REPORTABLE

REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT

HELD AT CAPE TOWN

CASE NO: VAT 382

In the matter between:-

XYZ Co Appellant

and

THE COMMISSIONER FOR THE SOUTH AFRICAN

REVENUE SERVICE Respondent

JUDGMENT: 13 June 2011

DAVIS J

Introduction

[1] This appeal arises from assessments issued by respondent in terms of the Value Added Tax Act 89 of 1991 ('the Act') which assessments were contained in a letter of 18 October 2004. The assessments relate to appellant's tax periods from March 2001 to January 2002.

[2] The dispute between the parties which arises from these assessments are whether the respondent was correct;

1. In determining that certain services acquired by appellant from a foreign supplier were imported services as defined in the Act and as being the subject of value added tax ('VAT') in terms of s 7(1)(c) of the Act.

2. In determining that the VAT paid by appellant on certain services acquired by appellant from local suppliers did not constitute input tax as defined in the Act and hence did not qualify to be deducted from appellant's output tax in arriving at the amount payable by appellant to respondent.

Factual Background

[3] Much of the narrative is common cause. Prior to the implementation of the relevant transactions in May/June 2001, the shares in appellant were linked to depository receipts representing an interest in shares issued by ABC Co, a Swiss company. A share in appellant and a depository receipt to which it was linked constituted a so called linked unit. The linked units were listed on various

exchanges including the Johannesburg stock exchange (JSE) the London stock exchange (LSE) and the Swiss exchange (SWX).

[4] By way of summary, appellant's main trading activities were the mining and selling of diamonds from South Africa. ABC CO and its subsidiaries owned diamond mining interests elsewhere in the world. The main trading activities of appellant were thus the mining and selling of diamonds. However, its subsidiaries operated further diamond businesses and also held an investment of 117 086 985 shares in DEF PLC , an English company whose shares were and still are listed on the JSE, LSE and the SWX. It appears that another company in the XYZ group, GHI Holdings, owned a further 27 196 890 DEF PLC shares. This cumulative shareholding constituted approximately 35.4% of the issued share capital of DEF PLC.

[5] Among the XYZ linked unit holders were DEF PLC, KLM a company incorporated in Luxembourg and DSW, a company incorporated in Botswana. These three companies held 32.3%, 2.6% and 5% respectively of the shares in appellant. Their combined stake of 39.8% represented 159 395 536 shares in appellant. The remaining 240 563 239 shares (60.2%) were held by a large number of institutional and other investors.

[6] In November 2000 DEF PLC, KLM and DSW proposed, as a consortium, that appellant enter into a transaction in terms whereof the other unit holders in appellant and ABC CO would have the interests in appellant eliminated and a new company, to be established by the consortium, would become the holding company of both appellant and ABC CO. This new company, BCD was to be incorporated in Luxembourg.

[7] In November 2000, the boards of both XYZ 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. The ICD were authorised to appoint and consult with NMR as independent financial advisors, NMR being an English advisory services company.

[8] At the same time, various advisors in South Africa were appointed, including HSBC Investment Services (Africa) (Pty) (Ltd) ('HSBC') the firms of attorneys known as Webber Wentzel Bowens ('WWB') and Edward Nathan and Friedland ('ENF') together with the auditing and advisory firm Deloitte and Touche

Advisory Services ('Deloittes'). All of these parties were referred to during the dispute as the local suppliers of local services.

[9] After months of negotiations, on 30 April 2001 the consortium made a final and improved offer. NMR considered that this offer was fair and reasonable to independent unit holders. The ICD then advised the boards that, in its opinion, the offer was fair and reasonable and the boards accordingly advised the independent unit holders.

[10] In essence the final offer constituted the following:

> The shareholding of the independent unit holders in XYZ (approximately 60.2%) would be eliminated through a distribution to them of DEF PLC shares, being all of the shares held by appellant in DEF PLC, together with some additional DEF PLC shares and cash, such that for each linked unit, the holder would receive 0.446 of an DEF PLC share, $15.35 in cash plus a further cash amount of $1.30 which constituted the final dividend of DEF PLC for the year ending 31 December 2000.

[11] This final offer reflected an assumed total value of XYZ of $18.7 billion, of which $9.4 billion was attributed to the 35.4% shareholding in DEF PLC and the balance of $9.3 billion to XYZ ' remaining assets.

[12] The transaction was implemented through a scheme of arrangement pursuant to s 311 of the Companies Act 61 of 1973 ('the Companies Act'). The court granted leave to convene a scheme meeting on 3 April 2001 and the offer, as improved, was accepted by the requisite majority of independent unit holders at the scheme meeting on 4 May 2001. The scheme was then sanctioned by the court on 18 May 2001 and implemented shortly thereafter.

[13] In effect, the scheme constituted a buy back leg and a cancellation leg. Briefly these can be described thus:

1. In terms of the buy back leg, appellant acquired from all unit holders including the consortium 1% of their shares in appellant in consideration for which it distributed to them pro-rata 130 380 071 DEF PLC shares plus a dividend of $1.30 per share which was attributable to the DEF PLC shares.

2. In terms of the cancellation leg the, balance of the shares in appellant held by independent unit holders were cancelled in consideration for which the latter received $15.35 in cash together with a further allocation of DEF PLC shares, such that each unit holder received inclusive of the DEF PLC shares received under the buy back leg, 0.446 DEF PLC shares per linked unit. It is not necessary to traverse the mechanics of the calculations used to determine the shares so allocated. Suffice to say, the additional shares were in the amount of 28 872 400.

