Moreover, it was content to merely incorporate the content of its Rule 31 statement by reference, coupled with the bald averment that the statement

showed that it had a '*bona fide* case.' The approach adopted by SARS did not enable the court to determine that it enjoyed good prospects of success.

(xiii) That it followed that the application for condonation must fail.

(xiv) That in regard to the jurisdiction of the Tax Court in Cape Town, the taxpayer had its principal place of business in Sandton, Gauteng and its application for default judgment was filed in the Tax Court at Megawatt Park in Gauteng. Following SARS' failure to deliver its answering affidavit timeously, and on 15 September 2017, the taxpayer's attorney wrote to the Registrar of the Tax Court (which is located in Pretoria) with the request that the matter be enrolled for hearing in the Tax Court Cape Town.

(xv) That although it was technically not necessary to do so, given that SARS was in default, this letter was also emailed to SARS. The Registrar acceded to the request and set the matter down for hearing in the Cape Town Tax Court in terms of a notice of set down dated 20 September 2017, which was also emailed to SARS.

(xvi) That in its affidavit filed in support of the application for condonation for late delivery of the answering affidavit, SARS contended that this court lacked jurisdiction to entertain the application for default judgment on the basis that the taxpayer had failed to obtain SARS' consent to transfer the matter to Cape Town for hearing, or to obtain an order from the Tax Court to that effect, as envisaged in Rule 41(2).

(xvii) That this argument had no merit because at the time when the request was made to the Registrar, SARS was in default, given that it had failed to timeously deliver its answering affidavit and it was only 'a party' to the extent that it had earlier delivered a notice of intention to oppose.

(xviii) That Rule 59 provided that where a party had failed to deliver a notice of intention to oppose, the taxpayer may apply to the Registrar to set the matter down and an application must be heard by a tax court having jurisdiction within any area in which the taxpayer resides or carries on business unless the taxpayer and the Registrar agree that it be heard in

another area.

(xix) That Rule 62 dealt with the set down of a matter for hearing where no answering affidavit has been delivered and it simply provided that: (1) If no answering affidavit is delivered by the respondent within the period referred to in Rule 60(*c*) (i.e. within 15 days of delivery of its notice of intention to oppose) the taxpayer may within 5 days of the expiry of that period apply to the Registrar to set the application down and (2) The Registrar must deliver to the parties a written notice of the time and place appointed for the application at least 10 days before the date upon which it has been set down.

(xx) That there was nothing, on the plain wording of Rule 62, that required an taxpayer in the position of the taxpayer to obtain the prior consent of a defaulting party, or an order from the Tax Court, for what had become an application for default judgment to be heard at a place other than where the application was originally filed. That such consent, or an order to that effect, is not required, is supported by the wording of Rule 59 which expressly provides that, where no notice of intention to oppose has been delivered, an taxpayer and the Registrar may agree that it be heard in another area. In any event, Rule 62 appears to permit the Registrar, in her discretion, to appoint the place for the hearing of the application and, in the normal course, she would appoint the place where the application has been filed. The Registrar clearly exercised her discretion in accommodating the taxpayer's request for the matter to be heard in Cape Town for the reasons set out in the email of 15 September 2017. It also appeared that the purpose of the 'default position' in the rules, namely that a matter will be heard at the place nearest to the residence or principal place of business of the appellant, was predominantly for the latter's convenience.

(xxi) That if the court was wrong in this regard, SARS was nonetheless given two opportunities to object to the transfer of the matter from Gauteng to Cape Town, namely upon receipt of the email dated 15 September 2017 and the Registrar's subsequent notice of set down and it raised no objection. Moreover SARS had failed to disclose to the court that the

interlocutory application between the same parties had earlier served before Henney J during 2016 and no objection was raised by SARS to that interlocutory application being heard in Cape Town and it was simply dealt with on its merits. Thus there could be little doubt that SARS, in any event, had tacitly consented to the transfer of this matter to Cape Town.

(xxii) That it was, for these reasons, that the point *in limine* had been dismissed with costs.

(xxiii) That the taxpayer had complied with the procedural provisions of Rule 56 and SARS had failed to show good cause for condonation of its default. In terms of Rule 56(2) the court was empowered to make an order under section 129(2) of the Tax Administration Act.

(xxiv) That the taxpayer had sought a final order under section 129(2)(*b*) to alter SARS' assessment in the manner contemplated in its notice of appeal and the court was persuaded that it was entitled to such an order and there was no reason why costs should not follow the result.

(xxv) SARS' application for condonation for the late filing of its answering affidavit was dismissed.

3.8. Volkswagen South Africa (Pty) Ltd v C:SARS

Volkswagen, one of the largest motor vehicle manufacturers in South Africa, derives its income from the sale of motor vehicles, not only those which it manufactured, many for export, but also from motor vehicles imported from abroad for sale in this country.

Commencing as long ago as 1995, the government initiated a motor industry development program (MIDP) aimed at an internationally competitive and growing automotive industry and by June 2000 much had been achieved since the MIDP had been introduced. Additional jobs had been created in the process and it was felt that the potential for greater growth and an increase in yet further employment opportunities was a reality.

In order to achieve this and to remain internationally competitive, South Africa had to lower costs in its production of motor vehicles whilst maintaining quality capable of competing with the products of manufacturers in other parts of the world. One of the ways of achieving this was thought to be to reduce the number of models being produced, as global trends had shown that common platform engineering and the resultant benefits in improved economies of scale, led to cost savings.

Consequently, as a result of the undoubted advantages it had shown to the economy of the country, the government was prepared to extend the MIDP, with one of its objectives being the rationalisation of models being produced in the automotive industry. However, it was one thing to merely agree to rationalise the number of models being produced; it was quite another to implement such a process.

Rationalisation of models would require plant upgrades and technology enhancements to put this country's manufacturers on a par with the world's best and this would involve substantial capital expenditure, *inter alia*, to provide dedicated buildings, to expand production lines, to install robots used in the production and assembly processes, and to update machinery and tooling.

As an incentive for the automotive manufacturers to embark on such an expensive capital programme, the Board on Tariffs and Trade recommended the introduction of a Productive Asset Allowance (PAA) to those manufacturers that had invested a certain minimum value in dedicated productive assets for the assembly of light vehicles and manufacture of automotive components to streamline their manufacturing base to manufacture a limited product range for the domestic and export markets, thereby improving their international competitiveness.

Pursuant to the aforementioned, the Department of Trade and Industry announced the introduction of a PAA with effect from July 2000 and the form in which the benefit was provided to participating manufacturers was by way of the issue of PAA certificates as envisaged in a rebate item contained in a schedule to the Customs and Excise Act, providing for a rebate on customs duty on certain categories of completely built-up imported light motor vehicles. The amount of the certificate was to be calculated as a percentage of the value of the 'productive

assets' approved by the Director-General: Trade and Industry for purposes of this rebate provision. The 'productive assets' referred to were described in the rebate item as including: 'buildings erected for the sole purpose of manufacturing specified motor vehicles or automotive components, and new or unused plant, machinery, tooling, jigs, dies and moulds, in-plant logistics, testing, design and production IT equipment and supporting software.'

Although the PAA scheme was initially administered by the Board of Tariffs and Trade on behalf of the National Department of Trade and Industry, its administration was later taken over by the International Trade Administration Commission of South Africa (ITAC).

In order for a PAA certificate to be issued, any claim for such benefits had to be audited by external financial auditors using prescribed audit standards in order to verify the investment in productive assets and, once that was done, an engineer appointed by ITAC was delegated to conduct a physical on-sight asset verification exercise which could lead to adjustments in their amount claimed. Only once all of this had been done and the amount of the claim claimed confirmed and agreed, would a PAA certificate be issued to a manufacturer and the amounts received in this way would be 20% of the capital investment so audited and verified.

These PAA certificates could then be used by the manufacturer to offset the duty which it became liable to pay on importing fully made up vehicles for sale in this country. In this way, manufacturers were encouraged to invest in procuring qualifying productive assets to rationalise their model production. Put somewhat differently, as a result of their participation in the PAA scheme and the rationalisation of the motor vehicles they were producing, they were reimbursed to an amount of 20% of their capital expenditure incurred in the rationalisation process by, effectively, paying less import duty than would have been the case had they not participated in the scheme and this was an investment incentive, not a trading incentive.

To sum up, the PAA was introduced as an incentive for the automotive manufacturing industry to make new capital investments in manufacturing capacity in order to produce a rationalised range of light motor vehicles. Only those

manufacturers who committed to the process of rationalisation and made the necessary investments in fixed capital to achieve rationalisation would be entitled to benefits under the scheme. Without doing so, they would not receive PAA certificates, each of which reflected as their benefit an amount calculated in regard to the capital investment they had made in pursuance of the scheme. The PAA certificates, in turn, could be used to reduce the amount of import duty a manufacturer became obliged to pay on importing certain fully built-up vehicles from abroad for resale.

The issue before the court was whether the accrual of rebates calculated with reference to capital expenditure, and to which Volkswagen became entitled under a government scheme to support the local motor industry, should be regarded as accruals of a revenue or capital nature.

The court *a quo* (see *ITC 1893* (2016) 79 SATC 159) had concluded that the accruals in issue were revenue in nature and therefore fell to be included in Volkswagen's gross income.

Volkswagen, in its income tax returns for the years of assessment 2008–2010, had reflected the PAA certificates that it had received as being accruals of a capital nature and the amounts involved were: R83 651 677 for 2008, R76 895 388 for 2009 and R48 338 557 for 2010.

SARS, had refused to accept that these amounts were of a capital nature, and had assessed the appellant to tax on the basis that they were income, which led to an appeal in the Tax Court from where the matter went to the Supreme Court of Appeal.

Judge Leach held the following:

(i) That the fundamental question was whether the PAA certificates were receipts or accruals of a capital nature and there was no simple litmus test which could be applied to determine what is capital or revenue although over the years, various guidelines have been laid down to assist in determining the nature of a particular receipt or accrual and these included whether the accrual was forthcoming from the realisation of a capital asset or whether it was received in the course of carrying on business or in

pursuance of a scheme of profit making.

(ii) That the necessity of using good sense to decide whether an accrual was capital or revenue in nature was echoed by the Supreme Court of Appeal in *WJ Fourie Beleggings BK* v *C: SARS* 71 SATC 125 where it was remarked that although common sense has been described as a blunt intellectual instrument, 'it remains the most useful tool to use in deciding the issue.'

(iii) That it appeared from Paragraph 3.2.3 of the SARS *Interpretation Note* No 59 of 10 December 2010, that the revenue authority regarded the purpose of a government grant of cardinal importance and that was supported by the case law, *ie ITC 402* 10 SATC 111, *Moolman* v *CIR* 19 SATC 127 and *ITC 1435* 50 SATC 117.

(iv) That, in the light of the aforementioned authorities, Volkswagen contended that the court in each case had looked to the 'real and basic cause of the accrual' to determine whether it was capital or revenue in nature and, that being so, it submitted that the inquiry should resolve itself into answering two questions: first, what was the real and basic cause of the accrual (or put somewhat differently, why or in respect of what conduct or activity was the grant made) and, secondly, whether that cause was, as a matter of fact, more closely associated with the equipment of the taxpayer's income producing machinery (in which event it should be regarded as capital) or with its income-earning operations (in which event it should be regarded as revenue) and that indeed seemed to be an appropriate approach in a case of this nature and it also appeared to be in line with certain English authorities.

