TAX UPDATE

For period: 1 April 2015 to 30 June 2015

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TABLE OF CONTENTS

1. INTRODUCTION 4

2. MEDIA STATEMENT - FIRST BATCH OF THE DRAFT TAXATION LAWS AMENDMENT BILL, 2015 5

3. NOTICES & REGULATIONS 7

3.1. Dispute resolution process – SARS' website 7

4. DRAFT NOTICES & REGULATIONS 13

4.1. Further reportable arrangement in terms of section 35(2) of the TA Act 13

5. CASE LAW 14

5.1. ITC 1867 (77 SATC 175) 14
5.2. ITC 1875 (77 SATC 161) 23
5.3. C:SARS v Tradex (Pty) Ltd and others (77 SATC 121) 29
5.4. ITC 1874 (77 SATC 1874) – Fiscal Appeal Court, Zimbabwe 41
5.5. ITC 1873 (77 SATC 93) 47
5.6. Z Co (Pty) Ltd v Zimbabwe Revenue Authority (77 SATC 82) 56
5.7. C:SARS v Bosch and another (77 SATC 61) 61
5.8. Kluh Investments (Pty) Ltd v C:SARS (77 SATC 23) 73
5.9. Capstone 556 (Pty) Ltd v C:SARS 84

6. INTERPRETATION NOTES 95

6.1. The supply of goods and services by professional hunters and taxidermists to non-residents – No. 81(2) 95
6.2. Appliction of sections 20(7) and 21(5) of the VAT Act – No. 83(2) 96

7. DRAFT INTERPRETATION NOTES 97

7.1. Provisional Tax Estimates – No. 1(2) 97
7.2. Resident – Place of effective management (companies) – No. 6(2) 100

8. BINDING PRIVATE RULINGS 102

8.1. BPR 191 – Refinancing of debt through preference share funding 102
8.2. BPR 192 – Cross border interest-free loan and withholding tax on interest 105
8.3. BPR 193 – Debt reduction by way of set-off 106
8.4. BPR 194 – Disposal of shares through a share buy-back and a donation 108

9. BINDING GENERAL RULING 112

9.1. BGR (VAT) 27 – Application of sections 20(7) and 21(5) 112
9.2. BGR (VAT) 28 – Electronic Services 113

10. BINDING CLASS RULINGS 116

10.1. BCR 45 – Post retirement medical aid benefits 116

10.2. BCR 46 – Dividends distributed by foreign companies 119

11. INDEMNITY 121

1. INTRODUCTION

The purpose of this update is to summarise developments that occurred during the second quarter of 2015, specifically in relation to Income Tax and VAT. Johan Kotze has compiled this summary, who is a Tax Executive at Shepstone & Wylie Attorneys.

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 following Tax Update will no doubt be dominated by the Taxation Laws Amendment Bill, 2015. The Media Statement of the first batch of the draft Taxation Laws Amendment Bill 2015 is reproduced in this update.

This update is dominated by a number of tax cases and rulings.

The update has two interesting cases from Zimbabwe which is worth reading, but the most important are probably the Bosch case and the Capstone case.

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. It is however important to note that these publications are not law, but may bind SARS. Taxpayers should nonetheless consider these publications carefully to determine whether, and how, they are actually applicable to their own circumstances.

Enjoy reading on!

2. MEDIA STATEMENT - FIRST BATCH OF THE DRAFT TAXATION LAWS AMENDMENT BILL, 2015

National Treasury will be publishing the full text of the 2015 draft Taxation Laws Amendment Bill for public comment in the first half of July 2015. National Treasury today publishes an initial first batch of the 2015 draft Taxation Laws Amendment Bill to cover specific provisions that require additional consultation. This initial and shorter public comment process will enable the more detailed second round process of public comments when these provisions are revised for the second batch of the draft Taxation Laws Amendment Bill in July. Written comments are due at the close of business on 26 June 2015.

This First batch of the 2015 draft Taxation Laws Amendment Bill is intended to solicit comments on three specific amendments that might require further consultation before it is included in the draft Taxation Laws Amendment Bill to be published in July. It will also serve notice to taxpayers of proposals for earlier effective dates for some of the proposed amendments.

The three specific amendments in the first batch include:

1. Counter measure for tax-free corporate migrations

With effect from 1 April 2014, changes were made in the Income Tax Act to counter erosion of the South African tax base through tax-free corporate migration facilitated through cross-border cross-issues of shares. The effect of these reforms is that, if a South African resident company issues shares as consideration for its acquisition of shares in a foreign company, a capital gain will result for the South African resident company.

However, concerns have been expressed that these anti-avoidance measures are very broad and also affect bona-fide commercial transactions, even in instances where there is no element of corporate migration and profit shifting. In addition, a number of potential tax avoidance schemes on tax-free corporate migrations involving the use of the participation exemptions have been identified as a potential risk to the fiscus.

In order to allow legitimate commercial transactions that will potentially grow and expand the base for South African companies operating in other countries, it is proposed that the issue of shares by a South African resident company as consideration for shares in a foreign company will no longer be subject to capital gains tax. It is proposed that this amendment should be applied retrospectively to the date of the introduction of the initial legislation i.e. 1 April 2014.

In order to counter the identified base erosion strategies that use the participation exemptions to facilitate tax-free corporate migrations, it is proposed that the disposal of foreign shares by South African residents to connected persons should not benefit from the participation exemption. In addition to this, it is proposed that upon ceasing to be tax resident in South Africa, any participation exemption benefits previously enjoyed by a South African resident during the three year period before ceasing to be a resident will be subjected to tax. Though these anti-avoidance measures will be considered by Parliament later this year and possibly legislated thereafter, notice is given that the intention of the Minister is that this provision will be dated to apply from today, 5 June 2015, the date of publication of this Media Statement.

2. Transitional tax issues resulting from the regulation of the business of hedge funds

With effect from 1 April 2015, Government classified the business of hedge funds as collective investment schemes, therefore subjecting them to similar rules as other collective investment schemes in terms of the Collective Investment Schemes Control Act. The regulation of the business of hedge funds has unintended transitional tax consequences. It includes the disposal of assets by the unregulated hedge funds to trading vehicles to be approved by the Financial Services Board as collective investment schemes.

In order to allow for the effective regulation of the business of hedge funds, it is proposed that transitional relief be allowed by deferring potential capital gains and income tax consequences that may arise on the transfer of assets from unregulated investment structures to persons that will be regulated as CISs. It is proposed in the draft legislation that this amendment will apply retrospectively from

1 April 2015, i.e. the date of the declaration of hedge funds as a CIS by the Minister.

3. Tax implications of outright transfer of collateral

Most debt agreements involve the usage of collateral, more specifically the use of equity going forward as the demand for high liquidity assets is increasing due to higher capital and liquidity requirements. The provision of collateral can take two forms, namely,

(i) pledge (no transfer of beneficial ownership with no tax implications) and

(ii) outright transfer (out and out cession of beneficial ownership with tax implications).

The taxation of the outright transfer of collateral may have negative effects on acceptable business practices. To mitigate these challenges, amendments are proposed to allow for situations where non-cash collateral is provided on an out-and-out basis. No capital gains tax and securities transfer tax implications will arise to the extent that the non-cash collateral is returned to the borrower by the lender within twelve months from the date that the collateral arrangement was entered into. It is proposed that these amendments will apply with effect from 1 January 2016.

3. NOTICES & REGULATIONS

3.1. Dispute resolution process – SARS' website

When taxpayers are aggrieved by an assessment or not satisfied with a decision taken by SARS if the decision is subject to objection and appeal, they have a right to dispute the assessment or decision.

Chapter 9 of the Tax Administration Act, 2011, and the rules made under section 103 thereof, provide the legal framework for these disputes across all tax types found in the various tax Acts administered by SARS, excluding the customs and excise Acts.

The rules made under section 103 of the Tax Administration Act (the ADR

rules) are made by the Minister of Finance and are of equal status to regulations and similar subordinate legislation.

Tax appeals in the first instance are heard either by the **Tax Board** or the **Tax Court**.

Tax Board

The Tax Board is established by the Minister of Finance under section 108 of the Tax Administration Act.

It is not a court as referred to in section 166 of the Constitution, but an administrative tribunal created under the Tax Administration Act.

The Tax Board hears tax appeals involving tax in dispute that does not exceed the amount determined by the Minister under section 109(1)*(a)* of the Tax Administration Act, 2011.

This amount has been **R500 000** with effect from 1 May 2007 and although it was announced under the Income Tax Act, 1962, section 269 of the Tax Administration Act makes provision that it stays valid until it is replaced by a Public Notice.

The taxpayer and SARS must also agree that a matter be heard by the Tax Board.

If the taxpayer or SARS is not satisfied with the decision of the Tax Board, the taxpayer or SARS may request that the matter be heard *de novo* by the Tax Court. This is not an appeal against the decision of the Tax Board, but a completely new trial.

The sittings of the Tax Board are not public and the Board's decisions are not published by SARS.

The decisions of the Tax Board are binding on the parties but have no precedent value.

Tax Court

The Tax Court is established by the President of the Republic under section 116 of the Tax Administration Act, 2011.

It is not a court as referred to in section 166 of the Constitution, but an administrative tribunal created under the Tax Administration Act, 2011.

The Tax Court has jurisdiction over tax appeals lodged under section 103 of the Tax Administration Act and may also hear interlocutory applications and procedural matters relating to objections and appeals.

The procedures of the Tax Court are regulated both under Chapter 9 of the Tax Administration Act and the rules issued under section 103 thereof.

Delivery of a notice of objection under Rule 7

There are two different procedures, depending on the type of tax.

1. For personal tax and corporate income tax, delivery must be made:
   - by means of the taxpayer's electronic filing page - if applicable
   - by post to any of the addresses listed below
   - by handing it in to SARS at any SARS branch office
2. For value-added tax, employees tax (PAYE) or other tax, delivery must be made:
   - to any of the addresses listed on the page for **Institution of Legal Proceedings** on SARS' website
   - by handing it in to SARS at any SARS branch office

Office	Postal Address	Physical Address
Alberton	Private Bag x15 Alberton 1450	St Austell Street Mackinnon Crescent New Redruth Alberton 1449

Bellville	Private Bag x11 Bellville 7530	Corner of Teddington & De Lange Road Bellville 7530
Doringkloof	PO Box 436 Pretoria 0001	7 Protea Street Centurion Pretoria 0157
Durban	PO Box 921 Durban 4000	201 Dr Pixley KaSeme Street Durban 4001

Delivery of any document, notice or making a request relating to the dispute process after delivery of a notice of appeal or an application in terms of Part F of the Rules:

Physical Address	Electronic Address
Tax Court Litigation Khanyisa Building - First Floor 271 Bronkhorst Street Nieuw Muckleneuk 0181	**Fax:** (+27) 12 422 5012 **Email:** taxcourtlitigation@sars.gov.za

Rule 3(1) read with Rule 2(1)*(c)*(iii) - Registrar of the Tax Court

The Tax Court hears tax appeals involving tax in disputes in terms of section 103 of the Tax Administration Act, 2011. These appeals would have either been dealt with first at a SARS branch, the Tax Board, or been through the ADR process in terms of Rule 13 of the Tax Court Rules.

Once the Notice to Appeal has been lodged by the Taxpayer, then SARS must

initiate the process in terms of Rule 31 and several pleadings are exchanged between the parties and documents discovered before it is ripe for hearing at the Tax Court.

All documents, notices or requests intended for the Registrar of the Tax Court, must be delivered at this address:

Name of Section	Physical Address for Service	Contact Details	
Office of the Registrar: Tax Court	**Chief Registrar: Tax Court** **Mrs Marisa McKenzie** Office of the Registrar: Tax Court First Floor Khanyisa Building 271 Bronkhorst Street Nieuw Muckleneuk 0181	**Fax** **Email**	(+2712) 422 5012 RegistrarTaxCourt@sars.gov.za

The sittings of the Tax Court are generally not public, although the president of the Tax Court may, in exceptional circumstances, on application by any person, allow a sitting to be public.

The Tax Court consists of a judge of the High Court, as well as an accountant member and a commercial member selected from a panel of members appointed by the President of the Republic.

The Tax Court may also, in matters involving more than R50 million tax in dispute and with the approval of the Judge-President of the jurisdiction within which the Tax Court sits, consist of three judges of the High Court and the two members.

The judgments of the Tax Court must be published for general information but, if the sitting was not public, it must be in a form that does not reveal the taxpayer's identity.

A taxpayer or SARS may appeal against the Tax Court's judgment to the full bench of the Provincial Division of the High Court, or to the SCA if the president

of the Tax Court on request allows a direct appeal to the SCA.

An appeal heard by the full bench may be further appealed to the SCA.

The judgments of the Tax Court are not binding on other courts, but only between the parties. However, the judgments of the Tax Court are of persuasive value in other Tax Courts, the High Courts and the SCA.

High Courts

The High Courts, which have previously been called 'The Supreme Courts', are spread throughout South Africa and are regulated by the Superior Courts Act, 2013. They have jurisdiction over the defined provincial areas in which they are situated and over all persons residing or present in that area. These courts hear matters that are of such a serious nature that the lower courts would not be competent to make an appropriate judgment or to impose a penalty in that regard, as well as matters referred to them by law.

Under section 133 of the Tax Administration Act, a taxpayer or SARS may appeal against the Tax Court's judgment to the full bench of the High Court which has jurisdiction in the area in which the tax court sitting is held. The sittings of the High Courts are public and its judgments are published for general information.

The judgments of the High Court are binding on all lower courts and tribunals and of persuasive value in other High Courts and higher courts such as the SCA and the Constitutional Court.

Supreme Court of Appeal (SCA)

The SCA is seated in Bloemfontein and is the highest court in South Africa, except for constitutional matters. It generally only deals with cases referred from the High Court, but statutory provision is made in section 133 of the Tax Administration Act for direct access from the Tax Court.

The sittings of the SCA are public and its judgments are published for general information.

The judgments of the SCA are binding on all lower courts and tribunals and, except for the Constitutional Court, no other court can overturn a decision of

the SCA.

Constitutional Court

The Constitutional is the highest court in all constitutional matters. It is the only court that may adjudicate disputes between organs of state in the national or provincial sphere of Government concerning the constitutional status, powers or functions of any of those organs of state, or that may decide on the constitutionality of any amendment to the Constitution or any parliamentary or provincial Bill.

The Constitutional Court makes the final decision on whether an Act of Parliament, a provincial Act or the conduct of the President is constitutional. In the context of tax appeals, it has a limited jurisdiction to review an SCA judgment dealing with a tax appeal.

4. DRAFT NOTICES & REGULATIONS

4.1. Further reportable arrangement in terms of section 35(2) of the TA Act

SCHEDULE

1. General

In this notice, unless the context indicates otherwise, any word or expression to which a meaning has been assigned in the Income Tax Act, 1962, or the Tax Administration Act, 2011, has the meaning so assigned.

2. Reportable arrangement

The following arrangement has been identified to be a reportable arrangement:

2.1. Any arrangement between a person that is a resident and a person that is not a resident for the rendering, to the person that is a resident, of technical, managerial or consultancy services, in terms of which:

(a) the person who is not a resident or an employee, agent or representative of the person that is not a resident:

(i) was or is physically present in the Republic; or

(ii) is anticipated will at any time be physically present in the Republic,

in connection with or for purposes of rendering those services; and

(b) the expenditure in respect of those services incurred or to be incurred,

on or after the date of publication of this notice, by the person that is a resident exceeds or is anticipated will exceed R10 million in aggregate.

5. CASE LAW

5.1. ITC 1867 (77 SATC 175)

The taxpayer had during March 2002 operated a call centre in Cape Town and had sold its assets to XYZ with effect from 1 March 2002 for a purchase price of R1 million and in terms of that transaction XYZ was granted an option to acquire all the shares in the taxpayer for R1.00 within a certain time period and, as a result of this transaction, the taxpayer had by 30 June 2002 ceased its operations.

During November 2002 XYZ had started looking for a buyer for the Cape Town call centre business purchased by it from the taxpayer. A company called D Company was interested and initially those negotiations came to nothing and on 5 March 2003 and at a stage when the negotiations were apparently not ongoing, XYZ exercised its option to acquire the shares in the taxpayer for R1.00 and thus became the sole shareholder of the taxpayer and at that stage the taxpayer had an assessed loss exceeding R85 million.

On 7 May 2003 the taxpayer and XYZ, who now controlled it, concluded an agreement which resulted in the restoration of ownership of the Cape Town call centre business to the taxpayer with effect from 6 March 2003, again for a purchase price of R1 million.

The taxpayer, in its correspondence with SARS had provided its version of this reversal as having to do with the fact that, because of litigation in which the taxpayer was initially involved, XYZ did not wish to acquire the business through the shares in the company, or at least not until those matters had been resolved, as they had been by March 2003.

Some months later the negotiations between XYZ and D Company resumed and this resulted in XYZ, on 25 November 2003, concluding an agreement with D Company for the sale of the shares in the taxpayer to D Company and pursuant to that sale agreement D Company nominated a subsidiary, E Company, as the purchaser, so that E Company became the sole shareholder of the taxpayer who then continued its Cape Town call centre operations and, apparently, its operations under E Company's control were also expanded considerably and substantial income was earned over the tax years 2005 to 2008.

The essential question raised by section 103(2) of the Income Tax Act was whether SARS was entitled to have disallowed the set-off of the taxpayer's assessed losses which had been in existence as at 2003 against the income earned in the taxpayer's 2005 to 2008 tax years.

The tax dispute between the parties had started with an audit which had resulted in SARS writing a letter to the taxpayer setting out the results of its audit findings and proposed adjustments to the taxpayer's assessments for the years 2005 to 2008 and the taxpayer responded to these audit findings in a letter dated 13 May 2010.

In its original audit findings SARS had not made mention of the sale of shares to D Company/E Company in November 2003 and it appeared that, at the time of making its audit findings, respondent was not aware of that further change in shareholding and had relied only on the first change in shareholding, *i.e.* when the taxpayer's shares had been acquired by XYZ for R1,00 in March 2003.

SARS, having considered the taxpayer's response of 13 May 2010, maintained its view that the adjustments to the assessments should be made and had issued an assessment letter dated 30 November 2010, setting out the reasons for the proposed revised assessments being raised and this letter included some of the additional material that had been disclosed in the taxpayer's response to the audit findings.

The taxpayer objected to the revised assessments on 22 February 2011 and the objection was disallowed by the taxpayer on 15 November 2011 whereafter the taxpayer noted an appeal and in December 2013 – prior to the promulgation of the new Tax Court Rules on 11 July 2014 under the TA Act – the taxpayer delivered its Rule 10 statement of the grounds of assessment.

The taxpayer, upon receipt of the taxpayer's statement of its grounds of assessment in terms of Rule 10 of the procedures to be observed in lodging objections and noting appeals under section 107A of Income Tax Act, took objection to the matter which now had become the subject of an application and counter-application and which could not be resolved in further correspondence and this resulted in the taxpayer bringing an application to the Cape Town Tax Court to amend his grounds of assessment in terms of Rule 10 of the rules that had previously governed proceedings of the Tax Court together with a counter-application by the taxpayer to strike out a paragraph and certain words from the taxpayer's grounds of assessment.

The application and counter-application raised the same essential question which concerned the extent to which the taxpayer may travel beyond the matters on which he had initially expressed satisfaction pursuant to s 103(2) of the Act and whether and to what extent SARS in the present case was attempting to travel beyond the matters on which he had been previously so satisfied.

The aforementioned Rule 10 provided that the statement of grounds of assessment must set out a clear and concise statement of the grounds upon which the taxpayer's objection is disallowed and must state the material facts and legal grounds upon which SARS relied for such disallowance.

Section 103(2) of the Act provided that whenever SARS is satisfied as to certain matters, one of the things he may do is to disallow the set-off of a company's assessed loss against the income referred to in s 103(2) of the Act. In the present case there were three distinct components for the invocation by SARS of s 103(2) and, as applied to the circumstances of the present case, the three components were the following:

(i) SARS must be satisfied that a change in the shareholding of the taxpayer had occurred

(ii) SARS must be satisfied that, as a direct or indirect result of that change in shareholding, income has been received by or has accrued to the taxpayer during a relevant year of assessment and

(iii) SARS must be satisfied that the change in shareholding was effected by any person solely or mainly for the purpose of utilising an assessed loss of the taxpayer and it was when SARS is satisfied of those three matters, that he could disallow the set-off of the assessed loss.

The taxpayer contended that the matters on which SARS was satisfied when issuing the revised assessments were directed at the first change of shareholding which had occurred in March 2003 when XYZ had acquired the shares in the taxpayer for R1.00 and it was that change of shareholding that satisfied SARS that income had been received by or accrued to the taxpayer and it was that change in shareholding that SARS was satisfied had been effected solely or mainly for the purpose of utilising the assessed loss in the taxpayer.

SARS, however, in his Rule 10 statement had made certain allegations which may have suggested that he was relying not only on the first change in shareholding but also the further change in shareholding that occurred in November 2003 when XYZ sold the shares in the taxpayer to D Company/E Company. Furthermore, it was clear from the counter-application that the taxpayer indeed wished to rely not only on the first but also the second change in shareholding and he submitted that he was entitled to do so and that he should be allowed to amend par. 40 of his statement of grounds of assessment in order to amplify the statement so as to clearly set out such reliance.

Judge Rogers held the following:

(i) That the set-off of an assessed loss is itself a matter governed by s 20 of the Income Tax Act and the provisions of s 103(2) of the Act were an anti-avoidance measure which allowed SARS, when he was satisfied of certain matters, to disrupt what would otherwise be the normal consequences of s 20 of the Act.

(ii) That while the parties to the dispute were of the view that the court should apply the provisions of the new Rule 31 in terms of s 103(3) of the TA Act, which is the successor to the old Rule 10, the court did not think that the new Rule 31 was applicable *in casu* as the Rule 10 statement had been filed at a time when the old rules still applied and hence the coming into force of the new Tax Court rules cannot effect the issue of what may legitimately be contained in a Rule 10 statement and that issue should be assessed with reference to the provisions of the legislation and the rules as they stood prior to the introduction of the new Tax Court rules on 11 July 2014.

