TAX UPDATE **PREPARED BY: JOHAN KOTZE**
FOR PERIOD: 1 OCTOBER 2012 – 31 DECEMBER 2012

INDEX

1. INTRODUCTION

The purpose of this update is to summarise the tax developments that occurred during the fourth quarter of 2012 (i.e. 1 October 2012 to 31 December 2012), specifically in relation to Income Tax and Value-Added Tax (VAT). Johan Kotze, Bowman Gilfillan's Head of Tax Dispute Resolution, has compiled this summary.

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

This update is dominated by eleven tax cases, some of which have farreaching consequences. One may not always agree with the judgments, but one has to accept that they form part of the legal landscape and cannot deny that they are considered judgments.

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 a specific provision. 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. REGULATIONS

2.1 VAT – Amendment of par. 8 of Schedule 1 to the VAT Act

Government Gazette No. 36002 amends par. 8 of Schedule 1 of the VAT Act, in terms of section 74(3)(a), to insert item 414.00 in consequence of the insertion of rebate item 414 in Schedule No.4 of the Customs and Excise Act, as follows:

'414.00 IMPORTED GOODS ADMITTED UNDER REBATE OF DUTY FOR CONSUMPTION OR USE AT AN INTERNATIONAL SPORTING EVENT APPROVED BY THE MINISTER, WHEN IMPORTED AND ENTERED BY THE CONTROLLING BODY OF A PARTICIPATING VISITING TEAM, A TEAM DOCTOR, AN OFFICIAL SPONSOR OF THE EVENT OR THE HOST OF THE EVENT ON BEHALF OF A PARTICIPATING VISITING TEAM

NOTES:

1. The event may be approved by the Minister having regard to -
   - (i) the foreign participation in that event; and
   - (ii) the economic impact that event may have on the country as a whole.

2. 'Official sponsor' means a sponsor of the event appointed by -
   - (i) the international organiser of the event; or
   - (ii) the host of the event in South Africa.

414.01/00.00/01.00 Pharmaceutical goods (including medicaments) imported by -

(i) a controlling body of a participating visiting team;

(ii) a team doctor of a participating visiting team accredited by the Department of Health; or

(iii) the host of the event on behalf of a participating visiting team, in such quantities as the Department of Health may allow by specific permit.

414.02/00.00/01.00 Non-alcoholic beverages and foodstuffs imported by a controlling body of a participating visiting team or the host of the event on behalf of a participating visiting team, for consumption by members of the team during their stay.

414.03/00.00/01.00 Promotional material, individually of little value, imported by an official sponsor of the event or the host of the event on behalf of an official sponsor, not for sale but for distribution or use at an event venue'.

2.2 VAT – Amendment of par. 8 of Schedule 1 to the VAT Act

Government Gazette No. 35932 amends item 470.00 in par. 8 of Schedule 1 of the VAT Act, in terms of section 74(3)(a), in consequence of the amendment of rebate item 470.00 in Schedule No.4 of the Customs and Excise Act, as follows:

GENERAL EXPLANATORY NOTES:

[ ] Words in bold type in square brackets indicate omissions from existing

enactments.

____ Words underlined with a solid line indicate insertions in existing

enactments.

(a) by the substitution in paragraph 8 for Note 2(a) to item 470.00 of the following:

'2 (a) The exemption in terms of **[items no's. 470.01 or]** <u>item no.</u> 470.03 is allowed only for goods to be used for the processing or manufacture of goods for export and the processed or manufactured goods must be exported –

(i) for the purposes of item **[470.01 and]** 470.03 (01.00 and 02.00) within 12 months from the date of entry thereof; and

(ii) for the purposes of item 470.03 (03.00) within three (3) years from the date of entry thereof;'

(b) by the substitution in Note 2 of proviso (ii) of the following:

'(ii) the application for such extension is made prior to the expiry of the period of 3 years, 12 months or 6 months, as the case may be;' and

(c) by the deletion of the following:

'**[470.01/00.00/01.00 Goods for processing, provided such goods do not become the property of the importer]**'.

2.3 Public notice listing reportable arrangements for purposes of section 35(2) of the TAAct.

Public Notice No. 1108 lists reportable arrangements for purposes of section 35(2) of the Tax Administration Act, which have been identified as arrangements which have certain characteristics that may lead to an undue tax benefit:

- Any arrangement which would have qualified as a 'hybrid equity instrument' as defined in section 8E of the Income Tax Act, if the prescribed period had been 10 years.
- Any arrangement which would have qualified as a 'hybrid debt instrument' as defined in section 8F of the Income Tax Act, if the prescribed period in that section had been 10 years, but does not include any instrument listed on an exchange regulated in terms of the Securities Services Act.

2.4 Incidence of non-compliance by a person in terms of section 210(2) of the TAAct that are subject to a fixed amount penalty in accordance with section 210 and 211

Notice No. 790 deals with the incidence of non-compliance by a person in terms of section 210(2) of the TAAct that are subject to a fixed amount penalty in accordance with section 210 and 211 of the TAAct, and lists such as follows:

- Failure by a natural person to submit an income tax return as and when required under the Income Tax Act for years of assessment commencing on or after 1 March 2006, where that person has two or more outstanding income tax returns for such years of assessment.

2.5 Distance above which a person may decline to attend an interview in terms of section 47(4)

Notice No. 789 deals with the distance above which a person may decline to attend an interview in terms of section 47(4) of the TAAct, i.e.:

- Which is more than 200 kilometres between the place designated in the notice adn the usual place of business or residence and back
- In the case of a person described in section 211(3)(a), (b) and (c) of the TAAct, the distance is 2 500 kilometres.

2.6 Form and manner of a report to a taxpayer on the stage of completion of an audit of section 42(1)

Notice No. 788 deals with the form and manner of a report to a taxpayer on the stage of completion of an audit in terms of section 42(1) of the TAAct as follows:

Due dates for reports

A SARS official involved in or responsible for an audit instituted before but not completed by the commencement date or instituted on or after the commencement date, must provide the taxpayer concerned with a report indicating the stage of completion of the audit:

(a) in the case of an audit instituted before the commencement date, within 90 days of the commencement date and within 90 day intervals thereafter, and

(b) in the case of an audit instituted on or after the commencement date, within 90 days of the start of the audit and within 90 day intervals thereafter,

until the conclusion of the audit.

Details of report

The report must include the following details as at the date of the report:

(a) A description of the current scope of the audit,

(b) The stage of completion of the audit, and

(c) Relevant material still outstanding from the taxpayer.

3. TAX CASES

3.1 Eveready (Pty)Ltd v C:SARS

Eveready was formerly a division of Gillette Group South Africa (Pty) Ltd that manufactured, distributed and sold zinc batteries under the name ‘Eveready’.

On 18 November 2002 Gillette sold the business as a going concern to Friedshelf 243 (Pty) Ltd, a shelf company that changed its name to Eveready (Pty) Ltd, which was the Eveready in the appeal and the effective date of the sale was 1 March 2003.

Eveready, in its income tax return for the 2004 year of assessment, which spanned the period 1 March 2003, when Eveready commenced trading, to its accounting year-end on 30 June 2004 – claimed a deduction from income of R103 532 179 for the trading stock that it had acquired from Gillette pursuant to the purchase of the business on the basis that the aforementioned amount was the market value of the stock at the date of acquisition, and that it was entitled to deduct its market value because it had acquired the stock from Gillette 'for no consideration' as contemplated by section 22(4) of the Income Tax Act

The appeal centred on section 22(4), which determined the value to be placed on trading stock that was acquired 'for no consideration' and it provided that the cost price of such stock for purposes of section 22(3) – and hence for determining its cost price where applicable in the earlier subsections – was deemed to be its current market price at the date of acquisition.

Section 22(4) provided at the relevant time:

> 'If any trading stock has been acquired by any person for no consideration ... such person shall for the purposes of subsection (3) ... be deemed to have acquired such trading stock at a cost equal to the current market price of such trading stock on the date on which it was acquired by such person ...'

SARS issued an additional assessment following an audit of the Eveready's business, in which the deduction was at first disallowed altogether but later SARS allowed a deduction of R21 562 918 and interest on the allegedly unpaid tax was levied under section 89*quat*(2).

SARS rejected Eveready's objections to the disallowance of the deduction and to the levying of interest and Eveready then appealed to the Eastern Cape Tax Court (see *ITC 1851* per Chetty J) which then dismissed Eveready's appeal against the disallowance of the deduction, but upheld its appeal against the levying of interest.

Eveready now appealed against the former order, and SARS cross-appealed against the latter order, with the leave of the court below.

SARS accepted that the trading stock acquired from Gillette – which constituted the opening stock of Eveready's business – was deductible from its income but what was in dispute was the amount to be attributed to the stock for purposes of the deduction.

SARS contended that Eveready was not entitled to deduct its market value because it was not acquired 'for no consideration' but submitted that the stock was acquired for consideration and thus it fell to be deducted at its cost price as contemplated by section 22(2)(b) of the Act, which he estimated to be R21 562 918, the amount that he allowed.

The sole issue in the appeal was whether Appellant acquired the trading stock from Gillette 'for no consideration' (in which case it fell to be deducted at its market value at the date of acquisition as provided for in section 22(4), or whether it was acquired for consideration (in which case it fell to be deducted at its cost price as provided for in section 22(2).

Judges Nugent and Tshiqi held the following:

<u>As to the appeal – the trading stock issue</u>

(i) That whether or not the stock was acquired for no consideration was a question of fact that depended upon what was agreed between the parties for its acquisition and in the court below Eveready sought to advance oral evidence as to the meaning of the written agreement in that regard but that evidence was rightly ruled to be inadmissible.

(ii) That the case advanced by Eveready turned solely upon the construction that it gave to Schedule 6 of the agreement of sale of the business as a going concern and its submission that the schedule demonstrated that the parties intended that no part of the purchase price was to be paid for the trading stock and thus it had been acquired 'for no consideration' had no merit as not only did the submission ignore the context in which the schedule had to be read but it was also inconsistent with the language of the schedule itself.

(iii) That it was apparent from the subject matter of the sale alone that the purchase price had been paid at least partly for the trading stock – clause 5.1 was not exhaustive of the purchase price that was to be paid for the business and clause 8 required a stocktaking to be done on the day prior to the effective date and the preparation of schedules reflecting all inventory and display inventory that existed on that date and clause 8.5 provided that those values were to be ‘used for the purposes of the Effective Date Accounts and the Working Capital Statement’.

(iv) That Schedule 6 did not purport to allocate R80 million, which was the basis for the submission made by Eveready but it purported to allocate ‘the purchase price’, which remained undetermined until such time as the working capital at the effective date had been fixed; moreover, in its terms the schedule determined, first, the order in which that price was to be allocated once it had been fixed, and secondly, the maximum amount that was to be allocated to each item and the blank space alongside inventory – and those alongside display inventory and receivables less payables (debtors less accounts payable) – clearly did not signify that the amount to be allocated to those items was nil.

(v) That the only basis for the contention by Eveready that no consideration had been paid for trading stock had been that the amount that the parties were said to have intended to allocate to inventory was nil but seen in its context that was not what the schedule meant; indeed, it would be most extraordinary if Gillette had given away trading stock for free that Eveready stated had a market value of over R100 million and it was quite apparent from the agreement read as a whole that part of the purchase price was paid for the trading stock but precisely what portion of the purchase price was paid for the trading stock was not a matter that was before the court in the appeal.

(vi) That, accordingly, the finding of the Tax Court on this issue could not be faulted and the appeal had to fail.

As to the cross appeal – the interest issue

(vii) That section 89*quat*(2) of the Income Tax Act levied interest on unpaid tax in certain circumstances but SARS, in terms of section 89*quat*(3), may in his discretion waive that interest in whole or in part if he was satisfied that the taxpayer's claim had been based on reasonable grounds and on appeal from his decision it was for the Tax Court to exercise that discretion and it was open to this court to interfere only if the Tax Court had failed properly to exercise its discretion.

(viii) That there were no grounds for finding that the Tax Court had failed properly to exercise its discretion and the cross-appeal had to fail.

3.2 NV v ER and Another

Applicant sought an order against the First Respondent, being his former wife, for the payment of the amount of R135 614, 27 in respect of the tax deducted from his pension interest in the Second Respondent and paid to the Receiver of Revenue consequent upon the First Respondent's invocation of section 37D(1)(d)(i) of the Pension Funds Act.

Applicant and First Respondent's marriage had been dissolved on 25 August 2006 and in terms of section 7(8)(*a*) of the Divorce Act 7 the court made an order encapsulating clause 5 of the parties' settlement agreement devolving their patrimonial benefits, which provided: 'the first respondent shall be entitled to 30% of the applicant's interest held with and accruing from his membership with the second respondent, calculated as from the date of divorce.'

In terms of section 37A(1) of the Pension Funds Act the First Respondent had to wait until the Applicant's pension had been paid out to the Applicant as a lump sum before her assigned 30% interest in the Applicant's pension fund became due and payable to her.

The lump sum paid to the Applicant attracted a tax liability in his possession and such tax liability was exclusively to his account and it was only after the

Applicant's lump-sum pension payment was taxed, that First Respondent's assigned 30% interest in the Applicant's pension accrued and became due and payable to First Respondent by the Second Respondent.

In terms of section 2B of the Second Schedule to the Income Tax Act part of the pension interest or amount is not deemed to have been received by, or to have accrued to, a person other than a member and in terms of the said section 2B, it is deemed to be an amount that accrues to the pension-fund member on the date on which the pension interest (of which that amount forms part) accrues to that pension member and it consequently followed that the tax liability was a debt incurred by and for the account of the Applicant, payable by him to the Receiver of Revenue in terms of section 2 of the Second Schedule to the Act.

From 1 March 2009, in terms of the amendment to section 37D(4)(*b*)(i) of the Pension Funds Act, a non-member spouse (First Respondent) became entitled to exercise an election for the payment of the 30% interest assigned to her, in terms of section 7(8)(*a*) of the Divorce Act, in the Applicant's pension interest in the Second Respondent at any time before the Applicant's resignation, retirement or death.

In April 2009 First Respondent duly exercised her right, and elected to withdraw the 30% interest assigned to her from the Applicant's pension interest in the Second Respondent by invoking section 37D(4)(*b*)(i) of the Pension Funds Act.

Second Respondent then advised Applicant that in terms of a tax directive from SARS the amount of R135 614,27 had been determined by the former as the tax payable, consequent upon the payment of First Respondent's assigned 30% interest from the Applicant's pension, resulting in a total deduction of R435 814,26 from Applicant's total pension of R1 000 666,63.

Applicant sought an order against First Respondent for the payment of the aforementioned amount in respect of the tax deducted from his pension interest in the pension fund and paid to the Receiver of Revenue, resulting from the First Respondent's invocation of section 37D(1)(*d*)(i) of the Pension Funds Act.

Applicant contended that, in terms of section 2B of the Second Schedule to the Act, he was entitled to recover from First Respondent the tax paid consequent upon her invocation of section 37D(4)(b)(i) of the Pension Funds Act and he contended further that, pursuant to the dictates of section 2B of the Second Schedule, such tax payment or liability was not a debt to his account as envisaged in clauses 3.2 and 6 of the settlement agreement.

First Respondent contended that the 30% interest assigned to her in terms of clause 5 of the settlement agreement was the total due and payable to her without deducting tax therefrom, and submitted that such tax-free payment was congruent with clause 3.2 of the settlement agreement, because at the execution of the settlement agreement it was within the parties' contemplation that in terms of the Income Tax Act the Applicant was liable to pay tax, because tax payable by the Applicant, consequent upon the payment of the First Respondent's assigned 30% interest in the Applicant's pension interest in the Second Respondent, was a debt due to the account of the Applicant in terms of clauses 3.2 and 6 of the settlement agreement.

Judge Mokgoatlheng held the following:

(i) That when the parties concluded the settlement agreement with reference to the Income Tax Act and in accordance therewith, Applicant was clearly responsible for the payment of his tax because First Respondent's 30% interest in Applicant's pension, strictly speaking, first accrued to Applicant, and only thereafter accrued to First Respondent upon the payment of her 30% interest in his pension and, consequently, the tax payable accrued to Applicant's account as it was levied on the pension lump sum paid to him.

(ii) That, however, when the parties entered into the settlement agreement at the time of the divorce, it could never have been in their contemplation that the Pension Funds Act would in future be amended to enable the non-member spouse to be entitled to the earlier payment of her 30% assigned interest in Applicant's pension, because secttion 2B of the Second Schedule to the Act was extant at the time of the dissolution of the marriage.

(iii) That, pursuant to the dictates of section 37D(4)(*b*)(i) of the Pension Funds Act, a non-member spouse made an election to enforce an order made in terms of section 7(8)(*a*) of the Divorce Act, the assigned 30% interest in the member's pension was taxed separately and that was evident and reaffirmed by the last portion of section 2B.

(iv) That, moreover, it was patent that Applicant's right to recover the tax liability paid was not based on contract, it arose *ex lege* and the reason it arose *ex lege* was because the non-member spouse, First Respondent, had made an election and had invoked section 37D(4)(*b*)(i) of the Pension Funds Act and once First Respondent had made the election, so to speak, to accelerate the payment of her assigned 30% interest in Applicant's pension, the Second Schedule to the Income Tax Act was triggered, the deducted payment of First Respondent's assigned 30% interest attracted a tax liability and was taxed in the hands of the member spouse who retained a right of recovery to such payment.

(v) That the applicability of section 2 of the Second Schedule to the Act made the position clear that, if the First Respondent had bided her time and did not invoke section 37D(4)(*b*)(i) of the Pension Funds Act, the tax liability would have been a debt accruing to the Applicant's account as envisaged in terms of the settlement agreement made an order of court on 25 August 2006 in terms of section 7(8)(*a*) of the Divorce Act.

(vi) That it was patent that the Applicant's entitlement and claim to recover the tax paid, as a consequence of First Respondent's invocation of section 37D(4)(*b*)(i) of the Pension Funds Act, was not a claim that arose during the subsistence of the marriage or at the execution of the settlement agreement but it was patently a claim that had arisen *ex lege* in terms of section 37D(4)(*b*)(i) after the inception of the amendment of section 2B of the Income Tax Act and the settlement agreement did not contain a waiver of the Applicant's rights to invoke the provisions of section 2B of the Second Schedule to the Act.

(vii) That, accordingly, First Respondent was ordered to pay to the Second Respondent the amount of R135 614,27 to be paid to the credit of the Applicant's pension interest in the Second Respondent and First Respondent was ordered to pay Applicant's costs.