(iv) That the decisions in *Seaham Harbour Dock Company* illustrated the importance of the purpose for which a government grant was paid and this, too, was stressed in para 3.2.5 of *Interpretation Note No 59*, which provided as follows: 'A government grant which is designated as being made towards the cost of specified capital expenditure is capital in nature because it is made in order to assist or compensate a person in meeting costs of a capital nature' and, essentially, one can have no quarrel with this

statement.

(v) That the difficulty before the court was why SARS appears not to have applied the *Interpretation Note* to Volkswagen in the present case. In disallowing Volkswagen's objection to the PAA certificates not having been regarded as capital accruals, SARS stated that 'there is no indication from the PAA Guidelines that the amount was received for the purpose of establishing an income-earning structure. . .' It went on to state that in calculating the PAA's certificates, the Department of Trade and Industry 'took into account the amount invested in qualifying plant and machinery, however this was done for the purpose of calculating the allowance' which did not imply that the appellant had been compensated 'for the capital outlay in respect of the plant and machinery.'

(vi) That the court's reaction to the aforementioned was similar to that of Davis AJA in *Pyott Ltd* v *CIR* 13 SATC 121 and it, too, saw 'insuperable difficulties in holding anything of the kind.'

(vii) That, as appeared from what the court had stated earlier in the judgment, it was clear that PAA certificates were in fact issued in order to compensate manufacturers for at least a portion of their capital outlay incurred in respect of the plant and machinery required for rationalisation and it was in this way that they were encouraged to go along with the rationalisation scheme and to suggest the converse was simply astounding. Indeed, the court *a quo* found that 'the grant was made due to capital expenditure'. That being so, why should it not have been viewed as an accrual of a capital nature as envisaged in para 3.2.3 of the *Interpretation Note*?

(ix) That in the light of the court *a quo*'s answer to the aforementioned question, it had held that as PAA certificates could only be redeemed by payment of customs duties, the diminished payment of customs duty was clearly related to the gross income of Volkswagen so that the PAA certificates were not of a capital nature.

(x) That the court was unable to agree with the conclusion of the court *a quo*: firstly, the PAA certificates did not only accrue once imports were made.

Once a certificate had been issued, it had immediate value which accrued to the benefit of Volkswagen. The fact that it would lapse if not used within a stipulated period did not mean that the benefit had not accrued, nor can it change the nature of the accrual. As they were issued to compensate a manufacturer for a percentage of its capital expenditure, they were clearly capital in nature and the fact that they might lapse could not change that position.

(xi) That, moreover, that the PAA certificates were not 'tradeable' speaks to me of them being capital in nature rather than revenue. And, as stressed, they had accrued by reason of the taxpayer having invested in income producing assets. SARS' pleaded contention that the investment which had been made was merely part of a formula to calculate the benefits under the PAA scheme, ignored that fact.

(xii) That the making of a capital investment was at the centre of the scheme and, without a manufacturer making such an investment, a PAA certificate could not be paid. Had the government paid in cash rather than by way of the PAA certificates, it clearly would have been a grant paid in respect of that capital investment. As it instead allowed a rebate in respect of import duties, this did not alter the fact that the benefit derived therefrom amounted to a benefit received by the appellant in respect of capital expenditure.

(xiii) That, consequently, the diminished payment of customs duty was not 'clearly related to the gross income of the appellant' as found by the court *a quo* but, rather, should be construed as a method of payment of a grant in respect of capital expenditure.

(xiv) That, accordingly, SARS' contention that the PAA scheme was not directly intended to support capital expenditure but merely to allow the appellant to reduce the cost to it of imported vehicles and thereby increases revenue, was groundless. PAA certificates were in no way received as part of a scheme of profit making. They reimbursed the appellant in respect of a percentage of its capital expenditure and hence the conclusion of the court

a quo that the PAA certificates should be construed as income rather than accruals of capital was clearly wrong.

Appeal allowed with costs.

3.9. United Manganese of Kalahari (Pty) Ltd v C:SARS

United Manganese of Kalahari (Pty) Ltd (UMK) had been the fourth largest producer of manganese in the country and owned a mine in the Northern Cape Province where it extracted unrefined manganese (manganese ore) which it crushed and screened before it was stockpiled.

UMK brought the manganese to the condition specified under Schedule 2 of the Mineral and Petroleum Resources Royalty Act 28 of 2008 (the 'Royalty Act') and the manganese ore was loaded onto a truck or train for delivery to UMK's customers.

UMK bore the obligation for the incurrence of all costs necessary to effect delivery of the manganese from the mine to its customers, if so required in terms of the relevant contract delivery terms and these costs included transport, insurance and handling ('TIH') costs in delivering the unrefined manganese to its customers.

UMK had conducted 'mining operations' as contemplated in the definition of the phrase in section 1 of the Mineral and Petroleum Resources Development Act 28 of 2002 (the 'MPRDA') and it was an 'extractor' of an 'unrefined mineral resource' (it mined unrefined manganese) and was liable for payment of a 'royalty' in terms of section 3 of the Royalty Act.

It was common cause that UMK had transferred manganese as contemplated in the definition of the word 'transfer' in section 1 of the Royalty Act during its 2010 and 2011 years of assessment. The manganese that was mined and sold by UMK was brought to the condition specified in Schedule 2, which was the point referenced as 'CV07'on the 'UMK Material Flow' diagram.

The Royalty Act contained particular provisions in respect of the calculation of

earnings before interest and taxes ('EBIT') as well as gross sales and, in particular, section 6(3)(*b*) provided that gross sales were to be determined without regard to any expenditure incurred by the extractor, such as UMK, in respect of the transport, insurance and handling of an unrefined mineral resource (the manganese) after it had been brought to the condition specified in Schedule 2 of the Royalty Act or any expenditure incurred in respect of transport, insurance and handling to effect the disposal of it.

UMK had incurred TIH costs post the CV07 point as well as expenditure to effect the disposal of the manganese only in respect of its export sales of manganese in the 2010 and 2011 years of assessment and it maintained that it had determined its gross sales in terms of section 6(3)(*b*) of the Royalty Act in respect of the 2010 and 2011 years of assessment with reference to expenditure actually incurred by it, and not based on any estimated figures as SARS had alleged that it did.

According to UMK, its export sales of manganese in the 2010 year of assessment had amounted to R1 668 024 909, the total TIH costs incurred by it were R1 131 943 849 and its export sales of manganese in the 2011 year of assessment amounted to R2 218 387 348 and the total TIH costs incurred by it were R1 458 544 720 and UMK had made full payment to SARS of the royalty payable in accordance with its assessments.

UMK contended that it was entitled, on a proper interpretation of the provisions of section 6(3)(*b*) of the Royalty Act, to calculate its gross sales by deducting from the amounts received by or accrued to it during the 2010 and 2011 years of assessment in respect of its transfer of manganese, the TIH expenditure, or any expenditure incurred by it in respect of TIH, after the manganese was brought to the condition specified in Schedule 2, or to effect the disposal of the manganese and UMK contended that the deductions could be made irrespective of whether such expenditure was specifically considered in the computations or determinations of the amounts received or accrued for the manganese.

SARS contended that the real question was whether UMK took TIH expenditure into account for purposes of the calculation of gross sales and if the TIH costs were not taken into account in the calculation of gross sales, UMK was precluded from

having regard to such costs.

UMK had submitted its mineral royalty returns (MPR3's) to SARS for the 2010 and 2011 years of assessment and during 2012 SARS had commenced an audit of UMK in terms of various provisions of the Income Tax Act 58 of 1962 (the 'IT Act') and the Royalty Act.

After further correspondence and meetings between the parties SARS for SARS issued a letter of audit findings in relation to the royalty audit of the 2010 and 2011 years of assessment and in that letter it was, *inter alia*, stated that SARS found that UMK had deducted transport and distribution costs from gross sales for the 2010 and 2011 years of assessment and, in so doing, it had estimated these costs instead of using actual costs incurred.

The letter of audit findings further stated that all assets used or expenditure incurred after point CV07 would be disregarded for the determination of royalty tax for the 2010 and 2011 years of assessment.

UMK, on 2 September 2016, furnished a written notice in terms of section 11(4) of the Tax Administration Act (the 'TA Act') to SARS, notifying it of UMK's intention to institute court proceedings for declaratory relief and it was stated in the notice that the dispute between UMK and SARS related to the 'interpretation and application of the provisions of section 6(3)(*b*) of the Act' as set out in the audit findings letter and the response thereto.

UMK then approached the High Court for declaratory relief in relation to the correct interpretation and application of section 6(3)(*b*) of the Royalty Act in order to resolve the dispute that had arisen between it and SARS pertaining to the correct manner of determining its 'gross sales' for the purpose of calculating the royalty payable by it in terms of section 3(2) of the Royalty Act.

UMK had also sought specific relief in relation to the monetary amounts which it was entitled to deduct for purposes of calculating its mineral royalty liability in respect of the 2010 and 2011 years of assessment.

SARS had opposed the relief sought by UMK on the following grounds:

(a) That the High Court lacked jurisdiction to hear this matter in that it ought to

properly have been brought in the Tax Court after SARS had an opportunity to render a decision in respect of the assessments at issue. In any event, UMK had failed to exhaust its internal remedies provided for in the Tax Administration Act;

(b) That the granting of declaratory relief was discretionary and the High Court ought not to exercise its discretion to grant such relief in the circumstances of this case;

(c) That the language of section 6(3)(*b*) of the Royalty Act was clear and unambiguous and the interpretation contended for by UMK ought not to be adopted by the High Court.

Judge Meyer held the following:

As to the jurisdiction of the High Court to hear this matter

(i) That tax cases are generally reserved for the exclusive jurisdiction of the Tax Court in the first instance but it is settled law that a decision of SARS is subject to judicial intervention in certain circumstances and one such circumstance is that the High Court has jurisdiction to hear and determine tax cases turning on legal issues.

(ii) That it is also noteworthy that a Tax Court established under the Tax Administration Act consists of a judge of the High Court and two assessors, one of whom an accountant and the other a representative of the commercial community (section 118(1)). But, 'If an appeal to the tax court involves a matter of law only or is an interlocutory application or application in a procedural matter under the 'rules', the president of the court sitting alone must decide the appeal' (section 118(3)).

(iii) That this court, therefore, has the power to hear and determine the declaratory relief claimed in prayers 1 and 2 of UMK's Notice of Motion. The order sought by UMK in prayer 1 of the Notice of Motion was a *declarator* in relation to the correct construction of section 6(3) of the Royalty Act and the one it sought in prayer 2 was the application of that construction to UMK, which was for this court to declare that UMK was entitled to calculate its gross sales (in terms of section 6(2) and section 6(3)(*b*) of the Royalty Act) in respect of the manganese transferred by it in the 2010 and 2011 years of

assessment by deducting:

(*a*) any expenditure incurred by it in respect of transport, insurance and handling of the manganese after the manganese was brought to the condition specified in Schedule 2 of the Royalty Act as well as

(*b*) any expenditure incurred in respect of transport, insurance and handling to effect the disposal of the manganese,

irrespective of whether any such expenditure was specifically and/or consciously considered in the determination of UMK's gross sales and irrespective whether such transport, insurance and handling costs are of a capital nature.

(iv) That the court disagreed with the submission by SARS that this was not a case in which this court ought to exercise its discretion to grant the declaratory relief sought in the Notice of Motion in so far as it concerned the declaratory relief sought in prayers 1 and 2 of the Notice of Motion.

(iv) That it was trite that the granting or refusal of declaratory relief was discretionary and it is a discretion that must be exercised with due regard to the circumstances of a particular case. However, the court was of the view that it should exercise its judicial discretion in favour of the adjudication of the relief sought in prayers 1 and 2 of the Notice of Motion.

