JUTA'S TAX LAW REVIEW

NOVEMBER 2012

Dear Subscriber to Juta's Tax publications

Welcome to the June edition of *Juta's Tax Law Review*. We thank you for your constructive suggestions and comments about this electronic review.

SOME POINTS ABOUT THE CASE NOTES:

The case notes, classified by subject, are not intended as comprehensive summaries of the various judgments referred to. Rather, their focus is to identify those aspects most likely to be of interest to tax practitioners, and to provide a concise evaluative commentary.

Following each case note is a link to the full text (when available) of the judgment on Juta Law's website. The successive reviews and judgments are incorporated in your Juta's Tax Library, providing a comprehensive record of tax case law.

Please continue to send feedback to the publisher, Steve Allcock (sallcock@juta.co.za)

Kind regards

The Juta Law Marketing Team

LEGISLATION

Since the June 2012 issue of the Juta Tax Law Review the following legislation has been promulgated:

- Tax Administration Act 28 of 2011
- Rates and Monetary Amounts and Amendment of Revenue Laws Act 13 of 2012

The Tax Administration Act, 2011 became effective on 1 October 2012, except for certain specific provisions dealing with the imposition of interest payable to SARS by taxpayers, and, also, by SARS to taxpayers.

Public notices issued in terms of the Tax Administration Act, which is defined and forms part and parcel part of the legislation, has been published in the *Gazette* on 1 October 2012:

- Incidences on non-compliance by a person in terms of s 210(2)
- Distance above which a person may decline to attend an interview in terms of s 47(4)
- Form and manner of a report to a taxpayer on the stage of completion of an audit of s 42(1)
- Electronic form of record keeping in terms of s 30(1)*(b)*

The following bills have been published by SARS and National Treasury:

- Taxation Laws Amendment Bill, 2012
- Tax Administration Laws Amendment Bill, 2012

EXPLANATORY MEMORANDA

- EM on *Taxation Laws Amendment Bill, 2012* has been published by National Treasury together with a clause-by-clause explanation.

BINDING RULINGS

Binding general rulings

BINDING GENERAL RULING (VAT): NO 11

Subject: Use of an exchange rate

Effective date: 1 September 2012
Affected legislation: Value-added Tax Act 89 of 1991,
Provisions: Sections 9, 10 and 20

Executive summary:

This Binding General Ruling (BGR) prescribes the foreign exchange rate that must be used when issuing tax invoices as well as for determining the output tax due where the consideration for the standard rated supply is in a foreign currency. Compliance with ss 20(4) and (5), as well as for determining the vendor's output tax liability, is addressed.

BINDING PRIVATE RULING: BPR 119

Subject: Transfer of amounts contributed to a foreign pension fund to a South African retirement annuity fund

Date: 31 August 2012
Affected legislation: Income Tax Act 58 of 1962
Provisions: Sections 1, definition of 'gross income', 9(1)(*g*), 10(1)(*g*C), 11(*k*) and (*n*), and paras 2(1)(*a*) and 5 of the Second Schedule.

Executive Summary:

This ruling deals with the tax consequences arising from a transfer of a pension fund interest from a source outside the Republic to a South African retirement annuity fund.

BINDING PRIVATE RULING: BPR 120

Subject: The interaction between sections 45 and 24J in the transfer of interest-bearing receivables under the corporate rules

Date: 12 September 2012
Affected legislation: Income Tax Act 58 of 1962
Provisions: Sections 45 and 24J

Executive Summary:

This ruling deals with the treatment of interest-bearing receivables to be transferred in terms of the corporate rules contained under s 45 of the Act as read with s 24J of the Act.

BINDING PRIVATE RULING: BPR 121

Subject: Secondary tax on companies or dividends tax

Date: 14 September 2012
Affected legislation: Income Tax Act 58 of 1962
Provisions: Sections 64B(1), definition of 'declared' and 64E(1) read with s 64D

Executive Summary:

This ruling deals with the question as to whether a dividend to be paid to shareholders will be subject to secondary tax on companies or dividends tax.

BINDING PRIVATE RULING: BPR 122

Subject: Transfer of a business of a company as a going concern to its holding company as a result of an amalgamation or merger transaction

Date:	11 October 2012
Affected legislation:	Income Tax Act 58 of 1962 ('ITA'); Securities Transfer Act 25 of 2007 ('STT')
ITA provisions:	Sections 11(*a*), 23(*g*), 45, 47 and 64FA(1)(*b*), para 38 of the Eighth Schedule
STT provision:	Section 2

Executive Summary:

This ruling deals with whether—

(a) 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 s 45(1) of the Act;

(b) the dissolution of the amalgamating company will be governed by s 45(4)(*c*) of the Act;

(c) the cancellation of the amalgamating company's shares as a result of the amalgamation will—

(c)(i) constitute a disposal 'between connected persons not at arm's length price' as provided for under para 38 of the Eighth Schedule to the Act; and

(c)(ii) result in the imposition of securities transfer tax (STT) under s 2 of the STT Act;

(d) 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 s 47 of the Act;

(e) 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;

(f) 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 s 11(*a*) read with s 23(*g*) of the Act.

BINDING PRIVATE RULING: BPR 123

Subject: Fibre-optic cable to be used for electronic communications

Date:	11 October 2012
Affected legislation:	Income Tax Act 58 of 1962
Provisions:	Section 12D, definition of 'affected asset'

Executive Summary:

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 s 12D(1) of the Act.

BINDING PRIVATE RULING: BPR 124

Subject: Repayment of shareholders' loans from proceeds of a new issue of redeemable preference shares

Date: 22 October 2012
Affected legislation: Income Tax Act 58 of 1962
Provisions: Sections 1(1), definition of 'contributed tax capital' and 20(1)(*a*)(ii), and paras 12(5) and 20(1)(*a*) of the Eighth Schedule

Executive Summary:

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.

BINDING PRIVATE RULING: BPR 125

Subject: Vesting by discretionary trust of dividend rights to the beneficiary of the trust

Date: 25 October 2012
Affected legislation: Income Tax Act 58 of 1962
Provisions: Sections 10(1)(*t*)(vii), 64D, definition of 'beneficial owner', 64F(*g*) and 64G(2)*(a)* and paras 63 and 80(1) of the Eighth Schedule

Executive Summary:

This ruling deals with—

(a) the capital gains tax (CGT) treatment arising from the vesting by a discretionary trust of dividend rights in its beneficiary under para 80(1) of the Eighth Schedule;

(b) 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 para 63 of the Eighth Schedule as the receipts and accruals of the beneficiary are exempt from tax under s 10(1)(*t*)(vii); and

(c) 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 s 64G(2)*(a)*.

BINDING PRIVATE RULING: BPR 126

Subject: Disposal of a business and investment shares, as a result of restructuring, and the distribution of certain shares to shareholder

Date: 8 November 2012
Affected legislation: Income Tax Act 58 of 1962; Value-added Tax Act 89 of 1991; Securities Transfer Act 25 of 2007
Provisions: Sections 42 and 46 of the Income Tax Act; Section 8(25) of the Value-added Tax Act; Section 8(1)*(a)* of the Securities Transfer Tax Act

Executive Summary:

This ruling deals with the question as to whether—

(a) 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 s 42 of the Act with the result that—

(a)(i) no capital gains tax will be payable in respect of the disposal of the assets;
(a)(ii) no allowances or deductions will be recouped by the transferor as a result of the disposal;
(a)(iii) the company and Newco will be deemed to be one and the same person under s 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
(a)(iv) the transfer of investment shares will be exempt from securities transfer tax under s 8(1)(*a*)(i) of the STT Act; and

(b) the distribution of Newco's shares by the company to its holding company will be an unbundling transaction under s 46(1) of the Act, with the result that—

(b)(i) the anti-avoidance provisions in ss 42(5), (6) and (8) will not be applicable to the unbundling transaction;
(b)(ii) no secondary tax on companies will be payable by the companies in respect of the distribution of the shares;
(b)(iii) no capital gains tax will be payable in respect of the disposal of the shares; and
(b)(iv) no securities transfer tax will be payable in respect of the transfer of Newco shares by the company to its holding company under s 8(1)(*a*)(iv) of the STT Act.