3.3 ITC 1859

The taxpayer had concluded a sale of shares agreement whereby it had purchased certain redeemable preference shares from E Bank that had been allotted and issued by B Ltd in accordance with Article 34 of its Articles of Association and Articles 34.2 and 34.3 of B's Articles of Association dealt with a dividend in respect of the preference shares and Article 34.5 dealt with the redemption of the preference shares.

The taxpayer, pursuant to the purchase agreement, had paid an amount of R274 149 831 to E Bank on 25 February 2004 and in March 2004 B Ltd redeemed the preference shares in accordance with Article 34, pursuant to a resolution dated 12 March 2004, for a total redemption price of R234 893 886.

At the time of the redemption of the preference shares the taxpayer and B Ltd were members of the same group of companies and were connected persons as defined in section 1 of the Income Tax Act.

The aforementioned redemption price was paid by B Ltd to the taxpayer on 12 March 2004 and the total redemption price included the issue price, the dividend in terms of Article 34.2 read with Article 34.3 and the redemption premium in terms of Article 34.5.

The cancellation of the preference shares was registered through STRATE (the licensed central securities depository for the electronic settlement of financial instruments in South Africa) and B Ltd was obliged to cancel the preference shares on redemption.

SARS had dismissed an objection raised by the taxpayer to his assessment for the 2003 year in which SARS had reduced and disallowed a capital loss claimed by the taxpayer in respect of the redemption of the aforementioned redeemable preference shares ('preference shares') which it had held in B Ltd, by B Ltd, on the basis that the loss was a 'clogged loss' contemplated in par. 39(1) of the Eighth Schedule to the Act.

There were two main issues before the court:

- The interpretation of par. 39(1) of the Eighth Schedule to the Income Tax Act and, more particularly, whether that paragraph applied to the redemption of the preference shares and accordingly rendered the taxpayer's capital loss, as a result of the redemption of the preference shares, a 'clogged loss' because of the connection between the taxpayer and B Ltd.
- The *quantum* of the taxpayer's capital loss and, more particularly, the meaning of the word 'recovery' in par. 20(3) of the Eighth Schedule and whether the taxpayer actually recovered part of the cost of purchasing the preference shares from E Bank when B Ltd redeemed them.

The taxpayer contended that par. 39(1) was not applicable because the redemption of the shares was not a disposal by it to any other person.

The taxpayer placed emphasis on the preposition 'to' which was used in addition to the term 'disposal' in par. 39(1) and submitted, in essence, that the kinds of disposal that were contemplated in par. 39(1) were those where the asset, or the rights in the asset, were transferred from the disposer to any other person.

The taxpayer submitted further that in the case of the redemption of shares there was no transfer of the shares (or the bundle of rights represented by the shares) from the holder of the shares to the redeeming company as on redemption the shares (or rights represented by the shares) were extinguished and ceased to exist.

SARS contended that par. 39(1) was applicable and that the redemption of the preference shares was a disposal.

SARS contended that the redemption was a kind of 'buy back' and was a disposal to the redeeming company (in this case B Ltd) as contemplated in par. 39(1) and that the taxpayer's loss was, accordingly, a 'clogged loss'.

The aforementioned submissions brought into focus the meaning of par. 39(1) and, in particular, whether the term 'disposal' in that paragraph had to be given a constrained meaning in the light of its context in that paragraph and, in particular, because it was used in that paragraph in conjunction with the preposition 'to'.

The taxpayer further contended that its capital loss was R120 875 153 whereas SARS contended that it was less, namely R35 517 539.

SARS contended that the difference arose because in determining the base cost of the preference shares (which were redeemed) the purchase price of those shares, namely R270 411 425 must be reduced by an amount of R85 357 614 (being the sum of the preference dividend payable in terms of B Ltd's Articles 34.2 and 34.3, namely, R1 433 909 and the redemption premium payable in terms of B Ltd's Article 34.5, namely R83 723 705) on the basis that the preference dividend and the redemption premium constituted a 'recovery' in terms of par. 20(3) of the Eighth Schedule.

SARS contended that the cost price of the preference shares ought to be reduced because the taxpayer 'reduced the price or recovered or has been paid the anticipated benefits' on redemption of the preference shares by B Ltd and the taxpayer bore the burden of proving that an amount was not subject to deduction in terms of section 82 of the Income Tax Act.

The relevant provisions are par. 20(1)(*a*) and 20(3) of the Eighth Schedule to the Act and the relevant portions of those paragraphs were the following:

Paragraph 20(1)

> 'The base cost of an asset acquired by a person is the sum of—
>
> (*a*) the expenditure actually incurred in respect of the cost of acquisition ... of that asset'

Paragraph 20(3)

> 'The expenditure contemplated in subparagraph (1)(*a*) to (*g*), incurred by a person in respect of an asset must be reduced by any amount which—
>
> (*a*) ...
>
> (*b*) has for any reason been ... recovered or become recoverable from or has been paid by any other person ...'

The taxpayer disputed that the dividend and the redemption premium constituted a recovery as contemplated in par. 20(3) because on a proper (literal) construction of par. 20 it was clear that in order to have recovered an amount, the taxpayer must have got back into its possession the expenditure (or part of the expenditure) incurred in respect of the acquisition of the preference shares and, in this case, to treat the dividend and/or premium as a recovery of the purchase price of the preference shares as contemplated in par. 20(3) would produce absurd results and the taxpayer equated such a situation with one where rental received in respect of a property which is disposed of is treated as a recovery of the purchase price of the property or part of such price. To illustrate, if the taxpayer bought a property for R1 million and had received rental of R1.5 million, the property would have a negative base cost.

Judge Coppin held the following:

<u>As to the applicability of par. 39(1) of the Eighth Schedule</u>

(i) That in interpreting fiscal or tax legislation one commences with a literal inter-pretation because such legislation ought to be certain and the golden rule of statutory interpretation meant that words in a statute had to be given their ordinary literal meaning within their context in the statute and in terms of this rule the ordinary grammatical meaning of the words must be adhered to if the language of the statute is unambiguous and its meaning is clear and the court may only depart from the ordinary meaning if it leads to an absurdity so glaring that it could never have been contemplated by the Legislature.

(ii) That it was also a fundamental principle that when interpreting legislation literally every word used by the Legislature must be taken into account and it also had to be borne in mind that in interpreting anti-avoidance provisions, such as par. 39(1), a wider interpretation is required so as to suppress the mischief at which the provision is aimed at and to advance the remedy but it is very important to bear in mind in this regard that interpreting 'widely' did not mean that the meaning of the provision being interpreted must be stretched beyond what its language permits.

(iii) That the mischief at which par. 39(1) is aimed is clearly to prevent a taxpayer from avoiding or reducing its tax liability by creating a capital loss through the disposal of an asset to a person (including a company) that it is connected to and to allow such losses, *i.e.* as a result of disposals to connected persons to be deducted generally, would provide fertile ground for the creation of fictitious losses; moreover, tax liability would be reduced while the asset, or the benefit thereof, would still be retained by the disposer, albeit through the connected person.

(iv) That the wording of par. 39(1) accordingly clearly covers all transactions such as sales, or the transfer of assets (including shares), from the disposer to a connected person or company and the difficulty arises where there is no transfer of the asset (or the rights therein) from the disposer to the connected person.

(v) That according to the canons of construction referred to above the preposition 'to' in par. 39(1) cannot be ignored unless its inclusion would result in an absurdity so glaring that it could never have been contemplated by the Legislature and on adopting a literal interpretation of par. 39(1) the disposal of the asset must thus be 'in the direction of', or 'so as to reach' the connected person and this implies a disposal of a kind in which the asset (or the rights represented therein, in the case of shares) must be transferred to the connected person.

(vi) That it was important to determine what occurred upon redemption of the preference shares and whether the act of redemption automatically resulted in the extinction of the shares, or whether it merely resulted in a transfer to the redeemer, who had to perform a further act of extinguishing them? Moreover, it was common cause that upon redemption the asset (in this case, the preference shares, or the bundle of rights they represented) were extinguished and in the present case and despite the provisions of the Articles of Association, it was common cause that no share certificates were handed over by the taxpayer upon redemption and that the shares were 'dematerialised' – they ceased to exist.

(vii) That the wording of par. 39(1) was clear – SARS had not submitted that the preposition 'to' was mere surplusage, nor did SARS make out a case for the deletion of that word from the paragraph. Furthermore, it had not been shown that the ordinary literal meaning of the paragraph (inclusive of the preposition 'to') led to an absurdity or that it would permit the mischief which the Legislature intended to prevent by means of that paragraph.

(viii) That while the redemption of shares constituted a 'disposal' as defined in par. 11 of the Eighth Schedule, it was not a 'disposal to any other person' as envisaged in par. 39(1) as the redemption of shares resulted in the extinction and not in a transfer of the rights embodied in the shares to the company redeeming them, or to any other person.

(ix) That, in the circumstances, par. 39(1) did not apply to the redemption of shares in the present case and the loss incurred was accordingly not a 'clogged loss' as envisaged in that paragraph.

<u>As to the extent of the taxpayer's capital loss</u>

(x) That the ultimate question relating to the *quantum* of the taxpayer's capital loss was whether the taxpayer actually recovered part of the cost of purchasing the preference issues in issue when B Ltd redeemed them, and in particular, whether, in determining the base cost of the preference shares, the purchase price of those shares had to be reduced by the sum of the preference dividend payable and the redemption premium payable on the basis that they constituted a 'recovery' in terms of par. 20(3) of the Eighth Schedule.

(xi) That the same principles applied in the interpretation of par. 20(3) as were discussed when dealing with the first issue in this case and the provision should also be interpreted contextually, bearing in mind the object and purpose of the Legislature in imposing capital gains tax and the aim and object of the paragraph being considered.

(xii) That there was merit in the contention that the fruit derived from an asset will, generally, not constitute a recovery envisaged in par. 20(3) and on a proper construction of that paragraph, in order for the amount to be a recovery the taxpayer must have got back the cost (or part) expended in acquiring the asset and the fruits of the asset, such as rent, in the case of the asset being a rental property, or dividends earned in respect of shares, are generally, not amounts that have been recovered as contemplated in par. 20, but constitute income earned from the particular asset; moreover, to treat the fruits of an asset as a recovery for the purpose of calculating the capital gain or loss could produce absurd and inequitable results, such as double-counting.

(xiii) That, on the other hand, a repayment to the taxpayer of part of the purchase price of an asset clearly constituted a recovery envisaged in that paragraph and whether a particular amount is a recovery, or merely fruit of the asset, was a matter of fact to be determined in every case.

(xiv) That both the dividend portion and the redemption premium portion of the redemption price could not be regarded as recoveries envisaged in par. 20(3) as they were fruits of the preference shares and the fact that these benefits might have been taken into account in determining the price which the taxpayer paid for the preference shares did not convert them into the recoveries envisaged in par. 20(3).

(xv) That when B Ltd paid the dividends and redemption premium to the taxpayer it did not intend to be repaying, or reimbursing, the taxpayer for an expenditure that the taxpayer had incurred in that regard in acquiring the preference shares, nor did it do so.

(xvi) That, accordingly, in calculating the capital loss of the taxpayer, SARS erred in treating the dividend portion and the redemption premium portion of the redemption payment made to the taxpayer by B Ltd, as recoveries of the cost of acquiring the preference shares.

Appeal upheld.

The matter was referred back to SARS for reassessment on the basis that par. 39(1) was not applicable to the redemption of the preference shares by B Ltd and in calculating the capital loss of the taxpayer the dividend and redemption premium amounts were not amounts that were 'recovered' as contemplated in par. 20(3).

3.4 Stellenbosch Farmers' Winery Ltd v C:SARS

Stellenbosch Farmers' Winery Ltd (SFW) was a wholly owned subsidiary of Stellenbosch Farmers' Winery Holdings Limited and the latter was in turn wholly owned by Stellenbosch Farmers' Winery Group Limited ('SFW Group').

SFW, at all material times, had carried on business as a producer and importer of liquor products, and as a wholesaler of a range of spirits, wine and other liquor products to retailers and, in contradistinction, SFW Group was exclusively a holding company and did not conduct other operational business activities.

SFW had, since the 1970s, *inter alia* imported and distributed Bells whiskey, together with Dimple and Haig whiskeys ('Bells') into South Africa.

United Distillers *plc* (UD), based in the United Kingdom, had concluded a joint venture agreement (the JV agreement) with SFW Group and Distillers Corporation (SA) Ltd (Distillers) which led to the formation of United Distillers Imports (Pty) Limited (UDI).

The JV agreement provided that UD would enter into distribution agreements with the entities in South Africa appointed by UDI as distributors of UD's products which included Bells and it was further recorded, in respect of SFW Group and Distillers, that the intention was that, as far as possible, the only distributors would be the marketing companies/divisions of those two entities.

As foreshadowed in the JV agreement, a further written agreement relating to the distribution of Bells in South Africa (the distribution agreement) was concluded on 12 May 1992 between UD and an entity styled simply 'Stellenbosch Farmers' Winery' but which the court accepted was SFW who did acquire the exclusive rights of distribution of Bells in South Africa and surrounding territories as provided for in the distribution agreement.

In terms of the agreement SFW undertook not to sell competing products in the area in question and the period of the distribution agreement was ten years, with effect from 1 February 1991, whereafter the agreement was terminable on 12 months' notice and, accordingly, it would, depending on when notice of termination was given, terminate on 31 January 2002 or on a date subsequent thereto.

Until it was terminated on 28 August 1998, the distribution venture proved to be extremely profitable for SFW as over the years it had built up the Bells brand to the position of a pre-eminent asset in South Africa which it did not occupy anywhere else in the world. Bells sales contributed between 18% and 25% of SFW's profit or 'bottom line' and this was significant for SFW as the sale of spirits delivered the real profit margins as opposed to other products.

After SFW's loss of the distribution rights for Bells, its trading income dropped very significantly, by many millions of rand, during the ensuing two financial years whereafter SFW was forced to merge with another entity to avoid bankruptcy.

During 1997 certain corporate structural changes in the form of company mergers took place in the United Kingdom and Europe and the changes effected the union of the spirit and wine businesses of, *inter alia*, UD and

UDI, and the distribution network of another distributor in South Africa, Gilbeys. The aforesaid changes entailed consequences for the liquor market in South Africa and UD accordingly sought to extract itself prematurely from the distribution agreement and negotiations towards that end were set in train.

As a result, a written agreement (the termination agreement) was concluded and the effective date of the agreement was 28 August 1998, *i.e.* some three years and five months before the earliest date on which the distribution agreement could have been terminated by UD giving notice as envisaged therein.

The termination agreement provided *inter alia* that in consideration of payment of the sum of R67 million to SFW, the latter and UD agreed that certain agreements would terminate and these included the JV agreement and what was referred to as the distribution agreement.

The amount of R67 million was in due course paid to SFW and its receipt was reflected in its financial statements for the 1999 tax year and it was this receipt that was the subject of the issue in the main appeal in case no *511/2011*.

In terms of section 82 of the Income Tax Act the *onus* was on SFW to establish that the receipt of the R67 million was of a capital nature and that it should not have been assessed to tax as part of SFW's gross income, as had been directed by SARS for SARS.

The court *a quo* (see *ITC 1850*) held that the question to be answered was whether SFW had been compensated for the capital value of the exclusive distribution right, *i.e.* whether the compensation of R67 million paid for the early termination of the distribution right was paid as compensation for the loss of the value of the capital asset, the distribution right, and therefore destined to fill a hole in the taxpayer's assets, or whether it was paid as compensation for a loss of profits in the sales of Bells, which would be the result of the early termination of the distribution right.

The second issue before the court related to the appeal in case no *504/2011* (see *ITC 1852*) where SARS had determined that the receipt of the R67 million by SFW (a registered vendor for VAT purposes in terms of the Value-Added Tax Act) was subject to VAT at the rate of 14% in terms of section 7(1) of the VAT Act.

SFW's appeal to the court *a quo* against that determination had been successful and the present appeal by SARS is against the substituted order of the court *a quo* that the receipt of R67 million by SFW was subject to VAT at the rate of zero per cent in terms of section 11(2)(*l*) of the Act.

It was common cause between the parties both in the court *a quo* and in the Supreme Court of Appeal that the matter concerned the issue of the supply of services in the course of an enterprise and not the supply of goods.

SARS, now as the Appellant in case no *504/2011*, appealed against the order of the court *a quo* setting aside the assessment by him that the taxpayer's receipt of the sum of R67 million was subject to VAT at the rate of 14% in terms of section 7 of VAT Act and the court *a quo's declarator* that the receipt by the taxpayer of the sum of R67 million was subject to VAT at the rate of zero per cent in terms of section 11(2)(*l*)(ii) of the Act.

The dispute between the parties centred around the issue whether the receipt of R67 million related to 'services' as defined in section 1 of the VAT Act, supplied by the taxpayer to a non-resident and not 'directly in connection with movable property situated inside South Africa of South Africa', as envisaged in section 11(2)(*l*)(ii) of the Act.

Both matters before the court found their origin in related sets of facts, many of which were common cause or not in dispute.

Judge Kroon held the following:

<u>As to whether SFW acquired distribution rights</u>

(i) That SFW did acquire the exclusive rights of distribution provided for in the distribution agreement and the judgment of the court *a quo* (*ITC 1850*) correctly proceeded on the premise that it was SFW who had surrendered the distribution rights in question and in consideration thereof had received payment of the sum of R67 million.

(ii) That the evidence also disclosed that the party with which negotiations were held in respect of the termination of the distribution rights was in fact SFW as substantiated by the evidence of its managing director, the corporate strategy and planning manager and the managing director of UDI and the evidence was not challenged.

As to whether the receipt of R67 million was of a capital or revenue nature

(iii) That while the Income Tax Act contained a definition of 'gross income', which excluded receipts or accruals of a capital nature (save for certain exceptions which were not relevant for present purposes), there was no definition of 'receipt or accrual of a capital nature' and there was no single criterion for determining whether a receipt or accrual was to be categorised as capital or income.

(iv) That the judgment of the court *a quo* set out a tabulation of a number of the guidelines which had been recorded in previous decisions of the courts but it was not necessary in the present judgment to repeat the tabulation and reference would be made only to those guidelines that appeared to be appropriate for a resolution of the issue on hand.

(v) That the finding of the court *a quo* that the exclusive distribution rights held by SFW in terms of the distribution agreement was a capital asset was correct and in this court that common approach was persisted in which was clearly correct and it followed that, consequent upon the termination agreement, SFW had lost an asset.