(v) That in prayer 3 of the Notice of Motion UMK claimed an order that it was entitled to deduct the amounts specified and reflected on Annexure 'X1' attached to the Notice of Motion and hence this dispute was not simply one of law that involved no question of fact nor was the relief sought interlocutory in nature. It was relief that was directed specifically at UMK's royalty liability for the 2010 and 2011 years of assessment.

(vi) That in order to grant the relief sought in prayer 3, this court would be required to enquire into the facts and to make factual findings *inter alia* on the correctness of the amounts listed in Annexure 'X1'and it is a technical assessment which UMK wishes this court to undertake in the absence of proper evidence and in circumstances where SARS itself remained seized with the assessment. UMK did not attach all the invoices to support its

calculation of the costs incurred and it merely offered to make it available to SARS, at its request and that was simply not sufficient and hence the proof of this claim was dependent on evidence which was not before this court.

(vii) That, consequently, the determination of this claim called for judicial deference and not for this court to usurp the function of SARS. The task of calculating and verifying the contents of Annexure 'X1' was properly the function of SARS and of the Tax Court, consisting of a judge of the High Court, an accountant and a representative of the commercial community, if SARS had refused to accept UMK's calculations and the assessments were challenged and the court would for these reasons also have refused to grant this order even if it was found that this court had the power to hear and determine it.

*As to the interpretation of section 6(3)(*b*) of the Royalty Act*

(ix) That section 6(3)(*b*) of the Royalty Act must be interpreted in accordance with the established principles of interpretation and interpretation is now 'essentially a unitary exercise' and the inevitable point of departure is the language of the provision itself read in context and having regard to the purpose of the provision and the background to the preparation and production of the document.

(x) That SARS' interpretation of section 6(3)(*b*) is patently flawed as it flies in the face of the ordinary grammatical and contextual meaning of the words in section 6(2) and in section 6(3)(*b*) and cannot be sustained.

(xi) That the term 'gross sales' is defined in section 1 of the Royalty Act to mean 'gross sales mentioned in section 6.' 'Gross sales' in respect of an unrefined mineral resource transferred is, in terms of section 6(2), 'the amount received or accrued during the year of assessment in respect of the transfer of that mineral resource.' In the present case, the 'amount received or accrued' is constituted by the purchase price earned or received by UMK during the relevant years of assessment in respect of the sale of its manganese ore.

(xii) That section 6(3)(*b*) then provides that for purposes of subsection (2), gross

sales is determined 'without regard to any expenditure incurred in respect of transport, insurance and handling of an unrefined mineral resource' post the condition specified 'or any expenditure incurred in respect of transport, insurance and handling to effect the disposal of that mineral resource.'

(xiii) That the phrase 'received or accrued' used in section 6(2) and in section 6(3)(*b*) prior to its amendment in 2009, and the phrases 'without regard to' and 'expenditure incurred' used in the amended section 6(3)(*b*) are not defined in the Royalty Act but the meaning of the term 'received or accrued' was well established in tax law and although the cases in point concerned income tax and income tax legislation, the analogous context in which the words 'received' and 'accrued' were used in section 6(2) of the Royalty Act required that the word 'received' be given the established meaning in the tax context of 'has been or actually received' in such circumstances that the recipient becomes entitled to it and the word 'accrued' the meaning 'entitled to' or 'unconditionally entitled to' in contrast to the meaning 'actually received.' Also, the context in which the words 'expenditure incurred' required that it be given the meaning of 'the undertaking to pay or . . . the actual incurring of a liability.'

(xiv) That there was no reason why the aforementioned concepts should not be interpreted to have a similar meaning in the context of the wording of the Royalty Act, also a tax context. The legislature used words given an established meaning in a tax setting in a series of judicial pronouncements, which the legislature is presumed to know.

(xv) That the words used in section 6(3)(*b*) were clear and unambiguous and made it plain that the legislature intended to exclude TIH 'expenditure incurred' post the condition specified and TIH 'expenditure incurred' to effect the disposal of the mineral resource whether or not the extractor 'actually received' or is 'entitled to' recover the TIH costs from its customer.

(xvi) That section 6(3)(*b*) can only be understood to provide for the exclusion of all expenditure relating to TIH costs incurred by the seller of an unrefined mineral resource and the provision is not limited to amounts received or

accrued by a seller in the recovery of distribution costs, as was the case prior to its amendment.

(xvii) That section 6(3)(*b*) contained no provision in terms of which UMK, an extractor, would have to show that expenditure incurred in respect of TIH or expenditure incurred in respect of TIH to effect the disposal of the mineral resource occurred in circumstances where such expenditure was taken into account in determining UMK's gross price.

(xviii) That the deletion by the legislature of the words any 'amount received or accrued for' the TIH of an unrefined mineral post the condition specified and of the words any 'amount received or accrued' to effect the disposal of that mineral resource when section 6(3)(*b*) was amended and the substitution of those words with the words 'any expenditure incurred in respect of' the TIH of an unrefined mineral resource and 'any expenditure incurred in respect of transport, insurance and handling' to effect the disposal of that mineral resource, also made it plain that the legislature intended to exclude TIH expenditure post the condition specified and TIH expenditure incurred to effect the disposal of the mineral resource, whether or not the extractor 'actually received' or was 'entitled to' recover the TIH costs from its customer, or, in other words, whether or not the TIH expenditure were included by the extractor in the calculation of its sales price(s).

(xix) That effect can be given to the Royalty Act and, in particular, section 6(3)(*b*) thereof 'as it stands' without the need to limit the TIH expenditure that falls to be disregarded in terms of that subsection to expenditure that was (first) included by the extractor in the calculation of its sales price(s).

(xx) That nothing in the context detracts from the clear and unambiguous meaning of section 6(3)(*b*) and the Royalty Act forms part of the taxation laws of this country. Its purpose is to impose a royalty on the transfer of a mineral resource extracted from within the Republic and in its 2008 *Explanatory Memorandum*, SARS stated the following with regard to the purpose of excluding TIH costs from the determination of gross sales: 'The

determination of both gross sales and EBIT excludes transportation, insurance and handling charges. This exclusion is necessary so as not to penalize minerals that are located far from markets, or an export port. Transport, insurance and handling charges for the transportation of minerals, in the conditions as per Schedules 1 and 2, between buyer and seller, are excluded.'

(xxi) That, accordingly, UMK was entitled to calculate its gross sales (in terms of subs 6(2) and 6(3) of the Mineral and Petroleum Resources Royalty Act 28 of 2008, as amended, in respect of manganese transferred by it in the 2010 and 2011 years of assessment by deducting any expenditure incurred by it in respect of transport, insurance and handling of the manganese after the manganese had been brought to the condition specified in Schedule 2 of the Royalty Act as well as any expenditure incurred in respect of transport, insurance and handling to effect the disposal of the manganese.

(xxii) That the aforementioned deductions were irrespective of whether any such expenditure was specifically and/or consciously considered in the determination of UMK's gross sales and irrespective of whether such transport, insurance and handling costs were of a capital nature.

3.10. ITC 1905

The taxpayer was a franchisee company operating certain 'chain' restaurants in terms of various franchise agreements between itself and the franchisor and the terms of the franchise agreements were virtually identical.

Clause Q1.1 of the franchise agreement provided that the taxpayer irrevocably undertook that at all times its main object and sole business shall be the operation of the specified restaurants.

The taxpayer was obliged, in terms of clause J.2 of the franchise agreement, to pay a monthly franchise and service fee to the franchisor in respect of each of the restaurants operated by it of 5% of gross sales less any VAT attributable thereto, subject to a minimum fee of R25 000 per month which escalated by CPIX

compounded annually.

In terms of clause L.1.4 of the franchise agreement, the taxpayer was required to upgrade and/or refurbish the restaurants at reasonable intervals as determined by the franchisor.

Clause Q1.1 obliged the taxpayer to operate the restaurant in question as its sole business and, significantly, clause T.16 entitled the franchisor to cancel the agreement if the franchisee failed to actively operate that business. Accordingly, failure by the franchisee to do so constituted a material breach, and an obligation was thus imposed on the taxpayer in terms of the franchise agreement itself to actively provide meals to its customers (which constituted its sole business in terms of that agreement) and the income generated from the sale of those meals was of course the same income that accrued to the taxpayer.

Also relevant were the number of clauses in the franchise agreement which dictated to the taxpayer the branded products that it must use, how its restaurant must be constructed in accordance with the franchisor’s requirements, how its staff was to be trained, supervised and even replaced at the franchisor’s election, the prices that it could charge, the monthly franchise fee payable, that it must maintain the restaurant in such manner as determined by the franchisor, upgrade and/or refurbish it, play only pre-recorded music approved by the franchisor, only offer food and beverage items approved by the franchisor, operate during business hours specified by the franchisor and contribute to the franchisor’s marketing fund in the manner specified.

The franchisee was also obliged to disclose a host of financial information on a regular basis to the franchisor, including sales figures, profit and loss statements, balance sheets, VAT invoices and returns and income tax returns. The franchisor was even entitled to access to ‘. . . any information on any computer system (including point of sale systems) utilised from time to time for the purposes of the conduct of the Restaurant.’

Such was the extent of the franchisor’s control over the income generating operation of the franchisee that it even had the right to interview the franchisee’s customers, without prior notice to the franchisee, to determine whether it was

complying with its obligations.

It was thus clear that the restaurant could not be operated by the franchisee and its income earned, other than strictly in accordance with the franchise agreement and it was no exaggeration to say that the franchisor exercised almost absolute control over the taxpayer *via* the franchise agreement.

Clause L.1.4 of the franchise agreement provided that the franchisee agreed to upgrade and/or refurbish the restaurants at reasonable intervals determined by the franchisor to reflect changes in the image, design, format or operation of the franchisor's restaurant chain from time to time and required of new . . . franchisees subject to approval by the franchisor of detailed plans and specifications for all construction, repair or refixturing in connection with such upgrading or remodelling.

SARS had raised additional assessments on the taxpayer for its 2011 to 2014 years of assessment resulting from SARS' refusal to allow deductions claimed by the taxpayer as allowances in respect of future expenditure for refurbishing and/or upgrading the restaurants in terms of section 24C of the Income Tax Act.

The instant matter came before the Tax Court as a stated case and the questions of law in relation to section 24C were whether:

- the income received by the taxpayer from operating its franchise businesses included or consisted of any amount received or accruing to it in terms of the relevant franchise agreements; and
- the expenditure required to refurbish or upgrade the restaurants was incurred by the taxpayer 'in the performance of the taxpayer's obligations under such contract' as envisaged in section 24C of the Act.

The crux of the dispute between the parties lay in whether or not the income received by the taxpayer from sales of meals to its customers could properly be regarded as arising directly from or accruing in terms of the franchise agreement itself.

Allied to this was the question whether there was a high degree of certainty that the taxpayer would incur future expenditure in order to refurbish or upgrade its restaurants in compliance with its obligation under the franchise agreement.

The taxpayer contended that it had satisfied the requirements of section 24C of the Act in that its income had been earned ‘in terms of’ the same agreement under which it was obliged to incur the future expenditure and that it had earned its income ‘in terms of’ the franchise agreement and that consequently it had qualified for the section 24C allowances claimed by it.

The taxpayer had also contended that there was nothing conditional about the obligation imposed on it under the clause obliging it to upgrade and/or refurbish the restaurant at reasonable intervals determined by the franchisor and that the words ‘subject to approval by the franchisor of detailed plans and specifications’ did nothing more than give the franchisor absolute control thereover.

SARS contended that in terms of the ‘framework’ of section 24C(2) it was an absolute prerequisite that only one contract must exist from which income is earned or received, and from which an obligation is created to incur future expenditure. It submitted that in the present matter there were two contracts.