[14] On 07 June 2001, NMR issued an invoice to appellant in the amount of $19 895 965 for the services rendered to by it in connection with the transaction. This constituted a portion of NMR's total charges, in that the balance was invoiced to ABC CO. Appellant settled this invoice at a rand cost of R 161 064 684.

[15] In the assessment of 18 October 2004 respondent determined that the NMR services were imported services in terms of the Act and assessed the sum of R22 549 055.76 to be payable by appellant as VAT in terms of s 7(1)(c) of the Act. Over the period of March 2001 to January 2002, the local suppliers rendered invoices to appellant for services rendered in connection with the transaction. These suppliers included VAT in their invoices and appellant treated this VAT as input tax in making its own VAT returns. In the assessment of 18

October 2004 respondent determined that the VAT did not qualify as input tax and raised assessments, thereby, in effect, disallowing input tax in the amount of R7 021 855.48.

[16] Appellant lodged an objection against these assessments in a letter of 1 February 2005, which objection was disallowed by respondent on 8 September 2005. It was against this decisions that appellant noted an appeal on 14 October 2005.

The relevant provisions of the Act

[17] Before canvassing the basis of the present dispute, it is useful to set out those sections of the Act which proved to be central to the determination of this case.

[18] Although it was common cause that the appellant, as a registered vendor, carried on an enterprise defined in s1 of the Act, whether that definition was applicable to the transaction described above was the subject of a key dispute. Enterprise is defined, inter alia, as follows:

> *"(a) in the case of any vendor, any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course or furtherance of which goods or services are supplied to any person for a consideration, whether or not for profit, including any enterprise or activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing, municipal or professional concern or any other concern of a continuing nature or in the form of an association or club…*

Provided that-

> *(i) anything done in connection with the commencement or termination of any such enterprise or activity shall be deemed to be done in the course or furtherance of that enterprise or activity;…*

(iv) any activity carried on by a natural person essentially as a private or recreational pursuit or hobby or any activity carried on by a person other than a natural person which would, if it were carried on by a natural person, be carried on essentially as a private or recreational pursuit or hobby shall not be deemed to be the carrying on of an enterprise;

(v) any activity shall to the extent to which it involves the making of exempt supplies not be deemed to be the carrying on of an enterprise;…"

[19] Section 12 of the Act deals with exemptions and provides, inter alia;

"*The supply of any of the following goods or services shall be exempt from the tax imposed under section 7(1)(a):*

(a) the supply of any financial services, but excluding the supply of financial services which, but for this paragraph, would be charged with tax at the rate of zero per cent under section 11".

Accordingly in terms of the Act, the supply of financial services, which are zero rated in terms of s11, are not exempt but are treated as a zero rated supply.

In terms of section 2 of the Act, the following activities are deemed to be 'financial services:

> ***"(a) the exchange of currency (whether effected by the exchange of bank notes or coin, by crediting or debiting accounts, or otherwise);***
>
> ***(b) the issue, payment, collection or transfer of ownership of a cheque or letter of credit;***
>
> ***(c) the issue, allotment, drawing, acceptance, endorsement or transfer of ownership of a debt security;***
>
> ***(d) the issue, allotment or transfer of ownership of an equity security or a participatory security;"***

In terms of section 2(2), a "debt security" means:

> ***"(aa) an interest in or right to be paid money; or***
>
> ***(bb) an obligation or liability to pay money***

that is, or is to be, owing by any person, but does not included a cheque."

In terms of section 2(2), an "equity security" means*;*

"any interest in or right to a share in the capital of a juristic person…"

[20] Section 7 (1) (a) of the Act, is the charging section, and levies VAT as follows:

"on the supply by any vendor of goods or services supplied by him … in the course or furtherance of any enterprise carried on by him"

[21] Such tax is

"to be calculated at the rate of 14 per cent on the value of the supply concerned".

[22] A taxable supply is defined thus:

> *"any supply of goods or services which is chargeable with tax under the provisions of section 7(1)(a), including tax chargeable at the rate of zero per cent under section 11"*

[23] Imported services are defined thus:

> "*a supply of services that is made by a supplier who is resident or carries on business outside the Republic to a recipient who is a resident of the Republic to the extent that such services are utilised or consumed in the Republic otherwise than for the purpose of making taxable supplies*".

[24] Where services constitute import services, s 7(3) levies VAT on the supply thereof calculated at the rate of 14% on the value of the supply concerned. Input tax is defined thus:

> "*tax charged … on the supply of goods or services made … to the vendor … where the goods or services concerned are acquired by the vendor wholly for the purpose of consumption, use or supply in the course of making taxable supplies or, where the goods or services are acquired by*

the vendor partly for such purpose, to the extent (as determined in accordance with the provisions of section 17) that the goods or services concerned are acquired by the vendor for such purpose".