(vi) That the ruling of the court *a quo* against SFW implied that the receipt of the R67 million by it was 'a gain made by an operation of business carrying out a scheme for profit-making' which was a well established guideline test considered by Smalberger JA to be the appropriate one in *CIR* v *Pick 'n Pay Employee Share Purchase Trust,* but that would mean that in the present matter SFW, admittedly in possession of a capital asset and treating it as such, changed its intention in respect thereof and decided to convert its use of the capital asset (part of its income-producing structure) to use thereof as trading stock (part of its income-producing activities) and the court was unable to align itself with that proposition.

(vii) That the judgment of the court *a quo* recognised that in the valuation of a capital asset it was not inappropriate to have regard to the profits anticipated from the use of the capital asset and stated that 'while the method of calculation of the amount of compensation is an important factor, it is not determinative of the nature of the receipt' and stated further that this was so because: 'It is a normal principle of valuation of a capital asset, whether it be land or the goodwill of a business or otherwise, to use the profits expected to be earned from the utilisation of the asset as a basis or starting point for the relevant calculations' – *per* McEwan J in *ITC 1341*.

(viii) That SFW validly argued that the nature of a receipt (*i.e.* whether it is capital or revenue) for income tax purposes, is not determined by how it is subsequently treated for accounting purposes and reference (by analogy) was made to the decision in *SIR* v *Eaton Hall* (*Pty*) *Ltd* where it was held that accounting practice cannot override the correct interpretation of the provisions of the Income Tax Act and their application to the facts of the matter and, as appears from the present judgment, the facts favour a finding of a capital nature; moreover, not only did the financial statement reflect that the receipt of the R67 million was an 'exceptional item', but note 4 to the statement specifically recorded that the receipt was 'compensation for the cancellation of the exclusive distribution rights', which points rather to a receipt of a capital nature.

(ix) That the manner in which a taxpayer deals with a receipt, after it has received it, cannot determine the nature of the receipt, *e.g.* the capital nature of the receipt of the proceeds of the sale of a building is not affected by the utilisation of the proceeds to pay a dividend.

(x) That one of the guideline tests adverted to in the court *a quo*, borrowed from the decision in *ITC 1341*, was whether a substantial part of the income-producing structure of the taxpayer had been sterilised by the transaction in question and in *Silke on South African*

Income Tax at par. 3.23 the following appeared: ‘An amount received by way of damages or compensation for the loss, surrender or sterilisation of a fixed capital asset or of a taxpayer’s income-producing machine is a receipt of a capital nature’.

(xi) That SFW’s counsel therefore correctly submitted that the court *a quo’s* reasoning reflected that it had erroneously focussed on only physical assets, instead of the much more valuable incorporeal assets constituted by the exclusive distribution rights (the loss of which, consequent upon the termination of the distribution agreement, brought in its train the disastrous consequences referred to earlier in the judgment) and the compensation for the impairment of the taxpayer’s business constituted by that loss was properly to be viewed as a receipt of a capital nature.

(xii) That, finally, it had to be emphasised that clause 4.5 of the termination agreement referred to payment of full compensation for the closure of the taxpayer’s business relating to the exercise of the distribution rights (an asset) and there was no reference in the termination agreement to a payment for loss of profits; moreover, there was no suggestion that the termination agreement did not reflect the intention of the parties or that it was in any way simulated and it need hardly be added that any suggestion that the taxpayer, faced with the option of concluding a capital transaction with no tax implications or an income transaction with such implications, would chose the latter, is, to say the least, an unconvincing one.

(xiii) That, accordingly, SFW, which did not carry on the business of the purchase and sale of rights to purchase and sell liquor products, did not embark on a scheme of profit-making and it did discharge the *onus* of establishing that the receipt of R67 million was of a capital nature.

(xiv) That, therefore, SARS had erred in including the receipt in the SFW’s gross income and assessing same to tax and SFW was accordingly entitled in the main appeal to the relevant orders set out in the judgment.

As to whether the receipt of R67 million was subject to VAT at rate of zero per cent

(xv) That it was correctly common cause both in the Tax Court and this court that the matter concerned the issue of the supply of services in the course of an enterprise, and not the supply of goods.

(xvi) That the court *a quo* found that, by agreeing to the early termination of the distribution right, SFW surrendered the remaining portion of the right, and that such surrender constituted the supply of services in the course of an enterprise by the taxpayer to UD for VAT purposes and there could be no quarrel with the correctness of these findings.

(xvii) That SARS' argument could not be upheld – *i.e.* that the services supplied by the taxpayer were constituted by the act of surrender and that the movable property in connection with which those services were directly supplied by the taxpayer was the exclusive distribution right provided for in the distribution agreement, now coming to an end in terms of the termination agreement, which right was situated within South Africa where it was being exercised; moreover, the distinction sought to be drawn by SARS between the act of surrender and the right surrendered was not a valid one.

(xviii) That the finding of the court *a quo* that the exclusive distribution right, which was incorporeal property, was not situated in South Africa was correct and the *situs* of an incorporeal right is where the debtor resides – *MV Snow Delta: Serva Ship Ltd* v *Discount Tonnage Ltd* 2000 (4) SA 746 (SCA) at par. 9-10.

(xix) That in this case the place of residence of the debtor, UD, was the United Kingdom, where it was registered and the matter therefore fell squarely within the purview of section 11(2)(*l*)(ii) of the VAT Act

(xx) That the taxpayer accordingly discharged the *onus* resting on it in terms of section 37 of the VAT Act to establish that the supply in question was subject to value-added tax at the rate of zero per cent, and that the contrary decision of SARS was wrong.

The main appeal (case no *511/2011*) was upheld with costs, including the costs of two counsel.

In the second case (case no *504/2011*) the appeal was dismissed with costs, including the costs of two counsel.

3.5 Barclay v Road Accident Fund

Barclay had been awarded damages in the High Court for the loss of earnings suffered by her but the quantification of Barclay's loss would be determined by the parties' actuaries.

The parties' respective actuaries had thereafter prepared separate reports on the basis of the court's findings which revealed a substantial difference between the calculation by Barclay's actuary of the capital value of her loss of earnings and the calculation thereof by RFA's actuary.

The aforementioned difference was due to the fact that they had departed from different premises in that Barclay's approach was that the amount of the income tax that Barclay would have paid on her lost earnings should not be deducted in arriving at the amount to be awarded whereas RFA deducted income tax from Barclay's loss of earnings in performing the calculation.

The difference between the results of the two calculations was material and the court accordingly invited the parties to submit written argument on this issue.

In the present case there had been a common mistake in that counsel on both sides had been under the impression that the question of the deductibility of Barclay's income tax savings was not a significant issue in the case and for that reason no argument had been addressed to the court on this issue at the hearing of the matter.

However, the issue had proved to be of considerable significance and accordingly the court was of the view that the question whether income tax should be deducted from Barclay's notional lost earnings should now be considered by it.

Judge Blignault held the following:

(i) That the starting point of the enquiry in this matter is a set of principles that are not controversial:

- the first is the trite statement that receipts of a capital nature are not subject to income tax whilst income is;
- the second is that the claim which is sometimes loosely described as one for the loss of earnings (as in the present case) is in truth a claim for the loss of the claimant's earning capacity which is an asset in his estate;
- the third is that an amount paid by way of damages takes on, in the hands of the recipient, the character of the loss in respect of which it is being paid, *i.e.*, if the payment is made in respect of a loss of a capital nature, the receipt is also of a capital nature;
- the fourth is that an award of damages for the loss of a claimant's earning capacity is intended to place him in the financial position he would have been in had it not been for the delict and the object of an actuarial calculation is to arrive at a lump sum that would allow the claimant to enjoy the financial benefits equal to the *quantum* of the earnings lost by him.

(ii) That the typical actuarial method (used in this case by both actuaries) of quantifying a claimant's loss of earnings or earning capacity takes place in two stages:

- in the first stage the notional income that the claimant would have earned over the relevant period is computed and
- in the second stage this amount is capitalised at a net discount rate which takes into account the rate at which the claimant is assumed to invest the lump sum to be awarded to him and the likely future inflation rate.

(iii) That the effect of income tax plays a role in both stages – in the first stage the question is whether income tax should be deducted in the calculation of the claimant's gross notional earnings over the relevant period and the question in the second stage is whether income tax should be taken into account in the quantification of the net discount rate.

(iv) That the deduction of income tax in the calculation of the claimant's gross notional earnings would, *ceteris paribus*, diminish the lump sum to be awarded to the claimant and the deduction of income tax from the income that the claimant is assumed to receive from his investment of the lump sum, would result in the employment of a lower net discount rate and a lower discount rate would, *ceteris paribus*, increase the lump sum to be awarded to the claimant.

(v) That it followed that it would in principle be unfair to the claimant if income tax is deducted from his gross notional earnings and a pre-tax investment rate is used in calculating the net discount rate which would in effect amount to the double taxation of the claimant to the benefit of the RFA and by the same logic it would in principle unduly favour the claimant if income tax is not deducted from his notional earnings in the first stage of the calculation but then deducted in the second stage to arrive at an after-tax net discount rate.

(vi) That the question of principle that arises for determination is which calculation is to be applied – should one deduct income tax in calculating the claimant's gross notional earnings and deduct it again in calculating the net discount rate or should one ignore income tax in both stages of the calculation?

(vii) That recognition of the implications of the fact that the claimant's earning capacity is a capital asset, leads one to the conclusion that income tax should not be deducted in the first stage of calculating the claimant's gross notional earnings; moreover, a claimant is not bound to employ his earning capacity in any particular manner and the fact that the *quantum* thereof is normally calculated with reference to the earnings which he would have earned over the period in question, did not change its nature as a capital asset.

(viii) That in regard to the proper approach to be adopted in the second stage of the determination, namely the manner of treating income tax in calculating the appropriate net discount rate, it followed that it would in principle be unfair to the RFA if an after-tax investment rate is used but there is no reason in principle why the net discount rate should be calculated on the assumption that the claimant would invest the award in such a manner that the proceeds would be fully taxable.

(ix) That the court was not in a position to determine what allowance should be made for the taxation of the income to be derived by Barclay from her utilisation of the award and did not have the requisite evidence before it.

(x) That in this case it would be unfair to the parties to subject them to another round of evidence and argument and accordingly the court proposed to award a sum which, on the evidence before it, was viewed as fair and reasonable compensation for Barclay's partial loss of her earning capacity and it was to be assumed in this regard that Barclay was likely to invest a substantial portion of the sum awarded to her in tax-free investments and on this basis an award of R500 000 to Barclay was proposed.

3.6 C:SARS v Tradehold Ltd

Tradehold was an investment holding company, incorporated in South Africa, with its registered office in Parow Industria and listed on the Johannesburg Stock Exchange.

Tradehold's only relevant asset during the tax year under consideration, being the year of assessment ended 28 February 2003, was its 100% shareholding in Tradegro Holdings which, in turn, owned 100% of the shares in Tradegro Limited, a company incorporated in Guernsey which owned approximately 65% of the issued share capital in the UK-based company, Brown & Jackson *plc*.

On 2 July 2002 at a meeting of Tradehold's board of directors in Luxembourg it was resolved that all further board meetings would be held in that country and this had the effect that, as from 2 July 2002, Tradehold became effectively managed in Luxembourg and with effect from 26 February 2003 Tradehold ceased to be a resident of South Africa.

SARS relying on the provisions of par. 12 of the Eighth Schedule to the Income Tax Act, contended that when Tradehold had relocated its seat of effective management to Luxembourg on 2 July 2002, or when it ceased to be a resident of South Africa on 26 February 2003, it was deemed to have disposed of its only relevant asset, namely its 100% shareholding in Tradegro Holdings, resulting in a capital gain being realised in the 2003 year of assessment in an amount of R405 039 083 and this tax is colloquially referred to as an 'exit tax'.

Par. 12(1) of the Eighth Schedule speaks of a person being 'treated as having disposed of an asset' and this is a deeming provision. A deemed disposal of assets, except those listed in subsections 2(1)(*b*)(i) and (ii), is triggered under par. 12 when a company ceases to be a resident of South Africa or is treated as not being a resident as a result of the application of a double tax agreement.

Tradehold had successfully appealed to the Cape Town Tax Court (see *ITC 1848*) against an additional assessment raised by SARS based on a taxable capital gain which, according to SARS, arose from a deemed disposal by Tradehold of its shares in Tradegro Holdings Limited, in terms of par. 12(1) of the Eighth Schedule.

Tradehold had contended in the court *a quo* that if there was a deemed disposal of the investment by itself during the 2003 year of assessment, the capital gain that resulted from that disposal was not taxable in South Africa, but in Luxembourg, and the reason therefor was that at the time the capital gain arose Tradehold was deemed to be a resident of Luxembourg in terms of Article 4(3) of the Double Tax Agreement (DTA) entered into between South Africa and the Government of the Grand Duchy of Luxembourg on 6 December 2000, which became applicable to South Africa in respect of the years of assessment beginning on or after 1 January 2001.

In terms of Article 4(3) of the DTA the deemed place of residence of a company is the place where its effective management is situated.

The court *a quo* rejected SARS' argument that the reference in Article 13(4) of the DTA to gains from the alienation of property did not include a deemed disposal of property as contemplated in par. 12(2)(*a*) of the Eighth Schedule.

Article 13(4) of the DTA provided as follows:

> 'Gains from the alienation of any property other than that referred to in paragraphs 1, 2 and 3, shall be taxable only in the Contracting State of which the alienator is a resident.'

SARS' principal contention was that a deemed disposal provided for in par. 12 of the Eighth Schedule was not an 'alienation' as contemplated in Article 13(4) of the DTA and hence a deemed disposal of an asset was notionally different from an alienation thereof.

Judge Boruchowitz held the following:

(i) That double tax agreements effectively allocate taxing rights between the contracting states where broadly similar taxes are involved in both countries and they achieve the objective of section 108 of the Income Tax Act, generally, by stating in which contracting state taxes of a particular kind may be levied or that such taxes shall be taxable only in a particular contracting state or, in some cases, by stating that a particular contracting state may not impose the tax in specified circumstances. A double tax agreement thus modifies the domestic law and will apply in preference to the domestic law to the extent that there is any conflict.

(ii) That a helpful approach in dealing with the correlation between domestic taxing legislation and a double tax agreement is to be found in *Ostime* (*Inspector of Taxes*) *v Australian Mutual Provident Society* [1959] 3 All ER 245 where it was stated that the first step in any interpretive inquiry is to ascertain where in the scheme of the double tax agreement the relevant tax falls, and then to consider whether the tax can be imposed consistently with the obligations undertaken thereunder.

(iii) That the crisp question that fell to be determined was whether the term ‘alienation’ as used in the DTA included within its ambit gains arising from a deemed (as opposed to actual) disposal of assets and the term must be given a meaning that is congruent with the language of the DTA having regard to its object and purpose.

(iv) That Article 13 of the DTA was widely cast and included within its ambit capital gains derived from the alienation of all property; moreover, it was reasonable to suppose that the parties to the DTA were aware of the provisions of the Eighth Schedule and must have intended Article 13 to apply to capital gains of the kind provided in the Schedule and it was of significance that no distinction was drawn in Article 13(4) between capital gains that arose from actual or deemed alienations of property and there was no reason in principle why the parties to the DTA would have intended that Article 13 should apply only to taxes on capital gains resulting from actual alienations of property.

(v) That, having regard to the factors mentioned, the term ‘alienation’ as it is used in the DTA was not restricted to actual alienation and it is a neutral term having a broader meaning, comprehending both actual and deemed disposals of assets giving rise to taxable capital gains.

(vi) That, consequently, Article 13(4) of the DTA applied to capital gains that arose from both actual and deemed alienations or disposals of property and it followed therefore that from 2 July 2002, when Tradehold relocated its seat of effective management to Luxembourg, the provisions of the DTA became applicable and that country had exclusive taxing rights in respect of all of Tradehold’s capital gains.

(vii) That the Tax Court was therefore correct in holding that SARS had incorrectly included a taxable gain resulting from the deemed disposal of Tradehold’s investment in its income for the 2003 year of assessment.

Appeal dismissed with costs, including those of two counsel.

3.7 C:SARS v De Beers Consolidated Mines Ltd

De Beers Consolidated Mines Ltd, carrying on the business of mining for and selling diamonds internationally, had been approached by a consortium that proposed a complex transaction in terms of which a new company to be established by the consortium would become the holding company of De Beers as well as of a linked Swiss company and effectively the newly established company would become the new owners of De Beers' diamond operations and all associated holdings and was to be incorporated in Luxembourg.

The boards of the De Beers companies resolved to establish an Independent Committee of Directors (ICD) to consider and advise the boards as to whether the consortium's offer was fair and reasonable to independent unit holders and to assist in negotiations with the consortium.

In considering the proposal by the consortium, De Beers engaged the services of NM Rothschild and Sons Ltd (Rothschild), a London-based company, as independent financial advisors in order to advise its board on whether the consortium's offer was fair and reasonable and, at the same time, De Beers appointed a range of South African advisors and service providers, including attorneys, to assist in finalizing the proposed transaction and all of these parties were referred to during the dispute as the local suppliers of local services.

The transaction was implemented through a scheme of arrangement pursuant to section 311 of the Companies Act and the scheme constituted a buy back leg and a cancellation leg, and was sanctioned by the court on 18 May 2001 and implemented shortly thereafter.

After the transaction referred to above had been realised, Rothschild issued an invoice in the amount of US$19 895 965 for the services rendered by it to De Beers, which was settled by the latter at a Rand cost of R161 064 684.

Over the period March 2001 to January 2002 the local suppliers of services in connection with the transaction rendered their invoices and they included VAT in terms of the Value-Added Tax Act, which De Beers treated as input tax in making its own VAT returns.

SARS in its assessment dated 18 October 2004, had determined that Rothschild's services were 'imported services' in terms of Act and had assessed the sum of R22 549 055.76 to be payable by De Beers as VAT in terms of section 7(1)(*c*) of the VAT Act.

SARS, furthermore, determined that the VAT charged by local service providers did not qualify as input tax and raised assessments thereby, in effect, disallowing input tax in the amount of R7 021 855.48.

De Beers lodged an objection against the aforementioned assessments and the objection was disallowed by SARS and it was against that decision that De Beers lodged an appeal to the Tax Court held in Cape Town (see *ITC 1853*).

The Tax Court held that the services provided by Rothschild did not constitute imported services, because they were utilized and consumed by De Beers for the purpose of making taxable supplies in the course or furtherance of its enterprise of mining and selling of diamonds, being a service legally required of a listed company carrying on a continuing enterprise, in the circumstances faced by De Beers, and in light of a statutory obligation of providing advice to the independent unit holders and which advice thus constituted an activity performed in the course or furtherance of De Beers' enterprise.