The first was the franchise agreement which created the right for the taxpayer to establish and operate the restaurants under the franchise licence and trademark of the franchisor in exchange for payments, *i.e.* franchise fees.

The second was the day-to-day sales of meals by the franchisee to customers who in turn pay for them, to which the franchisor is not a party.

It thus submitted that there were two separate contracts which were legally independent and separate from each other and no income was received by or accrued to the taxpayer in terms of the franchise agreement and hence no future expenditure was incurred in terms of the sales transactions to customers and therefore section 24C of the Act did not apply.

SARS further contended that the clause in the franchise agreement obliging the taxpayer to upgrade and/or refurbish the premises only imposed a conditional obligation on the franchisee because the franchisor had first to approve the upgrades and/or refurbishments before the taxpayer incurred any expenditure in respect thereof and it submitted that the words ‘subject to’ determined that the obligation was conditional only, and performance was suspended until the condition was met.

Judge Cloete held the following:

(i) That section 24C provided at the relevant time that if the income of any taxpayer in any year of assessment includes or consists of an amount received by or accrued to him in terms of any contract and SARS is satisfied that such amount will be utilised in whole or in part to finance future expenditure which will be incurred by the taxpayer in the performance of his obligations under such contract, there shall be deducted in the determination of the taxpayer's taxable income for such year such allowance (not exceeding the said amount) as SARS may determine, in respect of so much of such future expenditure as in his opinion relates to the said amount.

(ii) That para 4.2.1(*c*) of SARS *Interpretation Note* No 78 dated 29 July 2014 dealing with section 24C refers to the 'same contract' issue and states that 'The future expenditure must be incurred by the taxpayer in the performance of the taxpayer's obligations under the same contract as the contract under which the income was received by or accrued to the taxpayer . . . The contract does not have to (and rarely will) stipulate the exact expenditure that the taxpayer will incur. However, the taxpayer's obligations under the contract must be apparent or determinable and it is the expenditure which the taxpayer will incur in performing and meeting those obligations which is of relevance. . .'

(iii) That, according to SARS, it contended that in the present matter there were two separate and legally independent contracts and no income was received by or accrued to the taxpayer in terms of the franchise agreement and hence no future expenditure was incurred in terms of the sales transactions to customers and therefore section 24C did not apply and it also submitted that the taxpayer's obligation to incur future expenditure was conditional by virtue of the words 'subject to' approval by the franchisor of detailed plans and specifications when it was obliged to carry out upgrades and/or refurbishments.

(iv) That in the present matter the taxpayer's failure to sell meals to its

customers constituted a material breach which entitled the franchisor to cancel and the obligation to sell meals thus appeared in the body of the same contract containing the taxpayer's obligation to incur future expenditure.

(iv) That what had distinguished the contractual arrangement in the present matter from that in *ITC 1667* was that *in casu* there was an obligation imposed on the taxpayer, by necessary inference, in the franchise agreement to sell meals to its customers and although the customers were not parties to that agreement, the proximate cause of those sales was that obligation.

(v) That the sales of meals to customers were therefore not part of a scheme or transaction, but a component of an obligation integral to the same contract under which the obligation to incur future expenditure was imposed.

(vi) That what was also implicitly recognised in *ITC 1667* was that there did not physically have to be one contract document in order to give rise to the section 24C benefit, hence the court's assumption that the rental and maintenance agreements constituted one single contract for purposes of the application of section 24C of the Act.

(vii) That in the present matter the sale of meals was not triggered by the conclusion of the franchise agreement in the sense that such sales were merely an independent, separate consequence thereof. If that were the case the franchise agreement would not contain a clause that a failure by the taxpayer to sell meals to its customers was a material breach entitling the franchisor to cancel. Put bluntly, no sales meant no franchise agreement at the franchisor's sole election.

(ix) That an additional factor was that every aspect of the 'contract' between the taxpayer and its customers was dictated by the franchise agreement between the taxpayer and the franchisor. In other words, the franchise agreement intruded into every aspect of the taxpayer's generating of its income.

(x) That, applying the principles in *Natal Joint Municipal Pension Fund* v *Endumeni Municipality* 2012 (4) SA 593 (SCA), the court was persuaded that, given the language used in the franchise agreement; the context and apparent purpose to which section 24C was directed; the interpretation note; and the authorities referred to on key words and phrases; the franchise agreement and the sales of meals to customers were inextricably linked and they were not legally independent and separate.

(xi) That this interpretation leads to a sensible meaning and was to be preferred to one that would undermine the apparent purpose of the franchise agreement and it thus followed that the income was earned, for purposes of section 24C, under the same contract as the taxpayer's future expenditure will be incurred.

(xii) That the court was not persuaded that the words 'subject to' in clause L.1.4 resulted in the imposition only of a conditional obligation as far as incurring future expenditure is concerned. The primary obligation was that such expenditure will be incurred at reasonable intervals determined by the franchisor. The existence of an unconditional primary obligation cannot be rendered conditional by the precise manner in which that obligation was to be performed. There could be no question (and indeed SARS did not contend this) that the performance of the primary obligation carried a high degree of probability and inevitability. Merely because the franchisor gets to choose 'the colour of the tiles' as it were, did not detract from the unconditional obligation on the part of the taxpayer to perform and therefore the court did not agree with the argument advanced by SARS in this regard.

(xiii) That, as regards costs, SARS was not unreasonable in adopting the approach that it did in suggesting that the allowances claimed did not fall squarely within the provisions of section 24C of the Act and hence the court would not make an order for costs in favour of the taxpayer in terms of section 130(1)(*a*) of the Tax Administration Act 28 of 2011.

Appeal allowed.

Additional assessments raised by SARS were set aside.

Each party to pay their own costs.

4. INTERPRETATION NOTES

4.1. Meaning of 'extracted' – No. 100

This Note provides clarity on the interpretation of the word 'extracted' used in section 6A(1)(*b*).

A person must pay a royalty for the benefit of the National Revenue Fund in respect of the transfer of a mineral resource extracted from within the Republic. The Mineral and Petroleum Resources Royalty Act, No. 28 of 2008 (as amended) (Royalty Act) distinguishes between refined mineral resources (Schedule 1) and unrefined mineral resources (Schedule 2). Different formulae apply to refined and unrefined mineral resources for the purposes of determining the royalty. Since refined mineral resources generate higher sales value than unrefined mineral resources, a smaller percentage is applied to the gross sales of refined mineral resources. The purpose is to compensate the state for the value of the minerals extracted and not to impose the royalty on the value added through beneficiation.

The term 'unrefined mineral resource' is defined in section 1(1) to mean any mineral resource listed –

- solely in Schedule 2; or
- in Schedule 1 and Schedule 2 that has not been refined to or beyond the condition specified in Schedule 1 for that mineral resource.

The condition specified for mineral resources is important in determining the gross sales and EBIT for purposes of calculating the royalty payable under the Royalty Act. An unrefined mineral resource transferred beyond the condition specified in Schedule 2 requires a determination to be made under section 6A(1)(*b*) which deems the transfer to take place at the higher of:

- the condition specified for that mineral resource; or
- the condition in which that mineral resource was extracted.

This Note examines the meaning of the words 'condition in which that mineral resource was extracted'.

The point of extraction of an unrefined mineral resource creates uncertainty and it is necessary to determine at which point a mineral is considered to be extracted. Differing views exist on what the point of extraction is. This Note sets out what SARS' view is.

Should a mineral resource be transferred in a condition beyond that specified in Schedule 2, the mineral resource must be treated as having been transferred at the higher of the condition specified in Schedule 2 and the condition in which it was extracted.

The expression 'condition in which that mineral resource was extracted' in section 6A(1)(*b*) is regarded as the condition in which an unrefined mineral resource is initially extracted, that is, when the mineral resource is removed from the earth before it undergoes a process of beneficiation.

The condition in which a mineral resource is deemed to be transferred may result in an adjustment to gross sales and EBIT if the actual condition at the time of transfer differs from the condition specified.

4.2. Resident: Definition in relation to a natural person – Ordinarily resident – No. 3 (Issue 2)

This Note explains the meaning of the term 'ordinarily resident' as referred to in relation to a natural person in the definition of 'resident' in section 1(1) of the Income Tax Act.

South Africa has a residence-based tax system. Persons who are 'resident' in the Republic are taxed on their worldwide income, subject to certain exclusions. Non-residents are taxed only on their income from a source within the Republic.

A natural person is a resident for income tax purposes if the natural person:

- is ordinarily resident in the Republic; or

- meets all the requirements of the physical presence test, and

is not deemed to be exclusively a resident of another country for the purposes of the application of any tax treaty.

This Note focuses solely on how to determine whether a natural person is ordinarily resident in the Republic. For more information on the 'physical presence' test, see Interpretation Note 4 'Resident: Definition in Relation to a Natural Person – Physical Presence Test'.

4.3. Small business corporations – No. 9 (Issue 7)

This Note provides guidance on the interpretation and application of section 12E, which provides accelerated depreciation allowances for a taxpayer qualifying as an SBC.

This Note does not address other sections in the Act which contain provisions that refer to or apply to a 'small business corporation' as defined in section 12E. For example, section 8FA(3)(*a*) provides that section 8FA, which deems hybrid interest to be a dividend in specie, does not apply to a debt owed by an SBC. Section 8FA is not discussed in this Note.

Section 10(1)(*zK*) and section 23O apply when an amount of funding has been received by or accrued to an SBC from a 'small business funding entity' as defined in section 1(1). Generally, these sections provide for the exemption of such receipts and accruals and the reduction of the deduction available for related expenditure. In this regard, this Note considers only the impact of such receipts and accruals on the allowances available under section 12E(1) and section 12E(1A).

Section 12E sets out the requirements for a 'close corporation', 'co-operative', 'private company' as defined in section 1 of the Companies Act or 'personal liability company' as contemplated in section 8(2)(*c*) of the Companies Act to qualify as an SBC. All the holders of shares in the SBC must be natural persons who may not hold shares in other unlisted companies (with some exceptions), its turnover for the year may not exceed R20 million and not more than 20% of its receipts and

accruals, other than those of a capital nature, plus capital gains may consist of 'investment income' and income from rendering a 'personal service'. In addition, the entity may not be a 'personal service provider' as defined in the Fourth Schedule.

Section 12E provides for an accelerated depreciation allowance on certain capital assets acquired and brought into use by an SBC. There are two sets of accelerated depreciation rates which may apply. Subject to certain conditions, assets used directly in a process of manufacture or process of a similar nature, may qualify for a 100% write-off of cost in the year of assessment in which the asset is brought into use. Assets that do not fall into this category may be subject to a write-off under section 12E(1A), the amount of which may, at the election of the SBC, be calculated under section 11(*e*) or over a period of three years at a rate of 50%, 30% and 20% of cost in the respective years. The term 'cost' is specifically defined in section 12E(2). In addition to the accelerated depreciation allowance, the section also deals with the deduction of costs incurred in moving assets which fall within the ambit of the section.

SBCs are subject to concessionary tax rates which follow a graduated marginal structure and are not taxed at the corporate tax rate of 28%.

In order to qualify as an SBC, an entity must meet the requirements of section 12E in each year of assessment.

4.4. Pre-trade expenditure and losses – No. 51 (Issue 5)

This Note provides guidance on the deduction of pre-trade expenses (sometimes also called start-up costs) under section 11A.

While this Note provides general guidance on the application of section 11A, the facts and circumstances of each case must be considered in determining when and if pre-trade expenses will qualify for a deduction under this section.