[25] A further section which is relevant to the present dispute is section 17(1) which, at the relevant time, provided that:

"Where goods or services are acquired … by a vendor partly for consumption, use or supply (hereinafter referred to as the intended use) in the course of making taxable supplies and partly for another intended use, the extent to which any tax which has become payable in respect of the supply to him … of such goods or services … shall be an amount which bears to the full amount of such tax … the same ratio (as determined in accordance with a general written ruling by the Commissioner or a written ruling given by the Commissioner to such vendor) as the intended use of such goods or services in the course of making taxable supplies bears to the total intended use of such goods or services: Provided that –

(i) where the intended use of goods or services in the course of making taxable supplies is equal to not less than 95 per cent of the total intended use of such goods or services, the goods or services concerned may for the purposes of this Act be regarded as having

been acquired wholly for the purposes of making taxable supplies;…".

APPELLANT'S CASE

The NMR Services

[26] Appellant's primary contention can be summarised thus:

1. Imported services are utilised otherwise than for the purpose of making taxable supplies.

2. To fall outside the definition of 'imported services', NMR's services had to be shown to be consumed for the purpose of making taxable supplies.

3. A supply is a taxable supply if it is made 'in the course or furtherance of its enterprise'.

4. Given that appellant was a public company and conducted its operation within a particular regulated framework the legally mandated advice formed part of the furtherance of its enterprise.

5. Hence the services fell outside the definition of 'imported services'.

[27] Mr Emslie, who appeared together with Mr Janisch on behalf of appellant, justified appellant's case as follows: Appellant was faced with the offer made by the BCD consortium and was therefore legally obliged to obtain appropriate advice on the offer. Its manifest effect on all holders of linked units meant that necessary information had to be provided to shareholders to enable them to reach an informed decision as of the merits to the offer which had been made by the consortium. These obligations arose because appellant was listed as a public company on the JSE, the LSE and the SWX. In particular, in terms of s 440 C (3) of the Companies Act, appellant was classified as an offeree company under an affected transaction and was required to fulfil certain obligations in terms of the Securities Regulation Code ('Code') which had been promulgated under section 440 C (3). In particular, Rule 3.1 of the Code provided:

> "*The Board of the offeree company shall obtain appropriate external advice on any offer as to how it affects all holders of securities, including specifically, where applicable, minority holders of securities, and the substance of such advice shall be made known to holders of the relevant securities in the offeree company in a form and manner approved by the panel."*

Further, Rule 20.2 required the following of appellant:

> "*Holders of relevant securities shall be given sufficient information and advice to enable them to reach a properly informed decision as to the merits or demerits of an offer. Such information shall be available to holders of relevant securities early enough to enable them to make a decision in good time*."

Rule 20.3 of the Code imposed an obligation upon the directors of appellant, who were required to express an opinion and state that:

> "*They accept responsibility for the information contained in the document… and that to the best of their knowledge and belief (having taken all reasonable care to ensure that such is the case) the information contained in the document … is in accordance with the facts and, where appropriate, that it does not omit anything likely to affect the import of such information*."

[28] Mr C , the acting chief executive officer of appellant, who testified about the relevant transaction, and had particular knowledge thereof in that he was a director of WWB at the time of the transaction confirmed that, as a matter of commercial practice, appellant's board could not merely consider the offer and decide whether to endorse it or recommend its rejection. It was required to take steps to ensure that the best offer was brought to the shareholders and only then was it possible for the board to make a recommendation.

[29] On the strength of this evidence, Mr Emslie submitted that the appellant was obliged to obtain independent advice and to communicate this advice to shareholders. Thus, both the obtaining of the independent advice from NMR and the advice which was then furnished to shareholders, pursuant to the recommendations of NMR, were activities performed by the appellant for the purposes of making taxable supplies in the course or furtherance of its enterprise. Expressed differently, these services constituted “overhead activities”, giving rise to overhead expenses which was imposed upon appellant by the legal architecture under which it was incorporated. It therefore could be described as expenditure necessarily incurred by appellant by virtue of the enterprise which it carried out in the form chosen but it to so conduct its business, that is a public listed company. Appellant could not practically continue to have made future taxable supplies as a public listed company without acquiring the advice which it had procured from NMR so as to fulfil its statutory obligations..

[30] In support of this submission, Mr Emslie referred to the Canadian case of *BG Service Co Canada v R* [2002] GSTC 124 (TCC). In this case a publicly listed company incurred expenditure on financial advisers and lawyers in response to an unsolicited takeover bid. It was obliged to so obtain advice in the exercise of its duties as a public company. The court held that the fees were incurred in the course of the target company’s commercial activities, being its operational activities. Campbell J said the following at para 34:

> "*Associate Chief Justice Bowman, in International Colin Energy Corporation, held that advisory fess, incurred by a taxpayer in seeking a transaction to alleviate failing finances, were currently deductible. In the present case, Nowsco sought financial and legal advice because of an unsolicited takeover bid and in the process sought out a broad auction. In both cases, the expenses arose as a result of the necessary response to developments arising in the operation of the business to produce income. Although there is a distinction between direct and indirect, or ancillary expenses, as they relate to business operations, one may be no less important than the other in maintaining the overall viability of the corporate operations. During the time of a takeover bid, certain legal and public financial market expectations have developed and I see no reason to exclude from deductibility those costs which a taxpayer must incur to comply with those obligations. It is simply, and rightly so, just one of the costs of doing business in such a marketplace. Such costs are commercial in nature and as part of the business activities of Nowscom are therefore incurred for the purpose of gaining or producing income."*

[31] Mr Emslie sought to support this approach's application to VAT by reference to the definition of enterprise which includes "any enterprise activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing, municipal or professional concern." In his view, the words 'any

enterprise, activity' were extremely wide and thus any activity which was carried on by appellant which was linked to its commercial or mining concerns fell within the definition of enterprise. Thus, the provision of advice by appellant to the independent unit holders was itself an activity performed in the course or furtherance of appellant's enterprise and accordingly fell to be classified as a taxable supply.