Binding class rulings

BINDING CLASS RULING: BCR 035

Subject: Tax implications arising from the conversion of par value shares to no par value shares

Affected legislation: Income Tax Act 58 of 1962; Securities Transfer Act 25 of 2007
Provisions: Section 1(1) of the Income Tax Act, definition of 'gross income' and para 11 of the Eighth Schedule; section 1 of the Securities Transfer Act, definition of 'transfer'

Executive Summary:

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

NEW INTERPRETATION NOTES

The following new interpretation notes have been issued since June 2012:

INTERPRETATION NOTE: NO 67

Subject: Connected persons

Date: 1 November 2012
Affected legislation: Income Tax Act 58 of 1962
Provision: Section 1(1), definition of a 'connected person'

Executive Summary:

This Note provides guidance on the interpretation and application of the definition of a 'connected person' in s 1(1).

The Value-Added Tax Act 89 of 1991 contains a definition of the term 'connected persons' in s 1(1) of that Act. Apart from the fact that the term is defined in the plural, there are a number of other significant differences between the value-added tax definition and the income tax definition. For example, the value-added tax definition includes the estates of deceased and insolvent persons, a partnership and in specified circumstances a branch or division of a person, while the income tax definition does not. Although the two definitions share some common features, this Note only focuses on the income tax definition and should not be relied on for purposes of interpreting the value-added tax definition.

The Tax Administration Act contains a definition of a 'connected person' in s 1 which is cross-referenced to the income tax definition.

INTERPRETATION NOTE: NO 68

Subject: Provisions of the Tax Administration Act that did not commence on 1 October 2012

Date: 16 November 2012
Affected legislation: Tax Administration Act 28 of 2011
Provisions: Chapter 12 and schedule1

Executive Summary:

On 1 October 2012 the Act came into operation except for certain provisions relating to interest. This Note provides guidance on the identification of those interest provisions which have not come into operation.

REVISED INTERPRETATION NOTES

The following revised interpretation notes have been issued since June 2012:

INTERPRETATION NOTE: NO 43 (Issue 4)

Subject:

Date: 6 June 2012
Affected legislation: Income Tax Act 58 of 1962

Provision: Section 9C

Executive Summary:

This Note provides clarity on the interpretation and application of s 9C, which deems the amount derived from the disposal of certain shares held for a continuous period of at least three years to be of a capital nature.

Interpretation Note No 43 (Issue 2) 'Circumstances in which Amounts Received or Accrued on Disposal of Listed Shares are Deemed to be of a Capital Nature' (31 August 2010) deals with s 9B, the predecessor to s 9C. Section 9B applies to the disposal of JSE-listed shares before 1 October 2007, and Issue 2 therefore remains relevant to such disposals. It can be found on the SARS website under Legal & Policy/Interpretation Notes/Archive. Section 9C was inserted into the Act by s 14(1) of the Revenue Laws Amendment Act 35 of 2007.

It was deemed to have come into operation on 1 October 2007, and applies to any disposal of a 'qualifying share' on or after that date.

INTERPRETATION NOTE: NO 47 (Issue 3)

Subject: Wear-and-tear or depreciation allowance

Affected legislation: Income Tax Act 58 of 1962
Provision: Section 11(*e*)

Executive Summary:

This Note provides guidance on the application and interpretation of s 11(*e*) in relation to the determination of—

(a) the 'value' of a qualifying asset on which the allowance is based; and
(b) acceptable write-off periods of such assets.

This Note is a binding general ruling made under s 89 of the Tax Administration Act on s 11(*e*) in so far as it relates to the determination—

(a) of the value of an asset for purposes of s 11(*e*); and
(b) the amount that will qualify as an allowance.

This ruling applies to any qualifying asset brought into use during any year of assessment commencing on or after 1 March 2009.

WITHDRAWN INTERPRETATION NOTES

The following interpretation notes have been withdrawn since June 2012:

Interpretation Note 23 withdrawn with effect from 1 October 2012

OTHER SARS UPDATES

In this section readers are alerted to other SARS updates such as new forms, guides and general business requirements notices.

General Tax Administration

No Rulings List for purposes of Advance Tax Rulings

SARS External Policy for Administration of an Inquiry

Average exchange rates announced since June 2012:

- Table A: A list of the average exchange rates of selected currencies for a year of assessment as from December 2003
- Table B: A list of the monthly average exchange rates to assist a person whose year of assessment is shorter or longer than 12 months

Customs & Excise

- DA 185 and DA70 Forms
- SC-CC-38 - Manifests - External Policy
- SC-SE-05 - Bond - External Policy
- SC-SE-06 - Completion Manual of Bonds and Addendum
- Various tariff amendments to Schedule 1 and Schedule 3 have been implemented

Employers

SARS has issued an updated Business Requirement Specification: PAYE Employer Reconciliation

Updated UIF Guide for Employers

SARS recently published updated versions of the following documents related to Pay as You Earn:

- Pay As You Earn (PAYE) - GEN-DISP-02-FAQ01 -Dispute Administration - External FAQ, September 2011, *Updated September 2012*
- Pay As You Earn (PAYE) - GEN-DISP-02-POL01- Policy for Dispute Administration - External Policy, September 2011, *Updated September 2012*
- Pay As You Earn (PAYE) - GEN-PEN-05-FAQ01 - Penalty Debt Management - External FAQ, September 2011, *Updated September 2012*

- Pay As You Earn (PAYE) - GEN-PEN-05-POL01- Policy for Penalties Administration and Debt Management - External Policy, September 2011, *Updated September 2012*

VAT

SARS has issued an updated Business Requirements Specification (BRS) on VAT201 supporting data submission:

- BRS.
- Clarification document.

Dividends tax

SARS issued an updated version of its Business Requirement Specification (BRS) on Dividends Tax.

Provisional tax

Updated external policy that describes the circumstances under which taxpayers must be registered as a provisional taxpayer.

DOUBLE TAX AGREEMENTS

Protocol amending DTA between South African and Seychelles

CASE LAW

SUPREME COURT OF APPEAL

Commissioner SARS v Labat Africa Ltd [2011] ZASCA 157

Whether expenditure for the acquisition of a trade mark by assignment is actually incurred and therefore a deductible allowance?

Background

The taxpayer, under its former name of Acrem Holdings Ltd, purchased 'the entire business operations' of Labat-Anderson (South Africa) (Pty) Ltd in terms of a written agreement dated 15 February 1999. Its effective date was 1 June 1999. The business operations of Labat-Anderson were defined to include all its tangible and intangible assets including, more particularly, the trade mark. In terms of clause 6 of the agreement, under the heading 'sale', the taxpayer 'purchased' the business 'for a consideration' of R120 million, 'discharged by the issue to Labat-Anderson' of 133 333 333 Acrem shares 'at an issue price of 90 cents per share'. (Although called a sale, the agreement was not a sale because a sale requires payment in money and not consideration in kind.)

The clause further provided that the 'purchase price' was to be apportioned as to the net tangible assets at the values reflected in the accounts, then to the value of the trade mark and name in an amount as determined by an independent and suitably qualified valuator, and the balance was to be apportioned to goodwill.

Facts

The respondent acquired a trade mark through assignment during the tax year and sought to claim the deductible allowance. The agreement resulting in the acquisition of the trade mark involved the respondent purchasing the entire business operations of a company. That included all the company's tangible and intangible assets including the trade mark. Instead of money, the purchase price was discharged through the assignment to the seller, of shares in the purchasing company. The shares were issued and transferred in terms of the agreement and their value, at the time of transfer, was in excess of the issue price. The trade mark was valued at R44 462 000 and the allowance claimed was based on that valuation. The appellant, the Commissioner of SARS, disallowed the claim but the Income Tax Special Court upheld the respondent's appeal. The Commissioner's appeal against the judgment of the special court was dismissed by the High Court, leading to the present appeal.

Issue

The issue before the full bench of the North Gauteng High Court was the question of whether the issue by a company of its own shares in consideration for a trade mark constituted 'expenditure actually incurred' by the company for the purposes of s 11(*g*A)(iii) of the Income Tax Act.