(iii) That the question as to the extent to which SARS and the taxpayer could introduce new matter into their Rule 10 and 11 statements which were not covered by the earlier steps in the assessment procedure was not entirely settled. In *ITC 1843* 72 SATC 229, Claasen J had held, with reference to such statements filed in connection with a VAT dispute, that both SARS and the taxpayer were entitled to depart from their previously stated positions in letters of assessment and letters of disallowance on the one hand and objections and notices of appeal on the other. He had reached this conclusion with reference to the manner in which Rules 10 to 12 of the old rules were formulated, particularly that they had expressed the relevant grounds in the present tense rather than specifically with reference to earlier documents.

(iv) That, subsequently, in *Computek (Pty) Ltd* v *C:SARS 7*5 SATC 104, the court appeared to have considered that at least the taxpayer did not have the freedom of amendment which Claasen J had assumed. In *Computek* the court seemed not to have been referred to Claasen J's

judgment. It may also be that in *Computek* the court was influenced by the decision in *Matla Coal Ltd* v *CIR* 48 SATC 223 which it was respectfully observed was decided at a time when s 83(7)(*b*) of the Income Tax Act expressly stated that a taxpayer was limited to the grounds set out in his notice of objection but that provision was removed at a later stage from the Income Tax Act.

(iv) That, be that as it may, it appeared that a distinction needed to be drawn between a tax appeal which was concerned with objective questions of fact and law on the one hand and tax appeals which were concerned with the exercise by SARS of powers which he had upon being satisfied of particular matters. In the former class of case would belong the sort of situation where SARS disallows an item of expense as a deduction on the basis that it is of a capital nature and then later seeks to support the disallowance on the new basis that it was not incurred in the production of income. In the latter class of case one was dealing with a different situation in that one was not dealing with a situation where the law prescribes that certain expenses shall be disallowed or certain income shall be taxed if a certain state of affairs objectively exists but one was dealing rather with a situation where a particular fiscal result follows only if SARS himself is satisfied of certain matters and in this class of case it is SARS' satisfaction upon the points in question which constitutes the jurisdictional fact for the issuing of the assessment.

(v) That it was for this reason that one found that where SARS' powers are so expressed, special provision is made for an appeal against SARS' decision. In this case, for example, of ss 103(1), (2) and (3) of the Act, s 103(4) provided that any decision of SARS under the preceding three subsections shall be subject to objection and appeal. The reason why this is necessary was that ordinarily speaking if a certain result were to flow upon SARS being satisfied of the matters in question, there would not be an appeal, at least not the conventional appeal for which ss 81*ff* of the old Income Tax Act used to provide.

(vi) That even where there had not been an express provision for an appeal against SARS' satisfaction as to certain matters, the Tax Court had assumed to itself the power at least to review SARS' decision. For example, s 79(1) of the Act permitted SARS to issue additional assessments in certain circumstances but he could not do so after the expiration of three years from certain dates unless he was satisfied that the non-payment of the tax was due to fraud or misrepresentation or non-disclosure of material facts. It had been held that SARS' satisfaction was a prerequisite for allowing a late assessment under that provision and that the court could at least take his decision under review on conventional review grounds.

(vii) That, as applied to the present case, the question therefore was this: On what matters was SARS satisfied when he invoked the power to disallow the set-off in the taxpayer's 2005 to 2008 years? Once one has determined that question, one will know what it is that the taxpayer had a right to appeal against in terms of s 103(4) of the Act.

(ix) That the assessments had been issued under cover of SARS assessment letter of 30 November 2010 and that letter therefore could be taken to set out most fully and accurately the matters on which SARS was satisfied but that letter should be read in the context of what had preceded it.

(x) That at the time of the letter of audit findings of 10 December 2009 SARS was not yet aware of the second change in shareholding of November 2003 but he had nevertheless considered, on the strength of the first change in shareholding, that he was entitled to disallow the set-off in the years in question and clearly at that stage his foreshadowed satisfaction, although not yet final, was based on the first change in shareholding alone.

(xi) That then came the assessment letter of 30 November 2010 wherein SARS had expanded the factual background to include a number of additional facts disclosed in the taxpayer's response to the audit findings and in one paragraph SARS explained the factual background

by referring to the transaction in November 2003 by which XYZ had sold the shares in the taxpayer to D Company. He then proceeded to set out his view of the law and application of the law to the facts and had identified the three essential requirements for invoking s 103(2) of the Act and noted that the first requirement had been fulfilled by virtue of the change in shareholding which had occurred in March 2003 and he did not there refer to the second change in shareholding.

(xii) That when SARS stated in the relevant paragraph that he could come to no other conclusion than that the sole or main purpose of the 'change in shareholding' was the utilisation of the assessed loss, there was no doubt that he was referring to the first change in shareholding as that was the one he had identified under the first requirement and also in his discussion of indirect results in relation to the second requirement.

(xiii) That on the court's analysis of the letter of 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. Moreover, when the taxpayer turned in its letter of objection to consider the actual grounds of assessment and the three requirements isolated by SARS, it was clear that the taxpayer understood SARS to be focusing on the first change in shareholding and to be contending that it was this change in shareholding, coupled with matters said to be linked to it by way of the second and third requirements, that justified the disallowing of the set-off of the assessed loss.

(xiv) That the Rule 10 statement in its current form appeared to follow more closely the letter of assessment in focusing on the first change of shareholding as having had the direct or indirect result of the earning of income by the taxpayer and as having been concluded for the main or sole purpose of utilising the assessed loss.

(xv) That, accordingly, the court concluded that the change of shareholding, which formed the foundation for SARS' satisfaction of the three requirements to invoke s 103(2), was the first change of shareholding which occurred on 5 March 2003. The fact that SARS referred to and

accepted the fact that there had been a further change in shareholding did not, on a proper understanding and reading of the letter of assessment, disclose an intention to rely on the further change in shareholding as the change which had the result, directly or indirectly, of causing income to be earned by the taxpayer or as having been the transaction concluded for the sole or main purpose of utilising an assessed loss.

(xvi) That in regard to the entitlement or otherwise of SARS to depart from the grounds on which he was satisfied in a matter of this kind by way of an amendment of his Rule 10 statement, the court was referred to *ITC 1862* 75 SATC 34 which was a case arising under s 103(1) of the Income Tax Act and the question had arisen not in the context of an amendment to a Rule 10 statement but rather in regard to the extent to which SARS, at the end of a trial, could rely on grounds not contained in his Rule 10 statement but the court nevertheless agreed with the observations of Desai J contained in paras 59 and 60 of the judgment.

(xvii) That the court not only agreed with the aforementioned observations of Desai J in *ITC 1862*, *supra*, but they appeared to apply as much to what could legitimately be relied upon by SARS in his Rule 10 statement as to what he could rely upon at the end of a trial in the Tax Court. That is not to say that if, having assessed on the basis of being satisfied of certain matters, SARS discovers other facts which cause him to be satisfied on other matters, he cannot issue a further assessment based on his new satisfaction. However, it was only upon reaching satisfaction on the new elements that he could then issue a fresh assessment and what he could not do is support his existing assessment on the basis of matters on which he was not satisfied when he issued that first assessment.

(xviii) That it followed that SARS' application to amend his statement of the grounds of assessment had to be dismissed with costs and the taxpayer's counter-application to strike out the material that relied on

the second change in shareholding was upheld together with an order that SARS pay the taxpayer's costs of the counter-application.

5.2. ITC 1875 (77 SATC 161)

The taxpayer was a subsidiary of D Holdings and was listed on the Johannesburg and London Stock Exchanges.

The taxpayer operated a mine consisting of two inclined shafts and a concentrator plant located in Limpopo.

The taxpayer did not own the land on which it mined the mineral ore in issue and nor did it trade in the ore that it had mined and it was the extraction from the mineral ore brought to the surface that it sold.

The taxpayer derived mining income and the mining operations consisted of two distinct phases – Phase 1 was the extraction of the ore from the ground containing platinum, palladium, gold, rhodium, iridium, ruthenium as well as nickel, copper and cobalt and in Phase 2 the ore was transported to its concentrator plant and smelted to expose the mineral elements and was then subjected to a flotation process from which the minerals were derived.

The taxpayer stated that at no stage did it acquire the ore that it mined but merely took possession of the ore and it submitted that it also took possession of the subsequent concentrate as described in Phase 2 above and it did not acquire it as envisaged in terms of section 23F(2) of the Income Tax Act and therefore nothing should be recouped in terms of section 23F(2) for either Phase 1 or Phase 2 or, alternatively, if anything was to be recouped by SARS, it should be from the concentrate process.

The taxpayer had concluded a written contract with E Company for the supply of mineral concentrate and clause 7.1 of the contract provided that the exact amount of the full purchase price payable to the taxpayer for the mineral concentrate delivered in one month would only be quantifiable in the fifth month after the month of delivery and this was due to various uncertain factors such as ruling market prices for the metals and relevant foreign exchange rates. This

meant that the purchase price for the mineral concentrate delivered in the last four months of the year of assessment could only be quantified in the following year and it was common cause that the provisions of section 24M of the Act applied.

Section 24M provided:

- That if an asset is disposed of for a consideration that cannot be quantified in that year of assessment, the unquantified amount is deemed not to have accrued to that person in that year of assessment and the unquantified amount accrues to that person only when it can be quantified (section 24M(1));
- That if a person acquires an asset for a consideration that cannot be quantified in that year of assessment, the part of the consideration that cannot be quantified is deemed not to be incurred by that person in that year of assessment and the unquantified portion is deemed to be incurred only in the year of assessment in which it can be quantified (section 24M(2)).

Section 23F of the Act (Acquisition or disposal of trading stock) is an anti-avoidance provision and provides in section 23F(2) for the situation where:

- A taxpayer has disposed of trading stock in the ordinary course of his trade for a consideration that will not accrue to him in full during that year of assessment, and
- He could deduct the expenditure incurred on the acquisition of the trading stock under section 11(*a*) during that or any previous year of assessment (therefore a deduction in terms of opening stock or acquisition costs was claimed, but no 'balancing' addition to the taxable income is made in the form of proceeds from the sale of the trading stock).

Any deduction in respect of that trading stock will then be limited to any amount received or accrued from the disposal of that trading stock during that year of assessment. An amount that is deductible as opening stock, for example, shall be limited to the amount received or accrued during that year of assessment.

Excess deductions will therefore be disregarded during that year, but may be deducted from the income in any subsequent year. The deduction in subsequent years is again limited to the amount which is received by or accrued to that person in that subsequent year from that disposal (section 23F(2A)).

The taxpayer, in its returns of income for the 2007, 2008 and 2009 years of assessment, had excluded the aforementioned estimated amounts of income from its gross income (*i.e.* the value of sales of product made in the last four months of the year of assessment) on the basis of the application of section 24M.

The taxpayer, however, deducted the expenses for mining the ore and for the cost of the concentrate process in the year of assessment and it also deducted the cost of additional drying of the concentrate as the moisture level was outside the parameters as defined in the aforementioned contract and this additional drying had occurred at the E Company site and not at the taxpayer's premises.

SARS had conducted an audit into the income tax affairs of the taxpayer and in terms of section 23F(2) of the Act had disallowed a portion of the operating expenditure incurred by the taxpayer in the relevant years of assessment, *i.e.* these proportions were 23,87%, 30,86% and 26,96% of the total sales for those years.

The total expenditure claimed by the taxpayer in terms of section 11(*a*) of the Act for those years of assessment was R279 183 247, R740 179 830 and R872 659 397 and consisted of the mine-on-mine operational costs, concentration and smelting costs and overhead expenses.

The taxpayer had objected to the assessments disallowing the expenditure in issue and once its objection had been disallowed it noted an appeal to the Gauteng Tax Court.

The taxpayer contended that the mineral bearing ore mined by it did not meet the necessary requirements of trading stock and there was no acquisition by

the taxpayer of the mineral-bearing ore as envisaged by section 23F(2) of the Act and therefore the section was not of application.

In regard to the trading stock issue, the taxpayer contended that:

- The ore that was won from the ground was bulky and could not be sold and if it could not be sold in the state that it emerged from the earth, then it could not constitute trading stock. However, once the concentrate is extracted in phase 2 of the process it became a commodity which could be sold and if the concentrate could be sold it had to be considered as trading stock;
- The ore should be excluded from the definition of trading stock as it was acquired for the purpose of mining and not for manufacture, sale or exchange in the definition of 'trading stock' as contemplated in section 1 of the Act;
- The ore had been acquired for the purpose of mining and it was not intended to be disposed of in that state and did not fall within the definition of 'trading stock';
- Deriving the ore and the concentrate was essentially taking possession of the ore and then taking possession of the concentrate and because the ore never constituted trading stock it was only the cost of extracting concentrate that should have been disallowed in terms of section 23F(2) of the Act.

In regard to the acquisition issue, the taxpayer contended that:

- The word 'acquisition' in section 23F(2) should be interpreted to mean acquire ownership and not any other form of acquisition;
- Once the ore was mined and separated from the earth it was acquired by the taxpayer and it became the owner thereof. Ownership could not re-occur once the ore had been turned into a concentrated form;
- Therefore the costs incurred to mine the concentrate did not represent expenditure incurred to acquire ownership of the concentrate and did not fall within the scope of section 23F(2) of the Act.

SARS contended that the mineral-bearing ore did constitute trading stock and was acquired by the taxpayer as defined and thus fell to be determined by the provisions of section 23F(2) of the Act.

SARS contended that section 23F(2) sought to match expenses with the corresponding income in the same financial year and, in other words, the expenses incurred in respect of the deferred income could not be deducted in the year in which they were incurred but in the following year. In other words, if the taxpayer was to benefit from the provisions of section 24M of the Act, then it was also necessary for SARS to benefit from the provisions of section 23F(2) of the Act.

Judge Victor held the following:

(i) That in Phase 1 of the taxpayer's mining operation the ore that was won from the ground was bulky and could not be sold and if it could not be sold in the state that it emerged from the earth then it could not constitute trading stock. The ore was not kept in stockpiles as set out in *C:SARS* v *Foskor (Pty) Ltd* 72 SATC 174 and immediately went from the ground onto a conveyor belt to the concentrate process so that there were no stockpiles that required a determination in terms of section 22 of the Income Tax Act.

(ii) That in a statement of agreed facts between the parties it was agreed that the taxpayer's operation was a mining operation and in Phase 2 of the process, when the mineral-bearing ore was smelted to expose the mineral elements and be turned to concentrate, once the concentrate was extracted it became a commodity which could be sold and if the concentrate could be sold it must be considered to be trading stock.

(iii) That the decision in *Richards Bay Iron and Titanium (Pty) Ltd and Another* v *CIR* 58 SATC 55 dealt with stockpiles in the context of manufacture as opposed to those of a mining operation and, accordingly, in respect of the concentrate, the taxpayer had, during the relevant year of assessment disposed of trading stock in the ordinary course of his trade and the full amount of the consideration for the trading stock would not accrue to the taxpayer during that year of

assessment but in the future, hence bringing it within the ambit of section 23F(2) of the Act.

(iv) That, relying on *SIR* v *Safranmark (Pty) Ltd* 43 SATC 235, the ordinary connotation of the term ‘process of manufacture’ is an action or series of actions directed to the production of an object or thing which is different from the materials or components that went into its making and the emphasis has been placed on the difference between the original material and the finished product. The mineral bearing ore is not materially different from the finished product, being the mineral bearing concentrate, and, as a result, the process of obtaining the mineral concentrate did not meet the definition of a ‘process of manufacture.’

(iv) That the definition of mining in the Mineral and Petroleum Resources Development Act 28 of 2010 included ‘every method or process by which any mineral is won from the soil or from any substance or constituent thereof’ and therefore the extraction of the mineral bearing ore from the ground met the definition of mining.

(v) That there were similarities between the decision in *C:SARS* v *Foskor (Pty) Ltd* 72 SATC 174 and the taxpayer’s case. Some form of transforming low value raw materials occurred, resulting in high value finished goods. The only difference is that the taxpayer was involved in the entire process, from mining, to manufacturing and trading. The purpose of the taxpayer in both cases is similar, and hence their treatment should actually be the same as the raw material was acquired. The difference will be in the taxation formula applied in manufacturing versus mining.

(vi) That the ore extracted from the ground in the present case is subject to a similar process as that detailed in the *Foskor* case, *supra*, and therefore if the effect of section 23F(2) is to limit deductible expenditure it is submitted that the *contra fiscum* rule should be embraced. There must be a causal relationship between the expenditure claimed and the acquisition of the trading stock to ensure that the taxpayer is not penalised for income tax purposes.

(vii) That the drying charges, audit fees and administration fees were incurred post production, *i.e.* after the taxpayer had acquired the concentrate, and should properly be allowed and should not be dealt with in terms of section 23F(2) of the Act.

(ix) That, accordingly, the mineral ore upon extraction from the earth was a mining process and did not constitute trading stock. It would not be economically viable to sell it in that form and nor did the taxpayer intend selling it in that state. However, once the mineral ore had gone through the concentrator, it had been transformed into a higher value product and therefore qualified to be characterised as trading stock. Once transformed, it also met the definition of acquisition.

(x) That, in the result, SARS may only recoup deductions at the extraction phase and not at the first phase of winning. The second phase process of producing concentrate remained a mining process and not a manufacturing process and, accordingly, the taxation formula to be applied to the second phase would be that of mining.

(xi) That, accordingly, SARS shall only be entitled to recoup the deductions for the second phase, being the concentrate phase, in terms of section 23F(2) of the Act.

(xii) That the assessments for the 2007, 2008 and 2009 years be sent back to respondent for reconsideration on the basis that section 23F(2) only applies to the second phase being the concentrate phase.

Appeal upheld in part.

5.3. C:SARS v Tradex (Pty) Ltd and others (77 SATC 121)

First respondent (‘Tradex’) and Third respondent (‘BWA’) were entities owned and controlled by Second respondent (‘Wiggett’).

Applicant, being SARS, sought confirmation of a provisional preservation order granted in terms of section 163(4) of the TA Act.

Tradex began operations during 2002 after three years of research and development by Wiggett and it supplied technology solutions for automating and streamlining export and import processes and more recently it had expanded into consulting services in the international trade environment. Tradex had 38 full-time employees and it did not own any immovable property.

BWA started business during 2006–2007 and Wiggett caused BWA to purchase properties in Montague Gardens and Caledon and her idea was to develop the Montague Gardens property for letting to Tradex but she had had to hold that in abeyance because of unfavourable economic conditions. BWA had bought the Montague Gardens property during May 2006 and the price had been R2,149 million and a mortgage bond had been registered against the property. BWA purchased the Caledon property for R1,95 million.

BWA had agreed to provide Tradex with furniture, equipment, office accommodation and operational support services at market related charges and BWA had appointed Tradex as its agent in terms of section 54 of the VAT Act.

Wiggett owned a property in Langebaan which she had bought in 2000 for R33 060 and she also owned an undivided share of a property in Hout Bay that had been purchased in April 2001 for a combined price of R900 000 and at the same time a mortgage bond in the amount of R1 million was registered.

When the application for a preservation order was brought in August 2013 Tradex owed not less than about R4,1 million in respect of various taxes and its liability for income tax for 2010 and 2011 was unknown because it had failed to render tax returns for those years while its liability for VAT was also unknown because it had failed to render returns over the period January 2010 to March 2013. BWA had rendered no tax returns since 2006 when it started business and Wiggett had rendered no returns since registering as a provisional taxpayer during March 2000.

Wiggett had stated in her affidavit, without seeking to excuse the respondents' fiscal non-compliance, that with the growth of Tradex's business during 2005 she had engaged a full-time financial manager but that he had failed to comply with his duties and was eventually subjected to a disciplinary hearing during

2010 and after his departure she had appointed a new financial manager and a bookkeeper but the new financial manager had failed to keep deadline and this led to the filing by Tradex of various Voluntary Disclosure Programme ('VDP') applications during October 2011 and in September 2012 the financial manager 'absconded' without notice.

There were meetings between Wiggett and senior SARS executives at which the tax affairs of the respondents were discussed and pursuant to which she had presented an action plan to SARS in early December 2012 but did not receive a response. During January 2013 the tax affairs of Tradex and Wiggett were referred to SARS Unit: Preliminary Investigation and Enquiries and SARS warned that unless a payment plan was submitted it would continue with the process of instituting legal proceedings against the indebted companies and repeated its demand for payment of an outstanding amount of R3 801 725, 66 from Tradex.

Wiggett, in accordance with an undertaking that she gave SARS, appointed a firm of Cape Town auditors to conduct a due diligence investigation into Tradex and BWA's accounting records and their report of February 2013 showed that Tradex and BWA's records were in such disarray that they needed to be reconstructed for the period 2007 to 2013 and SARS was kept informed of these developments.

In addition to the auditors, Wiggett engaged an experienced tax consultant who was registered with SARS as a tax practitioner and later appointed new auditors.

However, it was common cause that the respondents' tax affairs were not in order when the *ex parte* application made by SARS for a preservation order was issued on 12 August 2013 and that the respondents' tax liability was likely substantially to exceed the known amount of R4,1 million and it was also clear that the respondents' financial records were in disarray.

It was impossible at the stage of this application for confirmation of the preservation order to determine with any precision the amounts of tax for which the various respondents would in due course be held liable but it was enough to say that by the end of April 2014 the respondents had paid an amount of

about R4,7 million in respect of the known liability mentioned in the founding papers and there had also been certain additional payments which SARS had not yet appropriated to specific tax debts. However, the financial statements and tax returns which had been outstanding as at August 2013 still needed to be finalised.

SARS notified the respondents on 9 April 2014 of its intention to conduct a field audit into their tax affairs and this was conducted at their premises over the period 12–15 May 2014 and SARS demanded that a substantial quantity of specified information be made available.

Over the period 15 May–9 June 2014 Wiggett's tax consultant delivered to SARS Tradex and BWA's outstanding annual financial statements and tax returns and Wiggett's personal tax returns for the period 2008-2013 together with other information requested by SARS which indicated the effort which the respondents were making in order to meet SARS' requirements.

SARSs alleged that their financial statements and tax returns were then up to date; that BWA had made losses and did not owe tax; that there was no outstanding tax owed by Wiggett; and that Tradex's estimated liability for income tax and VAT was R7 034 602 (*i.e.* over and above the amount of R4,7 million already paid) and they maintained that a preservation order was unnecessary.