[32] Appellant also relied on the evidence of Mr K, a director of appellant and a member of the ICD. According to Mr K, a number of advantages enured to appellant as a result of the services provided by NMR. In the first place, the computer model developed by NMR for the purposes of valuing the diamond business, and which was a critical tool employed by NMR in seeking to advise on the maximum bid price, continued to benefit appellant in the preparation of its annual financial planning and, with modification, still appears to be employed by appellant. Secondly, the increased financial commitment of the O family and the influence of Mr NO, following upon the transaction, continued to be of significant benefit to appellant's business operations. Thirdly, the advantage of being able to operate as a company which was not listed on a stock exchange enabled reduced disclosure, requirements greater flexibility and afforded the board the ability to take a long term view, free from the constraints of short term financial reporting. Finally, the re-rating of the value of appellant's business flowed from

the transaction, with concomitant benefits such as the motivation of appellant's management and accordingly the financial interests of the diamond enterprise.

[33] Mr Emslie contended that the fact that the provision of NMR's advice to shareholders was of a "once off" nature and not for consideration did not mean that the services were not utilised or consumed for purposes of making taxable supplies in the course or furtherance of the enterprise. To the contrary, the services fell within the necessary conduct of the appellants enterprise which was conducted pursued in corporate form.

[34] Appellant's alternative argument turned on the location of the consumption of the services. Appellant relied on the evidence of both Mr K and Mr H, an employee of NMR, both of whom testified that the services of NMR were predominantly rendered in London, where its offices were situated and where the majority of the modelling as well as the evaluation work was undertaken. Further W, the consortium's financial advisor was also based in London. Both witnesses testified that negotiations with the advisors occurred primarily in London. Further, the chairperson of the ICD, Mr A, resided in London and appellant's head of finance Mr V also worked from an office in London.

[35] Mr H conceded that a number of aspects of the advice did take place in South Africa such as work on a technical and financial report but he testified that all the central features of the services that were rendered by NMR had taken place in London.

[36] Faced with the contention from respondent in the grounds of assessment that, where advisory services are rendered by a foreign supply to a local resident, the services are in law utilised for consumption in South Africa, appellant contended that, although the services culminated in the provision of a written “fair and reasonable” opinion for inclusion in a circular and a second oral opinion expressed in relation to the increased offer, it would be incorrect to classify the services as having been used or consumed in the place when the board decided to support the bid and proceeded with the schemes of arrangement in terms of s 311 of the Companies Act. In effect, the contact between appellant and NMR took place through the ICD which was mandated as a committee of the board to appoint and consult NMR, to enter into discussions and to take such advice as to the offer it considered to be appropriate.

[37] Two meetings with the ICD took place in London. On 5 December 2000 the ICD met with NMR who made a substantial presentation on the strength of its valuation work to date. A further meeting took place on 25 January 2001, at which the revised bid was discussed.

[38] The chairman of the board, Mr R, was then mandated to seek an improved offer by way of negotiating for an additional $600 million. Appellant contended that these meetings were crucial components in the negotiation process that followed and which ultimately culminated in the advice given by the board to shareholders. Mr Emslie submitted that there had been a progressive interaction between the ICD and NMR, that the services had been consumed, in effect, by the ICD, and therefore in turn by appellant and much of this had taken place in London. In his view, a 50:50 apportionment would be appropriate, taking into account the services which were utilised or consumed by appellant in the Republic and those which were consumed elsewhere.

[39] In summary, appellant's case amounts to the following:

1. The provision of the services by NMR were necessarily attached to and accordingly a concomitant of appellant's mining or commercial

concern as a public company. Appellant having chosen to conduct its business as a public company, these services were directly linked to its making of ongoing supplies. Those services were wholly utilised or consumed in the making of supplies, in the course or the furtherance of appellant's mining or commercial concern and hence did not fall within the definition of imported services.

2. In the alternative, the services provided by NMR to a significant extent were utilised and consumed outside the Republic and therefore could not constitute imported services as defined, even if the court was to decide that they were utilised to consumed, "otherwise", than in the course of making taxable supplies.

Respondent's Case in relation to NMR

[40] Mr Rogers, who appeared together with Mr Blumberg on behalf of respondent, accepted that to fall outside of the definition of imported services and thus not to be taxable, NMR's services would have had to been used or consumed for the purposes of making taxable supplies. The difference between the submissions of the two parties was that respondent characterised the taxable supplies, which appellant made in the course of its enterprise, as defined, as the sale of rough diamonds extracted by it from its South African mining operations. That was the enterprise which it had carried on continuously or regularly in South

Africa and, in the course or furtherance of which, it supplied diamonds to other persons for their consideration. Accordingly, the question was whether NMR services were acquired to enable appellant to enhance its enterprise of extracting or selling diamonds. That question had to be answered in the negative. The enterprise were not, in the least, affected by whether or not appellant had acquired NMR's services. These services had nothing to do with its enterprise which it had carried on continuously or regularly; these services were acquired simply to enable appellant to advise its independent shareholders whether the amount they were being offered for their shareholding by the consortium was fair and reasonable. Accordingly, the NMR advice was solely to assist in maximising the price that the independent shareholders would receive for their shares and units.