Section 11(*g*A), as it read during the relevant 2000 tax year, provided for the amortisation of the cost of the acquisition of intellectual property rights at the rate of 4 per cent per annum. Taxpayers, who incurred any expenditure in acquiring a trade mark by assignment from any other person, where such trade mark was used by the taxpayer in the production of his income, could claim such expenditure as a deduction.

SARS contended that no expenditure had 'actually been incurred' by the taxpayer in acquiring the trade mark as required by s 11(*g*A)(iii) of the Income Tax Act on the ground that no expenditure had actually been incurred by the respondent in acquiring the trade mark in issue.

Decision

Harms AP (with whom Lewis JA, Heher JA, Maya JA and Plasket AJA concurred) held that the question the court *a quo* should have posed was whether the issuing of shares by a company amounts to 'expenditure' and not whether the undertaking to issue shares amounts to an obligation, which it obviously does.

The term 'expenditure' is not defined in the Act and since it is an ordinary English word and, unless context indicates otherwise, its ordinary meaning must be attributed to it. Its ordinary meaning refers to the action of spending funds; disbursement or consumption; and hence the amount of money spent. In the context of the Act, it would also include the disbursement of other assets with a monetary value. Expenditure, accordingly, requires a diminution, or at the very least movement, of assets of the person who expends. This does not mean that the taxpayer will, at the end of the day, be poorer because the value of the counter-performance may be the same or even more than the value expended.

In the present case, the respondent assigned the trade mark as consideration for the shares and did not 'expend' any money or assets in acquiring the trade mark. An allotment or issuing of shares does not in any way reduce the assets of the company although it may reduce the value of the shares held by its shareholders, and it can therefore not qualify as an expenditure.

In the premises, the appeal was upheld and the court *a quo*'s order was replaced with one upholding the Commissioner's appeal from the Income Tax Special Court with costs.

Cassimjee v Minister of Finance (455-11) [2012] ZASCA 101

Whether the High Court properly exercised its discretion to dismiss the appellants claim for want of prosecution on the basis that time delay was so unreasonable that it constitutes an abuse of the process of court?

Background

During 1977 the Department of Customs and Excise seized fuel tankers from the taxpayer appellant, Cassimjee, based on the allegation that the appellant was selling fuel under rebate to people who did not qualify for the rebate.

Facts

During 1977 the plaintiff issued summons and an exchange of pleadings carried on until 1981, after which the matter was inactive until 2001. The matter was then pre-maturely placed on the awaiting-trial roll but was once again inactive for a period of 5 years. During 2006 the appellant attempted to amend its particulars of claim which was opposed by the respondent but the notice of opposition was defective as it did not set out the grounds of opposition. The application before the high court was to set aside the objection as an 'irregular procedure' in terms of rule 30.

Issue

Has the High Court properly exercised its discretion to dismiss the appellant's claim for want of prosecution on the basis that time delay was so unreasonable that it constitutes an abuse of the process of court?

Decision

After conducting a factual inquiry, the court found that there were two principal mitigating factors to consider in so far as the delay in time is concerned, health problems and problems in instructing attorneys.

The SCA found that the explanations provided by the appellant lacked substance as it was characterised by a profound absence of detail. To revive the action would be extremely prejudicial to the respondents as many of the officials tasked with investigating the matter were deceased or could not recall the events.

The SCA dismissed the appeal with costs.

Commissioner for the South African Revenue Service v Tradehold Ltd (132/11) [2012] ZASCA 61

Whether a change of effective management resulted in a deemed disposal of assets and hence resulted in a capital gain.

Background

The respondent, Tradehold Limited ('Tradehold'), successfully appealed against an additional assessment raised by the Commissioner based on a taxable capital gain which, according to the Commissioner, arose from a deemed disposal by Tradehold of its shares in Tradegro Holdings Limited, in terms of para 12(1) of the Eighth Schedule to the Income Tax Act 58 of 1962 (the Act).

Facts

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. This had the effect that, as from 2 July 2002, Tradehold became effectively managed in Luxembourg. It nevertheless remained a 'resident' in the Republic notwithstanding the relocation of the seat of its effective management to Luxembourg by reason of the definition, at that time, of the

term ‘resident’ in s 2 of the Act. This status changed with effect from 26 February 2003, when the definition was amended and Tradehold ceased to be a resident of the Republic.

Issue

Relying on the provisions of para 12 of the Eighth Schedule to the Act, the Commissioner contended that when the respondent relocated its seat of effective management to Luxembourg on 2 July 2002, or when it ceased to be a resident of the Republic on 26 February 2003, it was deemed to have disposed of its only relevant asset, namely its 100 per cent shareholding in Tradegro Holdings, resulting in a capital gain being realised in the 2003 year of assessment in an amount of R405 039 083. This tax is colloquially referred to as an ‘exit tax’.

Decision

Acting Judge Boruchowitz upheld the Tax Court's position and confirmed 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.

The Commissioner therefore incorrectly included a taxable gain resulting from the deemed disposal of Tradehold’s investment in its income for the 2003 year of assessment and dismissed the application with cost.

Stellenbosch Farmers’ Winery v Commissioner for SA Revenue Service (511/2011 and 504/2011) [2012] ZASCA 72

Whether compensation received for the premature termination of an exclusive distribution agreement is of a capital or revenue nature and whether services supplied to a non-resident recipient on termination of the distribution agreement were zero-rated.

Background

The taxpayer is a wholesaler that imported and distributed Bells whiskey in South Africa. It concluded a 10-year agreement relating to this distribution which was prematurely cancelled more than three years before the earliest date on which the distribution agreement could be terminated.

As a result, the taxpayer received the sum of R67 million from United Distillers, a United Kingdom (UK) based company with which the taxpayer had concluded the distribution agreement. The Commissioner of SARS included the receipt of this payment as part of the taxpayer’s gross income in the assessment for tax. This was upheld by the Tax Court.

Issue

On appeal, the issue before the SCA was the taxpayer’s contention that the payment was of a capital nature which attracted no tax liability. The Commissioner’s cross appeal related to the Tax Court’s decision not to allow interest on the unpaid provisional tax while the appeal in the second case related to whether VAT was payable on the payment received because the payment allegedly related to services supplied by the taxpayer to a non-resident of South Africa but directly connected to movable property situate in South Africa.

Decision

The SCA held that the Tax Court misinterpreted the evidence where it reasoned that the payment received arose out of a calculation by the taxpayer of its future loss of profits, and therefore the payment was part of gross income. Evaluating the evidence in the case, the SCA found that the taxpayer 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 discharged the onus of establishing the payment was of a capital nature.

The cross-appeal was dismissed since the issue became moot once the SCA found that the provisional tax was not payable.

The appeal with regard to VAT was dismissed on the bases that the services in question, compositely the surrender of rights, were not connected to any movable property, and on the basis that in any event the exclusive distribution right held by the taxpayer was an incorporeal right not situated in South Africa since United Distillers was registered in the UK, which meant VAT was to be charged at zero per cent in terms of s 11(2)(I)(ii) of the Valued Added Tax Act.

Commissioner SARS v South African Custodial Services (Pty) Ltd [2011] ZASCA 233

Background

During August 2000, the taxpayer and the Minister of Correctional Services concluded a concession contract in terms of which the taxpayer would design, construct and operate a prison. The concession contract granted the taxpayer the right to occupy the land for the duration of the concession, but would have no title to, ownership interest in, liens, leasehold rights or any other rights in the land, and the Government would at all times remain the legal owner of the land.

The taxpayer in turn sub-contracted the design, construction and commissioning of the prison, as well as the running thereof to third parties. The concession agreement earned the taxpayer fixed and variable income from its running of the prison. The fixed fee income in turn was payment for the construction of the prison.

Facts

In response to an assessment issued by SARS ('the appellant') for the 2002 year of assessment, the taxpayer requested a reduced assessment in terms of s 79A of the Income Tax Act on the basis that certain expenses that qualified for deduction had not been claimed as deductions in its tax returns for the relevant period.