SARSs had also repeated an offer of security made in negotiations with SARS by way of the continued operation of *caveats* in respect of Wiggett's Langebaan property and the two immovable properties owned by BWA in Caledon and Montague Gardens and a cession *in securitatem debiti* by Tradex of book debts to the value of R10,5 million. Wiggett alleged that the security, worth more than R18 million, was substantially in excess of any tax that might be found owing.

Applicant's response was that it had not yet verified the tax estimate of R7 034 602 and that the respondents had ignored Tradex's potential liability for interest and penalties. SARS expressed doubt about the correctness of the recently submitted Tradex financial statements because they had differed from draft financial statements prepared by the previous auditors. SARS also did not

accept that BWA's financial statements were correct. In respect of Wiggett's personal tax affairs, SARS stated that it still needed to verify her returns for 2007 to 2013 and pointed out that she had not rendered any returns in respect of 2000 to 2006 but she had recently been assisted by her tax consultant in finalising these tax returns and SARS had assessed her thereon for tax of R459 906. SARS also cast doubt on the value of the book debts, referring to bad debts previously raised by Tradex.

However, when the present matter came before the court, the Applicant contended that for the years 2007 to 2013 respondents faced potential tax liabilities of R10,4 million and that it therefore sought confirmation of the initial *ex parte* preservation order whereby respondents be prohibited from disposing, dissipating of any assets and that SARS be authorised to cause *caveats* to be registered over respondents' immovable properties. In addition, SARS sought that a Mr Nel be appointed as respondents' *curator bonis* with all of the respondents' assets vesting in him.

Judge Rogers held the following:

(i) That section 163 of the TA Act was amended by the Tax Administration Laws Amendment Act 39 of 2013 promulgated on 16 January 2014 and the amendment of section 163 was stated to be with effect from 1 October 2012 but despite this provision for retrospectivity, the parties were in agreement that, because the present proceedings were launched and the *ex parte* order granted before the amendments were promulgated, the case needed to be adjudicated without reference to the amendments and references to section 163 are thus to the original text.

(ii) That a preservation order may be made if it is 'required to secure the collection of tax' (section 163(3)) but the 'tax' need not currently be due and payable and a preservation order would be permissible if it appeared that tax in a currently unquantified amount was likely to become due and payable. However, the fact that the tax is or is likely in the future to be due and payable is not enough. The preservation order must be 'required to secure the collection of' the tax but section 163(3)

does not say in what circumstances preservation will be regarded as ‘required’ to secure the collection of tax.

(iii) That in *C:SARS* v *C-J van der Merwe* 76 SATC 138 at par. [43] the court stated that no necessary implication exists which warrants reading a requirement of necessity into the statute and it followed therefore that for a court to determine whether a preservation order was required to secure the collection of tax in terms of section 163(3), it did not need to be shown that the grant of the order is required as a matter of necessity, or to prevent dissipation of the assets. Rather, in making the assessment as to whether to grant the order or not, the court must be apprised of the available facts in order to arrive at a conclusion, reasonably formed on the material before it, as to whether a preservation order is required or not to secure the collection of tax.

(iv) That, further, the aforementioned facts must not amount to a statement of the applicant’s opinion but must illustrate an appropriate connection between the evidence available and the nature and purpose of the order sought. Furthermore, it is not required of the court to determine whether the tax is, as a matter of fact, due and payable by a taxpayer or other person contemplated in section 163(1) which will be determined by later enquiry. Rather, at the preservation stage sufficient information is to be placed before the court to enable it to determine whether such an order is required against the persons against whom it is sought, *per* Savage AJ in *C:SARS* v *C-J van der Merwe*, *supra*, at par. [43].

(v) That the test is not one of ‘necessity’ and in another context information has been said to be ‘required’ for the exercise or protection of a right if the information would ‘be of assistance’ in the exercise or protection of the right. Preservation of assets could be said to be ‘required to secure the collection of tax’ if preservation would confer a substantial advantage in the collection of tax and once one has concluded that a ‘substantial advantage’ has been shown, one could simultaneously conclude that there was ‘an element of need’ sufficient to meet the ‘required’ (*i.e.* ‘reasonably required’) test.

(vi) That the court was less confident of Savage AJ's rejection of dissipation as being the focus of attention. In the amended section 163(1) it is made explicit that a senior SARS official may only authorise a preservation application 'in order to prevent any realisable assets from being disposed of or removed which may frustrate' the collection of tax and the *explanatory memorandum* which accompanied the amendments stated that the object was to 'clarify' the main purpose of a preservation order.

(vii) That while the latter statement (and the amendments themselves) may not be admissible material for interpreting section 163 in its original form, there are indications in the original text that the focus is dissipation. The word 'preservation' is used to describe the order but section 163(1) envisages an *ex parte* application, which would generally only be justified out of concern of dissipation. If more urgent action was needed than an *ex parte* order, section 163(2)(*a*) authorises SARS itself to seize assets 'in order to prevent any realisable assets from being disposed of or removed which may frustrate' the collection of tax. In determining whether a preservation order should be varied or rescinded in terms of section 163(9), the court is required to balance hardship to the taxpayer on the one hand and 'the risk that the assets concerned may be destroyed, lost, damaged, concealed or transferred' on the other.

(viii) That at common law the Applicant must establish *prima facie* that the respondent will dissipate his assets with the intention of defeating the Applicant's claim but the court did not think that 'required' in section 163(3) entailed proof of such an intention on the part of the taxpayer. However, SARS is required to show that there is a material risk that assets which would otherwise be available in satisfaction of tax will, in the absence of a preservation order, no longer be available. The fact that the taxpayer *bona fide* considers that it does not owe the tax would not stand in the way of a preservation order if there is the material risk that realisable assets will not be available when it comes to ordinary

execution and an obvious case is that of a company which, believing it owes no tax, proposes to make a distribution to its shareholders.

(ix) That in every case where a taxpayer is liable or likely to become liable for tax, there is a theoretical possibility that the value of its assets may for some or other reason be diminished by the time SARS is able to execute and the court did not think the lawmaker intended that a preservation order would routinely be available to SARS in every case of an actual or anticipated tax liability. There must be something by way of 'requirement' which places the particular case outside the ordinary run of cases and the existence of material risk that assets will be diminished is the obvious example. It is in such circumstances that the court could conclude that preservation would confer a 'substantial advantage' (*i.e.* over the position that would prevail without the order) and that there was thus 'an element of need' and the possibility is not excluded that there may be other examples but it is not possible to currently conceive what they might be.

(ix) That the question whether a preservation order is 'required' and whether the court should exercise its discretion to grant one calls for a consideration of the specific terms of the order sought by SARS and the question whether a preservation order is required cannot be answered in the abstract and the practical utility of the actual terms must be assessed.

(x) That Savage AJ in the *C-J van der Merwe* case, *supra*, was correct to hold that the Plascon-Evans rule did not apply as although the confirmation of a preservation order may have features which render it appealable, it is nevertheless interim in that its duration is limited and it does not finally determine the amount of tax, if any, for which the taxpayer is liable. The court should determine, on the affidavits, where the balance of probability lies on the issues relevant to the existence of the jurisdictional facts and to the exercise of its discretion.

(xi) That delinquency in the conduct of a taxpayer's tax affairs may in appropriate circumstances be part of the material from which one could

infer that there is an appreciable risk that assets available for collection of tax will be diminished. There is, however, no automatic connection between the two and a person may be disorganised and late in regard to its tax administration without there being any appreciable danger that its assets will be diminished by the time tax comes to be collected.

(xii) That SARS in its founding papers had focused on the failure on the part of the respondents to file tax returns and to have their tax affairs in order and their failure to comply with time-lines set in interactions between themselves and SARS and there were generalised statements to the effect that a preservation order would 'enable SARS to collect the totality of the tax' owed by the respondents and that the appointment of a *curator bonis* 'would ensure that' SARS recovers all taxes owed and that in the absence of an order SARS 'will in all likelihood sustain severe prejudice' but, however, no facts were alleged constituting a *prima facie* case that there was an appreciable risk of assets being diminished.

(xiii) That SARS was required to make out its case in the founding papers and while a great amount of detail was placed before the court in the subsequent sets of affidavits, focusing on updated efforts to achieve compliance and offering conflicting versions of the amount of tax likely to be found owing, SARS' theme remained essentially the same as in the founding papers, namely that the respondents' delinquency in completing their financial statements and making their returns and the initial disarray in their records were a basis for confirming the preservation order.

(xiv) That SARS did not seek to make the case that Tradex's business was being run into the ground or becoming less valuable. There was no reason to doubt that its business had expanded and that it had contracts with a number of blue-chip customers. There was no basis for finding that Wiggett was not in earnest in trying to make a success of Tradex or that she lacked the abilities at least from an operational perspective, to do so.

(xv) That despite SARS' possession of financial statements for Tradex, the conduct of a field audit and SARS' statutory rights of access to the respondents' records, SARS did not, in its replying and supplementary replying papers, allege that Wiggett was causing Tradex, innocently or deliberately, to dissipate its assets by distributing dividends or paying unreasonable salaries or engaging in other suspicious transactions.

(xvi) That Tradex did not own anything of significance by way of fixed assets and its value lay in its intellectual property and human capital and their exploitation for purposes of generating profit from the supply of services to its customers. If there were a *prima facie* case that Tradex would be run better under the care of a *curator bonis*, one might be able to say that a preservation order was 'required', because then one could conclude that there was a reasonable prospect that, without a preservation order, the business would be less valuable by the time tax came to be collected but no facts to support such a conclusion were advanced in the founding papers or subsequently.

(xvii) That one gained the distinct impression that SARS launched the application not so much because a preservation of the respondents' assets was required but in order to bring matters to a head by placing legal pressure on the respondents and this was consistent with the series of postponements on which the parties subsequently agreed with a view to affording time to the respondents to bring their tax affairs in order.

(xviii) That while SARS' frustration could be understood, that was not the purpose of the preservation application. There are other statutory mechanisms available to SARS to deal with taxpayers who fail to provide information, to render returns or to make payment of tax.

(xix) That the delinquency of the respondents in the rendering of their tax returns, while entirely unacceptable, appeared to have been attributable in substantial measure to the fact that the financial managers engaged by Wiggett had let her down and, furthermore, delinquency in rendering returns did not necessarily translate into a failure timeously to pay tax.

(xx) That the question whether a preservation order is 'required' cannot be answered in the abstract and the practical utility of the actual terms had to be considered and the terms of the order drew no distinction between Tradex, Wiggett and BWA. The order interdicting the respondents from alienating, encumbering, dissipating or dealing in any manner with their assets in a way 'that will cause a decrease in the value of' their assets could notionally be granted without the appointment of a curator. However, in the case of Tradex, which is an active trading entity, the grant of such an order would have the effect of forcing the company to shut down and SARS did not seek to close down Tradex's business. The granting of a preservation order which had that effect would not be just.

(xxi) That a preservation order would also not be 'required' unless there were reason to believe that a forced sale of the company's assets or its business would achieve a better outcome for SARS than if the business were to continue in operation and there was no basis for such a view.

(xxii) That if the interdict sought by SARS is only intended to restrict dealings in property which would cause a decrease in the value of Tradex's assets, it would be unacceptably vague in its operations and for the reasons given SARS' papers do not advance facts to show that Tradex, prior to the launch of the application, was dealing with its assets in a way which would cause a decrease in their value.

(xxiii) That the question still remains whether the appointment of a curator would achieve an appreciable advantage for SARS, in the sense that there would be a material risk of Tradex being worse-positioned to meet its tax liabilities if a curator was not appointed. It had to be emphasised in this regard that a curator's function is not to assist SARS to investigate the taxpayer's tax liabilities; his or her functions focus on the discovery and preservation of assets from which tax liabilities, whatever they may turn out to be, may be met and in this case the appointment of a curator is not, in this sense, likely to achieve a material advantage for SARS.

(xxiv) That, accordingly, in the present case a preservation order was not, and is not, 'required' to secure the collection of tax within the meaning of section 163(3) of the Act and the court dismissed SARS' application for the provisional preservation order to be confirmed. However, the court did direct that, pending the final determination and payment of the taxes found to be owing by the respondents, the *caveats* registered against the immovable properties remained in place unless the parties agreed in writing to their removal or the court otherwise directed.

As to the court's observations in regard to section 163 of the TA Act

(xxv) That although section 163 permits SARS to bring a provisional preservation application *ex parte*, it would be contrary to basic principles of fairness and constitutional values to read the section as providing that the application may be brought *ex parte* in the absence of circumstances justifying a departure from ordinary procedure.

(xxvi) That even where *ex parte* proceedings are warranted, it by no means follows that the provisional order should contain all the terms which SARS wishes to form part of the final order. For example, although section 163 permits a provisional order to incorporate the appointment of a *curator bonis*, it will often be the case that such appointment is not reasonably required to secure the interim position pending the return day.

(xxvii) That SARS should not frame preservation orders on a one-size-fits-all basis and the relief should be tailored to the circumstances of the case.

(xxviii) That section 163 is a procedure for preserving assets and it is not an execution mechanism. Once tax has been assessed or is otherwise due and payable, the pay-now-fight-later regime applies unless a senior SARS official otherwise directs (section 164). SARS may, if the taxpayer fails to pay on due date, obtain civil judgment in terms of section 172 of the Act and SARS is not required to give notice of the application for civil judgment if the giving of such notice would prejudice the collection of tax (section 172(3)). SARS may thereupon levy execution in the ordinary way against assets belonging to the taxpayer.

(xxix) That section 163 finds its primary application where the amount of tax has not yet been ascertained (*i.e.* where SARS cannot execute in the ordinary way). This being so, it is not appropriate that a preservation order should (as here) contain, as a standard provision, a power on the part of the curator to realise assets in satisfaction of the taxpayer's tax liability. The court did not overlook that section 163(7) empowered a court which grants a preservation order to make ancillary orders regarding how the assets must be dealt with, including 'the realising of assets in satisfaction of the tax debt.' However, it is questionable whether it is justifiable, at a time when the tax liability is unknown and contentious, to empower a curator to set about selling assets and appropriating monies towards an alleged tax debt. The order should rather make provision for SARS to approach the court at a later stage (once the tax has been properly determined) for the granting of authority to the curator to realise the preserved assets in satisfaction of the tax debt. In other words, a court is unlikely to be able to make an informed and fair decision on this question at the time that the application is initially granted and confirmed.

Application dismissed and the provisional order of 14 August 2013 is discharged.

5.4. ITC 1874 (77 SATC 1874) – Fiscal Appeal Court, Zimbabwe

The taxpayer was a registered operator and a manufacturer of steel and steel products who had been supplied with fuel and groceries imported from South Africa by a company, ZW (Pvt) Ltd ('ZW').

The taxpayer did not settle the debt owing to ZW for such fuel and groceries on delivery of the goods but at the commencement of the multi-currency regime in 2009 it created a liability in its books of account in favour of ZW in the sum of US$392 326,64 for the indebtedness.

The taxpayer, in due course, settled the aforesaid debt by providing ZW with 337.8 tonnes of steel of equivalent value to the debt owed by it and issued invoices and delivery notes in respect of the transaction.

The taxpayer's tax agents, a firm of chartered accountants, in a letter to the Zimbabwe Revenue Authority (ZRA), had described the transaction as barter trade and further treated it as a sale in another letter to ZRA.

The taxpayer had initially treated the transaction in its books of account as a sale but had later altered it to cost of sales.

The taxpayer disputed that it supplied goods to ZW and it did not collect or remit value-added tax (VAT) on the transaction.

ZRA treated the transaction as barter trade and had assessed the taxpayer for VAT and, as a result, the taxpayer objected to the assessment and ZRA disallowed the objection, so leading to the present appeal.

The issue for determination was whether the 337.8 tonnes of steel constituted a supply of steel or a payment by steel.

The taxpayer contended that it merely paid consideration in kind in place of cash and thus disputed ZRA's finding that the settlement of the debt by steel of equivalent value constituted a 'supply' as contemplated by section 6(1)(*a*) of the Act.

In the second issue in the case between the taxpayer and ZRA, the taxpayer and ZOS Company Limited (ZOS) had concluded a 'conversion agreement' whereby ZOS, a scrap supplier, had supplied scrap steel to the taxpayer, who was the converter, for conversion into finished products for ZOS's use.

ZOS delivered 4768,44 tonnes of scrap metal to the taxpayer between February and December 2009 for processing into finished steel products and, in return for the processing, the taxpayer received 1 tonne of finished steel products for every 5 tonnes of scrap processed.

The taxpayer, in return, delivered 1135,73 tonnes of finished products to the scrap supplier and the parties exchanged debit notes indicating their respective VAT liability.

The debit note from ZOS to the taxpayer indicated a taxable value of the supply of US$851 796 and VAT of US$127 796,40 giving an aggregate value of US$979 565,40.

The debit note from the taxpayer to ZOS indicated that the taxpayer had delivered 1135,728 tonnes of steel valued at US$851 796 and VAT was charged at 15% in the sum of US$127 769,40.

The taxpayer had submitted timeous VAT returns during the period February to December 2009 for other transactions but it had never declared the supplies of finished steel products it had made to ZOS in its returns for the months in question and it had also failed to claim for input tax for the scrap it had received during the relevant months.

ZRA had subsequently conducted an audit of the taxpayer's tax returns and it was discovered that the sales figures in the income tax return of the taxpayer were much higher than the total sales figure in its VAT returns and one of the causes was the failure on the part of the taxpayer to declare the supplies of the finished products that it had made to ZOS.

ZAS, acting in terms of section 30 of the Act, then directed the taxpayer to submit amended VAT returns for the months in question in order to ascertain the correct tax payable.

The taxpayer thereafter submitted the amended returns for the period in issue and also claimed the input tax for the scrap iron supplied to it by ZOS during the period in question.

ZRA disallowed the claims for input tax and re-assessed the taxpayer for VAT and added back the input tax claimed in the amended returns.

The issue for determination was whether the claim for input VAT had been validly made in terms of section 15(2)(*a*) of the Act, *i.e.* whether the taxpayer had provided the debit note in the prescribed period.

In terms of section 15(2)(*a*) the tax invoice, or debit note or credit note must have been provided within the period that the registered operator was required to furnish a return in terms of ss 27 and 28 of the Act or twelve months, whichever is the longer period.

Judge Kudya held the following:

<u>As to whether transaction in issue had been a supply of goods</u>

(i) That it was common cause that the taxpayer was a registered operator and that the transaction took place after 1 January 2004 and it was further common cause that the transaction was undertaken by the taxpayer in the course or furtherance of its trade and that the transaction involved goods.

(ii) That the only dispute between the parties revolved around the nature of the transaction and whether the settlement of the debt by steel of equivalent value constituted a supply as contemplated by section 6(1)(a) of the Act.

(iii) That the conclusion in the decision in Shell's Annandale Farm (Pty) Ltd v C: SARS 62 SATC 97 was wrong and this was confirmed in hindsight by the amendment of the South African Value-Added Tax Act to capture passive supplies as a passive supply is as much a supply as an active one and the ground for distinction eluded the court. Moreover, the word 'supply' bore both the passive and active meaning and it seemed that all forms of supply were contemplated by the Act, including derivatives of supply.

(iv) That all the cases referred to by the taxpayer that curtailed the meaning of 'supply' confirmed that the word has a large variety of meanings and in the present case 'supply' is defined in section 2 of the Act. The context in which it is used indicates reasonably clearly that a wider connotation than its usual and ordinary one should be assigned to the meaning of the word.

(iv) That the legislature was aware of the large variety of meanings of the word 'supply' and it appeared that the intention of the legislature was to catch all the shades of meaning of the word 'supply', hence the use of the wide, broad, deep, extensive and all-embracing phrase 'all forms of' prefacing it.

(v) That the purpose of the Act as set out in the Preamble was 'to provide for taxation in respect of the supply of goods and services and the importation and exportation of goods;' and it is in this architectural design that the context of the Act resides. VAT is levied in respect of the supply of goods and services and that is the context in which the controlling words in section 6(1)(a) operate. Moreover, both 'goods' and 'services' are defined in the Act and those definitions remove all forms of ambiguity as suggested by the taxpayer.

(vi) That it was correct that the taxpayer had received goods from ZW and had set off the debt through the supply of steel of equivalent value but the contention that the taxpayer had treated the set off as a payment was not borne out by the facts and the court was satisfied from the records that the transaction was a sale for which the taxpayer did not receive cash but offset the cash due against the debt owing.

(vii) That consideration by way of goods and services constituted 'supply' was clearly recognised in our Act and one need only refer to the provisions of section 7(1)(a) and (b) that deemed payment of debt through the disposal of goods of the debtor by the creditor in certain circumstances constituted 'supply' in the course of trade and there was therefore no contradiction between the wide definition of 'supply' and that of 'consideration' and it seemed, therefore, that the taxpayer had first supplied the goods and then instead of being paid cash and handing it back to its creditor forewent that cash in settlement of the debt and hence the taxpayer utilised a mechanism not disparate from the open market value of the goods to calculate the value of the steel before setting off the debt owing.

<u>As to whether input tax claim had been validly made</u>

(ix) That it was common cause that the debit note in relation to the supply was provided in accordance with sections 20 and 21 of the Act and it was also common cause that the debit note had been held by the taxpayer, a registered operator, seeking the deduction and it was further

common cause that the taxpayer had held the debit note when it furnished the return in respect of the supplier.

(x) That the dispute centred on whether the tax invoice, or debit note or credit note must have been provided within the period that the registered operator had been required to furnish a return in terms of sections 27 and 28 of the Act or twelve months, whichever was the longer period.

(xi) That section 28 outlined the period for submitting the returns and payment of tax to SARS and it was common cause that the taxpayer fell into category C which was one of the four categories that any registered operator fell into as set out in section 27 of the Act and it was clear that the ordinary time within which the taxpayer was expected to furnish returns to ZRA was within ten days of the end of its taxable period(section 27(7)(c)) and it was common cause that it did not do so.

(xii) That, like every other registered operator, it had a grace period to do so of twelve months from the last day of the month from which it was supposed to furnish the return but, again, it was common cause that it did not do so.

(xiii) That the main subject-matter in section 15(2)(a) of the Act was the submission of the return for the deduction of input tax and not the debit note which was one of the requisites for a registered operator to succeed in the claim. The registered operator must at the time of submitting the return, hold, in this case, the debit note and the debit note must conform to the requirements of ss 20 or 21 but the return, which is the main subject-matter, must be submitted by the 10th of each month or within twelve months from the last day of the month when it was due.