The Tax Court also found that the VAT paid by De Beers in respect of the local services was not a deductible input tax save insofar as the services of one firm of attorneys (WWB) was concerned.

The present appeal was granted with the leave of the Tax Court and on appeal SARS appeals against:

- The finding of the Tax Court that the services rendered by Rothschild to De Beers did not constitute 'imported services'; and

- The finding of the Tax Court that a part of the VAT on local services rendered by WWB to De Beers constituted deductible 'input tax' in De Beers' hands.

De Beers cross-appealed against the finding of the Tax Court that the VAT charged to it by the providers of local services did not constitute deductible 'input tax' and hence the question before the court on appeal was whether the conclusions by the Tax Court set out above were correct.

The court on appeal noted five features of the transaction in issue that put it in proper perspective and pointed to the real reason for the appointment of the foreign and local service providers:

- It had to be assumed that when the transaction was conceived and the consortium came into being, what was being sought was the acquisition of the whole of De Beers at the most advantageous price to the consortium and what complicated matters was the inter-relationship between certain of the negotiating parties.
- An important factor was that the company to be established which would effectively succeed De Beers would not be a listed company.
- Another feature of the proposal by the consortium was that it had not put any specific price for the acquisition of De Beers on the table and consequently the Independent Committee of Directors (ICD) engaged Rothschild and other London-based financial advisors who had previously advised Anglo American PLC on its listing on the London Stock Exchange and this engagement was aimed at establishing a price that could be put to the De Beers board and the shareholders as being fair and reasonable.
- By resorting to a scheme of arrangement in terms of section 311 of the Companies Act, a lower threshold of shareholder approval was required, namely, 75% as opposed to 90%.
- The ICD had at one stage resolved, after taking advice from Rothschild, that the minimum asking price for De Beers' diamond business was the amount of $6.5 billion and in response the consortium was not willing to pay more than $6.25 billion until three

large institutional shareholders of De Beers indicated their dissatisfaction and the consortium, without any prior indication, increased their offer significantly.

From the outset, when the bid was first tabled, WWB's services were immediately engaged but all the other actors were appointed in anticipation at the first meeting of the ICD in Johannesburg and their collective purpose was to ensure that the transaction materialised without impediment and this they ensured.

De Beers contended on appeal that VAT was not payable on the Rothschild transaction on the ground of what it considered to be the place at which the Rothschild services were consumed, *i.e.* it could rightfully be contended, on the basis of the definition of 'imported services', that the place of consumption was outside South Africa and the conclusion would follow that they could not be categorised as imported services.

De Beers contended that since a number of meetings at which financial advice was received from Rothschild took place outside South Africa, VAT could, at the very least, not be imposed in respect of the proportion of the services related to those meetings.

De Beers contended further that the provision of the services by Rothschild were necessarily attached to and accordingly a concomitant of its mining or commercial enterprise as a public company and as it had chosen to conduct its business as a public company which, while conducting its operations, had certain statutory obligations, it was submitted that these services were directly linked to its making of ongoing supplies. Thus, so it was argued, since these supplies could rightly be said to have been wholly utilised or consumed in the making of supplies, in the course or furtherance of De Beers' mining or commercial enterprise, they did not fall within the definition of imported services.

De Beers further contended that it had acquired Rothschild's services as a necessary input giving rise to an overhead expense, since De Beers could not realistically continue to operate its enterprise without complying with its legal obligation to acquire Rothschild's services.

SARS contended that the purpose in question was the purpose of the acquirer of the service and that, by its nature, the test was subjective. De Beers' reason for engaging Rothschild was to acquire advice in relation to a take-over by parties to which it was related and accordingly its board had a duty to report to the independent unit holders as to whether the offer was fair and reasonable and to obtain independent financial advice in that regard.

SARS further contended that Rothschild's services were unrelated to De Beers' core activities, which was the mining and sale of diamonds. Rothschild was not providing services directed at making any of De Beers' businesses better or more valuable.

Judge Southwood held the following (Leach JA and McLaren AJA concurring)

(i) That the VAT Act creates in section 7(1) three categories of persons liable for VAT:

- the vendor described in par. (*a*) of subsection (1);
- the person who imports goods into South Africa; and
- the recipient of 'imported services' and if the recipient of 'imported services' is a 'vendor' and utilizes or consumes the services in the course of making 'taxable supplies', no VAT liability is incurred.

(ii) That to be entitled to deduct 'input tax' in the calculation of his VAT payable, a vendor must be registered in terms of the Act, must be carrying on an 'enterprise' and must have paid VAT on goods or services which the vendor acquired wholly for the purpose of consumption, use or supply in the course of supplying goods or services which are chargeable with tax under the provisions of section 7(1)(*a*) of the Act (*i.e.* goods or services supplied in the course or furtherance of the 'enterprise').

(iii) That as far as VAT on 'imported services' is concerned, section 7(1)(*c*) and section 7(2) of the Act simply provide that the recipient of the imported services must pay the VAT, and liability for VAT is obviously dependent upon whether the services concerned fell within the definition of ‘imported services’ in the Act, *i.e.:*

> whether it is ‘a supply of services that is made by a supplier who is resident or carries on business outside South Africa to a recipient who is a resident of South Africa to the extent that such services are utilized or consumed in South Africa otherwise than for the purpose of making taxable supplies’.

(iv) That, therefore:

- if the services were not utilized or consumed in South Africa, or
- if utilized or consumed in South Africa they are utilized or consumed for the purpose of making ‘taxable supplies’,

the services would not be imported services and, accordingly, a vendor who acquires ‘imported services’ for the purpose of making ‘taxable supplies’ will not be liable for VAT on the cost of the ‘imported services’.

(v) That the aforementioned means that the same question must be answered in both the appeal and the cross-appeal, *i.e.* whether the services acquired by De Beers were required for the purpose of consumption, use or supply in the course of making ‘taxable supplies’, which meant supplying goods or services in the course or furtherance of the ‘enterprise’ and, in addition, the appeal required a consideration of whether the ‘imported services’ were utilized or consumed by De Beers in South Africa.

(vi) That the primary question required that there be clarity as to the nature of the ‘enterprise’ because the purpose of acquiring the services and whether they were consumed or utilized in making ‘taxable supplies’ could only be determined in relation to a particular ‘enterprise’ and what the ‘enterprise’ consisted of was a factual question, *i.e.* there had to be a particular activity which complied with all the requirements in the definition.

(vii) That there was no doubt that De Beers' 'enterprise' consisted of mining, marketing and selling diamonds and there was no merit in De Beers' contention that the definition of 'enterprise' incorporated two separate definitions which would mean that it would provide for two categories of 'enterprise' and these were to be found in par. (*a*) of the definition but the purpose of the words following 'including' was to make certain that the specific categories of activity referred to were included in the definition of 'enterprise'.

(viii) That, in the circumstances of this case, where De Beers is not a dealer in shares, the holding of shares and receipt of dividends by De Beers did not fall within the definition of 'enterprise' and it had to be found that De Beers' 'enterprise' for the purposes of the Act consisted of mining, marketing and selling diamonds.

(ix) That the question to be answered therefore was whether Rothschild's services were acquired for the purpose of making 'taxable supplies' in that 'enterprise' and the answer was clearly no. De Beers had acquired Rothschild's services because De Beers was the target of a take-over by parties to whom it was related and De Beers' board had a duty to report to independent unit holders as to whether the consortium's offer was fair and reasonable and to obtain independent financial advice in that regard. Such services were not acquired to enable De Beers to enhance its VAT 'enterprise' of mining, marketing and selling diamonds and the 'enterprise' was not in the least affected by whether or not De Beers acquired Rothschild's services. They could not contribute in any way to the making of De Beers' 'taxable supplies' and they were also not acquired in the ordinary course of De Beers' 'enterprise' as part of its overhead expenditure and they were supplied simply to enable De Beers' board to comply with its legal obligations.

(x) That the parties' reliance on foreign precedent in this regard was misplaced as the cases cited reached conflicting conclusions on substantially the same issue but in relation to provisions of the Canadian and Australian income tax statutes and the tests to be applied in terms of the relevant statutes differed from those of the Act; moreover, the facts differed from the facts of the present case and the cases did not deal with VAT or its equivalent in the two countries and the answer in the present case must be obtained by applying the provisions of the Act to the facts.

(xi) That the same reasoning regarding the making of 'taxable supplies' applied to the VAT paid on the services provided by the South African service providers as the services were provided for multiple purposes which included: enabling De Beers to comply with its statutory obligations to its unit holders; providing De Beers with tax advice on the implementation of the transaction; and obtaining the necessary court and unit holder approval in terms of section 311 of the Companies Act and the services were not acquired for the purpose of making 'taxable supplies' by an 'enterprise' which mines, markets and sells diamonds.

(xii) That, accordingly, the appeal was upheld with costs, including the costs attendant upon the employment of two counsel and the cross appeal was dismissed with costs, including the costs attendant upon the employment of two counsel.

<u>Per Navsa JA and Van Heerden JA</u>

(i) That the facts of the present case were unique and hardly likely to be duplicated and, in any event, the conclusions reached were based on the curious facts of this particular case.

(ii) That the first issue for decision was whether Rothschild's services were utilised or consumed by De Beers for the purpose of making taxable supplies in the course or furtherance of De Beers' enterprise of buying and selling diamonds and in this regard it was necessary to consider definitions and certain key concepts provided for in the Act.

(iii) That the submissions on behalf of SARS were undoubtedly correct, *i.e.* that Rothschild's services were unrelated to De Beers' core activities, which was the mining and sale of diamonds and Rothschild was not providing services directed at making any of De Beers' businesses better or more valuable and it was the interest of De Beers' departing shareholders and investors, rather than the interest of De Beers itself, that formed the focus of Rothschild's services.

(iv) That the court was unpersuaded by De Beers' contention that, on the evidence presented in the court below, a natural outflow of the protracted negotiation process were real advantages that redounded to the benefit of the diamond business and that, therefore, overall, the transaction was for the purposes of making taxable supplies.

(v) That De Beers belatedly and tentatively suggested that, in considering the definition of 'enterprise', the court should consider that there were two categories of enterprise encapsulated in par. (*a*) of the definition, the first of these being defined in that part of par. (*a*) which concluded with the word 'profit', while the second was to be found in that part of par. (*a*) commencing with the word 'including' and that once a vendor falls within the ambit of the definition of 'enterprise' (regardless of whether in the first or in the second category), any activity whatsoever of that enterprise formed an integral part and parcel of the enterprise, unless such activity was excluded in terms of par. (*v*) of the proviso thereof.

(vi) That De Beers' submission was wholly without merit – the word 'including' indicated that what followed was illustrative of what preceded it and there was no room for an interpretation that two categories of 'enterprise' were envisaged. Even though a company can engage in a number of different activities, the discrete 'investment category' sought to be relied upon in relation to De Beers' Anglo American PLC shareholding was, for the reasons stated above, untenable.

(vii) That, in regard to the place of consumption, what was required was a practical approach to that question – De Beers was a South African company, with its head offices situated in Johannesburg. That was where the independent committee of directors (ICD) met initially and resolved to acquire the services of Rothschild and the local service providers. That was where the full board of De Beers finally met to receive and approve the recommendation by the ICD. The section 311 scheme of arrangement, without which the transaction could not have been executed, was approved and implemented in South Africa and the fact that some meetings were held with Rothschild outside of the country could hardly be used to justify the conclusion that the services were not consumed in South Africa. On the contrary, the compelling conclusion was that Rothschild's services were consumed in South Africa.

(viii) That in regard to the issue whether the local services had been acquired by De Beers 'for the purpose of consumption, use or supply in the course of making taxable supplies', the same questions arise as with the primary question dealt with at the outset and it is necessary to recount the identity of the providers of local services utilised by De Beers in realising the transaction in question and to indicate the role played by each and the same reasoning in relation to Rothschild's services applies in respect of the provider of local services – in short, the services were acquired for the purposes of dealing with the proposal by the consortium and, from the outset, the intention was to ensure that the scheme conceived by Mr Oppenheimer materialised.

Appeal upheld with costs and the cross-appeal was dismissed with costs.

3.8 Armgold / Harmony Freegold Joint Venture (Pty) Ltd v C:SARS

Armgold / Harmony Freegold Joint Venture (Pty) Ltd (JV) was a company with limited liability established as a joint venture between the Armgold and Harmony groups of companies and its mining income was derived from working its three gold mines, respectively known as Freegold, Joel and St Helena.

During the 2003 and 2004 years of assessment, before any deduction for capital mining expenditure had been made but after the deduction of operating expenses, both the Freegold and Joel mines had produced a taxable income whereas the St Helena mine had operated at a loss.

The capital expenditure incurred in respect of both the Freegold and Joel mines, if deducted from the amount of their taxable incomes, was sufficient to reduce their taxable incomes to nil and neither the Freegold mine nor the Joel mine had a balance of assessed loss carried forward from the preceding year of assessment.

JV had derived a taxable income from non-mining operations and the amount of which exceeded the operating loss of the St Helena mine in each year.

The issue before the court was to determine the method by which deductions for capital expenditure and assessed losses are to be applied in the calculation of the taxable income of a mining company which owns and operates more than one mine, not all of which operate profitably and which also receives income from non-mining activities.

SARS had issued revised tax assessments for JV, adjusting its income tax liability for the 2002 to 2005 tax years and one ground was relevant to this appeal which related solely to the 2003 and 2004 years of assessment in that for those tax years SARS had set off the losses of the St Helena mine against the taxable income of the Freegold and Joel mines before taking into account the mining capital expenditure incurred in respect of those mines and the effect of this was to reduce the amount of capital expenditure that could be redeemed in respect of the Freegold and Joel mines.

JV objected to the revised assessment but its objection was disallowed and it then appealed to the Johannesburg Tax Court where its appeal was dismissed (see *ITC 1854*) and thereafter it appealed to the Supreme Court of Appeal with leave of the Tax Court.

JV contended that the loss of the St Helena mine effectively amounted to its ‘assessed loss’ as envisaged by section 20(1)(*b*) of the Income Tax Act and it therefore argued that in order to assess its taxable income, each mine should be regarded as being a separate trade and that, doing so, in order to calculate JV’s final taxable income the ‘assessed loss’ of the St Helena mine could only be deducted under section 20(1)(*b*) of the Act once the taxable incomes of the other mines (trades) had been determined.

JV, in addition, submitted that as section 36(7F) required the taxable incomes of each individual mine to be determined separately, approaching the assessment in the manner SARS has done resulted in the operating expenses of the St Helena mine being used to reduce the Freegold and Joel mines' taxable incomes before capex and this, it submitted, was impermissible, both as it offended section 20(1)(*b*) and as the Act, by ring-fencing those mines, intended their pre-capex taxable incomes to be determined by each individual mine's gross incomes and deductions.

JV contended that all of the above showed that it was impermissible to allow the St Helena loss, incurred by deducting its operating expenses from its gross income, to be deducted from the taxable income of the Joel and Freegold mines as, to do so, would amount to setting off of St Helena's operating expenses against the other two mines' incomes to determine their taxable incomes before making their capex deductions.

In essence JV had contended that each of its mines should be regarded as a separate trade, resulting in each of its profitable mines being entitled to deduct the full cap of its capex calculated under section 36(7F) of the Act without any regard being had to the loss suffered by another of its mines whereas SARS had sought to apportion that loss between JV's profitable mines and to reduce their taxable incomes before capex, reducing the amount of the capex deduction of each profitable mine.

Judge Leach held the following:

(i) That the operation of the scheme of the Income Tax Act in relation to the deduction of mining capital expenditure lies at the heart of this appeal: Section 15(*a*) authorises a deduction from the income derived by a taxpayer from its mining operations of 'an amount to be ascertained under the provisions of section 36' *in lieu* of certain other allowances (those allowances are of no relevance in the present case). Section 36(7C) in turn prescribes that subject to sub-sections 36(7E), (7F) and (7G) the amounts to be deducted under section

15(*a*) ‘from the working of any producing mine shall be the amount of capital expenditure incurred’ and in this somewhat tortuous way the legislature has allowed for the deduction of capital expenditure incurred in respect of any producing mine.

(ii) That it must be stressed that sub-sections 36(7E) and (7F) allow only a deduction of mining capital expenditure and they do not impinge upon the ambit of section 11(*a*) of the Act which allows the deduction of mining operating expenditure as an expense ‘not of a capital nature’ incurred in the production of income.

(iii) That, as stated in *Silke On South African Income Tax* (vol 2 at 16-10 to 16-11), section 36(7E) limits ‘the deduction of the aggregate of capital expenditure determined under section 36(7C) in a particular year of assessment in relation to any mine or mines to what is here referred to as the ‘gross mining taxable income’ derived by the taxpayer from mining [and] thus sets a general cap on a taxpayer’s deductions of capital expenditure.’

(iv) That section 36(7E) was in due course followed by the promulgation in 1985 of section 36(7F) as the legislature clearly felt that section 36(7E) did not go far enough and that further protection of the tax base was required in the event of a mining company owning more than one mine and thus the section introduced what is commonly called a ‘capex per mine ring-fence’, a restriction that ‘provides that deductible capital expenditure in relation to any one mine cannot exceed the taxable income ... derived by the taxpayer from mining on that mine’.

(v) That the main point of departure between the two sides lay in SARS having deducted the St Helena loss for the year in question – such loss being arrived at by deducting its operating expenses from its gross income under section 11(*a*) – from the taxable income before capex of the two remaining mines after apportioning such loss between them, thereby reducing the taxable income before capex of each profitable mine and, at the same time, reducing their capex deductions.

(vi) That it cannot be seen how the mining activities conducted by JV at each one of its three mines could be said to be a separate 'trade' – defined in section 1 of the Act as including, *inter alia*, 'every profession, trade, business, employment, calling, occupation or venture ...' – from that conducted at the other mines. A company which carried on mining operations certainly carried on the 'trade' of mining, but it would be both fanciful and artificial to regard its mining operations at the St Helena mine as being a different trade from the operations it conducted at its other two mines and had the legislature intended each mine's operations to be regarded as a separate trade, it could easily have said so; moreover, not only did it not, but the provisions of section 36(7E) in which reference is made to the 'aggregate of the amounts of capital expenditure ... in relation to any mine or mines', clearly excluded different mining operations being regarded as different trades and JV's argument based upon the necessity to regard its operations at its different mines as different trades had to fail.