SARS sent a letter to the taxpayer on 4 May 2007 which was described as containing revised assessments for the 2002–2004 tax years. The taxpayer subsequently lodged a notice of objection dated 19 September 2007, in which it described the year of assessment to which it applied as '2003–2004; alternatively 2002'. In response, SARS contended that as no objection to the 2002 assessment was received within the three-year period after the date of assessment, that assessment was final and conclusive. According to SARS, the date of assessment was 1 June 2004, the letter of 4 May 2007 was not a revised assessment, and therefore three years after the date of assessment the 2002 assessment became final. The taxpayer, on the other hand, argued that the letter of 4 May 2007 was indeed a revised assessment and consequently that the assessment for the 2002 year of assessment had not become final.

The second issue related to the construction of the prison by the taxpayer. The taxpayer contended that in the construction of the prison, it carried out a trade, hence the materials that were used to construct the prison constituted its trading stock. The materials, when they were built into the prison, acceded to the prison—and hence became the property of Government. As a result, the materials were deemed by the taxpayer to be trading stock held and not disposed of by it in terms of s 22(2A) of the Act. The taxpayer consequently argued, that it being expenditure actually incurred, and hence not being of a capital nature, and the cost of the construction of the prison was therefore a permissible deduction from the income in terms of s 11*(a)* of the Act.

Due to the fact that the taxpayer incurred a number of fees payable to various parties in order to bid for the tender and to raise the loans that it required to finance the construction of the prison, it claimed to be entitled to a deduction in respect of the various fees and the interest paid on the loans, in terms of s 11(*bA*) of the Act.

Decision

It was held that an assessment is defined in s 1 of the Act as 'the determination by the Commissioner, by way of a notice of assessment (including a notice of assessment in electronic form) served in a manner contemplated in section 106(2) . . . of an amount upon which any tax leviable under this Act is chargeable'. The court referred to case authority which states that a purposeful act is required, whereby the document embodying the mental act is intended to be an assessment. Referring the May 2007 letter, the court found that it did indeed constitute a determination by the appellant. The letter was titled a revised assessment, and the body of the letter ran along similar lines. It therefore recorded a determination. There was thus no merit in the point that the original assessment for the 2002 year of assessment had become final in terms of s 79A(2) of the Act, and the first point was decided in the taxpayer's favour.

The second issue was essentially whether the construction of the prison was a permissible deduction from the taxpayer's income in terms of s 11*(a)* of the Act for the reasons referred to above. Section 11(*a*) provides that, for 'the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived . . . expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature'. The issue turned on s 22, and particularly s 22(2A) of the Act. Section 22 concerns itself with amounts to be taken into account in respect of values of trading stocks. It had to be decided whether the taxpayer's activities fell within the terms of s 22(2A). The latter section provides that where a person carries on construction in the course of which improvements are effected by him to fixed property owned by any other person, such improvements and any materials delivered by him to the relevant property which are no longer owned by him shall, until the contract under which such improvements are effected has been completed, be deemed for the purposes of the section to be trading stock held and not disposed of by him. The question to be answered was whether the taxpayer ever held trading stock in the form of materials and equipment that were built into the prison or, put differently, did it ever effect improvements to the fixed property of the State by delivering materials and equipment to that property which it then built into the prison, thus losing ownership of the materials and equipment. Due to the fact that the taxpayer sub-contracted the building of the prison to another party, it never provided the materials or the equipment that were built into the prison, and never owned them at any stage. Therefore, the taxpayer was not entitled to the deduction contended for by it in terms of s 22(2A), read with s 11(*a*). The appeal was upheld in respect of this point.

Turning to the final issue of the deductibility of fees and interest paid by the taxpayer, the court held that both were deductible in terms of s 11(*bA*) of the Act, and the taxpayer thus succeeded on this issue.

Armgold/Harmony Freegold Joint Venture v CSARS (703/2011) [2012] ZASCA 152

Whether mines are considered to be carrying on one trading activity for purposes of ss 36(7F) and 36(7E) of the Income Tax.

Background

The appeal dealt with the deduction of certain mining capital expenditure in terms of ss 36(7F) and 36(7E) of the Income Tax Act 58 of 1962 as well as the basis of calculation where a mine of a taxpayer operates at a loss. The Supreme Court of Appeal dismissed the appeal before it.

Facts

Armgold and Harmony group of companies formed a joint venture known as Armgold/Harmony Freegold Joint Venture (Pty) for purposes of further its mining activities with three gold mines know as Freegold, Joel and St Helena.

In September 2008 SARS issued revised tax assessments for AHF JV (Pty) Ltd, adjusting its income tax liability for the 2003 and 2004 tax years. For those tax years SARS 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. The effect of this was to reduce the amount of capital expenditure that could be redeemed in respect of the Freegold and Joel mines.

Issue

Was it the correct approach on the part of SARS that the three mines are considered to be carrying on one trading activity for purposes of ss 36(7F) and 36(7E) of the Income Tax Act, and to set the net loss of the one mine off against profits of the other two mines before allowing capex?

Decision

The appellant's approach was rejected by the Supreme Court of Appeal. It found that the calculation made for purposes of calculating the capex was incorrect. However, it also rejected the respondent's calculation in principle. It was held by the court that the effect of s 36(7E) was to set a maximum cap for the total amounts deductible as capex. The loss suffered by the one mine reduced the total taxable income of the appellant, the individual caps allowable under s 36(7F) had to be reduced correspondingly.

The result of this is that SARS had arrived at the correct figure of the appellant's tax liability, albeit by the application of an incorrect principle. The appeal was therefore dismissed with costs.

Corpclo 2290 cc t/a U-Care v The Registrar of Banks (755/11) [2012] ZASCA 156

Whether a decision to investigate a person' business and institute proceedings for an interdict is an administrative action for the purposes of the Promotion of Administrative Justice Act 3 of 2000.

Background

During April 2009, acting on the instructions of the Governor of the Reserve Bank, the Registrar appointed three employees of PriceWaterhouseCoopers Forensic Services (Pty) Ltd as temporary inspectors to investigate whether the appellants, their directors, members and officers and related persons and entities were conducting the business of a bank in contravention of s 11(1) of the Act.

Issue

The issue in this appeal is whether the KwaZulu-Natal High Court, Pietermaritzburg (Booyens AJ) correctly granted an interdict in terms of s 81 of the Banks Act 94 of 1990 prohibiting the appellants (respondents in the court *a quo*) from continuing a business practice in contravention of s 11(1) of the Act.

Facts

The principal business of the appellant is that they conduct a charity funding business which provides a service to both donors (called 'participants') and charities. They make donation by the participants easier and less complicated and they distribute funds to charities on a regular monthly basis. This facilitates the operation of the charities which are assured of a regular monthly income.

The Registrar of Banks had reason to suspect that the appellants were contravening, and would continue to contravene, s 11(1) of the Act read with Notice 498. Consequently, the Registrar launched the application in court for the relief set out in s 81 of the Act.

Decision

The court held that the Registrar's decisions to investigate the appellants' business and institute proceedings against the appellants for an interdict in terms of s 81 of the Act were not administrative actions for the purposes of the Promotion of Administrative Justice Act 3 of 2000 ('PAJA') as they did not (as required by the definition of 'administrative action' in s 1 of PAJA) adversely affect the rights of the appellants or have a direct, external legal effect or have that capacity.

CASE LAW

High Court

Zikhulise Cleaning Maintenance and Transport CC (HC 28084/2012 NG)

Whether the administrative decision to withdraw a tax clearance is valid?

Background

Zikhulise Cleaning Maintenance and Transport CC is in the business of constructing affordable housing through Government tenders, it relies on a clearance certificate issued by SARS to be able to conduct its business. SARS issued such a certificate on 17 January 2012 which was valid for a period of 12 months.

Facts

On 16 March 2012 SARS issued a letter to the holder of the certificate informing them that the tax clearance certificate had been cancelled effectively from the date of their letter. Zikhulise Cleaning Maintenance and Transport CC received the letter on 18 March 2012.

On 26 April SARS issued a letter wherein it stated that it was in the process of considering whether to withdraw the certificate and that, 'the facts as to why you are not compliant appear from our letter of 16 March 2012'. Zikhulise Cleaning Maintenance and Transport CC is invited to make representations by 11 May if the applicant disputes the fact.