(xiv) That, accordingly, the taxpayer failed to meet the requirements of section 15(2)(a) in full in that it did not provide the debit note in the prescribed period and ZRA was correct in disallowing the claim for input tax and in re-assessing the taxpayer for value-added tax for the period February to December 2009.

Appeals dismissed on both issues with no order as to costs.

5.5. ITC 1873 (77 SATC 93)

The taxpayer, a wine farmer, carried on pastoral, agricultural or other farming operations as contemplated in section 26(1) of the Income Tax Act.

The taxpayer was a member of a co-operative (XY) and he delivered his harvested grapes to that co-operative and he had not declared his income derived from XY for the sale of wine produced from, *inter alia*, his grapes as deriving from anything other than farming operations.

The expert evidence revealed that winemaking was a simple process and agreed with the proposition that wine was nothing more than the controlled outcome of the natural process of growth and decay of the grape. Grapes will naturally ferment and turn into wine if left alone. The winemaking process is merely a way of controlling and fine-tuning this natural transformation of the grape juice. The addition of commercial yeast and some chemicals, controlling its temperature, and eventually filtering and clarifying did not alter the fact that the wine was, largely, the naturally developed juice of the crushed grape.

The taxpayer had included in his 2007 and 2008 income tax returns, in terms of par. 2 of the First Schedule to the Income Tax Act, under the narration 'wingerd boerdery' certain amounts as 'produce held and not disposed of' by him at the beginning and end of those years of assessment.

The evidence of the chartered accountant who had completed the taxpayer's income tax return was that those amounts showed values allocated to the grapes that were harvested and delivered by the taxpayer to the co-operative of which he was a member, namely XY. Those grapes were allegedly immediately crushed and were in the process of being made into wine at year-end. The value was based on the estimated yield from the delivered grapes multiplied by the published distilling wine price, a method which was followed because it was referred to in SARS *Draft Guidelines: Recognition of Produce Held by Wine Farmers in a Pool* and the taxpayer was assessed accordingly.

The aforementioned chartered accountant had undertaken a similar valuation exercise for the 2009 year of assessment, and a value for 'produce held and not disposed of' was initially included in the taxpayer's ledger accounts for that year as described by him in the balance sheet entries as 'Voorraad Wyn'. However, before the taxpayer's 2009 income tax return had been finalised, the chartered accountant formed the opinion that no closing stock amount fell to be included under the First Schedule to the Act and he reversed the relevant entries.

As a result, the taxpayer's 2009 income tax return reflected a zero value to be added back for 'produce held and not disposed of' at year-end but, despite this, the taxpayer claimed a deduction of R242 486 for 'produce held and not disposed of' at the end of the previous year.

SARS after an audit into the taxpayer's 2009 income tax year, had issued an additional assessment in which an amount of R789 338 was included in the taxpayer's taxable income. The letter of assessment stated that this was an amount in respect of closing stock from farming operations, based on par. 2, 3(1) and 9 of the First Schedule.

The method adopted by SARS in fixing the amount of R789 338 had been set out in an annexure to the letter of assessment and he took the tonnage of grapes delivered by the taxpayer at the 2009 year-end to XY (671.8 tonnes), converted that into litres of liquid derived from the grapes and he relied on an estimate of 773 litres *per* ton published by the South African Wine Information and Systems and multiplied the result by what he believed to be the 'estimated distilling wine price *per* litre' entries as 'Voorraad Wyn'.

SARS, however, admitted that he had made an error in calculating the amount determined and that the price of R1,52 *per* litre that he had used was wrong and that the price that ought to have been used was 97,84 cents *per* litre, being the agreed distilling wine price.

The taxpayer contended that he, as a member of the co-operative XY, once he had delivered his grapes to XY and they had been 'pooled' in the sense of being crushed and mixed with grapes or grape juice of a similar type delivered by other members, could no longer be said to have 'produce held and not

disposed of' to bring into account as closing stock and hence the taxpayer denied that as a matter of law any amount fell to be included at all but if, however, an amount was in principle to be included, he denied that the amount so fixed was fair and reasonable.

SARS sought to apply the provisions of par. 2, 3(1) and 9 of the First Schedule to the taxpayer's agricultural produce in the form of 'wine-in-process', the latter being harvested wine grapes that were already crushed, out of which the juice content had been pressed, and which were being fermented, as part of the wine-making process.

The evidence revealed that the wine in process on hand at the end of the year of assessment, arising from the taxpayer's grapes, could not have gone far in the winemaking process. Deliveries had occurred from 28 January to 25 February 2009 and it was not in dispute that the grapes were picked, delivered and crushed on the same day and although some of the juice extraction may already have been completed, the fermentation process would not have run its course.

Further, loss occurred during the process of wine-making and it was also explained that the success of the outcome was subject to factors such as climate, weather, sugar content, *etc*.

The evidence further revealed that a winemaker, like XY, would incur huge expenditure in advance on imported products such as chemicals before the first delivery of grapes by the farmers.

It was also accepted that the pulp would have a value but it was believed that in practice there was no market for the pulp as at the end of February. It was believed that the pulp would in fact have had a negative value at that stage once XY's costs were taken into consideration and those costs would already have been incurred, since the contributing farmers were liable once they had delivered their grapes.

Moreover, pulp in the process of fermentation would never have been dealt with commercially as no winemaker would want to take possession of it before the fermentation process was complete.

It was common cause that a member of the co-operative did not transfer ownership of his or her produce to the co-operative, and that the co-operative acted as an agent for the member in controlling the produce.

It was also common cause that, the mixing or mingling of a member's grapes or grape juice with that of other members, without the intention of transferring ownership but in circumstances where the further identification of each member's own grapes was not possible, had the effect of creating joint ownership, in undivided shares, of the pooled grapes and later, of the pooled wine *pro rata* according to each member's contribution of the grapes to the pool.

The key issues to be determined in the case were:

- Whether the grapes in process as at the end of February 2009 constituted the produce of the taxpayer;
- Whether the grapes were 'held' by the taxpayer during the course of his farming operations;
- Whether the grapes were 'disposed of';
- What method of computing should be followed in arriving at a value to be placed on the grapes in process.

Par. 2, 3(1) and 9 of the First Schedule to the Act provide that an amount must be included in farmers' gross income for the value of wine grapes harvested by them and already in the process of being made into wine at the financial year-end.

In terms of section 26(1) of the Income Tax Act 'the taxable income of any person carrying on pastoral, agricultural or other farming operations shall, in so far as it is derived from such operations, be determined in accordance with the provisions of this Act but subject to the provisions of the First Schedule'.

Par. 2 of the First Schedule provided that 'every farmer shall include in his return rendered for income tax purposes the value of all livestock or produce held and not disposed of by him at the beginning and at the end of such year of assessment'.

In terms of par. 9 of the First Schedule 'the value to be placed upon produce included in any return shall be such fair and reasonable value as SARS may fix'.

The following was held:

(i) That if the making of wine was recognised as a farming or agricultural operation (as it was when it was conducted by the grape farmer), it was unrealistic to say that the wine, or the wine in process, was not 'produce.' After all, the production of wine was the ultimate objective that the farmer's farming operation as a whole was directed at producing.

(ii) That it was not in dispute that the taxpayer carried on pastoral, agricultural or other farming operations, as contemplated in section 26(1) of the Income Tax Act.

(iii) That it was not in dispute that at the end of the taxpayer's 2009 year of assessment, i.e. at midnight on 28 February 2009, the taxpayer had no harvested grapes in his possession as all grapes that had been harvested between the beginning of the harvesting season at, the end of January and the end of February 2009, had been delivered to XY.

(iv) That in the absence of evidence to the contrary, it was accepted that the grapes in issue must have been in the very early stages of wine-making and it was not yet at a stage where XY regarded it as ready to be sold and delivered.

(iv) That the taxpayer had submitted that the 'wine-in-process' at the end of the year in question was not 'produce' as contemplated in the First Schedule to the Act as, by then, they had been crushed, pressed, mixed with the grapes of other farmers and chemicals were added to them so that they were no longer identifiable as the taxpayer's grapes. However, the word 'produce' was not defined in the Income Tax Act and there is no reported case in which it had been interpreted in an income tax context.

(v) That the authorities were unequivocal about the making of wine forming part of the activity of wine farming and the crushed and pressed grapes which are fermenting or on their way to becoming wine must logically, remain a result of the farming operation, in the same way that the harvested grapes were before they were crushed, and the completed wine will be.

(vi) That after the taxpayer had delivered his grapes to XY he became a co-owner in undivided shares in the pools to which his grapes had been added and the taxpayer's rights to the grapes and the eventual outcome of the winemaking processes were regulated by the 'Leweringsooreenkoms' read with the 'Statuut' of XY.

(vii) That the word 'held' was supplemented and reinforced by the phrase 'and not disposed of' because the phrase was conjunctive. The complete phrase 'held and not disposed of' made it patently clear that the produce must have formed part of the farmer's farming produce and the farmer must still have a legal right to the produce as at the financial year-end and it did not mean that the farmer must have had physical possession or control of the produce at the year-end as if that was what the legislature had intended, it would have used words that clearly conveyed that meaning.

(ix) That in regard to the taxpayer's submission that he had disposed of the grapes once they became mixed and crushed, there was no rational conclusion concerning ownership of produce to be drawn from the fact that the produce was mixed and its form altered because it did not necessarily follow in that instance, that the grapes were no longer 'held' by the taxpayer.

(x) That if the taxpayer's argument was taken to its logical conclusion, then no farming partnership would ever be required to account for closing stock because the partners owned the partnership assets in undivided shares. There was no reason, in principle, why a farming partnership should be presumed entitled to enjoy greater tax benefits than a sole proprietor.

(xi) That the following is a more commercially sensible interpretation: the grapes were held by the taxpayer as produce once they were picked. On delivery and acceptance into the various pools at XY, the taxpayer acquired a right to the proceeds of the wine, proportionate to his contribution of grapes. Accordingly, his ownership in the grapes is a crucial determining factor for calculating and asserting his right to a fraction of the wine in process and ultimately his right to claim a corresponding portion of the net proceeds of the wine.

(xii) That the fact that his ownership and/or rights to the grapes so delivered was circumscribed by the conditions set out in the agreements with XY, did not detract from the objective position that he did not dispose of the grapes in that he held a right to the resulting product of the winemaking process by virtue of his ownership in the grapes. The taxpayer had exchanged his right to claim back and/or exercise control over the raw material, namely the grapes, for a claim sounding in money subject to provision for certain contingencies. The taxpayer's claim to the value of the unprocessed grapes was subsumed by his claim to the net proceeds because the unprocessed grapes were an essential component of the wine.

(xiii) That expanding the legal manifestation of a right did not in this instance lead to a change in the substance of a right. It could accordingly not be said that in the sui generis contractual relationship between the co-operative and the farmer/member, that the grapes were disposed of in the commercial and legal sense contemplated by section 3(1) of the First Schedule to the Act.

(xiv) That the grapes picked at end of February 2009 was produce in the farming operations that were held by the taxpayer. Once they were crushed and pressed, under the auspices of XY, they remained the property of the taxpayer, albeit in fractional ownership. The taxpayer did not dispose of them until after the end of February 2009, when the grapes were finally processed into wine and sold.

(xv) That the grapes delivered to XY as at the end of February 2009 was accordingly closing stock of the taxpayer's farming operation and should have been reflected as such in his income tax return.

(xvi) That SARS grounds of assessment were deficient in the following respects: (a) the amount of R789 338 relied upon by SARS was manifestly erroneous, unfair and unreasonable. The error arose out of employing an illogical and incongruous methodology and no evidence was adduced on behalf of SARS in support of the error; (b) after SARS had amended his grounds of assessment, no alternative value was fixed and the taxpayer was not informed what SARS' case was on an alternative value to the amount of R789 338; (c) SARS did not respond to the taxpayer's request for reasons for the assessment which was required of him in terms of Rule 3 of the Tax Court Rules. The purpose of providing reasons which are to be provided before the objection, was not only to have SARS apply his mind to what has been assessed, but also to enable the taxpayer to know what case he had to meet and this procedural defect was not remedied in SARS' grounds of assessment.

(xvii) That the parties' conduct was more aptly akin to the conduct described in C: SARS v Pretoria East Motors 76 SATC 293 where the court noted that the onus was on the taxpayer to show on a preponderance of probability that the decisions of SARS against which it appealed were wrong but that was not to suggest that SARS was free to simply adopt a supine attitude. It was bound before the appeal to set out the grounds for the disputed assessments and the taxpayer was obliged to respond with the grounds of appeal and these delineated the disputes between the parties.

(xviii) That, turning to the value placed on the produce by SARS, and in the light of the errors in calculation conceded on behalf of SARS, and proved by the taxpayer, the amount assessed was neither fair nor reasonable.

(xix) That in view of the paucity of evidence adduced on what would constitute a fair and reasonable method of quantification, the court was

not in a position to substitute SARS' calculation with that of its own and, further, in view of the evidence advanced on the taxpayer's behalf that an apportionment of produce was necessary between wine produce and produce used for dried fruit sales, this court could not, on the available evidence, make a determination with regard to the amount of the assessment.

(xx) That the issue of determining the value to be placed on the produce had to be remitted back to SARS for further consideration and for re-assessment with due regard to the finding contained in par. 60 of the judgment.

(xxi) That, since SARS had been successful in having the basis of its assessment upheld and the taxpayer had been successful in proving that the amount of the assessment was justifiably challenged, although the taxpayer had not proven the correct calculation of the assessment, SARS was not entitled to levy interest on the assessed amount until it had been revised nor was any costs order being made.

(xxii) That, accordingly, the taxpayer held produce on hand that was not disposed of as at the end of the 2009 year of assessment that should have been and shall now be included in his gross income as the value of wine grapes.

(xxiii) That the issue of the method to be employed in determining the amount to be so included in the taxpayer's gross income and the actual amount assessed was to be referred back to SARS for a determination by him on a proper consideration of all the relevant factors, including allowing the taxpayer the opportunity to rework the costs associated with the closing stock, to ensure that both the closing stock value and the expense was included in the farmer's tax computation for the year under consideration.

5.6. Z Co (Pty) Ltd v Zimbabwe Revenue Authority (77 SATC 82)

The taxpayer was duly registered with the Tobacco Industry and Marketing Board (TIMB) as a tobacco merchant and purchased both auction and contract tobacco, processed, packaged and marketed it for manufacturers and then exported it.

The taxpayer operated in conformity with the financial architecture designed in the Exchange Control (Tobacco) Finance Order SI 61 of 2004 and the Reserve Bank of Zimbabwe directive dated 2 May 2008 issued in terms of section 35(1) of the Exchange Control Regulations SI 109 of 1996.

The aforementioned legal instruments directed that funds for the purchase of local tobacco and for financing contract tobacco growers should be sourced off-shore.

The taxpayer, on 30 June 2010, had, through its designated public officer filed the tax return ITF 12C for the year ended 31 December 2009 and it had disclosed in the return that the cost of sales included the amount of US$1 004 833 that had been liquidated to the Reserve Bank of Zimbabwe for the purpose of purchasing tobacco in terms of exchange control regulations but that had not been subsequently availed.

Zimbabwe Revenue Authority (ZRA) had issued an amended assessment in respect of the tax year in question and had added back into the taxpayer's taxable income for that year of assessment the amount in dispute that had resulted in a tax liability of US$453 575,22, which was made up of the principal amount of US$200 966,20, interest of US$51 642,82 and a penalty of US$200 966,20.

The taxpayer objected to the amended assessment and ZRA allowed the objection of waiver of penalty in full but had disallowed the objections on the principal amount and interest.

Thereafter the taxpayer gave notice of appeal and the parties' cases were filed during 2013.

The evidence revealed that there were five players who interacted with the taxpayer in the tobacco merchant operations and these were, firstly, the growers of the tobacco who interfaced with the taxpayer either as contract growers or auction floor vendors; secondly, the TIMB who registered the taxpaeyr each year as a tobacco merchant and issued it with a trading licence; and the remaining players were financial institutions, being the Reserve Bank of Zimbabwe, the off-shore bank that availed the foreign currency required by the taxpayer to purchase tobacco on the local market and the on-shore bank that acted as a conduit pipe for the channelling of the foreign currency requirements of the taxpayer and as the authorised dealer and interloper between the Reserve Bank of Zimbabwe and the taxpayer.

All interactions with the Reserve Bank of Zimbabwe during the negotiation of the loan facility, draft agreement, receipt of a return sheet and summary of terms and External Loans Coordinating Committee approvals were carried out through the authorised dealer and there was no direct communication between the taxpayer and the Reserve Bank of Zimbabwe.

In a nutshell, the currency of account for all purchases of local tobacco, whether from contract growers or auction floors, was denominated in United States dollars and these had to be sourced off-shore and transmitted through the on-shore bank to the Special Tobacco Foreign Currency Account for the taxpayer in the Reserve Bank of Zimbabwe. The account in the Reserve Bank of Zimbabwe represented a pre-payment of the anticipated tobacco purchases during each calendar year trading season and the on-shore bank kept a mirror account of the funds.

The taxpayer, on purchasing the tobacco, would be invoiced in the currency of account and it would transmit the invoice to the on-shore bank which would in turn dispatch it to the Reserve Bank of Zimbabwe (RBZ) who would then transfer the local currency equivalent of the invoiced amount to the on-shore bank and the amount would be deposited in the Zimbabwe Dollar Tobacco Special Account of the taxpayer held in the on-shore bank. The local currency would then be paid over to the tobacco grower at the auction floor or to the contract farmer.

In a nutshell the process was such that the tobacco merchant purchased the tobacco in foreign currency but paid for it in local currency and the foreign currency was sold to the central bank who converted the amount into local currency for transmission to the tobacco grower by the taxpayer through the on-shore bank.

The evidence confirmed the movement of funds between the off-shore bank and the Reserve Bank through the on-shore bank and explained how the amount of US$1 004 833 that remained outstanding in the Special Tobacco Foreign Currency Account had been calculated.

The aforesaid amount had been part of the US$5 million that, on the instruction of the taxpayer, had been remitted to the on shore bank and had been deposited with the RBZ for the purchase of tobacco by the taxpayer in August 2008 for that year's tobacco purchases.

There had been inadequate supplies of tobacco on the market to exhaust the amount deposited and a balance of US$2 299 070,04 remained outstanding. The RBZ and the taxpayer had agreed to roll over the amount to the 2009 tobacco season and it was common cause that the remaining amount of US$1 004 833 had not been converted by the Reserve Bank into local currency in the 2009 tobacco trading season.

At that time the local currency had been demonetised and the currency of account due to contract growers and on the auction floor was in United States dollars and not in local currency.

The RBZ had failed to avail the aforementioned funds (*i.e.* US$1 004 833) to the onshore bank for payment of thet taxpayer's obligations to the tobacco sellers notwithstanding that the taxpayer was entitled to buy tobacco to the value of the United States dollars held by the RBZ and not to receive Zimbabwe dollars.

The taxpayer contended that the missing money did not constitute planned voluntary expenditure as it did not spend the money before it was lost. The funds had been sitting in readiness to purchase tobacco and awaiting draw down and had been lost in the hands of the exchange control authority.

The taxpayer contended that the loss was not a cost of sales in the ordinary sense but it was money lost in the tobacco chain that constituted the core business of the taxpayer as it had been required by law to avail the US dollars upfront to the RBZ before it could purchase tobacco and the funds had been lost in its revenue or trading account where it had been reflected as a cost of sales and hence for the taxpayer it constituted a normal loss in trade and had been lost in the pursuit of trade.

The taxpayer further submitted that the loss of the money was an incidental risk inherent in the business of the taxpayer.

The issue for determination before the court was whether the taxpayer was entitled to rely on the provisions of section 15(2)(*a*) of the Income Tax Act for the deduction of US$1 004 833 in the 2009 tax year as being 'expenditure and losses to the extent to which they are incurred for the purposes of trade or in the production of the income except to the extent to which they are expenditure or losses of a capital nature.

It was common cause that the determination of this matter turned on the second rung of the formulation by Beadle CJ in *COT* v *Rendle* 26 SATC 326, that is, whether the US$1 004 833 fell into the category of 'expenses which are attached to the performance of the business operation by chance'.

ZRA contended that the taxpayer had failed to show that the risk or mishap giving rise to the involuntary expenditure was an inseparable or a necessary incident or inherent risk of the carrying on of its business operations.

ZRA contended further that the taxpayer did not suffer any loss as the Reserve Bank of Zimbabwe had acknowledged liability and was willing to repay the money.

Judge Kudya held the following:

(i) That the loss of the money in issue was an incidental risk inherent in the business of the taxpayer and the money had been borrowed for the purpose of purchasing tobacco which was deposited with the Reserve Bank by operation of law for payment after the purchase. Moreover, it was a legal requirement for the money to be deposited with the Reserve

Bank in advance of the purchase otherwise the taxpayer would be disallowed from buying tobacco.

(ii) That *ITC 807* (1955) 20 SATC 338 (T) was in point in this case and where Price J stated at 342–3 that the loss incurred in that case was deductible against the income of the taxpayer for the purposes of assessment for tax because it was integrated in and an adjunct of the ordinary trading of the taxpayer and it was the way in which it carried on its business and hence the amount, in the opinion of the court, was correctly brought up in the trading account and was expenditure incurred in the production of the taxpayer's income and was not an outlay of a capital nature.

(iii) That in the present matter the taxpayer made advance payment to the Reserve Bank of Zimbabwe for the purpose of paying for tobacco purchases and it was the normal, customary and legal practice for the taxpayer to conduct its business operations and the payment was therefore integrated in and an adjunct of the ordinary trading of the taxpayer. Moreover, the chartered accountant, in his uncontroverted testimony, stated that the money was reflected as a cost of goods in the trading accounts of the taxpayer and was never held as an investment and it was not revenue but working capital.

(iv) That the effect of the failure to avail the amount in question was that other funds were used to pay for tobacco purchases and to pay off the off-shore financier and it was accordingly clear that the loss of the money in issue constituted fortuitous expenditure that was closely linked to the business operations of the taxpayer.