5. BINDING PRIVATE RULINGS

5.1. BPR 301 – Taxation of dividends received by a borrower under a securities lending arrangement

This ruling determines whether a South African sourced dividend received by a borrower in terms of a securities lending arrangement must be included in the 'income' of the applicant and whether any related securities lending expenditure will be deductible.

This is a ruling on the interpretation and application of –

- section 1(1) – paragraph (*k*) of the definition of 'gross income', definitions of 'income' and 'securities lending arrangement';
- section 9(2)(*a*);
- paragraph (*ff*) of the proviso to section 10(1)(*k*)(i);
- sections 11(*a*) read with 23(*g*);
- section 64F

of the Income Tax Act.

<u>Parties to the proposed transaction</u>

The applicant: A non-resident company, who will be the borrower in terms of a securities lending arrangement

The lender: A non-resident entity, who will be the lender in terms of a securities lending arrangement

<u>Description of the proposed transaction</u>

The applicant will enter into a securities lending arrangement (SLA), in terms of which it will borrow South African equities (SA Equities) from the lender.

The applicant will then on-deliver (either by way of another securities lending arrangement or collateral arrangement) the SA Equities to independent third party entities. It is anticipated that the SA Equities will pay dividends. The applicant will recall the SA Equities prior to the dividend record date which is, on average, 20-30 days after the date of on-delivery.

The applicant, as owner of the SA Equity on the record date, will receive any dividend paid in respect of the SA Equity.

The applicant will be contractually required to pay a 'manufactured dividend' to the lender in terms of the SLA.

To the extent that any dividend or interest is paid on the collateral provided in terms of the SLA, the lender will make to the applicant a 'manufactured payment' in respect of the collateral.

On the close-out date of the SLA, the lender will return the collateral to the applicant; and the applicant will return the SA Equity to the lender.

Conditions and assumptions

This binding private ruling is subject to the following additional conditions and assumptions:

- The dividends received by the applicant in respect of the SA Equities must be 'dividends', as defined in section 1(1).
- The SA Equities held by the applicant will always represent a shareholding of less than 10%.
- The SLA complies with the definition of a 'lending arrangement', in the Securities Transfer Tax Act 25 of 2007.
- The SA Equities that are borrowed will be borrowed before any interim or final dividend on the relevant SA Equity is announced or declared.
- Neither the lender nor the entity to whom the applicant will transfer the SA Equities will be entities within the applicant's group of companies or a related party to it.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The dividend received by or accrued to the applicant in respect of the SA Equity (the dividend) will be from a source within South Africa as contemplated in section 9(2)(*a*) and will form part of the 'gross income' of

the applicant under paragraph (*k*) of the definition of that term in section 1(1).

- The dividend will under paragraph (*ff*) of the proviso to section 10(1)(*k*)(i) not be exempt from income tax on the basis that the dividend will be received by or accrued to the applicant in respect of a share borrowed by the applicant. The dividend will accordingly be included in the applicant's 'income', as defined in section 1(1) and the 'manufactured dividend', and other related expenditure to be paid to the lender under the SLA will be deductible by the applicant in terms of section 11(*a*) read with section 23(*g*). The portion of the dividend received or accrued to the applicant, remaining after the 'manufactured dividend' and any related expenditure paid to the lender has been deducted, will be included in the taxable income of the applicant.
- The dividend will be exempt from dividends tax under section 64F(1)(*l*).
- No ruling is made on whether the on-delivery of the SA Equities borrowed by the applicant in terms of another securities lending arrangement or collateral arrangement complies with the definitions of those terms in section 1(1).

5.2. BPR 302 – Corporate restructuring and unbundling of listed shares

This ruling determines the tax consequences for the Applicant and the Co-applicants of the proposed corporate restructuring and unbundling of listed shares to shareholders.

In this ruling references to sections and paragraphs are to sections of the relevant Act and paragraphs of the Eighth Schedule to the Income Tax Act applicable as at 6 April 2018. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of:

- the Act:
  - section 24BA;
  - section 40CA;
  - section 41(4);
  - section 42(1), 42(2)(*b*), 42(3A) and 42(8A);
  - section 45(1), 45(2) and 45(6);
  - section 47(1)(*b*) and 47(2)(*a*)(i); and
  - paragraph 12(2)(*a*), 12(2)(*b*) and 75(1)(*a*).
- the STT Act:
  - section 8(1)(*a*)(i), (iii) and (v).

Parties to the proposed transaction

The applicant: A public company and a resident of South Africa

Company A: A foreign company that is listed on several stock exchanges including the JSE

Company B: A foreign company that is a wholly-owned subsidiary of Company A

Company C: A company that is a resident of South Africa and is a wholly-owned subsidiary of Company B

Company D: A company that is a resident of South Africa and a wholly-owned subsidiary of Company C

Company D1: A company that is a resident of South Africa and a wholly-owned subsidiary of Company D

Company E: A company that is a resident of South Africa and a wholly-owned subsidiary of Company C

Company F: A public company that is a resident of South Africa and listed on the JSE

Description of the proposed transaction

Company A intends to separate its main areas of business. The proposed steps to implement the restructuring are as follows:

- Step 1: Company A and its shareholders will enter into a scheme of arrangement, for which they must seek judicial approval in Company A's jurisdiction, pursuant to which Company A will become a wholly-owned subsidiary of the applicant. In respect of the shareholders holding their shares on the South African register (SA Shareholders), the scheme of arrangement will be implemented in terms of an 'asset-for-share transaction' as contemplated in paragraph (*a*) of that definition in section 42(1) – to the extent that a SA Shareholder qualifies for the relief under section 42. With respect to the remaining shareholders (foreign shareholders), the transaction will not be implemented as an asset-for-share transaction contemplated in section 42.
    - The shares will be reclassified into 'A' ordinary shares (A Ords) in order to facilitate their cancellation on the foreign register. The rights of the A Ords and the shares of Company A on the SA register will be identical, save that the rights of the A Ords will provide for the shares to be cancelled under the scheme.
    - The share capital of Company A will be reduced by the cancellation of the A Ords.
    - The reserves arising as a result of the cancellation will be capitalised and applied to paying up the same number of new shares in Company A. The new shares will be allotted and issued to the applicant and in exchange for the cancellation of the A Ords, the applicant will allot and issue new ordinary shares to the foreign shareholders.
- Step 2: Company A will transfer its entire shareholding in Company B to the Applicant as a distribution *in specie*.
- Step 3: Company B will distribute its shares in Company C to the applicant as a liquidation distribution contemplated in section 47.

- Step 4: Company E will transfer, by way of an intra-group transaction as contemplated in section 45, a maximum of 4.7% of the shares it holds in Company F to a wholly-owned subsidiary of Company D (Company D1) in exchange for the reduction of its existing loan account owing by Company E.
- Step 5: Company E will unbundle all of its remaining shares (approximately 32%) in Company F to Company C by way of an unbundling transaction contemplated in section 46.
- Step 6: Company C will unbundle all of its shares in Company F to the applicant by way of an unbundling transaction contemplated in section 46.
- Step 7: The applicant will unbundle all of its shares in Company F to its shareholders, including the SA Shareholders and foreign shareholders, by way of an unbundling transaction contemplated in section 46.

<u>Conditions and assumptions</u>

This binding private ruling is subject to the following additional conditions and assumptions:

- In relation to Step 1: o The SA Shareholders and the applicant will not agree in writing that section 42 will not apply to their transactions comprising the scheme of arrangement.
    - The market values of the shares which are held by the SA Shareholders on capital account will exceed their base costs determined under paragraph 20 on the date of implementation of the asset-for-share transactions contemplated in section 42.
    - The market values of the shares which are held by the SA Shareholders as trading stock will exceed the tax costs, determined under sections 11(*a*), 22(1) or 22(2), of the shares on the date of implementation of the asset-for-share transactions contemplated in section 42.
- In relation to Step 3: o Company B and the applicant will not agree that the

provisions of section 47 will not apply to the proposed liquidation distribution by Company B of its shares held in Company C to the applicant.

- Company B's sole asset is its investment in the shares of Company C.
- The shares held by Company B in Company C are held on capital account.
- The Applicant will acquire the shares in Company C as capital assets.
- Company B's base costs in the shares of Company C will not exceed the market values of the Company C shares as at the date of the liquidation distribution to the Applicant.
- The steps contemplated in section 41(4) will be taken within the required timeframes to liquidate, wind-up or deregister Company B pursuant to the liquidation distribution of its shares held in Company C, and none of those steps will be withdrawn or invalidated.

- In relation to Step 4: o Company D1 and Company E will not agree that the provisions of section 45 will not apply to the transfer by Company E of its shares in Company F to Company D1.
  - The shares held by Company E in Company F are held on capital account.
  - Company D1 will acquire the shares in Company F as capital assets and hold them in its Corporate Fund contemplated in section 29A.
- In relation to Step 5 and 6: o No 'disqualified person' as defined in section 46(7)(*b*) will hold 20% or more of the shares in Company F, either alone or together with any connected person (who is a disqualified person as defined) in relation to that disqualified person, immediately after the unbundling of the shares in Company F by Company E to Company C and subsequently by Company C to the applicant.
  - At the time of the unbundling of the shares in Company F by

Company E, no other shareholder in Company F will hold the same number of equity shares or more in Company F, than Company E.

  - At the time of the unbundling of the shares in Company F by Company C, no other shareholder will hold the same number of equity shares in Company F or more, than Company C.
  - At the time of the unbundling of the shares in Company F by Company E and by Company C, at least 25% of the equity shares in Company F will be unbundled in terms of the unbundling transaction contemplated in section 46.

- In relation to Step 7: o No 'disqualified person' as defined in section 46(7)(*b*) will hold 20% or more of the shares in Company F, either alone or together with any connected person (who is a disqualified person as defined) in relation to that disqualified person, immediately after the unbundling of the shares in Company F by the applicant to the SA Shareholders and the foreign shareholders.
  - At the time of the unbundling of the shares in Company F by the applicant, no other shareholder will hold the same number of equity shares in Company F or more, than the applicant.
  - At the time of the unbundling of the shares in Company F by the applicant, at least 25% of the equity shares in Company F will be unbundled in terms of the unbundling transaction contemplated in section 46.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- Step 1
  - If section 42(8A)(*b*) does not apply to a SA Shareholder, the transfer by that SA Shareholder of its shares in Company A to the applicant will constitute an 'asset-for-share transaction', as defined in paragraph (*a*) of that definition in section 42(1).

- Section 42(2)(*b*) will not apply, because the proviso to that subsection will be fulfilled. Consequently, the applicant will be deemed to acquire the shares in Company A for an amount which will be equal to the market value of the applicant's shares to be issued to SA Shareholders, under section 40CA(*a*).
- Section 42(3A) will not apply because the proviso to that subsection will be fulfilled. Consequently, the contributed tax capital (CTC) created in relation to the applicant's issue of ordinary shares to the SA Shareholders will be equal to the market value of the ordinary shares in Company A issued to the applicant.
- Section 24BA will not apply to the transfer by the SA Shareholders of their shares in Company A to the applicant in exchange for the issue of shares.
- The transfer of shares by a SA Shareholder will be exempt from securities transfer tax (STT) in terms of section 8(1)(*a*)(i) of the STT Act.
- With respect to the scheme of arrangement involving the foreign shareholders, section 40CA will apply to the issue of shares in Company A to the applicant in exchange for the issue and allotment of shares in the applicant to the foreign shareholders. Consequently, the base cost of the shares in Company A acquired by the applicant will be equal to the market value of the new ordinary shares issued by the applicant.
- The CTC created in the applicant on the issue of the new ordinary shares to the foreign shareholders will be equal to the market value of the shares in Company A acquired by the applicant in terms of the scheme of arrangement.
- Company A will, on becoming a controlled foreign company (CFC) in relation to the applicant, be deemed to have disposed of and re-acquired all of its assets, including its shares in Company B, at market value under paragraph 12(2)(*a*).