[41] Mr Rogers therefore rejected the argument that the services of NMR constituted "an overhead" used by appellant in the course of making its supplies. In Mr Rogers's view, general overheads are those goods or services which the enterprise would typically acquire and consume in the course of conducting its enterprise, in this case of making taxable supplies relating to its mining business. Expenses which were necessitated solely because of the choice of the legal vehicle in which the business was located stood on an entirely different footing. These overheads related to duties which were imposed upon appellant to further

the interest of its shareholders, in consequence of the choice that had been made to conduct the enterprise of mining activities in a corporate form.

[42] In support of these submissions, Mr Rogers referred to an Australian decision of a Federal Court of Appeal in *FCT v The Swann Brewery Co Ltd* (1991) 22 ATR 295 (FCA) at 303. This case concerned the deductibility for income tax of expenditure incurred by a trading company in obtaining professional services to enable it to advise shareholders in respect of a takeover offer of which it was the target. The court held at 303:

> '*The costs incurred by the taxpayer were related to the discharge of duties by the taxpayer and its board of directors imposed by legislation relating to corporations. It could not be said that the expenditure was relevant or incidental to the gaining or producing of assessable income on the facts of this case. It was directed to duly informing the shareholders of the corporation of the true worth of their shares and the adequacy of the offer the offer to acquire their capital interest in the corporation… To qualify as an outlay to which the second limb of s 51 applies, it must be shown that the expenditure is characterised by the business ends to which it is directed, those ends forming part of or being truly incidental to the business… The expenditure upon aids to the consideration of the adequacy of the evaluation of the capital interest of the shareholders*

contained in the takeover offer and of the nature of the response to that offer recommended to shareholders owed nothing to the conduct of the business of the taxpayer.

The nature and profitability of the taxpayer's business and the assets of the corporation acquired by that business may well have dictated the worth and value of the interest of shareholders in the share capital of the taxpayer, but it did not mean that expenditure related to those interests was necessarily incurred in the carrying on of that business for the purpose of gaining or producing assessable income and, as the tribunal found, it clearly was not."

[43] In summary, respondents primary contention was that the fact that appellant might well have supplied a service to its shareholders did not mean that this constituted a supply made in the course or furtherance of appellant's enterprise which, in essence, constituted the extraction of diamonds for sale. Accordingly, the amount R 161 064 684 which was paid by appellant to NMR for the latter's advisory services could not be said to be consumed for the purpose of making taxable supplies.

[44] In the alternative, respondent contended that appellant was involved in three classes of business.

1. A business of extracting diamonds from mines in South Africa and selling them (at 90% of SSV) to a subsidiary company P;

2. A business of holding share in subsidiary companies such as P, DT, DBD and XYZ Marine which conducted their own enterprise;

3. A business of holding shares in listed companies such as DEF PLC, FR, DEF PLC Gold etc.

If it was accepted that appellant chose the corporate form to conduct these three business', then the 'NMR overheads' were also incurred in the course and furtherance of appellant's business of owning operating subsidiaries and of owing listed investments. On this basis, an apportionment would have to take the other two businesses.

[45] Turning to the location of the consumption, respondent contended that the services were consumed where appellant resided and carried on business. As appellant carried on business only in South Africa, the consumption of the services took place in South Africa and thus appellant's alternative argument stood to be rejected..

Evaluation

[46] The key distinction between the primary arguments presented to this court turns on whether it is permissible to classify the provision of advice by NMR to the ICD, which, in turn, enabled the board to advise the independent unit holders of the merits of the transaction, as services which were utilised or consumed for the purposes of making taxable supplies. In turn, a positive answer would mean that such services fell outside of the scope of imported services as defined. This conclusion then raises the question as to whether the purpose of utilising or consuming of these services was to benefit appellant's enterprise or whether these services were "at best incidental" to that enterprise.

[47] Although respondent relied upon the approach adopted in *Swann Brewery, supra* by an Australian court, it is significant that this was an income tax case and was not decided under comparable VAT legislation. Indeed, in a GST ruling (GSTR 2008/1) the Australian Taxation Office dealt with the implications of Swann Brewery for the purpose of its GST. At para 70 of its ruling, the office states that a number of considerations apply to the determination of whether a service was acquired for the carrying on of an enterprise. Factors of which account must be taken include when the acquisition is incidental or relevant to the commencement, continuance or termination of the enterprise; the thing secures a real benefit or advantage for the enterprise; the acquisition is one that an ordinary business person in the position of the recipient would be likely to make for the enterprise;

the acquisition helps to protect or preserve the enterprise; or "**the acquisition is made by the enterprise in accordance with, or to satisfy, a statutory requirement imposed on the enterprise.**"

The ruling continues at para 74:

> "*For GST purposes, however, the commissioner would, on balance, accept that acquisitions made by a company in these circumstances would be made in carrying on of its enterprise, having regard to all the factors mentioned at paragraph 70 of this Ruling*".