(iv) That the taxpayer had established on a balance of probability that the loss of US$1 004 833 was fortuitous expenditure, and not an outlay of a capital nature, incurred in the ordinary course of business and hence ZRA should have allowed the deduction.

(v) ZRA was directed to reimburse to the taxpayer the tax paid in the sum of US$200 966,20 together with interest paid in the sum of US$58 690,40.

Appeal upheld.

5.7. *C:SARS v Bosch and another (77 SATC 61)*

Ms Bosch and Mr McClelland (the taxpayers) were both senior employees of Foschini between 1998 and 2005, which was the period relevant to this appeal.

The taxpayers, in September 1998 and again in December 1998, were each given options to purchase shares in Lewis Foschini Investment Company Ltd (Lefic), Foschini's listed holding company, at a price determined as the Middle Market Price of those shares on the Johannesburg Stock Exchange (the JSE) as determined on the date of the notice containing the option. The options had to be exercised within 21 days of the offer and both the taxpayers exercised them within the stipulated period.

In terms of the share option scheme implemented by the Foschini Group in 1997, and known as a deferred delivery share scheme, the shares would be delivered in three tranches on the second, fourth and sixth anniversaries of the notice containing the option, subject to certain exceptions. The purchase consideration became payable on delivery and the taxpayers were entitled, instead of taking delivery, to dispose of the shares and to be paid the balance remaining after deducting the costs of sale and the purchase consideration.

The Supreme Court of Appeal was not concerned with the first two tranches of shares to which the taxpayers became entitled, as the Tax Court (see *ITC 1856* (2011) 74 SATC 76) had held that the gains on those tranches were taxed in terms of the practice then prevailing in the offices of SARS and there had been no appeal against that finding. The final tranches that were the subject of the appeal to the Supreme Court of Appeal were deliverable on 14 August 2004 and 2 December 2004 and these two dates were relevant because there was a potentially relevant amendment to the Income Tax Act ('the Act') that came into effect from 26 October 2004. If certain of the arguments on behalf of SARS, who was the the taxpayer in this appeal, were upheld, the amended provisions would apply in respect of the shares that fell to be delivered on the latter date.

Ms Bosch elected to sell her shares and receive the proceeds while Mr McClelland elected to take transfer of the shares and pay the consideration.

The interest of SARS was aroused by the fact that when this occurred the value of the shares on the JSE was considerably higher than the consideration paid for them and this emerged from a table taken from the judgment of the court below (see *Bosch and Another* v *C: SARS* 75 SATC 1) which showed the date on which the shares became deliverable; the market value of the shares on those dates; the consideration payable by Ms Bosch and Mr McClelland and the differences between the prices paid and the value of the shares, realised in the case of Ms Bosch and notional in the case of Mr McClelland and these were the amounts on which SARS levied additional income tax.

Many companies used share option schemes as a means of retaining staff and providing additional compensation to those staff members who were thought to make a significant contribution to the business activities of the company.

SARS, being SARS for SARS, had, in 2008, reviewed the aforementioned deferred delivery scheme and had issued additional assessments to income tax in relation to 117 employees and former employees of Foschini.

Appeals were lodged on behalf of the employees and the appeals of two of them, the the taxpayers, were taken as test cases before the Tax Court (see *ITC 1856* (2011) 74 SATC 76). Their appeals were partially successful before Allie J and SARS did not pursue a challenge to those of her findings that were favourable to the taxpayers.

The taxpayers appealed to a Full Bench of the Western Cape High Court (see *Bosch and Another* v *C: SARS* 75 SATC 1) against the findings that were adverse to them and their appeals succeeded in a judgment by Davis J in which Baartman J and, in all save one respect, Waglay J concurred.

SARS then made an application to the High Court for leave to appeal which was refused and on petition to the Supreme Court of Appeal the application for leave to appeal was referred for argument and the parties were directed to be prepared to address the court on the merits of the dispute and they had done so.

SARS had primarily relied on section 8A(1)(*a*) of the Income Tax Act in making the additional assessments and that section included in the taxpayer's income for the year of assessment the amount of any gain made by the taxpayer by the exercise, cession or release of any 'right to acquire any marketable security' if such right was obtained by the taxpayer before 26 October 2004 as a director or former director of any company or in respect of services rendered or to be rendered by him or her as an employee to an employer.

SARS' main contention was that when the the taxpayers had paid the consideration for the shares and had received either transfer or, if they elected to sell them, the proceeds, that was when 'the exercise of the right to acquire the shares' had occurred in terms of the section.

Accordingly, that was when the the taxpayers' incomes were taxable on the difference between the market value of the shares and the purchase consideration paid for them.

In the alternative and on various grounds, SARS contended that the agreements of purchase and sale of the shares concluded in consequence of the the taxpayers exercising the options were conditional on them remaining employees within the group until the date for delivery of the shares arrived.

The aforesaid argument was that the sale agreement arising from the exercise of the option only became exigible on fulfilment of the conditions at the later date when the price fell to be paid and the shares delivered. If that was correct then in relation to the earlier deliveries they were taxable under section 8A(1)(*a*) and in relation to the two later deliveries in December 2004 they were taxable under section 8C of the Act, which had been introduced to deal with deferred delivery share schemes.

Lastly, SARS contended that the mechanism by which the scheme operated was a simulation and that, once the disguise in which it had been concealed was stripped away, the true exercise of the right to acquire the shares occurred when the shares were paid for and delivered.

The taxpayers contended that when they exercised the options in 1988, they exercised the right to acquire the shares, albeit that delivery and payment of

the consideration was postponed in accordance with the provisions of the scheme. They submitted that it was at that stage that they had acquired an unconditional right to the shares and became liable to pay income tax under the section on any increase in market value of the shares between the date of the offer and the date on which they exercised the options (an inconsequential amount). They contended that they were not liable to tax on the difference between the market price of the shares on the date of delivery and the consideration payable at that time and rejected the notion that there was any simulation in the scheme or the contracts concluded pursuant thereto.

Judge Wallis held the following:

As to the application for leave to appeal

(i) That the issues raised in the case were important and, according to the affidavit on behalf of SARS, may affect a number of similar deferred delivery share schemes in relation to other companies and taxpayers. The points raised were reasonably arguable and in the principal respect were upheld in the Tax Court. It could not be said that there were no reasonable prospects of success and, in any event, the fact that the decision had wider implications justified SARS in seeking to canvass the issues before the Supreme Court of Appeal. Accordingly, leave to appeal was granted and the costs of the application for leave to appeal and the costs of the application for leave to appeal to the Supreme Court of Appeal were to be costs in the appeal.

As to the appeal on its merits – interpretation of section 8A(1)(a)

(ii) That the primary issue in dispute was whether the two taxpayers had exercised a right to acquire the shares, within the meaning of that expression in section 8A(1)(a) of the Act, when they exercised the options, or whether they only did so when the time for payment and delivery had arrived and that involved the proper construction of the section in accordance with ordinary principles of statutory construction.

(iii) That the words of the section provide the starting point and are considered in the light of their context, the apparent purpose of the

provision and any relevant background material. There may be rare cases where words used in a statute or contract are only capable of bearing a single meaning, but outside of that situation it is pointless to speak of a statutory provision or a clause in a contract as having a plain meaning. One meaning may strike the reader as syntactically and grammatically more plausible than another, but, as soon as more than one possible meaning is available, the determination of the provision's proper meaning will depend as much on context, purpose and background as on dictionary definitions or what Schreiner JA referred to as 'excessive peering at the language to be interpreted without sufficient attention to the historical contextual scene'.

(iv) That the section referred to the exercise by the taxpayer of a right to acquire any marketable security. It did not refer to the acquisition of a marketable security. That suggested that it was concerned with something prior to the actual acquisition of ownership, which is effected by transfer of the marketable security to the taxpayer. It foreshadowed a right that vests in the taxpayer and is capable of being exercised so as to bring about the acquisition of the marketable security. An obvious example of such a right, in the strict sense of that word, would be an option.

(iv) That an option is an offer to sell, joined with a binding contractual undertaking to keep the offer open for acceptance for a specific period. The option holder then has a right to acquire the subject of the option. If they wish to acquire it, they are said to exercise the option, thereby bringing a binding contract of purchase and sale into existence. This is the very language used in the section and it is language apt to describe the situation where a taxpayer has been given an option to buy shares, or some other form of marketable security, and exercises the right to do so. At the time the section was introduced it was commonplace for companies to have in place share option schemes in the form of options to purchase shares exercisable at a future date at a price determined when the option was given.

(v) That where an offer is made to sell a marketable security to a taxpayer, not linked to any undertaking to keep the offer open for a defined period, the taxpayer has a right to acquire that marketable security for so long as the offer remains open for acceptance. Until it is withdrawn the right vested in the taxpayer is the same as that created by an option and the exercise of that right has the same effect, namely to bring into existence a contract of purchase and sale in respect of the marketable security. In each instance the exercise of the right takes the form of an agreement to purchase the marketable security on the terms offered. The only distinction between the two situations was that in the case of an option the offeror is obliged to keep the offer open for a defined period, whereas in the ordinary case the offer will be revocable at the will of the offeror at any time before acceptance.

(vi) That other possible circumstances giving rise to a similar right to acquire a marketable security, capable of being exercised by acceptance, are the allotment of shares in a company, a rights issue to existing shareholders or an offer to make a donation or enter into an exchange in relation to a marketable security. For so long as it is open to the taxpayer to accept the allotment, follow the rights or, by acceptance, to conclude a contract of donation or exchange, they have a right to acquire shares capable of being exercised by them. Linguistically, section 8A refers naturally to the type of situation described in this and the preceding paragraphs. The characteristic of each of those situations is that they do not necessarily mean that the exercise of the right brings about the immediate acquisition of the marketable security in the sense of title to it as an asset and when that occurs will depend upon the terms of the contract that results from the taxpayer's exercise of the right.

(vii) That the alternative construction espoused by SARS fits less naturally with the wording of the section. It required not only the initial exercise of the right that led to the entitlement to acquire the marketable security, but the enforcement of the resulting contract thereafter. Cases, in which it has been said that the ordinary legal meaning of the word 'acquire'

was to acquire ownership were cited to the court but all that those cases demonstrated was that whether this was the correct meaning was always dependent upon context and that the word may have a broader meaning of the acquisition of the right to acquire ownership.

(ix) That there was nothing to indicate that section 8A(1)(a) was directed at performance of the contract resulting from a prior exercise of rights, as opposed to the exercise of a right leading in due course, in accordance with the applicable contractual provisions, to the acquisition of ownership of a marketable security.

(x) That SARS did not contend that the exercise of an option did not fall naturally within the language of the section, irrespective of when the resulting contract of purchase and sale was to be performed and that accorded with the view of the revenue authorities from 1969 when section 8A was incorporated into the Income Tax Act. There had been a suggestion thereafter that the section was confined to the exercise of an option and did not cover any other situation, but that suggestion was laid to rest by the decision of the full court in SIR v Kirsch 40 SATC 95, which dealt with an allotment of shares and not an option.

(xi) That Kirsch clearly identified the act of acceptance of the offer in the case of an option, or the acceptance of the offer to allot shares, as the event that gave rise to a potential liability to tax, rather than the performance of the contract. The court accepted that the problem confronting the court in Kirsch differed from the present case and accordingly the court was not directly concerned with the possibility of a right being exercised, giving rise to a contract of purchase and sale. However, the court in Kirsch did recognise that the allotment of shares would not occur simultaneously with the acceptance of the offer to allot shares and cited the example of a rights offer where the acceptance and performance of the resulting contract occur at different times. Nonetheless it identified the acceptance of the offer and the conclusion of the contract as the event that attracted liability to tax under section 8A and that was supportive of the contentions of the the taxpayers.

(xii) That the issues in this case appear to have come to the fore in practical terms when companies and their advisors started to adopt deferred delivery schemes and this resulted in SARS submitting a memorandum dealing with share option schemes generally and deferred delivery schemes in particular and its practice until the issue of the revised assessments in issue in this appeal was that the acceptance of the option in a deferred delivery scheme was the time at which the right to acquire a marketable security was exercised for the purpose of determining any taxable gain received by a taxpayer in terms of section 8A(2)(a) of the Act.

(xiii) That there was authority that, in any marginal question of statutory interpretation, evidence that it has been interpreted in a consistent way for a substantial period of time by those responsible for the administration of the legislation is admissible and may be relevant to tip the balance in favour of that interpretation and this is entirely consistent with the approach to statutory interpretation that examines the words in context and seeks to determine the meaning that should reasonably be placed upon those words.

(xiv) That the conduct of those who administer the legislation provides clear evidence of how reasonable persons in their position would understand and construe the provision in question. As such it may be a valuable pointer to the correct interpretation. In the present case the clear evidence that for at least eight years the revenue authorities accepted that in a deferred delivery share scheme the exercise of the option and not the delivery of the shares was the taxable event, fortifies the taxpayers' contentions.

(xv) That on the issue of the proper interpretation of section 8A(1)(a) of the Act some weight must attach to the fact that in October 2004 the Act was amended by the insertion of section 8C, which in part at least was enacted in order to render taxable the gains made by beneficiaries of deferred delivery share schemes when they took delivery of the shares under these schemes. It did this by providing that the critical date for

determining a tax liability was the date of vesting of the shares in the taxpayer.

(xvi) That, as explained in the Explanatory Memorandum accompanying the amending legislation when it was placed before Parliament, the existing provisions of section 8A(1)(a) 'fail to fully capture all the appreciation associated with the marketable security as ordinary income.' That not only identifies the purpose of the amendment, but is also a permissible guide to Parliament's understanding of the existing section.

(xvii) That, weighing all relevant contextual and background material it points consistently in favour of the construction of the section in the manner for which the taxpayers contend. That reinforces the linguistic analysis and the court concluded that when the section speaks of the exercise of a right to acquire a marketable security it is concerned with the action by the taxpayer that gives rise to a binding contract under which the taxpayer will be entitled, subject to compliance with the terms of the contract, to acquire the marketable security, whether the acquisition by transfer to the taxpayer occurs immediately or is postponed to a future date and the contrary contention by SARS must therefore be rejected.

As to whether the contract was conditional

(xviii) That SARS' submissions around this topic arose in consequence of a concession on behalf of the taxpayers that if the exercise of the option gave rise to a contract subject to a suspensive condition then section 8A(1)(a) would not be triggered. Firstly, SARS contended that the contracts concluded by the taxpayers when they exercised the options were subject to a suspensive condition that they remain in the employ of Foschini until the dates upon which each tranche of shares fell due for delivery. Secondly, that even if the contracts were not subject to such a true suspensive condition, they should for tax purposes be treated as if they were. Thirdly, it was contended that the fact that receipt of the shares was subject to a reciprocal obligation on the part of the taxpayers to pay the consideration therefor, made the contracts conditional.

(xix) That a suspensive condition is one that suspends the exigible content of a contract, either in whole or in part, pending the occurrence of an uncertain future event. In contending that the contracts for the purchase of shares concluded by the taxpayers were subject to a suspensive condition SARS needed to identify in what respect the exigible content of the contract was suspended pending a future uncertain event.

(xx) That what SARS' argument lacked was any articulation of the terms of the suspensive condition. The scheme itself contained no clause that could, even remotely, be construed as a suspensive condition. Clause 7.3 which provided for the postponed delivery dates did not purport to suspend the operation of the contract until those dates. The argument therefore required that the proposed suspensive condition be inferred by way of a tacit term of the scheme.

(xxi) That it was clear from clause 7.1.4 that continued employment until each of the three anniversaries of the notice date was by no means a requirement for receipt of the shares. A wide variety of circumstances would entitle the participant to receive the shares notwithstanding the fact that they did not remain in the employ of the company for the full period. Thus a person who died, or was retrenched, or retired either in the ordinary course or on grounds of ill-health, would still be entitled to receive the shares. All of these possibilities were inconsistent with the suggested suspensive condition making entitlement to receipt of the shares dependent upon continued employment at the date of delivery.

(xxii) That there was no practical reason for importing the suggested suspensive condition into the contract as it was perfectly workable without that term and achieved precisely the aims of the parties. For all the reasons given, there was no basis for importing the suggested suspensive condition into the scheme.

(xxiii) That, accepting that the contracts in terms of which the taxpayers purchased shares were not subject to a suspensive condition, it was difficult to appreciate on what basis they could be treated as subject to such a condition for fiscal purposes.

(xxiv) That this proposition lacked any foundation in the text of section 8A(1)(a) or in any other provision of the Income Tax Act. Once the section was held to apply by virtue of the exercise of an option bringing into existence a contract of purchase and sale, the tax consequences followed from the language of the section itself. Any gain realised by the taxpayer in the year in which the right was exercised was to be included in the taxpayer's income for that year.

(xxv) That the principle that SARS sought to invoke under the head of reciprocity was one common to many contracts, where performance by the one party is conditional upon reciprocal performance by the other. However, it can have no application in determining when a liability to pay tax in terms of section 8A(1)(a) arises as that is determined by the terms of the section and the key event is the exercise of the right to acquire the marketable security, not performance of the contract arising from the exercise of that right.

(xxvi) That, accordingly, all SARS' arguments under the general head of conditionality fell to be rejected.

<u>As to substance over form</u>

(xxvii) That, based on the passage in C: SARS v NWK Ltd 73 SATC 55 (par. 55), SARS contended that dishonesty is not a requirement for simulation and that, as the scheme had clearly been formulated to enable the participants to avoid any significant tax liability under section 8A(1)(a), it should be treated as giving rise to a conditional entitlement to shares that would only trigger the application of the section on payment for and delivery of the shares.

(xxviii) That the aforementioned submission involved a misunderstanding of the judgment in NWK, supra, as was pointed out in Roshcon (Pty) Ltd v Anchor Auto Body Builders CC and Others 2014 (4) SA 319 (SCA) where it was stressed that simulation is a question of the genuineness of the transaction under consideration. If it was genuine then it was not simulated, and if it was simulated then it was a dishonest transaction, whatever the motives of those who concluded the transaction.

(xxx) That the true position was that ‘the court examines the transaction as a whole, including all surrounding circumstances, any unusual features of the transaction and the manner in which the parties intend to implement it, before determining in any particular case whether a transaction is simulated. Among those features will be the income tax consequences of the transaction. Tax evasion was of course impermissible and therefore, if a transaction was simulated, it may amount to tax evasion. But there was nothing impermissible about arranging one’s affairs so as to minimise one’s tax liability, in other words, in tax avoidance. If the revenue authorities regard any particular form of tax avoidance as undesirable they are free to amend the Act, as occurs annually, to close anything they regard as a loophole and that is what occurred when section 8C was introduced.

(xxxi) That, once the aforementioned was appreciated, the argument based on simulation must fail. For it to succeed, it required the participants in the scheme to have intended, when exercising their options to enter into agreements of purchase and sale of shares, to do so on terms other than those set out in the scheme. That was manifestly implausible and was not suggested to either of the the taxpayers in evidence. Their approach was simply that they were being offered an opportunity to acquire shares on the terms of the scheme and they had accepted those offers and in this case there was no advantage to the parties in entering into a conditional contract of purchase and sale when they were free to enter into an unconditional contract and postpone performance of the obligation to pay the purchase price and deliver the shares.

(xxxii) That, accordingly, SARS' contentions based on the notion of substance over form had to be rejected.

Appeal dismissed with costs.

5.8. Kluh Investments (Pty) Ltd v C:SARS (77 SATC 23)

Companies in the Thesen group (Thesen) had previously owned property in Knysna on which they had conducted forestry, timber growing and plywood manufacturing businesses and the plantation at issue in the present case was a plantation which Thesen once owned and conducted.

During May 2001, Thesen and Steinhoff Southern Cape (Pty) Ltd (Steinhoff) had concluded written agreements in terms whereof the latter was to purchase the former's Knysna assets as a going concern for R45 million. The Steinhoff group was involved in furniture manufacturing, here and abroad but the transaction in issue was blocked by the board of Steinhoff's holding company because the group did not wish to own fixed property in South Africa.

However, Steinhoff wanted to have access to the plantation but needed to find a third party to acquire the fixed property and in the result Steinhoff went ahead to purchase Thesen's machinery and equipment and Kluh Investments agreed to purchase the other assets, including the plantation and the land on which it stood, for R29,5 million. It was agreed that Kluh Investments would keep the land and plantation but would on-sell the other assets to a third party with Steinhoff's assistance.

In terms of a written contract executed on 5 October 2001, Steinhoff purchased the machinery and equipment (including the sawmill) from Thesen for a price of R15 786 881 and Thesen sold these assets to Steinhoff as a business conducted as a going concern as contemplated in section 11(1)(*e*) of the VAT Act.

The sale of the remaining Thesen assets to the Kluh Investments was recorded in a written contract executed on 3 October 2001 and this contract likewise specified an effective date of 29 June 2001. The purchase price of R29,5 million was apportioned as follows: R11 956 121 to the plantation ('growing timber'), R12 528 459 to the plantation land and the balance to other assets.

The assets collectively were stated to comprise a business sold by Thesen to Kluh Investments as a going concern and for this reason the sale would be zero-rated in terms of section 11(1)(*e*) of the VAT Act.

Kluh Investments retained the land and plantation but forthwith sold the remaining assets (a plywood business, certain trade marks and an erf) to third parties.

Within less than two years, Steinhoff's board had been persuaded that, because of escalating timber prices and the scarcity of plantation resources, it would be desirable for the group to obtain ownership of the plantation and this cleared the way for Steinhoff to acquire the plantation and land which Kluh Investments had purchased from Thesen during 2001.

The aforesaid sale was recorded in heads of agreement executed in February 2003 and the parties also recorded that Steinhoff had 'managed the business on behalf of Kluh Investments.'

The purchase price of the plantation was to be determined by an independent valuer and thereafter the purchase price of the combined assets was agreed at R159,7 million, with R144,7 million being in respect of the 'Plantation' as defined.

The subject of the sale was described as being 'the plantation business' defined in the agreement to mean 'the business of commercial forestry operations, which includes the plantation sale assets, machinery and equipment and plantation contracts carried on by Kluh Investments at the plantations and the plantation immovable property as defined, as a going concern.' The agreement also stated that the business was being sold as a going concern and that the sale would thus be zero-rated in terms of section 11(1)(*e*) of the VAT Act.