(vii) That, however, much of JV's criticism of SARS' method of assessment had merit: section 36(7F) of the Act envisaged the capex deduction of each mine to be determined by having regard to the taxable income derived from that mine, an objective that will be defeated if the operating expenses incurred of one mine are to be taken into account in respect of another and, most importantly, section 36(7C) provides for the amount to be deducted under section 15(*a*) to be the capital expenditure on a particular mine, determined by the income derived from working that mine and violence would be done to this if the operating expenses of one mine were set-off against the income of another and it was impermissible to do so.

(viii) That did not mean, however, that JV had correctly calculated its taxable income and the court's concern with its method was that it effectively excluded the operation of section 36(7E) of the Act and it must be remembered that section 36(7E) of the Act sets the maximum amount of capital expenditure that may be deducted in respect of the aggregate of JV's taxable income before capex derived from its various mines (the so-called 'general cap') and this did not mean that its full cap must necessarily be allowed and as not all of JV's mines had produced a taxable income at that stage it must of necessity mean that the aggregate mining taxable income will be less than the combined taxable incomes of just those that have been profitable.

(ix) That, consequently, the general cap under section 36(7E) must of necessity be less than the aggregate of the taxable incomes of the profitable mines – and the taxpayer will not be entitled to deduct the full amount of each particular cap calculated in respect of those profitable mines as would have been the case had the St Helena mine not operated at a loss as to hold otherwise would be to permit the deduction of an amount exceeding the general cap prescribed by section 36(7E) of the Act.

(x) That the amount to be determined under section 36(7E) was the taxable income to JV's mining operations from all its mines, and in determining that amount the gross incomes and the operating expenses of all three mines had to be taken into account. The taxable income of a taxpayer is, after all, determined by deducting operating expenses from gross income, and the St Helena loss therefore cannot just be left out of reckoning and, accordingly, JV's taxable income before capex derived from its mining activities must be assessed at the sum of R1 146 million, *i.e.* R51 million less than the aggregate of the capex that JV wished to have deducted in regard to its Freegold and Joel mines.

(xi) That the end result is that, by reason of the operation of section 36(7E), JV was not entitled to deduct the full caps of the capex it calculated in respect of the Freegold and Joel mines but, rather, lesser amounts and the issue then becomes, how should the individual amounts of capex in respect of the Freegold and Joel mines be reduced?

(xii) That although section 36(7F) provided for a maximum or particular cap that may be deducted for capital expenditure in respect of each of the Freegold and Joel mines, it did not necessarily entitle JV to deduct the full amount of each such cap and thus the answer seemed to be for the individual capex caps of the Freegold and Joel mines to be reduced so that their total did not exceed the general cap imposed by section 36(7E) and in this way the two sub-sections will work *in tandem*, setting a maximum total deduction and reducing the Freegold and Joel mines maximum caps proportionally and this is similar to what is done when it becomes necessary to apportion between trades a balance of assessed loss brought into reckoning from a previous year.

(xiii) That the simplest method of calculating the amount of the allowable capex deduction was to deduct the amount of JV's taxable income from its mining operations from the total of the taxable incomes of the Freegold and Joel mines and to apportion the difference between the two mines in the manner described. Doing so, using the same ratio of approximately fifty to one used by SARS reduces the Freegold mine's capex deduction and that of the Joel mine, with the balance of capital expenditure in respect of those two mines standing over to the succeeding year under section 36(7F) being increased accordingly.

(xiv) That the result as determined by the court was the same result that was arrived at by SARS but that was a matter of arithmetic and not of principle as the underlying principles giving rise to the calculations differed and although the result may be the same, the route followed to reach it was different.

(xv) That, accordingly, it was clear that JV's principal and alternative argument based upon section 36(7G) could not succeed.

Appeal dismissed with costs, such costs to include the costs of two counsel.

3.9 ITC 1860

The taxpayer was a close corporation that carried on business in key account trade marketing which consisted of negotiating the listing and sales of mainly food products manufactured or imported by its principals, most notably supermarkets and departmental stores, with major retail corporates and its business also entailed the provision of promotional activities relating to the products of its clients and all related and ancillary activities including advising clients on various pricing issues, placement of clients' products, promotions of their products and assisting with consumer complaints.

It was common cause that in all the tax years under consideration the taxpayer's nature of business never changed except for the 2005 and 2006 years of assessment when the labelling of its business activities was described as 'marketing consultancy'.

The taxpayer employed one person on a half-day basis as a personal assistant during the relevant tax years and also employed subcontractors to carry out its functions in certain areas of South Africa in order to extend the scope of its activities and in carrying out these functions the taxpayer and its sub-contractors acted on the instructions of their principals.

The taxpayer had, in respect of the 2005 and 2006 years of assessment, submitted its tax returns on the basis that it was a small business corporation in terms of section 12E of the Income Tax Act and in the annual financial statements for these years the main income of the company was described as 'fees received, which ... represents the invoiced value of services provided to clients' and in the tax returns the taxpayer's business was stated as 'Marketing'.

The taxpayer was accordingly assessed for the 2005 and 2006 tax years as a small business corporation and it was common cause that the assessed taxes had been paid timeously.

Thereafter, SARS had issued additional assessments for the years 2005 and 2006 in which he had re-assessed the taxpayer as a company rendering a personal service and not as a small business corporation with the result that the taxpayer lost out on the concessionary tax rate accorded to small business corporations.

The taxpayer filed objections to the additional assessments on the ground that it met all the requirements for classification as a small business corporation in terms of section 12E of the Act in that it did not derive any income from the provision of a personal service and that its investment income for the relevant years was minimal but these were disallowed by SARS.

The taxpayer had also objected to SARS's refusal to issue revised income tax assessments for the years 2003 and 2004.

SARS was of the view that the taxpayer was not a small business corporation as contemplated in section 12E(4)(*a*)(iii) of the Act as it provided a personal service as defined in section 12E(4)(*d*) of the Act and derived more than 20% of its receipts and accruals from the provision of that service and from investment income, as prescribed by section 12E(4)(*a*)(iii) of the Act and was consequently not eligible for the concessionary tax rates applicable to small business corporations.

SARS further contended, in regard to its allegation that the taxpayer was rendering a personal service, that this was in the form of broking, consulting and management as contemplated in section 12E(4)(*d*) of the Act and that the services in question were performed personally by a person who held an interest in the taxpayer and who either acted alone or in conjunction with others.

SARS further contended that the assessments in respect of the 2003 and 2004 tax years had prescribed.

The court had to determine the following issues:

- whether the taxpayer qualified to be categorised as a small business corporation as contemplated in section 12E(4)(*a*) of the Act and in which case it would qualify for a concessionary tax rate, and if so;
- whether the taxpayer was barred from using such categorisation on the grounds that section 12(4)(*a*)(iii) read with section 12(4)(*d*) of the

Act operated against its categorisation as a small business corporation;

- in respect of the 2003 and 2004 tax years, whether the taxpayer was barred from contesting the years referred to on the grounds that no proper objection and appeal process were followed, alternatively, whether prescription did not find application in respect of those tax years.

The fields of activity listed as personal services in section 12E(4)(*d*) of the Act fell into two categories – the first of which is accounting, actuarial science, architecture, auctioneering, auditing, broking, draftsmanship, education, engineering, health, information technology, law, management, real estate, research, secretarial service, surveying, translation, valuation and veterinary service which are all professional or quasi-professional activities, requiring a particular qualification and, in many cases, a licence, certificate, or membership of a professional body before the person concerned can participate in that activity. The second category comprised broadcasting, commercial arts, entertainment and sport, none of which was relevant to the activity carried out by the taxpayer.

Judge Mbha held the following:

(i) That in deciding whether the taxpayer qualified as a small business corporation or not, the enquiry must of necessity be directed at the following:

  - what was the meaning of the words ‘consulting, broking and management’ in the definition of ‘personal service’ found in section 12E(4)(*d*) of the Act and did any of the above terms describe any part of the taxpayer’s activities?
  - And if the taxpayer did in fact provide any of the personal services referred to in section 12E(4)(*d*) of the Act, was any specific income generated by a person who was a member of the company and, if so,
  - did such income collectively with any investment income exceed 20% of the taxpayer’s receipts and accruals and capital gains?

(ii) That it is accepted generally that the meaning of words in a statute is derived from the common law and the basic rule of interpretation is that the meaning must, unless a statute provides otherwise, or unless it would result in an absurdity, be taken to be the ordinary meaning of the word which can be found in a dictionary of established authority.

(iii) That if there is any doubt about the ordinary meaning of a word used in a particular context, certain rules must be applied. There are two rules relevant to this matter: A word included in the group of words must be regarded as being of the same type as the other words in that group (*eiusdem generis*); on the other hand, if a word is not included in the group, it must not be regarded as subject to the same prescriptions as that group (*exclusio alteris*).

(iv) That the term 'consulting' as used in section 12E(4)(*d*) of the Act is not defined in the Act or in any other applicable law in South Africa and since there are no definitions of 'consulting' in the Act or in any other statute or judicial ruling, the rules already referred to that are applicable to the definition of terms used in a statute must be applied and these rules are well-established in our law and the basic rule is that in the absence of any legislated manner or binding judicial ruling, the meaning attributable to any word must be the meaning of the word as generally used which can be ascertained by referring to a dictionary.

(v) That the definitions of 'consulting' in the standard dictionaries reveal that there are several meanings to the nouns derived from the verb 'consult', namely consulting, consultant and consultation, and to the verb itself, and these fall into three major categories but the meaning of 'consulting' as referred to in section 12E(4)(*d*) of the Act fell into the second category (those derived from the intransitive verb 'consult' which means to offer advice or information by such person), as the activities referred to in the first and third groups did not normally involve any commercial transactions and would therefore not be relevant for taxation purposes.

(vi) That it was necessary to establish the intention of the legislature when passing the relevant provision and the legislature's intention embodied in section 12E of the Act could clearly be seen from the contents of SARS' Interpretation Note 9 (*supra*) which was issued at the time of the introduction of that section and, accordingly, in interpreting the term 'consulting' as applicable to a personal service provided by a small business corporation for the purposes of section 12E(4), the term 'professional person' is crucial in defining that term.

(vii) That the view that a person providing a consulting service must of necessity be a professional person, or someone of that nature, is supported by the application of the *eiusdem generis*-rule of interpretation and since the term 'consulting' is the least easily defined of all the terms, the rules of interpretation that have been referred to must be strictly applied and the dictionary definition of the term must be applied and it must be regarded as the offering of advice by a professional or qualified person and this approach is fortified by the specific reference to a 'professional person' in Interpretation Note 9 explaining the legislature's basis of section 12E.

(viii) That the taxpayer, in its own right, as a close corporation could not hold a certificate as a 'professional person', nor did the sole member of the taxpayer hold any such licence, certificate or membership of a professional body and it is accordingly concluded that the taxpayer in this case was not involved in the business of 'consulting' as used in section 12E(4)(*d*) of the Act.

(ix) That, in any event, even if no definite conclusion as to the interpretation of the term 'consulting' could be arrived at by the application of any of the rules of statutory interpretation referred to, then the *contra fiscum* rule must be applied and the statute interpreted in favour of the taxpayer as, in terms of this rule, where a taxing statute reveals an ambiguity and the ambiguous provision is capable of two constructions, the court will place a construction on the one that imposes a smaller burden on the taxpayer.

(x) That in regard to the question whether the taxpayer's activities constituted 'broking' and/or 'management' and having regard to the nature of the business activities of the taxpayer, it was clear that it did not conduct any broking transactions on behalf of its clients nor did it purport to act as a broker in any way; moreover, the taxpayer clearly did not control or direct the activities of its clients and the management function rested with the taxpayer's clients and hence the terms 'broking' and 'management' did not apply to any of the activities conducted by the taxpayer.

(xi) That SARS' contention that the taxpayer rendered a 'personal service' as defined in section 12E of the Act could not succeed and, having regard to the entire activities of the taxpayer, none of which is disputed by SARS, the taxpayer's explanation that providing advice to its clients was merely an incidental part of the services provided is accepted and that no income was directly attributable from that specific type of activity and even if any part of the taxpayer's income would be derived from negotiating on behalf of his clients it will not be possible to quantify that amount and, in the circumstances, the taxpayer's contention that the amount, if any, earned from that particular activity could not exceed 5% of the total income derived by the taxpayer was not far-fetched.

(xii) That in respect of the 2003 and 2004 tax years, it was common cause that the taxpayer did not lodge a proper objection and no appeal process was followed in respect of those years but, in any event, in terms of section 81(2) of the Act, the assessments in respect of the years of assessment 2003 and 2004 had prescribed.

(xiii) That, in the light of the above, SARS was incorrect in deciding that the taxpayer was a personal service provider as defined in section 12E of the Act as its activities did not constitute a personal service; alternatively, that the revenue generated by any personal service provided by a member of the taxpayer did not exceed the prescribed amount.

(xiv) That, in the result, SARS was ordered to withdraw the revised assessments for the years 2005 and 2006 and to issue revised assessments for the years of assessment 2005 and 2006 in terms of which the taxpayer was taxed as a small business corporation in terms of section 12E of the Act.

Appeal upheld with costs.

3.10 Rossi & others v C:SARS

Third Applicant had provided civil engineering services for which it used sub-contractors who invoiced it for such services.

SARS had inspected Third Applicant during October 1999 and this resulted in an opinion that Third Applicant was liable for payment of employee's tax in respect of these sub-contractors in the relevant periods in the total sum of R467 390.

Third Applicant and Respondent were not able to resolve the issue in negotiations and then Third Applicant received a demand for payment in March 2007 which resulted in its auditors filing an objection in terms of section 81 of the Income Tax Act which was dismissed by SARS on 2 July 2007 on the grounds that it had been filed after expiry of the three year period allowed for such objection.

Third Applicant, following further correspondence, made payments to SARS in May and October 2008 and in March 2009 SARS, acting in terms of section 99 of the Act, attached monies in First Applicant's bank account.

Applicants' case before the court had two aspects:

- They challenged the status of the disputed 'assessment' or extract therefrom on the basis of an averred failure to comply with the provisions of the Income Tax Act;
- They disputed the very claim for tax itself on the basis that they were not liable to deduct employee's tax in respect of the sub-contractors

and, even if there had been a valid assessment to this effect, such would be incorrect.

SARS was of the view that its 'extract' from the assessment provided was 'conclusive evidence of the making of such assessment, and ... shall be conclusive evidence that the amount and all particulars of such assessment are correct'.

SARS further submitted that Third Applicant was presently in arrears in an amount of R306 910, 73 which precluded any refund to Applicants.

SARS further pointed out that Applicants had taken eleven years to challenge the validity of the 1999 assessment and had provided no explanation for what was submitted to be an 'inordinate delay.' Furthermore, the 'assessment' in dispute was issued on 20 October 1999 and the present application was launched nearly ten years later and hence Third Applicant did not timeously object in terms of section 81 of the Act which prescribed certain time periods for noting such an objection. Lastly, there were a number of disputes of fact and these were on material issues, *i.e.* whether or not there was ever an assessment compliant with the Act, the status of the 'extract' submitted by SARS and the merits of Applicants' challenge to the basis of SARS's claim for the taxes recovered.

Applicants contended that an application for a refund, in terms of section 102, could not be brought before the Tax Court because that court was a creature of statute which was only empowered to review the correctness of assessments on appeal in terms of section 83(1) of the Act and accordingly it was argued that the Tax Court was not clothed with the necessary jurisdiction to adjudicate upon applications under section 102 of the Act.

Applicants further contended that a taxpayer who had failed to follow the remedies set out in the Act had available to it an additional and alternative forum, namely the High Court, which exercised concurrent jurisdiction with both the Tax Court and SARS.

Judge Satchwell held the following:

<u>As to jurisdiction of the Tax Court</u>

(i) That this application can and should be decided on the issue of jurisdiction alone.

(ii) That once there is an assessment or purported assessment, the starting point for expression of dissatisfaction of any sort is to lodge an objection as provided for in terms of section 81 of the Act and this was done by the Applicants but their objection was disallowed on the grounds that it was lodged out of time and thereafter Applicants had not taken SARS's decision to disallow the objection on either objection or appeal as provided for in terms of the Income Tax Act.

(iii) That a dissatisfied taxpayer may appeal against such assessment to the Tax Court as provided for in terms of section 83 of the Act but this was not done by the Applicants and they were precluded from doing so by their failure to comply with the time periods.

(iv) That the court was in agreement with what was stated in *Van Zyl NO* v *The Master and Another* 49 SATC 165, *i.e.* that the only way in which the assessment in issue could be questioned was in the manner provided for in the Income Tax Act by objecting to the SARS in terms of section 81 of the Act and then appealing to the Special Tax Court in terms of section 83 of the Act; moreover, the Act specifically prescribes that procedure and entrusted the determination of the amount owing to SARS and, on appeal from his decision, to the Special Income Tax Court.

(v) That since Applicants had disputed the existence of any assessment and disputed that the letter in issue was an 'extract' of or from an assessment as provided for in the Act, those issues and disputes become, in line with *Van Zyl*, *supra*, a matter for SARS to determine and thereafter the only way in which it is open to Applicants to challenge the assessment or amount claimed 'is a matter for the Special Court.'

(vi) That the Special Court constituted in terms of section 83(4) of the Act is a specialised court composed of the President who is a Judge of the High Court and two assessors, one of whom is an accountant and the other a commercial person and the benefits to the taxpayer of such a specialised Tax Court was expressed in *Metcash Trading Ltd* v *C: SARS and Another* where the court referred to it as 'that specialist tribunal' which was 'specifically tooled to deal with disputed tax cases' and the motion court of the High Court was certainly not a court 'specifically tooled to deal with disputed tax cases'.

(vii) That the reason why Applicants approached this court and sought to claim a different jurisdiction in respect of applications for refund in terms of section 102 of the Act was solely by reason of their failure to comply with time periods and the fact that they now perceived themselves to be beyond the reach of any other forum.

(viii) That, in any event, the order sought by Applicants was not an interim order but was a final order and the Constitutional Court in *Metcash*, *supra*, found that the High Court had jurisdiction to adjudicate upon tax matters only in circumstances where the relief sought was of an interlocutory nature.

(ix) That, furthermore, where the High Court did have jurisdiction to hear and determine income tax cases it would appear to be in respect of legal issues alone but as to whether a matter for decision involves a matter of fact or a matter of law must be decided by the president of the Tax Court sitting alone.

<u>As to the application of section 102 of the Act</u>

(x) That section 102(1)(*a*) of the Act provided that any amount paid in respect of any assessment by any person shall be refundable to the extent that such amount paid exceeded the amount so assessed.