- Step 2
  - Company A will be deemed to dispose of its shares in Company B to the applicant for proceeds equal to the market values of those shares under paragraph 75(1)(*a*). Consequently, a capital gain of Rnil will be realised by Company A as the base cost of the shares will be equal to the proceeds received or accrued.
- Step 3
  - The distribution of the shares in Company C by Company B to the applicant will constitute a 'liquidation distribution', as defined in paragraph (*b*) of that definition in section 47(1).
  - Under section 47(2)(*a*), the shares in Company C will be deemed to be disposed of by Company B at their base costs and the applicant will be deemed to acquire the shares at the same base costs.
  - The distribution of the shares in Company C by Company B to the applicant will be exempt from STT in accordance with section 8(1)(*a*)(v) of the STT Act.
- Step 4
  - The disposal of the shares in Company F by Company E to Company D1, to be held in its Corporate Fund, will qualify as an 'intra-group transaction' as contemplated in paragraph (*a*) of that definition in section 45(1).
  - Under section 45(2)(*a*), the shares in Company F will be deemed to be disposed of by Company E at their base cost and Company D1, in its Corporate Fund, will be deemed to acquire the shares at the same base cost.
  - No ruling is issued on the potential application of sections 45(4), 45(4A) and 45(5) in the future.
  - The disposal of the shares in Company F by Company E to Company D1 will be exempt from STT under section 8(1)(*a*)(iii) of

the STT Act.

- Steps 5 and 6
  - The distribution of the shares in Company F to Company C by Company E will be an 'unbundling transaction' as defined in paragraph (*a*) of that definition in section 46(1).
  - The distribution of the shares in Company F to the Applicant by Company C will be an 'unbundling transaction' as defined in paragraph (*a*) of that definition in section 46(1).
- Step 7
  - The distribution of the shares in Company F to the shareholders of the Applicant will be an 'unbundling transaction' as defined in paragraph (*a*) of that definition in section 46(1).

5.3. BPR 303 – Tax implications of a group restructuring transaction

This ruling determines the tax consequences of a group restructuring transaction which includes the discharge of debt by way of set-off, the disposal of shares in a subsidiary to unconnected persons and the tax implications of a replacement loan.

In this ruling references to sections and paragraphs are to sections of the Income Tax Act and the STT Act and paragraphs of the Eighth Schedule to the Act applicable as a t28 February 2018. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of:

- the Act:
  - section 1(1) – definition of 'contributed tax capital';
  - section 19; and

- section 24J(2);
- paragraph 12A; and
- paragraph 20(1).

- the STT Act:
  - section 2; and
  - section 6.

Parties to the proposed transaction

The applicant: A listed company and a resident of South Africa

Co-applicants 1, 2 and 3: Companies which are residents of South Africa

Co-applicant 4: A foreign company

Co-applicants 5 and 6: Companies which are residents of South Africa

Companies A, B, C, D and E: Companies which are residents of South Africa

Description of the proposed transaction

The applicant holds 100% of the shares in co-applicant 1, which holds 100% of the shares in Companies A and B. Company A holds 100% of the shares in Company C. Company B holds 100% of the shares in Company D. The shares in co-applicant 2 are held by Company C (80%), co-applicant 5 (17.5%) and Company E (2.5%). Co-applicant 2 holds 100% of the shares in co-applicant 3.

The applicant wishes to restructure its group and settle certain intra-group loans prior to it making a disposal of the shares held in co-applicant 2 to co-applicant 6.

As at 30 September 2017, the relevant intra-group loans included:

- a loan by co-applicant 1 to co-applicant 2 of R132 million;
- a loan by co-applicant 1 to co-applicant 3 of R108 million;
- a loan by Company D to co-applicant 2 of R171 million.

The proposed transaction will be implemented by way of the following transaction

steps:

Step 1

Co-applicant 1 will subscribe for 'A' preference shares and 'B' preference shares in co-applicant 2 for R161 million, plus the amount of any new loans granted by co-applicant 1 to co-applicant 2 after 30 September 2017 and up to 28 February 2018 ('new loans'). Co-applicant 1 and co-applicant 2 will agree the outstanding consolidated new loans balance before the implementation of step 1.

The consideration will consist of R108 million in cash with the balance (of R55 million plus the amount of the new loans) left outstanding on loan account.

Step 2

Co-applicant 2 will subscribe for additional ordinary shares in co-applicant 3 for cash of R108 million.

Step 3

Co-applicant 3 will use the cash thus obtained in step 2 to repay its loan to co-applicant 1 of R108 million.

Step 4

The loan owing by co-applicant 1 to co-applicant 2 will be set-off against an equal portion (that is R55 million, plus the amount of the new loans) of the loan owing by co-applicant 2 to co-applicant 1.

Step 5

Co-applicants 4 and 5 will subscribe for shares at arm's length consideration in co-applicant 6 so that co-applicant 4 will hold 32.84% and co-applicant 5 67.16% of the ordinary shares.

Step 6

Co-applicant 4 will acquire 49% of the shares in co-applicant 2 from Company C at arm's length consideration of one rand; and

Co-applicant 6 will acquire 31% of the shares in co-applicant 2 from Company C at arm's length consideration of one rand and 2.5% of the shares in co-applicant 2

from Company E at arm's length consideration of one rand.

Step 7

Co-applicant 4 will acquire 100% of the 'A' preference shares in co-applicant 2 from Co-Applicant 1 at arm's length consideration (of not more than R7 350) representing 49% of all the preference shares;

Co-applicant 6 will acquire 65.69% of the 'B' preference shares in Co-applicant 2 from co-applicant 1 at arm's length consideration (of not more than R5 025) representing 33.5% of all the preference shares; and

Co-applicant 5 will acquire 34.31% of the 'B' preference shares in co-applicant 2 from co-applicant 1 for arm's length consideration (of not more than R2 625) representing 17.5% of all the preference shares.

Step 8

Co-applicant 4 will advance an interest-bearing loan of R250 million to co-applicant 2. Then co-applicant 2 will settle the remaining balance of R77 million owing to co-applicant 1 and the R171 million loan owing to Company A.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

Step 1

- The base cost of the 'A' preference shares and the 'B' preference shares acquired by co-applicant 1 will be equal to the subscription price, being the sum of the cash consideration paid and the outstanding subscription price owing by co-applicant 1.
- The contributed tax capital attributable to each of the 'A' preference shares and the 'B' preference shares will be equal to the respective subscription prices of those classes of shares.

Step 2

- The base cost of the ordinary shares issued by co-applicant 3 to co-applicant 2 will be equal to the total cash subscription paid for the shares.
- The contributed tax capital attributable to the ordinary shares issued by co-applicant 3 will be equal to the total cash subscription price paid.

Step 3

- The cash settlement of the loan owing by co-applicant 3 to co-applicant 1 will not result in a 'reduction amount' and therefore section 19 and paragraph 12A will not apply to this transaction.

Step 4

- The set-off of the loan owing by co-applicant 1 to co-applicant 2 (loan 4) against an equal portion of the loan owing by co-applicant 2 to co-applicant 1 (loan 1) will not result in a 'reduction amount' and therefore section 19 and paragraph 12A will not apply to this transaction.

Step 5

- The base cost of the ordinary shares issued by co-applicant 6 to co-applicant 4 and co-applicant 5 will be equal to the respective subscription prices paid.
- The contributed tax capital attributable to the ordinary shares issued by co-applicant 6 will be equal to the total subscription price received.

Step 6

- The base cost for each of the parties of the ordinary shares in co-applicant 2 acquired by co-applicants 4 and 6, will be equal to the respective subscription prices paid for the shares.
- Securities transfer tax will be payable by co-applicant 2 at a rate of 0.25% on the higher of the consideration paid or the market value of the shares.

Step 7

- The base cost of the 'A' preference shares acquired, by co-applicant 4, will

be equal to the consideration paid for the 'A' preference shares.

- The base cost of the 'B' preference shares acquired by co-applicants 5 and 6, will be equal to the respective subscription prices paid for those' preference shares.
- Securities transfer tax will be payable by co-applicant 2 at a rate of 0.25% on the market value of the 'A' preference shares and 'B' preference shares since they will be acquired at nominal values.

Step 8

- Any interest incurred by co-applicant 2 on the loan from co-applicant 4 will be deductible under section 24J(2).
- The cash settlement of loan 1 and loan 3 at the respective face values of those loans by co-applicant 2 will not result in a 'reduction amount' in either case and therefore section 19 and paragraph 12A will not apply to those transactions.

5.4. BPR 304 – Debt reduction and subsequent liquidation of debtor

This ruling determines the income tax consequences of the settlement of a loan by way of set-off from the outstanding subscription price of a new issue of additional shares and the subsequent liquidation of the issuer.

In this ruling references to sections and paragraphs are to sections of the Income Tax Act and paragraphs of the Eighth Schedule to the Act applicable as at 29 August 2017. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) - the definitions of 'contributed tax capital' and 'dividend';
- section 8(4)(*a*);
- section 19;

- section 24J(4A);
- section 36(11) – definition of 'expenditure';
- paragraph 12A; and
- paragraph 20(1)(*a*).

Parties to the proposed transaction

The applicant: A resident company

The co-applicant: A resident company that is the majority shareholder in the applicant

Trusts A, B and C: Three resident trusts, which are minority shareholders in the applicant

Companies D and E: Two resident companies, which are minority shareholders in the applicant

Description of the proposed transaction

The co-applicant holds 74% of the shares in the applicant. Trusts A, B and C and Company D and E (the minority shareholders) hold the remaining 26% in varying percentages.

The applicant holds a 26% undivided share in the assets of an unincorporated mining and production joint venture established between the applicant and co-applicant (the JV).

The applicant met its funding obligations towards the JV, both for operational and capital expenditure purposes, by utilising the monies advanced to it by the co-applicant on loan account. Interest is charged on the loan and capitalised interest amounts to roughly a quarter of the total amount outstanding.

Because of operational and economic difficulties, the applicant has accumulated a significant assessed loss and unredeemed capital expenditure balance under section 36. The mine which operated under the JV is currently in care and maintenance.

The applicant and co-applicant want to dispose of their respective interests in the assets of the JV to a non-connected third party. The sales price for the complete mine (including all the mining assets) operated through the JV provisionally agreed to, is less than 10% of the total loan balance owing to the co-applicant.

After the disposal of the mine the applicant will have no assets on its balance sheet except for the disposal proceeds. Upon completion of the disposal, the shareholders of the applicant wish to liquidate the applicant.

The transaction steps will be as follows:

- The co-applicant will waive its claim against the applicant for an amount representing accrued interest on its loan to the applicant.
- The applicant will receive its share of the sale proceeds from the disposal of the assets of the JV, put aside a portion of the proceeds for the repurchase of the minority shareholder’s shares and use the remaining portion to repay part of the principal debt owing to the co-applicant.
- The co-applicant will subscribe for ordinary shares of the applicant for a subscription consideration equal to the applicant's principal debt owing to the co-applicant after the repayment of the sale proceeds and waiver of the capitalised interest.
- The subscription consideration owing by the co-applicant to the applicant will be settled by way of set-off against the remaining principal debt owing by the applicant to the co-applicant on loan account.
- The applicant will enter into a share buy-back agreement with the minority shareholders for the repurchase of the applicant’s shares.
- The applicant will commence liquidation steps.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The payment of the share subscription price by way of set-off against the co-applicant's loan will qualify as expenditure actually incurred for the

acquisition of the applicant's ordinary shares for purposes of paragraph 20(1)(*a*).