Issue

The issue before the court was whether the taxpayer should have received reasonable notice of SARS' intention to withdraw the tax clearance.

Decision

The court held in favour of the taxpayer and granted an order that the decision of SARS be of no force and effect.

CASE LAW

Tax Court

XYZ CC V CSARS (ITC 12860) [2012] ZATC 1

Whether the taxpayer qualified for all the requirements to be classified as a small business corporation.

Background

The South Gauteng Tax Court heard the appeal of the taxpayer, XYZ CC, based on the taxpayer's assertion that it meets all the requirements for classification as a small business corporation ('SBC') in terms of s 12E of the Income Tax Act 58 of 1962 ('the Act').

Section 12E(4) of the Act provides for a beneficial tax dispensation for small business corporations. Such corporations are entitled to be assessed for income tax purposes at preferential rates prescribed by the section. The definition of a SBC contains a list of

requirements to be met in order for a corporate entity to qualify as such. Simultaneously, the definition contains certain inclusionary and exclusionary criteria.

This landmark case for small businesses reported on **22 June 2012** is the first reported court decision considering the definition of a small business corporation for the purposes of s 12E. The Tax Court also interpreted specific words in the context of s 12E: 'management', 'consulting', 'broking'.

Facts

The taxpayer is a close corporation registered in terms of the Close Corporations Act 69 of 1984. It was incorporated in 1995 and has one member, who is also the public officer of the company. It carries on the business in key-account trade marketing, which consists 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 such as Checkers, Makro, Game. The taxpayer's business also entails the provision of promotional activities relating to the products of its clients and all related and ancillary activities including, but not limited to:

- advising clients on such issues as pricing, price increases, promotional prices, cycle deals, annual incentives and terms;
- placement of clients' products which involves listings, merchandising, displays, range audits and new store opening negotiations;
- promotions of clients' products, involving promotional packaging, bulk buys, promotional calendars, preparing trade sponsorships and in-store demonstrations;
- assisting with consumer complaints and providing feedback on consumer demands and requests;
- attending bi-monthly sales meetings with sales staff of clients, holding area meetings, providing support and assistance to sales representatives and sales management staff of clients, making product presentations, promotions scheduling and conducting training and fieldwork with representatives of clients.

During the years under consideration by the Tax Court, it was established that nature of business never changed, except for the 2005 and 2006 years of assessment, when the labelling of its business activities was described in the tax returns 'marketing' and Judge Mbha determined that it is 'marketing consulting'.

The taxpayer employed one person on a half-day basis, as a personal assistant during the relevant tax years, and also employed sub-contractors to carry out its functions in certain areas of South Africa in order to extend the scope of its activities. In carrying out these functions, the taxpayer and its sub-contractors acted on the instructions of their principals. They made recommendations to the principals relating to the exercise of their functions but did not advise them on any other matter. The appellant was remunerated on the basis of the sales generated by its activities and in some cases, there was a basic retainer which applied until the sales reach an agreed volume.

Issues

The taxpayer, in its accounting financial statements accompanying its tax returns for the 2000–2004 years of assessment, described its business as one of 'trade marketing consultancy'. The revenue of the taxpayer was described in these financial statements as 'consultancy fees'. In respect of the 2000–2004 years of assessment, the taxpayer accepted, as reflected in its returns of income (IT14s) for those years, that it was not a small business corporation, and SARS properly assessed the appellant, for the 2000–2004 years of assessment, as a company rendering a personal service and not as a small business corporation.

In respect of the 2005 and 2006 years of assessment, the taxpayer submitted its tax returns on the basis that it is a small business corporation in terms of s 12E. In the annual financial statements for those 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 appellant's business is stated as 'Marketing'. The appellant was accordingly assessed for the 2005 and 2006 tax years, as a small business corporation.

The issue before the Tax Court was whether the taxpayer met all the requirements for classification as a small business corporation ('SBC') in terms of s 12E of the Income Tax Act 58 of 1962 ('the Act').

Another issue before the Tax Court was SARS' contention that the appellant did not qualify for the classification as a SBC as it provided a personal service as defined in s 12E(4)*(d)*, and derives more than 20 per cent of its receipts and accruals from the provision of that service and from investment income, as prescribed by s 12E(4)*(a)*(iii) of the Act.

The taxpayer, on the other hand asserted 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.

Decision

Meaning of 'consulting'

Judge Mbha accepted that generally, the meaning of words in a statute is derived from the common law. He stated [at 19]:

> *'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.'*

SARS endorses this approach in Interpretation Note No 9, dated 13 December 2002, para 2.3(b).

Judge Mbha stressed that if there is any doubt about the ordinary meaning of a word used in a particular context, that certain rules must be applied. He emphasised two rules relevant to this specific case [at 21]:

> *'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*).'*

The word 'consulting' as used in s 12E(4)*(d)* is not defined in the Act or in any other applicable law in South Africa, hence Judge Mbha held that the two rules above must be applied and its meaning determined by reference to authoritative works.

The definitions of 'consulting' in the standard dictionaries consulted by the Tax Court revealed that there are several meanings to the nouns derived from the verb 'consult', namely consulting, consultant and consultation, and to the verb itself. Judge Mbha held [at 23] that these fell into three major categories:

- Those derived from the transitive verb 'consult', which means to seek advice or an explanation from a person with knowledge, from a dictionary or other sources.
- Those derived from the intransitive verb 'consult' which means to offer advice or information by such person.
- Those related to the idea of consultation as a form of discussion between persons having different interests in a particular situation.

Judge Mbha held that:

> *'…the meaning of "consulting" as referred to in section 12E(4)*(d)*, falls into the second category, as the activities referred to in the first and third groups do not normally involve any commercial transactions, and would therefore not be relevant for taxation purposes. It is necessary to establish the intention of the legislature when passing the relevant provision. The legislature's intention embodied in section 12E of the Act can clearly be seen from the contents of SARS' Interpretation Note 9, which was issued at the time of the*

introduction of that section [section 12e]. 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."

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. The fields of activity listed as personal services in s 12E(4)*(d)* fall 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 comprises broadcasting, commercial arts, entertainment and sport, none of which is relevant to the activity carried out by the taxpayer.

The Tax Court held that since the term ‘consulting’ is the least easily defined of all the terms, the rules of interpretation that have referred to, must be strictly applied. 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. Furthermore, the fact is that a taxpayer, as a close corporation, in its own right cannot hold a certificate as a ‘professional person’. Nor does the sole member of the taxpayer hold any such licence, certificate or membership of a professional body. Judge Mbha concluded that the taxpayer in this case is not involved in the business of ‘consulting’ as envisaged in s 12E(4)*(d)* of the Act.

In any event, even if no definite conclusion as to the interpretation of the term 'consulting' can be arrived at by the application of any of the rules of statutory interpretation the court has referred to, then the *contra fiscum* rule must be applied and the statute interpreted in favour of the taxpayer.

Meaning of ‘broking’ and/or ‘management’

With reference to the Concise Oxford Dictionary and Longman Business English Dictionary (2007), Judge Mbha held that ‘it is clear that the taxpayer does not conduct any "broking" transactions on behalf of its clients neither does it purport to act as a broker in any way’.

With reference to the Concise Oxford Dictionary and the Longman Business English Dictionary (2007), Judge Mbha held that the taxpayer clearly did not control or direct the activities of it’s clients and that the management function rested with the taxpayer's clients.

Held that the terms ‘broking’ and ‘management’ did not apply to any of the activities conducted by the taxpayer. The Tax Court relied on the evidence that was presented by the taxpayer and the documents filed as part of the dossier describing the taxpayer's business activities, that none of the activities of broking or management were reflected in the terms cited by SARS. The key word in the description of the activities must be ‘marketing’ which is not a professional service and the member who personally performs a part of the taxpayer's services has neither a professional qualification nor a professional licence.

SARS' contention that the taxpayer rendered a personal service, as defined in s 12E was unsuccessful.

The court held that SARS was incorrect in classifying the taxpayer was a personal service provider as defined in s 12E of the Act, as its activities did not constitute as 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.