(xi) That Applicants' argument that section 102 was enacted solely to assist a taxpayer who has not availed itself of prescribed remedies or has been unsuccessful in the exercise thereof was untenable and, indeed, the judgments in *Estate H M Brownson* v *CIR and Others*, *Crown Mines Ltd* v *CIR* and *Stroud Riley & Co Ltd* v *SIR* were not of assistance to Applicants; moreover, the aforesaid judgments are certainly not authority for Applicants' proposition that a taxpayer who has failed to follow the remedies set out in the Act has available to it an additional and alternative forum, namely the High Court, which exercises concurrent jurisdiction with both the Tax Court and SARS.

(xii) That it seemed clear that the Constitutional Court took the view that both objection and appeal were to be considered by the same tribunal – namely by the Income Tax Court constituted in terms of section 83 of the Act and it was therefore difficult to conceive why an Applicant should argue that a non specialist court would have concurrent jurisdiction.

(xiii) That the end result would appear to be that the aggrieved taxpayer must proceed to challenge the assessment in terms whereof payment has been made or extracted and in this case the taxpayer applicant had the opportunity to dispute whether or not the letter received or the demand made or the purported extract was an 'assessment' and that dispute should have been aired by way of objection and then by way of appeal to the Tax Court – and within the prescribed time periods.

(xiv) That, accordingly, the court did not exercise jurisdiction to decide this dispute and the dispute should have been pursued by way of an objection lodged with SARS and thereafter appealed to the Special Tax Court which is the appropriate forum for these matters.

Application dismissed with costs.

3.11 Modibane v SARS

SARS had issued an assessment for income tax, interest and additional tax against Modibane on 13 August 2007 and in terms of the assessment Modibane was liable to SARS in an amount of R22 million.

The aforementioned amount was not paid and on 17 January 2008 Modibane lodged an objection to the assessment which was dismissed on 30 January 2008.

Thereafter on 7 March 2008 Modibane lodged an appeal to the Tax Court against the disallowance of the objection and this appeal was still pending.

After several attempts were made by SARS to discuss Modibane's tax liability and which discussions were proving fruitless, SARS, on 5 March 2009, acting in terms of section 91(1)(*b*) of the Act, obtained judgment from the Registrar of the High Court against Modibane and the judgment was in the amount of R25 million inclusive of interest.

Modibane, on 18 November 2009, had approached SARS to request that the judgment be withdrawn as he stood to lose a substantial tender should the judgment be allowed to stand.

SARS refused to have the judgment withdrawn against Modibane and on 16 March 2011 Modibane launched the present application to have the judgment rescinded.

At the hearing of the application Modibane contended that the judgment was rescinded by Sutherland AJ on 3 May 2011 but SARS averred and contended that the order rescinding the judgment had been recalled by Sutherland AJ after Modibane had been duly notified and failed to attend court when the order was recalled.

When Sutherland AJ had been apprised of the full facts he recalled the order rescinding the judgment after Modibane had been notified that the order was to be challenged or recalled and the order of Sutherland AJ recalling the earlier rescission of judgment accordingly stood and was effective and at the hearing of this application the judgment in issue was thus no longer rescinded and stood.

The court then requested Modibane to argue the application for rescission of judgment.

Modibane contended that as there was at all material times, and still was, an appeal pending in the assessment, it was incorrect of SARS to proceed to obtain judgment against him.

Judge Tsoka held the following:

<u>As to whether Commissioner's statement in terms of section 91(1) was a judgment</u>

(i) That in terms of section 81 of the Act a taxpayer has a right to object to the assessment and if the objection is disallowed the taxpayer is, in terms of section 83 of the Act, entitled to appeal against the assessment to the Tax Court.

(ii) That, however, in terms of section 88(1) of the Act, prior to its amendment by the Taxation Laws Amendment Act 18 of 2009, the obligation to pay any tax and SARS' right to receive and recover any tax under the Act is not suspended by such an appeal and from the plain language of section 88(1) it was clear that a taxpayer's obligation to pay tax and SARS' right to receive and recover tax is not suspended by an objection or appeal to the Tax Court, unless SARS directs that such taxpayer's obligation to pay tax and its right to receive and recover tax is suspended.

(iii) That it was somewhat misleading to refer to the certified statement by SARS filed with the Registrar in terms of section 91(1) of the Act as a judgment as the Registrar was not granting any judgment or making any pronouncement on the statement. The statement merely had the effect of a civil judgment as if it were indeed a civil judgment. The sole purpose of the provisions of section 91 was to compel a taxpayer to comply with his obligations to pay tax and to facilitate SARS' right to receive and recover such tax that is due and payable.

(iv) That it was agreed that the observation made in *Capstone 556* (*Pty*) *Ltd* v *C: SARS and Another* 74 SATC 20 that the certified statement by SARS in terms of section 91(1) of the Act was not a judgment in the ordinary sense of the word was correct; moreover, if the statement was a judgment it could not be seen how the said judgment could, in terms of section 91(1)(*b*A), be unilaterally withdrawn by SARS and again SARS be at liberty to institute proceedings afresh based on the said withdrawn statement.

(v) That the provisions of section 91(1) of the Act were enforcement and recovery mechanisms enabling SARS to carry its obligation in terms of the Act, that is, to receive and recover any tax owed to it by a taxpayer and, if necessary, to execute on the certified statement which has all the consequences of a civil judgment.

(vi) That no judgment in the ordinary sense of the word was granted by the Registrar on 5 March 2009 and there was consequently no judgment that was susceptible for rescission, either in terms of the rules or the common law and particularly having regard to the provisions of section 92 of the Act and that, accordingly, disposed of the issue, *i.e.* there was no judgment to be rescinded by the court but in the event that the conclusion reached above was incorrect, then the court would continue to deal with the matter as followed.

<u>As to the requirements for 'sufficient cause'</u>

(vii) That in the event that the Registrar had granted judgment on 5 May 2009, in the ordinary sense of the word and as understood by the Modibane, and which judgment was susceptible to rescission, then Modibane must show sufficient cause why the said judgment should be rescinded.

(viii) That 'sufficient cause' or 'good cause' defied precise definition but the long-standing practice of our courts has established that 'sufficient cause' comprised of two essential elements – *i.e.* that (*a*) the party seeking relief must present a reasonable and acceptable explanation for his default and (*b*) that on the merits such party had a *bona fide* defence which *prima facie* carried some prospect of success and these elements must be met by a party seeking to rescind a judgment granted in his absence (see *Chetty* v *Law Society of Transvaal* 1985 (2) SA 756 (A)).

(ix) That Modibane had reacted to the assessment precisely because he had received the assessment and he was without doubt aware of the judgment otherwise PWC would not have notified SARS that an appeal would be lodged against the assessment.

(x) That as a result of Modibane's recalcitrant attitude and his failure to co-operate in this matter, SARS on 5 March 2009 had filed the certified statement in terms of section 91 of the Act and upon the judgment having been entered against Modibane same was delivered at his residence.

(xi) That in the result Modibane had been in wilful default.

(xii) That the provisions of section 91(1)(*b*) of the Act were clear – notwithstanding that an objection and appeal had been lodged, SARS was entitled to obtain judgment against Modibane who was not without remedy should his appeal succeed as in terms of section 88 of the Act, should Modibane succeed with his objection or appeal, he would be refunded what he had paid to SARS together with interest; moreover, a taxpayer's obligation and SARS' right to receive and recover tax from any taxpayer may only be suspended if directed so by SARS and this has given rise to the 'pay now, argue later' principle which has become established in our law.

(xiii) That, like the court's decision in *Capstone 556* (*Pty*) *Ltd and Another* v *C: SARS and Another*, this court is unable to agree with the decision of Spilg J in *Mokoena* v *C:SARS* 2011 (2) SA 556 (GSJ), also reported under the style *Sepataka* v *C:SARS*, that SARS cannot have resort to section 91(1)(*b*) of the Act when an appeal is pending. Section 91(1)(*b*) of the Act entitles SARS to exact payment from a taxpayer pending an appeal and the previous judgments referred to above all allude to and confirm the competency of SARS to exact payment of tax pending an appeal.

(xiv) That the decision of Spilg J in *Mokoena* (*Sepataka*) *supra* is not supported by the provisions of the Act and the *dicta* of both the Supreme and Constitutional Courts and the judgment is clearly wrong;

moreover the Modibane's contention that SARS was incompetent to obtain judgment was without merit and it is rejected and in the circumstances the application deserves to be dismissed.

Application dismissed with costs.

4. INTERPRETATION NOTES

4.1 Income Tax – Estimated assessments (foreign funds or assets) – No. 23

The purpose of this Interpretation Note is to provide guidance in respect of the application of the provisions of section 78(1A), (1B) and (1C) of the Act.

During 1997 the Government announced certain relaxations on foreign exchange controls and allowed residents to invest, within certain limitations, funds offshore. In order to cater for these announcements the Act was amended to subject to income tax investment income from foreign sources. With effect from 1 January 2001 and in respect of years of assessment commencing on or after this date, South Africa adopted a residence-based or worldwide system of taxation. In addition to substantive provisions dealing with the residence basis of taxation, various administrative provisions have been incorporated into the law to regulate the reporting as well as the consequences of non-compliance with the relevant reporting provisions of foreign income of taxpayers.

The provisions of section 78(1A), (1B) and (1C) are specifically aimed at ensuring compliance and provide a strong incentive for taxpayers to make full disclosure of their offshore assets and income in their returns of income.

4.2 Income Tax – The Brummeria case and the right to use loan capital interest free

This Note has been published as a result of the judgment of the SCA in the *Brummeria* case. For the purposes of interpreting the definition of the term 'gross income' in section 1(1), this Note –

- outlines the treatment of receipts or accruals in a form other than money; and
- serves as a BGR issued under section 89 of the Tax Administration Act, 2011 on the meaning of the term 'amount' as used in that definition.

The *Brummeria* case concerned a group of companies (the taxpayers) that granted life rights over units in a sectional title scheme operating as a retirement village to the occupiers (life-right holders). As a *quid pro quo* (in exchange) the life-right holders granted interest-free loans to the taxpayers for as long as they occupied the units.

The SCA had to adjudicate the appeal on the issues as defined in the statement of the grounds of assessment read with the statement of the grounds of appeal. Issues that were not raised in the statement of grounds of appeal could not be pursued before the court. The court had to consider the taxpayers' contention that the interest-free loans did not result in any 'amount' being 'received by' them which could be, and was, wrongly included in their gross income. T

he complete facts of the case and the arguments of SARS and the taxpayers may be found in the reported judgment and are therefore not repeated in this Note.

The SCA held that the right to use the loan capital interest free has an ascertainable money value that should be included in the gross income of the taxpayers.

The SCA did not, in the context of the appeal, consider the position of the life-right holders. This Note therefore focuses on the borrowers of the money in the context of trade and not on the position of the life-right holders.

The *Brummeria* case is clearly not authority for the general conclusion that the value of the right to use an interest-free loan should in each and every case be included in the borrower's gross income. The value of a receipt or accrual in a form other than money would usually not have to be included in gross income if the receipt or accrual did not take place in exchange for goods supplied or services rendered. The reason for this is that such a receipt or accrual would probably be of a capital nature. However, each and every transaction will have to be evaluated on its own merits and against the background of its own facts and the intentions of the parties.

As a general rule all amounts received by or accrued to a taxpayer (in cash or otherwise) that are not of a capital nature and are capable of being valued, should be included in the taxpayer's gross income and are therefore subject to income tax. The principles from the judgment should, however, be applied with due regard to the specific facts and circumstances of each and every matter involving an accrual or receipt in a form other than money (including the right to retain and use an interest-free loan).

5. DRAFT INTERPRETATION NOTES

5.1 Allowance for future expenditure on contracts

This Note provides guidance on the interpretation and application of section 24C which grants an allowance for expenditure to be incurred in a future year of assessment under a contract when income under that contract is received or accrued in advance.

The nature of certain taxpayers' businesses is that they receive advance payments which enable them to finance the expenditure they will incur in the future in order to earn that income. An anomaly arises where the income is received in one year and the expenditure is incurred in a subsequent year of assessment.

In the absence of section 24C the income would be fully taxable in the year received without any deduction for future expenditure. This arises because a number of sections require the expenditure to be actually incurred before a deduction is allowed [for example, section 11(*a*)] and, in addition, section 23(*e*) specifically prohibits the deduction of income carried to any reserve fund or capitalised in any way.

Section 24C was inserted in the Act as a relief measure to taxpayers who, because of the nature and special circumstances of their businesses, receive advance payments during a year of assessment and only incur related expenditure after the end of that year of assessment. The explanatory memorandum explains the reason for the insertion of section 24C as follows:

> 'The new section caters for the situation which often arises in the construction industry and sometimes in manufacturing concerns, where a large advance payment is made to a contractor before the commencement of the contract work, to enable the contractor to purchase materials, equipment etc. In a number of instances such advance payments are not matched by deductible expenditure, resulting in the full amounts of the advance payments being subject to tax.'

Although Section 24C was originally intended for taxpayers entering into building and manufacturing contracts, it does not mean that the section cannot be applied to taxpayers entering into other types of contracts. In ITC 1697 Galgut J stated that:

> 'The fact that the allowance might have been intended for building contractors does not mean, however, that it is not available to others. On the contrary, by the particular wording of section 24C the types of trades that the individual taxpayer might carry on, and the types of contracts concerned, are in no way limited. The sole question is whether the provisions of section 24C otherwise apply...'

Section 24C has been and can be applied to businesses in industries other than building and manufacturing provided the detailed requirements of the section are met. For example, the section has been applied to the motor industry, to the financial services industry, to publishers and to share block schemes.

In summary:

- Section 24C provides temporary relief, in the form of an allowance which reverses in the following year of assessment, to taxpayers who receive income in advance of incurring the expenditure related to the earning of that income.
- SARS must be satisfied that:
  - the taxpayer's income in a particular year of assessment includes an amount of income received or accrued in terms of a contract,
  - that all or part of the advance income will be used to finance future expenditure which *will be incurred* by the taxpayer in performing his or her obligations under that contract; and
  - that the future expenditure when incurred will qualify for a deduction or, in the case of the acquisition of an asset, will qualify for any deduction under the Act.
- The contract may be a written contract or a verbal contract, however in the latter case it may be more difficult to prove the existence of contract and its' rights and obligations.
- The words '*will be incurred*' indicate that SARS must be satisfied that there is a high degree of probability and inevitability that the expenditure will be incurred by the taxpayer. A taxpayer must therefore be able to demonstrate that, although the expenditure is contingent at the end of the tax year in question, there is a high degree of certainty that the expense will in fact be incurred in a future year. The facts of each case are critical. In circumstances where performance under the contract is *not* contractually obligatory but is

only *potentially* contractually obligatory due to an act or event other than just the taxpayer's client or customer taking action, the degree of certainty required is unlikely to be met.

- Assets already acquired do not represent future expenditure.
- Assets falling within the ambit of section 24C are those assets which will be acquired in order to perform under the specific contract giving rise to the advance income. The replacement of assets generally used in the taxpayer's trade fall outside the ambit of section 24C.
- The amount of the allowance is equal to the amount of advance income which SARS is satisfied will be used to finance future expenditure. The allowance may not exceed the amount of income received or accrued under the contract in a particular year of assessment. The amount of income received or accrued in a current year includes the reversal of the previous year's section 24C allowance.
- The section 24C allowance looks at how much of the advance income will be used to finance future expenditure, therefore the allowance may never exceed the amount of income even where the contract is running at a commercial loss.
- It is not possible to be prescriptive regarding the methods used to calculate the amount of the allowance, however, in a number of cases the 'gross cost method' will be appropriate.
- Generally, the calculation of the section 24C allowance must be performed on a detailed contract-by-contract basis, however there are limited circumstances where it may be appropriate to perform the analysis at a higher level by taking a number of contracts into consideration.
- An assessment of whether or not the provisions of section 24C are applicable must be performed annually taking up to date information into account.

- A decision made by SARS under section 24C is subject to objection and appeal in accordance with Chapter 9 of the Tax Administration Act, 2011.

6. BINDING PRIVATE RULINGS

6.1 BPR 122 – Transfer of a business of a company as a going concern to its holding company as a result of an amalgamation or merger transaction

This ruling deals with whether:

- the transfer of a business of a company as a going concern to its holding company as a result of an amalgamation or merger will constitute an 'intra-group transaction' as defined in section 45(1) of the Act;
- the dissolution of the amalgamating company will be governed by section 45(4)(*c*) of the Act;
- the cancellation of the amalgamating company's shares as a result of the amalgamation will:
    - constitute a disposal 'between connected persons not at arm's length price' as provided for under paragraph 38 of the Eighth Schedule to the Act; and
    - result in the imposition of securities transfer tax (STT) under section 2 of the STT Act;
- the transfer of a business of a company as a going concern to its holding company as a result of an amalgamation transaction will be governed by the provisions of section 47 of the Act;
- dividends tax will be payable in respect of the dividend *in specie* that will be declared and distributed by the amalgamating company as a result of the amalgamation;

- the holding company will be entitled to deduct the contingent liabilities taken over from the amalgamating company, as and when the liabilities are actually incurred by the holding company under section 11(*a*) read with section 23(*g*) of the Act.

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 18 April 2012 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 11(*a*)*;*
- section 23(*g*);
- section 45;
- section 47;
- section 64FA(1)(*b*);
- paragraph 38 of the Eighth Schedule; and
- section 2 of the STT Act.

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

The Applicant: A company incorporated in and a resident of South Africa that holds 100% of the shares in the Co-Applicant

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

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

The Co-Applicant intends to amalgamate or merge with the Applicant under section 113 of the Companies Act, No. 71 of 2008 (the Companies Act).

The Applicant will be the remaining company and will continue with the merged operations of the Co-Applicant.

The Co-Applicant will declare a dividend to the Applicant in an amount equal to the difference between the assets and liabilities that vest in the Co-Applicant. The intention is not for the dividend to be declared in cash, but *in* *specie* by merging the rights and obligations of the parties to the proposed transaction.

The securities of the Co-Applicant that are held by the Applicant will thereafter be cancelled, as soon as practically possible, under section 113(3) of the Companies Act.

<u>Conditions and assumptions</u>

This ruling is made subject to the conditions and assumptions that:

- the Applicant and the Co-Applicant form part of the same group of companies at the time of the declaration and payment of the dividend;
- the contingent liabilities to be assumed by the Applicant in the amalgamation or merger transaction will be as follows:
  - provision for leave pay;
  - bonus provision;
  - long-term incentive provision for when an executive leaves the company;
  - deferred bonus incentive provision; and
  - incentive provision where conditions for paying the incentive have not been satisfied;
- the Co-Applicant will be prohibited from claiming a section 11(*a*) deduction for the contingent liabilities to be assumed by the Applicant in the amalgamation or merger transaction; and
- the provisions of section 23E will apply in relation to any leave provision.