This view also finds support in European jurisprudence and in particular, in the decision of the European Court of Justice in *Skatteverket v AB* SKAF [2009] EUECJC – 29/08 at para 33:

> "*Moreover, it was clear from the Court's case law that transaction's relating to shares or holdings in the company are subject to VAT when they are carried out as part of a commercial share dealing activity or in order to secure a direct or indirect involvement in the management of the companies in which the holding has been acquired or where they constitute the direct permanent and necessary extension of the taxable activity..."*
>
> *"By the disposal of all its shares in the subsidiary and in the controlled company, SKF brought an end its holdings in those companies. That*

> *disposal, carried out in order to enable the parent company to restructure a group of companies, can be regarded as a transaction that consist in obtaining income on a continuing basis form activities which go beyond the compass of the simple sale of shares…That transaction has a direct link with the organisation of the activity carried out by the group and constitutes accordingly the direct, permanent and necessary extension of the taxable activity of the taxable person within the terms of the case-law cited in paragraph 31 of this judgment. Such a transaction consequently comes within the scope of VAT."*

It would therefore appear from this comparative authority that, if the transaction has a direct link with the organisational activity carried out by the appellant, this would constitute a direct permanent and necessary extension of the taxable activity of the appellant and consequently the transaction would fall within the scope of VAT (see para 33 of *Skatteverket*). Significantly, in the *BJ Services* case the court did engage with the purpose of the input, to the extent that it held that the maximisation of shareholder value was the main purpose of obtaining advice and that this was thus connected with the making of taxable supplies.

[48] As noted, Mr K testified that there were considerable benefits that flowed to appellant, pursuant to the transaction, including the computer model which had been developed by NMR and which had proved extremely useful to appellant in

its ongoing enterprise, the increased financial commitment of the O family which provided additional security for appellant in the conducting of its ongoing enterprise and the fact that as appellant would no longer be listed on a stock exchange, this would provide it with greater flexibility in the manner in which it conducted its operations and its ability to assume greater risks as well as a 're-rating' of the value of the appellant's business and, according to Mr K, greater motivation of appellant's management.

[49] These considerations however may not strictly relevant to the approaches which had been adopted both by the Canadian and European Courts. Similarly, those portions of the cross examination of both Mr K and Mr H concerning the contribution of NMR's advice to the offer that was finally accepted are not, in my view, of significance. Either the advice was required to be provided to shareholders which in turn was part of appellant's enterprise or it was not.

[50] Although not a VAT case, there is some support for the comparative approach in the decision in ITC 1842; 72 SATC 118, where the court dealt with the deductibility, for income tax, of audit fees. Of particular relevance is the following *dictum at* para 13:

> "*The mere fact that a taxpayer is by law required to perform certain acts does not necessarily mean that the costs of performing those acts are expenditure incurred in the production of income. The duty to incur expenditure for auditing, so Mr Koekemoer argued, follows the type of corporate entity adopted. In cannot accept this submission. The appellant as a legal persona is not responsible for the corporate identity which it bears.*"

In the present case, it was common cause that appellant conducted an enterprise. While the services rendered by NMR were not directly linked to its mining operations and were, in effect, "a once off transaction", appellant was legally obliged to engage such services, as a result of the proposed offer by the consortium. In other words, a legal obligation had been imposed upon the board. Once an activity is determined to have been carried on by appellant in the form of its commercial or mining concern, this would fall within the definition of enterprise, notwithstanding that the particular service might only have been required at one particular point in time during the duration of the existence of appellant's enterprise.

[51] Furthermore, there does not appear to be any justification in the language employed in the Act to limit the concept 'enterprise' so as to apply it exclusively assets which are used directly in the making of taxable supplies. In any event,

the evidence of K was to the effect that the DEF PLC shares in particular were treated as integral to its overall business. A legal obligation imposed upon an entity to seek and procure advice to be given to the shareholders, such as of appellant, was sufficiently closely connected to the conduct of its overall activities to justify its inclusion as a supply of services. Hence these services did not constitute 'imported services' because the services were used and consumed by the appellant for the making of taxable supplies and in the course of furtherance of appellant's enterprise of mining and selling diamonds.

[52] It is thus not necessary to deal with the problem of location of consumption. During both the extensive cross examination of Mr K and Mr H much was sought to be made of the fact that the core diamond businesses should have been subject to a ratio of 40:60 being appellant to ABC CO. But the value of the consideration for the services is the determinative factor in terms of s10(2) of the Act and it is thus difficult to decide a VAT case such as the present on the accuracy of such a ratio. Similarly, the fact that respondent emphasised the nature of both the diamond business and the shareholdings of appellant is hardly relevant to the costs of services, which as both Mr K and Mr H explained, related to the value of the diamond business. In any event, the consistent testimony of Mr K was that there was a direct and substantial link between the DEF PLC shares and the diamond business from the time that the business of appellant was conceived.

The local services

[53] In the case of services rendered by WWB, Mr C testified that these services related to the transaction as a whole, which encompassed all the activities necessary for appellant to perform from the time when the offer was first received by appellant from the consortium until the time when the s 311 schemes of arrangement were sanctioned by the court.

[54] According to Mr C WWB services included advice relating to all the activities which the appellant was required by law to perform in compliance with its legal and regulatory obligations as a listed company, once it had been confronted with an offer made by the consortium.