VAT 889

Remission of penalties for issuing fictitious invoices

Background

The taxpayer, a close corporation owned by a single member, appealed against a decision by SARS to imposing VAT and a punitive levy of 200 per cent on the taxpayer's tax liability.

The taxpayer, a registered VAT vendor, issued three tax invoices in January, March and April 2004 respectively to another close corporation ('PQR') for the supply of seafood products. PQR duly paid the amounts invoiced. The taxpayer thereafter submitted a nil VAT return for the relevant VAT periods. PQR submitted an input tax claim to the respondent. Pursuant thereto the respondent conducted an audit to verify whether the suppliers listed in the schedules provided by PQR had accounted for the corresponding output tax, and found that the appellant had submitted a nil VAT return for the relevant VAT periods.

As a result of the taxpayer's failure to account for output tax in respect of the supplies allegedly made during the January, March and May 2004 VAT periods, SARS raised additional assessments on 18 March 2005 in terms of s 31 of the Value Added Tax Act 89 of 1991 (the Act) and levied 200 per cent additional tax against the appellant in terms of s 60 of the Act.

The taxpayer admitted that on the documentation received by SARS, it was entitled to raise the additional assessments and to impose a 200 per cent levy. However, the member claims that the invoices were fictitious and that the taxpayer had supplied nothing to PQR.

Issue

At issue was whether the explanation given by the member is credible, and if it is found to be, whether it exonerates the appellant from liability.

The member, who is an accountant by profession and fully acquainted with the provisions of the VAT Act, gave the following explanation:

The members of PQR were Mr B and Mr C. They are related to a woman working in the office of his family business. Although he is not a close friend of the two men, they did meet socially from time to time. They proposed to him that he establish a close corporation with the business of supplying seafood products. They promised to order supplies from him. He duly incorporated the close corporation and registered as a VAT vendor. Thereafter the men asked him to issue fictitious invoices to PQR for the supply of seafood products. They told him that they wanted to raise a loan from D Bank. In order to acquire the loan they had to convince D Bank that they required the loan for the purpose of purchasing stock for their business. In truth, they did not require stock, but wanted to use the money for some nefarious purpose. The member said that he did not know what the purpose was. According to him, the men had assured him that they would take care of any tax implications that may arise from the issuing of the fictitious invoices. He said that they had sent him faxes explaining exactly what the invoices should look like, including the fictitious supplies and the amounts of the invoices. The arrangement was that D Bank would deposit the amounts invoiced into the appellant's bank account and that the appellant would return the money immediately to PQR. Mr A duly compiled three invoices for R474 194.40, R332 766.00 and R217 436.76 respectively. The amounts included VAT.

The member first testified that he had been forced to submit the fake invoices, but later explained that what he had meant was that Mr B and Mr C had badgered him on a daily basis until he relented. Mr B and Mr C left the country, leaving the member in the lurch.

Decision

The appeal was dismissed with costs on the following grounds:

1. The member did not provide a credible account of the circumstances under which he had submitted the tax invoices, and thereafter a nil VAT return

2. Whatever his explanation may be, he is patently liable in terms of the provisions of the Act for the VAT collected as well as the punitive levies.

CASE LAW

INTERNATIONAL

R (On the Application of Glenn & Co (Essex) Ltd) V HMRC [2010] EWHC 1469 (Admin)

Whether the removal of computers from business premises are legal?

Background

In this UK case, the Administrative Court was asked to consider the legality of HMRC's actions in removing computers from business premises.

Facts

The taxpayer company dealt in excise goods and had been registered as a revenue trader. HMRC officers had entered the taxpayer's business premises, unannounced, and without having obtained a warrant and stated that the purpose of the operation was to conduct interviews and to inspect business records including computers.

The officers disconnected and removed a computer server and desktop computers to interrogate their hard disks. The following day all but one of the computers was returned, with the remaining computer and server being returned on a later date.

Issue

The taxpayer's business premises was accessed, unannounced, and without having obtained a warrant for search and seizure.

The taxpayer challenged, by way of an application for judicial review, the legality of the officers' conduct in removing the computers on the ground that s 118B of the UK *Customs and Excise Management Act 1979* did not permit their removal because they were not documents as defined.

Decision

The court noted that search and seizure, as envisaged in terms of s 118B, permitted 'a substantial intrusion into the affairs of the persons against whom it may be invoked' and there was, therefore, a particular need to ensure 'that the provision is given no wider reading than Parliament must be taken to have intended'.

The court was of the view that, as a matter of first impression, the words contained in s 114(2) were sufficiently wide to extend the inspection power contained in s 118B to a computer, as a computer is a thing in which information is recorded.

While the taxpayer contended that a document was something tangible on which evidence or information is physically recorded and, by contrast, a computer is a piece of machinery comprising a number of features, operated by electricity and having a wide range of functions, the court dismissed the contention.

It is trite law that a computer hard disk was a single storage entity and was not just a container of files.

The court therefore concluded that the power of inspection did extend to the inspection of a computer.

Sent v Commissioner of Taxation [2012] FCA 382 (Australia)

Whether bonus paid to special purpose trust is taxable?

Backround

The taxpayer was a managing director, whose employment contract provided for bonus payments that are (i) accrued and payable, (ii) accruing but relating to periods which had been part performed and (iii) not yet accrued as they relate to future periods.

Facts

The taxpayer and his employer entered into an agreement whereby the taxpayer waived all his past and future bonus entitlement of $11.6m in return for the issue of five million fully paid ordinary shares in the company. The arrangement involved the payment of $11.6m to the trust in return for five million shares and the taxpayer subsequently acquiring all the units in the trust by way of a loan from the trust (under a round robin transaction). The units cannot be sold by the taxpayer within 12 months of issue.

Issue

The Commissioner assessed the $11.6m as assessable income to the taxpayer as ordinary income or statutory income and imposed 50 per cent administrative shortfall penalties.

Alternatively, it argued that Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) applied to include the $11.6m as assessable income. In the first instance, the Tribunal held that $7.25m was assessable income but that $4.35m of the $11.6m which represented future or contingent bonuses were not assessable. The Tribunal also held that Part IVA did not apply and that the shortfall penalties be remitted to 25%.

Both parties appealed from the decision of the Tribunal.

Decision

The Federal Court found that the entire amount of $11.6m payment was ordinary income on the basis that the payment was ultimately in substitution for income by way of bonus. An entitlement to the five million shares in the company was initially substituted for the taxpayer's bonus entitlement, and that that entitlement to shares was substituted for the payment. However, the payment maintained its character as income, being a reward for services.

By reason of its finding that the whole amount was assessable, the court found it unnecessary to consider whether Part IVA applies. However, the court held that the Tribunal had made an error in not finding that the taxpayer had failed to discharge the onus of proving that the Commissioner's imposition of an administrative penalty of 50 per cent of the shortfall amount was excessive, accordingly the 50 per cent shortfall penalty still stands.

The case illustrates the importance of carefully implementing a transaction. If the share incentive scheme had been implemented carefully (ie an appropriate contingency or restriction was placed on the receipt of the shares), the taxpayer may at least have been able to defer a portion of his income tax liability to a later year of assessment.

In South Africa, s 8C of the Income Tax Act 58 of 1962 (Act) provides that the income tax treatment will only arise on the vesting of the equity instrument (ie generally when all the restrictions placed on the equity instrument cease to have an effect).

Commissioner for the South African Revenue Service v De Beers Consolidated Mines Limited (503/11) [2012] ZASCA 103

Whether imported professional services were required for the purpose of consumption, use or supply in the course of making 'taxable supplies'?

Background

The taxpayer respondent, a leading international diamond producer and seller, was approached by a consortium which proposed a complex transaction which would result in a new company to be established by the consortium, hence becoming the holding company of the respondent and a linked company.

Facts

During November 2000 a consortium approached DBCM and proposed a complex structure in which the consortium would become the holding company and effectively become the new owners of DBCM and a linked Swiss company. In order for DBCM to satisfy itself that the proposal was fair and reasonable, it appointed NM Rothschild and Sons Ltd (NMR), a London-based company as well as various South African advisors for purposes of finalizing the transaction.