- The fully paid subscription price for the applicant's shares will qualify as 'contributed tax capital' as defined in section 1(1).
- The payment by the applicant to the co-applicant in settlement of its loan owing to the co-applicant by way of set-off against its subscription claim, will be regarded as consideration for the reduction of the debt as contemplated in section 19 and paragraph 12A.
- Pursuant to the interest levied in respect of the loan by the co-applicant to the applicant being irrecoverable, the amount of interest claim against the applicant written-off by the co-applicant will be an amount included in the applicant's income by virtue of section 19 read with section 8(4)(*a*). The co-applicant will be entitled to a deduction of the amount of interest which will become irrecoverable under section 24J(4A)(*a*).
- The amount of the proceeds received by the minority shareholders that exceeds the subscription price paid for the acquisition of the shares will constitute a 'dividend' as defined in section 1(1). Dividends received by trusts A, B and C will be subject to dividends tax at the rate of 20%. Dividends received by Companies D and E will be exempt under section 64F(1)(*a*).

5.5. BPR 305 – Registration of units in the name of the beneficial owners

This ruling determines the consequences of the transfer of units in an equity fund registered in the name of a nominee for the beneficial owner.

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 25 August 2017. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 54; and
- paragraph 2.

Parties to the proposed transaction

The applicant: A natural person and a resident

Co-applicant A: A natural person and a resident

Children: The three co-applicant children of the applicant and co-applicant A, who are also residents

Description of the proposed transaction

The applicant and co-applicant A are married and they had three children (the children), who are co-applicants. The youngest has reached the age of 18.

Some years ago the applicant and co-applicant A each acquired 3 000 units in an off-shore global equity fund (fund). It was decided that the children should also invest in the fund, money they inherited from relatives residing outside South Africa and held in off-shore bank accounts in the names of the children.

The fund rules did not permit persons under the age of 18 to buy fund units in their own names. Since the children were younger than 18 at the time, it was decided to invest the funds in the name of the applicant and co-applicant A, as registered unit owners, but with the children as the beneficial unit owners.

Three thousand six hundred units were purchased for each of the children and the applicant and co-applicant A each held half of the units on behalf of the children, who were recorded as the beneficial owners of the units with Fund X.

Later, due to circumstances, the units held by co-applicant A on behalf of the children were transferred to the applicant whilst the children remained the beneficial owners of the units. At the same time 1 400 of co-applicant A's own units were registered in the applicant's name, whilst the Co-Applicant A remained the beneficial owner of those units. The reason for the applicant holding co-applicant A's units, as nominee, is no longer relevant.

The Applicant intends to –

• register all of the units in her name in respect of the children in their names; and

• register the 1 400 units registered in her name in respect of co-applicant A in the name of co-applicant A.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The transfer of the units from the applicant to co-applicant A will not constitute a disposal of an asset as contemplated in paragraph 2.
- Section 54 will not apply to the transfer of those units.
- The transfer of the units from the applicant to the children will not constitute a disposal of assets as contemplated in paragraph 2.
- Section 54 will not apply to the transfer of those units.
- The base cost of the units held by the children is equal to the original purchase price of the units at the time of their acquisition.

6. GUIDES

6.1. Guide to Understatement Penalties

This guide is a general guide on understatement penalties under Chapter 16 of the Tax Administration Act,

The purpose of penalties under the Tax Administration Act is to encourage voluntary compliance and deter unwanted behaviour such as non-compliance and tax evasion. A rational person will not undertake an activity if the punitive sanctions flowing from it outweigh the prospective gain to be had from engaging in it.

6.2. Short Guide to the Tax Administration Act

This publication is provided to assist taxpayers to understand their obligations and

entitlements under the Tax Administration Act.

The drafting of a Tax Administration Act was announced by the Minister of Finance in the 2005 Budget Review. The first draft of the Tax Administration Bill was published in 2009, which was followed by an extensive public consultation process and the Tax Administration Act, 2011 (Act No. 28 of 2011) (the Act), was promulgated on 4 July 2012.

The Act came into operation on 1 October 2012 by Proclamation No. 51 of 2012, published in *Government Gazette* 35687 on 14 September 2012.

In terms of the law that has created SARS, the South African Revenue Service Act, 1997 (the SARS Act), SARS' objectives include the efficient and effective collection of revenue. Tax legislation, such as the Act, seeks to achieve this objective. Tax legislation typically comprises two aspects:

- Tax liability provisions or 'tax charging' provisions; and
- Tax administration provisions.

The Act only deals with tax administration, and seeks to:

- incorporate into one piece of legislation administrative provisions that are generic to all tax Acts and currently duplicated in the different tax Acts;
- remove redundant administrative provisions; and
- harmonise the provisions as far as possible.

6.3. Guide to the Employment Tax Incentive (Issue 2)

The employment tax incentive was introduced by the Employment Tax Incentive Act which was promulgated on 18 December 2013. This Act has since been amended on a number of occasions. This guide provides general guidance on the incentive.

The ETI is a temporary tax incentive that may be claimed by eligible employers and is aimed at encouraging such employers to employ young employees between the ages of 18 and 29, and employees of any age in special economic zones and in

any industry identified by the Minister by notice in the *Government Gazette*. Payment of the incentive is effected by eligible employers being able to reduce the employees' tax due by them by the amount of the ETI that they may claim - provided of course that they meet the requirements of the ETI Act. The ETI is administered by SARS through the employees' tax system that is deducted and withheld and accounted for to SARS (usually monthly) via the Pay-As-You-Earn (PAYE) system.

As mentioned, the ETI is a temporary programme initially covering a period of three years but has been extended for a further two years and two months.1 During this period an eligible employer may claim the ETI for a maximum of 24 months per qualifying employee. The ETI will be subject to continuous review of its effectiveness and impact in order to determine the extent to which its core objective of reducing youth unemployment is achieved. The ETI commenced on 1 January 2014 and will end on 28 February 2019. It applies to qualifying employees employed on or after 1 October 2013 by eligible employers.

7. DRAFT GUIDES

7.1. Draft guide on the calculation of the tax payable on lumpsum benefits (Issue 3)

This guide provides general guidance on the calculation of the tax payable on the taxable portion of lump sum benefits from retirement funds in South Africa.

A person who is or was a member of a retirement fund becomes entitled to a lump sum benefit when his or her membership of that retirement fund terminates. The taxable portion of the lump sum benefit is determined under the provisions of the Second Schedule, which takes into account certain allowable deductions. Once determined under the Second Schedule, the taxable portion of the lump sum benefit is included in the taxpayer's gross income and is subject to the rates of tax applicable to lump sum benefits.

This guide focuses on the determination of the tax payable on the taxable portion

of the lump sum benefit, and not on the actual calculation of the taxable portion in terms of the Second Schedule.

Aspects dealt with in the guide:

- Retirement fund lump sum withdrawal benefits
  - Pension funds and provident funds
  - Pension preservation funds and provident preservation funds
  - Retirement annuity funds
- Retirement fund lump sum benefits
  - Pension funds, pension preservation funds and retirement annuity funds
  - Provident funds and provident preservation funds
- Severance benefits

7.2. Draft guide on Mutual Agreement Procedures

This is a general guidance on the Mutual Agreement Procedure (MAP) which allows competent authorities from the governments of contracting jurisdictions to interact with the intent to resolve international tax disputes.

DTAs or tax treaties as they may be referred to, are international agreements between the governments of two jurisdictions aimed at eliminating double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance. Most tax treaties typically include the following broadly defined sections:

- A preliminary part on the scope of the tax treaty, for example, setting out the taxes on income and capital covered in the tax treaty and defining terms used.
- The main part of the tax treaty which settle the extent to which each of the contracting jurisdictions may tax income, that is determined based on the

different types of income and whether the jurisdiction is a source jurisdiction or resident jurisdiction. It further determines how double taxation are to be eliminated.

- A key part on special provisions such as the MAP article, which establishes the mutual agreement procedure for eliminating double taxation and resolving conflicts of interpretation of the tax treaty.
- Finally, a part on the implementing provision such as the entry into force and termination provision of the tax treaty.
- Tax treaties concluded between SA and other jurisdictions generally contain Article 25 on MAP based on the Convention. The Convention is an OECD model tax treaty which has been developed by the OECD. Article 25 of the Convention provides that the competent authorities shall endeavour, by mutual agreement, to resolve the situation of taxpayers subjected to taxation not being in accordance with the provisions of the Convention. It also invites and authorises the competent authorities of the two jurisdictions to resolve, by mutual agreement, problems relating to the interpretation or application of the Convention and, furthermore, to consult together about the elimination of double taxation in cases not provided for in the Convention.

Article 25 in treaties that provide for MAP, can seek to resolve disputes arising from juridical double taxation and economic double taxation, as well as inconsistencies in the interpretation or application of a treaty. International juridical double taxation refers to the imposition of income taxes in two (or more) jurisdictions on the same taxpayer in respect of the same income. An example of juridical double taxation is when a resident of one jurisdiction derives income from sources in the other jurisdiction, and both jurisdictions' domestic tax legislation would tax that income. It can also arise when each jurisdiction considers the taxpayer to be resident in that jurisdiction under domestic tax laws. Transfer pricing cases are a good example of circumstances that may lead to economic double taxation. For example, a tax administration adjusts a price charged between related parties with a resulting tax charged on the additional income in the hands of

one related party, where tax has already been charged in another jurisdiction on that same income in the hands of the other related party.

With regards the practical operation of the MAP procedure, Article 25 authorises the competent authorities to communicate with each other directly, without going through the diplomatic channels. Article 26 of the Convention applies to the exchange of information for the purposes of the provisions of this Article. The confidentiality of information exchanged for the purposes of an MAP is thus ensured.

What is a mutual agreement procedure?

Generally, in South African DTAs, Article 25 of the Convention provides a remedy for a taxpayer that considers that the actions of one or both of the contracting jurisdictions result or will result in taxation of the taxpayer not in accordance with the provisions of the tax treaty. The taxpayer may, irrespective of the remedies provided by the domestic law of the jurisdictions, presents its case in the first instance to the competent authorities of the jurisdiction of residence. The taxpayer may also present its case to both competent authorities of both jurisdictions. The taxpayer should notify both competent authorities that it submitted the MAP request to the competent authority of the other jurisdiction. The MAP article in the DTA empowers the competent authority to consider the taxpayer's case and to resolve the case by mutual agreement. This is a process of consultation, not litigation, between the two competent authorities. The taxpayer is not a party to this process, but is invited to participate informally, by providing all required information. If there is no DTA between SA and the other jurisdiction, there can be no mutual agreement procedure.

Article 25 of the Convention, in summary, consists of the following paragraphs:

- Paragraph 1 – Makes available to taxpayers a MAP when taxation is not in accordance with the Convention, without depriving them of the ordinary legal remedies available. The case must be presented within 3 years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.
- Paragraph 2 – A MAP case that has been accepted will only move to the

second, bilateral state of the MAP if it meets two requirements, namely:

  - the taxpayer's objection appears to be justified to the competent authority to which it has been presented, for example, if the taxation contrary to the provisions of the Convention is due in whole or in part to a measure taken in the jurisdictions to which the taxpayer has presented its MAP case; and
  - that competent authority is not able to arrive at a satisfactory unilateral solution.