<u>Ruling</u>

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

- The amalgamation or merger transaction will not be governed by the provisions of section 45.
- The dissolution of the Co-Applicant will not be governed by section 45(4)(*c*).

- The amalgamation or merger transaction will be governed by the provisions of section 47.
- The cancellation of the shares in the Co-Applicant will have no tax consequences under section 47(5)(*a*).
- The dividend *in specie* that will be declared and paid by the Co-Applicant to the Applicant will be exempt from dividends tax under section 64FA(1)(*b*).
- The Applicant will be entitled to deduct expenditure actually incurred which relates to the contingent liabilities under section 11(*a*) read with section 23(*g*), provided that the provisions of section 23E are also complied with in respect of any leave pay.
- There will be no securities transfer tax consequences pursuant to the cancellation of the shares in the Co-Applicant.

6.2 BPR 123 – Fibre optics to be used for electronic communications

This ruling deals with the question of whether a fibre optic cable to be used for electronic communications will constitute an 'affected asset' as defined in section 12D(1) of the Act.

In this ruling references to sections are to sections of the Act applicable as at 12 May 2012 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 12D, definition of 'affected asset'.

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

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

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

The Applicant has been granted the right under an agreement to build and operate a fibre optic broadband cable communications network. This network will transmit telephone and information technology communications (that is, internet, email, etc) to end-users at a commercially determined fee.

Conditions and assumptions

This ruling is not subject to any conditions and assumptions.

Ruling

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

- The fibre optic cable to be used for the transmission of electronic communications will qualify as an 'affected asset' as defined under section 12D(1).

6.3 BPR 124 – Repayment of shareholders' loan from proceeds of a new issue of redeemable preference shares

This ruling deals with the income tax and capital gains tax consequences arising from the repayment of shareholders' loans from the proceeds of a new issue of redeemable preference shares (a new issue of shares) under technically insolvent circumstances.

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 2 April 2012 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 1, definition of 'contributed tax capital';
- section 20(1)(*a*)(ii); and
- paragraphs 12(5) and 20(1)(*a*) of the Eighth Schedule.

Parties to the proposed transaction

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

The Co-Applicant: A private company incorporated in and a resident of South Africa that holds a majority of the equity shares in the Applicant

Shareholders of the Applicant:

- The Co-Applicant holds 51% of the equity shares in the Applicant
- Two other companies incorporated outside South Africa that hold the balance of the equity shares in the Applicant

Description of the proposed transaction

The Applicant has an assessed loss brought forward from the previous years of assessment. The Applicant continued to trade in the current year of assessment, but is incurring further losses. The Applicant's operations are mostly financed through interest bearing loans from shareholders and from banks. The Applicant is heavily burdened with debt and interest payments arising therefrom to the point that its liabilities now exceed the book value of its assets.

In view of the Applicant's current financial position the shareholders wish to recapitalize the company with a new issue of shares. The Applicant will utilise the proceeds from the new issue to repay its shareholders' loans in order to improve the solvency of the company and reduce the interest burden on the company.

Conditions and assumptions

This ruling is made subject to the conditions and assumptions that:

- The subscription price for the new issue of shares is to be settled in cash by the Applicant's shareholders.
- The shareholders' loans will be settled in full in cash by the Applicant.

Ruling

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

- The repayment of the shareholders' loans from the proceeds of the new issue of redeemable preference shares will not be regarded as a concession granted by or a compromise made by the Applicant's shareholders with the Applicant as envisaged in section 20(1)(*a*)(ii).

- Paragraph 12(5) of the Eighth Schedule will not be applicable to the repayment of the shareholders' loans.
- The payment of the subscription price to be made by the Applicant's shareholders in cash will qualify as expenditure actually incurred for the acquisition of the new redeemable preference shares for purposes of paragraph 20(1)(*a*) of the Eighth Schedule.
- The fully paid subscription price for the new redeemable preference shares will qualify as 'contributed tax capital' as defined in section 1(1).

6.4 BPR 125 – Vesting by discretionary trust of dividend rights to the beneficiary of the trust

This ruling deals with:

- the capital gains tax (CGT) treatment arising from the vesting by a discretionary trust of dividend rights in its beneficiary under paragraph 80(1) of the Eighth Schedule;
- whether the capital gain arising from the vesting of the dividend rights by the trust in the beneficiary will be disregarded in the hands of the beneficiary under paragraph 63 of the Eighth Schedule as the receipts and accruals of the beneficiary are exempt from tax under section 10(1)(*t*)(vii); and
- whether the beneficiary will be the 'beneficial owner' of the dividend amounts when the dividends are paid, and whether the company paying the dividend is required to withhold dividends tax from the payment of the dividend under section 64G(2)(*a*).

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 28 August 2012 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 10(1)(*t*)(vii);
- section 64D;
- section 64F(*g*);
- section 64G(2)(*a*); and
- paragraphs 63 and 80(1) of the Eighth Schedule.

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

The Applicant: A discretionary trust established in and a resident of South Africa

Co-Applicant A: A private company incorporated in and a resident of South Africa and that is 100% held by the Applicant

Co-Applicant B: A community and one of the beneficiaries of the Applicant

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

- The Applicant is a discretionary trust that is effectively managed in South Africa. One of the beneficiaries of the Applicant is Co-Applicant B that is recognised as a traditional community under section 2 of the Traditional Leadership and Governance Framework Act No. 41 of 2003 and is exempt from normal tax under section 10(1)(*t*)(vii).
- The Applicant holds 100% of the equity shares in Co-Applicant A that in turn holds equity shares in various subsidiary companies that are incorporated and effectively managed in South Africa.
- The current practice of the trustees of the Applicant is to consider each year what the budgetary requirements of Co-Applicant B will be for the following year. The trustees will then have to exercise their discretion in favour of Co-Applicant B by vesting dividend rights in Co-Applicant B that are considered to be a sufficient amount to meet Co-Applicant B's budgetary requirements.
- It is proposed that the trustees of the Applicant will, in their discretion, distribute dividend rights held in Co-Applicant A to Co-Applicant B, in its capacity as a beneficiary of the Applicant.

- On the payment date of the dividend, Co-Applicant B will be the 'beneficial owner' and will be entitled to the dividend amount.
- Co-Applicant A will pay the dividend amount to the Applicant, but Co-Applicant A will not withhold dividends tax from such payment to the Applicant to the extent that the Applicant has submitted a declaration (and written undertaking) to Co-Applicant A indicating that the dividend amount declared is exempt from tax in the hands of Co-Applicant B.

Conditions and assumptions

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

Rulings

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

- The vesting of the dividend rights by the Applicant in Co-Applicant B will not be subject to CGT in the hands of the Applicant under paragraph 80(1) of the Eighth Schedule.
- Any capital gains arising from the vesting of the dividend rights will not give rise to any CGT liability in the hands of Co-Applicant B under paragraph 63 of the Eighth Schedule as its receipts and accruals are exempt from normal tax under section 10(1)(*t*)(vii).
- Co-Applicant A will not be required to withhold dividends tax under section 64G(2)(*a*) from the dividend amount paid to the Applicant, if the Applicant has by the date determined by Co-Applicant A, or by the date of payment of the dividend, submitted a declaration to Co-Applicant A that the dividend amount is exempt from dividends tax under section 64F(*g*) and a written undertaking in such form as is prescribed to inform Co-Applicant A should Co-Applicant B cease to be the beneficial owner of the dividend.

6.5 BPR 126 – Disposal of a business and investment shares, as a result of restructuring, and the distribution of certain shares to shareholders

This ruling deals with the question as to whether:

- restructuring, which leads to the disposal of a business (as a going concern) and investment shares by a company to another company at book value, in exchange for shares in that other company (NEWCO), will comply with section 42 of the Act with the result that:
  - no capital gains tax will be payable in respect of the disposal of the assets;
  - no allowances or deductions will be recouped by the transferor as a result of the disposal;
  - the company and Newco will be deemed to be one and the same person under section 8(25) of the VAT Act in respect of the disposal of the going concern and accordingly, no value added tax will be due in respect of the supply of the above-mentioned going concern; and
  - the transfer of investment shares will be exempt from securities transfer tax under section 8(1)(*a*)(i) of the STT Act; and
- the distribution of Newco's shares by the company to its holding company will be an unbundling transaction under section 46(1) of the Act, with the result that:
  - the anti-avoidance provisions in section 42(5), (6) and (8) will not be applicable to the unbundling transaction;
  - no secondary tax on companies will be payable by the companies in respect of the distribution of the shares;
  - no capital gains tax will be payable in respect of the disposal of the shares; and

- no securities transfer tax will be payable in respect of the transfer of Newco shares by the company to its holding company under section 8(1)(*a*)(iv) of the STT Act.

In this ruling references to sections are to sections of the relevant Acts applicable as at 2 February 2011 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 provisions of:

- sections 42 and 46 of the Act;
- section 8(25) of the VAT Act; and
- section 8(1)(*a*) of the STT Act.

Parties to the proposed transaction

The Applicant: A wholly owned subsidiary of the Holding Company mentioned as Co-Applicant 1

Co-Applicant 1: The Holding Company of the Applicant

Co-Applicant 2: A private company in which the Applicant holds shares

Description of the proposed transaction

The Applicant and its Holding Company form a group of companies (the Group). The Applicant owns three businesses, (A, B and C) in South Africa. The Applicant intends to incorporate a company (Newco) as a wholly owned subsidiary of the Applicant and to move the business of C as a going concern (including all assets and liabilities of C) to Newco in exchange for additional shares in Newco.

The businesses of A and B are neighbouring operations and have the same operational methods and standards. The business of C is located a few hundred kilometres away from A and B. C adopts different operational methods and support standards from those tailored to A and B and its productivity is generally higher.

Given the particular requirements of C and the operation of the business, it is envisaged that it will be necessary to address the requirements of C separately from those of A and B. In particular, it is highlighted that:

- from an operational perspective, C will require a specific skill set and management aligned with the operational requirements of C;
- from a geographic perspective, C will require regional services appropriate to its specific needs; and
- from a commercial perspective, there is significant potential for C to grow production through the acquisition of businesses of a similar nature to that of C and undeveloped business properties in the area in which it is located.

Based on the above information it is clear C will commercially be in a better position as a separate entity.

The introduction of a Black Economic Empowerment (BEE) consortium will further benefit both C and the rest of the Group. It is proposed that a BEE consortium will subscribe for a certain percentage shareholding in Newco.

From the perspective of C and Newco the introduction of a BEE consortium will:

- introduce capital of hundreds of millions of rands into C; and
- provide a BEE shareholder which will significantly enhance the ability of C to do further transactions in its business area and will enhance the relationship between C and other stakeholders.

The following steps are envisaged in order to execute the proposed transaction:

- Step 1: The Applicant will incorporate Newco as its wholly owned subsidiary.
- Step 2: The Applicant will transfer the business of C as a going concern (including all assets and liabilities of C) at book value, in exchange for additional shares in Newco, under section 42 of the Act.

- Step 3: The Applicant will transfer all ancillary assets comprising 100% of the shares held by the Applicant in Co-Appplicant 2 at book value, in exchange for additional shares in Newco, under section 42 of the Act.
- Step 4: The BEE partner will subscribe for a certain percentage shareholding in Newco for a cash consideration.
- Step 5: Newco will issue an effective percentage of its issued share capital to a newly incorporated C Management Trust.
- Step 6: The Applicant will distribute its shareholding in Newco to its Holding Company under section 46 of the Act.

Conditions and assumptions

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

- The public officer of Newco will state on oath that the acquisition of the investment shares complies with the provisions of section 8(1)(*a*) of the STT Act.
- Newco will be registered as a vendor for VAT purposes.

Ruling

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

- The disposal by the Applicant of business C and its shares in Co-Applicant 2 to Newco at book value will constitue an asset-for-share transaction under section 42 of the Act.
- The Applicant and Newco will be deemed to be one and the same person in respect of the supply of the business of C as a going concern under section 8(25) of the VAT Act.
- The transfer by the Applicant of its shares in Co-Applicant 2 will be exempt from securities transfer tax under section 8(1)(*a*)(i) of the STT Act.

- The distribution of Newco's shares by the Applicant to Co-Applicant 1 will constitute an unbundling transaction under section 46(1) of the Act and will fall outside the scope of section 42(5) and (6) of the Act.
- Section 42(8) of the Act will not be applicable to the distribution of Newco's shares by the Applicant to Co-Applicant 1.

6.6 BPR 127 – Relief from double taxation of foreign income

This ruling deals with the granting of relief from double taxation of interest received or accrued from a Zambian source (foreign interest) in the hands of a resident of South Africa.

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Articles of the South Africa/Zambia DTA applicable as at 24 January 2012 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 1(1), definition of 'gross income' paragraph (*h*);
- section 5;
- section 10;
- section 24J;
- section 108; and
- paragraph 5 of Article XII of the South Africa/Zambia DTA.

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

The Applicant: A resident of South Africa

The Borrowers: Companies that are resident in Zambia

Description of the proposed transaction

The Applicant is contemplating advancing interest-bearing loan funding directly to the Borrowers. The Applicant will fund these transactions from its general funding pool, and will accordingly incur funding and other related expenses. The Applicant will receive foreign interest on the loans advanced at a market-related rate.

By applying the domestic tax laws of both countries, the foreign interest will be subject to tax in both South Africa and Zambia. However, the South Africa/Zambia DTA contains provisions which will, in essence, restrict South Africa's right to tax interest received or accrued from Zambia.

The relief from tax in South African of the foreign interest is dealt with by the provisions of paragraph 5 of Article XII of the South Africa/Zambia DTA, read in conjunction with the provisions of section 108. This paragraph reads as follows:

> 'Where interest is derived by any person from a person (hereinafter referred to as the debtor) who is ordinarily resident in one of the territories and the interest would, but for the provisions of this paragraph, be subject to tax in both territories, that interest shall be subject to tax only in the territory in which the debtor is ordinarily resident: Provided that if the debtor is ordinarily resident in both territories, the interest shall be subject to tax only in the territory in which that interest is allowable as a deduction in the determination of the debtor's taxable income.'

Conditions and assumptions

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

Ruling

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

- The foreign interest will form part of the Applicant's 'gross income' as defined in section 1(1) and must be reported as such.
- By virtue of the application of paragraph 5 of Article XII of the South Africa/Zambia DTA, as read in conjunction with section 108, the

foreign interest will not be subject to tax in South Africa. This will be achieved by reducing ‘gross income’, as defined in section 1, by the amount of the foreign interest.

- Any interest expense and related expenses incurred by the Applicant to produce the foreign interest will accordingly not be allowed as a deduction under any provision of the Act.

6.7 BPR 128 – Disposal of equity shares in a foreign company

This ruling deals with the disposal of equity shares in a foreign company, taking into account the calculation of the prescribed portion of assets held by that foreign company as contemplated in the definition of ‘foreign financial instrument holding company’ in section 41(1) of the Act and relevance to paragraph 64B of the Eighth Schedule to the Act.

In this ruling references to sections are to sections of the Act applicable as at 31 January 2012 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 1(1), definition of ‘financial instrument’; and
- section 41(1), definition of ‘foreign financial instrument holding company’ and ‘associated group companies’.

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

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

The Holding Company: A company incorporated in and a resident of France, which holds all the ordinary shares in the Applicant

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

The Applicant is held by the Holding Company as an intermediary holding company.

The Applicant in turn holds 75% of the ordinary issued share capital of ABC Ltd, a company incorporated in Mauritius and not a resident of South Africa. ABC Ltd is an investment holding company which does not conduct trading activities in Mauritius and it is not a bank, insurance company or a collective investment scheme.

ABC Ltd's assets consist only of ordinary shares held in three subsidiary companies, each resident in a different foreign country. The percentage shareholding held in each of these three subsidiaries is as follows:

- 100% of the ordinary issued share capital of operating Company A, resident in foreign country A;
- 51% of the ordinary issued share capital of operating Company B, resident in foreign country B; and
- 50.1% of the ordinary issued share capital of operating Company C, resident in foreign country C.

These subsidiary companies have independent operations.

The Applicant, the Holding Company, ABC Ltd and Company A (a wholly owned subsidiary of Company ABC) form a group of companies (the Group) and ABC Ltd and its three subsidiary companies form an associated group of companies.

The Applicant proposes to dispose of the shares it holds in ABC Ltd to the Holding Company in accordance with a reorganisation scheme being contemplated by the Group.

<u>Conditions and assumptions</u>

This ruling is not subject to any additional conditions or assumptions.

<u>Ruling</u>

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

- In determining whether ABC Ltd qualifies as a 'foreign financial instrument holding company' as defined in section 41(1), the Applicant must, in accordance with proviso (i)(*aa*) to the definition of 'foreign financial instrument holding company' in section 41(1), wholly disregard ABC Ltd's direct shareholding in the three subsidiary companies.

6.8 BPR 129 – Beneficial owner of dividends

This ruling deals with the exemption from dividends tax of dividends received by a company, as a result of being the beneficial owner thereof, that were paid in respect of that company's own shares.

In this ruling references to sections are to sections of the Act applicable as at 1 April 2012 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 64D, definition of 'beneficial owner'; and
- section 64F(*a*).

Parties to the proposed transaction

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

Share Trusts: Five separate trusts established by the Applicant, each of which is a resident of South Africa

Description of the proposed transaction

The Applicant has five existing share incentive schemes for its different categories of employees. The terms of each scheme is embodied in a trust deed that establishes a separate share trust. A set of scheme rules governs the operation of each particular share incentive scheme.

Share Trust 1 was established for the lowest paid staff. The Applicant awards a cash grant to the trust which uses the cash grant to acquire the Applicant's shares through a fresh issue or an open market purchase. The trustees vest these shares in qualifying employees, subject to a resolutive condition that they remain employed by the Applicant until their death, retirement, retrenchment or the sale of the division in which they are employed. In such an event the trustees will repurchase their entitlements to future benefits for a nominal amount, unless the trustees waive the right to do so. Dividends on vested shares may accrue and be paid by the trust immediately after a qualifying employee joins the scheme. Employees have full voting rights in respect of shares allocated to them.

Share Trust 2 is primarily for the benefit of staff who earn in excess of a specified monthly amount. The Applicant also funds this trust to acquire shares in the Applicant. Share options are granted to qualifying employees to acquire shares at an option strike price on specified dates and at specified intervals, failing which the options will be forfeited.

Share Trust 3 benefits senior management. It operates in a manner identical to Share Trust 2, except that the option strike price is subject to a discount, determined by divisional performance, on the vesting date and different intervals apply to the vesting of share options.