Issue

Subsequent to conclusion of the transaction, NMR issued an invoice in the amount of US$19 895 965 for the services rendered by it to the taxpayer, which was settled in cash amounting to R161 064 684, including value-added tax ('VAT'), which the taxpayer treated as input tax. SARS, in the assessment, determined that NMR's services were 'imported services' in terms of the VAT Act and assessed the sum of R22 549 055.76 to be payable by the respondent as VAT in terms of s 7(1)*(c)* of the Act. The respondent's contention that the relevant amount constituted input tax. The objection lodged by the respondent was disallowed and the taxpayer lodged an appeal in the Tax Court. The Tax Court upheld the appeal, leading to the appeal by SARS, to the present court. The Commissioner sought to challenge the Tax Court's findings that the services rendered by NMR to the respondent did not constitute 'imported services', and that a part of the VAT on local services rendered by a local supplier to the respondent constituted deductible 'input tax' in the respondent's hands. The Tax Court had held that the services provided by NMR did not constitute 'imported services' because they had been used by the respondent for the purpose of making taxable supplies, namely in the course of furthering its enterprise of mining and selling diamonds.

Decision

The court found that the same question must be answered in both the appeal and the cross-appeal; ie whether the services acquired by DBCM were required for the purpose of consumption, use or supply in the course of making 'taxable supplies', which means supplying goods or services in the course or furtherance of the 'enterprise'. In addition, the appeal requires a consideration of whether the 'imported services' were utilised or consumed by DBCM in the Republic.

It was found that DBCM is not a dealer in shares, the holding of shares and receipt of dividends by DBCM does not fall within the definition of 'enterprise' and this must therefore be disregarded. It must be found that DBCM's 'enterprise' for the purposes of the Act, consisted of mining, marketing and selling diamonds therefore NMR's services were not acquired for the purpose of making 'taxable supplies'. They could not contribute in any way to the making of DBCM's 'taxable supplies'. They were also not acquired in the ordinary course of DBCM's 'enterprise' as part of its overhead expenditure as argued by DBCM. They were supplied simply to enable DBCM's board to comply with its legal obligations.

The appeal was upheld with costs, including the costs attendant upon the employment of two counsel.

The cross appeal was dismissed with costs, including the costs attendant upon the employment of two counsel.

Hine v. The Queen, 2012 TCC 295 (Canada)

Whether a taxpayer acted with gross negligence when he failed to declare income.

Background

The taxpayer was successful in having gross-negligence penalties overturned. The decision confirms that the onus or burden is on the Minister in proving that gross-negligence penalties are warranted. Here, the taxpayer was able to show that there was no conduct to deliberately hide income, detailed records were kept, he cooperated with the Canada Revenue Agency ('CRA') and his conduct was reasonable in the circumstances. As a result, the benefit of the doubt went to the taxpayer.

Facts

Mr Hine failed to report $157 965 in business income in his 2006 tax return. He and his wife were in the business of flipping houses and he relied on his wife to keep records and prepare the returns. The wife effectively deducted a mortgage twice in determining the business income from a particular sale, resulting in a large loss on the tax return. The Minister applied gross-negligence penalties under ss 163(2) of the Act.

Subsection 163(2) provides that if a taxpayer knowingly, or under circumstances amounting to gross negligence, makes—or participates in, assents to, or acquiesces in the making of—a false statement or omission in a return, form, certificate, statement, or answer, the taxpayer incurs a penalty equal to the greater of $ 100 and 50 per cent of the understated tax. Justice Hershfield of the TCC noted that each case considering the application of penalties under ss 163(2) is fact specific. In this case, the significant issues were whether the taxpayer had knowledge of the negligence of his tax preparer and whether it was reasonable to find that the taxpayer should have been made further inquiries.

Decision

The court found that Mr Hine relied on his spouse to keep proper books and records and properly preparing his tax returns. Furthermore, Justice Hershfield found that the conduct of Mr Hine in not questioning the return prepared by his spouse did not constitute gross negligence, as his confidence in her, based on the evidence, was justified. His belief that she had reported his income properly was not unreasonable. The spouse's actions were just a simple mistake and not grossly negligent. Thus, the Minister failed to meet the burden of proof to warrant a finding that the taxpayer intended to make a false statement or in circumstances amounting to gross negligence made such a false statement.

There was also a motion for increased cost in this case on the basis that there had been a settlement offer made to the Crown. There was correspondence that offered to settle the matter without costs if the Minister agreed to vary the assessment on the basis of no gross-negligence penalty. The Crown argued that such an 'offer' was to abdicate the appeal and was not an 'offer of settlement'. Justice Hershfield agreed that this was a yes/no issue and that Crown was not able to accept that offer because the assessment was based on a reasonable belief that the taxpayer must have known of the misrepresentation.

HMRC and CSARS V Ben Nevis (Holdings) Ltd and Another [2012] EWHC 1807 (Ch)

Background

The first defendant ('Ben Nevis') is a company incorporated in accordance with the laws of the British Virgin Islands ('BVI'). Its corporate director is incorporated in accordance with the laws of Guernsey. Its sole registered shareholder is the third defendant ('HSBCT'), also a company incorporated in accordance with the laws of Guernsey. HSBCT holds the shares as trustee for the Glencoe Investments Trust ('GIT'), an offshore discretionary trust established in accordance with the laws of Guernsey for a class of beneficiaries that include Mr David King (a UK Citizen but a long time resident in RSA), his wife and children. Although disputed by the defendants, the claimants' case is that although Mr King is theoretically merely one of a class of beneficiaries of GIT, in practice he controls the structure to which I have so far referred. The issue has not been argued before me and I make no findings concerning it.

Ben Nevis is liable to SARS for taxes for the 1998, 1999 and 2000 years of assessment in the total sum (inclusive of various penalties and interest) of R 2.6 billion (approximately £222 million) following the final determination of a tax appeal in October 2010. On 4th March 2011, judgment was entered against it in proceedings in RSA for these sums.

The claimants' case is that Mr King learned that SARS was investigating Ben Nevis's tax affairs and that as a result he procured the transfer of Ben Nevis's assets to the second defendant., Metlika Trading Limited ('MTL'). MTL is also a company incorporated in accordance with the laws of the BVI, its corporate director is incorporated in accordance with the laws of Guernsey and its sole registered shareholder is HSBCT who holds the shares on trust as trustee of GIT. SARS became aware that as a result of these activities a fund of approximately £7.8 million had been credited to a bank account with a London bank in the name of MTL ('the Bank Deposit').

These proceedings were commenced on 22nd February 2012 and consist of two claims. The first ('the Tax Recovery Claim') is a claim by HMRC against Ben Nevis for the sum that Ben Nevis has been held to owe SARS in taxes penalties and interest and is purportedly brought pursuant to the mutual assistance provisions contained in Article 25A of a Double Tax Convention ('DTC') entered into between the UK and the RSA ('the 2002 Convention'), which became part of English law by the Double Taxation Relief (Taxes on Income) (South Africa) Order 2002, as amended by the Double Taxation Relief and International Tax Enforcement (South Africa) Order 2011 which gave effect to a protocol entered into by the Governments of the RSA and the UK in 2010 by which various amendments to the 2002 Convention were agreed ('the 2010 Protocol').

The second claim ('the IA Claim') is a claim by both claimants against all the defendants brought pursuant to, and seeking relief under, s 423 of the Insolvency Act 1986 ('IA'). The purpose of the IA claim is to enable the Bank Deposit to become available in partial satisfaction of any judgment obtained in the Tax Recovery Claim.

On 22nd February 2012, the claimants sought and obtained a freezing order against all the defendants. The purpose of this order was to preserve the Bank Deposit until after resolution of these proceedings. The initial hearing before Mann J, was in private and took place without notice to any of the defendants. Mann J made the order sought ('the Freezing Order') and fixed a return date hearing to take place on 29 February 2012. That hearing took place before Floyd J who continued the Freezing Order expressly without prejudice to challenges by the defendants both to jurisdiction and to the grant or continuation of the Freezing Order.