- Paragraph 3 – Provides for competent authorities to resolve, if possible, difficulties of interpretation or application of the treaty by means of mutual agreement.
- Paragraph 4 – Determines how the competent authorities may consult each other for the resolution by mutual agreement, either of an individual case coming under the procedure defined in paragraphs 1 and 2 or of general problems relating in particular to the interpretation or application of the Convention. It authorises competent authorities to communicate with each other directly without going through the diplomatic channels.
- Paragraph 5 – Provides for an arbitration process in cases where competent authorities are unable to reach an agreement.

The MAP is clearly a special procedure outside the domestic law. It follows that it can be set in motion solely in cases where tax has been charged, or is going to be charged, despite the provisions of the Convention.

A MAP article provided for in a treaty then allows competent authorities from the governments of the contracting jurisdictions to interact with the intent to endeavour to resolve international tax disputes if the objection appears to be justified. The determination of whether the objection appears to be justified requires the competent authority to which the case was presented to make a preliminary assessment of the taxpayer's request in order to determine whether the taxation in both contracting jurisdictions is consistent with the terms of the Convention. The purpose is to ensure that taxpayers entitled to the benefits of the Convention are

not subject to taxation by either of the contracting jurisdictions which is not in accordance with the terms of the Convention.

If the competent authority approached by the taxpayer recognises that the complaint is justified and considers that the taxation complained of is due wholly or in part to a measure taken in that jurisdiction, it must make such adjustments or allow such relief as appears to

be justified. In this situation, the issue can be resolved without moving beyond the first (unilateral) stage of the MAP. However, if it appears to that competent authority that the taxation complained of is due wholly or in part to a measure taken in the other jurisdiction, it will set in motion the second (bilateral) stage of MAP and submit the case to the competent authority of the other jurisdiction. A MAP case for this purpose is not considered to include a request for an APA and does not include a 'protective' MAP filing.

Typical examples of taxation not in accordance with a tax convention when a taxpayer may make a MAP request include the following:

- A taxpayer is considered to be a resident of two treaty countries under each jurisdiction's domestic law, and each jurisdiction claims that the taxpayer is a resident of its jurisdiction for purposes of the tax convention, which could lead to the taxpayer being liable for tax in both countries on the same income.
- Withholding tax is levied beyond what is allowed within an applicable tax Convention by one treaty jurisdiction on a payment to a resident of the other jurisdiction.
- A taxpayer subject to tax as a resident in one jurisdiction on income, including income from carrying on a business in the other treaty jurisdiction, is taxed in terms of that other treaty on the business income earned there, despite not having a permanent establishment in that jurisdiction under the tax Convention.
- A taxpayer operating a branch in one treaty jurisdiction is subject to additional tax because of an adjustment by that treaty jurisdiction of the

income allocated to the branch.

- A taxpayer is subject to additional tax in one jurisdiction because of a transfer pricing adjustment to the price of goods or services transferred to or from a related party in the other jurisdiction.
- A taxpayer can also contact the competent authority for clarification as to the interpretation and application of a Convention.

A MAP article in a DTA does not compel competent authorities to actually reach an agreement and resolve a tax dispute. Competent authorities are obliged only to use their best endeavours to reach an agreement. Arbitration will only be available if the relevant treaty allows arbitration.

In seeking mutual agreement, the competent authorities must first determine their position in the light of the rules of their respective taxation laws and the provisions of the Convention, which are as binding on them as much as they are binding on the taxpayer.4 While the status under domestic law of a mutual agreement reached pursuant to Article 25 may vary between jurisdictions, the principles of international law for the interpretation of treaties, as embodied in Articles 31 and 32 of the Vienna Convention of the Law of Treaties (1961), allow domestic courts to take account of such an agreement.

MAP is available to the taxpayer in addition to the normal legal remedies under the domestic law. Mutual agreements resolving general difficulties of interpretation or application are binding on administrations as long as the competent authorities do not agree to modify or rescind the mutual agreement. If a domestic court reached a decision in the case at issue, the competent authority is bound by the decision of the domestic court (and is not in the position to provide unilateral relief).

South Africa, amongst other countries, endorsed the BEPS published by the OECD that identified 15 Actions Items to address BEPS in a comprehensive manner.7 BEPS refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. Under the inclusive framework, over 100 countries and jurisdictions are collaborating to implement the BEPS measures and tackle BEPS. Recognising that the actions to counter BEPS must be completed with actions to ensure certainty and predictability for business,

one of the BEPS actions includes the *Making Dispute Resolution Mechanisms More Effective, Action 14 – 2015 Final Report* (the Action 14 Report).

The minimum Standard in the Action 14 Report consists of three core elements, namely, to ensure:

- that treaty obligations related to the MAP is fully implemented in good faith and that MAP cases are resolved in a timely manner;
- the implementation of administrative processes that promote the prevention and timely resolution of treaty-related disputes; and
- that taxpayers can access the MAP when eligible.

Through the adoption of the Action 14 Report, countries have agreed to important changes in their approach to dispute resolution by implementing a minimum Standard to ensure that they resolve treaty-related disputes in a timely, effective and efficient manner. Jurisdictions also committed to have their compliance with the minimum Standard reviewed by their peers. The peer review and monitoring are conducted with all OECD and G20 countries and any committed jurisdictions participating in this work on an equal footing. The first peer reviews commenced in December 2016.

Legal basis for mutual agreement procedure

The National Executive8 may, under section 108(1), enter into an agreement with the government of any other jurisdiction. These arrangements are made with such government with a view to the prevention, mitigation or discontinuance of the levying, under the laws of SA and of such other jurisdiction, of tax in respect of the same income, profits or gains, or tax imposed in respect of the same donation. An agreement is further entered into for the rendering of reciprocal assistance in the administration of and the collection of taxes under the said laws of SA and of such other jurisdiction.

Under section 108(2), approval of Parliament of an agreement, as contemplated in section 231 of the Constitution of the Republic of South Africa, 1996 (Constitution), must be obtained and the agreement will have effect as if enacted in the Act upon publication in the *Government Gazette*. Section 108(1) read with section 231 of the

Constitution therefore provide that as soon as the DTA is ratified and has been published in the *Government Gazette*, its provisions are effective as if they had been incorporated into the Act. It follows that Articles in DTAs therefore become part of SA's domestic law.

DTAs generally contain an article on MAP. In interpreting the MAP Article, reference should be made to the Convention read with the OECD Commentaries on the concept used in the Convention and the *UN Guide to the Mutual Agreement Procedure under Tax Treaties*. Reference is also made in this guide to the *Manual on Effective Mutual Agreement Procedures (MEMAP)* and the Action 14 Report, which are available to both tax administrators and taxpayers on the OECD website. The Action 14 Report provides basic information on the operation of MAP under bilateral tax treaties and to identify best practices for MAP.

Multilateral Instrument

The 'Multilateral Instrument' or 'MLI' is intended to transpose results from the OECD/G20 BEPS Project into more than 3 000 treaties worldwide. It will implement minimum standards to counter treaty abuse and to improve dispute resolution mechanisms while providing flexibility to accommodate specific tax treaty policies. It will also allow governments to strengthen their tax treaties with the other tax treaty measures developed in the OECD/G20 BEPS Project.

The substance of these tax treaty-related BEPS measures was agreed as part of the final BEPS Package approved by the OECD's Committee on Fiscal Affairs and endorsed by G20 Leaders in November 2015. Recognising that bilaterally renegotiating each of the more than 3 000 worldwide tax treaties would take years, if not decades, one of the other items in the Package (Action 15) called for the development of a multilateral instrument to swiftly modify bilateral tax treaties to implement BEPS tax treaty-related measures.

On 24 November 2016, the members of the *adhoc* Group on the Multilateral Instrument concluded the negotiations on the text of the Multilateral Instrument. Article 16 of the Multilateral Instrument contains the wording of the MAP article, that is, one of the treaty-related minimum Standards that was agreed as part of the Final BEPS package. Jurisdictions can therefore through the adoption of the

Multilateral Instrument modify the bilateral tax treaties in instances where the wording of Article 25 of the treaty is not in line with the wording of the agreed minimum Standards to improve dispute resolution mechanisms under the Action 14 Report. SA is also a signatory and party to the Multilateral Instrument.

A party to the Multilateral Instrument may reserve the right not to apply certain specific sentences of Article 16 of the Multilateral Instrument. More information on the Multilateral Instrument can be accessed on the OECD website.

The role of a competent authority

DTAs or treaties are usually concluded between the governments of two or more countries. These countries are then referred to as the contracting jurisdictions to such an agreement. The term 'competent authority' is used in DTAs and in the Multilateral Instrument to identify a position, person or body within a contracting jurisdiction to whom issues can be addressed to.

The role of the competent authority includes the exchange of information and providing assistance in collection of taxes based on the following exchange instruments: DTAs, Tax Information Exchange Agreements (TIEAs) and multilateral treaties. The competent authority is further charged with the responsibility to interact with its counterparts in any matters arising between the different contracting jurisdictions pertaining to the interpretation or the application of a DTA, and to resolve any international tax disputes that might arise. A competent authority is generally committed to ensure a good faith application of DTAs. The competent authority endeavours to resolve requests from its counterparts in accordance with the provisions of a particular DTA's Article on MAP.

The competent authority in SA is the Commissioner for SARS and MAP duties have been delegated to designated representatives in the Legislative Research and Development subdivision within Legal Counsel. These designated representatives have the authority to endeavour to resolve MAP cases and are committed to timely implementation of agreements reached, based on the objective and consistent application of treaty provisions to the specific facts and circumstances of a taxpayer's case. In resolving an MAP case, the designated

representatives do not require the approval or direction of the tax administrative personnel who made the adjustments at issue to resolve the MAP case, and, they are not influenced by considerations of the policy that the jurisdiction would like to see adopted and reflected in future amendments to treaties. The designated representatives may, however, consult with the tax administration personnel in order to obtain an understanding of the issues at hand.

South Africa mutual agreement procedure profile and website

Jurisdictions' MAP profiles can be found on a shared public platform on the OECD website, which provides the competent authority or duly authorised representatives contact details, links to domestic MAP guidance and other useful jurisdiction-specific information regarding the MAP process. The MAP profile is updated by the revenue authorities from time-to-time.

The competent authority also notifies the treaty partners of administrative or statutory processes and expressly addresses the effects of those processes with respect to the MAP in its public guidance and provides a link to such guidance on its MAP profile.

7.3. Draft guide on venture capital companies

The purpose of this guide is to provide users with general guidance on venture capital companies and investments in such companies. It does not delve into the precise technical and legal detail that is often associated with tax and should, therefore, not be used as a legal reference.

One of the main challenges facing small and medium-sized businesses, as identified in the 2008 South African National Budget Review, is the difficulty in accessing equity finance. Equity financing is essentially a method used by companies to raise capital by issuing company shares to investors. A share in relation to a company means any unit into which the proprietary interest in the company is divided. The holder of the share does not own the assets of the company, but owns the rights in the company, that is, the right to vote, the right to dividends and the right to capital distributions.

The cost of share investments held on capital account is generally not deductible from income. Section 12J was introduced as a tax incentive to encourage equity investment through VCCs in small and medium-sized businesses and junior mining companies. Section 12J allows a holder of shares to claim a 100% deduction of the cost of the shares issued by the VCC, provided certain requirements are met. The section is effective for venture capital shares acquired on or after 1 July 2009 but on or before 30 June 2021.

Section 12J has requirements at the level of the VCC and at the level of the 'qualifying company' whose shares are held by the VCC. A VCC is taxed as a company and does not enjoy any special tax concessions because of its VCC status.

8. INDEMNITY

Whilst every reasonable care has gone into the preparation and production of this update, no responsibility for the consequences of any inaccuracies contained herein or for any action undertaken or refrained from taken as a consequence of this update will be accepted.