Kluh Investments, in its 2004 tax return had treated the aforementioned disposal of the land and plantation as a capital transaction. In respect of the plantation, Kluh Investments had declared a capital gain of R45 623 115, being the difference between the disposal proceeds of R144,7 million and a CGT valuation of the plantation of R99 076 885 as at 1 October 2001.

SARS in an additional assessment issued during 2010 in respect of Kluh Investments' 2004 tax year, had treated the amount of R144,7 million, being

the selling price of the plantation, as part of Kluh Investments' gross income in terms of par. 14 of the First Schedule to the Income Tax Act.

SARS, in the additional assessment, had rejected the treatment of the plantation disposal proceeds as a capital transaction, claiming that section 26(1) of the Income Tax Act read with par. 14 of the First Schedule thereto had deemed the disposal proceeds to be part of Kluh Investments' gross income.

Kluh Investments, in its grounds of appeal, had alleged that its intention had been to acquire and hold the land and the plantation as a long-term investment and, in terms of an oral agreement between the parties, Steinhoff was engaged to manage Kluh Investments' investment with a view to maintaining and enhancing its value, on the basis that Steinhoff would be entitled for its own benefit to conduct the plantation operations.

There was no dispute between the parties that the cultivation, maintenance and harvesting of a plantation is a farming operation and there were important further factors which were not in dispute. At the time that Thesen disposed of the plantation in 2001, it was already a 'mature plantation in rotation' in that the plantation had reached the stage where it could annually yield a steady and sufficient number of mature trees for commercial felling, with younger trees taking their place year by year. It was orally agreed between the parties, during May/June 2001, that Steinhoff would be entitled to conduct the plantation business for its own profit and loss and was to have access to the land on which the plantation stood. It was entitled to harvest timber for its own account. Steinhoff owned the equipment for conducting the plantation operations and employed the employees who worked on the plantation. Moreover, Kluh Investments owned no equipment and had no employees. All operational income and expenditure were earned and incurred by Steinhoff and reflected in its accounts while Kluh Investments' financial records and financial statements for the period between acquisition and disposal reflected no operational income and expenditure.

The aforesaid arrangement was of indefinite duration and was expected to endure for a lengthy period and it was accepted that in law either side could have terminated the arrangement on reasonable notice.

Upon termination the plantation was to comprise trees of the same volume and quality as at the commencement of the agreement and this meant that Steinhoff, in conducting the plantation operations, had to keep the plantation in rotation and perform such other pruning, thinning and maintenance as would ensure that, upon termination, it could restore the plantation in the state it was in June 2001.

The aforesaid indefinite arrangement was terminated by agreement, ultimately with effect from 1 June 2004, after the Steinhoff group had changed its policy and became willing to purchase the immovable property in issue.

The crisp issue before the court was whether the proceeds of a disposal of the plantation by Kluh Investments had been correctly included in its gross income for the relevant year of assessment in terms of section 26(1) of the Act read with par. 14 of the First Schedule thereto and in that endeavour the issue to be determined was whether Kluh Investments had carried on 'pastoral, agricultural or other farming operations' as contemplated in section 26(1) of the Act between the relevant years of assessment and, if it did, then whether the proceeds of the disposal of the plantation were 'derived from such operations.'

Put in another way, the only question for determination by the court was whether the deeming provision in par. 14(1) of the Schedule applied to deem the proceeds of the disposal of the plantation to form part of the taxpayer's gross income.

The court *a quo* (see *ITC 1869* (2013) 75 SATC 329) had held that the proceeds of the sale of the plantation acquired by Kluh Investments were correctly included in its gross income in the 2004 year of assessment by virtue of section 26(1) of the Act read together with par. 14(1) of the First Schedule to the Act.

The court *a quo* had accepted as correct SARS' proposition that the key question was whether there was 'a sufficiently close or direct connection to the owner between the income generated and the farming activities conducted on the property.'

Kluh Investments contended that it had never conducted plantation farming operations for its own account, or indeed at all, as this had been done by the other company as described above at its own risk and for its own reward and account and that it had effectively granted a usufruct over the land to Steinhoff, retaining only the *bare dominium* thereof for the duration of the agreement.

SARS' contention that section 26(1) read with par. 14 of the First Schedule applied to the proceeds of the sale of the plantation was based on two alternative grounds – the first was that, even if Kluh Investments conducted no other farming operations, the mere disposal of an operating plantation was itself sufficient to trigger the statutory provisions in question and it was not necessary to view section 26(1) as 'a separate jurisdictional fact that is required to be fulfilled before the deeming provision of par. 14(1) can apply.'

SARS' second ground was that, although Steinhoff may have functioned as an independent contractor rather than an agent in performing plantation operations, such operations were nevertheless physically being conducted on land which belonged to Kluh Investments and it retained a direct interest in such operations, because Steinhoff was required to conduct the operations in accordance with agreed standards and to restore the plantation with the same volume of timber upon termination of the arrangement. Kluh Investments would not have acquired the assets unless it expected that, upon termination, the plantation would be worth more than the purchase price paid and that it could then, if it so wished, sell the plantation at a profit and there was thus a 'sufficiently close connection' between the disposal proceeds and the conducting of the plantation operations over the intervening two-year period to trigger the operation of section 26(1) and par. 14 of the First Schedule.

Both of the aforementioned grounds required, as a key element for triggering the relevant statutory provisions, that Kluh Investments had a commercial interest in the condition and value of the plantation upon termination (whenever that might be) of the arrangement between Kluh Investments and Steinhoff.

Judge Rogers held the following:

(i) That the important facts for purposes of answering the question whether Kluh Investments was carrying on farming operations were common

cause and it has been said that the questions whether a person is carrying on farming operations and whether particular income has been derived from farming operations are questions of fact but the interpretation of section 26(1) and par. 14 is a matter of law. Once all the facts relevant to determining whether the case does or does not fall within section 26(1) and par. 14 have been ascertained, the question whether on those facts there has been a carrying on of farming operations seems to be a question of law.

(ii) That although the *onus* was on Kluh Investments to prove on a balance of probability that the proceeds from the disposal of the plantation in its 2004 year were not subject to tax (see section 82 of the Income Tax Act, subsequently substituted by section 102 of the TA Act), it was convenient to consider the matter with reference to the two alternative bases on which SARS' counsel had submitted that section 26(1) read with par. 14 of the First Schedule applied to the proceeds.

(iii) That the critical question was essentially a legal one which arose from the undisputed facts as to the oral arrangement by which Steinhoff was permitted to conduct the plantation operations and the further undisputed fact that Kluh Investments had retained the ownership of the land and had a commercial interest in the plantation's being restored to it in good condition and with the same volume of trees as in June 2001.

(iv) That insofar as SARS' argument rested on the closeness of the connection between the disposal proceeds and the conducting of farming operations, the argument (and thus the finding of the tax court) conflates two distinct issues. Section 26(1) does not apply merely because there has accrued to the taxpayer income which has 'derived from' farming operations: the section applies to a person carrying on farming operations to the extent that his income is derived from such operations. Two questions must therefore be answered: (i) Was the person whom SARS wishes to tax a person carrying on farming operations during the year of assessment in question? (ii) If so, did the

particular item of income in dispute derive from those farming operations?

(iv) That where the first of the two questions identified was in issue, it was impermissible to proceed directly to the second question as if it would also provide an answer to the first. The question was not whether the accrual to the taxpayer of a particular item of income was directly connected to the farming operations of any person but whether it was directly connected to (*i.e.* derived from) the farming operations of the taxpayer himself.

(v) That certain tax court decisions (such as *ITC 166* (1930) 5 SATC 85 and *ITC 1630* (1996) 60 SATC 59) appear to have likewise erred in conflating the two questions. In both these cases the court went directly to the question whether there was a direct connection between the rent paid under the partiarian lease and the farming operations. The distinction between a fixed rent and rent linked to the proceeds of farming operations could be understood if the sole test were whether rent received by a taxpayer from a lease of agricultural land was income 'derived from farming operations' but that, however, is not the only question. There is an anterior question, namely whether the taxpayer to whom the income has accrued is a person carrying on farming operations.

(vi) That if, on the facts of the present case, one was to conclude that Kluh Investments was conducting farming operations, it would follow almost as a matter of course that the proceeds of the disposal accrued to Kluh Investments as a farmer. Ordinarily such a disposal would be of a capital nature but par. 14 of the First Schedule to the Act deems it to be gross income. The real issue in the present case is not the second one (a sufficiently close connection between the income and farming operations) but the threshold enquiry whether Kluh Investments was carrying on farming operations.

(vii) That the court rejected SARS' submission that par. 14 of the First Schedule itself provided the answer to the question whether Kluh

Investments was carrying on farming operations. The purpose of par. 14 was not to define what constituted the carrying on of farming operations but to characterise a particular type of accrual as gross income rather than capital. The question as to what constitutes farming operations is a threshold enquiry. Paragraph 14 does not stipulate in unqualified language that the proceeds of the disposal of a plantation constitute gross income. Paragraph 14 states that the disposal of a plantation constitutes deemed gross income if it is an amount received by or accrued to 'farmer', *i.e.* a person carrying on farming operations as contemplated in section 26(1) and thus there had to be conduct by the taxpayer apart from disposing of a plantation previously acquired by the taxpayer in order to constitute the carrying on by him of farming operations.

(ix) That farming operations involve the performance of a range of physical activities associated with the land with a view to profit and farming operations as contemplated in section 26(1) are a particular form of 'trade' within the broad definition of that term in section 1 of the Act. 'Trade' in that sense embraces any activity or venture carried out with the object of making a profit. Profit-making as a hallmark of trade is concerned with the generating of income of a revenue nature. A person who bought an asset as an investment rather than as trading stock may expect or hope, if and when he comes to sell it, that he will realise a capital profit but this expectation or hope does not make him a trader in relation to the asset.

(x) That despite the fact that the purchase and resale of the plantation was not alleged to be a profit-making venture, the disposal proceeds, despite their fiscal nature as capital, would be deemed to be part of Kluh Investments' gross income in terms of par. 14 of the First Schedule if, but only if, Kluh Investments was carrying on farming operations and SARS could not, for that threshold premise, rely on par. 14 itself and the court would thus reject SARS' first basis for invoking par. 14.

(xi) That it thus became necessary to consider SARS' alternative basis, which adds, to Kluh Investments' acquisition and later disposal of the plantation, the farming operations carried out on its land by Steinhoff. It was clear, on the undisputed evidence concerning the oral arrangement, that Steinhoff's operations on the farm were not conducted as an agent for Kluh Investments as Steinhoff was carrying on its own farming operations for its own profit and loss.

(xii) That it was so that Steinhoff was contractually obliged to Kluh Investments to maintain the plantation to a particular standard and to return it upon termination of the arrangement with the same volume of timber as at June 2001 but that was not enough to attribute Steinhoff's farming operations to Kluh Investments. If one reasons by analogy, it is at least settled law that section 26(1) did not apply to an owner of a farm who lets it out for a fixed rent rather than for a share of the farming profits and the case for treating Kluh Investments as a farmer is weaker still than a fixed-rent lease, because Steinhoff had effectively the same rights as a lessee and Kluh Investments was to receive no rent at all and there was no question here of Kluh Investments having had any share of the profits from the farming operations conducted by Steinhoff.

(xiii) That most leases contained express terms regarding the duties of the parties in regard to the maintenance of the premises and the lessee's duty to restore the premises but the fact that the lessee had an obligation to maintain premises and to restore them in the same good order plainly did not mean that the landlord could be said to be conducting the business of the lessee. The landlord has an interest in the maintenance of the premises because the property constitutes an investment and, upon termination of the lease, he might wish to continue earning rents from it or to dispose of it at a favourable price. For example, if the owner of hotel premises lets them to an operator for the latter's own profit and loss on the basis that the latter must conduct the hotel operations to a certain standard and restore the hotel in good order at the end of the lease, it could hardly be said that the landlord was carrying on a hotel business.

(xiv) That the oral arrangement between Kluh Investments and Steinhoff was not a lease because Steinhoff was not obliged to pay rent. Although it was unnecessary to place a precise legal label on the arrangement, it could be described as a quasi-usufruct in favour of Steinhoff and the duty of the usufructuary was to maintain the property and to restore it to the owner at the end of the usufruct *salva rei substantia*.

(xv) That in the present case SARS did not contend that the proceeds of the plantation were taxable on ordinary principles. The reasoning in *SBI v Aveling* 40 SATC 1 on section 26 and the First Schedule is, however, relevant to the present case. The Appellate Division seems to have accepted that, on the basis of the tax court's factual findings regarding the arrangement reached with the company, the taxpayer could not be said, after the conclusion of the lease, to have been carrying on farming operations as contemplated in section 26(1) and that a different conclusion could not be reached by having regard to a paragraph in the First Schedule which required the value of livestock under an arrangement similar to a sheep lease to be included as closing stock. In the context of section 26(1), the paragraph in the First Schedule could apply only if the taxpayer was in fact carrying on farming operations.

(xvi) That although standing timber in terms of common law principles adhered to the land, so that strictly speaking Kluh Investments remained the owner of any un-felled trees, paras 14 to 16 of the First Schedule effectively created a separate fiscal asset in the form of a plantation. As in the case of a sheep or other livestock lease, Steinhoff's obligation was not to return the same trees but trees of a similar quantity and quality. Indeed, and as appears from the decision in *Bourke's Estate v CIR* 53 SATC 86, where a taxpayer was engaged in farming operations in which timber was from time to time felled and sold, the trees, even prior to severance from the land, will be regarded on ordinary taxation principles as trading stock and what is relevant is the fiscal character of the trees, not their legal status as adhering to the land.

(xvii) That the inapplicability of section 26(1) is, in the present matter, an *a fortiori* case. In *Aveling*, *supra*, the taxpayer was conducting farming operations up to the moment he concluded the livestock lease, so one could at least argue – although the Appellate Division rejected the argument – that par. 3(3) required one to continue treating him as a farmer. Here, however, Kluh Investments did not even start to conduct plantation operations. From the outset Kluh Investments made the plantation available to Steinhoff so that the latter could conduct plantation operations for its own profit and loss.

(xviii) That the court had explained why the labels used in the documents and in the oral evidence were not decisive, having regard to the common cause facts but SARS had sought to persuade the court, with reference to the documents mentioned by the tax court and passages from the oral evidence, that Kluh Investments had appointed Steinhoff to manage the farming operations for it and Steinhoff's 'fee' for management being its right to fell and appropriate mature timber. However, this linguistic deconstruction did not lead to a conclusion that the operations conducted by the lessee or usufructuary for his own profit and loss are management operations performed on behalf of the owner.

(xix) That Kluh Investments was correct in submitting that, at most, Steinhoff was managing Kluh Investments' investment while at the same time managing its own farming operations and the documents or witnesses did not intend to convey more than this. Steinhoff could not be regarded as having been managing the farming operations on behalf of Kluh Investments for a fee (in the form of felled timber) when Kluh Investments stood to make no profit or loss from the farming operations. The only risk which Kluh Investments faced, if Steinhoff failed to conduct itself in accordance with the agreed standard, was that its investment's value might suffer a risk which a landlord or *bare dominium* owner would also face if the tenant or usufructuary had breached his obligations.

(xx) That, for the reasons set out, SARS' contentions had to be rejected and the tax court had erred in dismissing Kluh Investments' appeal and it may be mentioned that although the court's interpretation of section 26(1) in this particular case happens to have had an outcome favourable for the taxpayer, the more usual position was that it is the taxpayer who, because of certain favourable allowances granted in the First Schedule, seeks to bring himself within section 26(1) and had SARS' contentions in the present case been upheld, the result might have opened a Pandora's box for taxpayers.

Appeal upheld with costs.

5.9. Capstone 556 (Pty) Ltd v C:SARS

Capstone and BVI, its sole shareholder, were special purpose vehicles (SPVs), the sole purpose of Capstone being to acquire and hold shares in the JD Group (the JDG shares).

Capstone transacted no business, no director's meetings were held, and Capstone's only other commercial obligations were those associated with the funding required to pay for the JDG shares.

Capstone was funded to the extent of R100 million by the issue of three year and one day preference shares issued to FirstRand, which required Capstone to be a ring-fenced SPV which conducted no activity other than the holding of the JDG shares pledged to

First Rand as security for the redemption of the preference shares. Capstone was in addition funded by a shareholder's loan of R150 million, this funding having been advanced by Gensec to BVI, and in turn by BVI to Capstone, on the same terms and conditions applicable to the funding from Gensec to BVI. It was a condition of the funding advanced by Gensec that it should be used to enable Capstone to acquire the JDG shares, and Gensec obtained a reversionary right in respect of the JDG shares pledged to First Rand as partial security for the repayment of the funding advanced by it to BVI and, in turn, by BVI to Capstone.

Capstone had taken transfer of the JDG shares in December 2003 and had sold them in March 2004.

SARS had issued Capstone with an additional assessment in respect of its 2005 year of assessment and in terms of which an amount of R200 633 728 had been included in Capstone's taxable income which arose from the disposal by Capstone of certain shares in the JD Group in the 2005 year of assessment, the proceeds of which were taxed by SARS as being of a revenue nature. In addition, two deductions claimed, one amounting to R45 123 050 in respect of an 'equity kicker' and the other amounting to R55 million in respect of an indemnity obligation were disallowed by SARS as deductions from gross income.

Interest in the amount of R50 188 561,99 had also been imposed by SARS in terms of section 89*quat*(2) of the Income Tax Act.

Capstone had objected to this assessment on the ground that the proceeds of the disposal of the shares in issue were indeed of a capital nature and that its liabilities in respect of both the 'equity kicker' and the indemnity formed part of the base cost of the shares disposed of, for the purposes of CGT.

The background facts leading to Capstone's acquisition of the JDG shares were that by 2000, Profurn, a listed company in the retail furniture industry, had encountered serious financial difficulties and at the end of 2001 it had owed in excess of R900 million to FirstRand, which was also financially exposed to other companies in the furniture industry, and, in consequence, FirstRand sought a rescue plan for Profurn in order to reduce its financial risk.

According to the evidence of Dr Lategan, a senior executive of FirstRand, Mr Jooste was used as an intermediary to initiate an approach to a prominent German entrepreneur, Mr Daun, who had previously invested in the South African furniture industry, with the view to Mr Daun investing in Profurn. Mr Daun expressed interest in doing so, but only if the interim management of Profurn was taken over by Mr Sussman, the executive chairman of JDG, whom he regarded as having the necessary skills 'to turn the Profurn ship around.' A further condition of Mr Daun's participation was that FirstRand must agree to

provide funding for the proposed transaction by way of preference shares that would be redeemable after three years and one day.

Mr Sussman agreed to take over the interim management of Profurn, which was in dire financial straits, and was agreeable to the participation of Mr Daun, but he required a commitment from Mr Daun to remain invested at least until the Profurn ship had been 'turned around', which he estimated would take in excess of three years.

The detailed solution took the form of a rights issue by Profurn which resulted in R600 million of the debt owed by Profurn to FirstRand being converted to equity, followed by a merger whereby Profurn shares were exchanged for JDG shares. An agreement for the sale by FirstRand of the resulting JDG shares was concluded, by virtue of which a consortium led by Mr Daun ultimately acquired 5/6 thereof, with the remainder being retained by FirstRand.

In the result, the Daun consortium acquired some 35 million JDG shares for R500 million and a series of agreements and amended agreements were entered into, commencing with a memorandum of understanding (MOU) signed by Mr Daun in Germany on 26 June 2002 and it was accepted by all the relevant parties that this MOU gave rise to a binding commitment, and that the risk and reward in the contemplated transaction passed to Mr Daun on behalf of a consortium, which included himself and Capstone, with effect from 21 June 2002, the effective date of the MOU.

When the arrangements were implemented, the price of the shares ultimately acquired was fixed at their value on 21 June 2002, and interest was paid to the seller, FirstRand, with effect from that date.

The ultimate structure adopted was that one half of the JDG shares were acquired by Mr Daun's German company, Daun et Cie, and the other half was acquired by Capstone and its half was to be funded by the issue of preference shares by Capstone to FirstRand in the amount of R100 million, and the balance of R150 million was to be paid in cash (which was ultimately funded by Gensec by way of a loan to BVI, Capstone's sole shareholder, which in turn lent the R150 million to Capstone).

Capstone finally took transfer of its shares on 5 December 2003 pursuant to the negotiations which had commenced in late 2001 and culminated in the MOU in June 2002 and the amended agreements that followed.

The arrangement between Mr Daun and Mr Jooste was that Mr Daun would at all times control the full parcel of some 35 million shares in JDG and he described this arrangement as him being the 'captain of the boat in which Mr Jooste was a passenger', and he was adamant that he alone had the right to make all decisions concerning the full block of some 35 million JDG shares.

Capstone was owned by companies controlled or introduced by Mr Jooste but he was not, however, a director of Capstone at any time material to the appeal. The directors of Capstone were Mr Daun and the manager of his South African interests, Mr Schouten, as well as Dr Lategan, who represented the interests of FirstRand (to which the JDG shares acquired by Capstone were pledged), and Mr Muller, who represented the interests of Gensec, which advanced funding to Capstone *via* BVI.

The acquisition of the JDG shares carried with it two additional liabilities. In the first place, a contingent liability arose from the fact that Capstone was obliged to assume its share of an indemnity obligation which flowed from the acquisition of the Profurn shares by FirstRand, which had granted an indemnity of R150 million to JDG in respect of certain Profurn liabilities identified in the course of a due diligence exercise. R125 million of this amount was, in turn, indemnified by the consortium in favour of FirstRand, R62,5 million by Daun et Cie and R62,5 million by Capstone.

During the 2005 year of assessment Capstone assumed an unconditional liability of R55 million in favour of Daun et Cie in respect of its share of the indemnity, and Daun et Cie assumed full liability under the indemnity to First Rand, which enabled FirstRand to release the funds arising on the sale of the JDG shares.

The second liability was to pay a so-called 'equity-kicker' to Gensec, by way of BVI, which amount represented Gensec's share of the gain arising on the sale of the JDG shares by Capstone.

During the latter part of December 2003 and the first month of 2004, the South African Rand depreciated significantly and Mr Daun re-assessed his investment portfolio, which he regarded as having become disproportionately exposed to the South African Rand and this ultimately contributed to Mr Daun seeking to realise certain of his South African investments.