[55] Mr C described in detail a series of work streams into which the WWB services had been divided:

> "*The first one was that the Board was rightly concerned with the question of governance. So there was a governance work stream which was set up, because the Board was rightly, I believe, concerned about perceptions of*

buyers towards the bidder given the make-up of the bidder and given that the bidder appointed a significant number of directors to DBCM. There was a JC work stream, which involved ensuring that the transaction and all documents complied with the listing's requirements. There was a SRP work stream which in this transaction was principally covered by the code, which ensured that the transaction itself as well as all the documentation complied with the code. There was a tax work stream which dealt with a number of tax issues, not just the unbundling and even though Deloittes were the lead tax advisory, we were involved. There was competition work stream as mentioned. There was an exchange control work stream. There was a number of significant exchange control approvals required for the transaction for the bid to be made and to be consummated. There was a piece of work on unwinding the share incentive scheme, which involved legal, tax and regulatory issues. It was a piece of work involving coordinating all of the foreign legal advice, of which there was a great deal, particularly American, making sure that all fitted in the transaction. There was a piece of work on drafting the circular."

[56] Further, WWB provided services in relation to appellant's share incentive scheme which had to be terminated and replaced by a different scheme because the linked units in appellant would cease to exist if the consortium's offer was ultimately accepted. In addition, there was a tactical work stream which dealt with

the tactics of increasing the offer and ensuring that a maximum price could be obtained for the shareholders. Mr C also testified that:

> "*There was a piece of work involved in drafting the scheme itself, which is an annex to the circular, drafting the applications to convene and to sanction the scheme to convene a scheme meeting. To sanction the scheme, there was a piece of work involved in the scheme meeting itself and then there were similar pieces of work in relation to both the preference share schemes*."

[57] Mr Emslie submitted that all of this work was directly linked to appellant's enterprises as a mining and commercial concern in the course of which it made taxable supplies. To the extent that the WWB services related to the share incentive scheme, they were required for the purpose of use or consumption in the course of making taxable supplies as the share incentive scheme was part and parcel of appellant's enterprise.

[58] Mr Emslie conceded that the WWB services, which related to the preparation of the circular and the s311 scheme, to the extent that such activity involved the transfer of shares and cash, constituted services which were

required, partly for the purpose of use or consumption in the course of making taxable supplies, and partly in making exempt supplies.

[59] The additional problem with the WWB fee was, as Mr C testified, that the bulk of this fee had been charged on a globular basis and it was therefore impossible to allocate with precision how much could be allocated between the various components.

[60] Turning to the services supplied by Deloitte, which related to the share incentive schemes, Mr Emslie submitted they were, to this extent, required for the purpose of use of consumption in the course of making taxable supplies. Deloitte's also provided services relating to the tax and regulatory activities which were necessitated by the receipt of the consortium's offer as well as the provision of services pursuant to the s 311 scheme meeting. This stood, in Mr Emslie's view, to be classified as being acquired for the purpose of use or consumption in the course of making taxable supplies.

[61] The services of HSBC appeared to have been necessitated by virtue of appellant being a listed company. It was necessary for a sponsoring broker to be

engaged to liaise with the various stock exchanges. To the extent that these services involved advising the various stock exchanges on the implications of the scheme, appellant's contention was that these services fell into the same category as those of NMR and the WWB services pursuant to advice which was required to discharge the board's obligations. Again this fee was charged on a globular basis and Mr Emslie conceded, to the extent that the services led to making of both taxable and non taxable supplies, s 17 (1) would be of application with regard to the apportionment of this fee.

[62] The ENF fee concerned the chairing of a scheme meeting. To the extent that this service related directly to distribution of scheme consideration an apportionment of the fee was required in terms of section 17(1).

Respondent's case

[63] Mr Rogers observed that sections 11(2) and 12(a) of the Act applied only to financial services which, but for those provisions, would be charged to tax under s7(1)(a). Sections 11(2) and 12(a) only apply to the supply of financial services which would, but for these two sections, be classified as supplies in the course or furtherance of an enterprise taxable at the standard rate. When the disposal is of shares held as an investment, the Act classifies this as a supply of a financial service, save for the fact that the holding of shares as an investment is not an

enterprise and thus the disposal of these shares does not fall under s7(1)(a) Such a supply to a resident, other than if in the course of an enterprise making taxable supplies, is not considered as an exempt supply in terms of s 12 nor is it zero rated under s11(12)(1), in the case of a non resident. Such supply, being neither zero rated nor exempt, falls outside the scope of the Act.

[64] A disposal of DEF PLC shares which have been held as an investment was a supply of a financial service in terms of s2 (1)(d). However, since the holding of shares as an investment was not an asset in the enterprise, the disposal of these shares would in any event not fall under section 7(1)(a). The supplies were not zero rated nor exempt but on Mr Rogers' argument fell outside the scope of VAT.

[65] Mr Rogers submitted further that to establish its entitlement to an input tax credit, appellant had to show that the local services was acquired for the purpose of making taxable supplies; which would have to include the substantial part of WWB's services in connection with s311 scheme.

[66] To recapitulate briefly:

(i) A buy back leg in terms of which appellant purchased part of the share held by all listed unit holders (including the consortium) (1% of appellant's shares) in consideration for which it distributed to each holder on a *pro-rata* basis, 130 380 071 of the 144.3 million DEF PLC shares held by it.

(ii) A cancellation leg, which followed the purchase of the shares in appellant, the balance of the shares held by independent unit holders (excluding those held by the consortium) were cancelled in consideration for which these holders received $15.35 in cash together with further DEF PLC shares, such that together with the consideration in the buy back leg, independent unit holders would receive 0.446 DEF PLC share per linked unit.