Issue

The defendants maintain that the Tax Recovery Claim is unsustainable and misconceived because on its true construction Article 25A of the 2002 Convention does not apply to the enforcement in the UK of RSA taxes arising in any year of assessment prior to the coming into effect of the 2002 Convention by operation of Article 27 of the 2002 Convention, or if it does, then because the amendment took effect by operation of s 173 of the Finance Act 2006 ('FA 06') it is *ultra vires* and void to the extent that it purports to have any effect earlier than the date of commencement of that Act.

If neither of these points is correct, then it is submitted that the effect contended for is incompatible with Ben Nevis's rights under Article 1 of the First Protocol of the European Convention on Human Rights ('A1P1'). It is submitted therefore that there is no serious issue to be tried and that the permission to serve out granted by Mann J should be set aside and the Tax Recovery Claim dismissed. It is common ground that if this is the outcome then the IA Claim cannot be pursued and so must also be dismissed, and in consequence the Freezing Order will cease to have effect.

Even if all that is not correct, the defendants maintain that in any event:

(a) SARS has no *locus* to bring or continue these proceedings and thus the claim as brought by it should be dismissed; and/or

(b) HSBCT is not properly joined as a defendant because it is merely the registered shareholder of Ben Nevis and MTL and thus neither claimant has any cause of action against it

(c) Leave to serve the IA Claim should not have been granted and/or ought to be set aside on the grounds that:

(c)(i) There is no sufficient connection with this jurisdiction to justify the making of the Order; and/or

(c)(ii) The *forum convenient* for such a claim is Guernsey not England

(d) The Freezing Order ought to be discharged on the grounds that:

There is not and never was any real risk of dissipation because the Bank Deposit comes within the scope of the Restraint Order made by the Crown Court; and/or the Order was obtained from Mann J as a result of material non-disclosure both as to (1) the likelihood of the Restraint Order being discharged by the Crown Court and (2) the Defendant's likely defences to the Tax Recovery Claim; and/or the Claimants ought to have given notice to the Defendants of the making of the application.

Decision

The court set aside permission to serve these proceedings out of the jurisdiction in so far as they have been brought by SARS. Subject to any further submissions that might be made on the hand down of this judgment, the court considered it appropriate to dismiss these proceedings in so far as they have been brought by SARS.

The court further set aside permission to serve these proceedings on HSBCT and again subject to any further submissions to be made on the hand down of this judgment, the court considered it appropriate to dismiss these proceedings as against HSBCT.

Other than to the extent set out in (i) and (ii) in the judgment, the court dismissed the Jurisdiction and Freezing Order Challenges. The court will, however, hear further argument as to the scope of the Freezing Order as against MTL.

Her Majesty The Queen vs Global Equity, 2012 FCA 272 (Canada)

Can the Crown rely on new arguments which were not raised by the Minister in assessing the taxpayer nor relied upon by the Crown in the Tax Court?

Background

This matter was an appeal by the Crown from a judgment of the Tax Court of Canada (case 2011 TCC 507), allowing the appeal of Global Equity Fund Ltd ('Global') with respect to reassessments for the 1999, 2000 and 2001 taxation years issued by the Minister of National Revenue (the 'Minister'). The Minister, relying on the general anti-avoidance rule (the 'GAAR') set out in s 245 of the *Income Tax Act* (the 'Act'), had disallowed a business loss in the

amount of $5 600 194 claimed by Global following the disposition of shares it held in 953565 Alberta Ltd. That loss arose from the implementation of a planning technique known in the tax community as a 'value shift'.

Facts

Global was incorporated in 1999 for the purpose of investing in credit facilities and private placements. Its sole shareholder is a trust whose beneficiaries include Mr Riaz Mamdani, his spouse, their children, grandchildren, parents, siblings, nieces and nephews. At the time the concerned transactions were entered into, Mr Mamdani and his wife had two very young children.

Mr Mandani sought professional advice to implement a plan to defer tax. The plan, in essence a 'value shift', entailed the following:

(a) a new corporation, 953565 Alberta Ltd. ('Newco') was incorporated;

(b) a new trust was set up whose beneficiaries were Mr Mandami's children and grandchildren (the 'Children's Trust');

(c) Global subscribed to common shares of Newco for a consideration of $5 600 250;

(d) Newco declared a dividend on the common shares held by Global in the form of non-voting preferred shares which were redeemable and retractable for $5 600 250 and which had a paid-up capital of $56;

(e) Newco issued additional common shares to Global for a consideration of $200 000; however, it was acknowledged in the Tax Court that this step was inserted as window dressing in order to give the common shares some value;

(f) Global sold all the common shares it held in Newco to the Children's Trust for a consideration of $200 000; it was as a result of this sale that Global claimed a loss of $5 600 194;

(g) a loan was made by Newco to Global for $5 600 000; the loan bore interest at prime plus 2 per cent and the loan agreement provided for an equity participation of 25 per cent of the increase in fair market value of Global's assets while any part of the loan remained outstanding; an amendment to the loan agreement was made a few months later which deleted the interest and increased the equity participation to 50 per cent;

(h) Global granted an interest in its property to Newco to secure the loan.

At the time the plan was implemented, it was contemplated that the loss resulting from the sale of the common shares of Newco to the Children's Trust might be a business loss for tax purposes since Global itself was involved in the business of trading securities. Consequently, in the income statement and balance sheet filed with Global's corporate tax return for 2001, the transactions were reported as increasing its losses from operations. $56 was recorded as revenue from the stock dividend, and the subscription price for the common shares of Newco was deducted as part of the cost of sales. The overall result was that Global claimed a net business loss of $5 600 194. The claimed loss gave rise to a significant tax benefit through the elimination, or near elimination, of tax payable under the Act for Global's 2001, 2000 and 1999 taxation years.

The Minister, applying the GAAR, reassessed Global to deny this loss in its 2001 taxation year and the carry-back of the loss from the 2001 taxation year to the 1999 and 2000 taxation years. Global appealed to the Tax Court of Canada.

The Tax Court judge allowed the appeal on the GAAR issue even though she found that the transactions were 'highly artificial' and that the loss resulted 'from a shuffle of paper' by which 'no real economic loss was suffered'. She also noted that she may well have upheld the reassessments under the GAAR had the Crown raised different arguments.

The submissions made by the Crown in its appeal were substantially different from those it made in the Tax Court. The Crown now relied on specific provisions of the Act for the GAAR analysis whereas it previously, in the Tax Court, it did not allege that any specific provision of the Act had been misused or abused, but rather that the transactions resulted in an abuse having regard to the Act as a whole.

In addition, the Crown also relied on the former ss 245(1) which disallowed a deduction where income is 'unduly or artificially' reduced. Furthermore, the Crown added that the Newco shares were not inventory but capital property.

Issues

The principal issues to be determined were as follows:

(1) Can the Crown rely in this appeal on new arguments which were not raised by the Minister in assessing the taxpayer nor relied upon by the Crown in the Tax Court of Canada?

(2) Do the transactions in issue result in a misuse or abuse of the provisions relied upon by the taxpayer within the meaning of ss 245(4) of the Act?

Decision

(1) Subsection 152(9) of the Act governs the right of the Minister to advance an alternative argument in support of an assessment. The Minister cannot include transactions which did not form the basis of the taxpayer's reassessment and the right of the Minister to present an alternative argument in support of an assessment is subject to paras 152(9)(*a*) and (*b*), which speak to the prejudice to the taxpayer.

It was held that Global was prejudiced by two of the new arguments submitted for the first time during the appeal and that the Crown was therefore precluded from raising these arguments and these arguments must therefore be disregarded. The other arguments raised by the Crown are all legal arguments made on the basis of the existing evidentiary record and were therefore allowed.

(2) The FCA held that the loss generated by Global as a result of the transactions resulted from a value shift between one of the classes of shares held by Global to another class of shares it held. This is simply a paper loss. The fundamentals of the transactions are simple: the inherent value of the common shares in Newco held by Global was moved to the preferred shares issued to Global, with the result that the common shares were left with little value but still with a high cost associated to them, while the preferred shares issued as a dividend had a high value but a low associated cost. Nothing was gained or lost, however in selling the common shares to the Children's Trust, Global technically realized a large loss on paper.

There is no air of economic or business reality associated with the loss. The appeal was allowed with respect to the GAAR issue. It was, however, held that Global be entitled to its costs in both the FCA and the Tax Court.