Share Trust 4 benefits executive management. It operates in a manner identical to Share Trusts 2 and 3, except that discounts to the option strike price are determined by headline earnings per share performance on the vesting date and different intervals apply to the vesting of share options.

Share Trust 5 benefits the Applicant's executive directors. It operates in a manner identical to Share Trusts 2, 3 and 4, except that different intervals apply to the vesting of share options and no discount applies to the option strike price.

Each Share Trust invariably holds shares that have not been allocated to any staff beneficiary, either because a beneficiary has left the Applicant's employ in circumstances that required Share Trust 1 to repurchase the shares, or because a beneficiary of any of the other Share Trusts failed to exercise their share options, or because shares have been acquired by a Share Trust and the trustees of that trust have not yet allocated the shares or awarded options to purchase them, as the case may be.

The Applicant is a beneficiary of all five Share Trusts.

From time to time the Applicant will pay dividends via a regulated intermediary, as defined in section 64D, to its shareholders, which will include the five Share Trusts that have each acquired shares in the Applicant.

The trustees of each Share Trust will, on a date which precedes the last date to trade in the Applicant's shares for the relevant dividend, resolve to allocate the dividends received on unallocated shares to the Applicant as trust beneficiary.

Conditions and assumptions

This ruling is made subject to the additional condition and assumption that the Applicant must pay over the dividends in respect of unallocated shares to the regulated intermediary.

Ruling

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

- The Applicant will be the beneficial owner of the dividends paid in respect of unallocated shares if these dividends are, after their declaration date and prior to the last date to trade in the relevant shares, allocated to the Applicant by the trustees of the five Share Trusts.
- These dividends will be exempt from dividends tax in the hands of the Applicant under section 64F(*a*).

7. BINDING GENERAL RULING

7.1 BGR 8 (Issue 2) – Application of the principles enunciated by the Brummeria Case

This BGR reproduces paragraph 7 of Interpretation Note No. 58 (Issue 2) 'The *Brummeria* Case and the Right to Use Loan Capital Interest Free' dated 4 October 2012, which comprises a BGR under section 89 of the Tax Administration Act, 2011.

Background

Issue 1 of the Note was issued on 30 June 2010 as a result of the judgment in the *Brummeria* case. Issue 2 of the Note substitutes references to section 76P with references to the Tax Administration Act, 2011 and updates the dates in the examples. The principles dealt with by the Note and hence in this BGR remain unchanged.

Ruling

Paragraph 7 of the Note, which comprises a BGR, is reproduced in the **Annexure.**

ANNEXURE – PARAGRAPH 7 OF INTERPRETATION NOTE NO. 58

7. Granting of life rights over units in a retirement village – Binding General Ruling (BGR)

The contents of this paragraph constitute a BGR under section 89 of the Tax Administration Act, 2011 and relate to the definition of the term 'gross income' in section 1(1). This BGR applies with effect from the commencement of years of assessment ending on or after 31 December 2008 and will apply for an indefinite period.

Agreements in the retirement industry are frequently structured in such a way that one person (the owner of a unit) grants a lifelong right of occupation over that unit to another person (the life-right holder). As compensation the life-right holder advances the owner an interest-free loan for the duration of the period of occupation.

Only amounts received by or accrued to a taxpayer during a particular year of assessment must be included in that taxpayer's gross income for that year of assessment. The value of a right that accrues to a taxpayer in a particular year of assessment must be determined in that year.

In calculating the monetary value of the right to use an interest-free loan in the year in which it is granted, it should be taken into account that the owner of the unit has given something in exchange to the life-right holders. The *quid pro quo* is the granting of the lifelong right of occupation of the unit. The owner is therefore left only with the bare *dominium* of the unit for the full period of the loan. Only when the loan is repaid and the life right is re-united with the bare *dominium,* will the owner be in a position to deal freely with the complete ownership of the unit.

The value of this *quid pro quo* given by the owner of the unit to the life-right holder should therefore be determined and taken into account in the valuation of the right to use the interest-free loan.

The right to use an interest-free loan granted by an occupant in a retirement village to the owner of that unit in exchange for the granting of a life right of occupation in respect of that unit usually does not relate to a fixed period. Instead, the period over which the right to the use of the loan is to be enjoyed depends on the life expectancy of the life-right holder and certain other contractually agreed contingencies (such as the possibility that the life-right holder may cancel the loan before his or her death).

In view of the above, it may be accepted that the value of the right to use the interest-free loan should be calculated in the year that the loan is granted with reference to the following factors:

A = The monetary value of the right of use of the interest-free loan which must be included in gross income

B = The amount of the interest-free loan

C = The present value of R1 a year over the life expectancy of the life-right holder*, or in the case of more than one life-right holder, the youngest of them

D = The weighted-average prime overdraft rate for banks in respect of the relevant year of assessment

E = 93,1% (The percentage to be allocated to the monetary value of the life right of a unit, as opposed to the value of the complete ownership of the unit. This average percentage has been determined actuarially and is acceptable to SARS for all life rights granted.) SARS has accepted this method as a basis for calculating the amount to be included in gross income. This deduction accommodates the owner of the unit who gives a right to occupy the unit as a *quid pro quo* for the right to use an interest-free loan.

Formula: A = (B x C x D) – E x (B x C x D)

* The life expectancy of the life-right holder and the present value of R1 a year for the life of the life-right holder may be determined by using the life-expectancy table issued under Government Notice No. R1942 of 23 September 1977 under section 29 of the Estate Duty Act No. 45 of 1955 (see **Annexure**).

The monetary value of the right to use the interest-free loan in the year in which it is granted and paid must be determined by multiplying the amount of the loan by the present value of R1 a year for the lifetime of the life-right holder and the weighted-average prime overdraft rate determined for the relevant year of assessment. The amount so calculated is then reduced by 93,1%. **Note:** This is a once-off calculation of the amount to be included in the gross income of the borrower in the year of assessment in which the borrower becomes entitled to the right to use the loan. The amount is therefore not re-calculated and included in the borrower's gross income in each subsequent year until the loan is repaid.

Example 1 – Calculation of the monetary value to be included in gross income

Facts:

A retirement village is held under sectional title by the owner. The scheme is governed by the Housing Development Schemes for Retired Persons Act No. 65 of 1988. On 1 June 2011 the owner enters into an agreement, under which the owner grants a life right of occupation over a sectional title unit in the village to a person aged 75.

Under the agreement, the 75-year-old person and that person's spouse will be entitled to occupy the unit in exchange for the grant to the owner of the use of an interest-free loan of R400 000. The life-right holder advanced the loan on 1 July 2011.

The person turned 75 on 16 February 2011.

According to the life-expectancy table (see **Annexure**) the present value of R1 a year for the life of the 75-year-old male is 4,59354 (age next birthday = 76).

The interest-free loan is repayable by the owner of the village to:

- the life-right holder upon cancellation of the agreement under various circumstances, which include the life-right holder falling ill and requiring full-time medical care; or
- his or her estate when he or she dies.

The weighted-average prime overdraft rate for banks during the relevant year of assessment is 13,44%.

The financial year of the owner of the retirement village commences on 1 March 2011 and ends on 29 February 2012.

Result:

The monetary value of the right to the use of the interest-free loan is calculated as follows:

A = (B x C x D) – E x (B x C x D)

= (R400 000 x 4,59354 x 13,44%) – 93,1% x (R400 000 x 4,59354 x 13,44%)

= R246 948,71 – R229 909,24

= R17 039,47

An owner that is obligated to refund only a portion of the loan on death or cancellation of the agreement must include the amount not refundable in gross income in the year of assessment in which the loan is granted and paid by the person acquiring the life right.

Example 2 – Full loan amount not refundable

Facts:

The agreement between the owner and the life-right holder provides that only 80% of the interest-free loan of R900 000 is refundable on death.

Result:

The owner must include R180 000 (20% x R900 000) in gross income in the year of assessment in which the loan is granted and paid by the life-right holder.

In addition, an amount equal to the monetary value, calculated in respect of the right to use the interest-free loan, must be included in the owner's gross income in the year of assessment in which the loan is granted and paid.

Note: For purposes of calculating the monetary value, symbol 'B' in the formula is 80% x R900 000 = R720 000.

In the case of an interest-free loan, the benefit to retain and use the interest-free loan will accrue to the owner on the date the loan has been granted and paid by the person acquiring the life right.

Example 3 – Date of accrual of an interest-free loan

Facts:

B retired on 30 March 2012 and entered into an agreement with a retirement village owner. Under the agreement, B will be entitled to occupy a particular unit in exchange for the grant of the use of an interest-free loan of R400 000. The agreement is concluded on 15 February 2012. B undertook to pay the R400 000 on receipt of his lump sum benefit from his pension fund. He paid over the R400 000 to the retirement village owner on 12 June 2012. The year of assessment of the owner ends on 31 December 2012.

Result:

The date of accrual for purposes of calculating the monetary value of the right to use the interest-free loan is 12 June 2012.

8. BINDING CLASS RULING

8.1 BCR 31 – Income distributed by a discretionary trust and benefit units allocated to beneficiaries by virtue of employment

This ruling deals with the question as to whether:

- dividends received and distributed by a trust will retain its nature as dividends in the hands of the beneficiaries of the trust; and
- beneficial units allocated to beneficiaries will constitute equity instruments in their hands.

In this ruling legislative references to sections are to sections of the Act applicable as at 1 January 2011 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This ruling has been requested under the provisions of:

- section 1,definition of 'gross income';
- section 8C; and
- section 10(1)(*k)*(i).

<u>Class</u>

The class members to whom this ruling will apply will be the employees as described in point 4 below.

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

The Applicant: A holding company together with its subsidiaries, which formagroup of companies (the Group)

The Trust: A discretionary trust established by the Group

The Employees: A specific group of permanent employees of the Group (also to be known as the beneficiaries of the Trust)

Description of the proposed transaction

TheTrust has been established to enable theEmployees to participate in a broad-based black economic empowerment initiative of the Applicant.

One of the objectives of the Trustis to acquire ordinary shares (the shares) in two companies within the Group.Both these two companies are public companies duly incorporated under the Companies Act, No. 61 of 1973. These shares will vest in the Trust and will at all times remain under the control of the trustees save for those circumstances when the shares will be used as security. These shares will not vest in the Employees.

A further object of the Trust is to hold and administer the 'trust funds'.

The trust funds comprise all assets administered by the trustees of the Trust, except for the shares acquired in the two companies. The trust funds comprise the following:

- a donation;
- any other donation as may from time to time be made to the Trust;
- other assets, shareholdings or investments – movable or immovable, corporeal or incorporeal – which the trustees may acquire on behalf of the Trust, but not limited to shares; and
- interest, dividends or accruals to the Trust of whatever nature.

The trustees are empowered to apply and allocate the trust funds in the discretion of the trustees for the benefit of the Employees to achieve the following objectives of the Trust :

- the broad-based black economic empowerment of the Employees;
- the improvement of the lives and standard of living of the Employees;
- the educational needs of the Employees and their immediate families or other dependents, as identified by the trustees from time to time;

- the initiation and development of projects to promote the employment, health, recreation, mental- and spiritual welfare and general well-being of the Employees;
- the provision of urgent relief and/or medical care to Employees in times of unforeseen hardship; and
- such further purposes which the trustees in their sole and unfettered discretion may deem ancillary and supplementary to the objects detailed.

The trustees may exercise their discretion to vest in the Employees the dividends – ordinary or special – declared by the two companies, which accrue to the Trust, being the owner of the shares. The Trust Deed enables the trustees to deal with these dividends as follows:

- 20% of the cash dividends may be utilized by the trustees in their absolute discretion in order to satisfy the objectives of the Trust as listed above;
- the remaining 80% of the cash dividends may be used exclusively for repayment of the loans incurred to acquire the shares in the two companies;
- once the loans have been settled in full, the remaining 80% of all the cash dividends declared by the two companies and accruing to the Trust may be utilised by the trustees in their absolute discretion in order to satisfy the objectives of the Trust as set out above; and
- any non-cash dividends declared by the two companies and accruing to the Trust may be utilised by the trustees in their absolute discretion in order to satisfy the objectives of the Trust as set out above.

The Employees will also participate in the Trust by way of Beneficial Units which will be determined and allocated to them as the Beneficiaries in the Trust within 6 months of the year-end of the Trust.

The allocation method will result in a floating variable pool of the Employees eligible for Beneficial Units on an annual basis. They will share equally in the number of Beneficial Units to be allocated annually.

The Beneficial Units will be determined in accordance with the formula:

A = B/C

in which:

A means an amount of Beneficial Units to be allocated to each Employee;

B means an amount equal to the total portion of cash dividends received by the Trust that will be utilised for repayment by the Trust of the loans incurred to purchase the shares in each financial year; and

C means the number of Employees on the first day of the Trust's financial year to which the debt repayments in B above relate.

The Trust Deed provides that the Beneficial Units can only be valued as follows:

- the trustees will determine the price at which the Beneficial Units will be re-purchased in their sole and absolute discretion, taking into account the trust funds available for the re-purchase of the Beneficial Units on the relevant re-purchase date;
- the trustees are entitled to use such method of calculating the value of the Beneficial Units to be re-purchased at such date as they may deem fit and reasonable in their sole and absolute discretion at the time of the re-purchase of the Beneficial Units; and
- the trustees are entitled to put such measures in place relating to the payment of the re-purchase price of the Beneficial Units as they may deem fit and reasonable in their sole and absolute discretion.

The number of Beneficial Units will be the same as the value of the dividend amounts that will be used to repay the loans. If an Employee resigns or retires from a companywithin the Group he or she will be paid an amount based on the discretion of the trustees (re-purchase of the Beneficial Units). Whilst the number of Beneficial Units is equal to the dividends which could be vested in the Employees, the amount paid to Employees does not represent an amount equal to dividends which could not be vested. The re-purchase price is based on the trust funds available for the re-purchase of Beneficial Units. The value of the Beneficial Units are taxable in the hands of the Employees in the year in which the re-purchase value accrues to them.

Conditions and assumptions

This ruling is made subject to the conditions and assumptions that:

- the trustees' discretion in terms of Trust Deed is in no way linked to the performance of the Employees and cannot result in the payment of any form of remuneration or bonus to the said Employees;
- the vesting of the dividends in the Employees and the distribution thereof will not result in the settlement of an obligation of the Group in respect of the employment or services rendered by the Employees; and
- the re-purchase price of the Beneficial Units will in no way be linked to the value of the shares.

Ruling

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

- Any distribution made by the trustees of the Trust to the Beneficiaries (Employees) will, if the distribution is made within the same year of assessment in which the dividend was received by or accrued to the Trust, retain the character of a dividend in the hands of the Beneficiaries (Employees).
- Such distributions will be exempt in the hands of the Beneficiaries (Employees) under section 10(1)(*k*)(i).
- The Beneficial Units will not constitute equity instruments as defined in section 8C in the hands of the Beneficiaries (Employees).

8.2 BCR 35 – Tax implications arising from the conversion of par value shares to no par value shares

This ruling deals with the tax implications arising from the conversion of par value shares to no par value shares.

Relevant tax laws

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 22 June 2012 and unless the context indicates otherwise, any word or expression in this ruling bears the meanings ascribed to it in the relevant Act.

This is a rulingon the interpretation and application of the provisions of:

- section 1(1), definition of 'gross income';
- paragraph 11 of the Eighth Schedule; and
- section 1 of the STT Act, definition of 'transfer'.

Class

The class members to whom this ruling will apply are the Shareholders as described in point 4 below.

Parties to the proposed transaction

The Applicant: A public company incorporated in and a resident

of South Africa

The Shareholders: The shareholders of the Applicant

Description of the proposed transaction

- The proposed transaction will entail the conversion of all the ordinary par value shares in the Applicant to ordinary no par value shares as directed under item 6 of Schedule 5, read with Regulation 31 and section 35(2) of the Companies Act No. 71 of 2008, as amended (the Companies Act). The conversion is aimed at compliance with the

Companies Act, as well as part of a wider restructuring program to be undertaken by the Applicant.

- In particular, the Applicant will file an amendment to its Memorandum of Incorporation to convert its ordinary par value shares to ordinary no par value shares in accordance with sub-regulations (6) to (11) of Regulation 31 to the Companies Act.
- The steps required to implement the proposed conversion transaction are specified in Regulation 31 of the Companies Act, namely:
  - the preparation by the board of the Applicant of a report relating to the conversion;
  - the adoption of special resolutions by the shareholders of the Applicant to implement the conversion; and
  - the filing of the proposed special resolutions and report with the Companies and Intellectual Property Commission and the South African Revenue Service.
- In effecting the conversion by the Applicant of its ordinary par value shares to ordinary no par value shares it should be noted that:
  - the proposed transaction will be implemented on the basis that all ordinary par value shares in the Applicant will be converted to ordinary no par value shares. In this regard, there will be no distinction between any Shareholders, thereby ensuring that there will be no identifiable benefits or different rights applicable to any particular Shareholder;
  - the rights relating to the shares in the Applicant subsequent to the conversion will remain unchanged. Amongst others, there will be no change to any Shareholder rights relating to:
    - the voting rights in the Applicant;
    - any participation in any profits of the Applicant;
    - any participation in the capital of the Applicant;
    - the rights upon the winding-up of the Applicant;

- the rights of the Shareholders in the Applicant will be preserved pursuant to the implementation of the proposed transaction;
- there will be no compensation payable to any of the Shareholders pursuant to the conversion; and
- all Shareholders will be treated equally in relation to the implementation of the proposed transaction and there will be no changes to any of the Shareholder's rights relating to their shares in the Applicant.

Conditions and assumptions

This ruling is subject to the additional condition and assumption that the conversion is in accordance with the draft report that was prepared by the Applicant in terms of Regulation 31(7) of the Companies Act and does not deviate therefrom.

Ruling

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

- In respect of the conversion of the Applicant's par value shares to no par value shares:
  - there will be no 'disposal' for the Shareholders as contemplated in paragraph 11(1)(*a*) of the Eighth Schedule if the relevant shares in the Applicant are held on capital account;
  - there will be no 'receipt' or 'accrual' for the Shareholders as contemplated in section 1(1), the definition of 'gross income', if the relevant shares in the Applicant are held on revenue account; and
  - there will be no 'transfer' as contemplated in section 1 of the STT Act and therefore no liability to account for STT.

9. INDEMNITY

Whilst every care has been taken in the production of this update we cannot accept responsibility for the consequences of any inaccuracies contained herein or for any action undertaken or refrained from taken as a consequence of this update.