As a result of certain further discussions, a presentation was made by Citigroup in March 2004 concerning the process of a 'book-building' exercise, the aim of which was to dispose of the entire investment in JDG in a transaction to institutional investors without the risk of creating what was referred to as an 'overhang' and thereafter a further meeting was held between Citigroup and Mr Daun in Johannesburg on 25 March 2004 to discuss the concept of 'book building.'A further meeting then took place between Mr Daun and Mr Sussman and Mr Sussman raised no objection to the proposed sale of the JDG shares and had the effect of 'freeing' Mr Daun to sell the JDG shares even though Mr Daun had undertaken to 'stay the course' until 'the Profurn ship had turned around.'

In terms of an agreement between Capstone and Citigroup, completion of the sale and purchase of 14 141 182 of the JDG shares by Citigroup was to take place on 21 April 2004 and payment was also made on that date by Citigroup to Capstone.

On 30 April 2004, Gensec and BVI had concluded a further agreement to settle the loan agreement and by this time Capstone had sold the JDG shares, and the parties agreed to calculate the 'equity kicker', which was payable to Gensec on the basis of the proceeds actually realised by Capstone on the disposal of its JDG shares.

On 13 July 2004, an agreement between Daun et Cie and FirstRand was concluded in terms of which Daun et Cie assumed liability for the full indemnity agreed to by Capstone and First Rand on 1 December 2003 and Capstone undertook to make a further payment of R55 million to Daun et Cie.

Capstone declared and paid capital gains tax (CGT) in respect of its disposal of the JDG shares by way of a provisional tax payment of some R66 million and two deductions were also claimed as exclusions from the capital gains as part

of the base cost of the shares – *i.e.* Capstone's share of an indemnity obligation already described and expenditure actually incurred in respect of certain loans made to acquire the shares, being the 'equity kicker'.

The Tax Court, being the court *a quo* (see *ITC 1867* 75 SATC 273), had held that the proceeds of the disposal of the JDG shares had been of a revenue nature, but that both the indemnity and the 'equity kicker' were to be regarded as deductible expenditure.

The court *a quo* was of the view that the shares in question had been acquired with a mixed intention of profit-making and of holding them as a long-term investment but that by embarking on a 'book building exercise' and selling them so soon after they had been acquired, Capstone's mixed intention 'had converted into a clear purpose of selling to 'cash in' on the profit'.

The present appeal is directed at the Tax Court's finding that Capstone was unsuccessful in relation to the main issue, *i.e.* whether the amount in issue was rightly included as part of its income and the cross-appeal is directed at the court's findings in relation to the second and third issues, being the deductions in respect of the 'equity kicker' and the indemnity respectively.

The High Court held the following:

<u>As to the distinction between capital and revenue</u>

(i) That in CIR v Pick 'n Pay Employee Share Purchase Trust 54 SATC 271 the Appellate Division reaffirmed that the question whether receipts are capital or income is a matter of inference from the facts 'and therefore ultimately a question of law.'

(ii) That while it is true that the onus of establishing the facts from which the desired inference should be drawn is on the taxpayer, this factor is not a material consideration where, as in this instance, the primary facts are either common cause or not in dispute. In the absence of adverse credibility findings against any of the witnesses, this Court is, accordingly, at large to consider the issues afresh.

(iii) That turning to consider this perennial problem in tax cases, it has been pointed out that 'there is no simple and universally valid litmus test, the

decision whether particular income falls on the one side of the ill-defined borderline between capital and revenue or on the other being 'a matter of degree depending on the circumstances of the case.' This has given rise to 'unpredictability of the outcome of assessments' and has spawned a substantial body of jurisprudence.

(iv) That a variety of tests are employed in order to determine whether or not a particular receipt is one of a revenue or capital nature. They are laid down as guidelines only – there being no single infallible test of universal application; 'no simple and universally valid litmus test'.

(iv) That when considering the intention of a taxpayer, it is important to bear in mind that 'in a tax case one is not concerned with what possibilities, apart from his actual purpose, the taxpayer foresaw and with which he reconciled himself. One is solely concerned with his object, his aim, his actual purpose'. Put differently, the concept of dolus eventualis as applied in criminal law has no place in the context of tax law and, consequently, it is important not to confuse contemplation with intention in the above sense.

(v) That SARS had based his contention that at the time the JDG shares were acquired by Capstone, it did not intend to hold them as capital assets but intended to dispose of them in the short term for profit, inter alia on the objective facts that the JDG shares were held by Capstone for less than five months before being disposed of; that the purchase of the shares was financed from external sources, and not from Capstone's available funds; and that Capstone could not benefit from the dividends generated by the JDG shares. The objective facts relied on by SARS are among the considerations often invoked to support an inference that the shares were acquired in pursuance of a scheme of profit – making and that the proceeds of the sale are, accordingly, of a revenue nature. However, even if the objective facts suggest that the amount in question is prima facie of a revenue nature, the taxpayer may be able to provide an explanation to rebut such inference and the taxpayer's explanation of the events, including his or her intention in

respect of the transaction in question, is therefore relevant and must be tested in the light of all the other circumstances.

(vi) That the true factual matrix as it emerges in this case from the voluminous evidence before the court is far more complex and nuanced than the bare facts outlined above and it is essential therefore to consider the objective facts relied on by SARS in the broader context of the evidence as a whole.

(vii) That in regard to the objective factors on which SARS relied, it was true that the shares were finally acquired by Capstone only on 5 December 2003 and that they were sold less than five months later. If an investor in the street had acquired JDG shares on the same day and disposed of them five months later at a substantial profit, there could be little argument if SARS were to tax the resultant profit as revenue. However, as appears from the judgment of the Tax Court, this is not what happened in the present case. The effective date of the transaction as a whole dates back to 21 June 2002 and it is, accordingly, at that date that one must look when considering the period for which the asset was held.

(viii) That in the view that the court took of the present matter, it did not really matter whether one regarded either Mr Daun or Mr Jooste as the 'brain' of the company as it made no difference to the eventual outcome of the case for reasons that will appear in due course.

<u>As to Capstone's intention</u>

(ix) That the purpose behind the acquisition of the shares had been fully explained on behalf of the taxpayer, based on facts which are sui generis and this appeared, inter alia, from an affidavit prepared for submission to the Competition Commissioner in order to obtain the necessary approval for JDG to take over management of Profurn. It sketched in some detail the origin and relevant background to the transaction as well as Mr Daun's motivation for entering the deal. This was a crucial piece of evidence which was not challenged in cross-examination nor was it contradicted by any other evidence. The reasons

why a court is ordinarily wary of accepting the ipse dixit of a taxpayer as to his or her intention are absent in this instance, as the affidavit was deposed to by Mr Daun on 12 June 2002, i.e. some nine days prior to the effective date of acquisition of the asset and the contents of the affidavit make it clear that the whole purpose behind the scheme was a 'rescue operation', not a profit-making scheme and this was indeed the dominant purpose behind Mr Daun's decision to acquire the JDG shares.

(x) That the objective evidence thus showed overwhelmingly that the transaction involved a large-scale rescue operation in the South African furniture industry, one that was anticipated to require both capital and management expertise; that it would take between three and five years to be successfully accomplished, if at all; and there was no short-term intention on the part of anyone who participated in the arrangements concerning the JDG shares. This is further borne out, inter alia, by the facts – that the acquisition of the JDG shares had been accompanied by the assumption of a five-year indemnity, later extended until 23 April 2010, and that Mr Jooste had attempted to raise finance for the JDG transaction for a three to five year period.

(xi) That, in summary, Capstone's intention when it first decided to acquire the JDG shares was to make a strategic investment in a leading company in the furniture industry and to hold those shares for however long it took to turn around the Profurn ship, which was anticipated to take in excess of three years.

(xii) That the investment in the JDG shares was to last for a period of at least three years, arguably slightly longer and it was not incumbent upon Capstone to prove that the intention on acquisition of the shares was 'definitively' in its favour; a balance of probability is sufficient. It was likewise not incumbent upon Capstone to prove that it bought the JDG shares as a 'long-term investment' and all that it was required to prove was that it did not buy the JDG shares as trading stock in pursuance of a scheme of profit-making.

As to the decision to sell

(xiii) That, as for the decision to sell, the Tax Court placed considerable reliance on this fact in finding that the earlier 'mixed' intention had converted into a clear purpose of selling to 'cash in' on the profit. The court on appeal differed from the assessment as to an earlier 'mixed' intention on the part of Capstone. As for 'cashing in' on a profit, this is neither here nor there: any investor who sells a capital asset at a profit after holding it for some length of time also 'cashes in' on its profit and, in any event, the alleged 'intention to realise the shares for a significant profit' was no more than a fond hope that the transaction would turn out to be successful. It does not convert the transaction into a profit-making scheme. As mentioned earlier, it is not what the taxpayer contemplated that is relevant, but 'his object, his aim, his actual purpose.'

(xiv) That, in regard to Capstone's decision to sell, the approach from City Group was solely responsible for Mr Daun's inclination to sell the JDG shares, and that this represented a nova causa interveniens as contemplated by Miller J in ITC 1185 35 SATC 122 at 128.

(xv) That Capstone, as a separate legal entity, had no say in the decision to sell; it was a junior partner in a consortium controlled by Mr Daun and, as a fact therefore, Capstone had no choice in the matter. In the circumstances, the intention of Capstone at the time of the sale was irrelevant in determining the question whether the asset was of a capital or revenue nature and its only intention at that time was to honour its commitment to its consortium partner.

(xvi) That, on the evidence as a whole, the inference is, accordingly, more probable, that the JDG shares were acquired and held by Capstone as a capital asset and, accordingly, Capstone had discharged the onus of proving on a balance of probabilities that the JDG shares constituted capital and that they were acquired with a capital intention.

As to the change of intention

(xvii) That, on the evidence as a whole, the decision to sell was simply one to dispose of a capital asset; not to convert a capital asset into trading stock. The distinction is a subtle but important one. In the result, the profit realised from disposal of the shares in issue can only be described as 'fortuitous' with the result that it constituted a receipt of a capital nature within the definition of 'gross income' in section 1 of the Income Tax Act and it followed that the appeal should succeed.

As to the deductibility of the equity kicker and indemnity obligation

(xviii) That it was clear that the equity kicker obligation arose under the loan agreement in question and formed part of the quid pro quo for the loan and it was (in the same way as interest) a type of consideration for the loan of money or, differently put, part of the cost of borrowing. Accordingly, the equity kicker clearly constituted a 'borrowing cost' for purposes of par. 20(2)(a) of the Eighth Schedule to the Income Tax Act and it followed that only one-third of the interest formed part of the base cost of the JDG shares which may be deducted in terms of par. 20(1)(g) of the Eighth Schedule.

(xix) That, in the final result, an amount of R30 082 033 (two-thirds of the amount of R45 123 050) fell to be included in the capital gain on the basis that it did not constitute part of the base cost of the shares by virtue of the provisions of par. 20(2)(a), read with par. 20(1)(g), of the Schedule.

(xx) That the subsequent 'indemnity settlement obligation' undertaken by Capstone in favour of Daun in the sum of R55 million was therefore something completely new and served a different purpose as it was incurred as a direct consequence of the sale of the JDG shares, and its purpose was to clear up unresolved issues in Capstone after the sale of the shares.

(xxi) That, accordingly, the indemnity settlement amount thus incurred by Capstone in favour of Daun et Cie constituted a novus actus interveniens, entirely separate from the acquisition of the JDG shares and the cost may therefore more properly be regarded as a cost of

disposal, not a cost of acquisition and it followed that the amount of R55 million fell to be included as part of Capstone's capital gain in disposing of the shares.

Appeal upheld and the additional income tax assessment in respect of Capstone for the 2005 tax year is set aside and referred back to SARS for re-assessment in the light of this judgment.

Commissioner for SARS is ordered to pay 80% of Capstone's costs on appeal, including the costs of two counsel.

6. INTERPRETATION NOTES

6.1. The supply of goods and services by professional hunters and taxidermists to non-residents – No. 81(2)

This Note explains the VAT treatment of various supplies made to foreign hunters which includes:

- hunting services;
- taxidermy services;
- the supply of a trophy; and
- the subsequent export of the trophy.

This Note withdraws VAT Practice Note: No 13 dated 6 September 1994.

The general rule is that the supply of goods or services in the Republic by a vendor (in the course or furtherance of its enterprise) to a foreign hunter is subject to VAT at the standard rate on the basis that the goods or services are consumed in the Republic. There are certain exceptions to this rule as is evident from the discussion below.

Accommodation, hunting services and other goods or services supplied or rendered while the foreign hunter is present in the Republic are subject to VAT at the standard rate, unless the supply is exempt under section 12. The supply of the trophy by the hunting outfitter to the foreign hunter qualifies for zero-

rating if the trophy is subsequently exported to the foreign hunter. The supply of dip and pack and taxidermy services qualifies for zero-rating if the trophy is exported to the foreign hunter. The zero-rating of the abovementioned supplies are subject to the relevant supplier retaining supporting documentary evidence as is acceptable to SARS.

6.2. Appliction of sections 20(7) and 21(5) of the VAT Act – No. 83(2)

This Note:

- sets out the requirements that must be met in order for SARS to apply the provisions of sections 20(7) and 21(5);
- withdraws VAT Practice Note: No 2 dated 25 September 1991; and
- replicates under 5, paragraphs 2 and 3 of Binding General Ruling (VAT) No. 27 'Application of sections 20(7) and 21(5)'.

A vendor making a taxable supply of goods or services must, under section 20(1), issue a tax invoice to the recipient within 21 days of the date of that supply. However, section 20(2) allows a recipient of a supply, after obtaining approval from SARS, to issue a tax invoice for supplies made to it. The document issued by the recipient in this instance shall, subject to certain conditions, be deemed to be a tax invoice provided by the supplier under section 20(1).

A document must contain certain information prescribed in section 20 to qualify as a 'tax invoice'. Section 20(7) allows SARS, subject to such conditions considered necessary, to direct in instances where there would be sufficient records available to establish the particulars of a supply and SARS is satisfied that it is impractical to issue a full tax invoice, that:

- any one or more of the particulars specified in subsection (4) or (5) shall not be contained in a tax invoice; or
- a tax invoice is not required to be issued; or

- the particulars specified in subsection (4) or (5) be furnished in any other manner.

A vendor that has issued a tax invoice in relation to a supply, and the amount shown as tax charged on the tax invoice exceeds the actual tax chargeable for the supply, is required to issue a credit note under section 21(3)(*a*). A debit note on the other hand must be issued where the actual tax chargeable exceeds the tax shown on the tax invoice under section 21(3)(*b*). A recipient of a supply, after obtaining approval from SARS, may however issue a credit or debit note for a supply made to it as contemplated in section 21(4). The document issued by the recipient in this instance shall, subject to certain conditions, be deemed to be provided by the supplier under section 21(3).

Section 21(5) allows SARS to direct, in instances where there would be sufficient records available to establish the particulars of a supply and SARS is satisfied that it is impractical to issue a full credit or debit note, that:

- any one or more of the particulars specified in section 21(3) shall not be contained in a credit or debit note; or
- a credit or debit note, as the case may be, is not required to be issued.

This Note sets out the requirements that have to be met in order for SARS to apply the provisions of section 20(7) or 21(5). A vendor that satisfies the requirements does not have to apply for prior approval from SARS to not issue a tax invoice, credit or debit note.

7. DRAFT INTERPRETATION NOTES

7.1. Provisional Tax Estimates – No. 1(2)

This Note was released as a draft in 2014. Due to amendments promulgated in January 2015, which substantially changed the penalty provisions, SARS has issued an updated draft for a second round of comments. The due date for comments was 31 May 2015.

This Note provides guidance on the interpretation of the law relating to

provisional tax and considers:

- who is a provisional taxpayer;
- the calculation of provisional tax including how estimates of taxable income must be made;
- the consequences of an incorrect or late submission of estimates;
- the consequences of a late payment of provisional tax; and
- the consequences of failure to submit an estimate on time.

Employees who earn remuneration generally pay tax in the form of employees' tax (PAYE) on a monthly basis. This results in the collection of an employee's normal tax liability being spread throughout the year with a potential additional payment or a refund at the end of the year of assessment. However, for people who do not earn 'remuneration' as defined in the Fourth Schedule to the Act, for example, a self-employed person earning business income, in the absence of a provisional tax system the full amount of tax would only be payable on assessment at the end of the year of assessment, without the option or obligation of making interim payments like those paying PAYE monthly.

Provisional tax is not a separate tax payable by certain persons. It is merely a method used to collect normal tax,[2] that will ultimately be payable for the year of assessment concerned, during the year. Otherwise stated, provisional tax is an advance payment of a taxpayer's normal tax liability. A provisional taxpayer is generally required to make two provisional tax payments, one six months into the year of assessment and one at the end of the year of assessment, but has the option to make a third top-up payment after the end of the year of assessment.

Provisional tax payments are calculated on estimated taxable income (which includes taxable capital gains) for the particular year of assessment. These estimates of taxable income are submitted to SARS on an IRP6 return. The returns, which can be obtained through e-filing, SARS contact centre or a SARS branch office, must be submitted even if the amount of the provisional

tax payment is nil. The normal tax payable on the estimated taxable income is calculated at the relevant rate of tax that is in force on the date of payment of provisional tax. This would generally be the rate of tax as prescribed in the tax tables which are fixed annually by Parliament. SARS may, from time to time, prescribe alternative tax tables for optional use by provisional taxpayers falling within a certain category.

Provisional tax payments are not refundable. However, at the end of the year of assessment the provisional tax payments, together with any PAYE withheld during the year, are set off against the taxpayer's liability for normal tax. Any excess of provisional tax and PAYE over the liability for normal tax is refunded to the taxpayer, and any shortfall is payable by the taxpayer to SARS.

There are certain rules that must be adhered to when making estimates of taxable income for provisional tax purposes. Certain penalties and interest will be imposed if the estimates are inaccurate or if the submission of the estimates or the payment of provisional tax is late. This Note discusses these rules and the interest and penalties which may be imposed.

Provisional tax is a method used to collect normal tax which will ultimately be payable for a particular year of assessment. There are potentially three payments, two of which are compulsory. The first compulsory payment must be made within the first period which ends six months after the start of the year of assessment. The second compulsory payment must be made on or before the end of the second period which ends on the last day of the year of assessment. A third payment, which is voluntary, must generally be made within seven months of the end of the year of assessment for persons with a year of assessment ending on the last day of February and by companies with a different financial year, within six months of the end of such financial year.

The calculation of the amount of a provisional tax payment involves estimating taxable income for the year concerned. Depending on which payment (first, second or third) and on the facts and circumstances of the case, certain penalties may be imposed and interest levied if the estimates are not accurate.

The Act only permits a refund of provisional tax payments previously made if the taxpayer's liability for normal tax has been assessed by SARS and the sum of employees' tax deducted and provisional tax paid in respect of that period exceeds the total liability for normal tax as assessed.

SARS has a range of guides available on its website which provide further practical guidance on provisional tax matters, such as completing an IRP6 return.

7.2. Resident – Place of effective management (companies) – No. 6(2)

This Note provides guidance on the interpretation and application of the term 'place of effective management' in determining the tax residence of a company.

The concept of residency is critical in determining a person's South African tax obligations. In general, a resident is liable to income tax on gross income derived within and outside the Republic while a non-resident is only liable to income tax on gross income from a source within the Republic.

A person other than a natural person is a 'resident' as defined in section 1(1) if such person:

- is incorporated, established or formed in the Republic; or
- has its place of effective management in the Republic.

The definition excludes any person that is deemed to be exclusively a resident of another country for purposes of the application of any tax treaty. In addition, special considerations apply to a 'foreign investment holding company' as defined in the Act.

The term 'place of effective management' is not defined in the Act and must be ascribed its ordinary meaning, taking into account international precedent and interpretation. It does, however, not have a universally accepted meaning and various countries, including members of the OECD, continue to attach different meanings to it.

The purpose of this Note is to discuss the principles and guidelines that will be applied for purposes of considering the definition of 'resident' in section 1(1). These principles and guidelines are consistent with the determination of the place of effective management when that term is used as a tie-breaker rule in a tax treaty that adheres to paragraph 3 of Article 4 of the condensed version of the OECD Model Tax Convention as at 15 July 2014 and its accompanying Commentary.

Although this Note deals with effective management in the context of companies, the underlying principles will generally apply to other entities and bodies of persons that are not natural persons. For example, in the case of a trust, the structures involved and terminology used may require some adaptation but the determination of the place of effective management would take into account the same considerations as those discussed in the Note. Depending on the facts applicable there may be additional considerations that need to be taken into account.

Many countries have introduced legislation creating a variety of hybrid entities that combine traditional features of partnerships and companies. A number of countries have also enacted legislation creating new types of trusts. These new business vehicles may present unique issues that are not specifically addressed in this Note.

The place of effective management must be supported by the facts. A company bears the onus of proof on the issue of place of effective management and should retain the necessary evidence to support the view taken.

A company's place of effective management is the place where key management and commercial decisions that are necessary for the conduct of its business as a whole are in substance made. This approach is consistent with the OECD's commentary on the term 'place of effective management'.

A company may have more than one place of management but it can only have one place of effective management at any one time. There are normally multiple facts that need to be taken into account, often involving multiple locations, and from those facts and locations it is therefore necessary to determine a single dominant place where effective management is located.

Definitive rules cannot be laid down in determining the place of effective management and all relevant facts and circumstances must be examined on a case-by-case basis.

The place of effective management test is one of *substance over form*. It therefore requires a determination of those persons in a company who actually 'call the shots' and exercise 'realistic positive management'.

8. BINDING PRIVATE RULINGS

8.1. BPR 191 – Refinancing of debt through preference share funding

This ruling deals with the refinancing of current debt through preference share funding.

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule thereto applicable as at 12 November 2014 and 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 the provisions of:

- section 8E;
- section 8EA;
- section 19; and
- paragraph 12A.

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

The Applicant: A listed company incorporated in and a resident of South Africa

The Co-Applicant: A private company incorporated in and a resident of South Africa

Operating Company: A private company incorporated in and a resident of South Africa

Description of the proposed transaction

The Applicant historically held 100% of the equity shares in the Operating Company, which was diluted to 74% when the Co-Applicant subscribed for 26% of the equity shares. The Operating Company provided financial assistance to the Co-Applicant to obtain the shares, as contemplated in section 44 of the Companies Act No. 71 of 2008, resulting in an interest bearing loan (the subscription loan) owing by the Co-Applicant to the Operating Company.