[67] Mr Rogers contended, for the reasons he had advanced in relation to the construction of ss11(2) and 12(a), that the set of supplies relating to the buy back leg was a non enterprise activity. The cancellation leg, in terms of section 311, constituted a financial service, being the transfer of shares by appellant, pursuant to s2(1)(b) to (d) of the Act. These supplies however did not fall under s7(1)(a) and thus sections 11(2)(l) and 12(a). The services under the cancellation leg were not even connected with appellant's investment business of holding DEF PLC shares and could not be treated as non taxable supplies on the same basis.

In this leg, appellant acted as a distributor of cash and shares. It was an isolated ad-hoc activity which entailed the making of a supply of a financial service, not in the course of its underlying businesses but as a discrete activity. Hence it could not be considered to be an 'enterprise' and the supply was neither a taxable supply nor an exempt supply.

[68] To the extent that appellant was correct that a supply for no consideration could still constitute a taxable supply, respondent's argument was that this supply did not take place in the course or furtherance of appellant's enterprise but constituted a separate discrete activity which could only constitute an enterprise, if the supply was for consideration which was not the case.

Evaluation

[69] From the evidence of Mr C a considerable amount of the local services were employed by appellant pursuant to the s311 scheme. As already described, in the buy back leg of the transaction, appellant transferred 130.38 million DEF PLC shares to its shareholders, the transfer of which was a 'non enterprise activity' by appellant. Pursuant to the cancellation leg, appellant made payment of cash and transferred DEF PLC shares to independent unit holders.

[70] Contrary to the finding that the NMR services were employed as a result of a statutory obligation imposed upon the board of appellant to advise its unit holders as to the nature of an offer which had been made by the consortium, these local services were incurred in order to ensure the optimum transfer of shares and cash to independent unit holders. They therefore stand to be classified on a different footing.

[71] As set out in the description of respondent's submissions, a supply of a financial service to a non resident, other than the course of an enterprise making taxable supplies, does not attract tax of a zero rate in terms of s11(2). On the same reasoning, a financial service supplied to a resident, other than the course of an enterprise making taxable supplies, is not an exempt supply in terms of s12. These supplies are therefore neither zero rated nor exempt but appear to fall outside the scope of the Act. Given the finding that much of the local advice of WWB related primarily to the scheme of arrangement in terms of s311 and was therefore used for the purpose of making supplies in terms of this section, it cannot be said that these inputs qualify for an input tax deduction.

[72] This finding would also apply to the WWB tax advice provided to appellant as well as to its advice which was given pursuant to the necessary approval from the competition authorities. On the available evidence, it is difficult to determine on what basis the HSBC services were supplied. The lack of evidence would, in

terms of s37, which imposes an obligation upon the appellant to satisfy the court that is entitled to such an input tax deduction, is consequently fatal to appellant's case, insofar as these services are concerned.

[73] As noted above however, the WWB fee was in the form of a globular form and it is therefore difficult to determine precisely the breakdown of this fee. According to the evidence of Mr C , some of the work, which was done by WWB, related to the fiduciary obligations imposed upon the board to give advice to the shareholders and therefore stands on a similar footing to that of the NMR services. To the extent that the WWB services led to the making of taxable and non taxable supplies, an apportionment of this fee in terms of s17(1) becomes necessary.

[74] Mr Emslie submitted that the turnover based system pursuant to s17(1) was the standard method of apportionment which must be used in the absence of a specific ruling. By contrast, respondent appeared to contend that, where two supplies of services are made, one for the making of taxable supplies and another for the making of exempt supplies, and a single fee is charged, this calls for an allocation rather than apportionment; that is an allocation between the services in a fair and reasonable manner.

[75] If the turnover based method is used, then the proviso to s17(1) would apply. The proviso reads:

> (i) Where the intended use of goods or services in the course of making taxable supplies is equal to not less than 95% of the total intended use of such goods or services. The goods or services concerned may for the purposes of this Act be regarded as having been acquired wholly for the purpose of making taxable supplies.

[76] In this case, given the nature of the fee charged by WWB, it is unclear as to the ratio between the services which were required by appellant for use or consumption in the course of making of taxable supplies and the services acquired by appellant from WWB, which were for another purpose (as outlined above). In the circumstances, it is not possible to determine whether the proviso to s17 applies. Accordingly the assessment, with regard to the fee charged by WWB, must be referred back to the Commissioner for further investigation and reconsideration.

[77] Given the decision to which this court has arrived, there is no basis upon which respondent was entitled to impose a 10% penalty fee in terms of s39 of the Act.

[78] In the result, the appeal against the assessments is upheld and the following order is made.

1. The assessments of respondent as set out in its letter of 18 October 2004 are set aside.

2. A revised assessment must be issued on the following basis

    2.1 The services provided by NMR do not constitute imported services because they were utilised and consumed by appellant for the purpose of making taxable supplies, in the course or furtherance of its enterprise of mining and selling diamonds, being a service legally required of a listed company carrying on a continuing enterprise, in the circumstances faced by the appellant, and in light of a statutory obligation of providing advice to the independent unit holders, which advice thus constituted an activity performed in the course or furtherance of appellant's enterprise.

2.2 The VAT paid by appellant in respect of the local services is not a deductible input tax, save insofar as the services of WWB are concerned. In this case, this part of the assessment is referred back to the respondent in order to determine the appropriate ratio pursuant to which a percentage of these services will constitute a deductible input tax.

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D M DAVIS J

Assessors P Ranchod and P Surtees concurred