As compensation for the dilution of the Applicant's shareholding, the Operating Company declared a dividend equal to the subscription loan to the Applicant (the subscription dividend) which remained outstanding on loan account.

The Applicant and Co-Applicant wish to refinance the respective loans as follows:

- the Applicant will utilise cash (equal to the current outstanding balance of the subscription loan) to subscribe for preference shares in the Co-Applicant;
- the Co-Applicant will utilise the proceeds received from the preference share subscription to fully settle the subscription loan owing to the Operating Company; and
- the Operating Company will utilise the funds received from the Co-Applicant to fully settle the outstanding balance of the subscription dividend.

The salient features of the preference share subscription agreement will be as follows:

- The preference share dividends shall be paid by the Operating Company to the Applicant for and on behalf of the Co-Applicant as a first charge against any dividends receivable by the Co-Applicant.
- Any dividends which remain after the payment of the preference share dividends will be allocated as follows:
  - 6% thereof will be paid directly to the Co-Applicant; and

  - the remaining 94% must be paid into an escrow account for the benefit of the Co-Applicant on which the Co-Applicant will earn interest at a competitive interest rate. The funds in the escrow account may not be used for any purpose other than to redeem the preference shares.

- The Co-Applicant may redeem the preference shares in part or in full at any time after the date of issue.

- The exercise by the Co-Applicant of its option to redeem the preference shares (or a part thereof) will not create an obligation on the Co-Applicant to do so, nor will it give the Applicant the right to call on the Co-Applicant for the redemption. The exercise of the option to partially redeem will furthermore not alter any of the remaining preference share terms.

- There is no fixed date on which the Co-Applicant must redeem all of the preference shares, although it is expected that they will all be redeemed after a period of approximately three years from the date of issue.

- The Co-Applicant will not be obliged to utilise any other funds except the funds in the escrow account to redeem the preference shares.

Ruling

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

- The preference shares to be issued by the Co-Applicant to the Applicant will not be:
  - Hybrid equity instruments as defined in section 8E(1); or
  - Third party backed shares as defined in section 8EA(1).

- The issue of the preference shares will fall within the definition of 'qualifying purpose' as defined in section 8EA(1), read with section 8E;

- The voluntary redemption of the preference shares by the Co-Applicant, whether partially or in full, will not create a new 'date of issue' as defined

in section 8E(1).

- The provisions of section 19 and paragraph 12A will not be applicable to the repayment of the subscription loan and subscription dividend loan.

8.2. BPR 192 – Cross border interest-free loan and withholding tax on interest

This ruling deals with the question as to whether an adjustment made to taxable income or tax payable under section 31 can trigger withholding tax on interest levied under section 50B read with section 50E of the Act.

In this ruling references to sections are to sections of the Act applicable as at 11 May 2015 and 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 the provisions of:

- section 31; and
- section 50B read with section 50E.

Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of a foreign country which does not carry on business through a permanent establishment in South Africa

The Co-Applicant: A company incorporated in and a resident of South Africa which is a connected person to the Applicant

Description of the proposed transaction

The Applicant and the Co-Applicant will enter into an agreement in terms of which the Applicant will advance a loan to the Co-Applicant. The loan will be interest-free, unsecured and repayable on demand.

Ruling

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

- In the event that an adjustment is made to taxable income or tax payable under section 31:
    - the Applicant will not be liable for withholding tax on interest under section 50B; and
    - the Co-Applicant will have no obligation to withhold an amount of withholding tax on interest under section 50E.

8.3. BPR 193 – Debt reduction by way of set-off

This ruling deals with the repayment of shareholder loans by way of set-off. The loan outstanding from the subscription of a new issue of ordinary shares will be used to set-off against the amount outstanding under the shareholders loans.

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule thereto applicable as at 3 March 2015, and 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 the provisions of:

- section 19; and
- paragraphs 12A and 20(3)(*b*).

Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa

Foreign holding company: The holding company of the Applicant which is a resident of a foreign country

Description of the proposed transaction

The Foreign holding company provided loan funding to the Applicant which amount includes capital and interest and remains owing to it (the shareholder loan).

The shareholder loan was used to fund the acquisition of fixed property, erect improvements, acquire operating equipment and finance deductible expenditure (in other words, for working capital purposes or to fund the acquisition of assets for which allowances can be claimed).

The Applicant's current cash flow is insufficient to enable it to operate effectively and to pay interest on the loan. Furthermore, it is evident that the loan will fall foul of the South African thin capitalisation provisions and consequently not all interest due and payable will qualify for a tax deduction.

The balance sheet of the Applicant can also impair the company's ability to obtain credit for working capital requirements.

In order for the loan to be repaid or reduced, the following transaction steps are proposed:

Step 1

The Foreign holding company will demand repayment of a portion of the capital of the shareholder loan and payment of arrear interest owed by the Applicant.

Step 2

The Foreign holding company will then subscribe for 1 ordinary share with a par value of ZAR1 to be issued at a premium in terms of a subscription agreement to be entered into with the Applicant. The value of the share will be equal to the portion of the debt (capital and interest) that is due to be settled by the Applicant. The subscription amount will remain outstanding on loan account (subscription loan).

Step 3

Upon the subscription agreement becoming unconditional, the amounts of the corresponding loan accounts (shareholder loan and subscription loan) will be duly set-off.

Step 4

The Applicant will issue the 1 share to the Foreign holding company. The portion of the loan not settled will remain outstanding.

Conditions and assumptions

This ruling is subject to the additional condition and assumption that the transaction will be concluded within one year after the effective date of this ruling.

Ruling

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

The proposed subscription for 1 share in the Applicant by the Foreign holding company and subsequent settlement of the corresponding loan accounts between the parties will not fall foul of the following provisions of the Act:

- section 19;
- paragraph 12A of the Eighth Schedule; and
- paragraph 20(3)(*b*) of the Eighth Schedule.

8.4. BPR 194 – Disposal of shares through a share buy-back and a donation

This ruling deals with the disposal of shares through a share buy-back by a resident company from a non-resident person, and a donation of shares by the same non-resident person to another resident company, both for no consideration.

In this ruling references to sections and paragraphs are to sections of the relevant Acts and paragraphs of the Eighth Schedule to the Act applicable as at 22 May 2015 and 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 following provisions of:

- the Act:
  - section 1(1), definition of 'gross income'; and 'dividend';
  - section 18A;

  - section 54;
  - section 56(1)(*h*);
  - section 64D, definition of 'dividend';
  - paragraph 2(1);
  - paragraph 11(1) and (2); and
- STT Act:
  - section 2(1); and
  - section 6.

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

The Applicant: A private company incorporated in and a resident of South Africa

The Co-Applicants: HoldCo, a private company incorporated in and a resident of South Africa

Investor A, an individual who is a non-resident of South Africa

Company B: A broad-based black economic empowerment company whose shares are wholly owned by an employee trust whose aim is to address adverse socio-economic conditions in South Africa by fostering new business enterprises and employment opportunities

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

Investor A holds 5.16% of the issued ordinary shares of HoldCo in a blocked account for South African exchange control purposes. HoldCo holds 68.2% of the ordinary shares in the Applicant and the balance is held by Company B (17.8%) and Company C, a private company incorporated in and a resident of South Africa, (14%).

The Applicant and Co-Applicants have committed themselves to sponsoring the education of potential South African entrepreneurs and fostering their ventures. They now wish to extend their benevolence to other social challenges and issues in South African communities as identified by the employees of the

Applicant.

The Applicant will annually donate approximately 4% of its profits to charitable causes. The only eligible recipients of these donations will be entities qualifying under the criteria set out in section 18A(1) of the Act.

The annual donations will result in reduced profits available for distribution to the Applicant's shareholders. In order to facilitate the abovementioned donations and to compensate the shareholders of the Applicant for this economic dilution, HoldCo will repurchase a portion of the shares that Investor A hold in HoldCo (equal to approximately 4% of the issued shares of HoldCo) for no consideration.

The remaining shares held by Investor A in HoldCo (equal to approximately 1.6% of the issued shares of HoldCo) will be transferred to Company B for no consideration in order to ensure that Company B will effectively remain in the same economic position to be able to continue its socio-economic endeavours.

The shares repurchased by HoldCo will be cancelled, but they will remain as authorised shares, though unissued share capital.

Ruling

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

- There will be no amount that must be included in the gross income of HoldCo as a result of the repurchase by HoldCo of a portion of the HoldCo shares held by Investor A, for no consideration.

- There will be no disposal of an asset by HoldCo as a result of the cancellation of the HoldCo shares held by Investor A and repurchased by HoldCo. No capital gains tax implications will arise for HoldCo.

- Securities transfer tax (STT) will be payable on both (i) the repurchase by HoldCo of a portion of the HoldCo shares held by Investor A, and (ii) the transfer of the remaining HoldCo shares held by Investor A to Company B, at the rate of 0.25% on the market value of these shares immediately prior to the repurchase and transfer thereof. HoldCo will be

liable for the payment of the STT.

- The disposal for no consideration by Investor A of the HoldCo shares (by way of the repurchase by HoldCo) and the transfer of the remaining HoldCo shares (by way of the transfer to Company B) will not result in an amount that must be included in Investor A's gross income for South African income tax purposes.

- The HoldCo shares held by Investor A do not constitute assets contemplated in paragraph 2(1)(*b*) of the Eighth Schedule to the Act, therefore, Investor A as a non-resident will not be liable for capital gains tax on the disposal of a portion of the HoldCo shares and the transfer of the remaining HoldCo shares.

- The repurchase by HoldCo of a portion of the HoldCo shares held by Investor A for no consideration will not constitute a 'dividend' as defined in section 64D of the Act and accordingly there will be no dividends tax to be levied on such repurchase.

- The disposal and the transfer by Investor A of the HoldCo shares for no consideration will not be subject to donations tax as Investor A is a non-resident.

- The annual donations to be made by the Applicant of approximately 4% of its annual profits to entities qualifying with the criteria set out in section 18A(1)(*a*), (*b*) or (*c*) of the Act and which do not exceed 10% of the taxable income of the Applicant (prior to taking into account any deductions under section 18A) will be deductible from the taxable income of the Applicant.

- The donations made by the Applicant to entities qualifying under the criteria set out in section 18A(1)(*a*), (*b*) or (*c*) of the Act will be exempt from donations tax under section 56(1)(*h*) of the Act.

9. BINDING GENERAL RULING

9.1. BGR (VAT) 27 – Application of sections 20(7) and 21(5)

This BGR sets out the circumstances and conditions under which a vendor need not issue a tax invoice, credit or debit note.

SARS, subject to the conditions listed below, directs under sections 20(7)(*b*) and 21(5)(*b*) that a tax invoice, credit or debit note need not be issued.

Approved conditions

SARS considers that it would be impractical to require that a tax invoice, credit or debit note be issued when the transactions in question consist of a number of progressive or periodic taxable supplies made by a registered vendor in accordance with a written contract for a supply of goods or services which provides for a regular payment of a determinable amount. This will apply in the following circumstances:

- Rental agreements for movable or immovable property
- Royalty agreements
- Short-term insurance

SARS' direction in respect of the aforementioned transactions, is on condition that:

- the recipient is in possession of the contract document which contains the following information: (i) The names, addresses and VAT registration numbers of the supplier and recipient. The VAT registration number of the recipient will only be required if the recipient is a vendor. Furthemore, the name and VAT registration number of the recipient will not be required if the consideration for the supply does not exceed R5 000;
    - A description of the goods or services supplied; and
    - A statement that the supplies are charged with VAT at the

applicable rate.

- the supplier and recipient retains proof of payment of each amount paid where the relevant contract does not contain the consideration payable;
- the contract mentioned above contains a statement that the contract complies with SARS' direction under section 20(7) or 21(5), as the case may be; and
- the abovementioned contract which includes the relevant particulars must be retained for a period contemplated in compliance with section 55 read with Part A of Chapter 4 of the Tax Administration Act No. 28 of 2011.

9.2. BGR (VAT) 28 – Electronic Services

This BGR sets out the:

- information that must be contained in a tax invoice, credit or debit note in order to satisfy the requirements of section 20(7) or 21(5);
- exchange rate that must be applied in order to determine the amount of the VAT charged in the currency of the Republic; and
- manner in which prices must be advertised or quoted,

for the supply of electronic services by an electronic services supplier.

Tax invoices

SARS directs under section 20(7)(*a*), that an electronic services supplier must issue a tax invoice for a supply of electronic services containing, as a minimum, the following information:

- The name and VAT registration number of the electronic services supplier.
- The name and address of the electronic services recipient.

- An individual serialised number.
- The date on which the tax invoice is issued.
- A description of the electronic services supplied.
- The consideration in money for the supply in the currency of any country. If the consideration is reflected in the currency of:
    - the Republic, the amount of the VAT charged or a statement that it includes a charge for the VAT and the rate at which the VAT was charged; or
    - any country other than the Republic, the amount of the tax charged in the currency of the Republic or a separate document issued by the electronic services supplier to the electronic services recipient reflecting the amount of the tax charged in the currency of the Republic.
- The exchange rate used.

The tax invoice(s) containing the aforementioned information satisfies the requirements of section 16(2)(*b*)(ii).

Credit and debit notes

SARS directs under section 21(5), that a vendor that:

- has issued a tax invoice as contemplated above; and
- is required to issue a credit or debit note as required by section 21(3), and is unable to issue a credit or debit note that complies with section 21(3);

must issue a credit or debit note containing the following information:

- The name and VAT registration number of the electronic services supplier.
- The name and address of the electronic services recipient.

- The date the credit or debit note is issued.
- A brief explanation of the circumstances giving rise to the issuing of the credit or debit note.
- The increased or decreased consideration together with the increased or decreased amount of tax, as the case may be. If the consideration is reflected in the currency of:
    - the Republic, the increased or decreased amount of the VAT or a statement that the consideration includes the increased or decreased amount of VAT and the rate at which the VAT was charged; or
    - any country other than the Republic, the increased or decreased amount of tax in the currency of the Republic or a separate document issued by the electronic services supplier to the electronic services recipient reflecting the increased or decreased amount of tax in the currency of the Republic.
- The exchange rate used, being the exchange rate used in the tax invoice issued as contemplated above.

Value of supply

A vendor issuing a tax invoice contemplated above or a credit or debit note contemplated above reflecting the consideration in money in the currency of any country other than the Republic must convert the tax charged to the currency of the Republic. In this regard, the exchange rate that must be applied in order to determine the tax charged in the currency of the Republic, is the rate published by South African Reserve Bank, Bloomberg or European Central Bank.

The applicable exchange rate is the rate on the date the time of supply occurs or the monthly average rate for the month during which the time of supply occurs.

Advertised or quoted prices

SARS, for the period 1 June 2014 until 31 March 2015, makes an arrangement under section 72 allowing an electronic services supplier to advertise or quote the price of its electronic services exclusive of VAT on condition that it has a statement on its website indicating that supplies of electronic services to electronic services recipients will be levied with VAT.

An electronic services supplier may, on or after 1 April 2015, advertise or quote the price of its electronic services exclusive of VAT on condition that it has a statement on its website indicating that VAT will be levied on supplies of electronic services to electronic services recipients.

10. BINDING CLASS RULINGS

10.1. BCR 45 – Post retirement medical aid benefits

This ruling deals with the consequences for employees whose post retirement medical aid benefits will be cancelled and replaced with a once-off contribution to the employees' pension fund.

In this ruling references to paragraphs are to paragraphs of the definition of 'gross income' in section 1(1) of the Act, applicable as at 12 March 2015 and 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 the provisions of paragraphs (*c*), (*f*) and (*i*) of the definition of 'gross income'.

Class

The class members to whom this ruling will apply are described below.

Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa

The Pension Fund: A pension fund registered under the Pension Funds Act, No. 24 of 1956 and a resident of South Africa

The Class Members: Employees who were employed on a full-time basis by the Applicant before 1 January 2007 and who will still be in its employ at the time of the transaction (qualifying employees)

Description of the proposed transaction

The Applicant's human resources manual makes provision for qualifying employees to each receive a post-retirement medical aid subsidy (the subsidy) upon retirement.

The aforementioned subsidy is only available to qualifying employees and their dependents at the date of retirement. Qualifying employees were required to sign an agreement for the provision of the abovementioned subsidy upon retirement. That agreement contains a term that no change to it shall be of any force, unless it is reduced to writing and signed by both the parties (the Applicant and the Class Members).

The Applicant intends to extinguish its obligation towards the qualifying employees in respect of the subsidy by making a compulsory additional contribution, determined with reference to an actuarial valuation of the post-retirement medical aid benefit, into the account of each qualifying employee with the Pension Fund.

This contribution is intended to provide the qualifying employees with sufficient cash, in the form of their monthly pension amounts, to be able to pay the contributions that would currently be payable from the date of retirement by the Applicant in terms of the subsidy scheme.

The rules of the Pension Fund, as applicable to the Applicant, will be amended to require the Applicant, as the participating employer, to make an additional compulsory contribution into the qualifying employee's account with the Pension Fund during the month in which the transaction is implemented. The Pension Fund will obtain approval from the Financial Services Board for this rule amendment.

This contribution will form part of the monthly compulsory contributions to be made to the Pension Fund by the participating employer, as contemplated in the 'compulsory contribution rule' of the Pension Fund, rather than an

additional voluntary contribution as contemplated in the 'voluntary contribution rule' of the Fund.

This compulsory contribution differs from the additional contribution contemplated in the 'voluntary contribution rule' in the sense that the employee may instruct, or request, the employer to make a contribution under the 'voluntary contribution rule', while this is not possible in the case of compulsory contributions.

The Applicant has consulted with the Class Members as to the reasons for its decision and has considered alternative approaches in this regard, but has arrived at the conclusion that the course it proposes is in the best interests of the Applicant and of the Class Members.

The final decision to extinguish the post-retirement medical subsidy benefits and make the additional contribution will be made by the Applicant's management committee and communicated to the Class Members.

The Class Members will not have a choice or input as to the form or amount of medical aid benefits that they will receive. In other words, if the scheme is implemented by the Applicant's management committee, the post-retirement benefit will be unilaterally terminated and an additional compulsory contribution into each Class Member' account will be made in terms of the Pension Fund rules, during the implementation month.

The additional compulsory contribution is therefore in no manner payable on instruction of, or agreement with, the Class Members, but rather by reason of a decision by the Applicant's management committee.

Ruling

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

The additional compulsory contribution by the Applicant to the Pension Fund:

- will not constitute a taxable benefit to be included in the gross income of the Class Members, as contemplated in paragraph (*i*) of the definition of 'gross income'; and
- will not constitute an amount received by or accrued to the Class

Members, as contemplated in paragraphs (*c*) and (*f*) of the definition of 'gross income'.

10.2. BCR 46 – Dividends distributed by foreign companies

This ruling deals with dividends distributed by foreign companies and whether they will be foreign dividends as defined in section 1(1) of the Act.

In this ruling references to sections are to sections of the Act applicable as at 20 March 2015 and 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 the definition of 'foreign dividend' in section 1(1).

<u>Class</u>

The class members to whom this ruling will apply are described below.

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

The Applicant: A company incorporated and registered in a foreign country (Country X) that is a resident of and has its place of effective management in another foreign country (Country Y)

The First Co-Applicant: The branch office of a company incorporated and registered in a foreign country (Country Z) that is located in Country Y

The Second Co-Applicant: A company incorporated and registered in Country Y that is a resident of and has its place of effective management in Country Y 2

The Class Members: South African investors (SA investors) who are residents of South Africa and the beneficial owners of dividends associated from time to time with the Applicant's shares

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

SA investors will acquire shares (investor shares for purposes of this ruling) of the Applicant. Depending on the nature of the investor and the regulatory environment in which the investor operates, the acquisition may be by way of subscription for the investor shares or by way of the acquisition of the investor

shares via the First Co-Applicant subject to a repurchase agreement to be entered into between the investor and the First Co-Applicant. The investor shares will:

- rank pari passu with the ordinary shares in the Applicant in respect of any distribution of capital and any dividends by the Applicant;
- have no stated maturity date or redemption rights;
- rank pari passu with the ordinary shares in the Applicant on a winding up of the Applicant; and
- confer voting rights upon the SA investors.

The Applicant will subscribe for cumulative non-redeemable preference shares (preference shares) in the Second Co-Applicant. The preference shares will:

- rank pari passu with the ordinary shares in the Second Co-Applicant in respect of any distribution of capital by the Second Co-Applicant;
- have no stated maturity date or redemption rights;
- rank pari passu with the ordinary shares in the Second Co-Applicant on a winding up of the Second Co-Applicant, provided that any liquidation proceeds shall be limited to an amount equal to the subscription price;
- confer voting rights upon the Applicant; and
- confer a preferential right on the Applicant to have a quarterly dividend declared and paid to it. Such distributions on the Second Co-Applicant's shares will be treated as dividends or similar payments for purposes of the corporate income tax laws in Country Y.

The Second Co-Applicant will utilise the funds in its business operations.

There will be no direct or indirect re-investment of the funds into South African assets as a result of the proposed transaction.

The distributions which will be paid or payable to SA investors by the Applicant, and to the Applicant by the Second Co-Applicant, will be treated as dividends or similar payments not deductible for corporate income tax purposes in

Country Y.

Conditions and assumptions

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

- The distributions which will be received by the Class Members in respect of the investor shares held in the Applicant, will not include any amount that constitutes either a redemption of a participatory interest in an arrangement or scheme as contemplated in paragraph (*e*)(ii) of the definition of 'company' or a share in the Applicant.

- The distributions which will be received by the Applicant from the Second Co-Applicant in respect of the shares held by it in the Second Co-Applicant will not include any amount that constitutes either a redemption of a participatory interest in an arrangement or scheme as contemplated in paragraph (*e*)(ii) of the definition of 'company' or a share in the Second Co-Applicant.

Ruling

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

- The distributions which will be received by the Class Members in respect of the investor shares held in the Applicant will constitute foreign dividends as defined in section 1(1).

- The distributions which will be received by the Applicant from the Second Co-Applicant in respect of the shares held by it in the Second Co-Applicant will constitute foreign dividends as defined in section 1(1).

11. 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.